



Technology Program Country Note

BRAZIL



December 2010

Key Facts and Figures



- Population: 198,739,269 (2010 est.)
 - 86% urban (2008)
 - 26.7% under 14 (2010 est.)
- GDP per capita: \$10,200 (2009 est.)
- Surface area of country: 8,514,877 sq km
- Population below poverty line: 26% (2008)
 - % of poverty urban: 17.5 (2002–2003)¹
- Active MF borrowers: 820,000 (2009)
- Credit cooperatives: 1,451 (2008)
- Banking correspondents: 163,569 (2010)
- Simplified accounts: 10M, 5.5M active (2010)
- Branches per 10,000 adults: 12.71 (2009)

Summary

Brazil is seen as a global leader in branchless banking and as an example of how banks have created wide-reaching branchless channels that use cards and point-of-sale (POS) devices at various retail locations. Since 2002, all 5,564 municipalities in Brazil have access to formal financial services (all municipalities except for 34 have correspondents). Brazil's success with correspondents is a result of 10 years of back-to-back regulatory steps, evolving from more restricted possibilities to less stringent licensing conditions.

While banking correspondents are present in almost every municipality, until recently, they were mostly used as a channel for bill payments. The major banks with correspondent channels—Caixa Economica Federal, Banco do Brasil, and Bradesco—have used the channel primarily to process bill payments and disburse government payments.

A number of policy changes in the last year led to an increased offering of financial services to the poor through correspondent channels. For example, Caixa Economica Federal (Caixa), started to convert recipients of the government's major conditional cash transfer program, Bolsa Familia, to a type of simplified account (Caixa Fácil). Some of these accounts are now linked to savings products, while others are eligible for loan products. In another example, Banco do Brasil has created its own type of low-value account. It claims to have opened 39 million of these accounts. An expanding middle class and across-the-board rise in incomes have led many banks to realize that there may be untapped opportunities at the base of the pyramid. As a result, both Banco do Brasil and Bradesco have plans to use their correspondent channel as

¹ As of 2002–2003, the national poverty headcount index was 21.5 percent; the rural poverty headcount index was 41 percent.

full-fledged channels for banking services. Mainstream commercial banks, such as Santander, are interested in developing services for low-income people as well.

In the next 12 months, financial services via cell phones will also get a boost from new opportunities and several initiatives:

- Caixa has already developed a mobile account that can be linked to a simplified account.
- Vivo has hired an ex-banker and has struck several partnerships to offer financial services.
- Bradesco is now partnering with several MNOs (Vivo, Claro, TIM, and Oi) to offer special low-value accounts, where the customer's monthly maintenance fee is converted into airtime value.
- The Ministry of Social Development (MDS) will be holding a public call for a partnership between an MNO and a bank to deliver Cadastro Unico benefits.
- The possibility of accepting boleto payments via mobile should also open up opportunities.
- ANATEL, the telecommunications regulator, recently passed regulation allowing Mobile Virtual Network Operators (MVNO) licenses; this should also have an important effect on the industry.

However, challenges remain. Most transactional agents are exclusive to banks, so incumbent banks, such as Caixa, Bradesco, and Banco do Brasil, with large agent footprints can create barriers to entry for newer entrants to set up wide reaching agent networks.

Attempts to develop credit and other products over correspondent channels have not always worked. Total credit in the Brazilian economy has risen from the equivalent of just over 20 percent of GDP eight years ago to about 45 percent today. Much of the increase has come from consumer credit in new forms of collateralized loans and in payroll-consigned loans. The expansion in personal credit is also due to an increase in credit promoters²—companies that are considered correspondents—that offer payroll-consigned loans on behalf of banks. These promoters, in turn, hire pastinhas, or individual credit salespeople, to offer loans. The large increase in the number of pastinhas (there are about 500,000 of them today) and the lack of control of these by the banks have become an important issue on the Central Bank of Brazil's (CBB's) agenda. In fact, CBB has taken steps this year to ban exclusive contracts on payroll-linked consigned loans between employers and banks. Regulation that will increase the bank's control on pastinhas is expected to be released within the first two weeks of February 2011.

MNOs and other nonfinancial entities have limited opportunities to offer financial services beyond credit cards.³ Attempts to create a regulatory framework for electronic money (e-money) have stalled. However, with a large bank-dominant banking sector, nonfinancial entities, such as MNOs, may find it difficult to launch new payment services to begin with. Smaller banks

² According to ABBC, the small and medium banks' association, there are 20,000 credit promoters in Brazil.

³ Regulation does not require "credit administrators" to be banks.

may also find it difficult to compete against large banks in this space. Banco Lemon shut its banking business, citing severe competition from the big banks as a reason. Oi Paggo, Oi's mobile-based credit card company, has sputtered along; however, Banco do Brasil and Cielo—the largest acquiring network in the country owned by Bradesco and Banco do Brasil—just bought a stake in the company.

While Bolsa Familia is celebrated in the country and globally as a success story, some research indicates that its success has been largely confined to rural areas when most of the country's worst poverty is in urban areas. The program's incidence in rural areas is high: 41 percent of rural households were enrolled in 2006, against 17 percent of urban ones. In the two largest cities, São Paulo and Rio de Janeiro, less than 10 percent of households are in the program. Yet these cities have some of the worst poverty in the country. Moreover, the actual subsidy in Bolsa may be too small of an incentive for urban families to keep children off the street and in schools. State add-ons, such as as Bolsa Carioca (in Rio de Janeiro), provide additional subsidies on top of the general Bolsa Familia one, to account for cost of life in urban areas; however, there are only five in existence, and they are still quite small.

What happens next in Brazil when it comes to correspondent banking will serve as a considerable source of learning for the rest of the world. Success in financial inclusion for Brazil will come from broader bank-based financial services through correspondents, especially for the majority of the poor living in the North and Northeast. Learning from MDS's financial inclusion strategy regarding Bolsa Familia recipients will also impact initiatives elsewhere. The successful widespread adoption of mobile as a channel may reduce costs, especially in urban settings, where a sizeable share of the overall population—and a significant number of poor people—resides. The involvement of new actors, including nonbanks, such as MNOs, will bring more choice and create downward pressure on prices for the poor.

Key Facts on Brazilian Consumers

- Between 2003 and 2009, 28.8 million people surfaced out of poverty or moved into Class C or the “new middle class.”
- C, D, and E classes are younger, grow faster than A and B classes, and will be the next major consumer group.
- Transaction volume in classes C, D, and E in 2008 was US\$69 billion.
- 69 percent of credit cards and 78 percent of store cards are owned by consumers in this segment.
- According to research, saving for their children's education is an absolute priority for C, D, and E classes.

CGAP's strategy in Brazil would involve building on CGAP's strong relationship with CBB and knowledge of the local market. At the top of the agenda is the issue of licensing nonbank retail payment providers, such as e-money issuers. CGAP can support the regulator and policy makers on mobile banking and the role of nonbanks in financial services. CGAP could continue providing support to the Bolsa Familia program as it explores opportunities with cell phones and promote

product development at leading banks, especially Banco do Brasil and Bradesco, targeting low-income, financially excluded consumers in urban areas.

Situation Analysis

Regulatory Environment

Correspondent banking and microfinance are considered pillars of CBB's Financial Inclusion Strategy. Brazil's success in financial inclusion has positioned the country as a critical member of the G-20 Financial Inclusion group. Brazil's success with correspondents dates to 10 years of back-to-back regulatory steps, evolving from more restricted possibilities to less stringent licensing conditions. However, the lack of clear definitions in correspondent regulation has made correspondent banking vulnerable to lawsuits that threaten the future viability of the correspondent business. In fact, several lawsuits have already made it to a Supreme Court level, and, in many cases, the court has ruled that correspondents should be deemed banking employees. The growth of individual credit agents has also raised concerns for those credit agents to be properly covered under correspondent regulation. Moreover, there is a growing consensus in the industry that e-money regulation is needed and the definition of payment services needs to be clearer. CBB has not been able to clear an e-money regulation that has been in draft for two years. Nonbanks and banks, including the banking association, are in favor of some regulation that provides clear definitions and allows for multiple business models to emerge. Mobile-based financial services are growing in importance along with planned pilots promoted by MDS.

Financial Inclusion

CBB Financial Inclusion policy has rested on two main pillars: retail agents and microfinance (including loans to microentrepreneurs and many compulsory lending requirements). CBB has also encouraged the creation of simplified accounts and has been working intensively on strengthening the cooperative sector in the last decade.

In 2009, CBB launched its Strategic Project for Financial Inclusion. The objective of the project is to rethink the financial inclusion model in Brazil to expand access. The first phase of the project is to deepen the knowledge of the market in Brazil. During this phase, CBB formed a Financial Inclusion Committee that is made up of representatives from CBB that are directly related to financial inclusion and are responsible for defining CBB's role in this topic.

CBB has already organized two Forums on Financial Inclusion, the first took place in November last year, the second happened in November 2010. The forum served as a diagnosis of the microfinance industry in Brazil and also promoted partnerships and dialogue. Following the first forum, a book was printed with important articles on the topic. Following the second forum, a financial inclusion report was printed. CBB now has a financial inclusion unit that deals specifically with all issues related to this topic.

Agent banking

While the framework for retail agents was created in the 1970s, a series of changes between 1999 and 2008 created the conditions for agents to be present in every municipality (see Table 1). CBB does not interfere in the business model in terms of technology, remuneration, or exclusivity. Although it does not permit agents to open any type of account, agents can receive applications for any type of account, can forward client applications for account opening to the financial institution, and can accept deposits into any type of account.⁴

Regulation makes it possible for virtually any type of entity to be an agent. Most agents are commercial establishments, such as grocery and drug stores, post offices, notaries, and lottery outlets, but a financial institution may also act as an agent.

Previously, CBB authorization was required for a financial institution to hire an agent. However, CBB does not need to authorize this 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 they are authorized by CBB. To reduce 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

Table 1: Impact of agent regulation over time

| Year | Changes in regulations relevant for correspondent banking | Impact on the market (numbers from Febraban and CBB) |
|------|--|---|
| 1979 | Financial institutions set contracts with agents compliant with minimum requirements provided by regulation. | Not available |
| 1979 | Following services could be outsourced to agents: receiving loan applications, analyzing credit and personal information of loan applicants, collecting loan payments, and processing data. | Not available |
| 1995 | Agents not permitted to charge extra fees. | Not available |
| 1999 | All institutions regulated by CBB are held liable for their agents’ actions; the agent must post a notice stating that it is acting on behalf of the regulated entity. | Not available |
| 1999 | List of approved actions at agents expanded to include <i>receiving</i> account opening applications, performing deposits and withdrawals, and effecting bill payments. | 9,000 new agents formed when Caixa Economica partnered with the lotto chain |
| 2000 | Removed the prohibition on banks using agents in locations with bank branches. | (+261%) 32,511 agents by the end of 2002 |
| 2003 | All institutions regulated and supervised by CBB are allowed to hire agents, and CBB has full access to the documents, information, or data related to the transactions conducted by the agents. | (+12%) 36,474 agents covering all municipalities by the end of 2003 |
| 2008 | Institutions no longer need to obtain a license from CBB for each contract and must to register the agent online. | (+196%) 108,074 agents by the end of 2008 |
| 2008 | The agent is allowed to conduct international remittances (subject to specific procedures), limited to a cap of US\$3,000 per transaction. | (+51%) 163,569 agents by 1 September 2010 |

! Source: CGAP Research; CGAP Financial Inclusion Regulation Center

⁴ Resolution 3,110/2003, Art. 1.I

services” (opening and handling of bank accounts).

Currently, all 163,569 correspondents are registered in CBB’s system; however, CBB does not keep track of whether all of these are active or not.⁵ This number includes 20,000 credit promoters, but does not include credit salespeople or *pastinhas* (about 500,000 *pastinhas* are not accounted for or recognized by CBB as correspondents).

Microfinance

There are two main government initiatives to expand microcredit offerings to low-income customers. The first is a 2003 requirement that commercial banks direct 2 percent of their demand deposits to microcredit (as defined in specific regulation). 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 (NGOs). The amount a bank fails to invest must be deposited in CBB without remuneration. About 50 percent of such funds have been kept at CBB.

The second initiative is a set of rules that enable banks to make payroll-consigned loans. These loans are the fastest growing type of credit business for banks, and they are largely channeled through agents.⁶ Between January 2004 and April 2009, these loans grew tenfold, from 10,000 loans to approximately 100,000. There were three sets of regulations relevant to these loans: in 2003, for employees under labor law; in 2005, for the National Institute of Social Security employees; and in 2008, for federal employees. These payroll-consigned loans offer flexible interest rates and collateral repayment financing.⁷ Another advantage is that workers can pay off their loans directly from their salaries, significantly reducing the credit risk of the lender. All major banks in the country, including HSBC, Santander, Itau, Caixa, Bradesco, and Banco do Brasil, offer these types of loans. This has also become a primary activity for small and medium banks in Brazil. For banks such as BMG, for example, their entire business focuses on payroll-consigned loans.

The official numbers on microfinance in Brazil reported by CBB in its recent Financial Inclusion Report reflect only the regulated microfinance industry. These numbers do not include NGOs, such as OSCIPs (organizations for civil society), which also offer microcredit but are not allowed to accept deposits. Although the unregulated market is not very big, not accounting for it in official reports distorts the actual size of the entire microcredit market in Brazil.

Simplified accounts

Simplified current and savings accounts were created in 2003. They have a maximum balance of US\$500 and can be handled by banking correspondents (correspondents can receive account

⁵ Banco do Brasil, for example, claims to have registered approximately 30,000 correspondents; however, it states that only 10,000 of these are active.

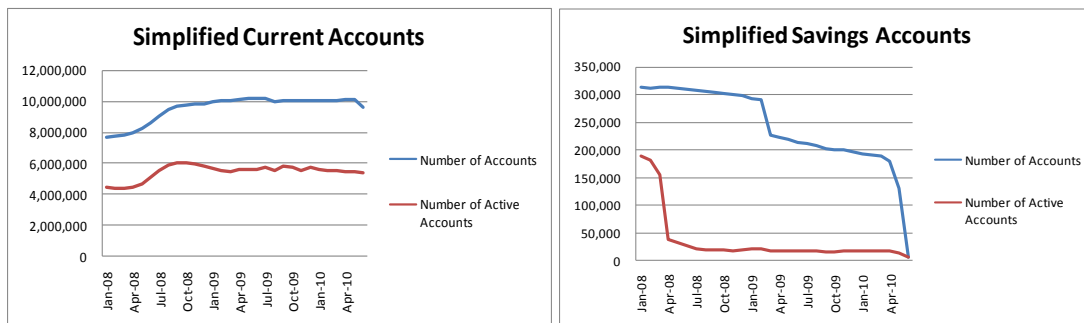
⁶ Law 10820/2003 (Crédito Consignado). A payroll-consigned loan is repaid directly out of the borrower’s salary.

⁷ Garantias reais de quitacao dos financiamentos.

applications, they can verify identification, and then forward these materials to the bank). These accounts can be held only by individuals who do not have other bank accounts. In addition, banks cannot charge for the first 12 transactions per month, and there is no maintenance fee.⁸ Only microloans can be channeled through these accounts. If the depositor has a microcredit account, then the maximum allowable balance is US\$1,500. The accounts are subject to a relatively relaxed customer due diligence procedure compared to regular checking accounts. There is no exemption to CDD requirements for any type or value of account.

While over 10 million simplified accounts have been opened, limits on these accounts set by regulation and the inability of banks to charge fees have made them unprofitable. Furthermore, the only credit product that can be offered to simplified account holders is microcredit, as defined by regulation. These characteristics make microcredit unprofitable, hence simplified accounts are unprofitable. Many of these accounts were opened (i.e., the process was started) at correspondents. Because these accounts are deemed unprofitable, it is no surprise that an overwhelming majority of them are opened by Banco do Brasil and Caixa Economica, state-owned banks with a commitment to the government’s financial inclusion efforts. Moreover, current accounts have held constant at 10 million for the last two years, while savings accounts have reportedly dropped from 300,000 to under 50,000 (see Figure 2). Active current accounts have remained roughly half of all accounts. As of October 2009, these current accounts had an average balance of R\$36.55 (US\$ 19.90).⁹

Figure 1: Numbers of Simplified Current and Savings Accounts, Jan 2008–Apr 2010



Source: CBB

Payments and Mobile Banking

CBB has drafted regulation to license nonbank financial services providers. Proponents of the regulation argue that it is better to license new nonbanking financial services providers than to

⁸ Simplified accounts are subject to a monthly balance limit (and total monthly deposit limit) of R\$ 1,000 [Resolution 3211/2004, Art. 1, II]. The opening and maintaining of these accounts are free, if there is no more than (i) four withdrawals per month, (ii) four balance statements per month, and (iii) four deposits (excluding loan deposits). [Resolution 3211/2004, Art. 7, I, II and III] “Funds may only be withdrawn by means of a magnetic-strip card or other electronic means.” [Resolution 3211/2004, Art. 1, III]

⁹ CBB, Microcredit Statistics, October 2009, available at <http://www.bcb.gov.br/?MICROFIN>. Accessed on 19 January 2010.

let them operate without clear regulation. The lack of regulation could also create an obstacle for the development of new electronic payments businesses further down the line, which would go against CBB's efforts to decrease the use of cash- and paper-based payments.

There are divergent views regarding the need for regulation of e-money issuers. Those who want to maintain the current status quo see no need for e-money regulation. Those who do want e-money regulation want to ensure that their investments will be protected and that future regulation will not stifle their initiatives. Nonbank financial service providers, such as OiPaggo, believe that there is need for regulation, but that regulation needs to be proportionate to the size of the transactions and the risks involved. Representatives from banks believe that new regulation might not be necessary. The telecommunications industry believes that regulation will only hurt the current landscape. The bank association, Febraban, believes that new regulation is absolutely necessary.

The banking and card industries are also attempting to influence the policy debate on nonbank financial services providers and mobile banking through Febraban. Febraban has ramped up discussions in mobile banking. It has convened a mobile banking working group that includes CBB. The association recently commissioned a study on the potential of mobile banking in Brazil. The study recommends a telecommunications-agnostic, open, and interoperable model for mobile financial services. There is concern over the participation of nonbanks, especially their participation in RTGS (although CBB has already allowed direct access of all nonbanks licensed by BCBS in RTGS). Febraban has asked CIP, the clearinghouse that is already used for banking switches, to handle mobile payments.

According to industry insiders, MNOs and banks are in the process of developing closer partnerships. A few will respond to the Bolsa Familia public bid. While banks are in the driver seat for these new negotiations, things were different 10 years ago. In the absence of e-money regulation and regulatory certainty, MNOs originally sought partnerships with banks. Banks were weary of what MNOs were proposing and nothing much came of those initial conversations. Today, the scenario has shifted, and banks are approaching MNOs to develop products in partnership. According to some, banks are more confident about what they want from these partnerships now that they have both individually and collectively through the Febraban investigated their options.

The Febraban mobile banking working group has been operating for five years now, and it is setting standards for the mobile banking industry as a whole. The purpose of the group is to enable mobile payments. It believes there are two ways in which mobile payments will happen: (1) through the existing value chain of electronic transfers, which will happen first and will impact existing bank customers with cards, and (2) through 80 percent of cash- and check-based transactions, a significant percentage of which are made by the unbanked. The goals of the group are threefold: (1) achieve real-time transfer of money and a sustainable business model (clearing money between banks and CIP); (2) meet with MNOs to understand what protocols and what technologies are needed across the industry, to negotiate bulk rates, and to set a

common set of rules; and (3) come to a common agreement on usability, minimum amount of data, and how to include people in a more viral way.

Relevant Telecommunications Regulation

Brazil is a market with high direct taxation for telecommunications—something mobile operators have to consider when developing new services. The tax regime is considered to be very complex. Some studies estimate that for every unit of currency a consumer pays for telecommunication services, 0.65 goes to the government in taxes through various schemes. The basic tax is the value-added tax (VAT), which is calculated over revenues. It is imposed by states and can range from 18 percent to 35 percent. While VAT is common in most markets, it is exceptionally high in Brazil. The average VAT in Brazil is 33 percent, which is double that of Mexico.¹⁰

CBB has had talks with the National Agency of Telecommunications (Anatel) about MNOs entering into the mobile banking area. But there is little awareness and coordination on this subject among the various CBB departments, let alone 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. CGAP traditionally has not had a relationship with Anatel.

In 2006, Anatel research, “Micro Top-up,” analyzed mobile banking models in other countries. The research concluded that these mobile payment solutions have a social impact, and there are no technological barriers to develop these services. The study identified the lack of interoperability of MNOs as a possible challenge in the long run,¹¹ although the recent introduction of number portability might have some impact on this view. Not much has been made of that study, however.

Anatel approved regulation that will see the entry of MVNOs into Brazil’s mobile market in early 2011. The regulator allows for MVNOs to operate either as agents or as virtual network licensees. An agent represents the personal mobile service provider through a representation agreement, which must be ratified by Anatel. The agent’s activity is not defined as a “telecommunications service” and is of significant interest to companies that operate in other sectors, such as large retailers, banks, and football teams. However, the activity of the virtual network licensee does fall within the definition of “telecommunications service” and is thus subject to all applicable rules. The virtual network licensee is required to enter into a network-sharing agreement with existing carriers and must request a grant from Anatel. The main innovation brought by the new regulation is the deregulation of the activity of agents (i.e., the representatives of the mobile providers), which was overly burdened by the original text of the

¹⁰ The Impact of Taxation on the Development of the Mobile Broadband Sector, GSMA, and Telecom Advisory Services

¹¹ 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.

regulation and, as such, was widely criticized.¹² Licensing prices are fairly low (\$200 for the lighter license and \$4,000 for the MVNO license). A number of companies have already expressed interest in launching such retail mobile services, including fixed-line incumbent Telesp, alternative operator GVT, BT, and Carrefour. The bigger incumbent banks, such as Banco do Brasil, are also interested, but see this as a medium-term project or investment.

Industry Overview

Background on Banking Industry

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.

There are 191 banks operating in the country.¹³ Six banks—Banco do Brasil, Itau, Caixa Economica Federal, Bradesco, Santander,¹⁴ and HSBC—collectively have 68 percent of the banking assets and 91 percent of the existing bank branches, and they employ close to half-a-million people in the banking industry (see Table 2). These banks also represent the largest banks in Latin America. Banco do Brasil is the largest bank in the region, followed by Itau-Unibanco and Bradesco. Only 30 percent of the adult population has bank accounts (there were 125.7 million checking accounts¹⁵ in 2008 and an estimated 40 million account holders—including the accounts of legal persons—against a total population of 191.9 million).

Eighty-four banks are part of the association for small and medium banks (ABBC). In 2004 when payroll-consigned loans entered the market, they were offered by small and medium banks because these types of banks did not have their own branch or agent network, and their focus was not on current accounts. They saw their ability to offer credit to nonclients as their competitive advantage. The larger banks continued to focus on bill payments and anything they could channel through current accounts. However, as larger banks saw an opportunity to increase their market share, they also began offering payroll-consigned loans and made strong inroads into this market. In December 2004, the value of consigned loans was R\$2 billion (loans outstanding). Today, the value of consigned loans is R\$60 billion (loans outstanding).

¹² <http://prepaidmvno.com/2010/12/08/anatel-approves-mvno-regulation-international-law-office/>

¹³ Buscabanco, Federação Brasileira de Bancos—Febraban, December 2010. <http://www.febraban.org.br/buscabanco/>

¹⁴ Santander is an IFC investee in Brazil. Banco Real was an IFC investee in 2004 and was then bought by Santander in 2008. There are currently \$280 million outstanding as a sustainability credit line.

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

Table 2: Overview of Major Brazilian Banks

| Bank | Total Assets | Total Deposits | Savings a/cs | Loans | Staff | ROA | ROE | Branches | Agents |
|-----------------|---------------|----------------|--------------|----------------|---------|------|-------|----------|--------|
| Banco do Brasil | \$405,205,070 | \$191,085,335 | 45,262,732 | \$ 169,979,233 | 123,996 | 1.5% | 31.5% | 4,985 | 15,300 |
| Itau | \$349,663,076 | \$109,032,558 | 28,782,571 | \$ 111,699,483 | 113,907 | 1.7% | 22.3% | 4,301 | - |
| Caixa | \$211,622,504 | \$108,731,305 | 64,574,279 | \$ 82,793,405 | 106,778 | 1.4% | 23.2% | 2,091 | 15,200 |
| Bradesco | \$275,116,432 | \$100,314,131 | 26,758,191 | \$ 95,669,872 | 85,136 | 1.7% | 21.4% | 3,484 | 30,000 |
| Santander | \$203,190,112 | \$ 56,951,211 | 14,832,812 | \$ 70,833,367 | 51,931 | 1.8% | 9.8% | 2,285 | 1,000 |
| HSBC | \$ 64,680,599 | \$ 38,873,831 | 1,838,863 | \$ 19,010,099 | 28,536 | 0.7% | 10.2% | 866 | - |

Sources: CBB, balance sheets processed until 31 August 2010; branchless banking agents in Brazil; CGAP; banks' financials

Brief Overview of Banks in Agent Banking

Caixa, Banco do Brasil, and Bradesco, collectively, have the most correspondent channels (over 50,000). They have used these channels primarily to process bill payments and disburse government payments. Although regulation allows agents to only receive applications for accounts and then to forward them to the bank,¹⁶ the process allows banks to pre-open accounts through agents (account opening approval can take as little as 24 hours, to a full seven days, depending on the location of the agent), and then decide to officially open the accounts later. Banks do not seem to feel constrained by this.

Several changes in the last year led to an increased offering of financial services to poor people through correspondent channels. For example, Caixa started to convert recipients of the government's major conditional cash transfer program, Bolsa Familia, to a type of simplified account (Caixa Facil), a percentage of which is now linked to savings accounts and eligible for loan products. This conversion, however, is not mandatory. Caixa is offering simplified accounts, but Bolsa Familia is not mandating transfers through these.

The Brazilian economy is rapidly changing, leading banks to reach out to poorer market segments. Each year a percentage of the population in the lowest D and E income segment "graduates" to higher segments. Between 2003 and 2009, 28.8 million people surfaced out of poverty or moved into Class C or the "new middle class."¹⁷ A middle segment that is rapidly expanding and a crowded market at the top of the pyramid have made it imperative for banks to target mass market customers. As a result, both Banco do Brasil and Bradesco plan to use their correspondent channel as a full-fledged channel for banking services. Mainstream commercial banks, like Santander, are interested in developing services for low-income people.

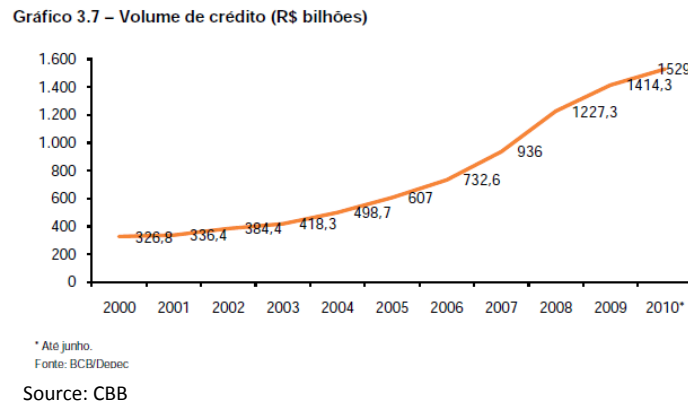
Total credit in the Brazilian economy has risen from the equivalent of just over 20 percent of GDP eight years ago to about 45 percent today. Much of the increase has come from consumer credit in new forms of collateralized loans, especially for purchases of motor vehicles and in

¹⁶ Resolution 3110, Art 1.I.

¹⁷ "The New Middle Class in Brazil: The Bright Side of the Poor." Fundacao Getulio Vargas, September 2010.

payroll-consigned loans, where repayments are deducted from borrowers' pay or pensions.¹⁸ From 2004 to 2009, credit transactions grew by 122 percent. Personal loans totaled R\$692.6 billion in June 2010, after a 19.1 percent expansion from June of the previous year. This represents 45.3 percent of the total amount of credit of the entire financial system.¹⁹ Brazil's credit industry is still young, however, and subprime as a market does not yet exist. Figure 2, from CBB's 2010 Financial Inclusion report, represents the growth in credit volumes from 2000 to June of 2010.

Figure 2: Credit volume (in billions of R\$) 2000–2010



While there is no specific regulation on agent exclusivity, Caixa, Banco do Brasil, and Bradesco are said to have exclusive arrangements with end-agents. This exclusivity may hinder newcomers, like Santandaer, from entering into the correspondent banking area. However, it is important to note that, in the case of credit promoters, which are also considered correspondents, exclusivity arrangements do not exist, and they offer products from different banks. This is especially true for small- and medium-size banks. An example of this is Banco BMG, a medium-size bank that operates exclusively through correspondents (credit promoters) and has no bank branches. In response to lawsuits from ABBC and larger banks' strong commercial exclusivity arrangements with credit agents, CBB has banned exclusive commercial contracts on payroll-consigned loans between employers and banks.²⁰

Caixa Economica Federal, a state bank, is the main institution used by the government to distribute government payments to the lowest classes. Caixa was the first bank to create a large, 9,000-point agent network through a partnership with lottery stores. Caixa is the official operator of the national lottery program, and it manages the lottery's back office (including information systems).

Caixa uses its agent network for bill payments and to make Bolsa Familia payments to 12 million households. It currently offers Caixa Facil, a type of simplified account with a card. About 2

¹⁸ Financial Times (FT.com), 16 November 2010.

¹⁹ CBB's Financial Inclusion Report, 2010.

²⁰ Business News America (bnamericas.com), 14 January 2011.

million people use these accounts (which are run like current accounts); 25 percent of those account holders have their account linked to Caixa's new savings account. Bolsa Familia's goal is to reach 4 million Caixa Facil users. Caixa has also introduced Conta Caixa Facil via cell phones; 6 percent of its customers have accessed mobile banking through these accounts.

By law, Caixa is the sole operator of Bolsa Familia. By decree, Caixa provides financial products, and MDS is the payment service. This means that Bolsa Familia always has to be channeled through Caixa (although this might change). Caixa, however, has considered distributing payments through mobile and MDS.

Banco do Brasil²¹ is a public bank with a strong commercial orientation (the government owns 53 percent of it). The bank recently went through an internal reorganization that put the correspondent banking channel in the center of a consolidated business for down-market customers, separating it from social and noncommercial projects. The bank has a strong strategic focus on the lower classes and the new emerging middle class. It is committed to offering customized products by market segment and will do so through correspondent banking, which it wants people to see as another "first class quality way" to offer banking services.

The bank has introduced monthly subscription packages (at R\$5 and R\$10–15), available through correspondent channels and branches, to its lower income clientele. Consumers can also access credit and microinsurance through these accounts.

The bank retired its Banco Popular brand and has struck an exclusive alliance with Banco Lemon's agents and its agent management business called Multi Bank. It considers these "acquired" Banco Lemon agents to be its best agents. The bank is currently developing a product strategy and has decided to expand beyond its current operations. The bank president unveiled plans for the next three years, calling the strategy Banco do Brasil 2.0. This involves an increase in the number of branches, correspondents, and strategic points.

Bradesco is the second largest private commercial bank in the country, with 59.1 million customers and total assets of R\$611.9 billion. It has an aggressive strategy targeting the lower income segments, classes C, D, and E. Bradesco's correspondent network is the largest in the country, with 30,000 correspondents (from its partnership with the post office, Banco Postal, and its partnerships with individual retail stores and chains, Bradesco Expresso). Banco Postal has 6,194 points of service, and Bradesco Expresso has 24,887 points of service. The bank has 4,731 branches, 41,000 ATM terminals, and coverage in all 5,564 municipalities in Brazil.

Bradesco is the only bank that partners with multiple MNOs (Vivo, Claro TIM, and Oi) to offer special, low-value accounts where the customer's monthly maintenance fee is converted into airtime value (Conta Bonus Celular Bradesco) in his or her prepaid mobile phone account (and post-paid for Claro customers only). The airtime needs to be used within 30 days. Bradesco is offering the product with Vivo, Oi, and Claro. The payment amount depends on whether

²¹ <http://www.bmfbovespa.com.br/cias-listadas/Empresas-Listadas/ResumoEmpresaPrincipal.aspx?codigoCvm=1023&idioma=pt-br>

customers access these accounts at branches (R\$ 16) or at Bradesco correspondents, primarily Post Offices and Bradesco Expresso branded locations (R\$ 11). To open a Conta Bonus Celular, customers need to present identification, taxpayer documents, and proof of address.²²

Santander is an example of a private commercial bank that is motivated to develop services for the newly minted middle classes and to find ways to reach low-income segments. According to the bank's own research, 7 million people leave poverty each year in Brazil. Santander acquired Banco Real, a bank that has a very strong reputation in the market as being sophisticated about segmentation and being innovative. Many bank initiatives have been derailed due to Santander's complex IT integration with Banco Real, which is expected to end by February 2011. Santander has also found it difficult to develop agent channels in a market where major banks have exclusivity clauses with end-agents.

Banco BMG is a medium-size bank that has no branches and operates exclusively through correspondents (credit promoters). BMG is a monoprodukt bank and offers only payroll-consigned loans. Its biggest challenge is maintaining the loyalty of its correspondents as they are not exclusive to BMG. BMG has currently launched a microcredit pilot in an urban slum in the outskirts of Sao Paulo.

Agents and Agent Managers

Agents conducted 2.8 billion transactions in 2009.²³ This represents 5.88 percent of the 47.6 billion total bank transactions, up from 4.75 percent in 2003.²⁴ Branch transactions, which used to represent around 20 percent of all bank transactions, now represent only 9 percent (ATMs are the most used electronic channel).²⁵

Most agents specialize in receiving bill payments, which account for approximately 75 percent of all agent transactions (47 percent of which are utility bill payments).²⁶ 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.²⁷

Most of the country's social transfers to 12 million poor families are cashed out at agents, particularly lottery houses, as are most repayments on consumer credit. Rural agents see more withdrawals and deposits as a proportion of their transactions (38 percent) than urban agents do (8 percent), suggesting agents play an important role in rural access.

Agents do about 166 transactions per day, but they make just US\$4.34 in profit per day—about 3 cents per transaction. Moving and protecting cash is costly, risky, and time consuming. Forty-

²² http://www.bradescoceleular.com.br/html/default.aspx?pag=content/servicos/conta_bonus_celular.aspx.

²³ Febraban, "O Setor Bancario em Numeros" Junho 2010.

²⁴ Ibid.

²⁵ Ibid.

²⁶ Data provided by Febraban (accumulated from January to June 2008).

²⁷ Ibid.

one percent of agents have been robbed in the past three years, losing on average of US\$535, equal to five months of profit.²⁸ To shield against this expense, banks have instituted very low limits cash agents can have on hand. As a consequence, some agents have to go to the bank several times per day. Despite this, many merchants feel they must be an agent for the boost it brings to foot traffic. Ninety-six percent of agents say losing their status as an agent would have a negative impact on their main business.

All major banks are using cash management companies. In Brazil, they are using Brinks and Proseguro. Cash management costs are high, and in some cases, they represent up to 40 percent of the costs in the correspondent model.

In 2003, regulation was passed to allow subcontracting in banking correspondent contracts. This mechanism allows a company contracted as a banking correspondent to transfer its banking duties to third parties, instead of performing the correspondent functions itself. Before that, only the company itself was allowed to carry out banking functions. These companies are known as gestor de rede or network managers (NMs). This outsourcing relationship (in the Brazilian regulatory framework this is considered subcontracting, which differs from outsourcing arrangements) with the bank can happen in three ways:

1. Complete management—NMs offer the bank business intermediation and technological integration, they have larger participation and influence in the operation of the correspondent banking channel, and they assume liquidity risk.
2. Partial management—the manager offers only technological integration services, and the bank assumes the selection, hiring, and other functions. This is more common in regions that are already covered by bank branches (the bank assumes the liquidity risk).
3. Low manager intervention/partnerships—this is mainly found in the partnership between Bradesco and Postal Services and between Caixa and the lottery networks.

Specialized agent managers have flourished, as have supporting businesses, such as software for agent managers. However, there is still no competitive market for their services—most are locked into exclusive deals with a particular bank. NMs offer a more complete range of services, including technology and agent management (such as the case of Telecom Services in Table 3). Virtual area networks (VANS) usually offer a less complete suite of services that, in most cases, includes just technology (as in the case of those offering services for Bradesco Expresso).

The business case for NMs varies greatly by contract and bank involved. In some cases, the bank will pay the NM a certain amount per transaction. In other cases, the bank will also base its payment to the NM on the amount of traffic diverted from the bank branch. Transactional contracts have not proven very profitable for NMs. However, they have been able to change the

²⁸ “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 February 2010.

business model by offering payroll-consigned loans. For example, Telecom Services began making money after it started working with credit.

Banco Lemon was the first bank to operate exclusively through correspondents. However, it quickly realized that it wouldn't be able to compete against the major banks in the Brazilian industry that also use agents. Banco Lemon's margins shrank, and it could not make the bill payment business work. As a result it became an NM for Banco do Brasil's 6,500 (out of 10,500) correspondents. It has the distinction of representing the "best performing" and the largest number of correspondents within Banco do Brasil's correspondent banking network.

Table 3: Sample of agent companies

| Agent Company | Bank Partner | Number of locations | Transactions | Also do credit via promoters? |
|--------------------------|---------------------------|---------------------|--|-------------------------------|
| Bradesco Expresso | Bradesco | 24,887 | 1 billion transactions in 2010 (Expresso and Postal) | Yes |
| Bradesco Postal | Bradesco | 6,191 | | Yes |
| Cielo | Banco do Brasil, Bradesco | 6,000 | 1.2–1.3 million/month | - |
| Lemon Bank | Banco do Brasil | 3500 | - | No |
| Telecom | Banco do Brasil | 1,000 | 1.2 million/month | Yes |
| Potencial | Banco do Brasil | 180 | 1.2 million/month | Yes |
| Instituto Palmas | Banco do Brasil | 41 | 120,000/month | - |

Source: CGAP interviews

Legal uncertainty threatens agent business

Legal uncertainty threatens the continuity of the agent business itself. Banks operating through agents and, in particular Caixa, are facing lawsuits from labor unions requesting pay equality for agent and bank employees. The unions are also questioning in court the authority of CBB to regulate this type of service provision altogether. The sanitary agency has issued a regulation (which has been suspended in court by Febraban's opposition) prohibiting drugstores to act as agents. A private security lobby group has proposed a draft law requiring banks to implement at agents the same security features applicable to bank branches. More recently, associations of shops and stores have also started to question the use of their affiliates to deliver financial services. Many cases have reached the Supreme Court, and rulings have positioned correspondents as banking employees.

These lawsuits could seriously destabilize the current correspondent banking business model and frustrate hopes of an inclusive financial system in the near future. This issue goes beyond business operations; it also has important legal repercussions, as it involves a hierarchy of norms (a Resolution versus the Labor Code) and is related to the rather vague regulatory definition of a

correspondent.²⁹ Because the agent regulation does not provide a definition for “correspondents” and is an infra-law document (as opposed to the Labor Law), it is open to wide ranging litigation. It appears that the best way to deal with this situation is to issue a law that defines the agent business and differentiates it from banking business. Febraban and ABBC have proposed a draft law that addresses these issues. Unfortunately, it has been stalled for more than two years now, and CBB traditionally refrains from supporting specific legal initiatives in Congress (despite its increasing interest in financial inclusion).

Payments Industry and Other Nonbank Players

There are two high-value settlement systems in Brazil, 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 licensed by CBB. These include brokers, credit cooperatives, credit and financing societies, among others. Today more than 150 institutions have direct access to RTS. CBB has also developed a platform to allow access to RTS via the Internet. The other access platforms are provided by two independent private telecommunication networks that form the National Financial System Network (*Rede do Sistema Financeiro Nacional*).

Over 90 percent of the total noncash bank retail payment transactions in 2008 were processed via electronic channels, with increased use of credit and debit cards as a payment instrument. The numbers of automatic teller machines (ATMs) and POS devices per 100,000 inhabitants in 2009 (112 and 2,247, respectively) are significantly higher than in most Latin American countries, but the number of POS devices relative to the total population is still below the average in industrialized economies.

CBB conducted an assessment of the retail payments industry, with a particular focus on card companies, and found several inefficiencies. As a result, it issued a Directive asking for more interoperability. Although Directives have no normative power, CBB was able to require interoperability among the largest acquirer networks. Exclusivity agreements between the acquirer Cielo (which used to run Visa exclusively) and Redecard (which used to run MasterCard exclusively) ended in July 2010. Currently, all credit cards run through both acquiring networks.

A new card brand, Elo, is being issued in cooperation among Banco do Brasil, Bradesco, and Caixa Economica Federal. Elo previously existed in the market, was taken off the market, and is now being picked up again by these three banks. It will target lower income segments.

²⁹ The loophole left by the regulatory definition facilitates the emergence of additional problems in the lending business through agents (a specific type of agent known as *pastinhas*). The issue is too complex to be discussed in this article but is one that CBB should consider in its effort to advance responsible financial inclusion.

Boleto Bancario

A boleto is a payment instrument (originally in paper but now available electronically) that customers use to pay companies and other persons for their products or services. The original and most common boleto is a bar-coded standardized paper document that allows bills to be paid via any branch, ATM, and bank correspondent and via the Internet until its due date. Any company with a bank account can issue boletos by contacting a bank branch. Febraban established the format of the document, which is printed by customers from the Internet or mailed by companies.

In 2009, the cost of the boleto was about R\$1–4 (\$0.5–\$2), depending on the bank. Banks charge an additional fee of approximately R\$2 (\$1) for the registered collection. In the same year, the Monetary Council, in accordance with the Consumer Protection Code, prohibited companies to charge customers for the issuance of boletos.

Febraban estimates that 2 billion paper boletos are issued per year, and that amount could be reduced by 40 percent. In October 2009, through the combined efforts of CBB, Febraban, banks, and the Interbank Chamber of Payments (CIP), *Debito Direto Autorizado—Authorized Direct Debit* (DDA), or the electronic boleto, was created. Unlike automatic direct debit, customers registered in DDA are able to decide whether or not they are going to pay each bill and can do so conveniently. Febraban estimates that DDA could reach 15 million checking accounts. DDA is a source of revenue for banks as they receive money for managing a portfolio of receivables of companies.

There have been notable changes in the remittance market. According to **Western Union**, the international remittances market, particularly that of inbound remittances, in Brazil has decreased significantly. Western Union's strategy is to focus on outbound international and domestic remittances. It has obtained a bank license (at a cost of \$16 million in reserves), so that it can make domestic money transfers and capitalize on this market. Western Union needed a banking license because there is no regulatory definition of money transfers, and therefore, these can be done only by banks and the Post Office (based on the Postal Services Law).

Both Visa and MasterCard are making inroads into mobile payments. **Cielo**, along with Banco do Brasil, just bought a stake in Oi Paggo. (Banco do Brasil itself has a 23 percent stake in Cielo, through its investment bank arm. Bradesco also has a stake in Cielo). Cielo used to be VisaNet. VisaNet was created in 1995 by Visa International, Bradesco, Banco do Brasil, Real ABN Amro Bank, and Banco Nacional to manage the merchant network, unify and develop new capture solutions, and provide financial clearing services. A year later, VisaNet Brasil began operating with a network of over 100,000 merchant locations that had been passed down from these partner banks. Today, in addition to managing the Visa acceptance network, Cielo develops and provides monitoring, capture, and processing solutions for Visa Vale, private-label cards, and issuing banks. Cielo, due to recent regulatory changes, has also been required to accept

MasterCard transactions. Furthermore, Cielo has 6,000 correspondents—5,000 for Banco do Brasil and 1,000 for Bradesco.

MasterCard is trying to gain ground in the market; Visa has the largest market share. MasterCard has embedded itself as an important “back-end” technology, particularly with several mobile products being launched by telecommunications companies and banks, and the company is endorsing a “true ecosystem” play. MasterCard formed a joint venture with SMART (from the Philippines) to offer mobile wallets to banks in Brazil through partnerships with Vivo and Itau Unibanco. The service is known as the Mobile Payments Gateway and is an open mobile payment processing platform.³⁰

Microcredit Providers and Cooperatives

Microfinance penetration remains low. Although the industry has grown in the past three years, its slow growth is counter to expectations that Brazil’s size and large low-income population indicate a large demand for microfinance (Brazil has about 820,728 active borrowers and a gross loan portfolio of \$934.5 million).³¹ Unlike that of microcredit, the growth and consolidation of the cooperative sector has been considerable. Credit cooperatives were first allowed to function through specific regulation in the 1970s; however, the sector grew stronger with the improvement of this regulation and supervisory framework in the 1990s, and in particular since 2002.

Wholesale funding from the banking system, a major source of financing in high-growth microfinance markets like India, has been limited. The wide availability of consumer credit and strong tradition of government-subsidized programs, particularly in rural finance, may account for the low rate of growth of microfinance institutions (MFIs).³² There are also other issues, such as interest rate caps, and other indirect costs on lending, such as the high reserve requirements that are contributing to the slow growth.³³

As noted earlier, the government has attempted to support the industry through regulation that banks direct 2 percent of their demand deposits to microcredit and that the amounts not invested be deposited in CBB without remuneration. Unfortunately, in recent years, half of the targeted 2 percent has been left with CBB.³⁴ This regulation creates additional reserve requirements for those banks that have not participated in microlending. However, it also adds to the tax burden of banks and could work against the desired broader development of the microfinance sector.³⁵

³⁰ http://www.mastercard.com/us/company/en/newsroom/mc_joins_forces_with_smart_hub.html

³¹ Mix Market Data (2009).

³² The legal framework allows banks to make payroll-consigned loans, a fast growing line of business that is channeled through nonbank agents (Law 10820/2003—*Crédito Consignado*. A payroll-consigned loan is repaid directly out of the borrower's salary). This has increased consumer credit dramatically, but has hindered the microfinance industry. See Bonnie Brusky and Joao Paulo Fortuna, “Understanding the demand for microfinance in Brazil: A qualitative study of two cities.” PDI/BNDES July 2002.

³³ Notes on Regulation of Branchless Banking in Brazil, CGAP, February 2008.

³⁴ Ignacio Mas, et al.

³⁵ Anjali Kumar. “Access to Financial Services in Brazil.” World Bank Report. Washington, D.C.: 2005.

Banco do Nordeste's Credi-Amigo is the most active and successful MFI and one of the largest microfinance programs in Latin America. Banco do Brasil is experimenting with microcredit through agents, but it has had poor results so far, particularly in terms of default rates.³⁶ Banco Lemon also has had limited success and withdrew from retail banking entirely.

In contrast to the microcredit sector, the growth of the cooperative sector in Brazil has been impressive. Credit cooperatives' assets grew from around R\$2.5 billion in 2002 to R\$11.5 billion in 2008, and loans grew from R\$1.4 billion to R\$4.6 billion. Their member base grew from 1.5 million in 2002 to the current 3 million members; however, the typical cooperative client is not the microfinance client. Cooperatives do not usually cater to the poor or the very poor. They represent an important channel for financial services, particularly due to their deposit-taking capacity, and because their use of agents enables increased outreach to remote areas, although the range of services offered through agents by cooperatives is not broad. Individual cooperatives find it difficult to invest in IT systems to connect agents to their core system, which is usually provided by a federation (Sistema). **The investment would need to come from Sistema, instead, for the benefit of all affiliated cooperatives, but there is little appetite and awareness for this.** Cooperatives, however, do not necessarily reach the poor.

Mobile Network Operators

Four MNOs 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)³⁷ to 173.9 million by the end of 2009 (82.5 percent prepaid), to the current 190 million subscribers.³⁸ Online top-ups are customarily made through both 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 (hence they are taxed as if they were voice service), although they are increasingly used as a customer retention tool.

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.³⁹ 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,⁴⁰ which, although highly controversial among MNOs, is already in place in various cities, including Sao Paulo.

³⁶ According to Banco Popular, the current default rate in microcredit is 17 percent. It was 24 percent in 2002, when the bank started operating.

³⁷ Anatel: Notícias, 23 de novembro de 2007.

³⁸ Anatel: Notícias, 29 de janeiro de 2010.

³⁹ Portal Anatel: [Consolidação Serviços Móveis no Brasil](#), January 2010.

⁴⁰ "Number portability" refers to the consumer's ability to change service providers while keeping the same telephone number.

Unlike in markets such as those in Pakistan or India, MNOs are not under pressure to develop value-added services. MNOs are not threatened by loss of market share, and revenue prospects remain stable (see Table 4). Analysts predict that, by 2013, there will be 50 million more connections; however, this will not change the relative market share for MNOs. It is not surprising to find that MNOs are letting banks drive the mobile payments business.

Table 4: Overview of Telecommunications Market

Major MNOs are divided on the usefulness of e-money regulation in a market that is dominated by banks, but they are likely to get more weight in ongoing negotiations if e-money regulations exist. Oi's mobile-based credit card company, OiPaggo, is co-owned by Cielo and Banco do Brasil, which has put it in a favorable position to offer a mobile wallet (m-wallet) type account, integrate closely to over a million acquiring points of the Cielo network (which is also owned by Bradesco and Banco do Brasil), and expand its service offering. OiPaggo prefers e-money regulation so there is regulatory certainty. On the other hand, Vivo, one of the largest MNOs, is less interested in the development of e-money regulation as it might prove to be confining. Vivo has struck unique, one-on-one business partnerships with banks and insurance providers.

| Mobile Network Operator | Market Share, Connections | Churn (Monthly) | ARPU |
|-------------------------|---------------------------|-----------------|-------|
| Vivo | 29.79% | 2.60% | 14.01 |
| Claro (America Movil) | 24.96% | 3.20% | 10.65 |
| TIM | 23.64% | --- | --- |
| Oi | 19.78% | --- | --- |
| Nextel (NII) | 1.48% | --- | --- |
| CTBC | 0.30% | --- | --- |
| Sercomtel | 0.04% | --- | --- |
| aeiou (Unicel) | 0.01% | --- | --- |

Source: Wireless Intelligence

As mentioned previously, Anatel's new regulation on MVNOs is expected to change the landscape. Banks, such as Banco do Brasil, and large retail chains, such as Carrefour, have expressed interest in acquiring MVNO licenses.

Vivo's new manager of financial services is a former executive in the card business from Itau. He uses his knowledge of the financial services landscape to design innovative products for particular market segments. Of the numerous financial products Vivo is launching, one that is being offered in partnership with Bradesco and MasterCard focuses primarily on the lowest income segments. Vivo is committed to financial services; however, the products are launched as trials, with particular emphasis on products that do not require major technological and resource investments from Vivo. In short, Vivo's strategy is to launch products that require low effort and low technology.

The mobile-based credit card company **Oi Paggo**,⁴¹ with its 250,000 active users, is a small player in Brazil's telecommunications arena, but its role is growing. Cielo and Banco do Brasil recently bought a share of the business. This new partnership will allow Cielo and Banco do Brasil to offer a mobile payments system in Brazil. However, it is unclear whether they will be allowed by the regulator to carry out business the way they originally intended to (as mobile wallets are similar

⁴¹ OiPaggo's technology platform was developed by the Brazilian company Freedom. Freedom continues to run its platform today, although this role may be transferred to Oi.

Bolsa Familia identifies, classifies, and monitors recipients through its Cadastro Unico or Single Survey, which classifies individuals' and families' economic status. Bolsa Familia's cash transfer is conditional on three areas: education, health, and social assistance. The program requires school attendance for children, vaccination, maternity care, and participation of youth in certain social programs.

MDS, which coordinates Bolsa Familia and Cadastro Unico, is very interested in having these programs distributed through mobile phones. For this reason, it will soon launch a public bid for partnerships between banks and operators to distribute Cadastro Unico benefits (it is not able to do this for Bolsa Familia, as Caixa, by law, is the only financial entity allowed to distribute it and hold recipients' accounts, although this may change in the near future). Cadastro Unico beneficiaries are those that are slightly better off than those who receive Bolsa Familia benefits (above minimum wage). The bid will be for a pilot in two cities that will target 3,000–10,000 beneficiaries. Many details of the bid, the timeline of the pilot, and a plan for what will happen to the pilot/ partnership after it ends are yet to be established.

While Bolsa Familia is celebrated in the country and globally as a success story, some research indicate that its success has been largely confined to rural areas when most of the country's worst poverty is in urban areas. The program's incidence in rural areas is high: 41 percent of rural households were enrolled in 2006, against 17 percent of urban ones. In the two largest cities, São Paulo and Rio de Janeiro, less than 10 percent of households are in the program. Yet these cities contain some of the worst poverty in the country. Moreover, the actual subsidy in Bolsa may be too small of an incentive for urban families to keep children off the street and in schools. State add-ons, such as Bolsa Carioca (in Rio de Janeiro), provide subsidies on top of the general Bolsa Familia one, to account for cost of living in urban areas. However, there are only five such add-ons in existence, and they are still quite small.

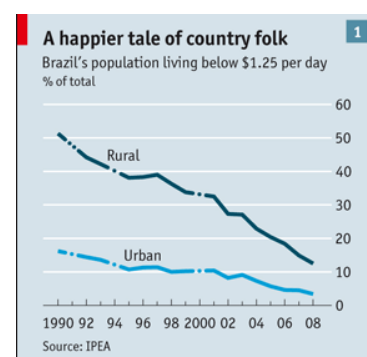
Bolsa Família does not publish figures on urban and rural poverty; however, the official report on the United Nations' millennium development goals, published in March, indicates that rural poverty fell by 15 points in 2003–2008, much more than the urban rate.⁴²

Key Challenges and Opportunities

Challenges

While banking correspondents are present in every municipality, until recently, they have not been used as a channel for much more than bill payments. The adoption and viability of savings, credit, and insurance products remain unproven. Moreover, only banks and credit cooperatives can take deposits from the public. One of the reasons MFIs are struggling with financial sustainability is because they are not allowed to take deposits. There is limited

Figure 4: Urban v Rural Poverty in Brazil



Source: The Economist

⁴²<http://www.economist.com/node/16690887>

experience with traditional microfinance methodology in Brazil, and few successful examples, such as Crediamigo and CEAPE Maranhao, to draw on.

The future of branchless banking in Brazil may be driven by large, established entities in the correspondent business that enjoy exclusive agreements with major banks. While there is no specific regulation on agent exclusivity, the three banks with collectively the largest agent footprint—Caixa, Banco do Brasil and Bradesco—are reputed to have exclusive arrangements with end-agents. This exclusivity has raised concerns about barriers to entry into correspondent banking for newer entrants, like Santander. Small and medium-size banks face the opposite problem as their correspondents, credit promoters are not exclusive to any bank, and banks are facing loyalty issues. CBB's new ban on payroll-consigned loans between employers and large banks will impact credit offerings, but might not change exclusivity for transactional correspondents.

Demand for higher pay for agents and other legal demands against banks using agents may increase the cost of operating agents to an unsustainable level. Labor unions are demanding equalization of pay between agents and bank employees, and there is a draft law on security requirements that would increase surveillance standards for agents. There are other legal uncertainties, such as the prohibition of drugstores to be hired as agents, by the National Sanitary Agency. These demands will result in cost increases for activities such as security and wages, among others, and there seems to be consensus by CBB and the banking sector that the business is seriously threatened by such demands. Furthermore, the existence of credit promoters and credit salespeople—known as *pastinhas*—are also affecting legal demands, as individuals are selling credit products and are acting in their own self-interest instead of in customers' best interests. Regulation to tackle transactional agents versus credit agents is necessary, as is the recognition of individuals as correspondents.

Nonbanks, such as MNOs, may not be motivated and do not have enough regulatory space to offer mobile financial services. MNOs are not threatened by loss of market share, and revenue prospects remain stable, so they are not under pressure to develop new services. Until there is regulatory clarity on nonbank retail payment services, such as e-money issuing, there will remain a looming uncertainty over the business, creating a real disincentive for nonbanks to enter this market.

Opportunities

Banks are changing their approach when it comes to correspondents, making it a more integrated and serious channel for financial services. The largest public sector bank, Banco do Brasil, and the second largest private bank, Bradesco, have plans to use their correspondent channel as a full-fledged channel for banking services for mass market consumers. Caixa, which is the second largest public sector bank and has the largest agent network, is introducing simplified accounts for government payments. Agent managers have thrived in the Brazilian

market, and some may be looking into finding ways to offer products via correspondent channels.

The changing structure of the socioeconomic pyramid and competition at the high-end market have made banks aware of opportunities at the base of the pyramid that may involve products via correspondents and mobiles. The Brazilian economy is rapidly changing. Each year a percentage of the population in the lowest D and E income segments “graduates” to higher segments. Between 2003 and 2009, 28.8 million people surfaced out of poverty (moved into Class C or the “new middle class”).⁴³ A crowded market at the top of the pyramid and middle segments that are rapidly expanding have made it imperative for banks to target mass market customers. As a result, both public and private banks previously involved in correspondent banking are expanding their offerings and are targeting lower income segments. For instance, Bradesco is developing new low-value accounts that will be accessible via correspondents. Banco do Brasil is improving the quality of service at correspondent channels. Brazilian banks have always had a strong consumer-product orientation, and a couple of those commercial banks are bringing that same orientation to develop products for low-income consumers.

In the coming year or two, financial services via cell phones will get a boost from new opportunities and multiple initiatives. MNO Oi created mobile-based credit card company Oi Paggo, and although Oi Paggo has only 150,000 customers, the fact that Cielo and Banco do Brasil have bought a stake in the company is significant. In the meantime, Vivo has hired an ex-banker and has struck multiple partnerships to offer financial services where it is not the business driving the service. It was the first MNO to work with Bradesco on an account. Vivo’s approach has been to work in an alliance with banks and card associations, presenting an alternative to what is widely seen in the market as Oi’s go-it-alone approach. Bradesco is now partnering with all MNOs, including Claro, TIM, and Oi, to offer special low-value accounts where the customer’s monthly maintenance fee is converted into airtime value. The main G2P program, Bolsa Familia, is exploring mobile options to foster financial inclusion. The possibility of accepting boleto payments via mobile should open up opportunities as well.

The changing nature of connectivity may create new opportunities for nonbanks. 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 the total population). However, as of January 2010, 88 percent of Brazilian municipalities have broadband, and the number of Internet users is expected to increase exponentially. Furthermore, the new MVNO regulation will likely change the face of this industry, as large retail chains and large banks have expressed interest in these licenses.

⁴³ Fundacao Getulio Vargas, “The new Middle Class in Brazil: The Bright Side of the Poor,” September 2010.