



# **Diagnostic Report on the Legal and Regulatory Environment for Branchless Banking in Colombia**

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These Notes summarize CGAP findings and recommendations based on the study of existing and upcoming regulation in Columbia.<sup>1</sup> Findings and recommendations are also based on insights from interviews with relevant parties such as Banco de la Republica de Colombia (BRC), the Superintendence of Finance (SFC), the Telecommunications Regulatory Commission (CRT), the Ministry of Finance, the Banca de las Oportunidades (BDO), mobile network operators (MNOs), the banking association (Asobancaria), private and state-owned banks and financial institutions, payment service providers, and experts. The list of persons interviewed is annexed.

## 1. Introduction

The Colombian government is committed to increasing financial access for the country's population and has embarked on a number of reform initiatives. Ongoing or recent reforms include (i) a new regulatory framework for the use of agents by financial institutions, (ii) the creation of incentives for the offering of low-value savings accounts by banks, (iii) the regulatory redefinition of microcredit, and (iv) exemptions from the financial transaction tax that is imposed on bank customers.

Although much has been achieved, there is still a long way ahead. Agents have been used on an experimental basis since the introduction of the enabling regulation in 2006. Any type of legal entity can act as an agent of a fully licensed financial institution to deliver financial services on the agent premises. The use of agents is expected to increase the number of financial services access points. However, the adoption of the agent model has been slow and industry actors indicate that the business case for agency arrangements has yet to be proven. Further efforts should focus on (i) reducing costs of agent cash-handling and using already existing distribution networks to facilitate the process, (ii) increasing the profitability of providing low-value accounts (for example, by distributing social welfare payments through such accounts) and (iii) simplifying account opening procedures, particularly for low-value accounts.

Furthermore, the government should allow for increased competition in remittances and payment services by opening the market to a broader range of players and by strengthening the enforcement of competition rules. Lastly, in order to deliver microcredit products via mobile technology, it should remove two of the main obstacles preventing banks from issuing microcredit(i) the financial transaction tax and (ii) the interest rate ceilings established by the "usury law."

These notes present CGAP's findings and recommendations as a result of its branchless banking policy and regulatory diagnostic in Colombia in late 2007.<sup>2</sup> CGAP has completed similar

### Some highlights

- Regulation for the use of agents by licensed financial institutions was issued in mid-2006. Agents have been used since then on an experimental basis.
- The adoption of the agent model has been slow and industry actors indicate that the business case for agency arrangements has yet to be proven.
- Over 70 percent of agent transactions are bill payments.
- High cash-handling costs, taxation of financial transactions, and interest rate ceilings are some of the obstacles for expanding banking services through agents.
- Nonbanks are not permitted to take deposits, but may issue multipurpose, non-repayable prepaid cards.

<sup>1</sup> Following CGAP's "Guiding Principles on Regulation and Supervision of Microfinance," this document uses the term *regulation* to refer to binding rules governing the conduct of legal entities and individuals, whether they are adopted by a legislative body or an executive body. The terms *regulatory framework* or *regulatory environment* or simply *regulatory* are, therefore, used in the broadest sense and include the full range of relevant binding rules.

<sup>2</sup> From October 29 to November 9, 2007, CGAP conducted an initial mission in Bogota, Colombia to analyze the regulatory environment for branchless banking and provide policy advice to the Colombian authorities. CGAP's Policy

assessments in other countries and an overall analysis resulting from the first seven diagnostics can be found in CGAP Focus Note 43, *Regulating Transformational Branchless Banking: Mobile Phones and Other Technologies to Increase Access to Finance*. A full description of CGAP's work on Branchless Banking and related documents is available under [www.cgap.org/policy/branchlessbanking](http://www.cgap.org/policy/branchlessbanking).

### **Background: CGAP and Branchless Banking**

CGAP is a global resource center for microfinance standards, operational tools, training, and advisory services. Its members—bilateral, multilateral, and private donors—are committed to building more inclusive financial systems for the poor. The CGAP Technology Program is a multiyear learning initiative co-funded by the Bill and Melinda Gates Foundation to find and test promising technology solutions to improve access to finance.

CGAP defines branchless banking as the delivery of financial services outside conventional bank branches using information and communications technologies and retail agents. Because of the potential to radically reduce the cost of delivery and increase convenience for customers, branchless banking can expand coverage to new, previously underserved segments of the population. Technology can help a range of market actors to push the boundaries of access to finance, including not only banks but also microfinance institutions, mobile phone operators, and technology companies.

Two models of branchless banking—bank-based and nonbank-based—can be distinguished. Both use retail agents, such as merchants, supermarkets, or post offices, to deliver financial services outside traditional bank branches. In the bank-based model, every customer has a direct, contractual relationship with a prudentially licensed and supervised financial institution—whether involving an account or a one-off transaction—even though the customer may deal exclusively with a retail agent who is equipped to communicate directly with the bank (typically using either a mobile phone or a point-of-sale (POS) terminal).

In the nonbank-based model, customers have no direct contractual relationship with a fully prudentially licensed and supervised financial institution. Instead, the customer exchanges cash at a retail agent (or otherwise transfers, or arranges for the transfer of, funds) in return for an electronic record of value. This virtual account is stored on the server of a nonbank, such as a mobile operator or an issuer of stored-value cards. The balance in the account can be used for making payments, storing funds for future use, transferring funds, or converting stored value back to cash at agents. If the system relies on a POS network and plastic cards, customers must visit a participating retail agent to conduct a transaction. If the system is mobile phone-based, customers need to visit a retail agent only to add value or to convert stored value back into cash. A more limited version of the nonbank-based model can be found in payment networks, which involve a technology provider or other nonbank institution offering a network of "payment points" (e.g., payment terminals, ATMs, or retail agents equipped with POS devices) where a customer can make payments to third parties or a governmental entity can make payments to beneficiaries.

The stored-value device is often referred to as *e-money*. There are various definitions of e-money, including the following from the European Union's Electronic Money Institutions Directive (2000): "monetary value as represented by a claim on the issuer which is: (i) stored on an electronic device; (ii) issued on receipt of funds of an amount not less in value than the monetary value issued; (iii) accepted as a means of payment by undertakings other than the issuer."

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Advisory Consultants Ernesto Aguirre and Denise Dias conducted the mission and authored these notes, which also include input from other 2008 CGAP advisory missions to Columbia. Beatriz Marulanda, consultant, provided local support and advice. Some additional information and recommendations regarding the agency business model resulted from a mission conducted in January 2008 by CGAP staff Ignacio Mas and Hannah Siedek. These notes were reviewed and edited by CGAP Microfinance Analyst Klaus Prochaska.

## 2. State of Play: Government Authorities

The Colombian government is committed to increasing access to finance for the country's population. The main problems for financial inclusion are (i) limited points of access to the formal financial sector, (ii) high cost of financial services, (iii) lack of financial literacy and (iv) a preference for informality as a way to avoid taxation. Other obstacles include: an interest rate ceiling on credit (stipulated in the "usury law"), the financial transaction tax,<sup>3</sup> and a certain rigidity of Anti-Money Laundering (AML) procedures which negatively affect account opening (see section 5.3).

To address these obstacles, the Colombian government created the Banca de las Oportunidades (BDO) as a long-term policy program aimed at expanding access to financial services for adult Colombians. The BDO promotes regulatory changes, coordinates financial education initiatives, and provides incentives, such as technical assistance, for financial institutions to tap the unmet demand for banking services. An important BDO initiative is the push for the use of retail agents. The BDO actively participated in the design and implementation of the agency regulations issued in 2006 (see section 5.1) and aspires to make banking services available in all of the country's 1,119 municipalities by 2010.

The BDO successfully advocated for the recent regulatory creation of small-value savings accounts.<sup>4</sup> Incentives for both clients and providers include simplified know-your-customer (KYC) procedures, fee exemption up to a specified amount of monthly transactions and the exemption of forced investments.<sup>5</sup> Furthermore, monthly debits of up to US\$3,500 from all savings accounts were recently exempted from the financial transaction tax (0.4%) popularly known as "*cuatro por mil*", levied on all debits to all accounts in the country. The BDO also pushed for a change in the regulatory definition of microcredit in order to make this market more attractive to banks.<sup>6</sup>

The Superintendence of Finance (SFC) is the financial regulatory and supervisory entity of Colombia. It is in charge of maintaining the integrity, efficiency and transparency of the financial market while protecting its consumers. As such it plays a central role in Colombia's efforts to increase access to finance for poor people.

## 3. State of Play: Industry

### 3.1. Banks and other licensed financial institutions

In Colombia, there are sixteen banks with a total of 5,215 branches,<sup>7</sup> 80 percent of which operate in urban areas. Among them is Banagrario, a first-tier, state-owned bank. Banks compete with twenty-five deposit-taking commercial finance companies, as well as with an active non-regulated microfinance sector dominated by NGOs. Currently, there are approximately 16 million bank accounts, out of a population of approximately 45.6 million. There is no estimate on the actual

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<sup>3</sup> The financial transaction tax is a deduction of 0.4% from every debit in a bank account, including accounts held by banks in the BRC. This tax ("*gravamen a los movimientos financieros*") was introduced by Law 633/2000. The exemption for debits up to the equivalent of US\$3,500 was introduced by Law 111/2006, Article 42

<sup>4</sup> Decreto 1119, April 11, 2008.

<sup>5</sup> Forced investments were introduced by BRC External Circular 03/2000 are directed lending provisions. They are compulsory investments in credit directed to specific sectors, imposed by the government on approximately 10% of demand deposit balance of banks.

<sup>6</sup> Under the previous definition, a large number of microcredit operations were classified as commercial loans in bank books, being consequently subject to lower rate ceilings. The new regulatory definition of microcredit is expected to partially remedy this situation by increasing interest rate ceilings and thereby making microcredit a more commercially viable option for banks..

<sup>7</sup> Superintendencia Financiera, as of December 2007.

number of account holders.<sup>8</sup> Of a total of 1,119 municipalities, 132 still lack access to formal banking services. There is limited product innovation and competition when it comes to low-income customers, although this segment has received more attention lately.

### 3.1.1 Financial institutions and retail agents

After the SFC issued regulations in 2006 allowing financial institutions to use retail agents, approximately 3,539<sup>9</sup> commercial establishments signed agency agreements with SFC-licensed entities. Citibank alone accounts for 3,329 (all lottery outlets) of these establishments. A large number of agents currently only provide bill payments. In January 2008, agents conducted a total of 357,721 transactions, more than 72 percent of which were bill payments, and 18 percent were deposits/withdrawals. Very few banks use agents to start account opening procedures and disburse loans.<sup>10</sup> Most agents are concentrated in Bogota, the nation's capital.

#### Examples of the use of agents in Colombia

**Citibank** has used agents almost exclusively to collect deposits. Its network consists of a chain of lottery outlets. It successfully renegotiated contracts with utility companies to improve profits from utility bill payments (see Section 3.4.2) The lottery outlets help decongest Citibank branches and there are plans to offer cash-out transactions soon.

**Bancolombia**, one of the largest Colombian banks, had been working with agents for a couple of years before the agency regulation was issued. These agents, known as PAC (Puntos de Atencion Cercana), promoted services and initiated account opening. The client then went to a branch to open the account and transact. When the 2006 agency regulation came into force, 61 of the 240 PACs were transformed into agents. This network may grow to more than 300 soon. Agents now conduct a variety of transactions, processing about US\$8,000 in monthly deposits for 30,000 clients.

**Davivienda** is piloting agents for two purposes: (i) decongesting branches and (ii) acquiring new customers. Based on the pilot, an agent network will be set up to offer payments, consultations, and account opening. Once the scheme reaches maturity, there are plans to expand the services offered to credit cards, loans, and insurance.

The use of agents faces many challenges. For example, deposit taking accounts for more than 80 percent of all agent transactions and consequently, surplus cash needs to be deposited in a bank. In remote areas where private banks are commonly absent, agents usually deposit their excess liquidity in Banagrario, the bank with the largest branch network in the country. Banagrario charges high interbank fees for this service, adding costs to agent services in rural areas. Cash handling may be costly in urban areas too, where agents often hire expensive private cash transport companies better equipped to manage security challenges in a country still struggling with high crime levels.

Another challenge is that banks are often wary of agents. Generally, banks have limited experience with agents, particularly with respect to managing agent liquidity, and mitigating the risk of fraud. Banks are concerned that selecting, equipping and training agents may require a heavy investment of financial and human resources (even though experience in Brazil and Peru shows that all these costs together are still lower than the cost of opening and maintaining branches). The business case for using agents is affected by the current agreements between banks and utility companies to not charge for bill payments, thereby depriving banks and agents of a steady source of revenue. A CGAP mission to Colombia in January 2008 found that banks offer little marketing support to agents, and that systems connecting banks and agents are subject to frequent failures.

<sup>8</sup> Asobancaria, "Reporte de Bancarización a septiembre de 2007", Sep 2007.

<sup>9</sup> Superintendencia Financiera, as of April 2008.

<sup>10</sup> Superintendencia Financiera de Colombia (as of January 2008).

Aware of such difficulties, BDO launched a program to foster the use of agents by providing subsidies for banks to cover the operation of agents in 132 municipalities that currently lack financial services and where the government provides welfare payments. According to Asobancaria, the Banking Association, the program lacked flexibility regarding the timeframe for the commencement of use of agents and the services the agents must offer. As a consequence, only Banagrario, the state-owned bank, availed itself of the subsidies.

### 3.1.2 Internet and mobile phones as delivery channels

Most banks offer internet banking and few offer mobile banking to existing customers for payments, transfers, and account inquiries. Bancolombia notably registered 21,000 clients for its mobile phone banking service in four months. Banks, MNOs, and the bank switches are still in disagreement regarding the possible technological platforms for mobile banking as well as profit sharing among them.

#### **Agency business model: Recommendations**

Given that a clear business case for the agency model has yet to be proven, both banks and agents remain skeptical. To promote the use of agents, the BDO should consider:

- Identifying and encouraging the use of existing large retail networks as agents and/or network managers for several banks,
- Encouraging the government to channel welfare and wage payments through low-value savings accounts, which may be offered by banks through retail agents,
- Encouraging nondiscriminatory agent schemes, such as shared agents that may provide services for several banks, fostering competition for lower-income clients,
- Providing technical assistance for design and risk management of products targeting low-income customers and promoting such products through awareness campaigns, and
- Finding and implementing solutions for Banagrario's high interbank fees and expensive cash transportation.

To reduce cash handling costs, banks could:

- Work with employers, utility companies, and local governments to process their payments electronically to increase profitability of agents,
- Invest in marketing agents and their services,
- Ensure transparency about the bank's full responsibility for agent's acts, especially outside the larger cities,
- Ensure the stability of the technological platform in which agent transactions are conducted to avoid loss of confidence in the agency scheme, and
- Find alternatives, such as staggering government payments, to avoid concentration of cash-in transactions in certain periods of the month.

## **3.2. The mobile phone industry**

There are approximately 25 million mobile phone users in Colombia.<sup>11</sup> Three MNOs cover 90 percent of the territory and 100 percent of the municipalities. Telefonica occupies 65 percent of the market share and the Telecommunications Regulatory Commission (CRT) is examining this dominant position in order to ensure healthy competition. Number portability is required by legislation<sup>12</sup> but its implementation will depend on the forthcoming regulation.

<sup>11</sup> Comisión de Regulación de Telecomunicaciones, as of December 2007.

<sup>12</sup> Convergence Decree (Decree 2870/2007).

### **3.3. Electronic commerce**

Electronic commerce in Colombia is embryonic compared to countries such as Argentina, Brazil, Chile, and Mexico. This is mainly due to low computer and internet penetration and concerns about security. ACH Colombia (the main payment clearing and settlement system) and Certicamara (a digital signature certifying authority), have created a certification process for e-banking transactions to encourage the use of internet banking.

### **3.4. Payment systems, instruments, and services**

#### **3.4.1. Payment systems**

The Banco de la Republica de Colombia (BRC) supervises and regulates the payment system. The law<sup>13</sup> defines “payment system” as a set of policies, rules, agreements, payment instruments, entities, and technological components that permit funds transfers through receipt, processing, transmission, settlement, and clearing of payments or transfer orders. Low-value payment systems are systems with accumulated daily transactions below US\$1 million.

The SFC regulates, licenses, and supervises low-value payment system managers (LVPSMs).<sup>14</sup> To obtain a license, each LVPSM must fulfill the same requirements imposed on commercial finance companies<sup>15</sup> and subject its internal rules to SFC scrutiny. Since the SFC started licensing LVPSMs in 2005, only one provider—Visionamos, a closed payment system—has applied and obtained a license. Financial institutions may adopt any new electronic payment instrument provided that they previously submit a business plan to the SFC and comply with standards for information security set in the regulation.<sup>16</sup>

A variety of nonbanks (such as public utilities) have access to the large-value payment system (RTGS) operated by the BRC. However, access is not open to all types of institutions.<sup>17</sup> The Colombian Retail Payment System is composed of two open interbank clearing and settlement systems (Cenit and ACH Colombia), two bank switches and clearinghouses (Redeban and Credibanco)<sup>18</sup>, three major ATM networks, and one check clearinghouse. The systems are interconnected and partially interoperable. Customers may use cards in any ATM or POS terminal, but may only make deposits in a bank where they have a bank account. With the exception of Cenit, all retail payment systems and components are owned by private banks.

#### **3.4.2. Payment instruments and payment services**

Cash is the preferred medium for low-value payments and is also used by the government to deliver welfare payments. There are over 6,000 ATMs and 62,000 POS terminals in the country, which are concentrated in the major cities.<sup>19</sup> There are approximately 3 million credit cards and 11.4 million debit cards in use. Debit cards are used primarily for withdrawing cash in ATMs, where nearly 90 percent of card transactions are conducted.<sup>20</sup>

There are no relevant examples of nonbank e-money issuance. However, Redeban (one of the bank switches and clearinghouses) plans to launch a large-scale mobile banking scheme. Value would be stored on the SIM card and all merchants and banks currently connected to Redeban would automatically participate in this platform. The objective is to gradually substitute POS and

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<sup>13</sup> Payment system regulation comprises Law 964/05, Decree 1400/05 and Decree 1456/07.

<sup>14</sup> Law 031/1992 and Bylaws, Article 48.

<sup>15</sup> Decree 1400/2005 and Bylaws, Article 80.

<sup>16</sup> SFC Circular 052/2007.

<sup>17</sup> BRC Resoluciones Internas 03/1997 and 03/2003.

<sup>18</sup> Redeban is associated with Mastercard and Credibanco with Visa.

<sup>19</sup> Fedesarrollo, “*Medios de Pagos Electronicos en Colombia: Evolución y Perspectivas*”, June 2006..

<sup>20</sup> Fedesarrollo, “*Mercado de Tarjetas en Colombia y el Debate sobre la Tarifa de Intercambio*”, May 2006.

plastic cards with phones. It is unclear, however, if the accounts will be held by Redeban or full-fledged commercial banks.

By tradition, banks do not charge utility companies for receiving utility bill payments, although such charges are not legally prohibited. This arrangement which effectively deprives banks of revenue, negatively impacts the viability of the agency model.<sup>21</sup>

The largest remittance streams to Colombia come from the USA and Spain.<sup>22</sup> Some estimate that remittances- a \$4.1 billion business<sup>23</sup> - are the single largest source of foreign currency entering the country. Most receivers belong to high-income urban segments. The reach of remittance distribution networks is limited due to regulatory obstacles.<sup>24</sup> The size of the market regarding domestic money transfers is unknown since most transactions are done through informal channels (i.e., non-SFC licensed). Legally, the National Postal Service is the only entity that can offer domestic transfers.

## **4 State of Play: Clients**

Colombia has approximately 45.6 million inhabitants, 73 percent of whom live in urban areas, and 64 percent of whom are below the poverty line. A USAID study<sup>25</sup> indicates that opening bank accounts is viewed as a difficult and complex process. Moreover, formal financial services are perceived as linked to taxation and traceability, and therefore are not always desirable for unregistered micro-entrepreneurs.

The CRT reports that internet penetration reached 13.2 percent of the population in mid-2006 although the current average internet cost of US\$30 per month is relatively high for low-income segments. The completion of three new fiber-optic cables in 2007 was expected to lower prices and increase connectivity.

With regards to mobile banking and e-money issuance by nonbanks, client adoption is expected to be a barrier due to a perceived distrust in nonbanks as depositaries of client funds. Redeban's mobile banking project, which is to be launched soon with limited functionality (bill payment, airtime purchases, and peer-to-peer transfers), will provide greater insight into consumer uptake of mobile banking products.

## **5 The Regulatory Environment for Branchless Banking**

### **5.1 The use of agents by SFC-licensed institutions**

According to the agency regulation, any type of legal entity, including savings and credit cooperatives, may, with prior SFC authorization, act as an agent of an SFC-licensed institution to deliver financial services either on its own premises or in other locations where its services/products are offered.<sup>26</sup> Agents may provide the following services:

- bill payments,
- fund transfers,

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<sup>21</sup> In neighboring Brazil, utility bills are paid exclusively through banks and constitute a major source of revenue for their total network of more than 120,000 agents.

<sup>22</sup> United Nations, [www.un-instraw.org/index.php?option=com\\_content&lang=en&id=328&task=view](http://www.un-instraw.org/index.php?option=com_content&lang=en&id=328&task=view).

<sup>23</sup> Inter-American Development Bank, Remittances 2005, *Promoting Financial Democracy*.

<sup>24</sup> Kugler, Maurice (2005), Migrant Remittances, Human Capital Formation and Job Creation Externalities in Colombia. Available at [www.banrep.gov.co/docum/ftp/borra370.pdf](http://www.banrep.gov.co/docum/ftp/borra370.pdf).

<sup>25</sup> Econometrica Ltda / USAID (2007), "Encuesta de Mercado de Crédito Informal en Colombia".

<sup>26</sup> Decree 2233/2006 allows banks and commercial finance companies to use agents. Decree 303/2007 and Decree 2965/2006 extended the permission to brokers and credit cooperatives, respectively..



- deposits and withdrawals from current accounts, savings, and time deposits,
- balances and statements regarding checking or savings accounts,
- disbursement or repayment of loans,
- receiving and forwarding account opening applications, and
- promoting the above services on behalf of the financial institution.

Agents may act on behalf of one or several SFC-licensed entities, which are fully liable for the agent's actions. The contracting financial institutions must set up adequate internal controls to monitor their agents and may use a third party (e.g. a network manager) to manage their agents. For purposes of SFC review, the contracting financial institution must keep all information and documentation related to agent activities. The SFC may inspect agents.

**Agency contracts must contain certain clauses including:**

- A reference to the financial institution's full liability
- Risk-mitigation measures (AML/CFT, transactional limits, financial settlement, insurance)
- The assignment of each agent to a bank branch and the means of communication between them
- The agent remuneration for each type of transaction
- The extent to which (if any) an agent may use deposited funds for its own business use and the conditions of such use
- A requirement that the agent provide a client with a receipt for each transaction

Agent transactions must be authorized online via dedicated terminals meeting minimum requirements set forth by regulation.<sup>27</sup>

Agents cannot:

1. operate if the communication with the financial institution fails,
2. concede loans without authorization of the financial institution,
3. charge extra fees,
4. offer any guarantee to bank clients, or
5. offer financial services without an agency contract with a financial institution.

Marketing and visual publicity are strictly regulated and should provide the customer with unquestionable certainty that the service is being provided on behalf of a licensed financial institution. Every transaction must produce an automatically generated receipt with the name of the bank. The bank is required to install mechanisms to file complaints against agents.

**An Agent is required to post on visible signs on its premises:**

- The word "correspondent" and the name of contracting financial institution(s)
- That the financial institution is responsible for the services
- That the agent is not allowed to provide financial services on its own behalf
- That withdrawals will only be processed if the agent has available cash
- The bank fees for each service provided
- The agent's business hours for providing financial services
- The ombudsman's phone number

To avoid double incidence of the *cuatro por mil* tax in agent transactions, the tax authority has exempted agent accounts from this tax (in other words, the transactions between the agent and

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<sup>27</sup> SFC Basic Circular, Chapter 9.

the bank are considered part of a single taxable bank transaction.)<sup>28</sup>

➤ **Comments and recommendations**

*Overall, the agency regulation provides an adequate balance between security and access. It does not limit the types of entity that can become agents; it holds fully licensed entities responsible for the services provided by agents and sets disclosure requirements and operational standards. One issue is how to reduce the risk of merchants acting as agents without having a valid agency contract. This risk could possibly be mitigated by requiring banks to provide free telephone numbers which customers could contact to verify an agent's legitimacy. Customer education on the need to check receipts is also encouraged.*

## **5.2 Banking business, e-money, and deposit-taking**

Both the SFC and the CRT expressed interest in financial service delivery through mobile phones, provided that such delivery ensures customer data security and is open to the scrutiny of the respective regulator. Currently, there is no specific regulation on e-money. Nonbanks can issue e-money provided that it does not constitute deposit-taking (i.e., repayable funds), but the interpretation of what exactly constitutes deposit-taking is subject to some doubts. Regulations which explicitly allow nonbanks to issue e-money could end legal uncertainty around this issue.

The banking law defines credit institutions<sup>29</sup> as those able to take demand or time deposits for financial intermediation. They are the only entities authorized to take deposits from the public. The SFC is legally required<sup>30</sup> to sanction others engaging in “massive and habitual collection of funds from the public”.

A deposit is defined as repayable funds (others than loans).<sup>31</sup> Massive and habitual deposit taking is defined as cash or virtual money kept by the “collector” with no obligation of providing a service or good in exchange when firstly at least one of the following conditions is met:<sup>32</sup>

- there are more than 20 depositors or more than 50 obligations (deposits), or
- in a period of three consecutive months, the collector incurs more than 20 contracts to manage funds from the public, or sells credit instruments with a resell obligation.

In addition, deposit taking requires one of the following conditions to be true:

- the value of the funds collected surpasses 50 percent of the collector's equity or
- the operations result from offers to unknown people.

➤ **Comments and recommendations**

*Colombian authorities should promulgate e-money regulations that set forth operational, technological, conduct-of-business, e-security and consumer-protection standards for both banks and nonbanks in the management of electronically-stored funds. Such framework should weigh the convenience of obviating the full range of prudential requirements for some business models of e-money issuing. An increased participation of nonbanks in the electronic payments business would require better inter-agency coordination to set and enforce requirements, deal with customer complaints, and share vital information this business.*

<sup>28</sup> Decree 086/2008.

<sup>29</sup> Namely banking institutions, financial corporations, commercial finance companies, and financial cooperatives

<sup>30</sup> By the banking law and the organic law of the SFC

<sup>31</sup> Decree 410/1971.

<sup>32</sup> Decree 2920/1982, Decree 3227/1982 and Decree 1981/1988.

### 5.3 AML/CFT regulation

The Colombian AML/CFT framework is spread throughout various laws.<sup>33</sup> The SFC has regulatory authority for supervised entities, including payment service providers, which are required to implement AML/CFT systems known as SARLAFT (*Sistema de Administración del Riesgo de Lavado de Activos y de la Financiación del Terrorismo*).<sup>34</sup> The SARLAFT requires financial institutions to report the following transactions directly to the Financial Intelligence Unit (FIU):<sup>35</sup>

- Cash transactions above US\$5,000 (exchange houses report transactions above US\$500). Payments to MNOs, public utilities, and government are exempted, but the financial institution must report information monthly on all exempted transactions,
- Foreign-issued credit or debit cards, if more than US\$5,000 per month,
- Foreign exchange (including remittances) over the equivalent of US\$200.

In addition, foreign remittances must be reported to the BRC regardless of the amount involved.

The KYC procedures for account opening and one-time transactions include obtaining customer information through a long application form and verifying such information.<sup>36</sup> To send/receive foreign remittances, an additional application form must be completed.<sup>37</sup>

The account opening process requires a personal interview and must generally be conducted by a bank employee. The SFC allows the interview to be conducted remotely (e.g., by phone) or by third parties, provided that the bank outlines the reasons for the exception in its AML/CFT policy. In such cases the SFC requires stricter ex-post monitoring. The SFC distinguishes different levels of risk for AML/FT depending on the geographic region. In high risk regions the personal interview must be conducted by a bank employee.

Banks have also been exempted from the need to conduct KYC procedures for recipients of welfare transfers (*Familias en Acción* and *Familias Guardabosques*), pension and wage payments, if the accounts are used exclusively for these transfers.<sup>38</sup>

The SFC highlights that the AML framework does not pose an obstacle for financial access, since institutions can adapt the procedures to the risk level of each client. Only few fields on the application form must be completed and verified by the bank, while for others a mere declaration will suffice. Moreover, the supporting documentation required by the regulation is only indicative - banks are free to accept other documents depending on the client's risk profile.<sup>39</sup>

#### ➤ Comments and recommendations

<sup>33</sup> Law 356/1997, Penal Code (Law 599/2000), Financial System Bylaws (Law 510/1999 amended by Law 795/2003), Law 747/2002, Law 793/2002, Capital Markets Law (Law 964/2005), Law 1121/2006, and Law 1108/2006.

<sup>34</sup> The main regulations (SFC Circular-Letter 062/2005, SFC Circular-Letter 037/2006, and SFC External Circular 022/2007) are compiled in Chapter XI of SFC Basic Circular.

<sup>35</sup> SFC External Circulars 040/2004 and 061/2007.

<sup>36</sup> SFC Basic Circular, Chapter XI, 5.

<sup>37</sup> *Declaración de Cambio - Servicios, Transferencias y Otros Conceptos - Formulario 5* and *Declaración de Cambio por Compra y Venta de Manera Profesional de Divisas y Cheques de Viajero - Formulario 8*. The regulation expressly permits financial intermediaries to fill out these forms on behalf of the remitter/receiver and also substitute the paper version by electronic document whose signature has been certified.

<sup>38</sup> The client information is provided by the government body or company responsible for the payments. SFC Circular 01/2007.

<sup>39</sup> SFC Circular-Letter 037/2006. Electronic documents may be accepted if e-signature certification process is used to guarantee its authenticity.

*The AML/CFT framework does not impose significant barriers to branchless banking. However, the BRC requirements for foreign remittances should be simplified for low-value remittances. Furthermore, the SFC should apply simplified KYC procedures for low value accounts. Interviews indicated that unsophisticated financial customers are intimidated by the application forms and that the overall costs of KYC procedures render low-value accounts unattractive for banks.*

*In addition, customer due diligence may be ineffective due to large numbers of counterfeit identification documents. Although the government since 2000 has been replacing the old paper-based identification cards for security-enhanced cards to curb fraud, the process is sluggish.*

## **5.4 Remittances and the foreign exchange regulation**

BRC sets the foreign exchange policy and licenses entities to operate in this market while SFC supervises them.<sup>40</sup> Since there is no regulatory definition of money transfer as a payment service, foreign remittances are considered exchange transactions.<sup>41</sup> Domestic money transfers are a legal monopoly of the National Postal Service.<sup>42</sup> However, in practice they are offered by a wide array of unlicensed entities such as freight companies and gas stations. Money transferors such as Western Union offer remittances in partnership with SFC-licensed institutions, most of which are exchange houses.

For prepaid cards that can be used abroad, BRC requires nonbank issuers to partner with a deposit-taking institution abroad.<sup>43</sup> The operation is subject to BRC's previous approval and the acquiescence of the foreign financial authority. The nonbank must provide information on users and balances to BRC twice a month.

### **➤ Comments and recommendations**

*The current regulatory framework limits competition in domestic remittances by conceding a monopoly to the not fully functioning National Postal Service. It also constrains the ability of international money transferors to offer remittances by requiring them to partner with licensed financial institutions. This results in the use of unauthorized entities, such as freight companies engaged in cross border travel, in providing money transfers in Colombia. The SFC and the BRC should consider reforms to eliminate such hurdles and open competition to other entities that would ideally be registered in the SFC as a payment service provider. Finally the BRC's foreign exchange regulation should be altered to permit simplified KYC for small transactions.*

## **5.5 Consumer protection**

### **5.5.1 Financial consumer protection**

The Colombian Consumer Protection Code applies to all customer/client-provider relationships, including financial services, and is enforced by the Superintendencia de Industria y Comercio (SIC).<sup>44</sup> The code sets general principles for disclosure, fairness, and quality of services, as well as sanctions in the case of noncompliance. Draft laws intend to give powers to the SIC to regulate bank and credit card fees.<sup>45</sup>

The SFC is legally required to ensure that financial activities are carried out with quality,

<sup>40</sup> Decree 2116/1992.

<sup>41</sup> Decree 1735/1993, Article 1, item 5.

<sup>42</sup> Decree 2854/2006. Reportedly, the Postal Service is not in full operation due to an ongoing restructuring process.

<sup>43</sup> BRC Circular DCIN-83/2007

<sup>44</sup> Estatuto de Protección del Consumidor (Decree 3466/1982). The Code is partially regulated by Decrees 863/1988, 1490/1993, 1485/1996, and 147/1999. SIC's powers are set in Law 446/1998, Article 145

<sup>45</sup> Proyecto de Ley 022/2007 and Proyecto de Ley 043/2007..

transparency, and efficiency.<sup>46</sup> Consequently, the SFC has implemented a complaint-filing structure for disputes up to US\$13,000. Licensed entities are required to have an ombudsman to hear complaints up to US\$26,000.<sup>47</sup> Financial institutions must inform the public about the ombudsman's functions and procedures.<sup>48</sup> If the ombudsman's decision is not satisfactory to consumers, they have recourse to the SFC or the court system. A draft law in Congress<sup>49</sup> intends to modify the Consumer Protection Code to require alternative conflict resolution and complaint filing mechanisms for electronic financial transactions.

The SFC has recently issued regulations to improve price transparency and security levels for electronic channels and requires institutions to educate customers about the safe use of such channels. These measures must be fully implemented by July 2010 but banks consider them too costly.<sup>50</sup>

#### 5.5.2 Mobile phone user's rights

Consumer protection in mobile phone services is shared between the SIC and the CRT. Based on a recent regulation,<sup>51</sup> the CRT requires MNOs to disclose the phone number and address of their customer care units in the statements sent to the user. Consumers may file complaints both with the CRT and the SIC.

#### 5.5.3 Data privacy regulation

There is no data privacy law in force, although a forthcoming bill<sup>52</sup> will govern the collection, management, storage, and sharing of credit information by credit bureaus, financial institutions, and other entities, such as MNOs. This law intends to preserve data privacy rights and will not introduce obstacles for the cross-border flow of information regarding financial transactions. The bill confers enforcement powers to the SFC regarding supervised entities and to the SIC regarding other entities.

#### ➤ **Comments and recommendations**

*The overall framework for financial consumer protection is adequate, although there is anecdotal evidence that enforcement is weak. Moreover, there is no administrative authority such as a central ombudsman with the prerogative to issue decisions regardless of the amount involved. Also, conflict resolution in the court system is too costly and complex for small claims.*

*The effects of the SFC's new regulations for electronic channels will not be clear until the changes are fully implemented. The provisions requiring price transparency and responsibility for educating customers with regard to electronic channels are welcome. However, the deadline of 2010 seems too ambitious, given that technological upgrades on ATMs and POS devices are necessary for complying with the new rules.*

*In addition, the government should increase efforts toward financial education. Customers should learn about their rights, conflict resolution mechanisms, and the use of electronic channels. Customers should also be better informed about the characteristics of low-value savings accounts, particularly the tax exemption, the simplified KYC procedures and the fee structure.*

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<sup>46</sup> Ley Organica del Sistema Financiero

<sup>47</sup> SFC Basic Circular, Chapter 6 and Law 446/1998, Art. 146. Decree 690/2003 and SFC External Circular 15/2007.

<sup>48</sup> SFC Letter Circular 021/2007.

<sup>49</sup> Proyecto de Ley 115/2000 (Estatuto del Consumidor y el Usuario).

<sup>50</sup> SFC External Circular 052/2007.

<sup>51</sup> CRT Resolution 1732/2007.

<sup>52</sup> Habeas Data Law (Statutory Law 221/2007).

## 5.6 Competition

BDO is currently studying the cost of opening and maintaining savings accounts with the purpose of proposing changes in current practices and regulation. The concentration of payment services has triggered an investigation by the SIC about anticompetitive acquiring and pricing practices that may discourage new competitors. The regulation defines anticompetitive behavior such as collusion and gives the SIC enforcement powers.<sup>53</sup> However, the dividing line between the enforcement authorities of SIC and other agencies is blurry. This lack of clarity has been problematic in an ongoing investigation by the SIC on pricing and access practices of Redeban and Credibanco. The banks refused to disclose information to the SIC alleging its lack of authority. Although the Financial Sector Bylaws hold the SFC responsible for ensuring competition, the banking and payment sectors have never been under investigation by the SFC, regardless of criticisms by the media for oligopolistic pricing practices.

With regard to the mobile phone industry, the CRT is currently revising the rules for access/sharing of installed infrastructure to facilitate the entrance of new competitors, increase coverage, and allow for a future number portability scheme (client's prerogative to maintain their phone number when switching providers, services, or regions).<sup>54</sup>

### ➤ Comments and recommendations

*Entrance barriers to the payment services business (such as access and pricing practices imposed by Redeban and Credibanco) limit competition and maintain the dominant market power of existing players. This might delay the expansion of the POS network and innovation in payment services.*

*The authority for investigating anticompetitive acts in financial services and imposing penalties (including penalties for noncompliance) should be clarified. Clarifying the role of each supervisory agency would bring certainty for potential and actual market participants and encourage investments in innovative payment solutions. Enforcement is as important as a good regulatory framework.*

## 5.7 Regulation of telecommunication services

The CRT regulates and supervises mobile phone services. The SIC oversees compliance with the general Consumer Protection Code and the CRT checks compliance with its own consumer protection framework. The Convergence Decree issued in mid-2007 confirmed the CRT's authority to create and enforce competition rules and simplified the licensing process by requiring only one license for the provision of all types of telecommunication services. The provision of voice services is compulsory for any provider. Accordingly, MNOs cannot engage exclusively in the business of prepaid cards. An enabling framework for value-added-services (VAS) was recently created to stimulate use of SMS and increase competition.<sup>55</sup> The new decree also requires the CRT to take actions relevant to branchless banking, such as defining the terms in which dominant players will be required to grant access to its infrastructure to others.

### ➤ Comments and recommendations

*The regulation of telecommunication services does not pose obstacles for the development of branchless banking products that use mobile phones. Such services would be treated as VAS (i.e., services that are not voice communication). Moreover, the Convergence Decree clarifies the CRT's authority to enforce competition and consumer protection rules, sets the ground for number portability, and calls for fewer entrance barriers to the telecommunication sector.*

<sup>53</sup> Law 155/1959 and Decree 2153/1992.

<sup>54</sup> CRT, Proyecto de Resolución, 01/23/2008, which changes the Resolution CRT 532/2002.

<sup>55</sup> Decreto 2870/2007

*The potential increased participation of MNOs in the financial sector would require better coordination between the CRT, BDO, and the SFC to establish minimum technical, conduct-of-business and consumer protection standards, as well as to clarify each agency's responsibility in the oversight of this sector. BDO should use the "bancaization" momentum to explore ways to increase use of mobile phones for electronically stored accounts by discussing with the banking authorities the potential of testing nonbank-based models that could increase competition in banking services.*

## **5.8 Electronic transactions and data security**

Legislation<sup>56</sup> provides for adequate recognition of electronic documents and creates the root certification authority within a public key infrastructure. According to the law, electronic commerce involves any commercial transaction using electronic messages to effect agreements. A digital signature will only have legal value and binding force if it incorporates the attributes dictated by international best practices.<sup>57</sup> All certifying authorities are licensed and supervised by the SIC.<sup>58</sup> Digital certificates issued abroad may be recognized by Colombian certifying authorities.

There are no laws criminalizing acts such as *spamming*, *pharming*, *phishing* and similar acts of fraud, which is considered one of the main constraints for e-commerce. There is a draft law which is expected to reform the penal code with regard to this matter.<sup>59</sup>

E-security is a component of the SFC's operational risk review. Supervised institutions are required to design and implement e-security policies and contingency plans. The SFC establishes minimum requirements for security and quality of information transmitted through electronic channels.

### **➤ Comments and recommendations**

*Generally the framework for electronic transactions is adequate. However, the lack of express criminalization of e-crimes poses an obstacle for the growth of e-commerce. Reforming the penal code in this regard would benefit the security of branchless banking. With regards to the new requirements for electronic data security issued by the SFC, banks are concerned about the significant investments necessary for compliance..*

## **5.9 Taxation**

One of the most debated obstacles for expanding financial services is the existence of the *cuatro por mil* tax on financial transactions. Although it has recently been abolished for debits up to US\$3,500 from savings accounts, withdrawals from checking accounts are still taxed. The existence of the *cuatro por mil* tax is believed to discourage individuals from using formal remittance providers because many customers are not aware of the exemptions.

The implementation of the exemptions is not as simple as one would expect: (i) banks reportedly do not always apply the exemption (ii) informed customers are required to present a written declaration to banks stating that there is only one account benefiting from such exemption, and (iii) accounts held by more than one person cannot be exempted.

Tax regulation does not pose any obstacle to mobile banking.

### **➤ Comments and recommendations**

<sup>56</sup> Law 527/1999, partially regulated by Decree 1747/2000.

<sup>57</sup> Uncitral Model Law on Electronic Commerce ([www.uncitral.org/uncitral/en/uncitral\\_texts/electronic\\_commerce.html](http://www.uncitral.org/uncitral/en/uncitral_texts/electronic_commerce.html)).

<sup>58</sup> Digital certification is the process through which the legal requirements for digital signatures to be accepted in lieu of physical signatures are confirmed.

<sup>59</sup> Proyecto de Ley 042/2007.

*The cuatro por mil tax discourages low-income customers and micro-entrepreneurs, from using the formal financial sector and increases complexity of agency schemes. This tax potentially delays the results of the financial inclusion efforts led by BDO given its negative impacts on both supply and demand. The most effective measure would be abolishing it, as proposed by the IMF in a recent mission to Colombia.*

*While abolishing such tax is not currently included in the government's agenda, the BDO and the tax authority should work to simplify exemptions. The requirement for customers to present a written declaration should be eliminated and the exemption should comprise accounts held by more than one person, as well as checking accounts. Lastly, the BDO and the government should increase efforts to better inform the public of such exemption within its financial education initiatives.*



## Annex 1: List of persons interviewed

| Entity                                   | Name                                    | Title  |
|--|---|--|
| Superintendence of Finance               | Mr. Cesar Prado                         | Superintendent   |
| Superintendence of Finance               | Mr. Camilo Zea                          | Director – Research and Development  |
| Superintendence of Finance               | Mr. Gabriel Hernan Aguilar Leal         | Sub-Director Norms   |
| Superintendence of Finance               | Mrs. Luz Amanda Garcia Bolivar          | Delegate - Credit Risk   |
| Superintendence of Finance               | Mrs. Maria Carolina Afanador            | Coordinator – AML/CFT  |
| Superintendence of Finance               | Ms. Juliana Lagos Camargo               | Advisor – Risk Analysis and Supervision  |
| Superintendence of Finance               | Mr. Daniel Mauricio Rojas               | Advisor – Risk Analysis and Supervision  |
| Ministry of Finance                      | Mr. Roberto Borrás                      | Director Financial Regulation  |
| Banco Caja Social de Colombia            | Mrs Eulalia Arboleda de Montes          | President  |
| Banco Caja Social de Colombia            | Mr. Luis Daniel Cortes Urquijo          | General Manager  |
| Banco Caja Social de Colombia            | Mr. Patrick Tissot                      | VP – Risk  |
| Banco Agrario                            | Mr. Luis Carlos Lopez Hoffmann          | Manager Corporate Banking  |
| Banco de la República de Colombia        | Mrs. Carolina Merlano Gil               | Director – Electronic Payment Systems  |
| Banco de la República de Colombia        | Mrs. Marcela López                      | Manager – ACH CENIT  |
| Banco de la República de Colombia        | Mr. Mauricio Chavarro                   | Sub-Director Electronic Services   |
| Banca de las Oportunidades               | Mr. Carlos Alberto Moya                 | Director   |
| Banca de las Oportunidades               | Mrs. Maria Clara Hoyos Jaramillo        | Coordinator  |
| Marulanda Consultores                    | Mrs. Beatriz Marulanda                  | Consultant   |
| Finamerica                               | Mr. Gregorio A. Mejia                   | President  |
| Finamerica                               | Mrs. Franczy Patricia Rueda Tocarruncho | Director – Risk  |
| Giros y Finanzas                         | Mr. Alfonso Otoya Mejia                 | Director New Business  |
| BBVA                                     | Mr. Juan Carlos Gil Quintero            | Manager Commercial Channels  |
| BBVA                                     | Mrs Marta Consuelo Campos Vasquez       | Manager Indirect Channels  |
| AV Villas                                | Mr. Rodolfo Velez                       | VP – Operations and Technology   |
| Bancolombia                              | Mr. Carlos Esteban Montoya              | Manager - Channels   |
| Redeban Multicolor                       | Mr. Valentin Echeverry                  | VP Operations and Technology   |
| Telefonica Movistar                      | Mr. Arbey Gomez                         | Director – Marketing SME/Colombia  |
| Telefonica Movistar                      | Mrs. Guliana Barbosa                    | Director – VAS Colombia/Venezuela  |
| Telefonica Movistar                      | Mr. Gustavo Adolfo Pinzon               | Director Products and VAS/Colombia   |
| Da Vivienda                              | Mrs. Maritza Perez Bermudez             | VP - Marketing   |
| Da Vivienda                              | Mrs. Maria Claudia Mena Cardona         | VP - Commercial  |
| Da Vivienda                              | Mr. Juan Carlos Rojas                   | Manager – Remittances  |
| Da Vivienda                              | Mrs. Olga Lucia Martinez Lema           | VP - Finance   |
| Telecommunications Regulatory Commission | Mr. Gabriel Adolfo Jurado Parra         | Commissioner   |
| Visa (Credibanco)                        | Mr. Orlando Garcia Torres               | President  |
| Visa (Credibanco)                        | Mr. Pedro Luis Villegas Ramirez         | VP Operations and Systems  |
| Visa (Credibanco)                        | Mr. Gustavo Leano Concha                | VP - Marketing   |
| Visa (Credibanco)                        | Mr. Alex Acosta                         | Manager, Product; Business Development   |
| Citibank                                 | Mrs. Beatriz Londono                    | VP - Distribution and Channels   |
| Citibank                                 | Mr. Jaime Alberto Upegui Cuartas        | Country Manager (Retail Banking)   |
| Citibank                                 | Mr. Francisco A. Aristeguieta           | President  |
| Tigo                                     | Mr. Marcelo Benitez                     | VP - VAS   |
| Tigo                                     | Mr. Ramiro Avendano Jaramillo           | VP - Commercial  |
| Jit Asesores                             | Mr. Jorge Juan Toro                     | Mobile Banking Consultant  |
| Asobancaria                              | Mrs. Maria Mercedes Cuellar Lopez       | President  |
| Asobancaria                              | Mr. Carlos Alberto Sandoval             | VP - Economics   |
| Archila Abogados                         | Mr. Emilio Archila Penalosa             | Lawyer and President of the Colombian Association of Securities' intermediaries. |