WHITEPAPER

Spotlight on Central America's Sistemas de Interconexíon de Pagos (SIP)

Regional payment schemes are becoming much more in vogue, with the SEPA Inst scheme soon to be launched in Europe and a scheme for the ASEAN+3 under discussion. Central America, however, is already celebrating six years of its regional payments infrastructure – Sistemas de Interconexíon de Pagos (SIP). But does simply creating the conditions for cheaper, safer cross border payments encourage customers to use it?

Top Banks in Central American Monetary Council (CMCA) countries by assets, March 2013:

1. Banco Industrial, Guatemala (US$ 7553m)
2. Banco Nacional de Costa Rica (US$ 6967m)
3. Banco de Costa Rica (US$ 6432m)
4. Banco Popular Dominicano, Dominican Republic (US$ 5300m)

What is SIP?

The Sistemas de Interconexíon de Pagos (Interconnected System of Payments), or SIP, is a regional payment system in Central America which allows transfers between the Isthmus' countries to be made in real time, at low cost, safely and securely. It comprises the nations of the Central American Monetary Council (CMCA), namely Guatemala, El Salvador, Honduras, Nicaragua, Costa Rica, and the Dominican Republic.

During the 1980's and 1990's intraregional trade in Central America saw exceptional growth, with reciprocal trade reaching a share of 28% of total exports, the highest share ever recorded. However, from 2002 until 2011 trade stagnated. Reasons why have been touted as due to a lack of a fully functioning common market, no common currency, and cross border payments being a cumbersome and expensive process, amongst others. Officially launched in 2011, SIP was seen as part of a wider initiative that seeks to develop financial infrastructure with a view to furthering a regional financial market and is aimed at supporting the orderly development of integration.

Central American Monetary Council (CMCA) Countries:

GDP: US$ 259.33bn (World Bank, 2016)

Population: 53.38 million

Currencies:

Colon (Costa Rica, CRC)
Cordoba (Nicaragua, NIO)
Lempira (Honduras, HNL)
Peso (Dominican Rep, DOP)
Quetzal (Guatemala, GTQ)
US Dollar (El Salvador, USD)

It is a framework for interlinking the regions' payment systems, allowing for cross border electronic funds transfers between participants without the need for corresponding banking relationships. SIP contemplates and incorporates the following aspects:

- A solid legal framework
- Standards and best practice
- High level functional design
- A business model that harmonises payment systems.

The purpose of SIP is to provide an automated mechanism that, through transparent, efficient and secure processes, enables participants to electronically and in real time settle their operations derived from intraregional payments in US Dollars. At the time of writing 68 banks belong to Central America's Payments Interconnection System (SIP).

Why is SIP important?

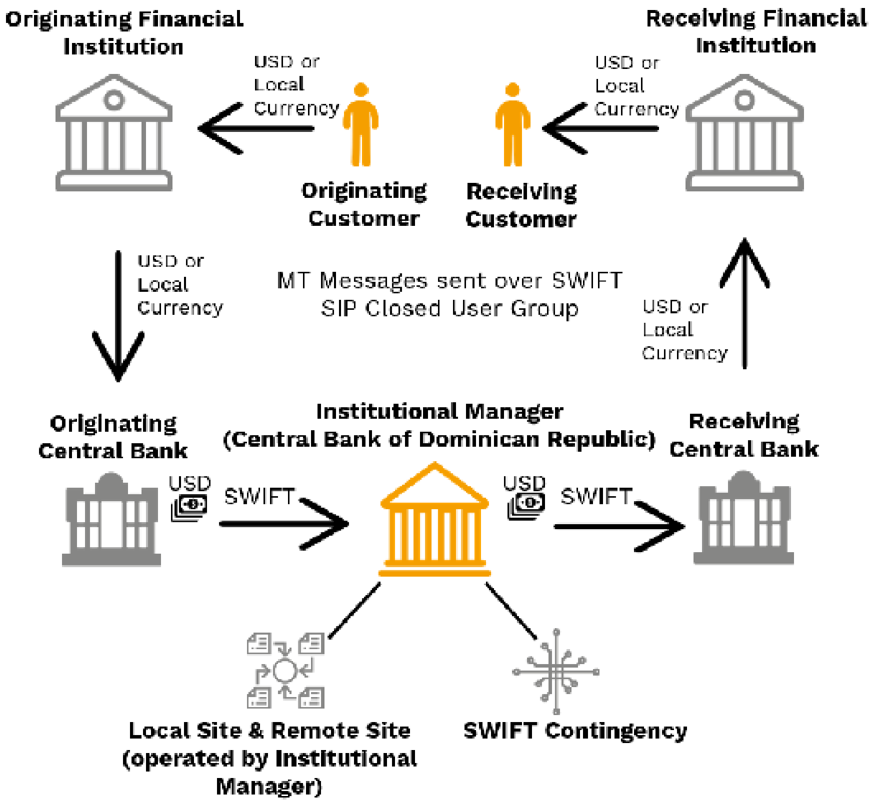
- Promotes modernisation of national payment systems
- Contributes to the elimination of restrictions on cross border payments
- Materialises the treaty on payment and settlement systems of Central America and Dominican Republic
- Gives greater access to cross border payment services
- Compliments other regional initiatives regarding trade.

SIP's legal framework is governed by the treaty on payments and securities settlement systems in Central America and the Dominican Republic, in force since 2008.

The Bank of Guatemala emphasises it is not just aimed at facilitating trade but also promoting the modernisation of national payment systems in the region.

How does the system work?

SIP is operated within a Closed User Group on the SWIFT network, meaning that each participant must integrate the SWIFT platform in their internal systems, utilising SWIFT MT messages as its protocol and the IBAN standard at the central bank level.



Source: Banco Central de la República Dominicana

Mayan Ruins in Tikal Site, Guatemala

The operation of SIP requires one member country to take the role of 'Institutional Manager'.

The obligations for an Institutional Manager are:

- The management of limits for settlement accounts of participants
- The capacity to manage collateral
- The capacity to operate within various time zones
- Queue management and prioritisation of payments
- The ability to process payment instructions with a future settlement
- Automated confirmation of settled payments
- Automated generation and communication of account statements at the end of each operating day
- Management of tariffs/fees
- Native integration with SWIFT formats and messaging systems
- Audit trails
- Separate settlement of both national and regional operations.

At the time of writing, the Central Bank of the Dominican Republic acts in this capacity, with no plans for this to change.

The payment flow, as illustrated above, works as follows:

1) If a person or entity in any of the Central American member countries wishes to transfer money to another member country, they must make the payment order in a participating bank in their member country. The payment can be made in local currency at the relevant US Dollar rate, or directly in Dollars.

2) The initiating bank sends the payment instruction to the local central bank.

3) The local central bank transfers the funds to the institutional manager of SIP, which is currently the Central Bank of the Dominican Republic via SWIFT.

4) The Central Bank of the Dominican Republic then sends the funds to the destination central bank also via SWIFT.

5) The destination central bank transfers the funds to the relevant commercial bank in the recipient's country, which must be a SIP member.

6) The funds are then credited to the recipient's account with a choice of USD or local currency.

The intermediary chain of payments is in US Dollars and transactions are irrevocable.

Operating hours are 9am until 3pm in Central America, and 11am until 5am in the Dominican Republic, with transactions taking no more than two hours.

Transaction record by central bank (Jan-Sept 2017)

	Volume Payed (USD millions)	Number of Transactions
Dominican Republic (BCRD)	2.5	479
El Salvador (BCRES)	43.2	226
Guatemala (BANGUAT)	0.1	45
Honduras (BCH)	8.1	417
Nicaragua (BCN)	0.4	99
Total	54.3	1266

SOURCE: CONSEJO MONETARIO CENTROAMERICANO SECRETARÍA EJECUTIVA

Tower of Santa Ana Cathedral, El Salvador

Settlement

In terms of settlement, the SIP system operates a Real Time Gross Settlement model that will process and settle transactions with the settlement date equal to the value date, provided funds are available in the central bank's account. Each member bank must have a settlement account with the Institutional Manager for SIP purposes. Member central banks can order a cancellation of in-flight payments only if they are pending before operations close for the day. The Institutional Manager may cancel a transaction at the end of the day due to insufficient funds. This lack of funds is then reported to the Central American Monetary Council. Transactions processed after hours will be settled on the next business day.

Who participates in SIP?

Whilst sending funds over the SIP platform is optional for Financial Institutions, receiving funds is mandatory. Any Financial Institution that is permitted to partake in their own domestic RTGS systems may participate in SIP. In Guatemala, Honduras, El Salvador, Nicaragua and the Dominican Republic, all commercial banks belong to SIP. Costa Rica is connected to the system but has yet to adjust domestic regulations in order to perform any operations.

How much does SIP cost?

The transactional cost to the customer is $5, regardless of the amount of the transaction. Before SIP, cross border transactions cost $35 and the value rose in proportion to the amount transferred. Customers may be required to pay a surcharge of $5 if a transaction is returned due to inconsistent information for example. However, central banks of member countries define internally the chargeable rate per operation to commercial banks. It is necessary for central banks to publish the tariff which is charged at the regional level, and any modifications to fees must be published prior.

What is SIP being used for and what are its advantages?

The advantages of SIP are many. It allows for the consolidation of regional operations into a single platform. It also reduces transaction speed and increases security. Although not 24/7, the system has wide operating hours and a low cost comparably to normal bank cross border channels. It has the potential to be used for remittances, payment of imports, bill payments, as well as innovative cross border payment services by third parties.

Is SIP a success story?

Unfortunately, to date, this system is little used in intraregional banking transactions. But why? With legal and operational certainty, it was hoped that the development of SIP would stimulate business and trade as well as help modernise domestic and regional infrastructure. The system promotes legal and transactional security, strengthens the competencies of the monetary authorities of each country and in particular reduces cost and time; a transfer between a buyer in Country A and a supplier in Country B in the absence of SIP is relatively complicated and costly since private banks will charge a commission to its clients or customers for this service. These factors are decisive in the competitiveness of economic actors in the region. The existence of Central America as a free trade zone emphasises the importance of having a payment system that is efficient and fluid cross border. Given the push towards a single customs territory in Central America, a strong, efficient and reliable payment system is vital.

The lack of usage is difficult to pin down, but so long as banks are not forced to promote and encourage SIP transactions to their customers, and businesses and individuals remain unaware of its existence, banks may still promote their own channels for cross border transactions. The Central American Monetary Council may need to make a more concerted effort centrally to promote SIP as a service for banking customers across the region.

Road to Arenal Volcano, Costa Rica

The unique factors of SIP that differentiate it from other regional payment systems are as follows:

- It is designed and run by central banks
- It links exclusively to RTGS systems rather than an ACH system in one country and a central bank in another (i.e. the US-Mexico model)
- It operates in a currency that is not common to all participants.

Some of these factors may contribute to its low usage. In particular, as the currency used is the US Dollar, at a minimum the central bank must assume the cost of obtaining a currency that is not its own. The financing conditions of this could be expensive.

This goes to show that the mere investment, creation and development of real time, low cost solutions for customers is not necessarily sufficient in ensuring its usage.

That being said, there is interest in SIP from countries outside its current membership. Given the tighter regulation on US banks and Know-Your-Customer requirements, this has led to many account closures in Central America. The payment system between Dominican Republic and Central America has a potential role to play. It can allow transfers from one bank to another within the system without having a correspondent bank in the US. Previously, it was common to send money through a bank in the US and this in turn to the bank in the country of final destination, as per normal correspondent banking practices. SIP could be a way of counteracting limitations resulting from tighter regulation in the US and providing another solution through normal channels, while complying with all anti-money laundering rules.

Discussions are currently underway for other Latin American countries to join, which may start the regional payment system revolution that CMCA envisioned for the future.

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