



Global Payments: Spotlight on Colombia

Over the last decade, Colombia has experienced reasonable economic growth. In 1990, Colombia was Latin America’s 5th largest economy and had a GDP per capita of only US\$1,500, by 2015 it became the 4th largest economy in Latin America, and the world’s 31st largest. As of 2015, the GDP per capita has increased to over US\$14,000, and GDP increased from US\$120 billion in 1990 to nearly US\$700 billion. Poverty levels were as high as 65% in 1990, but decreased to under 24% by 2015. How is this economic shift changing the payments landscape?

Top Colombian Banks by assets in 2016 (USD millions):

1. Bancolombia (38,693)
2. Banco de Bogotá (25,909)
3. Davivienda (22,631)
4. BBVA Colombia (16,772)
5. Banco de Occidente (10,925)

Retail Electronic Payments by Volume and Value (2013):

	Millions of transactions	Traffic (COP Billions)
CUD	7.430	41.767
ACH Colombia	611.228	2.877
ACH Cenit	44.743	723
Cheques	86.537	1.179



Population: 49.16 million

Language: Spanish

Currency: Colombian Peso (COP)

Payment systems in Colombia

Colombia is widely seen as having a robust and well-managed regulatory regime, with commercial banking and investment banking governed separately. The commercial banking sector is primarily regulated by two institutions:

- The Colombian Central Bank - Banco de la República, set up in 1922, is responsible for monetary policy and foreign exchange. It has the authority to adopt certain macroprudential measures, manages and exercises surveillance functions over the payment system, provides liquidity to markets, and acts as a lender-of-last-resort. Banco de la República has

responsibility for the financial stability of the payment systems. In 2010, the Central Bank established a separate department to carry out oversight of these responsibilities.

- The Financial Superintendence of Colombia - Superintendencia Financiera de Colombia, which came into being in 2005, is the result of the merging of two separate institutions which had been dedicated to the regulation of the banks on the one hand, and of capital markets on the other.

As of September 2015, there were 25 commercial banks in operation with gross assets of \$126.2bn. The top five banks dominate the industry, and between them account for two-thirds of the sector's total assets.

Colombia has a variety of payment systems for both retail and wholesale payment transactions. Cash is an important payment medium in Colombia, particularly for low-value transactions, and cash transactions are exempt from the financial transactions tax.

Electronic Payments

Credit transfers are used for both high-value and low-value payment transactions. Electronic credit transfers are used by companies for salary, supplier and benefit payments. High-value (alto valor) and urgent credit transfers are cleared and settled via CUD (Sistema de Cuentas de Depósito), Colombia's real-time gross settlement (RTGS) system. CUD is operated by the central bank. CUD transfers are also used to settle participants' obligations resulting from the various clearing houses in Colombia. There is a maximum value threshold of up to \$150 million or its COP equivalent for transactions processed in CUD.

As of December 2015, 146 direct participants had a deposit account within CUD, including banks, public financial entities, social security information operators and the stock exchange.

Low-value and non-urgent credit transfers (pagos directos) are batched and processed through ACH Colombia (for company and individual payments) or ACH CENIT (for government collections or payments). Low-value credit transfers typically include payroll, pension, supplier and tax payments. Funds are available to the beneficiary on T+0 or T+1, depending on when the transaction is processed.

ACH CENIT (Sistema de Compensación Electrónica Nacional Interbancaria) is a net settlement system operated by the central bank. ACH CENIT clears, and settles via CUD, positions in participants' accounts at the end of each processing cycle. ACH CENIT operates 24 hours a day, with cuts for clearing and settlement of payment orders and collections in five daily cycles of operation.

ACH Colombia is a private automated clearing house operated by a group of commercial banks. ACH Colombia operates on a net settlement basis. It processes batches of electronic credit transfers and direct debits, and settlement is made in participants' accounts at the central bank.

ACH Colombia and ACH CENIT operate using similar processing cycles. The structures and messages used by both were developed in accordance with the operating rules and regulations of the National Automated Clearing House Association (NACHA) in the USA, but have been modified based on local country needs.

Direct debits (débitos directos) are available in Colombia and used for low-value recurring payments such as utility bills. Direct debits are processed via ACH Colombia or ACH CENIT. Funds from direct debits are generally available to beneficiaries on T+0. Direct debits may be used for one-time or recurring payments, provided there is a signed authorisation in place. The volume of interbank direct debits in Colombia remains low. The majority of ACH transactions processed are interbank credit transfers.

Cheques are still an important payment medium in Colombia, although their usage has been in steady decline in favour of electronic methods. Cheques are processed and cleared electronically via CEDEC (Compensación

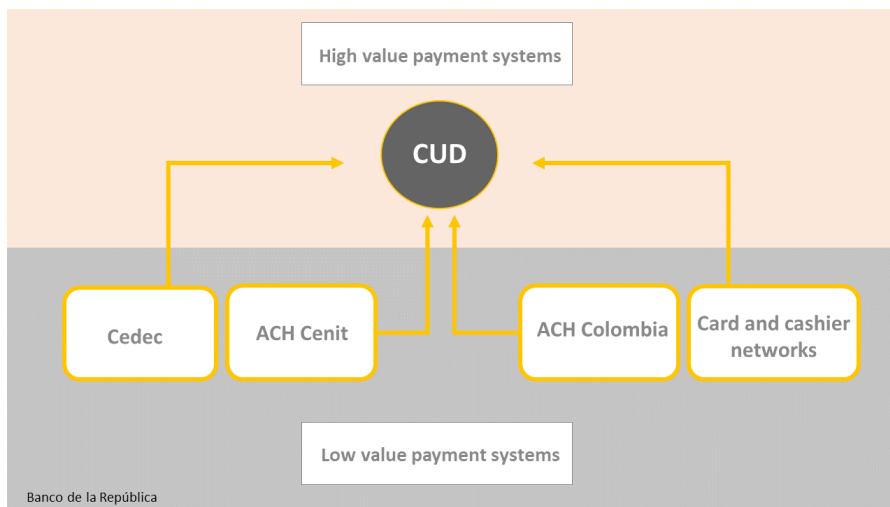


de cheques). There is a maximum value threshold of USD 100 million or its COP equivalent. Cheques are physically exchanged by banks after electronic clearing.

61% of online payments in Colombia are made with credit and debit cards and bank deposits. Card is one of the main online payment methods in the country and has a lot of space for growth. According to research from Lafferty Group in 2014 - "Merchant Acquiring Latin America", there are only 41 credit cards per 100 adults in Colombia.

The main cards brands in Colombia are Visa (50%) and MasterCard (40%), followed by Diners (5%) and American Express (5%).

Even if the credit card market is still concentrated in the higher income segments of the population, a lot of the main retail stores that have launched private-label cards are able to access lower income segments. These cards are slowly getting franchised by Visa and MasterCard. The main private cards are Cencosud, CMR Falabella, Coomeva, and Exito with around 10% of the actual Market Share for credit cards.



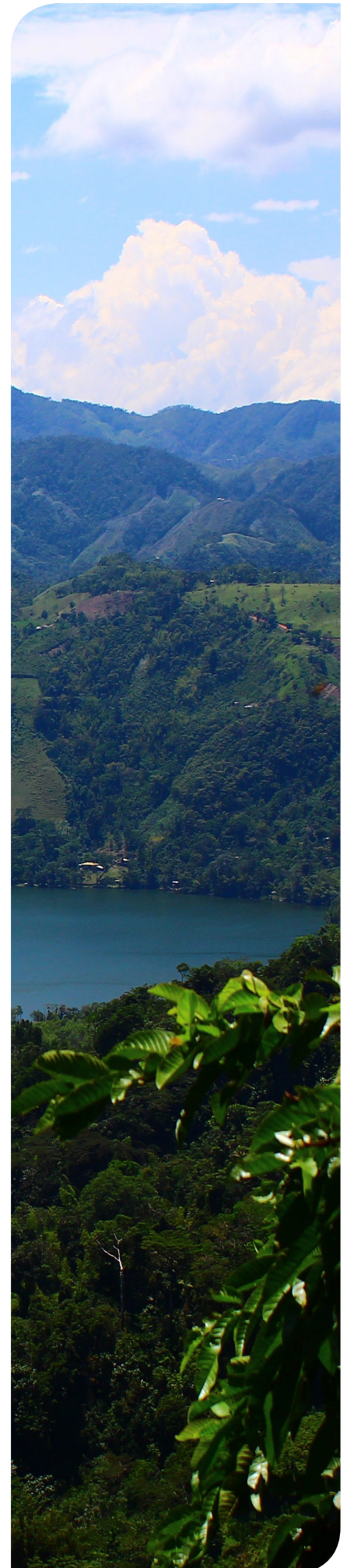
In banks we trust

It is reported that in Latin America, 65% of people don't use banks, because they do not trust them. However, unlike the banking industry in other markets, where trust in banks has been strained since the financial crash, Colombian banks do not seem to be experiencing this. According to a study of Colombia's top 50 brands published in 2015 by consultancy firm Compass-branding, the second and third most valuable brands in the country were Banco de Bogotá and Grupo Bancolombia, respectively. Banco de Bogotá and Grupo Bancolombia brands were each calculated to be worth around \$2.5bn. A number of other banks also made the consultancy firm's "top brands" list, including Davivienda, Banco de Occidente, Banco Popular and Banco Colpatria.

Colombia hasn't dodged the financial inclusion problem

Like many countries in Latin America, financial inclusion presents a hellacious challenge in Colombia. Given an unequal distribution of income and high levels of poverty, a significant proportion of the Colombian population, particularly in rural areas, has limited access to financial services. According to the World Bank, in 2013, 30.6% of the population was living below the poverty line, an improvement on the 42% poverty rate registered in 2008. The penetration of banking services in Colombia is low compared to the penetration rates in the OECD economies and relative to some of the country's Latin American peers. According to banking association Asobancaria, the "bankarisation rate", which is defined as the proportion of adults using at least one financial product, stood at 75.9% in June 2015, lower than in neighbouring countries such as Brazil and Chile. Asobancaria said that its members are aiming to raise the bankarisation rate to 84% by 2018.

The government has been following a series of initiatives to promote financial



inclusion. Its efforts were recognised in a 2015 report by the Economist Intelligence Unit, which ranked 55 countries around the world according to the degree of support for financial inclusion. Colombia was ranked second overall, behind Peru and ahead of Chile sixth, Bolivia eighth and Mexico joint eighth.

No need for regulators to push innovation

Instant Payments

Whilst Colombia enjoys a T+0/T+1 payment system, there has been discussion of a true immediate P2P retail payment system in Colombia for a number of years. The industry and the regulators have not managed to gain consensus on this topic. However, at least one bank is circumventing the absence of an industry-wide instant payments system.

Banco Davivienda has implemented Daviplata – a mobile P2P immediate payments platform that does not require individuals to bank with the institution. Daviplata stands out for its innovative approach to reaching those with lower incomes. Through a “freemium” model, customers can transfer money across wallets, cash in and out, and request their wallet balance from their phone at no cost. Whilst the levels of financial inclusion are relatively low, Colombia has a 105% cell phone penetration. Virtually, everyone in the country has a mobile device; and most importantly, Colombia’s network infrastructure covers 100% of its geography. Daviplata allows individuals who set up a Daviplata account to send funds to other Daviplata members. Funds can then be withdrawn at a Davivienda ATM or Daviplata points across Colombia.

As the bank may have no information on the customer, it uses the central ID database controlled by the government. Through this database they can check whether the information delivered through the mobile phone is in fact real data from the government issued ID.

Daviplata has allowed Concepción, a sleepy town in rural Colombia, to become the first and, so far, only town in the world to stop using physical currency, relying solely on mobile payments, even when most of its residents continue to use old mobile devices.

No doubt due to the success of Daviplata in the private sector, the platform won a government contract to distribute government-to-person payments to more than 900,000 recipients of Familias en Accion, a social “safety net” program including subsidies to families who provide children with healthcare and enable them to stay in school.

Premium banking

In retail banking, higher-income individuals, representing around 10-12% of the main banks’ customer base in terms of the number of accounts, are reported to be one of the fastest-growing segments in the Colombian market. These are generally defined as customers earning over COP20m (\$7360) per month. To cater for these customers, institutions are offering a wide range of personal banking services and access to related financial products. Banco de Bogotá has created 13 “premium” branches around the country which are dedicated exclusively to this segment of the market. BBVA said it hoped to have a total of 7500 premium banking customers by the end of 2016, representing an annual increase of 50%.

Wearables

According to Colombia-based Super Financiera, in 2016, 32% of the 4.9m operations in the financial system were via internet or mobile devices. This data shows the growth and boost of non-traditional banking in the country. In 2016, Grupo Aval was the first Colombian entity to implement the payment bracelet called Aval Pay, which was issued by AV Villas Bank. This bracelet enables contactless payment through identification by incorporated radio frequencies. Following this, in July 2016, Banco de Bogota launched a mobile token for the Apple Watch, enabling clients to register accounts, as well as conduct bank transfers, payments and data updates quickly and easily. In 2017, Bancolombia launched a variety of functions through applications for Apple and Android, enabling customers to simply facilitate money and non-money transactions through QR codes.



Mobile wallets

There has been a significant boom in the mobile wallet space in Colombia. The larger banks offer electronic wallets that allow customers to pay without cards, using stickers that can be attached to a mobile phone or other device. Typically they also allow users to manage their cards for contactless purchases in store or online. They differ from internet banking apps in that they do not support P2P electronic payments but are geared more towards P2B payments. Davivienda, BBVA and Bancolombia, among others, all have sophisticated mobile wallet apps.

The road ahead

Colombia is definitely in the midst of a change, increasing banks focus on innovation and digital transformation—thereby improving customer and payment experiences. However, there are no industry wide programs to ensure ubiquity, standardisation or consistent user experience. Banks differ in their approach and time to market. For example, an industrial scale P2P instant payments infrastructure would likely support the market in spring-boarding innovation that the banks are driving independently. It may also open up the market to smaller financial institutions and payment service providers as well as ensuring competition with other larger markets in the region such as Mexico, Chile and Brazil. Until such time as the regulators and the industry work together toward these infrastructure renovations, innovation is likely to be sporadic and dissonant.

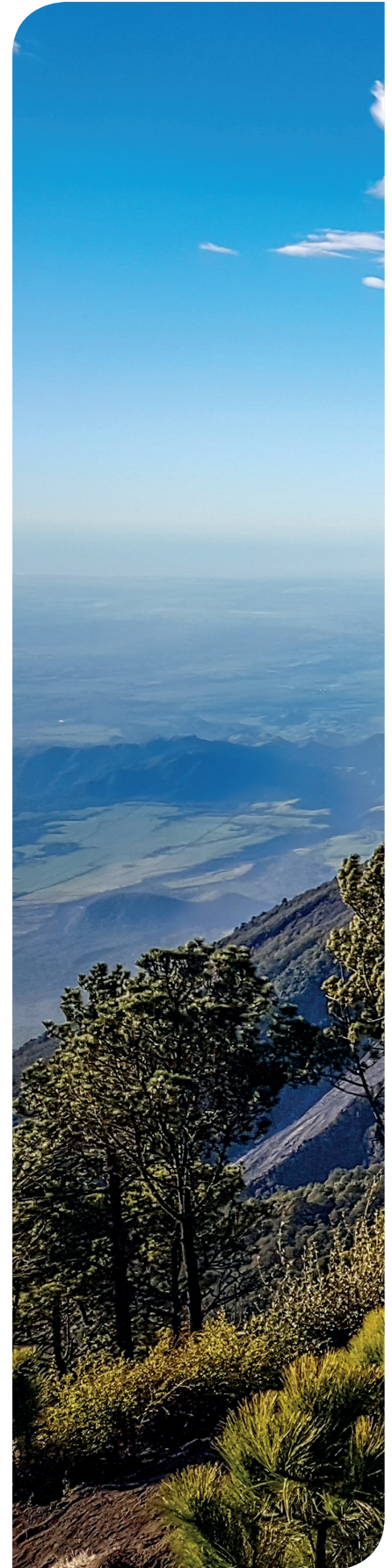
Author: Lauren Jones, International Payments Ambassador, Icon Solutions.

Lauren is an experienced freelance payments expert with a particular specialisation in standardisation, regulation and industry engagement. She is currently travelling in South America providing insights for Icon and the instant payment hub InstaPay.today.

lauren.jones@iconsolutions.com

[linkedin.com/in/laurenjones](https://www.linkedin.com/in/laurenjones)

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[iconsolutions.com](https://www.iconsolutions.com)



+44 207 147 9955



info@iconsolutions.com