

# Expanding Bank Outreach through Retail Partnerships

## *Correspondent Banking in Brazil*

*Anjali Kumar*

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# Abstract

This paper explores the extent to which formal, regulated financial institutions such as banks have been able to partner with “correspondents,” commercial entities whose primary objective and business is other than the provision of financial services. The paper illustrates the case of Brazil, where banks have recently developed extensive networks of such correspondents. It shows that such arrangements result in lower costs and shared risks for participating financial institutions, making these arrangements an attractive vehicle for outreach to the underserved especially for certain financial services such as payments and transactions. Correspondent banking required a supporting enabling environment to emerge, and poses some regulatory challenges and some increase in risk. The example from Brazil may be replicable elsewhere if appropriate regulatory adjustments are undertaken.





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## **CURRENCY EQUIVALENTS**

Currency Unit–Brazilian Real (R\$)/US dollar (\$)

### **EXCHANGE RATE**

2000 R\$1.95 = US\$1

2001 R\$2.41 = US\$1

2002 R\$3.54 = US\$1

2003 R\$2.90 = US\$1

2004 R\$2.66 = US\$1

2005 R\$2.33 = US\$1

March 2006 R\$2.15 = US\$1



# Introduction and Summary

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Since around 2000, there has been an unprecedented growth in the outreach of Brazil's banking system. Around 9 million new current accounts have been created since 2002; only 45 million current accounts existed in 2002.<sup>1</sup> Some 865 new bank branches were set up, along with some 125 new credit cooperatives and 40 microfinance companies between 2000 and 2004. Increases in electronic distribution systems were far more numerous; ATMs grew from some 14,450 to 25,600 during this period. The most striking has been the huge expansion in "correspondent banking outlets"; more than thirty-two thousand new correspondent outlets were added from 2000 to 2004 (Table 1).

Correspondent banking arrangements refer to bank partnerships with non-banks, typically retail commercial outlets, ranging from lottery kiosks, pharmacies, post offices, construction goods stores, and so forth, to provide distribution outlets for financial services. These are private contracts where each contract determines the scope of services, fee paid, risk shared, and so on. In Brazil, 74 financial institutions (57 banks and 17 financial companies) had over 38,000 formally recognized correspondent outlets by the end of 2004, and an estimated 90,000 of formal and informal correspondents by end 2005.<sup>2</sup> Many financial services are offered through correspondents without the need for an account. While only 43 percent of the adult urban population had a bank account, almost twice that proportion had access to some bank services through the use of the correspondent outlets. With

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1. Kumar (2005) details the status of financial access in Brazil in 2001/2, including the relative provision of branch and distribution systems, public and private providers, etc. In a survey that reported banking sector penetration from 99 countries by Beck and others (2005), Brazil ranked 35th in loans per capita and 25th in deposit accounts per capita. The data reported for Brazil was for 2003.

2. Estimates from the Central Bank of Brazil.

the use of correspondent bank outlets, the number of municipalities with no financial services has shrunk to zero. Financial services became available to many in geographically remote regions and to poor people, who had been chronically underserved.<sup>3</sup>

From the 1970s to the 1990s, Brazil, like many other countries, relied on its public banks to provide outreach. In 2001, public banks still accounted for over half of its banking system's assets. Yet, public banks did little better in terms of account provision to the poor than private banks. Microfinance institutions in Brazil have had a limited presence, and besides, the ability of stand alone microfinance institutions to achieve scale is debated.<sup>4</sup> Brazil's correspondent bank arrangements appear to illustrate a model of achieving scale, with the added advantage that both public and private banks have been known to adopt this model.

Correspondent banking is not new; post office savings banks, commonplace in many countries, may be regarded as one form of correspondent banking.<sup>5</sup> However, the range, scale and quality of services provided, and the new technological platforms that enable such service provision are unique to the current generation of correspondent banking arrangements.<sup>6</sup> Services are provided through a POS (point of sale) device, typically already installed by the merchant, which can permit financial transactions in real time, or near real time. These may be combined with a bar scanner which scans bills for electronic payments, PIN pads, teller machines and in some case, personal computer interfaces. They are typically linked to parent computers' servers with dial-up or satellite connections. Some are always on line while others periodically dial their central servers.

Correspondent banking outlets in Brazil focus primarily on transactions and payments services (invoice payments, collection services and payment orders, including government benefits and pension receipts, as well as newer payments services such as pre-paid cell phone cards and smart cards). However, some also offer other banking services, such as making deposits to and withdrawals from savings accounts, as well as contributions to and withdrawals from investment funds.<sup>7</sup> They can also provide a channel for receipt and forwarding of banking instructions, such as proposals for opening demand, term and savings accounts. Credit services have been more limited, but correspondents authorized to offer banking services are able to take loan and other financing requests, credit cards applications and registrations.<sup>8</sup> The diversification of banking business beyond payments has been steady, although payments services still predominate.

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3. Correspondent partnerships differ from bank partnerships with informal finance providers such as self help groups (India's NABARD, South Africa's First National Bank's People's Benefit Scheme, which partners with the stokvels) and strategic alliances between rural financial institutions such as financial NGOs, non-bank finance companies, credit unions and formal financial institutions (Gallardo and others (Forthcoming)). They also differ from limited branch services such as the E-Plan of Standard Bank in South Africa that use ATMs and POS devices (Porteous, 2006, forthcoming), but without correspondent partnerships. They can however be seen as an approach towards downscaling. Valenzuela (2002) reviewed the experience of 53 institutions that attempted this in the 1990s.

4. Morduch (1999), Morduch and Haley (2002), and Honohan (2004)

5. A recent review of postal networks in 60 developing countries reports 390 million savings accounts with savings of US\$ 94.1 billion (Huynh-Segni, draft).

6. Typically, postal bank services have focused on deposit taking, with some money transfer facilities through postal giro arrangements.

7. CMN Resolution 3,110, of July 31, 2003 (altered by CMN Resolution 3,156, of December 17, 2003), Article 1, parts I-II (Appendix Table A1.3).

8. CMN Resolution 3,110, of July 31, 2003 (altered by CMN Resolution 3,156, of December 17, 2003), Article 1, parts III-IX (Appendix Table A1.3).

Most businesses that enter into correspondent contracts with banks have pointed to benefits from an increase in clientele, an increase in revenue, differentiation from other competitors, instruments that help develop customer loyalty and a new source of revenue. Benefits to the population include access to the financial system in a simplified form, flexibility with business operating hours, greater ease in transactions by combining banking services with shopping, easier receipts of social benefits, and reduced travel and costs for accessing financial services.

This paper provides a preliminary exploration of the nature, value, and replicability of correspondent banking arrangements in Brazil. The next two chapters characterize the correspondent banking model and then detail the various forms of correspondent arrangements in Brazil. Each arrangement is evaluated in terms of reductions in costs or risks, compared to conventional branch banking. This demonstrates the flexibility of the model, which permits its use by private as well as public banks, and its use of conventional as well as the special accounts created by Brazilian legislation to expand access. Chapter 4 summarizes the dimensions of the growth of correspondent banking and Chapter 5 shows how it has succeeded in expanding access to the most difficult segments—those in geographically remote areas, and those who are among the poorer segments. Chapter 6 examines the legislative framework and shows that regulatory changes towards banks, their correspondents, and towards the rest of the financial system, influenced the development of the correspondent system. Finally, the concluding chapter analyzes the reasons underlying the growth of correspondent banking, in terms of regulatory, organizational and cost factors and considers the extent to which other countries may be able to benefit from such correspondent arrangements.

To summarize the main findings in this study, correspondent banking in Brazil has been successful in penetration to poorer segments and to remote regions, but the central focus of some major correspondent networks remains urban. It has indeed permitted the opening of many accounts, however, their maintenance in active form will remain a challenge. Its success lies mostly in the transactions and payments spectrum of banking services and expanding services to encompass credit is still at an early stage.

Correspondent banking reduces the costs of enhancing financial access. Specifically, it reduces high variable costs due to small transaction size, by sharing the point of service interface with retailers. In addition, in some cases, fees can be split with the participating correspondent. It also reduces high fixed costs associated with maintaining bank branches in remote areas where population density or economic activity is low. High fixed costs in Brazil are exacerbated by regulatory costs due to restrictive government labor policies that apply to bank branches and high costs of branch safety requirements. While difficult to quantify and allocate overheads for bank branch operations, examples are provided suggesting very substantial cost savings.

As regards risks, correspondent banking reduces some risks but increases others. In a few cases, where there is active participation in the credit process correspondents may reduce the credit risk associated with the lack of information on small clients as this information is already available to the participating correspondents.<sup>9</sup> However, payment and

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9. Under some arrangements in Brazil, it appears to be possible to reduce the liquidity risk associated with cash needs to service clients at branches, and the risks of transporting cash to remote locations, by sharing liquidity with the merchant or contracting company generating its own cash flow.

cash handling risks increase with the introduction of non-bank personnel handling cash at the correspondent's location. This liability is often borne by the correspondent or intermediary, under agreement with the bank. Nevertheless, clients would still be exposed to some additional risks and some cases of fraud have occurred. Settlement risk increases when transactions are not undertaken on a real-time basis. VSAT or online connections permit real-time completion of transactions, but in some cases synchronization is only undertaken periodically to avoid keeping connections open when they are not in intensive use.

Why has this model evolved in Brazil and is it exportable to other countries? Brazil may have had some advantages because of its technologically sophisticated banks, a legacy from the 1990s when float income in the period of hyperinflation required rapid recording and synchronization of all banking transactions. It may also have had advantages due to an enabling regulatory environment, where there were no restrictions against cash handling functions at non-banks, unlike, say, India. Conversely, high labor costs and strong unionization urged banks to push new service delivery outside formal banking channels. Finally, there has been strong political support for expanding financial access, which has contributed to the exceptionally rapid recent growth of correspondent banking. The recent expansion of this model to neighboring countries in the region, including Mexico and Bolivia, as discussed further below, suggests it can be replicated and can apply to a range of financial institutions, both public and private. Public support for the creation of a supportive enabling environment will accelerate the process.

# Characteristics of the Correspondent Arrangement

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## Definition

Broadly speaking, a banking correspondent in Brazil is a commercial establishment, with a different primary business focus, that renders services on behalf of a financial institution.<sup>10</sup> Each financial institution decides the type of services it wants its banking correspondent to offer to the public in accordance with its strategic plan. Contracts between the financial institutions and the commercial establishments are private contracts and as such, are covered by the Civil Code. Caixa Econômica Federal, with the largest network of correspondents in Brazil, differs slightly as it not only has private contracts with commercial establishments, but also a social role in the delivery of federal benefits. Caixa Econômica Federal has a special relationship with the nation's lottery houses, or "*casa lotéricas*" which began as a means to deliver social benefits to all recipients in Brazil. The lottery houses, which are franchises, have special permission to render services on behalf of Caixa Econômica Federal, based on public contracts which are covered by Law 8,987 (1995), the Law of Concessions and Permissions.<sup>11</sup>

## Services Offered

Correspondent banks offer a variety of services in practice. Not all correspondent outlets offer the full range of services. Correspondent banking legislation in Brazil divides services

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10. CMN Resolution 3,110, of July 31, 2003 (altered by CMN Resolution 3,156, of December 17, 2003). The legal foundations for the correspondent relationship and its evolution in recent years are discussed in greater detail in Part 4 below.

11. Law 8,987 of February 13, 1995.

into two broad categories: banking services; and other financial services (see Chapter 6 for more details regarding the legislation). “Banking services” consist of the opening of current accounts and savings accounts, as well as transactions connected to these accounts using a debit card (for example, deposits, withdrawals, and account balances). Only those banks authorized by the Central Bank can offer correspondent banking services.

Other financial services include services that can be offered by all banking correspondents. These include receiving invoice payment, payment of benefits, payment orders, and collecting information for credit analysis and registration of applications for loans, and credit cards (correspondents collect the necessary data from the prospective client and forward it on to the contracting bank where it is analyzed and a decision is given).

## Contractual Obligations

It appears from discussions with banks offering correspondent services that contracting institutions are not responsible for the security of the correspondent and do not need to invest in infrastructure and staffing. Services are provided by the correspondents’ existing staff. In certain cases, the correspondent may need to take on extra staff in order to accommodate the increase in services provided. It is important in some countries to know if non-bank entities can handle cash. In Brazil, this was never an obstacle. Some correspondents offer automated services such as an ATM, but the majority contain a physical counter, where the correspondent staff member handles the cash personally. Staff deliver correspondent services on an on-call basis (for example, postal workers provide both postal services and correspondent services using the same POS equipment).<sup>12</sup>

Security arrangements at correspondent premises vary. The lottery houses, due to their high volume of transactions, sometimes have bullet-proof glass installed as their primary security measure. Some post offices contain revolving doors with metal detectors, similar to that of regular banks. Most correspondents, however, do not have any special security arrangements.

## Remuneration

Typically, correspondents are remunerated on a fee for service basis, deducted, in turn, from the fee charged to the ultimate client. For every new client, every transaction made, every product sold, the correspondent receives a fee. The fee varies from one financial institution to another and can also vary according to location, product, and transaction. Typical fees for basic services vary between R\$0.15-R\$2.00. For example, Lemon Bank charges R\$0.30 to make payments using a debit card, and R\$1.00 to obtain an account statement, consult an account balance or make a withdrawal.<sup>13</sup> However, contracting institutions are

12. It would be desirable in a further phase of research to obtain details and examples of contracts between banks and their correspondents. What is clear however that there is considerable latitude in the parameters of such obligations.

13. These costs refer to Lemon Bank’s ‘Pay and Use’ account which does not have a monthly account keeping fee. Lemon Bank provides other accounts that charge a monthly fee, which include some basic services for free or at a discounted rate. Appendix Table A1.2 has a schedule of fees for services provided by the popular correspondent banks.



often keen to attract bank correspondents as this adds to their client flow and in some cases, have undertaken to establish correspondent outlets free of charge. Contracting institutions can make these arrangements directly or through intermediaries which act on their behalf. When intermediaries are used, fees generated must be distributed between the contracting institution, the intermediary and the correspondent in accordance with the contractual agreements. For example, both Lemon Bank and Banco Popular do Brasil contract the services of intermediaries who in turn are responsible for locating and contracting prospective correspondents.

## Technology and Equipment

These also vary from one correspondent to another depending on the types of services to be offered, training, support, risk management preferences and the level of infrastructure at the correspondent's premises. Most correspondents have a point-of-sale device (POS), with or without a personal computer (PC), barcode readers and/or additional keypads for clients to enter their personal pin numbers. All correspondents are linked to their contracting institutions' servers using a telephone line, cable or satellite (VSAT) technology. Most transactions take place in real-time via high-speed internet connections, though in some cases, a dialup or other periodic connection is used. All transactions are verified by the contracting institution's server and the data is encrypted using the institution's own data protection technology. A web type interface is not necessary and there is no internet use. If a contract is terminated, the contracting institution removes any equipment installed and can reuse it at another correspondent.<sup>14</sup>

## Client Interface

In most arrangements, the client interface for the correspondent bank is provided by regular staff in the correspondent, on an as-needed basis, as they would for any other service that the establishment provides. For transactions involving a debit card, clients use an ATM machine, if available, or utilize the services of the correspondent's staff member with a numerical keypad interface.

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14. Cracknell (2004) analyzes the potential of electronic banking—use of Personal Digital Assistants, ATMs and POS devices, Magnetic Stripe Cards, Smart Cards and Cell-phone Banking—in expanding financial access. Electronic payments are generally considered to be one-half to one-third less costly compared to the paper alternative (Humphrey and others 2003). A CGAP study identifies 63 banks and micro-finance institutions in 33 developing countries which use electronic payment channels (Ivatury 2005). Klapper (2004) finds that while electronic fund transfers increased 600 percent between 1993 and 2003, and debit card transaction increased 600 percent between 2001 and 2003.



## Growth and Penetration of Correspondent Banking in Brazil

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At the end of 2004, there were some 38,160 banking correspondent outlets in Brazil, compared to less than 6,000 at the end of the year 2000. In comparison, bank branch outlets increased from around 16,400 to 17,260 and ATMs grew from 14,450 to 25,600 (Table 1). Clearly, correspondents have provided the single largest avenue of expansion to one spectrum of banking during this period. In 2004, banking correspondents accounted for forty-two percent of all financial service points, compared to less than thirteen percent in 2000.

Brazil's second largest bank, Caixa Econômica Federal (CEF) was the first to enter this segment, in 2000, by expanding on its existing partnership with the national chain of lottery shops (Casas Lotéricas). CEF initially contracted Casas Lotéricas to provide services such as the payment of social benefits and bill payment. The largest private bank in Brazil, Bradesco, followed with a correspondent arrangement with Brazil's postal services in the year 2001 to provide financial services, following a national auction of the postal franchise. The first postal bank was launched in 2002. More recent examples include Banco Popular do Brasil (BPB), a wholly owned subsidiary of Brazil's largest public bank, Banco do Brasil (BB), which operates its correspondents through a large network of supermarkets, pharmacies, bakeries and construction goods stores and Lemon Bank, a new private bank that provides financial services solely through banking correspondents using establishments similar to those used by Banco Popular. The four largest correspondent networks account for 76 percent of the total numbers of correspondents; the single largest one among them, the Caixa Econômica Federal (CEF) alone accounts for 37 percent.

Brazil's correspondents have gradually proceeded towards the provision of more complex financial services, although clearly their role in credit services is still very limited. While payments services dominate the financial services provided by correspondent

| Type of Service Post                | 2004          | 2003          | 2002          | 2001          | 2000          |
|-------------------------------------|---------------|---------------|---------------|---------------|---------------|
| <b>Total Service Points (000)</b>   | <b>90,871</b> | <b>82,676</b> | <b>74,336</b> | <b>57,950</b> | <b>46,283</b> |
| Of which:                           |               |               |               |               |               |
| Bank Branches (000)                 | 17,260        | 16,829        | 17,049        | 16,841        | 16,396        |
| Bank Service Points (PAB) (000)     | 6,687         | 6,845         | 7,108         | 7,318         | 6,562         |
| ATMs (000)                          | 25,595        | 24,367        | 22,428        | 16,748        | 14,453        |
| Other (000)                         | 3,171         | 3,211         | 3,042         | 2,928         | 2,933         |
| <b>Banking Correspondents</b>       | <b>38,158</b> | <b>31,424</b> | <b>24,709</b> | <b>14,115</b> | <b>5,939</b>  |
| Banking correspondents % (of total) | 42.0          | 38.0          | 33.2          | 24.4          | 12.8          |
| Credit Cooperatives                 | 1,436         | 1,454         | 1,430         | 1,379         | 1,311         |
| SCMs—Microcredit Companies          | 51            | 49            | 37            | 23            | 11            |

*Note:* PAB—*Posto de Atendimento Bancário* are bank service points that are set up on the premises of a private or public institution. They are attended by one bank staff member and may also include ATM services. They provide services to persons belonging to the institutions where they are installed.

*Source:* Central Bank of Brazil—Report: Evolution of the National Financial System 2004. The numbers refer to authorized correspondents only, actual numbers are estimated to exceed these.

arrangements, their share in total transactions and services provided has declined, and the share of traditional banking services has increased (Table 2). In 2002, invoice payments and receipts accounted for 86 percent by volume and 79 percent of the value of services offered by the five large correspondents. However, two years later in 2004 (based on six months' data), the share of invoice payment and receipts had declined by ten percent in volume and twenty percent in value terms while the values of deposits and withdrawals rose to almost a third of the total.

Credit operations however are only a small part of correspondent business, less than 0.2 percent of value in 2002. While they have increased over time, their share remains limited at below one percent of the value of transactions at end 2004. Using correspondent arrangements and POS devices for payments requires the lowest level of liquidity risk, as the device, or partner institution, does not have to be capable of entering into cash handling arrangements. With the addition of deposit and withdrawal facilities, cash counting, handling and storage become necessary and these require more sophisticated arrangements between the bank and the correspondent. Finally, if credit services are to be offered, services must be expanded to include loan appraisals and servicing, which involve credit risk responsibilities. At present, correspondents do not evaluate credit risk or assume credit decisions.

| Consolidated <sup>1</sup>                    | Jan–Jun 2004 |      | 2003         |      | 2002         |      | 2001           |      |
|--|--------------|------|--------------|------|--------------|------|----------------|------|
|  | No.          | %    | No.          | %    | No.          | %    | No.            | %    |
| <b>I—Transactions (millions)<sup>2</sup></b> |              |      |              |      |              |      |                |      |
| Deposit Accounts Opened                      | 3.7          | 0.6  | 2.3          | 0.4  | 0.6          | 0.2  | —              |      |
| Deposits                                     | 29.4         | 5.0  | 19.5         | 3.4  | 5.6          | 1.7  | 2.6            | 17.2 |
| Withdrawals                                  | 42.9         | 7.3  | 33.4         | 5.9  | 12.1         | 3.8  | 5.6            | 37.1 |
| Credit Transactions                          | 0.4          | 0.1  | 0.2          | 0.0  | 0.0          | 0.0  | —              |      |
| Payments/Benefits                            | 49.3         | 8.4  | 46.4         | 8.2  | 26.6         | 8.2  | 6.9            | 45.7 |
| Invoice Payment Receipts                     | 443.4        | 75.6 | 452.1        | 79.4 | 277.2        | 86.0 | — <sup>4</sup> |      |
| Other Services                               | 17.5         | 3.0  | 15.2         | 2.7  | 0.4          | 0.1  | —              |      |
| <b>Total</b>                                 | <b>586.6</b> |      | <b>569.1</b> |      | <b>322.5</b> |      | <b>15.1</b>    |      |
| <b>II—Values-(R\$ billion)<sup>3</sup></b>   |              |      |              |      |              |      |                |      |
| Deposits                                     | 9.2          | 17.8 | 5.9          | 14.5 | 0.8          | 4.6  | 0.5            | 33.3 |
| Withdrawals                                  | 7.5          | 14.5 | 5.3          | 13.0 | 1.6          | 9.2  | 0.6            | 40.0 |
| Credit Transactions                          | 0.2          | 0.4  | 0.1          | 0.2  | 0.0          | 0.0  | —              |      |
| Payments/Benefits                            | 4.1          | 7.9  | 3.0          | 7.4  | 1.2          | 6.9  | 0.4            | 26.7 |
| Invoice Payment Receipts                     | 30.4         | 58.7 | 26.3         | 64.5 | 13.7         | 78.7 | — <sup>4</sup> |      |
| Other Services                               | 0.4          | 0.8  | 0.2          | 0.5  | 0.1          | 0.6  | —              |      |
| <b>Total</b>                                 | <b>51.8</b>  |      | <b>40.8</b>  |      | <b>17.4</b>  |      | <b>1.5</b>     |      |

*Note:* 1/ Information supplied by Caixa Econômica Federal, Banco do Brasil, ABN Amro, Bradesco and the Lemon Bank. 2/ Amount accumulated in the year. 3/ Balance in the database. 4/ Not available.

*Source:* Central Bank of Brazil.



# Case Studies of Key Institutions Engaged in Correspondent Banking in Brazil

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The four largest players in the correspondent banking business in Brazil are two public banks (Caixa Econômica Federal and Banco Popular do Brasil) and two private banks (Bradesco and Lemon Bank). Table 3 presents the growth of correspondent bank operations of these banks from 2001 to 2004. In 2004, these banks accounted for more than seventy-five percent of all banking correspondents in Brazil. Caixa Econômica Federal had 14,268 correspondents, and it became the first financial institution to be present all over the country through bank correspondents. It accounted for more than thirty-seven percent of all banking correspondents, using its partnership with the country's lottery houses (Casa Lotéricas) and other partnerships. Bradesco, the largest private bank in Brazil had 4,276 correspondents (Banco Postal), and partners with the country's post offices (Correios). Lemon Bank (5,579 correspondents), and Banco do Brasil (4,695 correspondents), the majority of which are through its' subsidiary bank Banco Popular do Brasil, use a vast range of partnerships with supermarkets, drugstores, department stores and many other small businesses. Two other private banks, Banco ABN AMRO Real and Unibanco, also have a significant number of correspondents, but have not been included in this study. At the end of 2004, Banco ABN AMRO Real had 3,516 correspondents and Unibanco had 405 correspondents.<sup>15</sup>

## Caixa Econômica Federal

Caixa Econômica Federal initiated its operations when it was appointed as the agent of the Federal Government to distribute social benefits such as school grants, food and income subsidies. This required reaching remote locations and involved more than R\$2 billion a

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15. Central Bank of Brazil—Report: Evolution of the National Financial System 2004.

|   | 2004          | 2003          | 2002          | 2001         |
|---|---------------|---------------|---------------|--------------|
| Caixa Econômica Federal                     | 14,268        | 12,702        | 12,232        | 9,078        |
| Lemon Bank                                  | 5,579         | 4,642         | 1,740         | —            |
| Banco do Brasil<br>(includes Banco Popular) | 4,695         | 1,182         | 1,082         | 265          |
| Bradesco                                    | 4,276         | 4,276         | 2,689         | —            |
| <b>Total</b>                                | <b>28,818</b> | <b>22,802</b> | <b>16,003</b> | <b>9,343</b> |

Source: Central Bank of Brazil—Report: Evolution of the National Financial System 2004.

year. Caixa contracted the Lottery House Association (Associação Brasileira das Empresas Lotéricas (Abraelo)) to help it reach remote locations. From 2000, (after Resolution 2,707 of the Central Bank, which formally recognized correspondent banking) Caixa expanded the range of services offered by the lottery houses, which then became known as banking correspondents. The objective was to enable access to basic financial services to the Brazilian population via the lottery house network, with priority for the payment of social benefits and banking services (withdrawals, deposits, account balances, and statements).

A major challenge for achieving the new objective was upgrading the technology used. The terminals used in the lottery houses at the time, provided by the American firm GTECH, were not compatible with the new services. In 2000, Caixa created a new contract with GTECH, valid for 32 months, to develop network terminals (capable of providing lottery services and financial services) and to implement new services (banking correspondent and government payment services). A new phase of the logistical and technological plan was introduced in May 2005 for the maintenance and uninstalling of old terminals, and their replacement with new terminals offering a wider range of services.

By May 2002, Caixa had established its presence in over 5,500 municipalities—almost the entire country, with 11,000 correspondent outlets, and arranged for around 70 percent of payments from the Federal Government's Social Benefit programs, by way of magnetic cards. In 2003, almost 68 million benefits were distributed by the lottery houses, totaling R\$2.4 billion. At present, more than half of the invoices for public utilities such as water, electricity and telephone services are paid at lottery houses. Additional payments can include payments to other banks, other invoices, prepaid cellular phone credit, etc. Lottery houses also collect federal, state and municipal taxes, as well as union contributions. Lottery houses receive more than half of all tax declarations for those who are exempt, representing approximately 30 million people in 2004.

With new microfinance regulations introduced in 2003, the Caixa correspondent network expanded to include an additional 2,250 new correspondent outlets, thus increasing its total to more than 14,000, and adding around 2.8 million accounts. Significant in this phase was the establishment of accounts at other correspondent networks, beyond the lottery shops. One million accounts had been established by November 2003 and 2 million by July 2004. Currently, Caixa operates two thirds of its outlets through lottery houses and the remaining third outlets through local retailers in small locations where there are no lottery shops. With the lottery shop, investments are minimal, if any, whereas with other retailers investments could include point-of-service and communication equipment including satellite antennas.



Caixa brands its correspondent operations as Caixa Aqui. Products in Caixa Aqui are specially adapted for the low income segments, using measures outlined in the new regulations (using simplified account, with card only withdrawals, no minimum balance requirement, no fees, and no proof of income). Caixa Aqui outlets are mostly in remote areas and use existing retailers' employees at separate kiosk within the retailer, while the traditional down- to mid-scale Caixa branch with over 20 employees operates in urban areas. Caixa defines its correspondent networks as delivery channels and not as separate business segments, thus there is no separate accounting. Caixa Aqui customers are Caixa customers, so they can use all of Caixa's infrastructure and branch network. Caixa's traditional banking customers can also use the Caixa Aqui network.

Counting only branches and lottery houses, 134 million persons out of Brazil's population of 170 million people have access to Caixa in their own municipality. Those that do not have such access have to travel an average distance of 52 kilometers to access a Caixa outlet. By adding Simplified Lottery Houses, which are a scaled down version of regular lottery houses that can only be located in municipalities where no other lottery houses are present, the number of people with access to Caixa increases to 160 million, and the average distance of those without access falls to 24 kilometers. Finally, with the addition of Caixa's other correspondent bank outlets (comprising of retail businesses such as supermarkets and drugstores), the number of people with access to Caixa expands to the full 170 million people in the population and the dislocation falls to zero.<sup>16</sup> Table 4 shows a breakdown of the types of businesses most used by Caixa for banking correspondents, other than the lottery houses. The table shows that a greater variety of retail partners is used by Caixa in municipalities least served by traditional branch banking.

Accounts can be opened at any Caixa branch using only an ID card, CPF (tax file number) and proof of residence or an address declaration. The minimum age to open an account is 16. Caixa Aqui clients have access to the Caixa's entire network including

|                       | Type of Municipality        |                               |                          |
|-----------------------|-----------------------------|-------------------------------|--------------------------|
|                       | No access to Caixa Branches | Some access to Caixa Branches | Access to Caixa Branches |
| Supermarket           | 64%                         | 67%                           | 76%                      |
| General Store         | 11%                         | 4%                            | 6%                       |
| Bakery                | 5%                          | 0%                            | 6%                       |
| Drugstore             | 10%                         | 4%                            | 0%                       |
| Construction Material | 6%                          | 11%                           | 4%                       |
| Gas Station           | 2%                          | 0%                            | 1%                       |
| Butcher               | 2%                          | 15%                           | 6%                       |
|                       | 100%                        | 100%                          | 100%                     |

Source: Caixa Econômica Federal. November 2004.

16. Caixa Econômica Federal. Population numbers refer to the 2000 Census.

branches, lottery houses and other correspondents. Both credits and debits attributed to the account cannot exceed R\$1,000 per month. Clients are allowed four withdrawals and four account statements per month. Additional transactions are R\$0.50 each. Deposits and balance enquiries are free of charge.

**Table 5. Caixa Econômica Federal—Services at Caixa Aqui**

| Services Exclusive to Caixa  | Services currently offered at Caixa Aqui  | Services to be Added in Caixa Aqui  |
|--|---|---|
| <ul style="list-style-type: none"> <li>• Payment of Social Benefits (Fome-Zero, Bolsa-Família);</li> <li>• Payments available with the Citizen Card—<i>Cartão do Cidadão</i> (PIS, FGTS);</li> </ul> | <ul style="list-style-type: none"> <li>• Receive and forward proposals for opening simplified accounts;</li> <li>• Receive invoice payments, payment of benefits and other activities in accordance with agreements for rendering services;</li> <li>• Execution (active or passive) of payment orders in name of the client;</li> <li>• Personal credit</li> <li>• Withdrawals, deposits and balance statements</li> </ul> | <ul style="list-style-type: none"> <li>• Receive and forward proposals for loans and financing (overdraft, microcredit, personal loan);</li> <li>• Credit analysis and registration;</li> <li>• Receive and forward proposals for emitting credit cards;</li> </ul> |

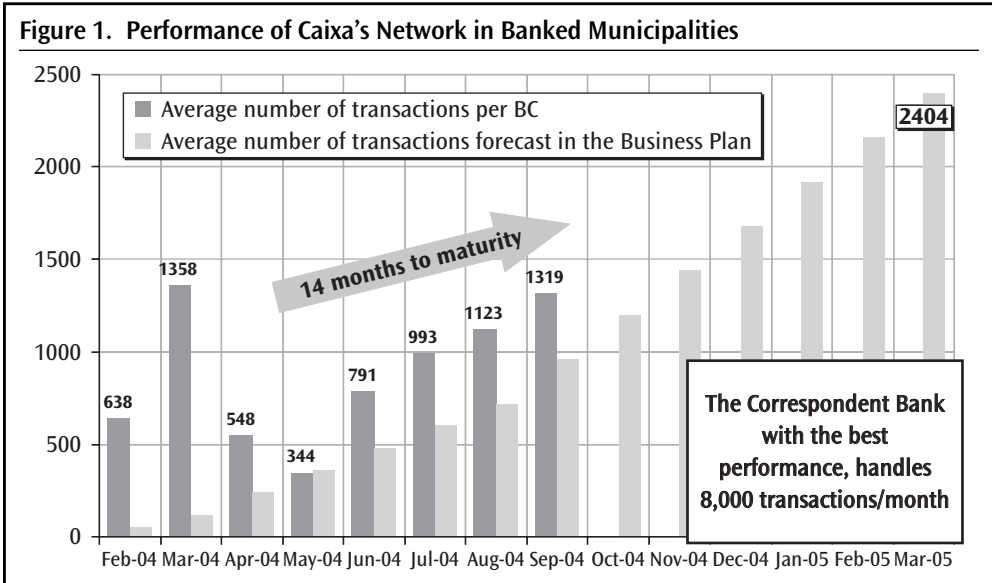
Source: Caixa Econômica Federal. November 2004. PowerPoint presentation.

While the lottery houses are traditional service outlets, retailers such as supermarkets, drugstores, and general stores run a separate business and are the typical point of contact of the low income population in remote areas. They have the advantage of friendliness but the possible caveat of locking in the customer pushing him or her to use parts of the deposits to buy goods in their store, particularly in the case of social benefits in rural areas. In the case of lending, credit risk is completely assumed by Caixa, which uses a simplified demographic credit scoring system, and there is no credit risk sharing with the retailer.

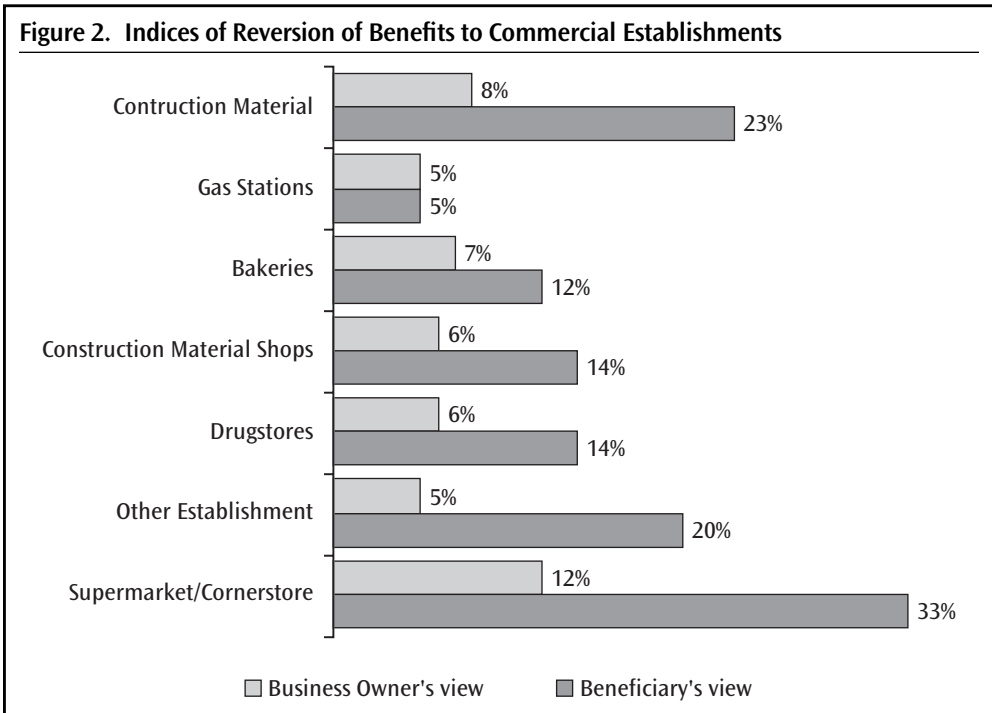
Caixa's business plan projected a return on investment within 36 months. The target was achieved in 18 months. Caixa's own depiction of its successful expansion is illustrated below.

Caixa points out that banking correspondent arrangements make a positive impact on the businesses that become correspondents. Research carried out by Vox Populi, an opinion polling firm, in 2003/2004 showed that the interest of business owners in becoming a correspondent to a bank (Caixa Aqui) was high.<sup>17</sup> Around three quarters of surveyed business indicated an interest in such contracting arrangements. Business owners already engaged as correspondents showed a 96 percent satisfaction rate and 88 percent of business owners reported an increase in sales (on average by 20 percent). The amount spent per client at the business increased by around 16 percent. Figure 2 shows that both busi-

17. Source: Caixa Econômica Federal. November 2004. PowerPoint presentation.



Source: Caixa Econômica Federal. November 2004. PowerPoint presentation.



Source: Caixa Econômica Federal. November 2004. PowerPoint presentation.

ness owners and customers perceive that benefits revert to the business establishment that has become a correspondent, although the perceived extent of such reversion varies.

The study found 93 percent of respondents to be satisfied with Caixa Aqui. The study showed that prior to the opening of a Caixa Aqui outlet in their municipality, 51 percent of respondent clients from municipalities without banking services had to travel more than an hour to get banking services. Additionally, 44 percent of respondents had to spend between R\$5–R\$15 in travel expenses each time. These expenses were greatly reduced with correspondent banking.

## **Banco do Brasil and Banco Popular do Brasil**

Banco do Brasil, another leading public bank of Brazil and a main competitor for Caixa Econômica Federal, adopted a different approach to correspondent banking. It promoted Banco Popular do Brasil as a wholly-owned subsidiary; Banco Popular has a separate legal identity and accounting framework from the parent bank, though most services are subcontracted from Banco do Brasil. This allowed it to have an apparently lean structure of only 70 staff in Brasilia, for almost one million new accounts opened. It was authorized to operate by the Central Bank of Brazil in December of 2003.<sup>18</sup>

Banco Popular contracts management companies which then subcontract local retailers (supermarkets, bakeries, and so forth) as banking correspondents to provide its services. These management companies must have a prior working relationship with Banco do Brasil and good credit standing. Banco Popular plans to have two of these companies per state. Initial investments are mostly undertaken by the management company and the retailer has to provide a telephone line only.

Banco Popular focuses primarily on Brazil's large informal market by offering simplified accounts and microcredit loans. Unlike the Caixa, lending constituted a large part of its proposed core business. A pilot program was launched at the end of 2003 and, with 350 correspondent banks in five cities. It grew to more than 4,000 at end-2004 via private bids to management companies all across the country.

Banco do Brasil's clients can use the Banco Popular correspondent network for account transactions, but Banco Popular clients cannot access the parent's network. Depending on the size of the establishment and its customer base, forms of service provision at the Banco Popular outlets vary from using existing employees of the correspondent retailer to having a dedicated employee managing a separate kiosk within the retailer. Customers have the benefit of using their accustomed neighbor outlet (supermarkets, drugstores, etc.).

Banco Popular, similar to Caixa Aqui, offers the use of simplified accounts, introduced in new legislation in 2003. The only documentation required is an identity card and a tax identification number. Every client is provided with a debit card to carry out transactions. The account has no monthly account maintenance fee and it provides 12 free transactions per month (4 statement enquiries, 4 withdrawals, and 4 deposits). Other services provided by the Banco Popular include basic life insurance, with coverage of R\$2,500 and a bi-annual premium of R\$12.00, and the receipt of invoice payments (Table 6).

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18. Law No. 10,738, of September 17, 2003.

**Table 6. Banco Popular do Brasil—Services**

| Services being provided   | Services proposed to be added  |
|---|--|
| <ul style="list-style-type: none"> <li>• Receive and forward proposals for opening simplified accounts;</li> <li>• Receive invoice payments, payment of benefits and other activities in accordance with agreements for rendering services;</li> <li>• Personal credit;</li> <li>• Withdrawals, deposits and balance statements;</li> <li>• Life insurance</li> </ul> | <ul style="list-style-type: none"> <li>• Receive and forward proposals for loans and financing (overdraft, microcredit, personal loan);</li> <li>• Savings account;</li> <li>• Capitalization account;</li> <li>• Receive and forward proposals for emitting credit cards</li> </ul> |

*Source:* Banco Popular do Brasil. November 2004. PowerPoint presentation.

In lending, credit risk is wholly assumed by Banco Popular; it uses an internally developed credit scoring system (both demographic and behavioral). The retailer only verifies identity. Banco Popular's credit system is unusual; it offers an initial line of credit of R\$50 to any client, and this can be later increased if serviced according to agreed terms. This initial credit limit is available to all account holders, with no initial waiting period, provided only that the client has a clean credit history with local credit scoring agencies (for example, SERASA, a Brazilian credit bureau which focuses on low income segments).<sup>19</sup> No proof of income or guarantees is required to secure the credit. Banco Popular has devised its own models for determining when and by how much a client's credit limit will be increased. This is a significant departure from traditional credit scoring models for small clients. Banco Popular hopes to establish its own credit information through the use of these methods.

The initial business plan involved US\$22 million in total investments as well as US\$100 million of zero cost funds on-lent by its parent institution, Banco do Brasil. In its first year of operations, the Banco Popular had a loss of R\$30.3 million, which corresponded to a third of what the directors had originally anticipated. The current business model predicts that Banco Popular will turn a profit only in 2007. However, the financial results by the end of 2005 were disappointing.

## **Bradesco and Banco Postal**

Banco Postal emerged in 2001 from a public bid promoted by the Brazilian Post Office (Empresa Brasileira de Correios e Telegrafos, ECT) and won by Bradesco, the largest private bank in Brazil. Bradesco paid R\$200 million; twice as much the second offer. It provided Bradesco with exclusive access to 5,300 of the 10,500 post offices all across Brazil. Bradesco then created Banco Postal as a wholly owned subsidiary. The Post Office already had a well developed technological platform and its own satellite communications network to distant regions and Bradesco only had to set up a line between the bank and the Post

19. See Kumar (2005), Chapter 6 for a fuller description of SERASA and its clientele.

Office Headquarters in Brasilia. Thus, incremental investment on either side has been minimal. Bradesco's contract with the Post Office included, by government stipulation, some provision regarding outreach to unserved municipalities. It required that by end 2002, that Banco Postal would be present in no less than 1,000 municipalities without banking services, which already had a post office. By end 2003, Banco Postal was to have reached all remaining municipalities without banking services.

| Country         | Number of Service Points | Value of Deposits (US\$) | Target Clientele   |
|-----------------|--------------------------|--------------------------|--|
| <b>Holland</b>  | 4,252                    | 25.1 million             | <ul style="list-style-type: none"> <li>• Young</li> <li>• Low/middle income</li> </ul>     |
| <b>France</b>   | 17,000                   | 5.8 billion              | <ul style="list-style-type: none"> <li>• Low/middle income</li> </ul>                      |
| <b>Germany</b>  | 13,500                   | 45.1 billion             | <ul style="list-style-type: none"> <li>• Young/old</li> <li>• Low/middle income</li> </ul> |
| <b>Japan</b>    | 24,000                   | 2 trillion               | <ul style="list-style-type: none"> <li>• Entire population</li> </ul>                      |
| <b>Spain</b>    | 10,700                   | N/A                      | <ul style="list-style-type: none"> <li>• Young/old</li> <li>• Low/middle income</li> </ul> |
| <b>Portugal</b> | 4,940                    | 0.3 billion              | <ul style="list-style-type: none"> <li>• Low/middle income</li> </ul>                      |
| <b>India</b>    | 154,000                  | 14.5 billion             | <ul style="list-style-type: none"> <li>• Low/middle income</li> </ul>                      |

*Source:* Bradesco. November 2004. PowerPoint presentation; World Bank (2002) for India data.

Banco Postal is a specific business unit of Bradesco, with separate accounting. However unlike at Banco Popular, customers of subsidiary and parent can use both networks. The post office network is used both in distant areas with poor or nonexistent banking infrastructure and to serve the unbanked in urban areas. According to interviews with bank management, low income people feel more comfortable entering a post office than a traditional bank branch, a situation that they call “the revolving door effect.”<sup>20</sup> Thus, the most successful Banco Postal correspondent outlet is located in downtown São Paulo.

Products offered by Banco Postal span a full spectrum of bank services; checking accounts, savings accounts, deposits, withdrawals and account balances, credit cards, bill payments, credit, and overdraft facilities. Banco Postal fees are lower than those of its parent bank Bradesco, as a result of the segmentation strategy of the financial holding. The post office does not sell other retail products, thus “locking in” customers is not an aim, unlike Caixa Aqui and particularly Banco Popular. In its lending services, a cautious approach is adopted. Amounts are very low (R\$50 to R\$100) and the credit risk is completely assumed by the bank as in the case of Caixa Aqui and Banco Popular.

The Banco Postal, unlike Caixa and Banco Popular, does not offer the simplified account. Banco Postal offers a regular current account that requires an identity card and tax number and proof of residence. Every client is provided with a debit card. The account

20. Indeed, banks are required to have revolving doors made of bullet proof glass, which can be jammed when the security guard is suspicious—low income clients often complain of being trapped in these ‘revolving doors’

### Box 1. A Case Study: Banco Postal

#### **On its first anniversary, Banco Postal opened a branch in Santa Rosa do Purus, Acre, one of the most remote and inaccessible cities in Brazil**

Santa Rosa do Purus is probably the most remote city in the State of Acre and one of most remote of Brazil. Bounded by the international border with Peru, it is inaccessible by road. Small aircraft may land on its improvised grass covered landing strip. Its river constitutes the main channel for transporting products and passengers but a journey to the capital, Rio Branco, takes eight days by boat and road. Lacking even basic sanitation, the city awaits progress. And progress has begun to manifest itself. On March 8, 2004, the inauguration of the local Banco Postal brought Santa Rosa do Purus a little closer to the rest of Brazil.

The new bank branch is connected to the Post Office's corporate network. It conducts online operations and has a public terminal with access to the Internet for the general population. It represents a technological leap unprecedented in the brief history of a city which until recently had only two sources of media: an amateur radio and the loudspeaker of the local church. "The inauguration of Banco Postal is a symbolic act of great meaning for the Brazilian Amazon and for the isolated populations of the country", said one of the inaugural senators. "It is an initiative of national integration, of social inclusion and consolidation of citizenship by means of communication."

The Mayor viewed the arrival of the Banco Postal with satisfaction. "Every month, the city hall faced difficulties paying wages", he explained. "The new channel is more secure as well as more convenient. Now the local government can pay its 100 federal and state government employees directly at the Banco Postal, which also collects its municipal, state and federal taxes. And life will also be easier for our 200 retirees and pensioners, who can now receive their money without having to travel outside the city."

"The result of this small monetary revolution is an increased volume of money in circulation, benefiting commerce and generating jobs", continued the Mayor. "Santa Rosa do Purus needs this liquid capital to develop. Its population, which has a strong indigenous presence, includes some 2,250 inhabitants, 80 percent of whom lives in rural areas. Illiteracy is high, affecting practically 50 percent of all inhabitants. Besides helping the local economy, the opening of the Banco Postal, and its technology, will be fundamental in removing the city from isolation."

Selecting this distant city in Acre clearly symbolized the Post Office Bank's strategy of devoting attention to the country's social issues. Above all, however, Banco Postal wants to characterize its project as a mechanism of inclusion, reaching out to a public of 45 million unbanked Brazilians. And, it points out, Banco Postal is also an excellent instrument for conducting business and supporting entrepreneurship.

*Source:* Based upon materials at: <http://www.correios.com.br/>

has a monthly fee of R\$3.80 and provides up to 14 free transactions per month (4 statement enquiries, 4 withdrawals, 4 account balances, and 2 transfers). Discounts on the monthly fee are available thorough the use of other products. Additional transactions cost an extra R\$0.55. Other services provided by the Banco Postal include the receipt of invoice payments, personal credit and checking facilities (Table 8).

Each post office branch with a Banco Postal is linked to a Bradesco branch via satellite so that transactions can be conducted in real-time using Bradesco's network. The Correios' staff are trained by the parent bank, Bradesco, to provide information on their products. Banco Postal is open longer hours than a regular Bradesco branch. Similar to Caixa, Banco Postal account holders are also Bradesco clients and have access to all the same services provided to regular Bradesco customers (for example, internet and phone banking, access

**Table 8. Services Offered by Banco Postal**

- Receiving and forwarding proposals for opening accounts
- Receiving invoice payments, payment of benefits and other activities in accordance with agreements for rendering services
- Personal credit
- Withdrawals, deposits and balance statements
- Requesting debit cards and checkbooks
- Payments (salaries, benefits, etc.)
- Receiving and forwarding proposals for loans and financing

Source: Correios website (Brazilian Post Office): <http://www.correios.com.br/>

to the entire Bradesco ATM network, and so forth). Some limits do apply depending on the type of transaction. Table 9 suggests that Banco Postal significantly increases outreach of financial services in Brazilian Municipalities.

## Lemon Bank

Lemon Bank, unlike the preceding cases, is a new venture, led by the former Argentine founders of a financial service company, who reinvested the sales proceeds of a part of their business empire in the establishment of the Lemon Bank. Lemon Bank began operations in June 2002, with an initial investment of US\$40 million. A private bank, devoted exclusively to correspondent banking, it has no opportunities for cross subsidies or synergies with a parent institution. Its one office in São Paulo serves as its headquarters, together with its network of 5,579 correspondent banking outlets across the country. These outlets are mainly retailers (minimarkets, pharmacies) and payment outlets subcontracted by management companies. Investments include PCs, POS, and telecommunications equipment costing around R\$1,500 to R\$3,000. These costs are borne by the bank, which owns the equipment until termination of contract. The mode of delivery of services to the final client varies. In some locations, existing employees of the correspondent are used to pro-

**Table 9. Banco Postal in Municipalities: Role in Enhancing Access (2004)**

| <b>Bradesco—Banco Postal</b>   | <b>Qty</b> | <b>%</b> |
|--|------------|----------|
| Total number of Municipalities in Brazil   | 5,561      |          |
| Total number of Municipalities attended by the Correios  | 4,683      | 84%      |
| Municipalities served by Banks and attended by the Correios  | 3,093      | 56%      |
| Municipalities unserved by Banks and attended by the Correios  | 1,590      | 29%      |
| Municipalities served by the Bradesco Group directly   | 1,388      | 25%      |
| Municipalities not served by Bradesco and attended by the Correios (other banks or totally unserved) | 3,295      | 59%      |

Source: Bradesco.



vide services; in others, a separate kiosk has been established within the correspondent's premises, manned by a bank employee or by staff of the management company.

The primary target clientele of Lemon Bank are the unbanked in dense urban areas. As in the case of Banco Postal, a full spectrum of products is offered but with lower fees than at a conventional branch. The "simplified account," offered under Brazil's regulations to expand access, is not used.<sup>21</sup> Lemon Bank offers five different current accounts that vary in the number of free transactions offered and cost between R\$0–R\$15 per month. Credit services are also offered and, in this case, there is some basic risk control mechanism as the owner of the outlet provides an opinion based on customer history. Additionally, formal credit evaluation and approval processes are applied by the Bank.

Lemon Bank's Conta Brasil, a current account, can be opened by anyone with proof of residence, identity and tax documents. Proof of income is not required. Clients have to pay a fee from R\$0.30–R\$1.00 for each transaction above the five free transactions permitted per month.<sup>22</sup> The overall business model is therefore full spectrum service provision at low cost, for a somewhat restricted package. However, there is no dependence on the capital or facilities of a parent institution, and conventional methods, combined with some additional information based on local knowledge, are used for risk appraisal.

## Case Studies: A Summary

Table 10 presents a comparative matrix of the four case studies. It can be seen that a wide variety exists in almost all factors. Both public and private institutions are involved, as stand alone, wholly separated subsidiaries, or as integrated parts of the business organization of large institutions. The terms of services provided, fees charged, and risk assessment methodologies vary.

These four banks have different delivery models in terms of business orientation, segment focus, products offered, type of outlets, risk sharing, and several other mechanisms. For the larger banks, contracting institutions are typically responsible for providing the correspondent with basic equipment, training, and marketing materials. The financial institutions can either do this directly or they can contract intermediaries to do this on their behalf. Caixa Econômica Federal and Bradesco have their own specialized departments for banking correspondents. In contrast, Lemon Bank and Banco Popular use intermediaries to expand their network of banking correspondents. Intermediaries are remunerated on a "fee for service" basis. Caixa Econômica Federal and Bradesco also benefited from their partnerships with the Lottery Houses and Post Offices, respectively, as the technological infrastructure was already in place and needed minimal modifications to begin operations.

Each of the four banks reduces the cost of providing services (regulatory-adherence costs, variable costs, and fixed costs) and in some cases mitigates risks. While the cost of opening a bank branch can vary from half to one million reais, the initial investment needed to connect a correspondent outlet, in terms of POS device, varies between R\$1,500 and R\$5,000. Connectivity charges are around R\$400 per month. Personnel costs decreases

21. The simplified account, introduced in 2003 by the government, is discussed further in Section 6 below.

22. The five free transactions refer to Lemon Bank's basic 'use and pay' account with a zero monthly cost. Other paid accounts offer more free transactions.

| Particulars                                  | Caixa Econômica                                | Banco do Brasil                                | Bradesco   | Lemon Bank  |
|--|--|--|--|---|
|  | Federal<br>Caixa Aqui)                         | (Banco Popular)                                | (Banco Postal)                                       |   |
| Year Started                                 | 2003   | 2003   | 2001   | 2002  |
| Ownership                                    | Public   | Public   | Private  | Private   |
| Number of Correspondents by end 2004         | 14,268   | 4,695  | 4,276  | 5,579   |
| Nature of Correspondents                     | Lottery houses and other retailers.            | Retailers                                      | Post-offices   | Retailers and payment outlets.  |
| Institutional Arrangement                    | Integrated with parent                         | Fully-owned subsidiary of parent               | Business unit of parent                              | Exclusive correspondent bank.   |
| Service delivery personnel                   | Existing employees of correspondent            | Existing employees and separate kiosk          | Existing employees of correspondent                  | Existing employees and separate kiosk   |
| Current Account Type                         | Simplified                                     | Simplified; debit card                         | Regular; debit card                                  | Regular   |
| Documents needed for opening account         | Identity Card, tax number, and residence proof | Identity Card and tax number                   | Identity Card, tax number, and residence proof       | Identity Card, tax number, and residence proof                                    |
| Products offered                             | Full spectrum basic products                   | Full spectrum                                  | Full spectrum  | Full spectrum, including credit.  |
| Free transactions                            | 8 per month                                    | 12 per month                                   | 14 per month   | 5 per month   |
| Fees   | R\$ 0.50 per transaction over free transaction | R\$ 0.50 per transaction over free transaction | R\$3.80 monthly; R\$0.55 for additional transactions | Up to R\$15.00 monthly; R\$0.30 to R\$ 1.00 per transaction over free transaction |
| Who takes Credit risk?                       | Bank   | Bank   | Bank   | Lemon Bank  |
| Credit Risk assessment                       | Simplified demographic credit scoring system   | Internally developed credit-scoring system     | Small initial amounts                                | Conventional methods  |
| Correspondent clients can use Parent network | Yes  | No   | Yes  | Not Applicable  |
| Parent clients can use correspondent network | Yes  | Yes  | Yes  | Not Applicable  |

from R\$3,000 for a typical bank employee to R\$1,500 for a typical retail store employee, even if employed whole time. Furthermore, while bank regulations require the whole time employment of branch bank staff, a correspondent can function with the marginal time of existing employees. All of these factors significantly reduce the break-even point for operations to be profitable.

True, lower startup investments and ongoing costs are partly due to regulatory arbitrage (lower security requirements, absence of a unionized bank labor force), but there is still a big market-driven difference due to economies of scale. Initial investments for a correspondent outpost can be as low as 0.5 percent of those of a traditional bank branch, and ongoing costs are negligible if existing employees and information and communications networks are used.



# Role of Correspondent Banking in Expanding Access to Financial Services

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## Regional Penetration

To what extent have correspondent bank arrangements succeeded in taking financial services to small and underserved municipalities, or to remote regions of Brazil? At end 2000, of the 5,636 municipalities in Brazil, 1,659 municipalities had no bank services (branches or bank service outposts), and 10 were served solely by bank correspondents (Table 11). By the end of 2003, thanks to correspondents, no municipalities remained without services, demonstrating the potential of this new form of outlet for geographic outreach in thinly served locations. In 2002, correspondents accounted for a large proportion of financial services in the poorer North and Northeast; municipalities served only by correspondents comprise 51 and 42 percent, respectively (Table 12).<sup>23</sup>

However, the majority of corresponding banking outposts were located in municipalities, which had branch banking services. In the more prosperous southern part of the country, only 17 percent of the municipalities in the South, or 15 percent in the Southeast, were served by correspondents alone. In the urban agglomeration of Rio, only one of the 917 correspondents in Rio de Janeiro was in an unserved municipality; 91 out of 92 municipalities in Rio already enjoyed some form of financial services. In the state of São Paulo, there were 2,820 correspondents in its 646 municipalities, including 26 municipalities served only by correspondents (Appendix Table A1.1). These data suggests that even in areas already having banking services, correspondent outlets serve a niche by serving specific client segments. This was emphasized by banks interviewed, who pointed out that

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23. This proportion is as high as 72 and 71 percent, respectively, in the Northeastern states of Rio Grande do Norte and Piauí and 71 and 63 percent, respectively, in the Northern states of Tocantins and Roraima (Appendix Table A1.1).

**Table 11. Financial Services in Municipalities—Role of Correspondents (2001–04)**

|  | Oct. 2004 | 2003  | 2002  | 2001  | 2000  |
|--|-----------|-------|-------|-------|-------|
| Municipalities                                       | 5,578     | 5,578 | 5,658 | 5,654 | 5,636 |
| Municipalities with bank branches                    | 3,831     | 3,978 | 3,993 | 3,973 | 3,977 |
| Municipalities served only by correspondents         | 1,747     | 1,600 | 1,577 | 237   | 10    |
| Municipalities with neither banks nor correspondents | 0         | 0     | 88    | 1,444 | 1,649 |

Source: Central Bank of Brazil.

**Table 12. Financial Services in Regions of Brazil—Role of Correspondents (2002)**

| Geographical Region | No. of municipalities | No. of correspondents | Municipalities served only by correspondents | % Municipalities served only by correspondents | Municipalities without a branch or banking outpost | Municipalities without correspondent, branch or banking outpost |
|---------------------|-----------------------|-----------------------|--|--|--|---|
| Northeast           | 1,840                 | 3,743                 | 768  | 42   | 818  | 50  |
| North               | 470                   | 920                   | 239  | 51   | 260  | 21  |
| Central-West        | 482                   | 1,209                 | 113  | 23   | 119  | 6   |
| Southeast           | 1,670                 | 5,793                 | 257  | 15   | 261  | 4   |
| South               | 1,196                 | 2,484                 | 200  | 17   | 207  | 7   |
| <b>Total</b>        | <b>5,658</b>          | <b>14,149</b>         | <b>1,577</b>                                 | <b>28</b>                                      | <b>1,665</b>                                       | <b>88</b>   |

Source: Central Bank of Brazil—Report: Evolution of the National Financial System 2002.

lower income people tend to prefer to receive services in stores or through familiar agents, perceived to be friendlier than regular branches.

## Poverty Outreach

Table 12 showed that the less prosperous North and Northeast regions have a larger proportion of municipalities where financial services are provided only by correspondents. The benefit from correspondents to low-income population is further underscored if one looks at data on regional population and per capita income (Table 13). Brazil's Northeast has the lowest regional GDP per capita but the population served per correspondent outlet is approximately the same as that in the affluent states of the South and South East, where per capital income is more than twice as high.

More evidence on the benefits of correspondent arrangements to underserved population can be gleaned from the data provided by some banks on the income profile of their correspondent clients (Table 14). Eighty seven percent of Caixa Econômica Federal's clients earn less than R\$400 per month; in the case of Bradesco, 73 percent of its clients belong to this group.

**Table 13. Poverty Outreach of Correspondent Banking (2004)**

| Regions       | Population<br>(million) |      | GDP/<br>capita<br>R\$ | No. of<br>Correspondents |      | Population<br>per<br>correspondent<br>in 000 |
|---------------|-------------------------|------|-----------------------|--------------------------|------|--|
|               | 2000                    | %    | 2000                  | Nov. 2004                | %    |  |
| Northeast     | 47.7                    | 28.1 | 3,010                 | 6,206                    | 26.4 | 7.7  |
| North         | 12.9                    | 7.6  | 3,910                 | 1,405                    | 6.0  | 9.2  |
| Central-West  | 11.6                    | 6.8  | 6,560                 | 2,493                    | 10.6 | 4.7  |
| South         | 25.1                    | 14.8 | 7,690                 | 3,556                    | 15.2 | 7.1  |
| Southeast     | 72.4                    | 42.6 | 8,770                 | 9,801                    | 41.8 | 7.4  |
| <b>Brazil</b> | 169.8                   |      | 6,470                 | 23,461                   |      | 7.2  |

*Note:* Data here refers only to the 4 largest players: Caixa Econômica Federal, Bradesco, Lemon Bank and Banco Popular.

*Source:* GDP and population data—IPEA Brazil. Data on correspondents are submitted by individual banks and thus may not have the same totals as Central Bank data.

Looking at individual financial institutions, the public bank Caixa provided for over 40 percent of the correspondent services of relatively poor regions such as the North and Northeast (Table 15). But on examining the breakdown of its business, almost two thirds (64 percent) was in the affluent South and Southeast. By contrast, Banco Popular and Bradesco, the private banks, had around 43 percent of their portfolio in the South and Southeast. The privately owned Lemon Bank was in between, with around 55 percent in the South and Southeast. Thus public banks do not appear to have an intrinsic advantage in terms of penetration through correspondent networks, unlike traditional branch networks.

The differences noted here in the regional engagements of the banks reflect deeper differences in their orientation, their methods of functioning, and their business delivery models.

**Table 14. Income Profile of Correspondent Clients (%)**

|                                  | Up to<br>R\$200   | R\$200.01–<br>R\$400 | R\$400.01–<br>R\$800 | Above<br>R\$800 |
|----------------------------------|-------------------|----------------------|----------------------|-----------------|
| Caixa Econômica Federal (Public) | 47.9              | 39.2                 | 8.6                  | 3.6             |
| Bradesco—Banco Postal (Private)  | 58.0 <sup>1</sup> | 15.0 <sup>2</sup>    | 17.0                 | 10.0            |

*Note:* <sup>1/</sup> Data for Bradesco is for income up to R\$260.00

<sup>2/</sup> Data for Bradesco is for income from R\$260.01–R\$400.00

*Source:* Individual banks.

|                               | Total       |               | North      |                     | North-east |                     | Central-West |                      | South      |                      | South-east |                      |
|-------------------------------|-------------|---------------|------------|---------------------|------------|---------------------|--------------|----------------------|------------|----------------------|------------|----------------------|
|                               | (000s)      | %             | (000s)     | %                   | (000s)     | %                   | (000s)       | %                    | (000s)     | %                    | (000s)     | %                    |
| Caixa<br>Econômica<br>Federal | 11.9        | 100<br>(50.6) | 0.6        | 5.3<br>(45.1)       | 2.7        | 22.5<br>(43)        | 1            | 8.3<br>(39.7)        | 2.2        | 18.9<br>(62.9)       | 5.3        | 45<br>(54.5)         |
| Bradesco–<br>Banco<br>Postal  | 5.3         | 100<br>(22.6) | 0.4        | 8.4<br>(31.7)       | 1.6        | 30.3<br>(25.9)      | 0.5          | 9.6<br>(20.4)        | 1          | 18.3<br>(27.3)       | 1.8        | 33.5<br>(18.1)       |
| Lemon Bank                    | 3.8         | 100<br>(16.0) | 0.1        | 2.7<br>(7.1)        | 1.1        | 29.3<br>(17.7)      | 0.6          | 16<br>(24.1)         | 0          | 0                    | 2          | 52<br>(19.9)         |
| Banco<br>Popular              | 2.5         | 100<br>(10.8) | 0.2        | 8.9<br>(16.2)       | 0.8        | 32.8<br>(13.4)      | 0.4          | 15.6<br>(15.9)       | 0.3        | 13.7<br>(9.8)        | 0.7        | 29<br>(7.5)          |
| <b>Total</b>                  | <b>23.5</b> |               | <b>1.4</b> | <b>6.0</b><br>(100) | <b>6.2</b> | <b>2.6</b><br>(100) | <b>2.5</b>   | <b>10.6</b><br>(100) | <b>3.6</b> | <b>15.3</b><br>(100) | <b>9.8</b> | <b>41.7</b><br>(100) |

*Note:* Figures in parentheses refer to the share of each individual bank in the region.

*Source:* Individual banks.



# Legal and Regulatory Measures Impacting on Correspondent Banking

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**T**o what extent was the growth of correspondent banking fostered by specific regulatory changes? There are at least three broad areas of such regulation which could impact upon the growth of correspondents. First, those rules which pertain directly to correspondent banks. Second, regulations which pertain to traditional branch banking system but which indirectly impact the growth of correspondent banking by altering the choices, or relative profitability, of bank branch services compared to correspondents. These refer particularly to rules dealing with the operation or governance of bank branch services, compared to correspondent outlets. And third, regulations concerning other forms of business obligations for banks, which increase or reduce the attractiveness of correspondent banking. A number of such measures were introduced in recent years; some of these eased the access of persons to bank accounts, and thus arguably made it easier for correspondent business to expand, while others posed obligations on banks' business with certain segments and could thus have constrained the growth of correspondent banking. This section reviews relevant provisions in each of these areas, and comments on their likely relevance for the growth of correspondent banking.

## Regulations Governing Correspondents

Legislation for banking correspondents began with Circular 220 (1973), Resolution 562 (1979) and Resolution 2,166 (1995). Up until this point, services to be rendered were limited, mostly to the receipt of funds, a situation which remained practically unchanged until August 1999.<sup>24</sup>

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24. Details are provided in Appendix Table A1.3.

A series of measures to consolidate, clarify and extend the old rules, over 1999 to 2000, allowed banking correspondents to become one of the main mechanisms for the popularization of access to financial services in Brazil. Resolution 2,640 of (1999) permitted banking financial institutions to formally contract companies as banking correspondents, to provide a range of financial services, including receiving proposals for opening sight (demand) deposit accounts, term deposit accounts and savings accounts, conducting receipts and payments, and receiving financing proposals, previously carried out only at bank branches.<sup>25</sup> Initially, this was permitted only if bank branch services were not available, but shortly after, Resolution 2,707 (2000) eliminated the restriction of operating in unattended areas alone.<sup>26</sup>

Circular 2,978 (2000) introduced new guidelines for the process of contracting correspondents and detailed contracting institutions' obligations to provide information to the Central Bank.<sup>27</sup> Resolution 2,953 (2002), extended permission to review a bank's clients' data deemed necessary to open/maintain a deposit account, on the financial institution's behalf, to correspondents authorized by the Central Bank of Brazil.<sup>28</sup> Thus the Central Bank took on an active role of oversight at least with regard to the provision of information from contracting institutions.

A new regulation in 2003 allowed correspondent arrangements to be extended to certain financial institutions in addition to banks. Resolution 3,110 (2003)<sup>29</sup> extended permission to contract correspondents to investment banks, finance companies and savings and loans associations. Subsequently, Resolution 3,156 (2003)<sup>30</sup> extended the faculty of contracting to all financial institutions and other institutions authorized to operate by the Central Bank.

Thus, authorities in Brazil created an enabling environment, by clarifying the nature of services covered, the financial institutions involved, and the nature of reporting obligations accompanying contracting arrangements. Central Bank approval was required for deposit taking services and certain other services. While initially targeted explicitly at expanding services to geographically remote areas, the role of such arrangements in bringing services to the underserved in a variety of locations was recognized and accepted, so that such arrangements became as potentially valuable for the urban poor as for the geographically remote.

## Comparison of Regulations: Bank Branch Services vs. Correspondents

Banking correspondents have advantages over other types of service points, such as bank branches, as not all of the regulations that apply to financial institutions apply to corre-

25. CMN Resolution 2,640 of August 25, 1999.

26. CMN Resolution 2,707, of March 30, 2000.

27. Financial institutions contracting companies to provide 'banking' services would require prior authorization from the Central Bank of Brazil and would need to show the companies' information, the names of signatories, a copy of the contract, and a list of the municipalities involved. There was a simplified process for 'other financial services' where prior approval of the Central Bank was not needed, though information on the services to be rendered, important dates involved, and the municipalities to be involved still needed to be sent to the Central Bank. Circular 2,978, of April 19, 2000.

28. CMN Resolution 2,953, of April 25, 2002.

29. CMN Resolution 3,110, of July 31, 2003.

30. CMN Resolution 3,156, of December 17, 2003.

**Box 2. Services Provided by Correspondents (Resolutions 3,110 and 3,156)—  
Current Legislation**

**Banking Services**

(Authorization from the Central Bank required)

I—receiving and forwarding proposals for opening sight (demand) deposit accounts, term deposit accounts and savings accounts;

II—receipts and payments relative to sight (demand) deposit accounts, term deposit accounts and savings accounts, as well as contributions and withdrawals in investment funds;

**Other Financial Services**

III—receipts, payments and other activities linked to accords for the rendering of services kept by the contractor in the form of the current regulation;

IV—active or passive execution of payment orders in the name of the contractor;

V—receiving and forwarding loan requests and financing requests;

VI—credit analysis and registration;

VII—execution of collection services;

VIII—receiving and forwarding proposals for emitting credit cards;

IX—other control services, including data processing, from convened operations;

X—other activities, within the criteria permitted by the Central Bank of Brazil.

spondents. Regarding the physical security of the premises, the legislation pertaining to the security of financial establishments (Law 7.102, of 1983, modified by Law 9.017, of 1995) is not applicable to correspondents in Brazil, and the responsibility is that of the contracting institution, as established in the regulation. Also, security of information, rendering of services and depositing of funds, occurrence of fraud and other crimes practiced against account holders (theft of checks and magnetic cards, improper password access, and so forth) are the total responsibility of the contracting institution. With regards to money laundering, the contracting institution cannot be exempted of its responsibility for the prevention of crimes of this kind, even in the case of contracting a correspondent for the rendering of services (Law 9,613, of 1998, articles 9, 10 and 11, determines that the institutions of the National Financial System are directly responsible for the identification of the customers and the registering of operations). Banking secrecy legislation (also sentencing) includes not only the contracting institution, but also the contracted company and its employees. Correspondent activity does not characterize, by itself, nonfulfillment of the rules of secrecy.

It is also pointed out that banks are obliged, in the opening of new branches, to provide high levels of security (including cameras, strong rooms, revolving doors), which add considerably to branch costs not only on a one-time but also ongoing basis. Moreover, bank employees are unionized and must be employed on a full time basis, and bank branches must remain open for a full business day, even if customer flow is limited. These restrictions can be considerably relaxed in a correspondent environment, where the employees of the contracting correspondent can provide banking functions on an as-needed basis. To the extent that correspondent's employees have training in financial products or services, or are better screened for security, this could also lead to some diminution of the risk of bank clients.

Regulations concerning liquidity management have not been issued so far. One advantage of the correspondent arrangement is that liquidity needs for dispensing or depositing cash can be shared between the business and its banking functions; however, how this is to be handled in the event of shortfall is not clear.

What are some of the challenges that regulators will face in the future? One question will be the differentiated treatment given in the case of one financial institution contracting another one (“correspondent bank”), and how much information is to be remitted to the Central Bank. Another area will be the specifics that involve cooperative banks contracting singular cooperatives (those not attached to a larger association of cooperatives). Additionally, future legislation will have to take into account the revision, and possible expansion, of the list of services that can be contracted, and the reevaluation of the parameters for the transferring of authority of a contract to third parties. In the medium term, the relaxation of safety and employment rules for opening correspondent outposts might have an impact on the currently stricter rules for bank branches.

## Parallel Changes in Regulations towards Microfinance

In 2003, the government introduced a series of measures intended to expand financial outreach. Key among these measures was a provision for “special deposit” accounts, for sight deposits, which offer a basic package of bank services, free of charge up to certain transaction limits, without checking facilities, and with all withdrawals by card only.<sup>31</sup> Balances are limited to R\$1,000, and conditions for opening a bank account are simplified, without the need for proof of income.

In addition, new regulations were also introduced which required all banks to earmark two percent of their sight deposits for microfinance lending. As many banks do not have the capacity for specialized microfinance operations, and recognize that such lending may require special design features for success, banks are seeking ways of fulfilling these obligations through specialized correspondent arrangements, or through bank subsidiaries which could cater to the needs of such clients. Banco do Brasil is relying extensively on Banco Popular for helping it to meet these obligations and Caixa Econômica Federal similarly relies on Caixa Aqui.

Table 16 shows the performance of microcredit since the new legislation was enacted. These refer to micro loans with interest capped at 2 percent per month. Public banks that offer simplified accounts, such as the Caixa Econômica Federal and the Banco Popular do Brasil, have an average microcredit loan size of around R\$228 and R\$86 respectively. Bradesco, Brazil’s largest private bank, has an average microcredit loan size of around R\$522.

Caixa Econômica Federal and Banco Popular do Brasil, both public banks, use the new simplified bank accounts (Table 17). Note that some of the simplified accounts initially opened, especially at Caixa and at Banco Popular do Brasil appear to have subsequently been closed. By contrast, Bradesco and Lemon Bank, both private banks, use common bank accounts which have been tailored for their correspondent networks and are not free of charge.<sup>32</sup> The public banks have more of a social obligation and as such, cater more

31. CMN Resolution 3,211 of June 30, 2004.

32. Lemon Bank does offer one type of free account with limited banking services available free of charge.

**Table 16. Microcredit Provided by Major Banks (August 2003–July 2005)**

|                                      | Number of<br>Contracts | Value<br>(R\$ thousands) | Average Loan Size<br>(R\$) |
|--------------------------------------|------------------------|--------------------------|----------------------------|
| Caixa Econômica Federal <sup>1</sup> | 2,820,450              | 642,926                  | 228                        |
| Banco Popular do Brasil              | 1,131,650              | 97,619                   | 86                         |
| Banco do Brasil                      | 1,601,936              | 708,336                  | 442                        |
| BASA <sup>2</sup>                    | 30,253                 | 16,661                   | 551                        |
| BNB <sup>3</sup>                     | 499,928                | 349,852                  | 700                        |
| Bradesco                             | 1,485,605              | 774,981                  | 522                        |
| <b>Total</b>                         | <b>7,569,822</b>       | <b>2,590,375</b>         | <b>342</b>                 |

*Note:* 1/ Includes CAIXA AQUI revolving credit operations, small pledge based credits (“*Micropenhor*”) and automatic credit from simplified accounts. 2/ Banco da Amazônia. 3/ Banco do Nordeste do Brasil—Includes resources used by Crediamigo for microcredit loans. *Source:* Ministry of Finance Brazil, October 2005, PowerPoint presentation “Microcredit and Microfinance under the Lula Government.”

**Table 17. Number of Simplified Accounts in Selected Banks (July 2005) (thousands)**

| Banks                        | Number of<br>Simplified Accounts |              |
|------------------------------|----------------------------------|--------------|
|                              | Active                           | Opened       |
| Caixa Econômica Federal      | 2,817                            | 3,296        |
| Banco Popular do Brasil      | 937                              | 1,621        |
| Banco do Brasil <sup>1</sup> | 926                              | 935          |
| BNB                          | 45                               | 154          |
| BASA                         | 24                               | 25           |
| <b>Total</b>                 | <b>4,750</b>                     | <b>6,031</b> |

*Note:* 1/ Beneficiaries of INSS (Social security). *Source:* Ministry of Finance Brazil, October 2005, PowerPoint presentation “Microcredit and Microfinance under the Lula Government.”

towards the lower end of the income range. These new legislative requirements are likely to have impacted upon the growth of client outreach of correspondent banking arrangements. However, they may not be essential for the development and success of such banking arrangements. At present, an attempt to assess the specific contribution of these measures in the overall success of correspondent banking has not been undertaken.



# Conclusions

## *Prospects in Brazil and Possibilities of Replication*

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**T**he differences and particularities of the cases described above may reflect initial variations of an emerging industry, where specific business models which will ultimately dominate are yet to be established. Or they may illustrate that there are a wide variety of models compatible with the phenomenon of correspondent banking.

However, it is clear that the industry is growing at a tremendous speed. It has become the primary form of financial access in remote areas where the population would otherwise have to go to another city to get social benefits or basic banking services. On the supply side, it allows outreach to the unbanked profitably, and allows risk sharing arrangements with retailers. Significantly lower initial investment and ongoing costs compared to traditional branch banking appear to be a prime driver. Perceptions of lower income population that retail or service outposts are more “friendly” than traditional bank branches also appears to have contributed to the growth.

Regulatory changes appear to have spurred the growing popularity of correspondent banking in varying degrees. Going forward, it would be important to investigate the robustness of the outcome with less emphasis on special accounts or special provisions compared to normal banking. It is worth speculating on whether the success story above builds a case for the relaxation of regulations on bank branching as much as a case for establishing correspondent banks, which may be a ‘second best’ solution, in the present circumstances where obstacles to normal bank expansion and account opening are significant. There is also a need for an evaluation of the outcome of increased risk taken, and also the extent to which correspondents have chosen to sustain the relationship over time. Services remain concentrated in the payments area. Clearly, expansion towards the provision of credit, which allows the correspondent to take on a larger role than conveying applications, has not yet occurred on a significant scale.

Brazil may have created an unusually favorable environment for correspondent banking. It is interesting that correspondent banking is not significant in countries such as the USA, by contrast, where first of all, premise sharing requires a clear rental arrangement and a separately demarcated area, due to regulations under the Bank Protection Act. Sharing of staff with a correspondent is also restricted, except in the case of credit unions, which are member-run and often have a closed membership. The per fee remuneration to the correspondent is also unknown. And the practice, at least, of some liquidity sharing with the correspondent would not be permitted. Brazil also offers some Central Bank oversight of the correspondent, which would not be available in many environments.

As for potential for replication, there are some regulatory issues that are very specific to Brazil, in particular, regulations regarding space and equipment for bank branches and agreements related to salaries of bank employees. These will clearly differ across countries, affecting the potential benefits to be gained from correspondent banking arrangements. In terms of account design, the need for the simplified account for the low income population is not clear, since in some cases the financial institutions decided not to leverage this new regulation and offer normal banking products, but with success similar to the others.

Efforts to replicate the Brazilian experience are underway. Prodem in Bolivia is following the Brazilian correspondent example and in 2005, set up 30 correspondent partnerships in gas stations and supermarkets. Banco Azteca in Mexico similarly established over 800 branches in 2002. It used the correspondent outlets of the Grupo Elektra stores, where the parent has long offered installment-plan financing for merchandise purchases and had a database with the credit records of 3 million customers. India is now taking a strong interest in the Brazilian model and has recently taken measures to introduce a version in India.

To summarize, while the specifics of costs and regulatory regimes could affect the details of profitability or differential advantage of correspondent banking compared to branch banking, the story of Brazil's success in correspondent banking nevertheless suggests a channel for financial institutions to increase outreach profitably. It allows them to gain proximity to small and perhaps higher risk clients through a format that is friendly to this population segment, but with significantly reduced startup investments and ongoing costs. Economies of scale allow this despite low balances and profit margins from business with these clients. Experience in developed countries is that use of POS devices continues to rise even after credit card use tapers off. This suggests that the future of POS devices such as those used by Brazilian correspondents is likely to continue to rise. This concept seems to be potentially replicable in most emerging markets, and particularly in those that face problems due to geographical remoteness in some parts of their territory. Nevertheless, increased risks faced by banks, their customers, and retailers must not be forgotten. Expansion beyond simple payment services to the provision of credit and more complex services will remain a challenge.



# Appendix Tables

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| State and Geographical Region | No. of Municipalities | No. of Correspondents | Municipalities Served Only by Correspondents | % of Municipalities Served Only by Correspondents | Municipalities w/o Banking Services | Municipalities with Correspondents w/o Banking Services |
|-------------------------------|-----------------------|-----------------------|--|---|-------------------------------------|---|
| Alagoas                       | 103                   | 192                   | 44   | 43  | 44                                  | 0   |
| Bahia                         | 418                   | 863                   | 84   | 20  | 84                                  | 0   |
| Ceará                         | 184                   | 438                   | 45   | 24  | 45                                  | 0   |
| Maranhão                      | 216                   | 378                   | 91   | 42  | 91                                  | 0   |
| Paraíba                       | 251                   | 394                   | 150  | 60  | 177                                 | 27  |
| Pernambuco                    | 185                   | 500                   | 44   | 24  | 45                                  | 1   |
| Piauí                         | 240                   | 369                   | 170  | 71  | 190                                 | 20  |
| Rio Grande do Norte           | 167                   | 343                   | 121  | 72  | 122                                 | 1   |
| Sergipe                       | 76                    | 266                   | 19   | 25  | 20                                  | 1   |
| <b>Northeast</b>              | <b>1,840</b>          | <b>3,743</b>          | <b>768</b>                                   | <b>42</b>   | <b>818</b>                          | <b>50</b>   |
| Acre                          | 23                    | 38                    | 13   | 57  | 13                                  | 0   |
| Amapá                         | 16                    | 28                    | 9  | 56  | 10                                  | 1   |
| Amazonas                      | 73                    | 169                   | 29   | 40  | 40                                  | 11  |
| Pará                          | 144                   | 324                   | 57   | 40  | 59                                  | 2   |
| Rondônia                      | 56                    | 123                   | 20   | 36  | 23                                  | 3   |
| Roraima                       | 16                    | 28                    | 10   | 63  | 11                                  | 1   |
| Tocantins                     | 142                   | 210                   | 101  | 71  | 104                                 | 3   |
| <b>North</b>                  | <b>470</b>            | <b>920</b>            | <b>239</b>                                   | <b>51</b>   | <b>260</b>                          | <b>21</b>   |
| Distrito Federal              | 17                    | 199                   | 0  | 0   | 3                                   | 3   |
| Goiás                         | 246                   | 557                   | 44   | 18  | 45                                  | 1   |
| Mato Grosso                   | 142                   | 249                   | 57   | 40  | 59                                  | 2   |
| Mato Grosso do Sul            | 77                    | 204                   | 12   | 16  | 12                                  | 0   |
| <b>Central-West</b>           | <b>482</b>            | <b>1,209</b>          | <b>113</b>                                   | <b>23</b>   | <b>119</b>                          | <b>6</b>  |
| Espírito Santo                | 78                    | 234                   | 0  | 0   | 1                                   | 1   |
| Minas Gerais                  | 854                   | 1822                  | 230  | 27  | 231                                 | 1   |
| Rio de Janeiro                | 92                    | 917                   | 1  | 1   | 1                                   | 0   |
| São Paulo                     | 646                   | 2820                  | 26   | 4   | 28                                  | 2   |
| <b>Southeast</b>              | <b>1,670</b>          | <b>5,793</b>          | <b>257</b>                                   | <b>15</b>   | <b>261</b>                          | <b>4</b>  |
| Paraná                        | 401                   | 889                   | 61   | 15  | 64                                  | 3   |
| Rio Grande do Sul             | 501                   | 1021                  | 98   | 20  | 101                                 | 3   |
| Santa Catarina                | 294                   | 574                   | 41   | 14  | 42                                  | 1   |
| <b>South</b>                  | <b>1,196</b>          | <b>2,484</b>          | <b>200</b>                                   | <b>17</b>   | <b>207</b>                          | <b>7</b>  |
| <b>Total</b>                  | <b>5,658</b>          | <b>14,149</b>         | <b>1,577</b>                                 | <b>28</b>   | <b>1,665</b>                        | <b>88</b>   |

Source: Central Bank of Brazil—Report: Evolution of the National Financial System 2002. Detailed data in a comparable format are not available for subsequent years.

| Most Used Products and Services                    | Maximum Value (R\$) |        |        |       |      | Unit           | Period   |
|--|---------------------|--------|--------|-------|------|----------------|--|
|  | Bradesco            | BB     | CEF    | Lemon | BPB  |                |  |
| <b>1. Data profile</b>                             |                     |        |        |       |      |                |  |
| 1.1—Client registration                            | 15.00               | 0.00   | 15.00  | 0.00  | 0.00 | per client     | per event  |
| 1.2—Renewal of client registration details         | 15.00               | 15.00  | 15.00  | 10.00 | 0.00 | per client     | Bradesco, BB & CEF every 360 days, Lemon 365, BPB 0. |
| 1.3—Inquiries regarding credit protection services | 0.00                |        | 16.00  |       | 0.00 | per occurrence | per event  |
| <b>2. Magnetic Card</b>                            |                     |        |        |       |      |                |  |
| 2.1—Common, for debit, withdrawal and inquiries    | 3.00                | 3.00   | 9.00   | 0.00  | 0.00 | per card       | Bradesco & BB every 30 days/Lemon & BPB 0, CEF 365   |
| 2.2—Debit, withdrawal and checking—annual fee      |                     |        | 19.00  | 0.00  |      | per card       | CEF every 180 days, Lemon 0                          |
| 2.3—Debit, withdrawal and checking—new card        |                     | 0.00   | 9.00   | 0.00  |      | per card       | per event  |
| 2.4—Multiple card—national—annual fee              | 60.00               | 45.00  | 48.00  |       |      | per card       | every 360 days                                       |
| 2.5—Multiple card—national—new card                | 60.00               | 0.00   | 0.00   |       |      | per card       | per event  |
| 2.6—Multiple card—international—annual fee         | 300.00              | 300.00 | 189.00 |       |      | per card       | every 360 days                                       |
| 2.7—Multiple card—international—new card           | 152.00              | 0.00   | 0.00   |       |      | per card       | per event  |
| 2.8—Additional Multiple card—national—annual fee   | 30.00               | 22.50  | 48.00  |       |      | per card       | every 360 days                                       |
| 2.9—Additional Multiple card—national—new card     | 30.00               |        | 0.00   |       |      | per card       | per event  |

(continued)

Appendix Table A1.2. Brazil—Bank and Banking Correspondents Tariffs (2005) (Continued)

| Most Used Products and Services   | Maximum Value (R\$) |        |        |       |      | Unit      | Period         |
|---|---------------------|--------|--------|-------|------|-----------|----------------|
|   | Bradesco            | BB     | CEF    | Lemon | BPB  |           |                |
| 2.10—Additional Multiple card—intern.—annual fee                            | 150.00              | 150.00 | 189.00 |       |      | per card  | every 360 days |
| 2.11—Additional Multiple card—intern.—new card                              | 150.00              | 0.00   | 0.00   |       |      | per card  | per event      |
| 3. Check  |                     |        |        |       |      |           |                |
| 3.1—Checkbook—10 checks   | 6.30                | 0.00   | 3.30   | 6.00  |      | per check | per event      |
| 3.2—Checkbook—20 checks (second checkbook in a month)                       | 9.70                | 6.60   | 6.60   | 8.00  |      | per check | per event      |
| 3.3—Business check  | 24.00               |        | 20.00  |       |      | per check | per event      |
| 3.4—Single Check  | 2.90                | 3.00   | 2.20   |       | 3.00 | per check | per event      |
| 3.5—Check returned due to insufficient funds                                | 14.00               | 10.00  | 10.00  | 10.00 |      | per check | per event      |
| 3.6—Cancellation/stop-payment of check                                      | 8.00                | 7.00   | 2.00   | 3.00  |      | per check | per event      |
| 3.8—Inclusion to the registry for bounced checks                            | 0.00                | 0.00   | 0.00   | 15.00 |      | per check | per event      |
| 3.9—Exclusion to the registry for bounced checks                            | 19.00               | 18.18  | 17.50  | 15.00 |      | per check | per event      |
| 3.10—Fee for cashing check  | 0.45                | 0.50   | 0.00   | 0.25  |      | per check | per event      |
| 3.11—TB Check (Bank Transfer w/o CPMF)                                      | 3.50                | 0.50   | 6.60   | 0.60  |      | per check | per event      |
| 3.12—Business Check with Value = or > R\$5.000,00 (fixed Value + %)         | 0.11%               |        | 0.07%  |       |      |           | per event      |
| 3.13—Fee for cashing Check with Value = or > R\$ 5.000,00 (fixed Value + %) | 0.11%               | 0.09%  | 0.07%  | 0.00% |      | per check | per event      |
| 3.14—TB Check with Value = or > R\$ 5.000,00 (fixed Value + %)              | 0.11%               | 0.09%  | 0.07%  | 0.00% |      | per check | per event      |

|  |       |       |       |       |       |                 |  |
|--|-------|-------|-------|-------|-------|-----------------|--|
| <b>4. Current Account</b>                                    |       |       |       |       |       |                 |  |
| 4.1–Opening account  | 0.00  | 0.00  | 15.00 | 0.00  | 0.00  | per account     | per event                                      |
| 4.2–Active account maintenance fee                           | 6.90  | 5.00  | 5.00  | 15.00 | 0.00  | per account     | every 30 days/BPB every 0 days                 |
| 4.3–Inactive account maintenance fee                         | 15.00 | 15.00 | 10.00 | 10.00 | 0.00  | per account     | every 30 days, BPB 0                           |
| 4.4–Advance deposit, incl. excess limit of overdraft account | 19.50 | 16.00 | 15.00 | 12.00 |       | per transaction | per event                                      |
| 4.5–Concession of overdraft account                          | 18.00 | 7.00  | 19.00 | 10.00 |       | per account     | per event                                      |
| 4.6–Renewal of overdraft account                             | 18.00 | 7.00  | 19.00 | 10.00 |       | per account     | Bradesco & Lemon every 90 days, BB 30, CEF 360 |
| 4.7–Direct debit from current account                        | 0.00  | 0.00  | 3.50  | 0.00  |       | per transaction | per event                                      |
| 4.8–Domestic Bank–main account (with limited access)         | 1.70  | 8.50  | 0.00  | 0.00  |       | per account     | Bradesco & BB every 30 days, Lemon & CEF 0     |
| 4.9–Domestic Bank–secondary account (with limited access)    | 1.70  | 6.00  | 0.00  | 0.00  |       | per account     | Bradesco & BB every 30 days, Lemon & CEF 0     |
| <b>5. Movement of Funds</b>                                  |       |       |       |       |       |                 |  |
| 5.1–Withdrawal at external ATM/banco 24 horas                | 1.75  | 2.00  | 2.50  | 2.75  |       | per withdrawal  | per event                                      |
| 5.2–Emission of DOC “C”                                      | 12.00 | 15.00 |       | 9.00  | 15.00 | per transaction | per event                                      |
| 5.3–Emission of DOC “D”                                      | 12.00 | 15.00 | 10.00 | 9.00  |       | per transaction | per event                                      |
| 5.4–Payment Order  |       | 21.00 | 20.00 |       |       | per transaction | per event                                      |
| 5.5–Deposit in another branch                                | 0.00  | 0.00  | 0.00  |       |       | per transaction | per event                                      |
| 5.6–Electronic Transfer–TED                                  | 12.00 | 15.00 | 15.00 | 9.00  |       | per transaction | per event                                      |
| <b>6. Account Balance</b>                                    |       |       |       |       |       |                 |  |
| 6.1–ATM  | 1.30  | 1.50  | 2.10  | 2.75  |       | per emission    | per event                                      |
| 6.2–By other means   | 2.00  | 5.00  | 2.10  | 2.75  | 0.50  | per emission    | per event                                      |

*(continued)*

| Most Used Products and Services                                 | Maximum Value (R\$) |        |       |       |       | Unit            | Period                              |
|---|---------------------|--------|-------|-------|-------|-----------------|-------------------------------------|
|   | Bradesco            | BB     | CEF   | Lemon | BPB   |                 |                                     |
| 6.3—Copies of microfilms, microfiches or similar                | 6.80                | 5.00   | 4.20  | 10.00 |       | per emission    | per event                           |
| <b>7. Collections</b>   |                     |        |       |       |       |                 |                                     |
| 7.4—Extension of expired invoice                                | 5.20                | 0.00   | 2.00  |       |       | per invoice     | Bradesco & CEF every 30 days / BB 0 |
| 7.5—Debt sent as protest  | 5.20                |        | 0.10  |       |       | per invoice     | per event                           |
| 7.6—Cancellation of protest                                     | 5.20                |        | 2.00  |       |       | per invoice     | per event                           |
| 7.7—Returned invoice  | 4.50                |        | 2.00  |       |       | per invoice     | per event                           |
| <b>8. Credit</b>  |                     |        |       |       |       |                 |                                     |
| 8.1—Credit opening (setup)                                      | 500.00              | 200.00 | 40.00 | 25.00 | 2.00% | per transaction | per event                           |
| 8.2—Debt negotiation  | 0.00                |        | 40.00 | 10.00 | 2.00% | per transaction | per event                           |
| 8.3—Guarantee substitution                                      | 100.00              | 150.00 | 30.00 |       |       | per transaction | per event                           |
| 8.4—Custody of pre-dated check                                  | 0.50                | 0.30   | 0.20  |       |       | per transaction | per event                           |
| <b>9. Other Services</b>  |                     |        |       |       |       |                 |                                     |
| 9.1—Replace original document                                   | 6.80                | 5.00   | 3.80  | 0.00  |       | per copy        | per event                           |
| 9.2—Reimbursement of expenses—telephone                         | 5.90                | 0.00   | 5.00  | 1.00  |       | per call        | per event                           |
| 9.3—Reimbursement of expenses—fax                               |                     | 0.00   | 5.00  | 1.00  |       | per sheet       | per event                           |
| 9.4—Placing documents in envelopes                              |                     |        | 2.50  | 3.00  |       | per envelope    | per event                           |
| <b>10. Foreign Capital and Foreign Exchange</b>                 |                     |        |       |       |       |                 |                                     |
| 10.1—Export: Creation of Foreign Exchange contract              | 503.00              | 190.00 |       |       |       | per transaction | per event                           |
| 10.2—Export: Creation of Foreign Exchange contract via Internet | 100.00              | 114.00 |       |       |       | per transaction | per event                           |

|  |        |        |                 |           |
|--|--------|--------|-----------------|-----------|
| 10.3–Export: Collection (cash-in a security) via Payment Order                     | 335.00 | 76.00  | per transaction | per event |
| 10.4–Export: Document confirmation   | 335.00 | 190.00 | per transaction | per event |
| 10.5–Export: Simplified Foreign Exchange (all of the clients expenses at the Bank) | 503.00 | 190.00 | per transaction | per event |
| 10.6–Import: Creation of Foreign Exchange contract                                 | 167.00 | 190.00 | per transaction | per event |
| 10.7–Import: Emission of Payment Order   | 167.00 | 380.00 | per transaction | per event |
| 10.8–Import: All other fees (does not include overseas expenses)                   | 335.00 | 380.00 | per transaction | per event |
| 10.9–Import: Simplified Foreign Exchange (all of the clients expenses at the Bank) | 503.00 | 76.00  | per transaction | per event |
| 10.10–Financing–Funds Received: Creation of Foreign Exchange contract              | 335.00 | 190.00 | per transaction | per event |
| 10.12–Financing–Funds Received: Collection via Payment Order                       | 503.00 | 380.00 | per transaction | per event |
| 10.13–Financing–Funds Received: Use of ROF   | 670.00 | 380.00 | per transaction | per event |
| 10.14–Financing–Funds Received: Use of ROF scheme                                  | 670.00 | 190.00 | per transaction | per event |
| 10.15–Financing–Funds Received: Registration in the Cademp                         | 503.00 | 76.00  | per transaction | per event |
| 10.16–Financing–Remittance of Funds: Creation of Foreign Exchange contract         | 335.00 | 190.00 | per transaction | per event |
| 10.18–Financing–Remittance of Funds: Emission of Payment Order                     | 335.00 | 380.00 | per transaction | per event |
| 10.19–Financing–Remittance of Funds: Alteration of ROF                             |        | 190.00 | per transaction | per event |

Source: Central Bank of Brazil

| <b>Appendix Table A1.3. Correspondent Banks in Brazil: Evolution of Enabling Legislation</b> |                        |   |
|--|------------------------|---|
| <b>Year</b>  | <b>Legislation No:</b> | <b>Major Provisions</b>   |
| 1973   | Circular 220           | <p>First norm to give the name of “correspondents” to companies providing banking services</p> <ul style="list-style-type: none"> <li>■ Permitted commercial banks to establish special contracts for the practice of correspondent functions</li> <li>■ Limited contracting of services and execution, active or passive, of payment orders in the name of the contractor</li> </ul>   |
| 1979   | Resolution 562         | <ul style="list-style-type: none"> <li>■ Permitted SCFIs to contract service rendering companies to forward financing requests, credit analysis and registration, ‘friendly’ collections and other control services of credit operations.</li> </ul>  |
| 1995   | Resolution 2,166       | <ul style="list-style-type: none"> <li>■ Extended permission given under Resolution 562 to multiple banks with credit, financing and investment portfolios, maintaining the other rules, including the limitation of services to be rendered, a situation which remained practically unchanged until August 1999.</li> </ul>  |
| 1999   | Resolution 2,640       | <p>Allowed the contracting of companies to render the following services (requires previous authorization from the Central Bank as per Circular 2,978, of 2000):</p> <ul style="list-style-type: none"> <li>■ Receiving and forwarding proposals for opening sight deposit accounts, term deposit accounts and savings accounts</li> <li>■ Receipts and payments relative to these accounts</li> <li>■ Contributions and withdrawals in investment funds</li> </ul> <p>Also:</p> <ul style="list-style-type: none"> <li>■ Determined that the new services can only be rendered in municipalities unattended by branches or any other bank outpost</li> <li>■ In cases where the installation of such outposts were to take place in such locations, the services would have to be cut off in 180 days</li> </ul> |
| 2000   | Resolution 2,707       | <ul style="list-style-type: none"> <li>■ Made the rules of Resolution 2,640 more flexible, eliminating the restriction of operating in unattended areas</li> <li>■ In the context of social, administrative and operational restructuring of the financial institutions, with the contracting of a network of branches</li> </ul>   |
| 2000   | Circular 2,978         | <p>Financial institutions contracting companies to provide ‘banking’ services require prior authorization from the Central Bank of Brazil and need to show:</p> <ul style="list-style-type: none"> <li>■ Requirement—identification</li> <li>■ Contracted—names of signatories</li> <li>■ Copy of the contract—including conditioning the startup to Central Bank authorization</li> <li>■ The municipalities where the contracted company will render services, in case not indicated in the contract—CNPJ + address of dependents of the contracted</li> </ul>  |



**Appendix Table A1.3. Correspondent Banks in Brazil: Evolution of Enabling Legislation**  
*(Continued)*

| Year | Legislation No:  | Major Provisions   |
|------|------------------|--|
|      |                  | <p>Contracts with companies offering other financial services would only need to be communicated to the Central Bank (Departamento de Gestão de Informações do Sistema Financeiro–Defin):</p> <ul style="list-style-type: none"> <li>■ Social denomination + CNPJ + complete address of the contracted companies base</li> <li>■ Nature of the services to be rendered</li> <li>■ Dates of the start of the contract and the start of rendering services</li> <li>■ The municipalities in which the services are to be rendered, CNPJ and address of each dependent</li> </ul>   |
| 2002 | Resolution 2,953 | <ul style="list-style-type: none"> <li>■ Extends permission to review a clients' data, on the financial institution's behalf, deemed necessary to open/maintain a deposit account, to correspondents authorized by the Central Bank of Brazil</li> </ul>   |
| 2003 | Resolution 3,110 | <ul style="list-style-type: none"> <li>■ Extends the faculty of contracting correspondents to investment banks, credit, financing and investment societies (SCFIs) and savings and loans associations</li> <li>■ Includes the sale of capitalization securities and consortium quotas, as well as services such as receiving and forwarding proposals for emitting credit cards, as permissible to be executed by correspondents</li> <li>■ Eliminates the blockage of transferring authority of contracts to third parties</li> <li>■ Clarifies that only services related to activities allowed by the financial institution by current legislation and regulation can be contracted.</li> <li>■ Prohibits contracting companies, from the rendering of services, including the opening of deposit accounts, the transactions of such accounts, and deposits and withdrawals in investment funds, whose main or only activity is to operate as a correspondent.</li> <li>■ It establishes necessity of previous authorization for contracting companies who use the term "bank" as a social denomination or as a made up name</li> <li>■ It emphasizes the total responsibility of the contracting financial institution for the services rendered by the contracted company, also in the hypothetical situation of the total or partial transfer of authority of the contract to third parties</li> <li>■ It strengthens the possibility of full and unrestricted access of the Central Bank to all the information, data and documents relative to the contracted company, the third party through transfer of authority and the services rendered</li> <li>■ Clarifies that, in the hypothetical situation of transferring authority of a contract to a third party, the contracted company will have to get previous consent from the contracting financial institution</li> </ul> |

*(continued)*

**Appendix Table A1.3. Correspondent Banks in Brazil: Evolution of Enabling Legislation**  
(Continued)

| Year | Legislation No:  | Major Provisions   |
|------|------------------|--|
| 2003 | Resolution 3,156 | <ul style="list-style-type: none"> <li>■ Extends the faculty of contracting to all financial institutions and other institutions authorized to operate by the Central Bank</li> <li>■ excludes mentioning the obligation of releasing funds relative to loans and financing contracts solely by means of a nominative, crossed and untransferable check</li> <li>■ shows that the obligation of foreseeing authorization for the contracting or transferring of authority of a contract to third parties of companies who use the term “bank”, relates only to the companies that are not integrants of the National Financial System</li> </ul>   |
|      |                  | <p>Responsibilities</p> <ul style="list-style-type: none"> <li>■ the contract must contain a clause foreseeing (art. 4° of Resolution 3,110, with the writing given by Resolution 3,156): <ul style="list-style-type: none"> <li>● the total responsibility of the contracting institution on the services rendered by the contracted company, also in the case of transferring of authority of the contract to third parties</li> <li>● the integral and unrestricted access of the Central Bank, on behalf of the contracting institution, to all the information, data and documents relative to the contracted company, third party with transfer of authority of the contract and the services rendered for these</li> <li>● in the hypothetical situation of transferring of authority of the contract to a third party, the necessity of the contracted company to get the previous consent of the contracting institution</li> <li>● the contracted company is forbidden to: <ul style="list-style-type: none"> <li>○ to advance payment on account of resources to be released by the contracting institution</li> <li>○ to emit, in its favor, stub-books or securities relative to the intermediated operations</li> <li>○ to charge a tariff, by one’s own initiative</li> <li>○ to give any type of guarantee in the contracted operations</li> <li>○ that the financial corrections must occur to every 2 working days</li> <li>○ that in the loans or financings, the release of the resources must be effected in favor of the beneficiary or the selling commercial company</li> <li>○ the obligation of spreading of information that shows the condition of the contracted company as a simple lender of services to the contracting institution</li> </ul> </li> </ul> </li> </ul> |

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