ACI UNIVERSAL PAYMENTS℠

REAL-TIME PAYMENTS IN LATIN AMERICA: POTENTIAL FOR MASSIVE DISRUPTION

The current scenario, general framework and disruption potential of real-time payments across Latin America

A thought leadership paper by ACI Worldwide® and Americas Market Intelligence

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ABOUT ACI®

ACI Worldwide®, the Universal Payments® (UP®) company, powers electronic payments for more than 5,100 organizations around the world. More than 1,000 of the largest financial institutions and intermediaries, as well as thousands of global merchants, rely on ACI® to execute $14 trillion each day in payments and securities. In addition, myriad organizations utilize our electronic bill presentment and payment services. Through our comprehensive suite of software solutions delivered on customers' premises or through ACI's private cloud, we provide real-time, immediate payments capabilities and enable the industry's most complete omni-channel payments experience.

ABOUT AMI

Americas Market Intelligence (AMI) is the premier market intelligence firm for Latin America, providing powerful market and competitive intelligence-driven insights that help companies succeed in the region. Its industry expertise includes payments, healthcare, logistics, resources/infrastructure, insurance, consumer/retail, and more. AMI's customized research reports deliver data-based clarity and granular strategic direction based on expert sourcing.

The company's payments practice is focused on helping financial institutions, merchants and others navigate the unique payments landscape in Latin America and compete in a rapidly digitizing environment. AMI consultants are recognized thought leaders in verticals such as e-commerce, mobile payments, digital wallets, online banking, contactless payments, and other digital payment technologies.

EXECUTIVE SUMMARY

Despite attempted disruption by fintech competitors in recent years, Latin America's overall payments structure remains largely unchanged. Traditional credit card schemes, present in Latin America for decades, are extremely profitable for issuers, acquirers and card networks. By the same token, low-margin merchants struggle to accept card payments because of their heavy operational costs, which include merchant discount rates and chargebacks. Nearly half the region remains unbanked and electronic payments represent a small percentage of consumer spending.

To truly democratize payments in the region, therefore, a change must come from within. Central banks and regulators in Latin America realize this and are pushing for reforms that increase competition and enable alternative business models. Real-time payments, a technology defined as instant electronic bank account transfers available 24/7, are one such alternative.

Globally, real-time payments are transforming financial services by expanding access to electronic payments, cannibalizing cash transactions, enabling e-commerce and boosting cross-border spend. Despite being in varying stages of maturity in Latin America, real-time payments have the potential to truly disrupt the legacy systems that prop up persistent mass volumes of cash spend, disenfranchise millions of consumers with respect to financial services, limit government's abilities to raise taxes and hinder economic growth overall.

Real-time payments pose opportunities and threats for different actors in the payments ecosystem. Banks stand to lose interchange revenue from card payments but simultaneously can gain exponential revenue from an expanded electronic payments pie. By accepting real-time payments, merchants can reduce operating costs, get paid faster and sell to a wider range of customers. Fintech start-ups, if positioned properly as partners of banks rather than adversaries, have enormous latitude to provide the delivery of real-time payments and innovative user experiences. Finally, consumers will be the biggest winners, achieving greater control over their funds while experiencing less friction and greater visibility, all at reduced cost.

Up-to-date, real-time payment infrastructure is one of the most disruptive forces occurring in the payments industry globally today. This whitepaper is a call to action for every actor involved in this ecosystem to embrace this technology and move toward interoperability. It intends to demonstrate what is at stake for each player, as well as to highlight the innovation opportunity for early movers.

DEFINITIONS

WHAT ARE REAL-TIME PAYMENTS?

Real-time payments (also called immediate payments or instant payments) refer to interbank money transfers wherein both the payer's and the receiver's bank accounts are updated instantly upon the initiation of a payment transaction. Real-time payments describe the ability to make and receive a payment on any day, at any time, using bank account funds. These are not to be confused with regular same-day settlement wires or bank transfers.

In real-time payments, also known as account-2-account credit transfers, the customer typically initiates a push payment. Clearing is done in real-time (1.5 – 15 seconds), and settlement is either deferred or done in real-time. With this payment type, there is certainty around transaction authorization, confirmation and clearing, since transactions are made only upon the verification of good funds.

Real-time payments are frequently available through interoperable platforms such as clearing houses, or through closed-loop initiatives. Some countries require that such payments comply with robust data standards, such as ISO 20022, while others process the real-time payments without rigorous data requirements.

In sum, real-time payments eliminate delays and friction from the funds settlement process. Beneficiaries receive payment confirmation within seconds and online (in real time) access to transferred funds.

INTRODUCTION

The global banking industry is undergoing a strong consumer-led market shift. Thanks to digital disruption in nearly all market segments, customer expectations in terms of quality, convenience, customization and affordability have reached new heights. Banking has been disrupted by the advent of digital P2P payments, online lending, digital-only banks, QR codes, open banking and other innovations. And real-time payments—fast gaining traction in India, the United States, Europe, and Latin America—are a major contributing factor.

According to GfK, a leading market research firm, the number of smartphone users in Latin America will exceed 240 million in 2019. An estimated 30% of Latin American banked customers, a number that is on the rise, use their mobile phones for banking. The Brazilian Banking Federation (FEBRABAN) reports that mobile banking transactions exceeded Internet transactions for the first time in 2016 and jumped 10% from 2016 to 2017, totaling 71.1 billion operations. The arrival of digital-only banks as well as payment services offered by fintechs continue to nudge Latin Americans toward mobile financial services.

Since bank accounts are usually the first—and often the only—financial product to which Latin Americans have access, the addition of real-time payments to the mobile financial menu would open up convenient, low-cost electronic transactions to millions of consumers in the region. Specifically, they would enable online purchases, bill payments, mobile phone account top-ups, retail purchases, and personal fund transfers from bank accounts at any moment, 365 days per year. Such a shift would solve numerous consumer pain points, including the need for regular ATM visits, standing in line to pay bills, carrying large amounts of cash to make high-value purchases and manually transferring cash to friends and family.

Simply put, real-time payments present the opportunity to reduce cash use, which benefits financial institutions, merchants and consumers alike. They may also displace some credit and debit card usage. Merchants would benefit from this, as bank transfer commissions are almost always cheaper than card swipe fees (also known as merchant discount rate or MDR), and reduced cash intake lowers cash management costs. And, in some markets, it can take up to 30 days for merchants to receive payment from credit card sales; with real-time payments, funds are received almost instantly.

Real-time payments are on the rise around the world. More than two dozen countries already boast nearly fully developed real-time payment networks, and an additional 45 are rapidly developing their own capabilities. Global markets are mixed between closed-loop, privately-led or consortium-led initiatives such as Venmo, Zelle, WeChat and Alipay, and publicly pushed initiatives like Faster Payments in the U.K., or Giro in Hungary. In the U.S., the company The Clearing House launched its real-time payments scheme in 2018 and, alongside the other live solution, Zelle, is leading adoption in the U.S.

To some extent, banks in Latin America have embraced real-time payments. In select markets, like Brazil, Mexico, Chile and Costa Rica, central banks and regulators are pushing real-time payments in an effort to democratize payments. In other markets, real-time payments are still far from priority. Global momentum will continue to push the region toward interoperability and openness, and governments and financial institutions who embrace this inertia stand to be the mega-disruptors the Latin American payments industry truly needs.

WHITEPAPER OBJECTIVES

This whitepaper examines real-time payments, analyzing both their current state and ongoing initiatives to promulgate them in Latin America and around the world. It also explores the potential benefits and challenges that consumers, merchants, financial institutions and fintech players are likely to face as a result of broader real-time payment adoption. The underlying objective of this whitepaper is to make the case for real-time payment implementation in the region and urge the region's financial institutions and central banks to work toward this end.

METHODOLOGY

Research for this whitepaper was conducted between June and October 2018. It consisted of in-depth interviews with payments industry executives in key markets in the region. AMI researchers also consulted a number of public sources in order to add relevant data in support the content of this document.

REPORT CONTENTS

The report opens with a discussion of the advantages of real-time payments for consumers, merchants and financial institutions. We then turn to an examination of the state of real-time payments in the region, with a focus on the regulatory landscape and government actions surrounding real-time payments infrastructure. Finally, we describe the challenges and opportunities that banks, card acquirers, networks and payment service providers face in this changing environment.

Global momentum will continue to push the region toward interoperability and openness, and governments and financial institutions who embrace this inertia stand to be the mega-disruptors the Latin American payments industry truly needs.

WHY REAL-TIME PAYMENTS FOR LATIN AMERICA?

FINANCIAL INCLUSION

According to the World Bank, 49% of the adults in Latin America—nearly 320 million people—do not have bank accounts. And even among bank account and debit card holders, account usage can be extremely limited. On payday, workers flock to the ATM to withdraw the totality of their paycheck in cash; in most markets in the region, POS purchases represent only 10%-30% of all debit card volume. The remaining 70%-90% is associated with withdrawals from ATMs.

Brazil boasts the deepest penetration of electronic payments, with card purchases comprising 35% of spend, according to ABECS, the Brazilian payment card association. But this number tumbles to between 5% and 20% in the rest of the region, where cash still dominates. Even within e-commerce, a vertical thought to be inherently electronic in nature, cash-based vouchers represent an estimated 20% of all spend.

Real-time payments can speed up financial inclusion throughout the region because they remove the need for a credit or debit card. They also help reduce the costs borne by consumers associated with cards, such as plastic issuance, ATM and membership fees, as well as interest charges. Real-time payments also reduce costs for digital banks and other fintechs—whose value proposition is closely tied to financial inclusion—by reducing their dependency on making both cards and bank branches universally accessible. In most places, consumers can move easily from cash to digital translations: all they have to do is establish a bank account that's linked to a mobile phone number.

On the government side, multiple financial inclusion programs can benefit from real-time payments: payroll, microfinance and government-sponsored assistance programs, among others. A combined value proposition that leverages mobile phones, digital wallets and real-time payments could dramatically improve the distribution of government payouts and reduce costs for consumers and government assistance agencies.

Despite their efforts, most card-based financial inclusion plays—usually centered around prepaid cards—have failed to gain traction in Latin America. Card usage is not deepening so far as to cannibalize cash. As such, the growth potential of electronic payments in Latin America is limited to the extent that credit, debit and cash remain dominant, with no viable alternative. Real-time bank transfers offer a new possibility for financial inclusion and democratizing access to electronic payment instruments.

TABLE 1. BANKING PRODUCT PENETRATION OF THE TOP 10 LATIN AMERICAN MARKETS BY GDP PER CAPITA

	OWNERSHIP, % OF POPULATION 15+ Y/O		
	BANK ACCOUNT	DEBIT CARD	CREDIT CARD
Chile	74%	60%	30%
Brazil	70%	59%	27%
Costa Rica	68%	52%	14%
Uruguay	64%	56%	41%
Dominican Republic	55%	32%	16%
Argentina	48%	41%	24%
Panama	46%	29%	8%
Colombia	45%	26%	14%
Peru	42%	28%	9%
Mexico	35%	25%	10%

Source: World Bank Findex, 2018

REAL-TIME PAYMENTS FROM THE MERCHANT PERSPECTIVE

POS terminal penetration remains limited in Latin America. Nearly all modern retail establishments (big box stores, fast food chains, hotels, shopping malls, gas stations, etc.) accept cards, but within traditional retailers, where most Latin American consumption still takes place, POS penetration is extremely restricted. For example, local sources reveal that only 19% of small businesses in Mexico[1] and and 10% of small business in Peru[2] accept card payments.

The main reason for this is cost. Many retailers in Latin America have a compressed profit margin, and swipe rates can be prohibitively expensive. According to the *2017 Nilson Report*, card purchase volume in Latin America reached US$707 billion dollars in 2017. According to ABECs and Brazil's Central Bank, the average merchant discount rate (MDR) in Brazil is 1.45% for debit and 2.60% for credit and trends higher in other markets. Settlement time is often prolonged to several weeks, potentially crippling merchants by restricting their cash flow. When all of this is combined—along with chargebacks, reconciliation and POS rental fees—card acceptance can become prohibitively expensive.

> The growth potential of electronic payments in Latin America is limited to the extent that credit, debit and cash remain dominant, with no viable alternative.

Real-time payments present a tempting alternative: the opportunity to reduce processing costs, speed up settlement time from days and hours to seconds, and expand the acceptance footprint of electronic payments across local economies. And the benefits to merchants are not limited to decreased costs and increased speed. Refund processing is commonly a headache, characterized by lack of transparency and frequent delays that can hurt burgeoning client relationships. With real-time payments, refunds can be processed instantly and thus resolve countless customer grievances.

1 Banco de México, 2018, and AMI analysis

2 Market interviews and AMI analysis

THE IMPACT OF REAL-TIME PAYMENTS ON B2B PROCESSES

Real-time payments also have the potential to change the way businesses and governments make payments. Companies can benefit by instantly confirming funds availability—and at a low processing cost. This is especially helpful for companies using a subscription model wherein services must be available on demand, at any time. For example, a utility company can restore power to an in-arrears client if the overdue bill is successfully paid on a Tuesday at 9 p.m. via a real-time payment. Along with cash, wire transfers are the principal payment method used for B2B payments in Latin America, but these usually come with hefty fees and delays. Real-time payments can remove these pain points by improving cash flow visibility and reducing costs.

OPPORTUNITY IN CROSS-BORDER TRANSACTIONS

The implementation of real-time payments in Latin America has important implications for cross-border transactions. Connecting and standardizing the payment experience across neighboring markets opens up potential for intra-regional trade and travel, supports the movement of migrants and helps remittance money flow more freely. As domestic real-time payment schemes become consolidated, the natural next step is to leverage these existing infrastructures by extending them outward. Such cross-border structures are currently being built across Europe and South East Asia.

Real-time payments could help improve the flow of goods, services and people across Latin America, strengthening local economies. A potential driver of cross-border trade in Latin America is the growth of e-commerce overall (~20% per year[3]) and that of regional e-commerce sites including Uber, Uber Eats, MercadoLibre, Rappi, Cornershop, Easy Taxi, Nintendo and Playstation. Yet the disjointed nature of payment methods between nations limit this potential; not only do most Latin Americans not have a credit card, but only a limited number of cards issued locally are enabled for international use. This means a Colombian Easy Taxi customer may have difficulty using the app when traveling to Mexico, or that businesses in Argentina can more easily sell to American or Chinese consumers than to Brazilians and Chileans. Interoperable real-time payments across borders would ease these pain points.

Payment integration across countries via real-time payments would make Latin America more competitive on a global scale. Many multinational corporations shy away from Latin America because on their own, most markets are too small to justify an investment. If money can flow freely across borders, each country's market size essentially increases, making them better able to compete. Such an implication would be powerful for regions like Central America, a grouping of small countries that draw from a limited pool of internal resources. Costa Rica, whose Central Bank's interbank transfer infrastructure is already in place, could be an excellent catalyst for the construction of real-time payment rails inside of and between its neighbors.

FRAUD IS STILL A CHALLENGE

Of course, real-time payments have their challenges. The most salient is the fact that instantaneous transfers increase the risk of financial crimes and money laundering. While card networks have established rules to reduce fraud based on decades of experience, there is no established framework for account-based transfers. As central banks embrace real-time payments, governments must define for the first time how potential disputes should be managed. In one of the most advanced global cases, the government of the U.K. is drafting recommended guidelines and appointing a steering committee to define and enforce the standards for payers and payee disputes. The global industry as a whole is far from adopting widespread, agreed-upon rules of play.

> Real-time payments present a tempting alternative: the opportunity to reduce processing costs, speed up settlement time from days and hours to seconds, and expand the acceptance footprint of electronic payments across local economies.

3 Local e-commerce chambers of e-commerce, interviews and AMI analysis.

STATE OF REAL-TIME PAYMENTS IN LATIN AMERICA TODAY

THE REGULATORY LANDSCAPE AND COUNTRY-FOCUSED INITIATIVES

Despite economic crises, hyperinflation and high fraud rates, over the past 20 years, Latin America has nevertheless built a cash settlement system well above the global average. Some Latin American markets, especially Brazil and Mexico, can even outperform the payments infrastructure of more developed nations, offering lower cost transactions and faster settlement. And all major markets in the region have been active in the creation of a more open banking environment and alternatives to promote better financial services.

Yet, in most cases, a true real-time payment scheme—in which anyone can pay anyone at any time—is not a reality. In most countries featuring them, same-day bank transfers are available only during business hours. In other cases, only intra-bank transfers are offered, with payments to accounts at different financial institutions taking 24 hours, if not several days. And across the region, the user experience for bank transfers remains poor overall.

The user interface for bank transfers developed by legacy players is a far cry from the attractive, frictionless platforms developed by global technology companies such as Venmo, WeChat and AliPay.

Whereas many tech-driven platforms need only a recipient's phone number or the scan of a QR code to transfer funds, bank-created solutions in Latin America require extensive data, including a recipient's full account number, as well as a branch number and other identifiers. Because the user experience is poor and availability is limited, real-time payments have not been widely adopted by consumers.

The following is a description of real-time payment initiatives in key markets in Latin America, as well as regulations related to fintech in general.

FIGURE 1. VARYING LEVELS OF REAL-TIME PAYMENTS DEVELOPING IN THE REGION'S TOP MARKETS

REAL-TIME PAYMENTS, COUNTRY BY COUNTRY

1 BRAZIL

The Brazilian Central Bank was among the first in the region to push interoperability for payments. Initial discussions in 2010 were focused on payment processor interoperability and have evolved toward bank transfers and real-time payments. Low-cost interoperable bank transfers are enabled by nearly all banks in Brazil, in the form of Express Wire Transfers (known as TEDs) and Credit Transfer Documents (known as DOCS).

Brazilians have become well-accustomed to these financial products, which can be easily used online or via mobile app. In addition to the *boleto bancario*, a bank-issued electronic invoice which can also be paid online, Brazilian consumers and businesses made 5.3 billion electronic bank transfers in 2017.[4]

This infrastructure has limitations, however. TEDs are typically settled on the same day, but they are available only during banking hours, and DOCs and *boletos* both take at least one day to clear. There are also cost implications; the average price of $R9 per transfer (around US$2.50) is affordable for large transfers but expensive for small purchases and P2P transfers. Their cost is coming down; several digital banks now offer free unlimited TEDs to accountholders, but for most, bank transfers are not yet priced at a level to induce greater consumer adoption.

To address these shortcomings, there is an ongoing discussion led by the Brazilian Central Bank to develop a 24/7 instant wire payment infrastructure. This working group includes regulators, banks, fintechs and law firms and aims to define the infrastructure needed as well as practical use cases for real-time payments. A final version of the proposed regulatory framework should be ready by the end of 2018.

4 Banco Central do Brasil database, 2018.

2 MEXICO

Mexico is one of the global leaders in real-time payments implementation. Mexico's central bank, Banxico, has mandated that real-time payments be available 24/7 since late 2017 through the SPEI, its interbank electronic payment system, originally established in 2004.

However, usage of SPEI among consumers is low. To make a SPEI transfer, users need the recipient's full 18-digit account number or debit card number, and the user experience is clunky and unappealing. The estimated US$8 billion in low-value SPEI transfers in 2017 was mostly to pay credit card and insurance bills[5]—banks have struggled to expand SPEI usage beyond financial services into other use cases. Small transfers between individuals are conducted overwhelmingly in cash.

To promote SPEI usage, Banxico is developing, "Cobro SPEI", a platform to enable merchants and receivers to initiate funds collection against the payer's authorization. Cobro SPEI incorporates QR codes with the goal of providing merchants a cheap mechanism to accept electronic payments (in lieu of a POS terminal) and enables them to sell online.

Banxico's challenge will be to encourage banks to support Cobro SPEI, since many banks have developed their own mobile wallets and QR code platforms. BBVA Bancomer and Banorte have developed their own closed-loop systems for P2P payments. Without cooperation from Mexico's retail banking division, Banxico's efforts to scale real-time interbank transfers may become frustrated.

5 Banco de Mexico database, 2017 and AMI analysis

Finally, Mexico is leading fintech innovation in Latin America through its recently passed Fintech Law, novel both in Latin America and globally. This regulatory framework, passed in early 2018, attempts to create rules of play and compliance requirements for fintech companies, which should generate greater trust and security for consumers, financial institutions, and investors interacting with fintech companies. It also creates stability for fintech companies by establishing legal grounds for their integration with banks via open APIs and ensuring that they have continued access to financial services. While the direct implications of this law remain to be seen, the fintech community is optimistic that the law will creates the conditions for fintech growth throughout the country.

3 COLOMBIA

Colombia is one of the first Latin American markets to have a true automated clearing house (ACH) clearing solution. Through the "PSE *botón de pagos*," which enables online payments via bank accounts, Colombians have greater flexibility and convenience when paying for online purchases. ACH Colombia is currently in the process of implementing Real-Time ACH, an initiative to enable bank account payments more widely and in real time.

In 2016, the financial regulatory agency (Superfinanciera) established the operational and legal framework for "Sociedades Especializadas en Depósitos y Pagos Electrónicos" (SEDPEs), which provides a special license to non-banks to offer deposit and payment services. This model enables the construction of digital wallets and easy onboarding of unbanked customers. MOVII was the first SEDPE to go live in Colombia (July 2018) and offers a prepaid solution for digital P2P payments, mobile top-ups and other services.

While the SEDPE regulation creates a framework to expand financial services, it says nothing about interoperability. The likely result will be the creation of various closed-loop digital wallets; while this is noble in intention, without offering wider connectivity, such products may fall short of their full potential. In contrast, ACH Colombia has the potential to create payment interoperability through real-time payments.

4 PERU

Peru's card acquirers still operate under exclusivity agreements with card networks for most transactions. VisaNet is the sole acquirer for Visa in Peru, which holds a dominant market share estimated at 70%. This is slowly changing as regulators assert the first waves of pressure onto VisaNet to create a more even playing field. In Q3 2018 VisaNet opened up its rails to Mastercard, Discover and Amex networks for certain merchant verticals. However, Peru is still quite far from reaching full card processing interoperability.

This situation improves the potential for a payments infrastructure built on bank accounts, since a lack of competition in card acquiring means that swipe fees are high. POS penetration is <10% of merchants, according to local media sources, and cash inevitably dominates across the economy.

To combat this, banks understood that they needed to build an interoperable bank transfer system and banded together to create Bim, an interoperable mobile wallet, the first of its kind globally. Launched in 2017, Bim is backed by most banks in the country, enabling interoperable P2P payments, mobile top-ups, bill payments, and other services. However, Bim was created with financial inclusion in mind, developed initially for feature phones and designed for the unbanked. This has hurt Bim's growth potential and its user base has not yet exceeded 500,000.

Alongside Bim, banks are creating their individual payment solutions, the most noteworthy being Yape, a P2P transfer platform developed by Peru's largest bank, BCP. Gaining decent traction among account holders, Yape is piloting merchant payments based on QR codes, which in turn has triggered competing banks to develop their own wallet products. These being closed-loop, however, limits their growth potential and the scaling of bank transfers as a payment method countrywide.

In addition to individual bank efforts, Peru's clearing house, the CCE (the Electronic Clearing House), enables interoperable account-to-account transfers. Although these are almost exclusively used currently by financial institutions only, usage of account-to-account payments are likely to extend to consumer use in the short term, as the CCE is evolving toward enabling real-time payments. It recently adopted the Vocalink platform (ACH payment platform acquired by Mastercard in 2016 and the same technology used to power the Faster Payments Service in the UK) to improve this service.

5 ARGENTINA

Beginning in 2017, regulators began to crack down on Argentina's concentrated payments system. Most importantly, the government mandated the sale of Prisma Medios de Pago and divestment by 14 owner banks. As the sole Visa acquirer, Prisma controlled 75% share of card volume and made it impossible for merchant aggregators with alternative business models to compete. With Prisma currently in sale negotiations, it is unclear which card-acquiring structure will emerge. The final result should enable greater competition to flow into Argentina's payment space.

In additional efforts to promote interoperability, since 2016 the Central Bank has enabled two new free, instantaneous payment methods: "Débito Inmediato" (DEBIN), which enables debit card holders to immediately push payments to recipients and "PEI," real-time interbank payments taking place over a digital wallet, mPOS device, or online. Banks, however, see these plays as relating to financial inclusion and therefore as unprofitable. Without widespread bank support and strong marketing efforts, consumer uptake will remain low.

6 CHILE

Years behind Brazil and Mexico, Chilean regulators have focused on opening up the market for new card processors (until late 2017, Transbank was the sole card acquirer in Chile). As the payment space liberalizes, the discussion of real-time payments and fintechs may now become relevant.

Transbank, seeing its acquiring business come under competitive threat, is expanding its services by engaging with consumers directly. In 2018 it launched mobile app OnePay, a card-on-file digital wallet enabling payments over mobile device and online using QR codes. In its first iteration, only credit cards are available, but Transbank expects to enable debit in the coming months. A card-centric solution, OnePay plays to the infrastructure developed by bank-owned Transbank and indicates that banks are not yet ready to embrace a new set bank account-based rails.

Despite its shortcomings around card interoperability, Chile is advanced in the region in real-time payments thanks to the *Centro de Compensación Automático* or CCA (its automated clearing house), which currently conducts over 560,000 transactions per day in real time for a variety of use cases, including bill pay and P2P payments. To scale this service, Chile needs the growth of consumer-facing fintech companies to integrate with the CCA and banks and deliver an attractive user experience and expand use case.

OBSTACLES TO REAL-TIME PAYMENTS ADOPTION IN LATIN AMERICA

Thus, while progress has been made in Latin America toward interoperable real-time payments, there is much to be done to fully reap the benefits such infrastructure can deliver. As evidenced here, most central banks are keen to develop real-time payments and global trends are nudging them in this direction. There are several obstacles to overcome in this pursuit, however.

> Banks may act to quash—or at least slow-pedal—any initiative that threatens interchange. It takes a highly progressive financial institution to embrace a change that might threaten this business to bet on something greater.

Banks are likely the only party to feel threatened and simultaneously tempted by the prospect of real-time payments. The biggest threat is that interchange revenue stands to be reduced or even eliminated. For most markets in Latin America, this fee is around 0.8% for debit card transactions, and in Brazil, for example, interchange from debit cards alone generated R$4billion. As such, banks may act to quash—or at least slow-pedal—any initiative that threatens interchange. It takes a highly progressive financial institution to embrace a change that could threaten its business in the hopes that it could pay off down the line.

On the other hand, real-time payments represent incremental revenue potential, specifically if transactions expand the electronic payments pie rather than compete with existing card volume. Additionally, account-based transfers increase accountholder engagement and offer the possibility to cross-sell. Finally, by upgrading their systems to enable real-time payments, banks can finally move away from the outdated legacy systems that limit their ability to compete with fintech start-ups.

> Perhaps the most exciting opportunity for the region's banks is the potential to get out from under the influence of card networks, which act as golden handcuffs.

On the credit card side, banks can also benefit from real-time payments by using them as a tool to process credit transactions. Technically speaking, cards are just a way to access one's available credit line over a payment network—one which could be replaced by real-time payments communication and disbursement. This would be a huge innovative disruption for the card payments industry.

Perhaps the most exciting opportunity for the region's banks is the potential to get out from under the influence of card networks, which act as golden handcuffs. While card networks help banks to earn interchange, they also charge onerous authorization fees and impose ever-changing requirements. Most recently, Visa, Mastercard and American Express issued contactless card mandates for all issuers in Latin America, meaning that as of 2019, newly issued payment cards must carry pricey contactless technology. Issuers absorb most, if not all, of this expense, and some banks have naturally pushed back against this mandate. Enabling real-time payments and promoting their widespread adoption would empower banks to slacken their relationships with card networks and become more self-sufficient.

MARKET IMPACT: IMPLICATIONS FOR OTHER PLAYERS

CARD ACQUIRERS AND CARD NETWORKS

Card acquirers and networks are the players most threatened by a potential real-time payments implementation. In the worst-case, yet long-term, scenario, they could be displaced as debit and credit transactions migrate toward a bank-to-bank structure.

Considering that international card networks are essentially payment processors with huge investment budgets, there remains a chance for them to reinvent themselves as their industry shifts toward real-time payments. There is still much to be defined when it comes to user interface, network stability, interoperability, scalability, cybersecurity and fraud management. Acquirers and networks have invaluable and extensive experience in these areas, which could prove vital as competitive advantages against any new payment method or rivals.

Card networks have invested heavily in proprietary wallets, wearables and other payment vectors that aim to reduce dependency on plastic and promote a better user experience. Acquirers have also made some strides in financial inclusion, redoubling their outreach efforts on traditionally cash-intensive segments such as cab rides, farmer's markets and micro businesses in general. And both Visa and Mastercard have developed push-payment products that drive funds to payment cards in real time, demonstrating their preparation for increased competition from instant payments.

PAYMENT SERVICE PROVIDERS (PSPS) AND FINTECHS

According to the Latin American Private Equity and Venture Capital Association (LAVCA), VC tech investment in Latin America reached an all-time high of US$1.1 billion in 2017. LAVCA reports that VC investments in LatAm startups totaled US$780 during the first half of 2018, suggesting the total could reach at least US$1.5 billion.

Most PSPs and fintechs have battled with financial institutions in an attempt to level the playing field. They now enjoy an advantageous position against traditional organizations when it comes to client experience and pricing. Smaller teams and innovative technologies have helped fintechs to quickly scale across different product niches such as payments, lending, investments and digital banking. But they lack the reputation, trust, and scale of incumbent financial institutions, who—at least so far—have stubbornly maintained their lead.

As such, fintech start-ups have huge potential to contribute to the real-time payments evolution in Latin America. Many have tried and failed to offer closed-loop solutions, because they lack the resources needed to scale. A change of tactics is in order: they should move to become part of the distribution network of real-time payments—and look to banks to provide the rails. Once real-time payment rails become interoperable and accessible, these companies have the opportunity to showcase their solutions by providing the last-mile delivery of real-time payments to end users. In sum, the winning strategy for these companies is to work alongside banks as a complement, not a competitor.

CONCLUDING THOUGHTS AND NEXT STEPS

Many financial institutions, corporations, merchants and consumers in Latin America remain unaware of the immense potential of real-time payments to transform their industry for the better. Real-time payments offer the opportunity to truly expand financial inclusion, ease the flow of funds across borders, improve governments' tax collection efforts and help Latin America become an integrated economic bloc. Naturally, banks fear losing fee revenue from credit and debit cards, but this fear is short-sighted. As open banking advances globally and digital disruption fosters interoperability, earnest efforts to build bank-account-based payment rails will increase the region's competitiveness overall.

To do this, financial institutions must do several things, including:

1. Partner with regulators, merchants, fintech companies, legal teams and others to open (or advance) the conversation on real-time payment implementation
2. Look to global case studies in Europe and Asia for learnings and best practices
3. Connect and work closely with clearing houses to ensure payment interoperability
4. Partner with fintech companies who can provide innovative capabilities in user experience
5. Open discussions with card networks on how they can add value to real-time payments infrastructure
6. Partner with experienced technology companies who can help adapt and update financial institutions' legacy technology platforms

Creating a new payments infrastructure is not easy—nor will it be accomplished overnight. The journey toward full bank account interoperability will be long and certainly bumpy. However, the pace of technical innovation in payments is accelerating, and what has happened in other industries—the removal of intermediaries, the elimination of excessive cost and the implementation of customer-centric products—is inevitable in payments. By proactively promoting real-time payments, financial institutions in Latin America can be the catalysts—instead of victims—of this process.

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