

# Economic Watch

Mexico

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Financial Inclusion

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## The challenge of financial inclusion and the regulatory framework of mobile banking in Mexico

- The low level of banking penetration in Mexico raises the challenge of increasing the range of financial services on offer through innovative challenges. Mobile phones are an attractive way to do this, given their extensive presence in the population and their capacity to rapidly and securely connect parties in a transaction.
- Regulatory changes in Mexico have enabled us to establish favorable conditions for the development of the market for mobile banking: a system of simplified accounts, an extensive network of banking correspondents and specific regulations for mobile accounts.
- This new regulation follows in the wake of international experiences where mobile banking has enabled the financial inclusion of people not in the banking system.
- It is now possible to open an account without having to present documentation and without keeping a minimum balance in the account thanks to a scheme of simplified accounts and the regulation of mobile banking.
- Mobile payment models are particularly attractive for the lower-income population living in remote areas, for whom the sending of money via transfers or deposits between traditional bank accounts is not available

## Cell phones: a channel for financial inclusion

Mobile telephony as a channel for accessing financial services can help reduce costs for both the user and the financial institutions. As a payment instrument, cell phones permit the creation of new products and innovative business models that can be offered to the broad segment of the population who own cell phones but still do not have a banking product for savings.

Today, mobile phones represent a potential channel for promoting financial inclusion, given their extensive penetration in the population and feasibility of interconnecting data securely and economically. Therefore, the use of mobile phones linked to banking products enables the development of new business models that can provide financial services to people who traditionally would have been excluded from the formal financial system.

## What is Mobile Banking?

Mobile Banking is online banking<sup>1</sup> accessed via a cell phone, whose number is associated with the service.<sup>2</sup>

Unlike other countries, in Mexico the business models associated with Mobile Banking must be strictly banking<sup>3</sup>. Given that only authorized financial entities can participate as suppliers in the mobile financial services market, only slight adjustments needed to be made to the financial regulations, and not to those for telecommunications, in order to permit operations with these new schemes.

There are in fact two groups of mobile banking users: those that use general banking services and those that do not<sup>4</sup>. The first group considers mobile banking to be an additional channel to the traditional ones (branches, ATMs); the second group are the non-users of banking services, with low incomes, who do not necessarily live in big cities and perhaps have not had previous access to banking services, but need them.

## Main changes in the regulations

In 2009 the Central Bank (Banco de México) issued a regulation<sup>5</sup> for bank accounts associated with a cell phone number. However, the rules for opening and operating accounts, initiating procedures and anti-money laundering (AML) rules were out of line with the new reality. It was not until 2010 that the CNBV, the Central Bank and the Secretariat for Finance and Public Credit (SHCP) harmonized different pieces of the regulation<sup>6</sup> to create a new scheme of simplified accounts and develop a regulatory framework that would permit, on the one hand, a flexible system for opening banking products and, on the other, facilitate the linking of those products to mobile phones.

<sup>1</sup>: Set of banking services and operations carried out through electronic media (equipment, optical media or any other technology, automated data processing systems and telecommunications networks, be they public or private).

<sup>2</sup> See the Disposiciones General aplicables a Instituciones de Crédito (General Provisions Applicable to Credit Institutions)

<sup>3</sup> See López-Moctezuma and Samaniego (2012).

<sup>4</sup> See Deloitte (2012)

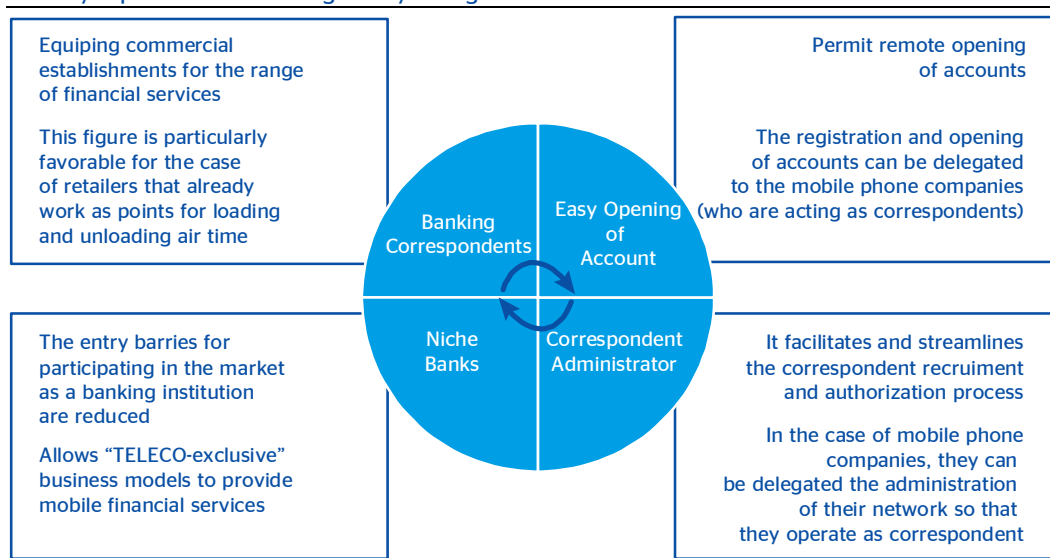
<sup>5</sup> Circular 26/2009 Bank of Mexico

<sup>6</sup>: CNBV modified Chapter XI of the CUB and SHCP Rules of Article 115 of the Credit Institutions Act

The rules for customer identification and compliance with documentation requirements issued by the SHCP establish measures to prevent money laundering, but, at the same time, provide the flexibility needed to allow banks to open different types of accounts (low transaction or low-risk accounts), depending on the identification information provided by the customers.

In order to allow the development of new banking business models, in 2010 the CNBV modified the General Provisions Applicable to Credit Institutions, also known as the Single Bank Circular or CUB, to include rules for operating through banking correspondents, mobile financial services, simplified account opening and niche banks. Thus, the regulatory measures recently implemented in Mexico have been extended to permit the use of alternative channels in the range of financial services, granting certainty to the user on the means of electronic access to financial products.

Chart 1  
Primary aspects of the CUB regulatory changes



Source: CNBV (2012)

With reference to the figure above, we will now analyze the role of the four elements highlighted.

**a. Opening simplified accounts**

In April 2010 the Credit Institutions Act (LIC) was amended to include a new alternative for opening deposit accounts that allows the application of simplified and flexible procedures. This new system facilitates the rendering of financial services by banking correspondents and mobile telephony. In this way, four levels of accounts were established according to the potential levels of risk of money laundering and fraud: the "traditional" accounts are classified as level 4 accounts, which have no limit to the deposits that can be received and allow the use of checks for making payments; the level 1 to 3 accounts are considered "simplified", low-risk accounts, since, in line with the amount of customer information that can be collected by the bank, limits are placed on the monthly deposits that can be received.

No documentation is required to open level 1 accounts; as they can be anonymous; they are the only accounts with restrictions on the balances that can be maintained and cannot be linked to cellular phones or online banking to issue electronic transfers. In all of the other accounts, all electronic means and channels can be linked to issue or receive payments. The level 2 accounts are considered to be the most appropriate for the range of mobile financial services at the base of the pyramid.

Simplified Accounts can be opened easily at any banking correspondent, or even remotely through any other channel. This multi-channel option for opening the accounts significantly reduces the costs for mobile financial service providers and for the users of these services.

It should be noted that the idea behind the Simplified Accounts linked to a cell phone is that these phones can be used not only as electronic wallets for making payments in multiple establishments, but also as means for transferring money<sup>7</sup> to other accounts and for completing deposits and withdrawals for up to 2,000 investment units (UDIS<sup>8</sup>) per month and under the same restrictions as ATMs and banking correspondents with average daily withdrawal limits of 6,000 pesos per day.

For the population that are not normal users of the banking system, Simplified Accounts are a mechanism that permits financial inclusion, especially in areas where there are no bank branches. The main features of these accounts are:

- Easy opening: they can be opened with few requirements and without the need to go to a branch
- Easy use: they can be operated through a cell phone
- There are some transaction limits, based on the opening requirements, which make them a low-risk product according to recommendations by the Financial Action Task Force on Money Laundering (GAFI).
- Banks can use the correspondent scheme to open and operate this type of account.
- Availability: The customer can have access to the funds in his/her simplified account through correspondents or a branch of the bank.
- Easy Access: The population without access to computers can easily make electronic transfers.
- Low Costs: Banks do not need a branch to offer electronic payments with accounts linked to cell phones. They can use interconnecting channels already in place.
- Security: Money transfers must comply with the security requirements established by the CNBV for electronic media (Chapter X of the CUB); for example, to send transfers for amounts over 70 UDIS, the destination account must be registered.
- Interoperability. Since they are bank accounts, banks must allow their customers to send and receive transfers between accounts linked to mobile phones and other types of bank accounts, regardless of the bank and telephone company.
- Transaction costs can be significantly reduced, particularly in low-income areas, with the use of a mobile account, since the population without access to financial services

<sup>7</sup> By cash, check or electronic transfer

<sup>8</sup>: The value of the UDI as of June 2013 is 4.95 pesos.

because of the high costs, or due to their non-existence, can obtain them using their cell phone.

- Taking advantage of the payment infrastructure: Use of banking correspondents to open and operate mobile accounts

For example, to open the simplest account (level 1), no account holder information is needed. As a result of this change, people without documentation are expected to have greater access to basic formal financial services, and business models that focus on serving the segments of the population in the market that are currently not covered are now viable. As a result, the potential for financial inclusion has increased. Therefore, the population facing obstacles to compile complete identification records can have access to basic financial services, and the costs that would be incurred by the retailers designated with correspondents will be reduced as they will not have to register complete information from all of the financial service users. The authorities are working so that, later on, these new simplified accounts can evolve beyond merely transactional functions to provide more extensive access to the financial system through a range of other financial services. These services will include voluntary savings in pension funds, sending and receiving remittances, micro-loans, micro-insurance policies, investment in government bonds, online transactions and conditional direct transfers from the government. Below is a table showing the requirements for opening simplified accounts, based on the level of risk and transactionality:

Table 1  
**Bank deposit products**

	<b>Low-risk bank accounts (Simplified procedure)</b>				
	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Level 4</b>	<b>Traditional</b>
<b>Holder's information</b>	None (anonymous).	Full name, date of birth, gender and address.	The same as level 2 accounts	The same as level 2 + country of birth, nationality, occupation, profession, business activity, telephone number.	The same as level 4 accounts.
<b>Opening and identification requirements</b>	Not in person	Not in person. Only information, no copies.	In person and not in person (verify information). Only information, no copies.	In person opening. Check information against identification. Only information, no copies.	In person opening. Save copies of documentation.
<b>Place of distribution or opening</b>	Branches, brokers, electronic media and retailers.	Branches, brokers, electronic media.	Branches, brokers, internet.	Branches, brokers, incorporated entities.	Branches
<b>Limits</b>	Deposits: 750 UDIS per month. Maximum balance: 1,000 UDIS	Deposits: 3,000 UDIS per month.	Deposits: 3,000 UDIS per month.	Deposits: 10,000 UDIS per month.	Limit set by the bank.
<b>Access to funds by cell phone</b>	No	Yes, subject to the limits per transaction set by Online Banking regulations			
<b>Means of access</b>	Branches, ATM, POS terminals and brokers.	Branches, ATM, POS terminals, brokers, electronic media and cell phone.			Branches, ATM, POS terminals, brokers, online banking, cell phone and checks.
<b>Coverage</b>	Domestic	Domestic	Domestic and international		
<b>Additional controls</b>	All of the accounts are subject to monitoring, operational and technological controls to guarantee the integrity of the information.				

Source: Bank of Mexico (2011)

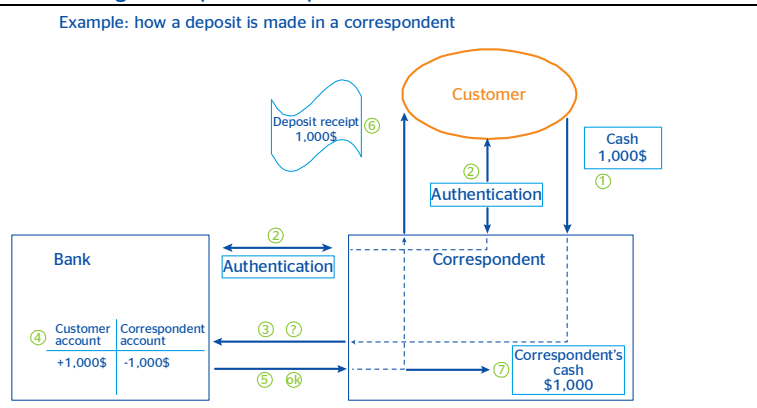
**b. Banking Correspondents**

In December 2008, the LIC introduced the concept of banking correspondents, which are third parties that establish business relationships or connections with a credit institution in order to offer financial services to its customers for and on its behalf. Taking advantage of the infrastructure of the existing commercial establishments, banking correspondents offer a profitable business model to provide the population with access to cash deposits, transfers and withdrawals in premises that are familiar and convenient. In this way, correspondents address several of the obstacles currently facing the inclusive range of financial services:

- They expand the banking infrastructure faster and at a lower cost.
- They reduce transaction costs for customers, as they bring financial services to establishments that they already frequent every day.
- They foster the development of financial products that adjust to the needs of the population not covered by traditional banking.

The scheme implemented by the banks to operate through banking correspondents affects the accounts involved in real time, gives the customers the certainty that they are operating with their bank and guarantees the funds of all the participants are protected. Example of a deposit with a correspondent: (1) The customer arrives at the correspondent and requests a deposit of \$1,000; (2) the customer is authenticated (proof of identity) to the correspondent and the bank using an electronic method. The correspondent authenticates itself to the customer and the bank using the same electronic method; (3) the correspondent requests the bank to make the deposit; (4) the Bank applies the transaction, online and in real time: the bank withdraws the money from the correspondent's account and deposits it in the customer's account; (5) the Bank sends authorization to the correspondent; (6) the correspondent gives the customer the transaction receipt provided by the bank; (7) the money received by the correspondent is its property; it does not belong to the customer or to the bank.

Chart 2  
**Diagram of banking correspondent operation**



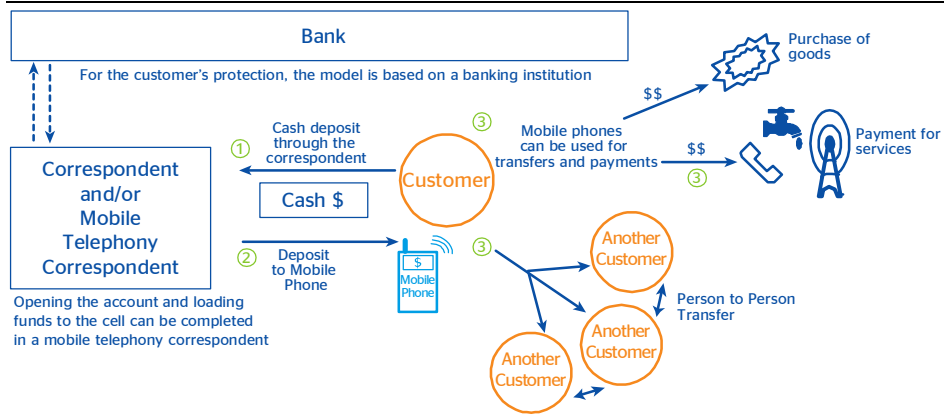
Source: CNBV (2012a)

In order to guarantee that the transactions carried out through banking correspondents offer users the same security as those in a traditional branch, the regulation calls for operational requirements, including the following: (i) the employee and the customer withdrawing the deposit must identify themselves with two modes of identification; (ii) the

account balances, of both the correspondent and the customer, must be updated online in real time; (iii) automatic generation of a receipt for the transaction, issued by the institution.

Chart 3

Diagram of banking correspondents and the development of mobile payments

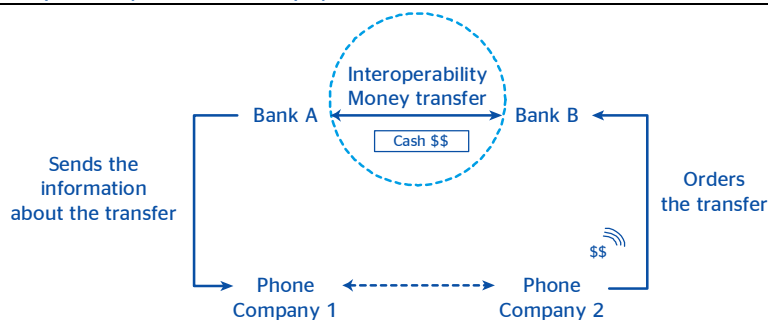


In order for different service models to be developed, the regulatory framework allows different commercial agreements to be entered into between banks, telecommunications companies and third parties, ranging from purely banking agreements (that use telephony only as a means for sending information or as a carrier), to shared business models in which telephone companies can administer the operating platform.

It is important to keep in mind that a bank is involved in all cases and that, in the last resort, it is the party responsible for the funds deposited. Moreover, in order to increase competition in the financial services market, the regulatory framework fosters the interoperability between the banks' platforms, as shown below:

Chart 4

Interoperability of the mobile payment business models



Source: CNBV (2012a)

### c. Correspondent Administrator

The role of correspondent network administrator is of great importance, as it significantly streamlines the process of recruitment, authorization and management of

correspondents. Through this concept, the banks can grant powers of attorney to the network administrators so that, on behalf of the banks, they can sign correspondent contracts and carry out the management of their network of correspondents.

Along the same lines, mobile phone companies are very attractive as administrators of correspondent networks because they have contractual relationships with an extensive network of establishments; they maintain customers who are familiarized with loading and reloading air time through their network, and have penetration in market segments that do not use banking services.

#### d. Niche banking

In February 2008 and December 2009 amendments were published to the Credit Institutions Act with respect to the concept of Niche Banking. The aim was to promote greater competition in the sector by streamlining the levels of mandatory capitalization for entities that operate in and/or develop a limited or specialized financial market without offering all the services associated with multiple banking. The minimum amount of capital required by credit institutions now depends on the operations expressly included in their company bylaws, the infrastructure necessary for their development and the markets in which they intend to operate.

Table 2  
**Minimum capital requirements for banks**

Type	Permitted operations	Minimum capital UDIs	Minimum capital USD
1	All operations	90,000,000	33,375,000
2	Only domestic operations	54,000,000	20,025,000
3	Institutions specialized in corporate clients	36,000,000	13,350,000
4	Institutions specialized in emission of money and payments	36,000,000	13,350,000

Source: Credit Institutions Act

This encourages the creation of new specialized intermediaries who can gather funds from the public, have access to the payment system and be subject to the same regulatory standards as multiple banking, but whose minimum capital requirement is lower. According to the Alliance for Financial Inclusion (2010), though Mexico has not authorized non-banking institutions to issue electronic money, niche banks can do so, under lower capital requirements than traditional banks.

Currently there were four authorized niche banks, as shown in table 3:

Table 3  
**Niche banks**

Bank	Services offered
<b>Banco Bicentenario</b>	Financing foreign trade companies.
<b>Agrofinanzas Banco</b>	Loans for agro-businesses and medium-sized agricultural producers.
<b>Banco Forjadores</b>	Group micro-loans to small entrepreneurs.
<b>Banco Pagatodo</b>	Payment channel services in small and medium-sized retailers (prepaid cards, payment for services, recharging of cell phones, loyalty programs, distribution of government aid programs such as pensions for elderly adults in the Federal District).

Source: BBVA Research with information from El Economista. "CNBV autoriza creación de dos bancos de nicho" (CNBV authorizes the creation of niche banking), September 18, 2012

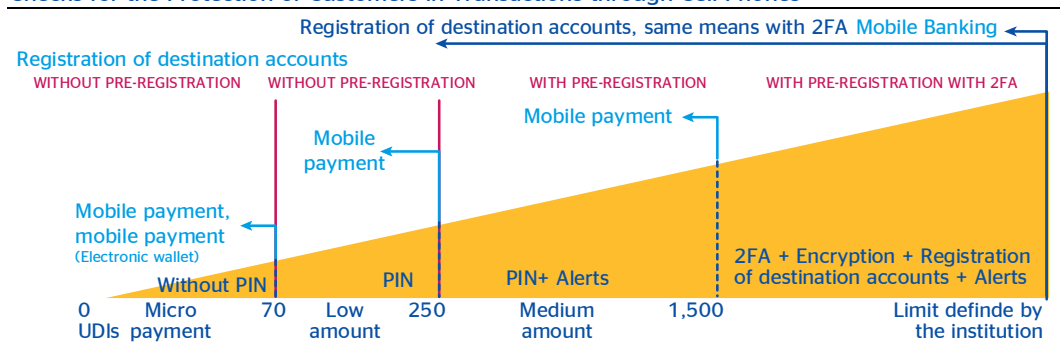


## Customer identification and security mechanisms

The CNBV assumes a risk-based approach in defining the growing controls of customer authentication based on the amount of the transaction and its implicit risk, as the CUB indicates that banking institutions must use authentication factors to check the identity of its users and their ability to carry out transactions through the online banking service.

A gradual approach to authentication and transmission of data for mobile financial services based on the amount of the transaction makes it possible for micro-payments<sup>9</sup> to be carried out without need for a PIN, so that these payments are quick and simple. As the transaction amount increases, two authentication factors (FA), as well as additional security systems, are required, such as encryption, pre-registration of all payment beneficiaries and mandatory notices for the user. This progressive approach is shown below.

Chart 5  
Checks for the Protection of Customers in Transactions through Cell Phones



Source: CNBV (2012a)

## Evaluation

The recent regulatory changes to the Mexican financial sector have encouraged the appearance of new participants in the financial system and the generation of new business formulas in accordance with the needs of the regions and social sectors that are still not being attended to. The aim is for the greatest number of people to have the possibility of benefiting from the financial system through the appropriate use of financial products and services. This new regulation has followed in the steps of other international experiences in which the models based on a range of financial services through mobile telephony have led to significant advances for the financial inclusion of the population without access to banking services.

The recent regulatory changes in Mexico, focused on establishing a system of simplified bank accounts, an extensive network of banking correspondents and the concept of niche banking, have provided favorable conditions for the development of the mobile banking market.

The system of simplified accounts increases the number of potential users by increasing the critical mass of customers needed for the model to be profitable for the suppliers and attractive to those who use it. Furthermore, the correspondents provide greater access to

<sup>9</sup>: Transactions up to the equivalent in national currency of 70 UDIs.

cash deposits and withdrawals for the population residing far from traditional branches, thus increasing the availability of the funds for mobile financial services users.

Finally, the mobile payment schemes are attractive to the population without access to the financial system as they increase access to financial products and services; provide products and services that are easier to use; decrease the risks involved in carrying cash and reduce the operational costs for both banks and customers.

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