

BANGOR BUSINESS SCHOOL



Correspondent banking 4.0

New correspondent banking initiatives for cash-based societies must be mindful of the social context in which they operate, say José Alarcón-Molina, Ministry of Health, Chile; Juan Espinosa-Cristia, Andrés Bello University, Chile; and Bangor University's Bernardo Bätz-Lazo.

Internet banking and digital payments have made significant inroads in Australia, Europe and North America, but Latin American countries, in which bank notes and coins remain the chief medium to settle retail transactions, remain cash-based societies.

Here, retail bank branches are unsurprisingly often full of people – customers and non-customers – queuing up to deposit money, cash cheques, pay bills or conduct remittances. Many Latin American countries lack a dense retail branch network outside the main commercial cities; established banks don't offer convenient access to ATMs across the country while regulation denies possibilities for independent ATM deployers.

Faced with such challenges, some financial institutions in Latin America have invested in examining every aspect of their cash management journey, identifying inefficient processes and areas where new technology could make a difference. At the same time, a number of entrepreneurial start-ups, or FinTechs, have been looking to leverage technological applications to address that type of problem. Some of these initiatives work in tandem with established financial institutions while others aim to work around them.

The rise of Correspondent Banking

An example of the former initiatives is a remote banking service commonly known as correspondent banking or agent banking. For those new to the idea, a quick description may be in order.

Correspondent banking agreements first emerged in early modern capitalism. They envision a contract where one financial intermediary

provides services on behalf of another for a fee (charged to the agent bank, the customer or both). The service provider (correspondent/sub-agent) will typically keep cash deposits from the agent bank to facilitate customer transactions. For instance, thanks to its correspondent banking agreements London-based Midland Bank, today HSBC, was able to claim the accolade of “biggest bank in the world” (in terms of assets) in the 1940s and 1950s.¹

Correspondent banking grew as it enabled international trade in the absence of electronic transfers and global banks. Interestingly, in the USA it also enabled small and medium-sized banks to provide commercial services given restrictions to geographic growth of retail banks and retail bank branch networks.

According to recent survey by the International Monetary Fund, correspondent banking remains an important although less significant function at the turn of the 21st century.² This is due to its continued role in facilitating foreign exchange operations, international trade, and cross-border remittances.

A new take

Correspondent banking thus emerged and has been used in financial markets primarily to solve the problem of geographic distance. In the late 1990s, however, Brazilians transformed the correspondent banking model by legally nominating and delegating commercial establishments to offer services otherwise provided in the retail branches of financial institutions.³

The Brazilian innovation spread throughout Latin America while using correspondent banking to ameliorate not only geographic distance, but also rugged terrain, high crime rates in cities, or inadequate retail banking and communications infrastructures. Most of these initiatives also sought to increase financial inclusion by enabling cost-effective access to retail financial services for people living in regions where it was uneconomical to operate fully owned retail bank branches and ATMs. This was indeed the rationale that led BancoEstado, a government-owned but commercially run bank, to approach Chilean retailers of different sizes and launch a network of correspondent banking retailers in 2005 called “CajaVecina”.


The CajaVecina network envisioned the deployment of a purpose-built point of sale terminal among independent small and micro grocery retailers in urban and rural settings to provide low-income Chileans access to banking services including cash withdrawals and deposits, balance enquiries, money transfers, and credit card payments.

Theory vs reality


A key feature of correspondent banking is that both the customer and his/her bank expect the service provider (sub-agent/correspondent bank or in this case, a small retail shop) to act as if the customer were dealing with his/her bank (in this case BancoEstado).

However, our fieldwork in Chile among retailers who signed up to CajaVecina suggested the shop owner often departed from the norms of the agency agreement in at least two ways. First, we found behaviour aimed to reward loyal customers and preserve cash on hand. Shop owners would, for instance, protect the level of their cash float through mendacity, that is, telling non-recurrent customers that the CajaVecina terminal was broken when that was not the case. Alternatively, they would keep the recurrent customer's details and cash while finalising the transaction at a time of low foot traffic – when they are legally required to finalise a transaction with the customer physically present.

A second form of departure, one which is also difficult for BancoEstado to police, relates to security. Shops with CajaVecina terminals are often located in high crime zones or rural areas, locations where BancoEstado was particularly keen to increase financial inclusion and seldom serviced by bank branches or ATMs.



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But the shop owner and neighbours are well aware that a CajaVecina service could increase the amount of cash located at the shop, thus increasing the risk of robbery. In response, the shop owner would adopt strategies that reward recurrent customers or limit the service to hours of high foot traffic.

In summary, the case of CajaVecina suggests that for all the promises of greater efficiency and financial inclusion on the back of technological innovation, system designers mustn't lose sight of the social context in which these innovations will operate. **CB**

¹ Holmes, A.R. and Green, E. (1986). Midland: 150 Years of Banking Business. London, B.T. Batsford

² Liu, Yan and others (2017) Recent Trends in Corresponding Banking Relationships: Further Considerations, Washington, DC: International Monetary Fund. Available at: <https://www.imf.org/-/media/Files/Publications/PP/031617.ashx> (Accessed 11-Jul-2019).

³ Loureiro, E., Madeira, G., & Bader, F. (2011). Expansão dos correspondentes bancários no Brasil: uma análise empírica. Trabalhos para discussão, Banco Central Do Brasil.



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