



## Social Protection Discussion Paper Series

Transferring Cash Benefits Through the Banking Sector in Colombia

by Maria Teresa Lafaurie and Claudia A. Velasquez Leiva

May 2004

Social Protection Unit

Human Development Network

The World Bank

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# Transferring Cash Benefits Through the Banking Sector in Colombia

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May 2004

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## GLOSSARY OF TERMS

<b>OMO:</b>	Open Market Operations
<b>GDP:</b>	Gross Domestic Product
<b>IMF:</b>	International Monetary Fund
<b>IBRD:</b>	The World Bank
<b>IDB:</b>	Inter-American Development Bank
<b>FOREC:</b>	Fund for the Reconstruction and Social Development of the Coffee Cluster - ( <i>Fondo para la Reconstrucción y Desarrollo Social del eje Cafetero.</i> )
<b>PAC:</b>	Annual Fund Plan - ( <i>Plan Anual de Caja</i> )
<b>DNP:</b>	National Planning Department - ( <i>Departamento Nacional del Planeación</i> )
<b>DAPR:</b>	Administrative Department of the Presidency of the Republic ( <i>Departamento Administrativo de la Presidencia de la Republica</i> )
<b>FIP:</b>	Peace Investment Fund - ( <i>Fondo de Inversiones para la Paz</i> )
<b>SISBEN:</b>	Beneficiary Identification System ( <i>Sistema de Identificación de Beneficiarios</i> )
<b>IPS:</b>	Health Care Provider ( <i>Institución prestadora de salud</i> ).
<b>POS:</b>	Point of Sale .
<b>ATM:</b>	Automatic Teller Machine
<b>PIN:</b>	Personal Identification Number
<b>CARDHOLDER:</b>	Holder of a Debit or Credit Card.
<b>CDT:</b>	Fixed Term Deposit Certificate - ( <i>Certificado de Depósito a Término</i> ).

## PREFACE

This report has been prepared by the consultants following the Terms of Reference (refer to Annex 1) provided by the World Bank. Such document requested an analysis of the practical aspects and the relative costs required to transfer cash benefits through the Banking Sector.

The consultants were in charge of the implementation and commissioning of the Colombian Cash Transfer Program titled *Familias en Acción* (Families in Action). For two years, María Teresa Lafaurie acted as the National Coordinator of the Government's Social Safety Net, whose main component was the Conditional Transfer Program. She began her participation in the National Planning Department during the Program's final design phase, and was subsequently appointed as General Strategy Coordinator during the overall commissioning and stabilization process.

Claudia Velasquez was initially in charge of the payments division in the process design, definition and commissioning phases, and was subsequently appointed to the Program's Management Information System as the party responsible for all the processes defined for Program operation.

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## Executive Summary

The following list presents the main conclusions of the document “Transferring Cash Benefits through the Banking System in Colombia”, which focuses on the practical aspects and relative costs required to transfer cash benefits through the banking sector.

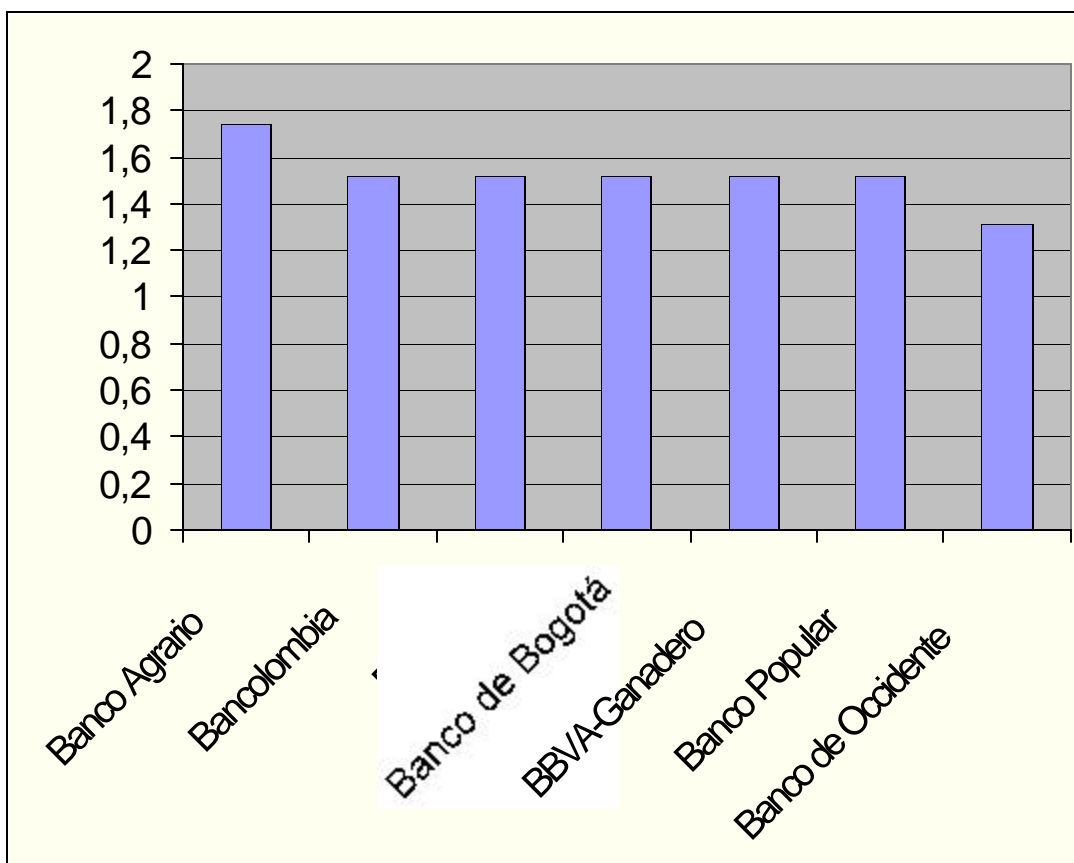
- Colombia relies on a mixed banking network which consists of seven banks, six local and one foreign. Out of these seven institutions, two are state-owned and the other five are privately owned. Only a bank consortium can guarantee maximum coverage to the target municipalities.
- The greatest advantages in relying on the bank system for transfers:
  - Expertise in cash management.
  - Alternative technology-based arrangements.
  - Experience as payers.
  - Geographical Coverage: 89.4 percent of total eligible municipalities in Colombia.
  - Risk Management.
  - Leaders in processes and technologies.
- Some disadvantages were also identified:
  - Those municipalities that lack a branch office may be excluded (10.6% of eligible municipalities).
  - The program’s operating scheme must rely on the specifications of the banking system.
  - There is also the risk that some of the banks hired may abandon the program.

The cost of the transfer was agreed at a single rate per payment provided, regardless of the geographical location, distance or other variables. This improves the efficiency of the reconciliation process and minimizes cost related impacts for remote locations. Chart 1 shows the cost per transaction agreed with each bank.

The Colombian Program covers 622 municipalities out of a total of 696 eligible target municipalities. This means a fairly high effectiveness of an 89.4 percent coverage. The ratio between benefited population in municipalities with banks against population in all eligible target municipalities amounts to 91.7 percent, as remote municipalities have lower population density than non-remote municipalities.



**Chart 1: COST PER PAYMENT MADE IN THE BANKS - US \$**



**Note:** For all banks, under this negotiation the program will deposit the funds five days before the beginning of the payment process.

The program has addressed all extra cost issues related with remote municipalities. The banks have centralized their procedures and therefore can ensure full effectiveness and consistency in payments, regardless of location.

- The payment mechanism and frequency is described below:
  - Transfers shall be completed at branch offices through direct payments over the counter. For such purpose, applicable ID is required (citizenship or identity cards). Beneficiaries are not required to open an account. The frequency is bimonthly. Under no circumstances will payment be provided to a person other than the main benefit holder.
  - This payment mechanism, which involves personal appearance, submission of applicable ID, and individual assistance over the bank's counter, prevents all risks related with cash deviation/collection of unlawful fees and intimidation that may divert program funds to individuals other than the benefit holder. In addition, the beneficiary must sign his/her consent, due to which all risks of fraudulent appearance are fully undertaken by the Bank.

- The payment agreement with the banks involves a rate per payment made. Therefore, if due to any reason the Program needs to temporarily interrupt payments, no costs will be charged by the Banks.
- The optional payment mechanisms discussed for the Colombian program were:
  - **TRUST COMPANY**
    - The system originally included in the program design which involves a trust company that would in turn manage the banking network.
    - Involved higher program costs as a result of the management fees charged by these institutions: US\$7 million. Involved 7 additional days for the payment cycle. No added value for the operating processes
  - **VOUCHERS**
    - design requires cash payments and vouchers are a substitute of cash to purchase goods and services. The philosophy of vouchers became impaired under the program, which brought multiple operational difficulties.
  - **THE BANK OF THE NEAREST MUNICIPALITY**
    - A convenient system for small municipalities located near municipalities with a bank. The system has not been implemented in Colombia since there is an agreement not to include more municipalities for the meantime.
  - **THE COLOMBIAN TELECOMMUNICATIONS COMPANY (TELECOM)**
    - This is not legally feasible in Colombia.
  - **TRANSPORTER OF VALUABLES**
    - In Colombia, valuables must be transported by air for safety reasons.
    - The Mayor's Office of the Municipality that makes the payment requires a cash management insurance policy.
    - This is a very good alternative for remote municipalities that were excluded for not having a bank. It has not been implemented in Colombia because the design prevents the introduction of additional municipalities.
- The Families in Action program considered options other than the banking network mainly to cover remote areas that were excluded from the program as they lacked a bank office. Unfortunately, size-related reasons prevented the implementation on such municipalities. If the budget would have permitted more

municipalities, the options chosen by the Colombian program would have followed this order:

- Banks in the adjacent municipality: 10 municipalities
  - Transporter of valuables: 64 municipalities
- Using innovative technologies could be a feasible alternative, but this requires a deep analysis of the market, technological development, coverage, and specific costs, since developing countries show a varied level of banking e-business maturity. The products assessed were:
- **PREPAID DEBIT CARD**
    - No need to open a bank account.
    - The card can be used at different POS and ATMs. Therefore, coverage is limited to the existing network of ATMs and POS.
    - Beneficiaries do not need to travel to the bank office.
    - Greater security due to the use of a secret password.
    - Given its efficient cost structure, banks can provide lower rates.
  - **SMART CARD**
    - No need to open a bank account.
    - Can be used in remote areas difficult to reach in terms of communications because of off-line chip scanning.
    - High cost in terms of technological adaptations and expensive card (US\$3) compared to the current cost of a Debit Card (US\$0.20).
    - Low coverage in Latin American countries.
    - The card must be taken to reload the chip. Therefore, the location of the reloading points deserves operational attention. Those countries wishing to implement this option should carefully investigate the level of progress of the card.
  - **AUTOMATIC CLEARING HOUSE SYSTEM**
    - Requires the opening of a bank account.
    - The beneficiary can schedule the date for fund withdrawal with the bank.
    - Flexibility in payment scheduling (for the program).
    - Lower costs than traditional options (for the program).
    - Nation-wide coverage (the same as the banking network).
    - Effective use of financial resources (for the program). It may involve account maintenance costs charged to the users by the banks. If the program is expected to bear such costs, it may be an overly expensive option.

- We recommend an investigation of this system’s level of progress in the country where it is intended to be implemented.
- **TRAVELING BANK**
  - Allows to reach remote locations that lack a traditional office. Implies the transportation of cash among municipalities; this can increase transaction costs.
  - The following table shows a summary of all the options considered, along with the applicable costs for the Colombian case:

**Table 1: TRANSACTION COSTS OF PAYMENT OPTIONS**

<b>PAYMENT OPTION</b>	<b>UNIT COST US\$</b>
<b>DEBIT CARD</b>	0.60
NETWORK OF BANK BRANCHES NEAREST MUNICIPALITY	1.74
VOUCHERS	1.74
TRANSPORTER OF VALUABLES	2.50
TRUST COMPANY	3.83
INTELLIGENT CARD	N.A.
ACH	*5.48
TRAVELLING BANK	*4.24
TELECOM	N.A.

*\*Estimated value:*

*ACH includes transfer and maintenance costs for checking or savings accounts.*

*Costs for the Traveling Bank include the transportation of valuables and payment of transfers.*

- After analyzing all the options, we recommend the use of a bank network that guarantees maximum coverage.

If the Colombian case can be compared to other countries, we must conclude that no single solution applies. Considering the countries’ different levels of development, the options to be studied should be subject to a deep and anticipated program setup analysis, in order to assure equity for the beneficiaries and cost-effectiveness for the program.

## **I. INTRODUCTION**

In response to the most severe economic crisis faced by the country during the last seventy years, Colombia has implemented the following three social programs: Empleo en Acción (Employment in Action), Familias en Acción (Families in Action) and Jóvenes en Acción (Youth in Action). The Families in Action program provides cash transfers to poor households who meet certain conditions - such as taking their children to school and to preventive health care services, (based on the child's age). In order to ensure that the resources are effectively invested in the children, transfers are made to the woman of the household. The amount of the benefit varies according to the age of the child. A primary school age child receives US\$6 per month, while a secondary school child receives US\$12 per month. Those families that take their children to preventive health care facilities receive US\$20/month.

This report discusses the experience of just one aspect of the Families in Action program, i.e. the system to transfer benefits to beneficiary households. This logistical and administrative function is a relevant aspect of all fund transfer systems, and often presents a considerable challenge. The experience of this program is presented here as an example to assist other programs.

### **A. BRIEF HISTORY AND DETAILS OF THE PROJECT**

As stated by the Presidential Council for Social Policy, in their book entitled "*POLITICA SOCIAL, POBREZA Y DESARROLLO*" Volume 1: "The Social Safety Net is a set of government actions, within the framework of the social risk system, targeted both at the poor who have been most severely affected by the economic crisis of the late nineties (see Annex 2 for a Macroeconomic Summary), and at those who, for various reasons, live permanently in conditions of extreme poverty. The programs that make up the Net are therefore designed to address those risks which create vulnerability in households (for instance, a drop in income), and to promote investments in human capital, thereby enabling the target population to overcome poverty through these actions".

To fund this strategy, the Colombian Government signed three foreign credit operations with the World Bank and the Inter-American Development Bank for an amount of US\$526 million. A Coordinating Unit was established under the guidance of the Presidency of the Republic to put into effect a strategy based on three programs: Employment in Action, Families in Action and Youth in Action.

Employment in Action is aimed at protecting the income of the poorest unemployed households, by providing support for small social infrastructure projects. Families in Action is a conditional cash transfer program for extremely poor families in more than 600 municipalities. These have been selected based on absolute poverty levels and an adequate supply of health care and educational services. The third program, called

Youth in Action, targets the unemployed youth of the country and aims to improve their employability through skills training and an additional component to help them to project their future.

The Families in Action program began its operations in January 2001, with the launching of a pilot project in 22 municipalities. It was then developed through a two-stage expansion phase, to achieve full coverage of the 622 municipalities that are currently receiving assistance.

## ***B. BRIEF HISTORY OF THE BANKING SYSTEM***

The origins of the Colombian banking system go back to 1841, when the first banking institution was created, the *Compañía de Giro y Descuento*. Subsequently, in 1864, an English bank, “The London”, opened a branch in the country. The first commercial bank with fully domestic capital was established in 1870, under the name of Banco de Bogotá. At the same time, subsidiaries of foreign banks were operating to provide banking services.

In 1923, following the recommendations made by the Kemmerer mission, Act 45 of 1923 was enacted, resulting in the modernization of the banking service. This law remained in place until 1990, when, under the so-called Finance Reform, a new Act 45 of 1990 was passed. Following the principle of economic liberalization, this law opened the economy to foreign capital, which until then had been restricted, placing a restraint on the development and growth of the banks.

In response to the financial crisis of 1982, protectionism in the banking sector – called “Colombianization” – had limited the participation of foreign capital to 49 percent of the banks’ shares. Colombian banks saw their development and modernization stalled, and this had serious implications on their efficiency and competitiveness. This resulted in extremely high intermediation costs compared with banks in other Latin American countries and in more developed countries.

Market scope and conditions have an impact on the performance of the banking sector as a means of distributing social monetary benefits. Therefore, we need to briefly describe the Colombian banking system to help the reader understand the context.

The finance reform law launched an opening-up to foreign capital that has resulted in the arrival of big multi-national banks and a dizzying rate of development, culminating in rapid technological progress and fierce competition. This has obviously meant improvements in the services traditionally provided by banks to their customers. However, we should mention that intermediation margins are still very high, with a current average of about 7 percent, compared to the figure for developed countries which stands at 4 to 4.5 percent. A desirable figure for a country like Colombia is 5 percent.

This is an important issue, since the fees that banks charge are directly related to market conditions. If openness in trade and competition among the banks continue, considerable improvements could be achieved in terms of rate negotiations. Banks are evolving quickly in this respect, with technological innovations that improve efficiency and reduce costs. We must therefore remain alert to find the most favorable market conditions.

Colombian banks have another very important characteristic, which is that they have extensive experience in cash payments. This task has been entrusted to them by public and private agencies, which need to pay considerable amounts of cash to their beneficiaries, such as retirees, teachers, payrolls, suppliers etc. Additionally, the banks collect payments of taxes, public utility bills, mobile telephone bills, tuition fees for schools and universities and many other services. This is very valuable experience for the implementation of large volume payments since they can organize a payment system in record time as compared to other alternatives.

Annex 3 provides a detailed analysis of the types of Banks operating in the country, as well as a list of all the banks that currently operate in Colombia, the different players involved in the Banking System, and the tasks performed by each. This information is considered to be highly relevant for the reader who wishes to learn more about the Colombian Banking System.

### ***C. ORGANIZATION OF THE REPORT***

The report is organized in three chapters which provide an in-depth analysis of the cash transfer program implemented in Colombia. To help the reader learn about the Colombian context and understand typical features of this country, the report provides detailed information about the macroeconomic setting in which these types of programs are structured; a description of the Colombian banking sector, its features and main players.

Secondly, we describe in detail the process by which the mechanism that was first selected in the design stage of the program was discontinued; the main applicable arguments; details of the initial financial cycle implied by this decision; and the original arguments for the decision to make use of the banking system.

In addition, the report provides: in-depth information on the hiring of banks to make the transfers through their network of branch offices; a description of the financial cycle; a detailed description of the role played by beneficiary mothers and by all the players involved in the process; a revision of the impact that the payments have had in terms of the complaints made by the beneficiaries; opinions gathered from different regions of the country; and a detailed review of the security aspects which are a major concern for the Bank.

Relevant guidelines are also provided regarding the process of negotiating with the banks; the importance of being familiar with market aspects; and analysis guidelines for rate negotiations with banks.

Thirdly we describe other payment options which we tested or tried to test in the case of Colombia, with the lessons learnt in each case. Additionally, the consultants suggest other options offered by Banks with more advanced techniques, their features, operating cycles, and recommendations on how they could be implemented in these types of programs. The consultants also propose options using other mechanisms than the banks, which might be implemented depending on the conditions of each program and the degree of development in each case.

The final chapter provides conclusions and recommendations, specifically reviewing the options explored for Colombia. Justifications are provided for the option selected as well as information about other options that might be considered.

## **II. CURRENT SYSTEM AND DEVELOPMENT**

### **A. OPTIONS CONSIDERED: TRUST COMPANIES Vs BANKS**

#### **1. Background**

The Families in Action program is targeted at households that belong to SISBEN Level 1 and who have children under 18 years of age. The program's aim is to help families keep their children in school and to guarantee adequate levels of nutrition and health care. To achieve these aims, the program has defined two types of grants, i.e. school and nutrition grants, which are provided to beneficiary mothers as from their registration until June 30, 2004.

The initial design was based on the recent experience of the Fund for the Reconstruction of the Coffee Cluster (FOREC)<sup>1</sup>. Based on this initiative, the initial design sets forth that "all the resources provided by the National Government, i.e. foreign credit resources and current domestic resources to fund nutrition and school grants, will be managed by a Trust Company. The DAPR-FIP will provide the applicable instructions for the Trust Company to proceed with payments".

Based on the above decision, the Colombian Government negotiated credit No. 1280 with the IDB, which was signed on June 19, 2001. Clause III, 3.01, Annex A of this agreement provides that "systems hired will include project information system management and trustee services for the disbursements required under the household program".

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<sup>1</sup> See Annex 2 for information about this Fund.



The program would then set up a management and payment trust agreement, through which the Trust Company would collect the resources from the Nation and Multilateral Banks through direct transfers made by the Trustor to the bank accounts for each fund source.

According to the initial design, the DAPR-FIP would hire the trust company which in turn would carry out the appropriate actions with the banking network. The network is in charge of making the final payments to the eligible households. Therefore, the trust company is responsible for managing the payments through a banking network, for consolidating the information, and for submitting the appropriate reports to the program.

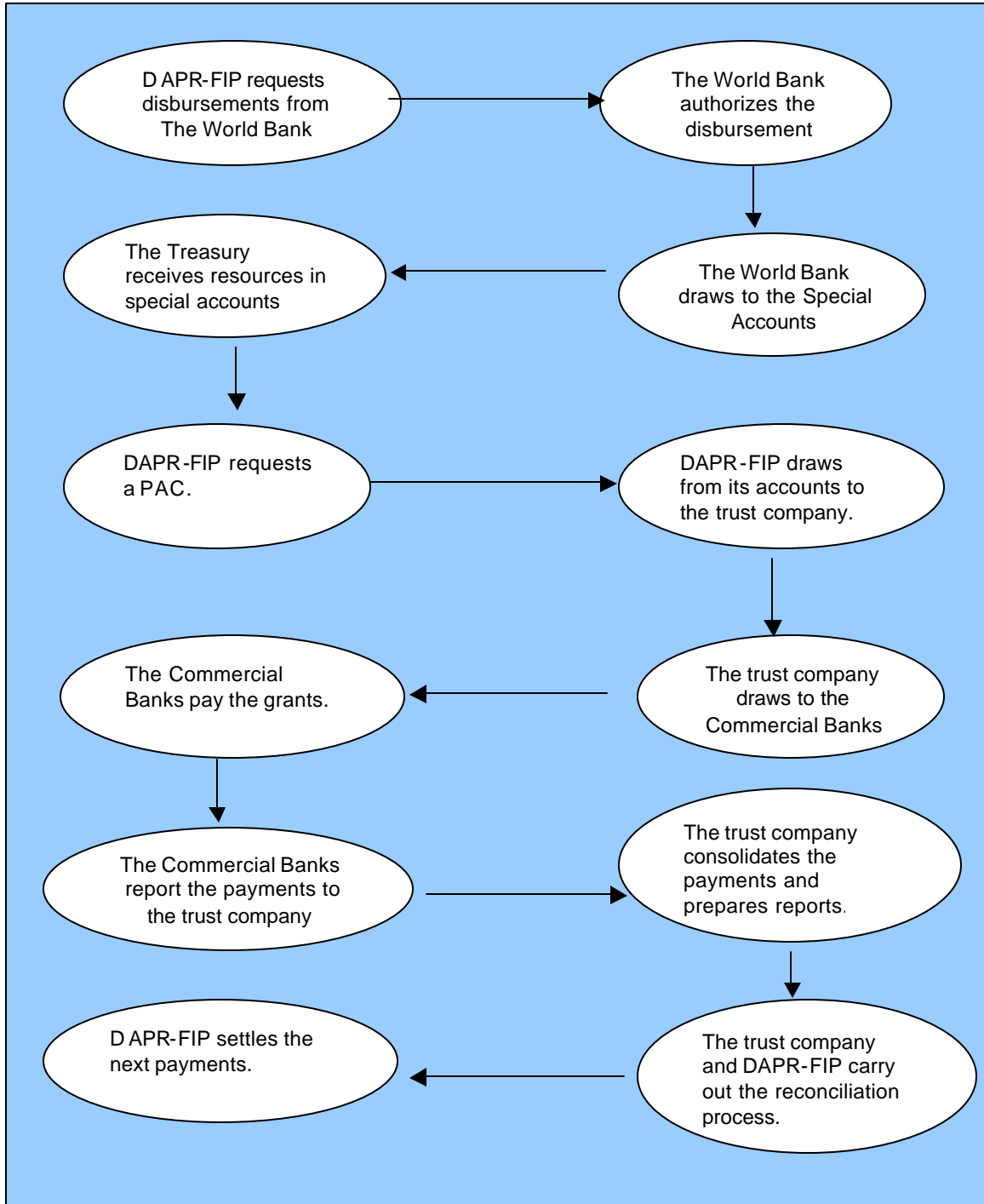
The Coordination of the Social Safety Net and the program, jointly with the DNP, scheduled the first meetings with the trust institutions for September 2000, to discuss the design of the fund management task described above.

This review concluded that a trustee approach for the case would provide no operational advantage, since under the design, the program was responsible for the tasks related with settlement and reconciliation, complaint management and data base administration. On the contrary, a trustee approach would mean additional costs for the program, based on the following issues:

- The success of the trustee approach in social projects such as the FOREC is not comparable with the cash transfer program, given the latter's national coverage. The FOREC was targeted at a restricted geographical area.
- Trustee operations in Colombia mainly cover larger cities, which are not included in the municipalities targeted by the program. However, should they be willing to cover the targeted municipalities, they would do so through agreements with banking institutions, which means extra intermediation costs for the program. These costs can be avoided by establishing direct agreements with the financial institutions.
- The operational costs involved in the Trustee approach amount to approximately 6 percent of the funds disbursed, excluding the transaction costs charged by the banking network which amount to approximately 5 percent. This yields a total of 11 percent in operational costs.
- In operational terms, the trust company is a mere intermediary between the DAPR-FIP and the banking network, and has no responsibility related to the payments made to the beneficiaries. Therefore, coverage of the municipalities defined in the program could be provided most effectively by financial institutions.
- An analysis of the operating scheme revealed its enormous burden, with double reconciliation of payments, which increased the likelihood of errors. The time period to finalize the payment cycle increased by at least 10 percent, which had a negative impact on the productivity required to comply with the bimonthly payment cycle which had been laid down.

Chart 2 describes the payment cycle through the trust company, according to the initial program design.

**Chart 2: INITIAL PAYMENT OPERATION SCHEME UNDER THE COLOMBIAN CASH TRANSFER PROGRAM**



An analysis conducted by the Program's System Management found that the 60 days laid down for the cycle were insufficient, taking into account that a series of activities must be completed before the payment process can begin. A comparative analysis of these activities for the options with trust company and with banks is shown in Table 2 "COMPARATIVE ANALYSIS OF THE ACTIVITIES INVOLVED IN THE PAYMENT CYCLE". The table shows the considerable time that was saved by eliminating the trust company.

Given this restriction, the Continuous Improvement Committees decided to eliminate all those processes that were not absolutely indispensable for the payment cycle. The first process left out was the participation of the trust company.

Clearly, actions must be taken on those variables that are under the direct control of the Program, since, as will be seen later, there are other extraneous factors where it is much more difficult to make changes or improvements.

Table 3 "COMPARISON OF PAYMENT OPTIONS" compares the two options. The evidence regarding the advantages involved in establishing a direct relationship with the banking network are conclusive.

**Table 2: COMPARATIVE ANALYSIS OF THE ACTIVITIES INVOLVED IN THE PAYMENT CYCLE**

<i>ACTIVITY</i>	<i>RESPONSIBILITY OF</i>	<i>DAYS WITH TRUST CO.</i>	<i>DAYS WITH BANKS</i>
FULFILLMENT OF COMMITMENTS			
COLLECTION OF MUNICIPALITY ES2	OUTSOURCING	10	10
COLLECTION OF ES2 DEALT WITH	OUTSOURCING	3	3
OPENING AND READING ES2	OUTSOURCING	15	15
RECEPTION AND FILING	PROGRAM	1	1
FILE LOADING	PROGRAM	1	1
INCONSISTENCIES	PROGRAM	1	1
FULFILLMENT OF COMMITMENTS TO SETTLE		31	31
BANK RECONCILIATION			
SUBMISSION OF FORMER CYCLE PAYMENT FILE	BANKS	15	15
RECONCILIATION AND SUBMISSION OF FORMER CYCLE PAYMENT FILE	TRUST COMPANY	5	0
RECONCILIATION OF FORMER CYCLE PAYMENT FILE	PROGRAM	3	3
SUBMISSION OF SIFA PAYMENT FILE	PROGRAM	1	1
FILE LOADING	PROGRAM	1	1
INCONSISTENCIES	PROGRAM AND BANK	1	1
BALANCE FOR SETTLEMENT		26	21
SETTLEMENT	PROGRAM	3	3
CREATION OF FILE AND REVISION	PROGRAM	1	1
CREATION OF FS1 FS2 LISTS	PROGRAM	5	5
DISTRIBUTION OF FS1 FS2 LISTS	PROGRAM	3	3
SUBMISSION OF CD TO TRUST COMPANY	PROGRAM	1	
SUBMISSION OF CD TO BANKS	PROGRAM/ OR TRUST CO.	2	1
SETTLEMENT PROCESS		15	13
<i>ACTIVITIES</i>	<i>RESPONSIBILITY OF</i>	<i>DAYS WITH TRUST CO.</i>	<i>DAYS WITH BANKS</i>
BANKS PAY ELIGIBLE HOUSEHOLDS	BANKS	20	20
PAYMENT PROCESS		20	20
REQUESTING RESOURCES FROM THE TREASURY	PROGRAM	0	0
DRAFT TO THE BANK	PROGRAM	2	2
RECIPROCITY TIME	PROGRAM	5	5
FINANCIAL PROCESS		7	7
TOTAL DAYS OF PAYMENT CYCLE		68	61

Note: **Activities marked in red** are not included in the total as they are simultaneous to the settlement and payment process. They are listed given their importance within the payment process and because they are part of the cycle.

**Table 3: COMPARISON OF PAYMENT OPTIONS**

<b>PROCESS DESCRIPTION</b>	<b>WITH THE BANKING NETWORK</b>	<b>WITH THE TRUST COMPANY</b>
<b>COVERAGE</b>	<b>NATION-WIDE COVERAGE</b>	<b>ONLY HAS OFFICES IN LARGER CITIES.</b>
<b>COSTS</b>	<b>ESTIMATED AVERAGE OF 5 PERCENT OVER TOTAL PAYMENTS</b>	In addition to the banking network costs, there is an additional 6 percent. This yields a total of 11 percent over total payments.
<b>RECONCILIATION</b>	<b>ONE RECONCILIATION WITH THE PROGRAM IS REQUIRED.</b>	Two reconciliations are required, one with the banking network and one with the program.
<b>PROCESS TIME</b>	<b>MEETS THE SCHEDULE LAID DOWN BY THE OPERATIONS MANUAL EXACTLY</b>	Increased by an additional 10 percent over the schedule laid down by the Operations Manual.
<b>ADDED VALUE IN PAYMENT PROCESS</b>	<b>CARRIES OUT THE PAYMENT TO PROGRAM BENEFICIARIES.</b>	No additional input to the process; only resource intermediation between the program and the banks.

## **2. Savings Made in the Colombian Cash Transfer Program**

Under the initial program design, implementation was to be carried out in phases. Implementation on a small scale was to begin in municipalities of the Departments of Tolima and Boyacá, and be complemented by the inclusion of the Departments of Cundinamarca, Antioquia and Putumayo.

The National Government decided that an expansion phase should be implemented in order to cover households in more than 300 municipalities. This phase was concluded by the end of 2001. The second expansion phase was effected during the first semester of 2002 to bring coverage to a total of 622 municipalities.

Table 4 shows total expected payments to be made under the program, including payments made in 2001 and 2002. Also included is a cost savings estimate for each period as a result of the elimination of the trust company, which would amount to approximately US\$ 7 million. This represents an average of 600 household grants.

**TABLE 4: COST SAVINGS (US\$)**

<b>RESOURCES FROM</b>	<b>PAID 2001</b>	<b>PAID 2002</b>	<b>PROJ 2003</b>	<b>PROJ 2004</b>	<b>TOTAL</b>
IDB	2,985,153	11,539,216	14,421,291	6,586,030	35,531,690
WORLD BANK	2,286,026	21,432,800	42,582,100	16,437,254	82,738,181
<b>TOTAL COUNTRY</b>	<b>5,271,179</b>	<b>32,972,017</b>	<b>57,003,391</b>	<b>23,023,284</b>	118,269,871
CURRENT BANK CHARGES.	277,729	2,109,761	3,448,226	1,340,490	7,176,207
MANAGEMENT COSTS WITH TRUST COMPANY (*)	593,886	4,141,543	6,822,355	2,722,105	14,279,888
<b>COST SAVINGS</b>	<b>316,157</b>	<b>2,031,781</b>	<b>3,374,128</b>	<b>1,381,615</b>	7,103,682

*SOURCE: INFORMATION PROVIDED BY THE PROGRAM. Projected devaluation for years 2003 and 2004 is estimated at an annual average of 10 percent. Costs for the trust company are estimated at 11 percent over total grants settled, which includes management and intermediation with banking institutions.*

The operation's initial design was drawn from a successful scheme used in another Government program (FOREC). However, no in-depth analysis was made of the different options that could be used for the cash transfer payments. The payment system proposed involved an additional cost of US\$7 million for the program, without any guarantee of increased operational efficiency.

In this particular case, and given the experience acquired by some of the staff hired to implement the program in the Colombian banking system, the same staff members led the changes that took place during the implementation stage. However, it is preferable for this type of analysis to be conducted during the design stage in order to guarantee improved efficiency and prevent delays during implementation.

This explains why a re-negotiation process with Multilateral Banks had to be undertaken when the program was already underway, as it was necessary to modify contractual clauses which still included the Trust Company. This means additional time and work for the executors, which in our opinion should be devoted to the implementation tasks.

The following paragraphs describe the negotiation process with the Multilateral Banks and its outcome:

### **3. Agreements with Multilateral Banks**

Taking into account the arguments provided by the officials of the Government of Colombia (RAS Coordination and National Planning Department), The World Bank approved the elimination of the Trust Company simultaneously with the negotiation of credit No. 7050, effective as from November 9, 2001. Based on this approval, the Program was entitled to negotiate agreements with one or more commercial banks to the satisfaction of The World Bank. At that time, the World Bank authorized the negotiation process with Colombian commercial banks.

The process with the Inter-American Development Bank was lengthier, as it required the GOC to submit an amendment request to credit No. 1280 agreed on June 19, 2001, which provided for the contractual agreement of the Trust Company scheme. The application was submitted on February 26, 2002, approved on August 28, 2002 and duly signed on October 10, 2002, with a new clause worded as follows:

“The services to be hired shall include: the management of the project information system; and payment services for the subsidies under the household support program, through Financial Institutions and other payment institutions authorized by the Program and the Bank. In locations with only one financial or payment institution, direct agreements will be established with that institution; otherwise, institutions will be selected based on lower management costs and wider coverage”.

With this amendment, the IDB approved the bank selection process, which took place during year 2001.

### **Lessons Learnt**

The most important lesson learnt from this process is that former experiences which have proved successful will not necessarily be the most suitable for different models in the future. This is basically because operation schemes should meet program designs and be based on the fundamental objectives for which they were created, rather than the reverse.

In the case of the FOREC, whose main purpose was the reconstruction of the coffee-growing region damaged by the earthquake, the trust company played a leading role in terms of project administration, with specific tasks that added value to resource management. Additionally, the FOREC involved infrastructure projects amounting to considerable sums of money, for which Colombian trust companies have extensive experience.

The objectives of the cash transfer program (Families in Action) differ considerably from those of the FOREC, particularly since the cash transfer program does not include physical infrastructure project management tasks, but rather the direct provision of cash, in which banks have most experience. Additionally, the design of the transfer program involves no operational or management tasks for the Trust Company, but only resource intermediation functions, which in this case create no added value.

For the reasons described above, several options should be considered and compared during the design stage so as to guarantee that the final option is the best in terms of future development. This prevents unexpected difficulties during the implementation phase, which in the end only cause additional delays and costs.

### ***B. BANK SELECTION PROCESS AND SYSTEM STRUCTURING FOR THE COLOMBIAN PROGRAM***

The assessment of different payment options for the implementation of this type of program should be approached from several points of view:

- The option selected must guarantee effective, efficient and agile program implementation. In other words, experience is a critical factor especially for cash management and processes that involve customer services on a massive scale.
- A key issue for decision-making is cost analysis, especially looking for economies of scale and taking advantage of the payment volumes to be managed.
- A very important issue is the compatibility of processes and a certain degree of universality for the exchange of information between the program and the paying institution. Otherwise, the need to make technological updates could have a major impact on costs and implications for the implementation schedule, which is a critical aspect for these types of programs.
- Geographical coverage should also be considered, especially when remote areas need to be served. Often, reaching these areas has a large impact on operations, costs and process schedules.
- The risk factor is perhaps one of the most critical issues when deciding on the paying institution. The Program must clearly establish that the risks are to be assumed in their totality by the institution, and that the rate must include all the insurance policies to be taken out in order to guarantee the protection of resources against any eventuality.

A risk map should be prepared, especially if the institution hired is not a banking institution. This map facilitates the assessment of recommended control processes and points for the institution.



- Credibility is also an issue to be considered in the selection of the paying institution, especially in view of the population sector targeted by these programs.

For all the considerations given above, the advantages and disadvantages of all the options involved were assessed in order to decide on the best mechanism for the Program. In the case of Colombia, the banking sector was undoubtedly the most attractive as it successfully addressed all the key issues described above. None of the other options which were considered, or indeed tested, provided benefits which matched those of the banking scheme.

The analysis of advantages and disadvantages made for the situation in Colombia is detailed below.

#### **4. Advantages of Using the Banks for this Type of Program**

- Banks have a long-standing expertise in cash management, due to which they offer the greatest economies of scale in terms of cash administration. Therefore, the cost-benefit ratio should be lower as compared to other options.
- Banks have developed alternative schemes for people to withdraw cash in remote areas (ATMs, intelligent terminals, remote terminals activated by mobile phones etc).
- Banks have extensive experience as paying agents: retirement pays, payrolls, suppliers; and in the collection of: taxes, public utilities, mobile telephone, tuition fees for schools and universities etc. For instance, the pension system that includes the Social Security System, the Teachers' Board and the FOPEP (Pension Fund) makes 800,000 monthly payments through the banking system. Therefore, implementing a new program is much easier with the banking system than with other systems that lack such experience.
- Banks provide wide geographical coverage, using a number of distribution channels. This allows them to reach a large number of potential beneficiaries simultaneously. For the specific case of Colombia, 85 percent of the municipalities targeted by the program have at least one bank office. If we consider the total number of eligible households in each municipality, the coverage of beneficiaries in municipalities with banks, as compared to the total number of potential beneficiaries in eligible municipalities, amounts to 91.7 percent.
- The fact that the banking sector assumes the full risk of cash management is extremely important, since this means that the program does not have to make additional investments in the insurance cover that would otherwise be needed.

- Banking institutions are at the forefront of technological development. This means that the cost-benefit ratio may be reduced in the future, which – as a result of market competition – may have an effect on the final rate charged.

## **5. Disadvantages of Using the Banks for this Type of Program.**

- The system may be considered unfair, since eligible municipalities which have no bank office are automatically excluded from the program.
- The program must adapt the operating scheme to the conditions laid down by the banking sector; however, there is a great deal of universality in the management of these programs depending on their level of technological progress.
- Since these are agreement contracts, there is the risk that a participating bank may decide to withdraw from the program. This would exclude households in municipalities that only have a branch office of the bank in question.

## **6. Analysis of the Selection Process of the Banks that are Involved in the Program**

The targeting strategy of the program involves an initial phase which is “a pre-selection according to general criteria, i.e., those municipalities with a banking institution will be pre-selected.....”<sup>2</sup>. Taking into account the difficulties which emerged with respect to the trust companies, the program prepared an open process aimed at 26 banks based in the country to establish their interest in participating in the program. This was carried out during 2001 through the National Coordinating Unit of the Social Safety Net and involved different types of banks (state-owned, private, national, foreign). The objective was to provide total transparency in the hiring process.

Out of the 26 banks that were contacted, fifteen responded to the notice. Ten stated that they were interested in participating in the program; while five replied that they lacked coverage in the municipalities involved. This process is detailed in Table 5.

Once this stage was concluded, the Program began the final bank selection process. It should be noted that at this point of the negotiation, operations were already underway with the Banco Agrario, since this institution already provided its support during the entire pilot project. The Banco Agrario is the state-owned bank with the largest nationwide coverage and has ample experience in third-party payments; in addition, it offered its support in the pilot phase, assuming all the risks involved.

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<sup>2</sup> Taken from the Operations Manual of the Families in Action Program

**Table 5: SUMMARY OF THE BANK SELECTION PROCESS**

<b>No.</b>	<b>FINANCIAL INSTITUTION</b>	<b>RESPONSE</b>	<b>INTEREST</b>	<b>AGREEMENT</b>
1	BOGOTA	YES	YES	YES
2	BANCAFE	YES	YES	YES
3	SANTANDER	NO		
4	CONAVI	YES	NO	
5	COLMENA	YES	YES	
6	GRANAHORRAR	YES	YES	
7	BANAGRARIO	YES	YES	YES
8	MEGABANCO	YES	YES	
9	COLPATRIA	NO		
10	DAVIVIENDA	YES	NO	
11	BANK BOSTON S.A.	NO		
12	SUPERIOR	YES	NO	
13	CAJA SOCIAL	NO		
14	TEQUENDAMA	YES	NO	
15	BANK OF AMERICA COLOMBIA	NO		
16	STANDARD CHARTERED COLOMBIA	NO		
17	OCCIDENTE	YES	YES	YES
18	UNION COLOMBIANO	NO		
19	BANCOLOMBIA	YES	YES	YES
20	GANADERO	YES	YES	YES
21	SUDAMERIS	NO		
22	LLOYDS TSB BANK	NO		
23	CITIBANK	NO		
24	ABN AMBRO BANK	NO		
25	BANCODE CREDITO	YES	NO	
26	POPULAR	YES	YES	

*SOURCE: Financial Co-ordination Department of the Families in Action program – Colombia*

Once the analysis of the banks that responded to the invitation was completed, the decision was made to continue operating with the Banco Agrario and to expand the operation to those banks that offered the best conditions, so as to reach the target number of municipalities.

The main reasons for continuing to work with the Banco Agrario are summarized below:

- This bank supported the pilot test and therefore, had all the experience to guarantee the success of the expansion.

- This bank has the largest geographical coverage of the entire banking system and serves 80 percent of the municipalities eligible for the program.
- This bank is the only bank in 300 municipalities.
- This is a state-owned bank, which guarantees its permanence. This provides the beneficiaries with complete stability.
- This bank has ample experience in third-party payments, and although its technological platform is not as efficient compared to other banks, it has a strong operations department that provides excellent logistical support.
- Since the main mission of this bank is to serve the country's rural areas, it is very close to rural customers and very well informed about the profile of the Program's beneficiaries, which gives it a high added value.
- Although this bank is not as efficient as private banks, its quote per transaction came to US\$1.74, very close to the values provided by other banks. This cost is considered reasonable, especially if we take into account that operating with remote municipalities involves significantly higher costs, mainly in terms of operational expenses, transportation of cash, communications, and processing.

The selection process for private banks, both national and foreign, ensued, with particular attention being paid to the following aspects:

- First, the conditions of the banking market were analyzed. It should be noted that this analysis revealed that the operation costs involved in a cashier transaction are three times higher than costs involved in an electronic transaction. Therefore, we anticipated that the costs per transaction to be charged by the banks for paying the grants would be considerably higher than the costs involved in the withdrawal of money from an ATM, which at that moment ranged between US\$0.65 - US\$1.30. Taking this information into account, in addition to the Program's budget for the cost per transaction, a maximum ceiling for the negotiation was initially set at US\$2.
- Secondly, the coverage of all the country's financial institutions was verified in detail. This is a very important issue, since the program has to cover municipalities located at great distances from the principal cities and urban areas.
- The experience reported by each bank in the different geographical areas and in similar programs was analyzed.
- Meetings were arranged with the officials of the banks' operations and technology departments to review the compatibility of the technological platforms and the need to make appropriate adaptations.
- The results of the pilot project were reviewed in order to draw out the most important lessons learnt, which were as follows:
  - To set up an automatic payment reconciliation process, which was not considered in the operations manual.

- To de-bug the information exchange mechanisms between the banks and the program.
- To de-bug the reports that should be sent to and received from the banks.
- To establish the time actually needed to make the payments to the beneficiaries and for the submission of the information by the banks, in order to carry out the reconciliation of payments with the program.
- To define a payment schedule for days other than the last week of the month, to prevent beneficiaries wasting a lot of time waiting in lines, as these are the days with the highest attendance at branch offices in Colombia.
- To establish a maximum of 250 payments per day in order to provide the beneficiaries with an appropriate service. This figure was established taking into account the operational capacity of a teller during one day.

This information was used in compiling a guideline for operations, which was introduced as an integral part of the agreements signed with the banks.

- Security issues were examined in detail. A risk map was established in order to determine the critical control points and to define, during the negotiation process, the importance which the banks would give to beneficiary payment security. This aspect is also an integral part of the agreements signed with the banks.
- A request was made to the General Treasury of Colombia to authorize operations with the selected banks. One of the banks selected was not approved by the Treasury, as it had a less than optimal financial standing. Therefore, it was not included in the agreement.

## **7. Rate Negotiations**

Taking into account the main aspects related to the financial margin analysis carried out by the banks, as well as the aspects mentioned at the beginning of this chapter, the rates to be negotiated with the banks may differ based on the following:

- The financial margin guaranteed by the program to the bank through checking account deposits.
- The coverage of the network of branch offices.
- Operational efficiency.
- The number of branch offices per municipality, which will determine the amount of competition. Those municipalities with a larger number of branch offices are generally larger and have more economic resources and productive activities; those municipalities with only one, or with no branch offices at all,

feature very low levels of productive activities, which provide no attraction for the banks to open a branch.

To begin the negotiation process, the ceiling defined for the rate to be agreed was US\$2. This was considered a reasonable figure taking into account that the maximum amount charged by the banks to withdraw from an ATM was US\$1.30.

The first quote sent by some private banks by the beginning of the program was of about US\$10 per transaction, assuming that no reciprocal checking account deposits were made. However, the program declared that the amount of the payments to be made could be deposited in a checking account five days before the beginning of the payment period. This, as explained in Annex 5, provides an added value in terms of the intermediation margin. Based on this new information, the banks revised their figures and provided new proposals.

Finally, negotiation with the Banco Agrario yielded a figure of US\$1.74 per payment made, with the commitment on behalf of the program to deposit the appropriate funds five (5) days before the actual payments to the beneficiaries were made.

Once the process with the Banco Agrario was completed, we needed to expand the coverage to other municipalities beyond the coverage of this bank. The process then shifted to the private banks, starting with Bancolombia, with a rate of US\$1.52 per payment; followed by BANCAFE with US\$1.52; the BBVA Banco Ganadero with US\$1.52; the Banco de Bogotá with US\$1.52; the Banco Popular with US\$1.52; and the Banco de Occidente with US\$1.31 (This bank has a very small number of branch offices and can only serve a few municipalities). The program also made the commitment to deposit the appropriate funds five (5) days before making the payments to the beneficiaries.

The negotiation margin with the institutions that manage government funds is restricted by the provisions of the General Treasury pursuant to which the funds cannot be deposited more than five (5) days in advance. This means that the rate per transaction which could be negotiated was limited by this provision. The transaction costs would have been reduced even further if the funds were allowed to remain in the Bank for a longer period.

The following is a brief summary of target eligible municipalities currently covered by the banking network:

A. MUNICIPALITIES WITH BANKS Vs TARGETED MUNICIPALITIES	85%
B. MUNICIPALITIES WITH BANKS Vs ELIGIBLE MUNICIPALITIES	89.4%
TOTAL TARGETED MUNICIPALITIES	731
NON-ELIGIBLE TARGETED MUNICIPALITIES	35
TOTAL ELIGIBLE MUNICIPALITIES COVERED	622
TOTAL ELIGIBLE MUNICIPALITIES NOT COVERED	74

## **Lessons Learnt**

The following two factors were critical during this process i) the competition established among banks for the rates; and ii) the broad knowledge about the market that was available during the negotiation. Another important issue was the participation of people with extensive experience in the Colombian banking sector, which provided the program's negotiating group with a great competitive advantage and made it possible to achieve a rate below the established ceiling amount.

The lesson to be learnt is the importance of relying on banking experts who are familiar with both the cost structures of the banks and the overall domestic market, so as to achieve reasonable rates. We must not forget that bankers are skillful negotiators who know how to take advantage of their counterparts' weaknesses.

### ***C. RELEVANT ASPECTS OF THE CURRENT SYSTEM***

#### **1. The Impact of the Banking Payment Mechanism on the Complaints Made by Beneficiaries**

This issue was consulted with the User Complaint Department of the Transfer Program (Families in Action). According to the information provided, the volume of complaints regarding failures of the paying banks made by beneficiary mothers has been very low.

There is one specific event at the Banco Agrario, where the bank failed to report payments by US\$218.000 in a total of 15 branches during one of the first payment cycles. This resulted in amounts being paid twice during the following cycle. The bank fully acknowledged the failure and corrected the situation directly with the beneficiary mothers.

The Training Coordinator also reported some complaints made by beneficiary mothers, for the poor service provided in some municipalities of the Department of Cauca. The complaints referred only to the quality of the service provided by some of the staff of the banking institution, but were not related to operational failures.

The following two tables (Tables 6 and 7) were prepared by the User Complaints Department to summarize the main complaints and new events processed during the second semester of 2002. The figures suggest that most complaints mainly respond to operational and/or procedural causes.

All operational issues have implications on payments made to the beneficiaries. Therefore, the work to be carried out through the User Complaints Department will be critical to assure a good quality service. If this department is able to identify those factors with the largest incidence on households not receiving their payment or receiving incomplete payments, the Program –through its Continuous Improvement

Committee– must look for mechanisms to solve the problems and to work on those issues that impact normal process operation. Table 6 lists the following as the most common complaints:

- No IPS code. IPS is the health care institution in which the beneficiary household is registered. This information must be requested upon the registration of the eligible household. Therefore, the registration process must be totally reviewed to guarantee the inclusion of this information from the outset. This information could have been provided by the beneficiaries but omitted during the data collection process. Therefore, appropriate controls are required in the collection validations.
- ICBF Beneficiaries. The Colombian program specifically provides that those households benefited with a grant from the ICBF (Colombian Institute of Family Welfare) cannot be benefited by the Families in Action Program. The solution for this problem must be carried out jointly with the ICBF, which is the institution that provides the information.
- No school certificates. This case is similar to the first situation; therefore, the same procedures must be carried out.
- The household status is operational and will be defined based on the features of the household itself and on the full submission of the documents required for eligibility. For this case, the municipalities’ training processes must be revised, as well as the procedures defined in the operations department in order to determine the actual household status.

**Table 6: “MAIN COMPLAINTS PROCESSED DURING THE SECOND SEMESTER OF 2002”**

<b>Months</b>	<b>No IPS Code</b>	<b>ICBF Beneficiary</b>	<b>No School Certificate</b>	<b>Household Status</b>
<b>JULY</b>	1,665	2,843	1,508	4,191
<b>AUGUST</b>	1,080	1,902	1,819	3,822
<b>SEPTEMBER</b>	771	780	2,677	2,588
<b>OCTOBER</b>	555	402	1,681	1,038
<b>NOVEMBER</b>	606	1,074	1,308	1,774
<b>DECEMBER</b>	248	459	721	1,001
<b>TOTAL</b>	4,925	7,460	8,099	14,414
<b>%</b>	7.23%	10.95%	11.89%	21.15%

*Source: User Complaints Department of the Families in Action PROGRAM*



For new events, the most representative volumes are:

- Correction of ID card of the beneficiary mother. This issue emerged because the SISBEN's database, the primary source of information used, was extremely inconsistent as to the field of ID numbers. Since to receive the payments the beneficiaries are required to submit their ID card, the banks cannot provide the money if the ID information is inconsistent.
- The removal of ICBF beneficiaries is related to the solution of the complaints made due to the errors in the database of such institution.
- Change of beneficiary mother. The information of the SISBEN's database is outdated due to the mobility of household members; for instance, a mother who travels to another city and leaves her children with the grandmother. There are also forced displacements as a result of public disturbances that take place in the country.

**Table 7: MAIN NEW EVENTS PROCESSED DURING THE SECOND SEMESTER OF 2002**

<b>MONTHS</b>	<b>CORRECTION OF ID CARD</b>	<b>REMOVAL OF ICBF BENEFICIARIES</b>	<b>CHANGING THE BENEFICIARY MOTHER</b>
<b>JULY</b>	1,131	1,240	224
<b>AUGUST</b>	1,250	514	87
<b>SEPTEMBER</b>	1,269	1,062	112
<b>OCTOBER</b>	1,713	651	71
<b>NOVEMBER</b>	1,299	1,445	104
<b>DECEMBER</b>	80	761	5
<b>TOTAL</b>	5,443	5,673	603
<b>%</b>	14.22%	14.82%	1.57%

*Source: User Complaints Department of the Families in Action PROGRAM*

Based on the former analysis, one of the main advantages of working with the banking system is the extensive experience of banks as payers, which minimizes risks such as payments not delivered to their targets or those made erroneously. This of course results in very high effectiveness rates. As provided, the largest volume of complaints results

from operational or information management issues, especially during the first cycles, which are due to mistakes during the registration process of eligible households.

The most important lesson to be drawn from this point is the need to rely on a strong complaints department to take care of the issues that may impact the process with full independence and to lead the process of change through a Continuous Improvement Committee.

## **2. The Opinions of Poor Colombian Households about the Payment System.**

This study considered that it was important to know the opinion of Beneficiary Mothers about the payment system selected by the program. Therefore, we requested information about the mothers' level of understanding, security expectations, and proposals for alternative methods in municipalities that lack a banking branch.

To carry out the survey, focus groups of beneficiary mothers were formed in the municipalities of Guacari and Jamundí, Department of Valle del Cauca; Granada in the Department of Meta; Chocontá in the Department of Cundinamarca, Morroa and Rionegro in the Department of Antioquia, Tolú Viejo in Sucre. The methodology used and the questionnaire are described in Annex 7.

Table 8 shows the matrix of the responses given by the beneficiary mothers, organized by region

### **Conclusions**

The following conclusions can be drawn from the responses provided by the beneficiary mothers regarding the cash transfer program:

- The mothers clearly understand the role played by the banks in the payment process. The mothers declare to know that the bank has the responsibility of providing the money on the dates agreed with the Mayor's Office, for which they always need to show their ID card.
- The mothers know that any complaint regarding the amount of cash provided should not be made to the bank but rather to the Municipal Link, and overall, they feel satisfied with the service provided by the Bank.
- The institutions most favored as alternative payment mechanisms for those municipalities that lack a banking branch are the Parish and Telecom. Isolated references were made to health care centers and the army battalion. All of them offer the same level of credibility. The region where the army battalion was mentioned is a militarized region due to Colombia's internal conflict.
- Another relevant issue mentioned by mothers is the fact that there are remote rural areas where the municipal head is located further than the neighboring

municipality. The mothers suggest that payments to such households should be made at neighboring municipality.

- No concerns were expressed about safety issues when payments are made at the banks. Overall, banks are institutions highly regarded by the community.

**Table 8: SUMMARY MATRIX OF RESPONSES PROVIDED BY BENEFICIARY MOTHERS IN FOCUS GROUPS**

<b>REGION</b>	<b>HOW DO YOU FIND OUT YOU ARE GOING TO RECEIVE THE PAYMENT?</b>	<b>WHO DETERMINES THE PAYMENT DATE?</b>	<b>WHAT DO YOU HAVE TO DO AT THE BANK?</b>	<b>IN WHICH OTHER PLACES COULD YOU RECEIVE PAYMENT?</b>
<b>EAST</b> Granada – Department of Meta	-Lists posted at the Mayor's Office. - Reports in the Local Radio.	-The Presidency, in Bogota . -The Mayor's Office -Organized payments to go to the Bank.	-Show my citizen ID. -Receive the amount of money provided in the voucher . -Sign the sheet.	- Parishes - The Military Battalion. - Telecom
<b>CENTER</b> Chocontá – Department of Cundinamarca	- Notice from the Presidents of the Community Boards. - Posting of lists at the Mayor's Office.	- Those who are in charge of the Program at the Presidency.	-Take my ID card to receive payment. -Receive the money they send from Bogota. - Sign the bank's list.	- Parishes - Telecom
<b>NORTH-WEST</b> Morroa and Rionegro – Department of Antioquia	-Information from the leader mothers. -Lists posted at the Mayor's Office by the Municipal Link.	- The Program from the Presidency of the Republic.	-We must submit the ID card. -Verify that the amount I am going to receive from the teller matches the sum provided in the voucher that I received at the Mayor's Office . -Sign the bank's list.	- Parishes - Health Care Centers. - In the neighboring municipality, as rural areas are closer.
<b>SOUTH-WEST</b> Guacari and Jamundi – Department of Valle de Cauca	-The local radio informs about payment dates -Lists posted at the Mayor's Office. -Information from the leader mothers.	- The Program in Bogota, from the Presidency of the Republic .	-I collect my grant by showing my ID card. -Sign the lists provided by the teller.	- Telecom. - Parishes
<b>NORTH</b> Tolú Viejo – Department of Sucre	-Leader mothers. -Lists posted in the Mayor's Office. -Community Action Boards	- The Families in Action Program.	-Take the ID card and collect the grant they give me from Bogota.	- In the neighboring municipality .

- Threats to safety do not take place inside the banks but rather outside, once the payment has been received. During the first payments made in some areas, beneficiary mothers were subject to robbery by common crooks. Therefore, the area's safety systems were reinforced by the Municipal Management for subsequent payments.
- Another safety concern is the chance of bombings within the bank branches, especially in the region of Antioquia, as a result of actions by armed groups.
- The beneficiaries are quite familiar with the roles that each participant plays in the process, such as Municipal Links, Mayors, Program's officials and bank tellers.

### **3. Security Issues Related to the Payments Made through the Banking System**

It is important to stress that the Colombian banking system is strongly regulated. As already mentioned in Chapter I, regulations cover from the definition of the Monetary Policy, through regulatory governmental agencies, to the decisions made by the FUND OF GUARANTEES OF FINANCIAL INSTITUTIONS (*FONDO DE GARANTIAS DE INSTITUCIONES FINANCIERAS* - FOGAFIN), which guarantees the deposits made by the general public in the Banking System.

Additionally, the opening of checking accounts in Commercial Banks by any Colombian governmental agency must be approved by the General Treasury. This agency keeps permanent and updated financial information about the banks, and only approves the opening of accounts in those banks with fully satisfactory financial qualifications.

On the other hand, each Bank has internal control departments and fiscal audits in place to certify its financial statements. Additionally, they also subscribe global cash management policies in order to protect the funds against any losses due to robbery, assaults, or mismanagement on behalf of their employees (fidelity guarantee).

Therefore, each bank is responsible for cash management and for assuring that the funds reach the applicable beneficiary. Should fraudulent actions arise which involve the fraudulent supplantation of a beneficiary, the bank involved shall be accountable before the program for the monies thus surrendered.

As is widely known, Colombia is living under extremely complex safety conditions due to the advance of armed groups into the communities, which of course involves the banks in several locations. This risk has been directly undertaken by the banks, so that in such places where the branches have been subject to attacks, no losses have resulted for the program and/or for beneficiaries. The only impact has been a delay in payments until the bank has been able to find an alternative facility.

Given all the arguments provided above, we can conclude that the transfer payment system through banks is one of the safest, both for the program as well as for the beneficiaries, especially in a country as Colombia that is severely exposed to risks.

The concern that some banks failed to submit proposals due to fears of an increase in risks does not apply to the Colombian case. Actually, the main aspects focused by the banks were geographical coverage and affordable rates. In sum, the banks that showed no interest are those with branches mainly concentrated in urban areas and therefore with an inappropriate coverage; the banks that showed interest are those with the largest nation-wide branch networks.

The safety of beneficiary mothers outside the banks is the responsibility of the mayor, who must reinforce vigilance during payment dates in order to prevent thefts and attacks. As was mentioned above, isolated cases have taken place in some communities, especially during the first payments. They were, however, duly addressed by the municipality upon a community request. These have been strictly isolated cases and are not a widespread condition of the program.

Since mothers receive their payments personally at the bank's counter and only upon showing their ID card, there is no possibility for the diversion of funds, or for fraudulent appropriation by government officials or program managers. These latter persons do not attend the payment process which takes place exclusively at the bank office. Additionally, responsibilities have been clearly identified and such officials have no access to the payment settlement system, which is fed by the information provided by the banks and the updates of the commitment compliance carried out through a private outsourcing mechanism totally external to the Program.

#### **4. Additional Cost Issues for Households**

An issue considered since the commissioning of the program's pilot was the difficulties that some mothers could face to reach the municipal head and collect their payments, due to considerable distances and high transportation costs.

Therefore, the program hired a consultant to study this issue and inform on the causes due to which some households failed to collect their grants. As a main conclusion, this study suggested the lack of information on behalf of the mayor's office about the payment process. Transportation was a negligible issue, as most families need to travel to the municipal head to carry out other activities (market days, health care centers, etc.), an opportunity which they use to go to the bank and collect their payment.

The program therefore instructed the Mayors to improve the information process, and to the banks to give priority service on any day of the payment cycle to those beneficiaries who claim to have suffered such a problem.

The arguments presented above lead us to conclude that transportation does not involve significant costs for poor households to come to the banks and claim their payments.

According to the consultant's study, there are other reasons that explain why some households fail to claim their payments during the specified dates. According to the program's regulations, when a household fails to claim its payment the resources are accumulated until the immediately following cycle. If the beneficiary once more fails to claim the payment, the payment is suspended so that the program officials of the municipality can investigate on the reasons that are causing the absence.

The following table has been prepared by the program to analyze the payment process carried out during year 2002. It is interesting to note how the ratio between number of households who received payment and number of households settled increased during the year, as the program gained in stability, with 86.48% for payments made during March, 2002, to 94.1% for payments made during December, 2002. These figures show that while operational, training, and information processes develop, the number of households which actually come to the bank to collect their payment increases. Thus, by the end of the year, only 5.9% of households failed to come to the bank and collect their payment within the specified dates.

**Table 9: RELEVANT STATISTICS ABOUT THE PAYMENT PROCESS**

<b>YEAR 2002</b>	<b>No. of Eligible Households</b>	<b>No. of Registered Households</b>	<b>No. of Beneficiary Households</b>	<b>No. of Households Settled</b>	<b>No. of Households Paid</b>
<b>MARCH - 328 Municipalities</b>	<b>300,383</b>	<b>192,196</b>	<b>148,529</b>	<b>107,668</b>	<b>93,106</b>
		63.98%	77.28%	72.49%	86.48%
<b>JULY - 567 Municipalities</b>	<b>501,903</b>	<b>365,280</b>	<b>279,081</b>	<b>240,340</b>	<b>222,255</b>
		72.78%	76.40%	86.12%	92.48%
<b>SEPTEMBER - 605 Municipalities</b>	<b>547,150</b>	<b>388,642</b>	<b>342,558</b>	<b>257,476</b>	<b>238,857</b>
		71.03%	88.14%	75.16%	92.77%
<b>OCTOBER - 612 Municipalities</b>	<b>559,280</b>	<b>395,101</b>	<b>351,737</b>	<b>277,157</b>	<b>254,610</b>
		70.64%	89.02%	78.80%	91.86%
<b>DECEMBER - 621 Municipalities</b>	<b>577,019</b>	<b>405,564</b>	<b>364,251</b>	<b>320,890</b>	<b>301,962</b>
		70.29%	89.81%	88.10%	94.10%

Source: Families in Action Program

## ***D. MAIN CHALLENGES AND LESSONS LEARNED FROM THE IMPLEMENTATION PROCESS***

### **1. Program Structure**

The Program's executors had to additionally adapt the organizational structure, due to the operational problems related to the structure defined by the Program's original design.

#### **Definition of Profiles**

When the DAPR-FIP formed the working team to implement the Program –pursuant to the structure initially approved in the design– the executors found out that no specific profiles had been defined for Project Management. Rather, the profiles were mainly based on previous experience in governmental programs with an emphasis on social and community projects. In fact, some inconveniences emerged at the beginning when staff with ample experience in banking issues was hired, especially in the Operations and Systems Departments. Since this was a state-run program, it was thought that people who came from the banking sector would not be able to adapt to the social work and would not understand the problematic behind the program. This could be attributed to a cultural shock given the large differences in professional training.

The proposal of such profiles was made directly by the Coordination of the Social Protection Net, which, based on the experience of the banking sector's project management –which involves a high-technological and operational content– expressed the need to strongly consolidate the program's operation. If the different processes to implement its support were not carefully addressed, the program's success would be at risk.

According to the structure of the initial Program, the Operations Department was mainly focused on the territorial aspect. The Payments Department was in charge of only one person, and so was the Customer Complaints Department. No Management had been established for the Database, in spite of the fact that the program had to be supported by a strong information system that would act as its backbone. (Please refer to the initial Program's organization chart in Annex 6 "INITIAL ORGANIZATION CHART FOR THE FAMILIES IN ACTION PROGRAM").

#### **Changes in the Structure**

Based on the previous arguments, a change in the program's structure was proposed through the definition of the following positions:

- a) Program's Financial Coordination, which is in charge of the program's financial flow. The financial specialist of the World Bank made special emphasis on this issue, since his analysis revealed major financial support weaknesses in all the programs of the Social Protection Net.

- b) Payment professionals. The structure is reinforced with one additional person and the full reconciliation process with the banks is defined.
- c) User Complaints Coordination. This department was strengthened and the entire complaints solution was operationally designed. The first step was to make a list of all the complaints that were collected in the pilot tests. This is one of the most relevant issues when dealing with programs or projects that involve massive processes with high technology contents, as the products or services have a direct impact on beneficiaries and communities and therefore require quality processes. The fact that this is a governmental social program does not mean that quality should not be a concern. In our opinion, vulnerable groups must be treated with special care and dignity.
- d) The departments that handle user complaints must act separately from process departments in order to guarantee full independence, as this is the best screen to detect and solve operation problems.
- e) Management of the Information System that handles process development and database administration. When the programs or projects are sustained by technological platforms, the system users shall rely on an expert group of professionals to manage the databases and supervise the system processes, in order to guarantee sound quality products and meet the expectation of all the players involved.
- f) Process Adviser. Temporary position responsible for process tune up and coordination of the Continuous Improvement Committee. These types of massive programs need permanent monitoring in addition to self-criticism of their own work, in order to pursue increasing productive rates that can release unproductive resources to favor the beneficiaries they serve.
- g) Logistic professionals to strengthen the Operations department during the follow-up of operating processes such as the compliance of commitments, registration procedures, follow-up of operating processes in regions, and follow-up of preset schedules.

Annex 6 “APPROVED ORGANIZATION CHART OF THE FAMILIES IN ACTION PROGRAM”, details the final organization chart approved for the Program.

## **2. Definition of the Program’s Implementation Stages**

Since this is a temporary program, it is very important to define the different stages from the beginning, including the applicable schedule and the priority of the different processes, activities and resources involved.

The following stages were defined for the Colombian case:

- a) Training process
- b) Dissemination process



- c) Registration process
- d) Information gathering process
- e) Validation of commitments' compliance process
- f) Payment process
- g) User complaints process
- h) Monitoring and assessment process

All of these processes are interrelated and the program made enormous efforts to integrate them into a single schedule that defined process timing and simultaneity.

The payment process can be impacted if one of the other processes fails, especially because the cycle has been set to last 60 days, a very tight term to carry out all the activities prior to the settlement, which is a pre-condition for payment.

Table 2 (page 14 ) describes in detail those activities which were timely defined as key for the payment process, in order to accommodate the cycle to the 60-day term. It is crucial for the analysis to determine which activities can be carried out simultaneously in order to improve the cycle's efficiency and to minimize the critical route as much as possible.

### **3. Lessons Learnt from the Implementation**

- In our opinion, one of the most important lessons learnt is that these types of programs should establish an interdisciplinary working team from the outset. The professionals that must take part in this working team are experts in social projects, governmental programs, and project management with experience in massive processes, in order to consider all the success factors involved:
  - Social aspects
  - Financial aspects
  - Operational aspects
  - Technological aspects
  - Management aspects
- Defining the profiles of the officials to be hired is also important, as well as planning the times in which such persons must be hired-removed from the processes. It should always be kept in mind that these projects need flexible organization charts that must permanently adapt to the changing conditions of the implementation process.

In our opinion, the follow-up of profiles on behalf of the Multilateral Banks is extremely important in these types of projects, as well as the efforts to help

the programs meet the contractual agreements provided in the credit documents. This in order to guarantee that the programs are implemented as planned, that changes are always agreed upon and that they rely on appropriate support.

- We also recommend an analysis of the key activities involved in the payment process, as well as of the times and resources involved since the design stage. In addition, we suggest implementing a follow-up tool from the outset, such as the Continuous Improvement Committee, with the participation of all the areas that are part of the Program so as to analyze, on a permanent and timely basis, any problems that may impact the process, and to define changes or solutions required to improve its efficiency.

For such purpose, we recommend the future executors to visit similar projects implemented in other countries –in the absence of similar experiences locally– so as to get a clearer vision of the issues involved. Another important issue is for the executors to be involved in the project as from the design stage, in order for them to provide all their experience from the outset.

- A further relevant issue is to consider that the payment process must be constantly monitored and customized, as this is the most important success factor of these types of programs.

### **III. OTHER PAYMENT ALTERNATIVES**

#### ***A. JUSTIFICATION***

One of the major concerns expressed by the executors was over the need to leave some extremely poor municipalities out of the program because they lacked a bank branch to pay out the grants. This was always thought to be extremely unfair to these locations.

Undoubtedly, the banking system was the best payment alternative for the program, in terms of coverage, efficiency, security and costs. However, other alternatives needed to be found to cover those municipalities which had no bank branch. A search was therefore begun for feasible options which could successfully address those concerns, such as security, efficiency and costs, already resolved with the banking network.

In sum, the motivation to look for other options was the need to cover remote, extremely poor municipalities that had no bank branch, as the program had already made the decision to work with the banking system which guaranteed an 89.4 percent coverage of eligible municipalities. In other words, these other options would complement the banking network which had already been selected.

## ***B. DESCRIPTION OF THE PROCESS TO ASSESS OTHER PAYMENT OPTIONS CONSIDERED***

Taking into account that the main premise was to find feasible options for remote municipalities, which would guarantee efficiency, security and reasonable costs, the Program launched a process to study the different options described below:

### **1. Vouchers**

Based on certain previous experiences in the country, vouchers were considered a good option to carry out the transfer payment process. The only important consideration was that, according to the design of the program, beneficiary mothers should receive the grant in cash. It was therefore necessary to design a mechanism which would allow the vouchers to be redeemed in cash, and not in kind, which is was the most common use of such systems.

#### **Advantages of a Payment System Using Vouchers**

- Spending can be directed to specific goods and services, such as food, clothing, health care, school materials, etc.
- It is counter-cyclical and anti-inflationary in nature, since it links expenditure in goods and services with production.
- It can be linked to other social programs because it is complementary in nature.
- Greater control to ensure that the grant is used in compliance with the program's objectives.
- The use of vouchers minimizes the risk of government funds ending up in the wrong hands or being used for unlawful activities.
- The delivery of benefits by use of vouchers opens up the possibility for private participation in governmental programs.
- The institutions that issue the vouchers compete with the banking system in the placement of products for populations with and without banks, which can result in a healthy competition with the banks during the negotiation of operation costs.

#### **Disadvantages of the Payment Process using Vouchers**

- Payment using vouchers impairs the objective of making transfer payments in cash.
- There is a risk that Households may be charged a fee for voucher redemption in the participating facilities.

- Given the limited institutional capacity of the small municipalities in which the grants are generally received, the few facilities eligible can attain a very strong negotiating position. This can result in high costs for the program or the beneficiaries.
- Considerable effort must be expended in training households in the use of the voucher system.

### **Pilot Project of Cash Transfer Payments using Vouchers in Colombia**

The delivery of grants using Sodexho Pass vouchers:

One of the first options considered was the proposal submitted by Sodexho Pass. This company expressed its interest in supporting the grant program through the delivery of vouchers redeemable in cash. The proposal was based on the company's worldwide experience in similar projects, and a very attractive feature of the program was the proposal to carry out a pilot project. This proposal was submitted to the approval of the Multilateral Banks along with the following comments:

- The company began its operations in Colombia in 1994.
- The main shareholders in the country are: Sodexho Aliance and Suramericana de Seguros, two companies with a well-established record, the first world wide and the second at the national level.
- It is the first of its kind in Colombia.
- It has nation-wide coverage.
- Issues about 20 million vouchers per year, for more than US\$ 60 million.
- Has positioned itself as a good option for the population sector that do not have bank accounts.
- Through the issue of service vouchers or cards, it operates in two areas:
  - a) Management of benefits guaranteed by public or private companies to their employees, as part of fringe benefits.
  - b) Management of benefits and/or grants guaranteed by the public or private sector aimed at specific target groups of beneficiaries.
- This has become a sound control and management mechanism, which guarantees that the benefits are used in an appropriate manner and in compliance with the objectives set forth by the paying or sponsoring institution.
- The program has been implemented in countries such as Germany and the United Kingdom, which currently run or have run programs for refugees, and in Venezuela, with the Bolivariano Check System.

A joint mission of the World Bank and the IDB carried out from April 22 to May 5, 2001 authorized the pilot project in the Municipality of Tocaima, in Cundinamarca. The operating scheme and appropriate controls to begin this pilot scheme were defined by

the Program's Operations Co-ordination and by the representatives of Sodhexo Pass. The cycle defined is described below:

- The program is responsible for the settlement of the grants, just as is done in the banking system. The information is submitted in magnetic form, with the specifications to be jointly defined by the two parties.
- The company is responsible for printing the booklets with the vouchers for each household, packing them and transporting them to the appropriate municipality.
- The municipal link is responsible for delivering the booklet to the beneficiary mother. It should be noted here that the vouchers are only valid when the titleholder takes them to the business establishment and shows her ID card.
- The participating establishment is obliged to pay off the voucher in cash to the beneficiary mother, without any type of charges. However, the beneficiary mother may, if she wishes, purchase goods and services in the establishment. Therefore, the program and Sodexho Pass were especially careful to select only those establishments providing goods and services which could satisfy basic nutrition, educational and health care needs.
- Once every two months, in accordance with the program's operational cycle, Sodexho Pass collects the redeemed vouchers and scans the bar codes. These contain the information which must be provided to the program in magnetic form, and this information is used to carry out the reconciliation and to pay Sodexho Pass, which in turn makes the applicable clearance with the business establishments. It should be noted that, unlike the agreement reached with the banks whereby the moneys have to be deposited five days in advance, the Program only disburses the moneys once it is certain that the vouchers have been paid off. This reduces (financial) opportunity costs of using the cash and, since no moneys are returned, speeds up the reconciliation for the settlement of the new payment cycle.
- The program begins a new cycle through the settlement process.

Chart 3 describes the process cycle for payment using vouchers, which was jointly defined with the issuing company. This company brought the benefit of all its previous experience in running programs of this type.

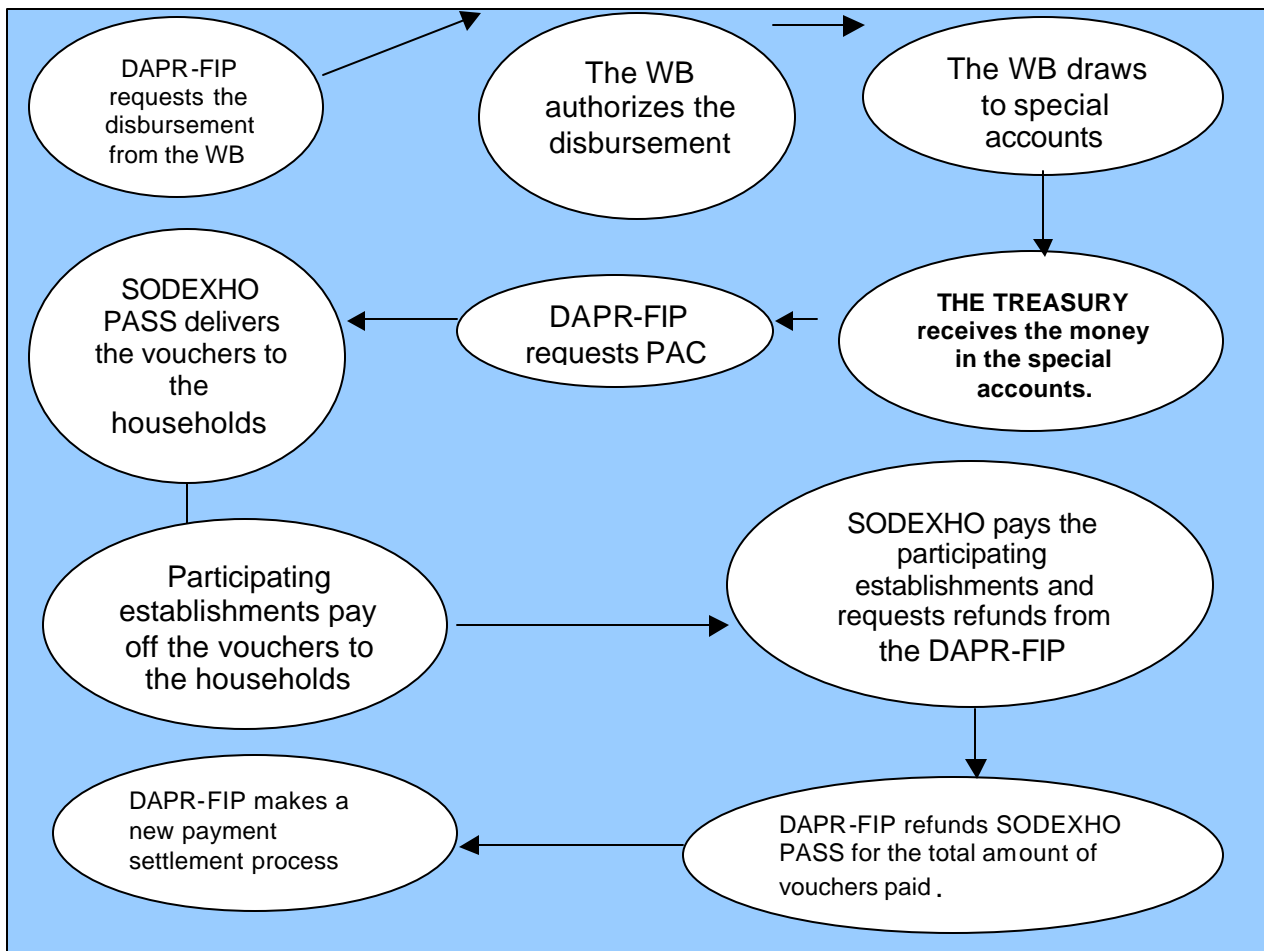
The pilot scheme began on May 24, 2001, and was interrupted in December 2001 to carry out an assessment, which produced the following results:

- Beneficiary mothers understood the process quite well and reported no major concerns regarding the way in which Sodexho Pass fulfilled their commitments.
- However, beneficiary mothers reported that retail stores did not have enough cash to redeem their vouchers. According to a Consultancy firm hired to assess alternative payment systems, "during the first and second payment, 68% of interviewed mothers reported that they were satisfied with the payment system;

while during the third cycle 84.2% of interviewed mothers reported that they were dissatisfied with the payment system due to the difficulties they faced in redeeming the vouchers for cash”.

- In the beginning, retailers showed great interest in supporting the program. However, in some cases they did not have enough cash to meet the commitments. This was the major problem during the running of the pilot scheme.
- The Mayor’s Office also showed great interest in the development of the Program. The Mayor himself has positively assessed the system in several meetings to which he was invited, since, in his opinion, the participation of private retailers boosts the municipality’s economy.
- The Program did not face any operational problems; on the contrary, as explained above, the payment cycle made shorter by the fact that the reconciliation was easier, and by the absence of returned grant moneys.

**Chart 3: PAYMENT CYCLE USING VOUCHERS**



SOURCE: INFORMATION PROVIDED BY THE PROGRAM AND SODEXHO PASS

One of the objectives of the pilot scheme was to assess whether this system could be expanded to other municipalities. However, a joint mission carried out by the World Bank and the IDB during March 2002, agreed not to introduce any more municipalities for reasons of scale. In addition, the results obtained up to that moment did not warrant the expansion of this operation system to other municipalities.

The most important lesson learned from this pilot scheme is that, in order to comply with the program's initial design, vouchers must be redeemed in cash in the business establishments. To a certain extent, this goes against the main objective of these types of vouchers, which traditionally serve as a means of payment to purchase goods and services, replacing cash.

This suggests that for programs of this type, it must be decided from the outset whether the system can operate if there is no easy way to ensure a sufficient supply of cash, rather than trying to change the operating philosophy.

## **2. Making Payments in the Nearest Municipality to the Household**

Another of the options proposed by the program team was the payment of grants at a bank branch in the nearest neighboring municipality. The proposal was based on the fact that some municipalities, which were left out because no bank branch was available, were located very close to other municipalities which were included the program. This would allow municipalities with no bank branch to be included, since the beneficiaries could easily go to the bank in the neighboring municipality.

### **Advantages of Making the Payments in the Nearest Municipality**

- An agreement has already been established with the paying bank.
- No cash management risk, therefore no additional policies are required.
- The program requires no significant operational modifications to function.

### **Disadvantages of Making the Payments in the Nearest Municipality**

- The only disadvantage is the traveling cost involved for mothers.

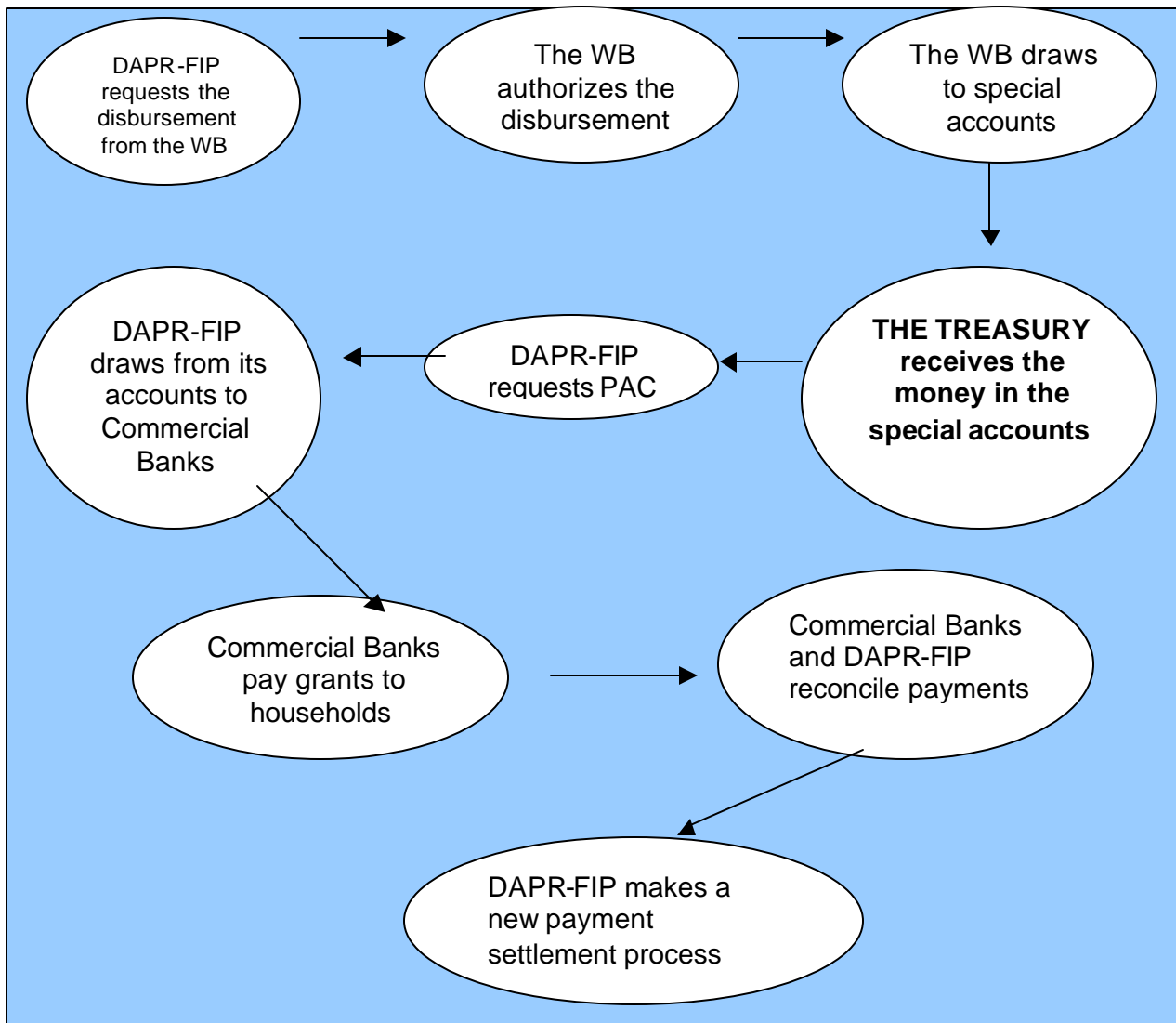
### **Experience of the Colombian Transfer Program**

A joint mission of the World Bank and the IDB carried out in April 22 to May 5, 2001, approved the pilot project in the Municipalities of Guayabal de Siquima, Quipile, Prado, El Molino, Distracción, Hato Nuevo, Albania and Uribe; located in the departments of Cundinamarca, La Guajira and Tolima. This pilot was supported by the Banco Agrario.

The procedures were specially customized by carrying out modifications to the information system. The bank also carried out modifications to its internal operations manual in order to guarantee appropriate flow of information to operations management, the department in charge of consolidating the information for the program.

Certainly, the most important issue to assess under this scheme is how difficult it is for beneficiaries to travel to the neighboring municipality. This mainly is a question of transportation costs, and how high they will be in comparison with the grant received.

**Chart 4: PAYMENT CYCLE THROUGH THE BANKING SYSTEM  
(NEAREST MUNICIPALITY)**



SOURCE: OPERATIONS MANUAL OF THE FAMILIES IN ACTION PROGRAM



The consultancy specially hired to assess this scheme suggested that the system was the most feasible option for small municipalities which are located very close to a municipality with a bank. This is very often because these smaller municipalities were part of the larger unit before the passing of law No. 388 on territorial management.

Overall, the operational cycle is similar that defined for payment through the banks, since control is carried out through the information systems of the program and the paying bank.

In the end, the program decided not to carry out the pilot scheme, in compliance with the agreements of the joint mission, completed in March 2002, not to introduce any more municipalities for reasons of scale.

### **3. Payment Through the Colombian Telecommunications Company – Telecom**

Telecom is the Colombian State Telecommunications company, established in 1947 to provide telephone services to the Colombian municipalities. As such, it has offices throughout the country to provide its services; where here is no bank branch these offices also have to collect payment from users.

#### **Advantages of Making Payments Through TELECOM**

- The Colombian Telecommunications Company – TELECOM has a very wide geographical coverage, reaching most the country's municipalities.
- Given its business activity, it receives daily cash payments that would enable it to meet the Program's requirements.
- The high costs involved in the transportation of cash from municipalities without banks is a problem for TELECOM. If under the program the cash were used to pay the grants, this would reduce the risks and costs, as the amount of cash to be transported would be less.

#### **Disadvantages of the Payment Process through TELECOM**

- TELECOM has never implemented a cash payment system, therefore starting up such a system would be very costly for the parties involved.

#### **Experience of the Colombian Transfer Program with TELECOM**

One of the most interesting aspects of this proposal is the possibility of reducing transportation costs and risks, which, as is well known, are extremely high for security reasons. Therefore, Telecom would pay the grants in those municipalities without banks and the funds would be refunded by the Program in a central bank account in the city of Bogota.

This would imply a benefit both for Telecom and for the program. Telecom would solve its cash management problem in those remote locations that face a high risk of armed attacks; and the program would reach poor populations unable to receive the grant because they lack a bank branch.

Once the two institutions had reached an agreement on the mutual benefits of the scheme, it was sent to the appropriate Legal Departments for review, and preparation of a draft contract. It was then that the principal objection to the scheme came to light. This relates to the fact that Telecom's corporate purpose, as provided by the constituting law, No. 142, does not provide authorization for payments to third parties. This created a legal impediment which could only be surmounted through a Law of the Republic to be passed by the National Congress.

In these circumstances, the High Council for the Colombia Plan and the General Management of Telecom were the bodies responsible for deciding whether to submit a request for the amendment of the Telecom act to the National Congress. At this point, the decision was taken to suspend the process, because a change in the law was expected to be very time-consuming, and because it would be necessary to define those municipalities that would finally be part of the program in order to comply with the implementation schedule of the program.

The lesson learnt from this process with Telecom was the importance of carrying out in advance a legal feasibility review of the proposed agreement jointly with the institution involved. In this case a lot of time was spent studying the operational model; the legal study, which finally proved that the process was not feasible, was only requested thereafter.

However, it should be noted that similar experiences in countries such as Mexico have proven successful. Countries can explore the option and not meet with any restrictions of this type; however, the important thing is to ensure that there is no legal impediment before going into the question of operational viability.

#### **4. Payments Using Transporters of Valuables.**

This option was discussed for the Colombian case. However, cash must be transported by air given unsafe road conditions, which increases costs considerably. Therefore, economies of scale were pursued through the company responsible for transporting cash for the Colombian banks. A specific procedure was defined, as explained below, taking advantage of the delivery journeys made to supply bank branches with cash.

- The transporter of valuables will notify the program of the flight schedule planned for the financial institutions. This schedule will serve as a basis to program the payments in the applicable municipalities.

- An authorized official appointed by the program will receive the cash on arrival at the heliport. This person will identify him/herself with an authorized password and will receive the bag with all the envelopes.
- The official must verify the number of the safety seal and the number of the bag; the safety seal must be in perfect condition. After checking, the official will sign the cash waybill as a receipt and will go to the payment location established by the municipality to begin the payment process.
- The Mayor's Office shall be responsible for safe-custody of the cash during the payment process as well as for keeping unclaimed envelopes in a safe until the transporter of valuables returns to take them back.

Note that in the case of Colombia, because of the high risk conditions existing in these municipalities, the transporter of valuables assumes no responsibility for the delivery of the envelopes, thus frustrating the original scheme. This means that the mayor's office of each location must take out a cash management insurance policy at its own cost. It must also store the cash in its facilities which results in increased risks in these insecure areas.

For the reasons detailed above, the pilot project proposed for the municipality of Ataco was postponed. To date no efforts have been made by the program to develop this proposal considering that no additional municipalities can be brought into the program.

### ***C. PAYMENT USING ALTERNATIVE SYSTEMS WITH ADVANCED TECHNOLOGIES THROUGH THE BANKING SECTOR***

So far, we have described the process followed for the Colombian program. However, in response to the request of the World Bank, we will now describe other options using new banking technologies.

In fact, the banking system has a wide range of feasible options to support the cash transfer system. There have already been some successful experiments with Colombian NGOs that could be used as models by other programs under implementation.

As stated above, transactions carried out by electronic means are far less costly for banks than transactions processed over the counter. This is a general fact for all banks, regardless of the level of development of the country.

For this reason, the other options proposed by the banking sector are based on high tech products such as ATMs (through debit cards), intelligent cards, mobile banks or ACH.

However, due to their characteristics these products cannot guarantee the same geographical coverage as bank branches, since for obvious, market-based reasons, they are only offered in municipalities with a certain market potential. Therefore, many of the target municipalities have no access to these types of products.

All the non-conventional options offered by the banking sector to replace bank branches in the operation of cash transfer systems are described below:

### **1. Prepaid Visa Debit Card**

The debit card is an additional service provided by the banks to the holders of savings and checking accounts. The card allows them to withdraw cash from ATMs and to make payments, without the use of cash, in POS (points of sale) that are part of the electronic payment system network.

Therefore, in order for beneficiaries to be issued with a debit card, they must hold a savings or checking account, with the operational and management costs which this implies. For this reason, the cost saving associated with payment through ATMs, as opposed to payment over the counter in the bank, may be neutralized by the maintenance costs of current and/or savings accounts, whether borne by the beneficiaries or by the program.

Debit cards are generally not considered an option for cash transfer programs due to the difficulties experienced by the beneficiaries in opening current or savings accounts. Payments are low and there is no profitability since the funds deposited are withdrawn in a few transactions. Banks prefer to make payments at their own branches, through the management of a central account with reciprocity and a fixed amount per payment made. For the specific case of the Colombian program, this alternative was studied by the banks and discarded for the reasons specified above, in addition to the fact that the ATM network only covers 131 of the 622 municipalities served.

Beneficiaries also prefer to receive the payments over the bank counter, as this sector of the population has not had access to banking services. However, some few beneficiary households have shown an interest in using different services, such as ATMs or bank accounts into which the funds are deposited.

In order to address the interest expressed by the World Bank in terms of searching for other innovative technologies that could be implemented in the Colombian program and in other countries, the consultants requested further information from the banks, and especially from the VISA payment system. This latter produced a very interesting alternative, precisely for the opportunity of servicing a market still untapped by banks, and to support those customers that need to make payments to third parties at reasonable costs.

For this reason, we would like to present the prepayment debit card developed by the Visa Colombia network, an interesting option that was not available at the end of year 2000 when the Familias in Acción program began operating with the banks. This system solves the problem posed by standard debit cards which involve the opening of a savings or checking account for beneficiaries. Although this development is so far only available in Colombia, the technology could be transferred to countries that belong to the VISA payment network.

## **Description of the Prepayment Visa Card**

The Prepayment Visa card is a debit card issued to customers without bank accounts. Cardholders can withdraw cash from ATMs and/or POS, with the debit being charged to the main account of the paying institution. The main feature is that beneficiaries are not required to open a savings or checking account.

## **Advantages of Using the Prepayment Visa Card**

- Banks improve their services to corporate and business customers and to payment beneficiaries in an easy and affordable manner.
- Banks can improve the operational efficiency of payments made to third parties.
- Users without bank accounts may eventually enter the banking system, depending on developments.
- Cost rationalization in cash management and administration.
- Banks take less risks in terms of cash custody.
- Less operational burden in the verification and reconciliation process. Faster payment settlement process.
- Beneficiaries do not need to open transactional bank accounts to receive their payments periodically.
- The card can be used in different POS that are part of the system.
- Users can make withdrawals from different ATM networks operating in the country.
- Beneficiaries do not need to travel to branch offices during peak hours and wait in long lines.
- Improved security based on a secret password or PIN.

## **Disadvantages of Using the Prepayment Visa Card**

- Product coverage depends on the network of ATMs and POS that are part of the VISA system, which means the exclusion of locations outside the network.

## **Basic Operation Scheme**

- Creating and Issuing Cards:

Based on the information provided by each bank, VISA Colombia creates a personal file, the card itself and the flex envelope with the PIN, which are then entrusted to the transporter of valuables.

- Transportation and Delivery:

The transporter of valuables delivers the plastic cards and the flex envelopes to the hiring institution for distribution to the final users. This procedure can also be out-sourced to a company specializing in the delivery of valuables. This is recommended, considering that the institutions which handle the payments are often governmental agencies that manage public resources.

➤ **Monetary Update:**

Based on the settlement information provided by the hiring institution, each bank sends VISA Colombia the balances available for each beneficiary. Another option would be for the hiring institution to provide the files directly to Visa Colombia, separated by issuing bank. This is a perfectly feasible option and eliminates a step in the process when several banks are involved.

VISA Colombia updates and controls the balances and carries out the maintenance of the databases.

➤ **Authorizations:**

The beneficiary cardholder goes to the POS or ATM of any of the networks operating in Colombia to withdraw the cash or to purchase goods and/or services to the amount authorized. To do this, the beneficiary must present his/her card and personally enter the secret code.

The transaction is carried out on-line and in real time at the VISA Colombia server, which authorizes the transaction and updates the balance using validation processes based on international standards.

The transaction is authorized at the POS terminal or ATM and the beneficiary receives either the good or service or the cash accordingly.

➤ **Clearance and Deposit:**

VISA Colombia makes the clearance process to separate the transactions made daily by the beneficiaries in authorized ATMs or POS on a per bank basis.

Once the bank which issued the card receives the clearing order from VISA Colombia, it makes the clearance with the principal account of the hiring institution.

The clearance of the cash used by the beneficiaries in authorized ATMs and/or POS is carried out through VISA Colombia.

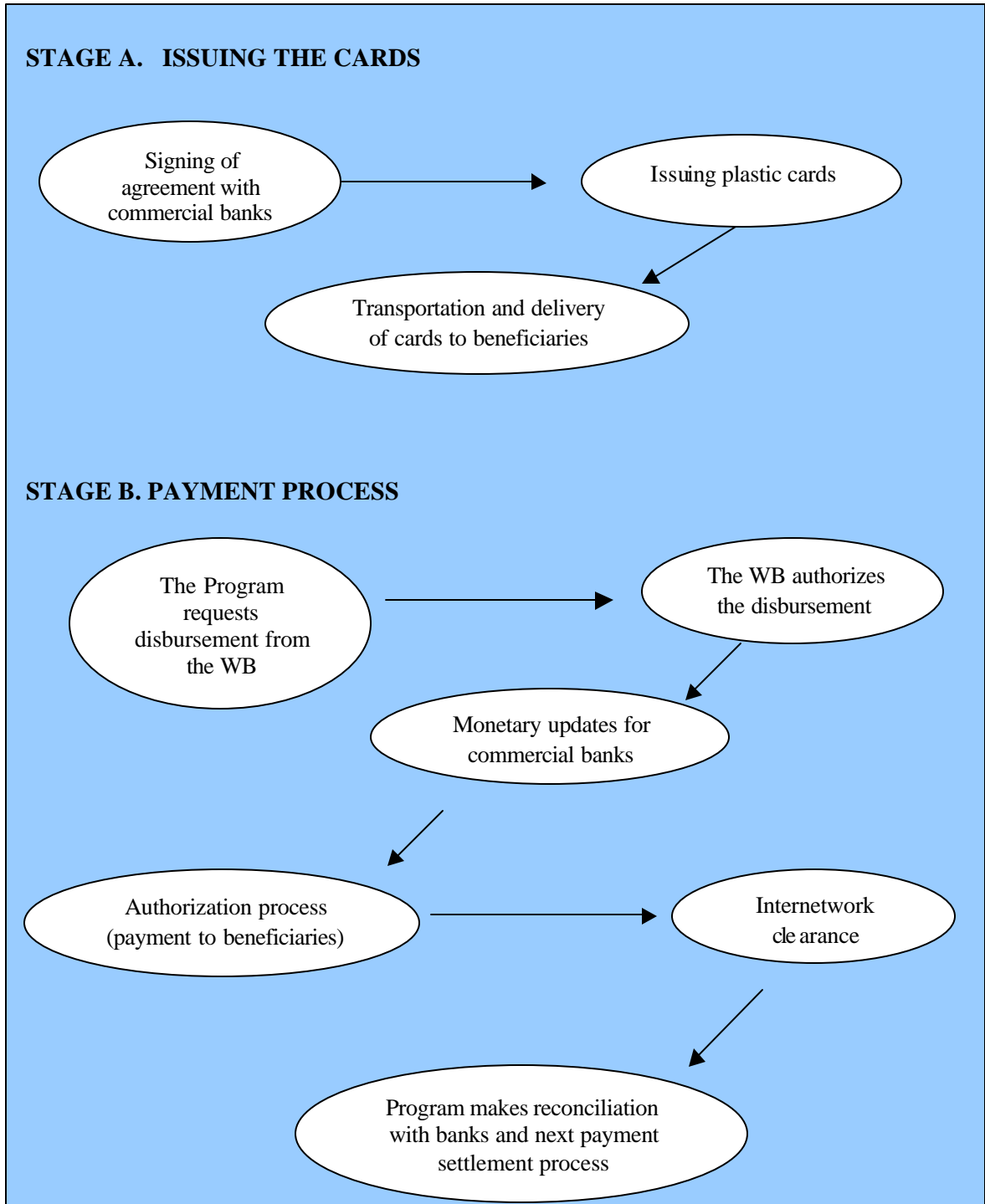
## **Guidelines for Negotiations with the Banks**

### ***Sources of Income for Banks***

- 100% of the Electrón commission paid by business establishments goes to the bank that issues the cards.

- Use of the cash float, since the beneficiaries take time to withdraw all the cash deposited in the main account of the hiring institution.
- Service charge to the hiring institution (global fee or on a per card basis).
- (Corporate) customer charges for technically successful transactions.

**CHART 5: OPERATION OF CASH TRANSFERS USING PREPAID DEBIT CARDS**



The institution contracting the service of payment to third parties must use great negotiating skill to reduce transaction fees, based on the volumes generated as a result of the cash float (reciprocity). These should if possible be reduced below market levels, considering the volumes of deposits to be made, which involve significant profitability for the bank. In our opinion, the cash float generated must be subject to permanent monitoring and the fees revised periodically. In other words, the hiring institution must make full use of its negotiating power according to market laws.

### **Banks that Participate in the VISA System in Colombia and Latin America**

The following list includes the banks that participate in the VISA system and which would be able to provide the prepayment system:

1. BANCO AGRARIO
2. ABN AMRO BANK
3. BANCAFE
4. BANCO CAJA SOCIAL
5. BANCO DAVIVIENDA
6. BANCO DE CREDITO
7. BANCO POPULAR
8. BANCO SANTANDER
9. BANCO SUDAMERIS
10. BANCO SUPERIOR
11. BANCO TEQUENDAMA
12. BANCO UNION COLOMBIANO
13. BANCOLOMBIA
14. BBVA GANADERO
15. CITIBANK
16. CONAVI
17. INTERBANCO
18. LLOYDS TSB
19. MEGABANCO
20. RED MULTIBANCA COLPATRIA

There are twenty Colombian banks that are part of the VISA system, accounting for 74 percent of all the banks in the country. This list includes all the banks which currently provide payment services for the Families in Action Program, except for the Banco de Occidente which belongs to the Master Card network. Therefore, this suggests an interesting potential to shift to this product in municipalities with ATMs, which could possibly result in considerable cost savings for the program.

Annex 7 “**AVAILABLE ATMs**” provides information on the municipalities that have at least one ATM. In Colombia there are 230 municipalities with at least one ATM, of which 131 municipalities belong to the Families in Action Program. This represents a



coverage of 21 percent of all the municipalities, where an additional banking option could be implemented.

Annex 7 shows a table with the **“AVAILABLE DATA PHONES (POS) OF THE VISA SYSTEM”** per region.

This platform was developed by VISA, Colombia. However, other countries of the LAC region could quickly implement the platform through a technology exchange with the Franchising company. Annex 7 shows a table, **“BANKS WHICH PARTICIPATE IN THE VISA SYSTEM IN LATIN AMERICA”** listing VISA affiliated banks in the following countries:

- Antigua
- Netherlands Antilles and Curaçao
- Argentina
- Bahamas
- Barbados
- Bermuda
- Bolivia
- Cayman Islands
- Chile
- Ecuador
- Jamaica
- Mexico
- Paraguay
- Peru
- Puerto Rico
- Dominican Republic
- Saint Vincent
- Saint Lucia
- Trinidad and Tobago
- Turks and Caicos Islands
- Uruguay
- Venezuela

### **Recommendations**

Regardless of how the Colombian program continues its operation, this product is already available in the market. Therefore, we suggest that the possibility of shifting to this payment system should be explored in those 131 municipalities with ATMs. This could involve considerable cost reductions which would improve the program’s overall cost structure.

## **2. Smart Card**

The main feature of the smart card (microcircuit) is the introduction of a microchip into the plastic, on which all the information required for use in off-line scanning devices can be saved. For this reason, it is extremely convenient in remote areas where access to a reliable communications system is difficult. The system has been strongly developed in European countries such as France, where there is a large number of applications.

There are several types of smart cards:

- a) **Electronic Purse:**  
The electronic purse has an embedded microchip which is loaded with a certain amount of money and is discarded once the amount is used. This is a replacement for cash and its most frequent applications are telephone, toll and transportation cards.
- b) **Smart Card:**  
A card with a magnetic band that also has an embedded microchip. It can be used in conventional terminals and teller machines, as well as in microcircuit scanning devices. It has multiple applications since the microchip allows additional information, such as clinical files, university credits, library book loans, etc to be saved.

### **Advantages of Using this System**

- The major advantage is the fact that there is no need to open a savings or checking account in order to issue a microchip card.
- It can be used in remote areas where access is difficult (in terms of communications) since the chip permits off-line scanning.

### **Disadvantages of Using this System**

- One of the major problems relates to the high costs involved in technological upgrades, and the low coverage in LAC countries.
- Another problem is the high cost of the card (US\$3), which considerably exceeds the current costs of standard debit cards (US\$0.20).
- An additional problem is the availability of chip loading points, as the card must be taken in for the chip to be re-loaded.

### **Experiments in Colombia**

The VISA and MASTER CARD networks have carried out pilot schemes with credit and debit card systems in LAC countries. One of the countries selected was Colombia, since the level of electronic product development is among the highest in South America.

In an interview with the Project Manager of the VISA network, the pilot schemes completed – mainly in universities – were discussed. It was clear that they have not been successful, due to the high costs of the new technology for the partner (university), the participating banks and the VISA network.

This type of card needs a special plastic containing a microcircuit, with a unit cost of US\$3, while the cost of a conventional card is of US\$0.20. Additionally, the card needs a POS terminal whose unit cost ranges between US\$600 - US\$700, and a special re-loading device, which can amount to approximately US\$700.

The cost of modifying the technological platforms of the banks and payment networks is also extremely high, considering the current economic setting in LAC countries.

Furthermore, the payment networks need corporate partners that require these types of solutions, such as telephone or transportation companies, universities, prepaid health care providers, etc.. However, such partnerships have been sought since 1996, with no positive results to date.

The same issues arise in trying to apply this technology to off-line remote cash tellers. To the cost of the cash teller, banks need to add the cost of the special microchip scanning and re-loading device. Therefore, cost-benefit analyses have so far proved unsatisfactory for the banks also.

According to the Project Manager of VISA Colombia, this project is currently suspended and is unlikely to continue in the short-term, unless an important partnership is agreed into with a large corporate partner.

Therefore, we do not expect this system to be used in the near future for a transfer payment program, since the program would have to incur high implementation costs. Also, no bank seems to be willing to support this type of scheme or if it were, the cost would be extremely high.

If Colombia is being used as a pilot country, product development in other LAC countries is expected to be at a similar or lower level of development. Therefore, the issue should be analyzed in depth before considering the implementation of this type of solution in any cash transfer program.

### **Operation Scheme of the Smart Card**

➤ Production and issue of the plastic cards:

Drawing on the information provided by the program, the bank prepares the personal file and then issues the cards and hands them over to the transporter of valuables. The bank also prepares a flex envelope with the PIN and gives it to the transporter of valuables.

➤ Transportation and Delivery:

The transporter of valuables delivers the plastic cards and the flex envelopes to the hiring institution for distribution to the final users. This procedure can

also be out-sourced to a company specializing in the delivery of valuables. This is recommended, especially when the institution handling the payments is a governmental agency managing public resources.

➤ Loading and Re-loading the Microchip:

The Program sends the balances of each beneficiary to the commercial bank and to the authorized POS for loading onto the microchip.

The information is loaded in the authorized locations and each beneficiary must present his/her card and ID.

➤ Using the Cards:

The beneficiary cardholder goes to a POS or ATM that has a microchip scanner to withdraw cash or to purchase goods and/or services as authorized. The beneficiary must produce his/her card, and enter the secret code personally.

The information saved in the microchip is checked, the transaction is registered and the balance updated using all the validation mechanisms defined by international standards.

The beneficiary is fully responsible for the handling and custody of his/her card, since a card with a loaded chip is practically like carrying cash.

➤ Clearance and Deposits:

The payment network carries out clearance to separate the daily transactions made by the beneficiaries at the different chip re-loading points on a per bank basis.

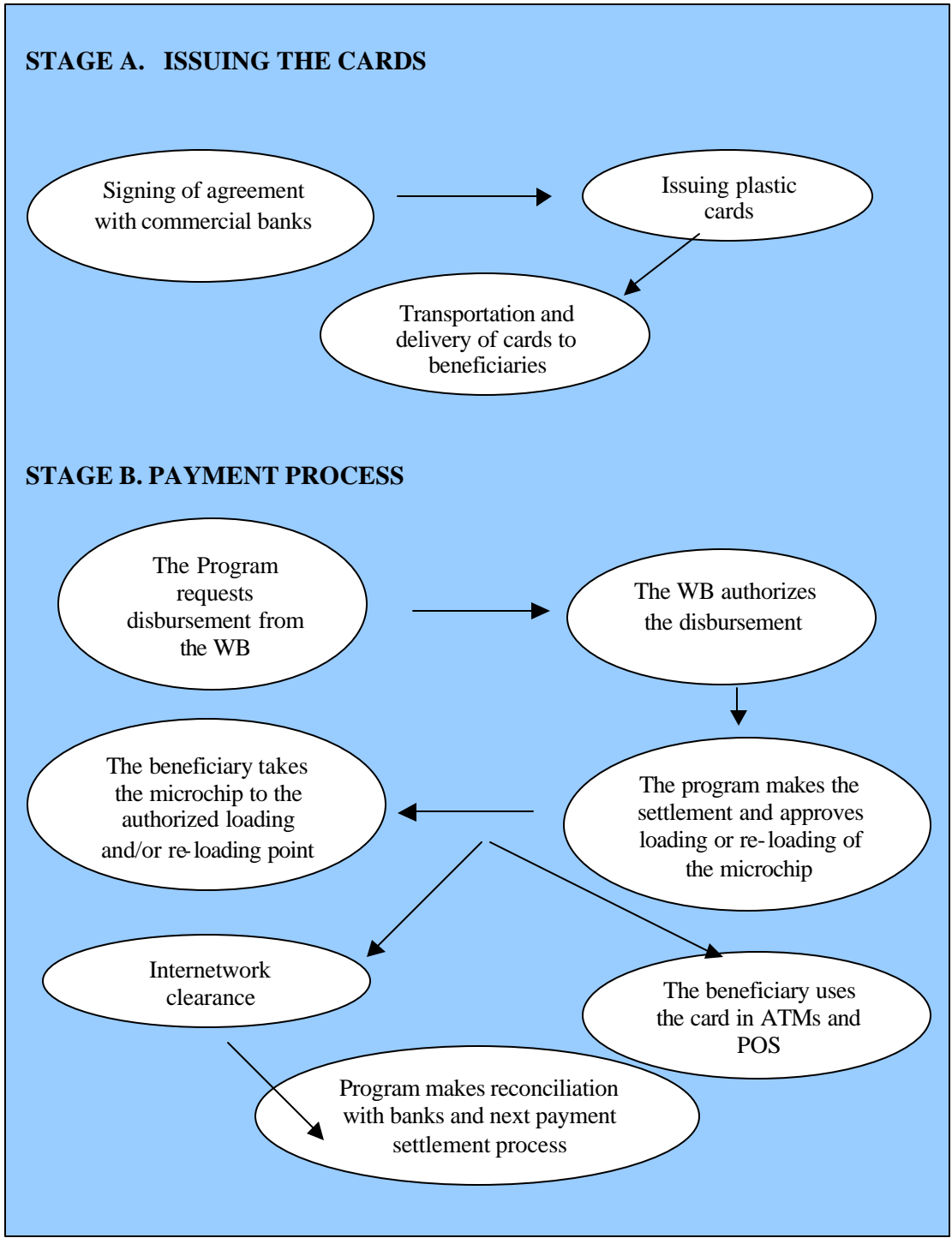
Each card-issuing bank carries out a clearance with the principal account of the hiring institution, once it receives the clearing order from the payment network.

➤ Reconciliation and Settlement:

The program receives detailed information on the card loading carried out in authorized POS from the payment network and/or the banks. This information is used to complete the reconciliation of payments made to beneficiary families. The database is then updated to begin the settlement of the next payment cycle.

The reconciliation is carried out between the cash originally drawn to the banks for the total payments to be made and the loading actually made to the beneficiaries. Therefore, upon the reconciliation the bank must return any cash corresponding to unmade payments.

**Chart 6: OPERATION OF CASH TRANSFERS THROUGH SMART CARDS**



## **Recommendations**

It would appear to us that this system is still under development except for specific cases in industrialized countries. It involves costly technological upgrades which cannot be met in the short term by LAC countries given their current circumstances.

In spite of Colombia's high technological development at the banking level – as evidenced by the fact that it was chosen as a pilot for the development of the intelligent card in Latin America – widespread introduction of this product has not been possible in the country. Therefore, similar outcomes can be expected in other Latin American countries.

Unless a banking institution is willing to make all the investments required for its implementation, we think that this system should not be used for the cash transfer program in the short term given the extremely high costs involved.

### **3. Automated Clearing House (ACH)**

The ACH is an inter-bank clearance system for the electronic management of third party payments through net multilateral clearance. It operates with an immediate and guaranteed final settlement in the destination accounts for the payments.

To operate, the beneficiaries must have current or savings accounts in any bank affiliated to the electronic clearing system.

Currently, there are two ACH systems in Colombia:

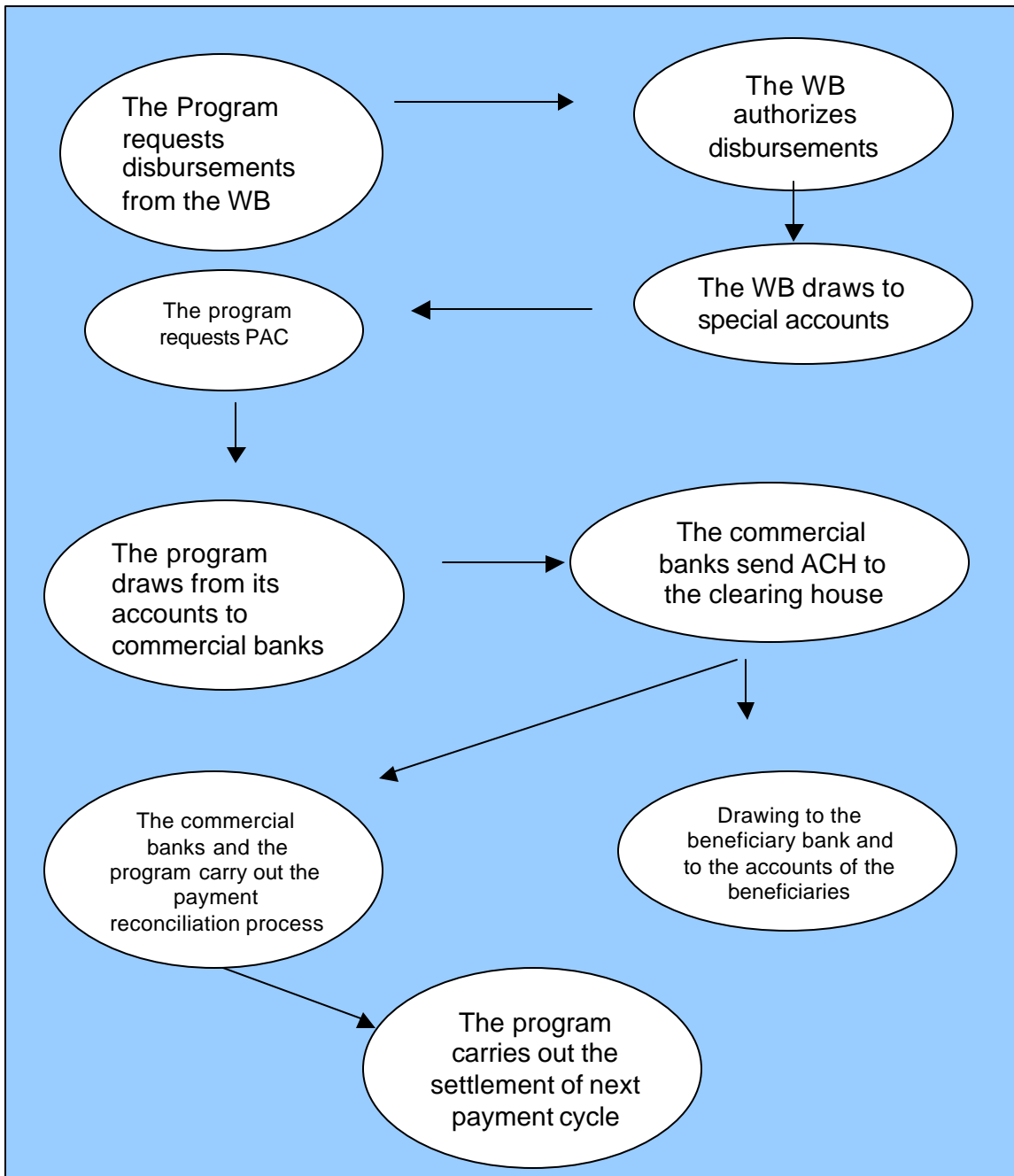
- a) ACH Cenit. The automated clearing house of the Banco de la República, through which the customers of any national bank can make payments or collect funds. The network was implemented by the Banco de la República as a neutral system that could provide equal operating conditions to all the country's financial institutions.
- b) ACH Colombia. The clearing house that groups a number of member banks.

#### **Advantages of the ACH**

- High security
- Fewer administrative processes, lower costs and reduced operational burden compared to traditional systems.
- Flexibility in payment schedules.
- Lower cost compared to traditional options.
- Confidential information management.
- Eliminates traveling to bank branches, which saves time.
- Nation-wide coverage.

- Optimal use of financial resources.

**Chart 7: PAYMENT CYCLE THROUGH ACH**



### **Disadvantages of the ACH**

- The main disadvantage is that payment beneficiaries must open a savings or checking account in a bank. The target population of cash transfer programs are usually households who cannot afford the service charges involved in holding a traditional bank account. The alternative of the program taking care of such service costs is not feasible, as this involves twice the costs of other options such as a debit card:
  - Fees collected by the ACH
  - Service fees for a large number of savings accounts.
- Some countries may have a poorly developed technological platform, inadequate for electronic clearing. This is not the case in Colombia, as the country has been a leader in Latin America in the management of payment systems.

### **Operating Scheme**

- The customer sends a payment order to the bank (originating bank) through an electronic notice.
- The (originating) bank creates a file with all the payments ordered by its customers and sends it to the ACH.
- The ACH processes the files received from the banks and sends them to each (receiving) bank.
- The (receiving) bank credits the money to the accounts of each payment beneficiary.
- The originating bank and the program carry out the clearance and then the program settles the next payments.

### **Most Common Applications**

- Payment of payrolls
- Payment of pensions
- Payment of dividends
- Reimbursement of expenditures
- Payment to suppliers
- Transferring cash between banks
- Payment of insurance, mortgages, public utilities, cable TV, mobile phones, etc.

### **Recommendations**

This option can easily be implemented in those countries with a well developed ACH tool supported by proven technological platforms, and where the banking market has



not institutionalized high rates for the use of current or savings accounts. This is not feasible in Colombia since the costs to users involved in holding a current or savings account are extremely high, and beyond the reach of the target population.

#### **4. Cash Transfers through a Traveling Bank**

This option involves a traveling bank providing cashier-related services for occasional payments. Large Colombian companies with many employees without bank accounts often use this service to handle their payroll.

A critical issue for a grant payment program in remote municipalities is to rely on a secure transportation system, as the funds need to be carried from the nearest municipality with a bank branch.

Due to Colombia's internal conflict, banks no longer transport cash by roads. Therefore, the system was discarded. However, it may be a feasible option in other countries for beneficiaries in municipalities that lack a bank branch.

##### **Advantages of Using the System**

- The advantages of using this system are similar to those of using the banking system, since this is only an extension of a bank teller.
- Covers remote areas where there is no traditional bank branch

##### **Disadvantages of Using the System**

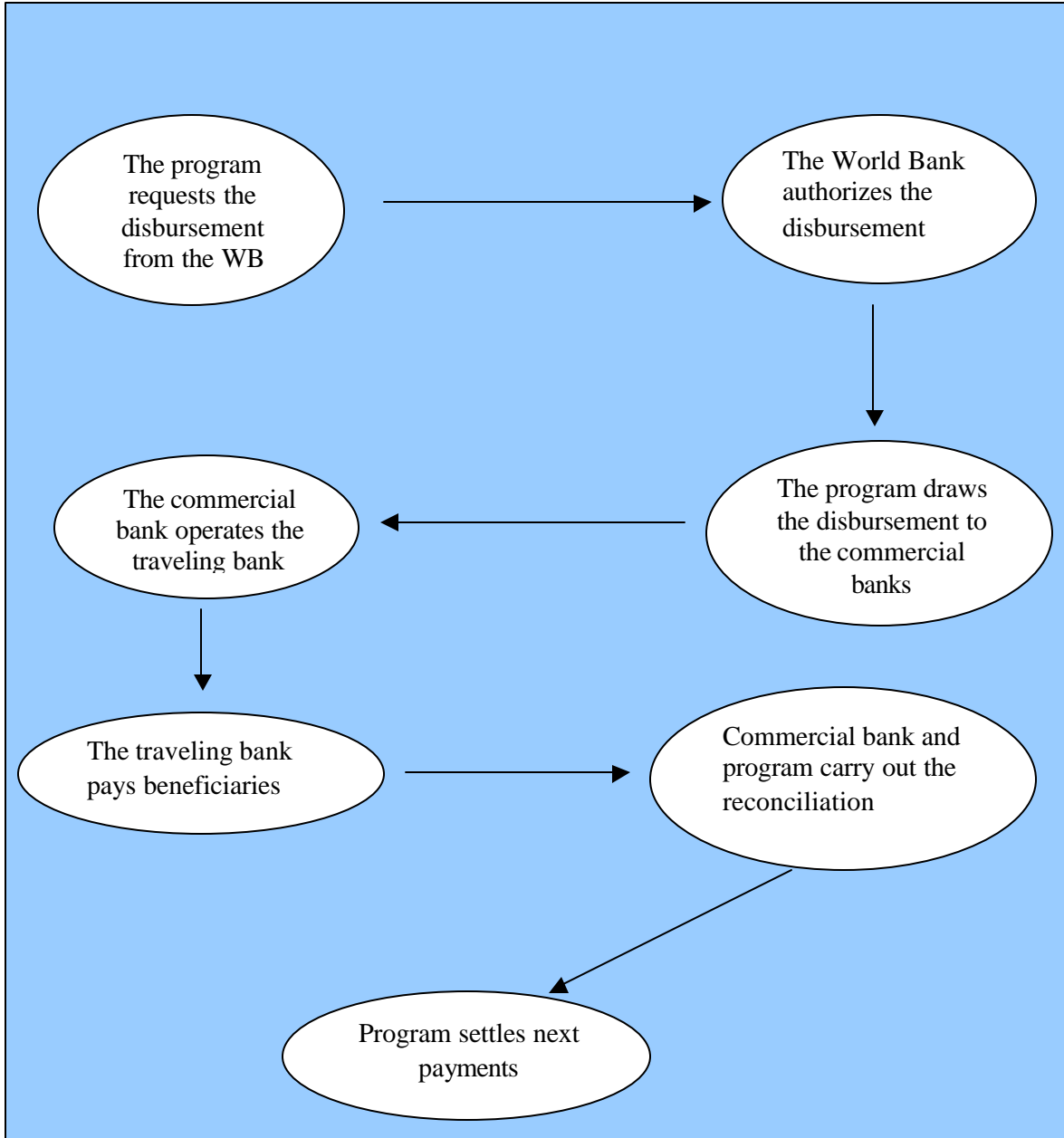
- High traveling costs involved.

##### **Operating Scheme**

The operation of this scheme is similar to that of the banking system. However, the bank which pays the grant must be clearly identified, just as with any other municipality with a bank branch.

The only modification is that the cash travels from one municipality to the next, together with the bank officials that are responsible for paying the beneficiaries in the local municipal office.

**Chart 8: PAYMENT CYCLE THROUGH A TRAVELLING BANK**



**Recommendations**

This is a feasible option for countries where traveling by road is safe. Otherwise, to transfer the cash by air can be extremely costly.

In our opinion, this option can be used as a complement to a banking payment system in order to reach remote areas. However, it is not advisable as an option by itself because it would not be operationally feasible for banks.

Since this service is in fact more costly for banks, it should be included in the negotiation process where all the reciprocal benefits from checking account deposits are discussed in order to define a single cost per transaction. We strongly recommend not to set an independent rate for this service, which would be marginal within a large payment contract with the bank.

#### ***D. OTHER POSSIBLE OPTIONS FOR COUNTRIES THAT LACK A HIGHLY DEVELOPED BANKING SYSTEM.***

Considering that there may be some cases in which the banking system will be insufficiently developed, or where market conditions can make the banking option unaffordable, we recommend other complementary options to make the payments. If the number of municipalities had not been restricted in Colombia for reasons of scale, one or more of these options could have been explored to reach remote areas that were not serviced by the traditional banking system.

#### **1. Companies Specializing in Cash Custody - Transporters of Valuables**

##### **Advantages of Using the System**

- Experience in cash handling and custody.
- Experience as payers, which would facilitate the definition of operations.
- Given the nature of their work, these companies already have the insurance policies required for cash management in place.

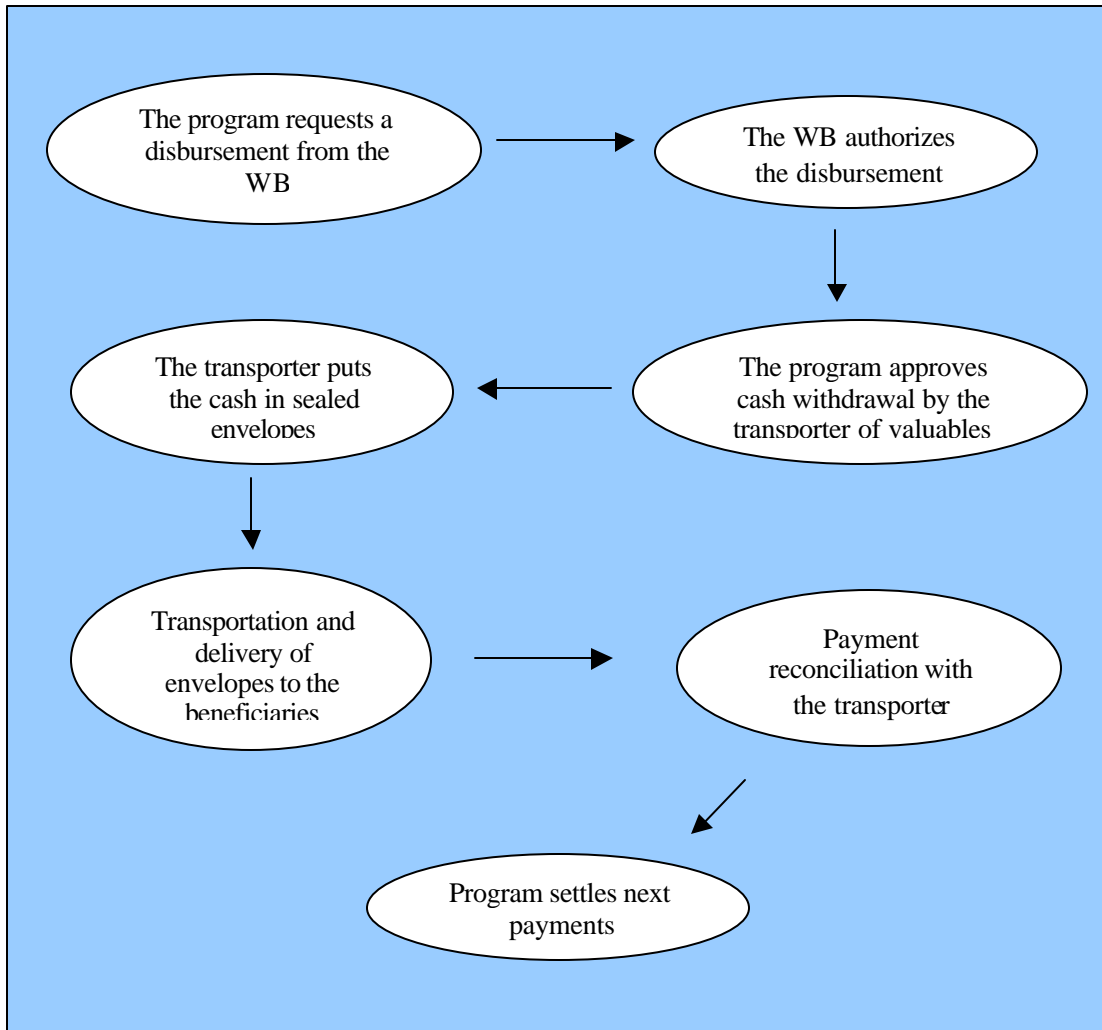
##### **Disadvantages of Using this System**

- Insufficient geographical coverage, which could have an effect on rate negotiations.

The transporters of valuables also provide a cash payment service that includes counting and packing the cash in sealed envelopes and the delivery to a specific point previously defined by the hiring institution.

This service is used in Colombia for payrolls and for contractors who do not have bank accounts, especially in remote areas such as oil fields, mines, farms, etc.

**Chart 9: CASH TRANSFERS USING A TRANSPORTER OF VALUABLES**



Source: Thomas Gregg and Sons of Colombia, Transporters of Valuables

### Operating Scheme

- Under this system, the total amount of cash to be paid to the beneficiaries is withdrawn from a bank account. Data on the beneficiary's full name, ID and grant amount is provided to the transporter of valuables in magnetic form.
- Once the cash is withdrawn from the bank and the appropriate information has been received, the packing process takes place. If required, the transporter of valuables provides the beneficiary a payment stub.
- After this process, the same transporter of valuables will carry the payments to the specified location and will identify the beneficiaries and deliver the envelopes against a signed receipt.

- Payment reconciliation is simple. The transporter of valuables will deliver the payment receipts and will return to the bank account those unpaid amounts, in addition to a report thereon.
- Once the reconciliation has been made, the program will settle the next payments.

### **Recommendations**

This payment system is recommended for countries whose commercial banks are not well developed or which lack adequate geographical coverage, and which have transporters of valuables offering extensive coverage, as these companies often have vast experience in making small cash payments to third parties in remote areas.

It can also be used to complement a main payment system in order to cover remote areas.

Cost-related issues should be discussed on a per country basis, but it should be noted that these companies often supply the banking system, therefore their rates should be affordable.

## **2. State-Owned Bodies or Other Non-Profit Institutions**

An interesting option for countries that are implementing cash transfer systems is the use of state-owned companies (e.g. TELECOM) or other non-profit institutions such as social-pastoral (Church), cooperatives, and others that may often be well regarded by the community and whose mission may be consistent with this type of program. Many beneficiary mothers interviewed in the focus groups mentioned institutions such as these as an alternative for municipalities which have no bank branch. Most probably, they will not cover all the geographical requirements of the program, but they may serve as a useful complement to another system.

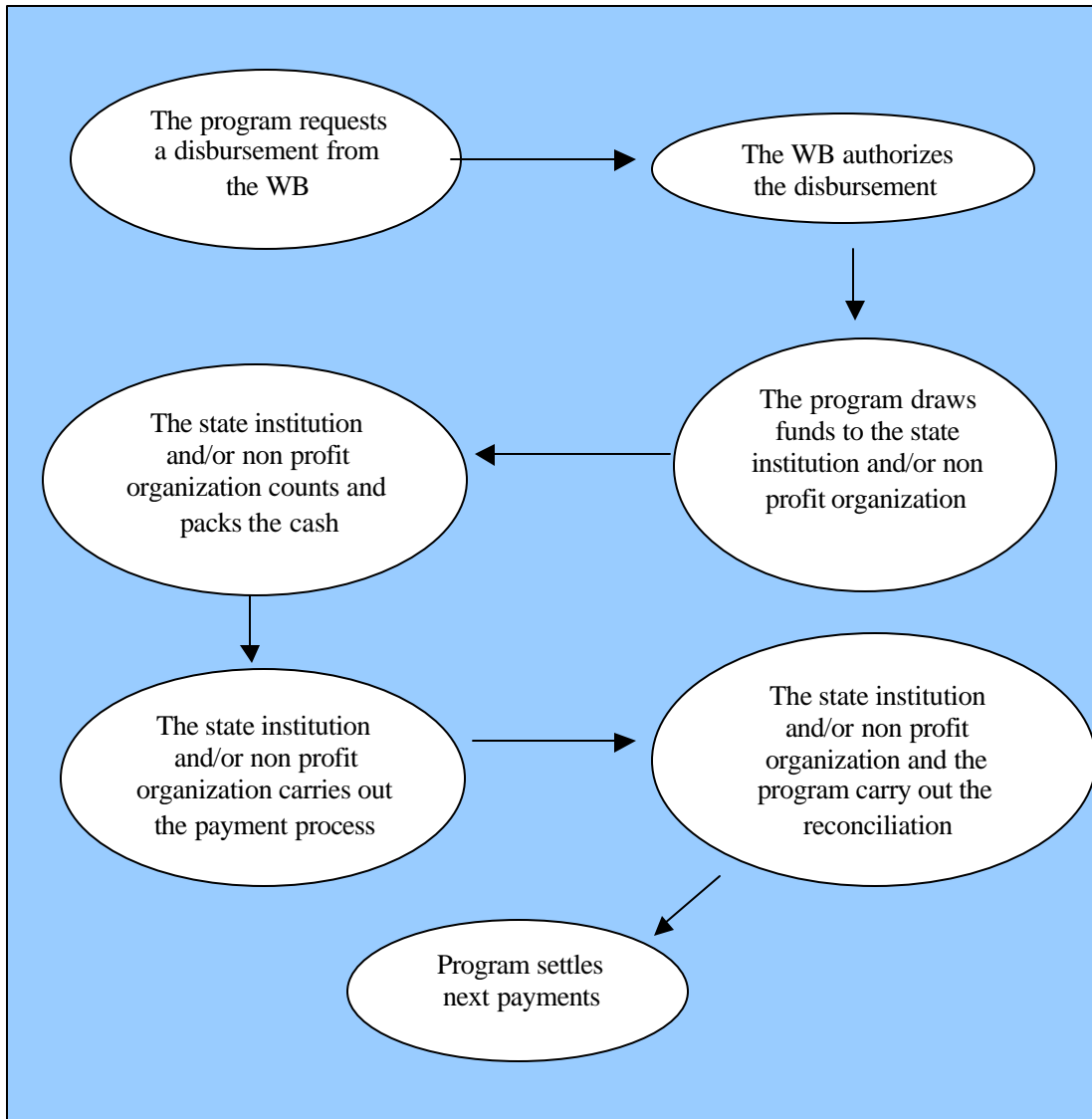
### **Advantages**

- The network involved develops the operating scheme according to the needs of the program.
- The program may choose one or more networks to guarantee coverage.

### **Disadvantages**

- Often, these institutions lack previous experience in the payment of cash to third parties, which can delay program implementation.
- Since cash management is not their main purpose, additional insurance policies must be taken out, which will increase program costs.

**Chart 10: CASH TRANSFERS THROUGH GOVERNMENTAL INSTITUTIONS AND/OR NON PROFIT ORGANIZATIONS**



### **Operating Scheme**

- The total amount of money to be paid to the beneficiaries is withdrawn from the bank account. The state institution should be responsible for transporting the cash, if required. For this to be accomplished, the program should previously provide the beneficiary's full name, ID number and amount of money to be paid in magnetic form.
- Once the company has the cash and the information on the beneficiaries, the packing process will begin. If required, the state institution will provide the beneficiary with a payment stub.

- After this process, the state institution will identify the beneficiaries and deliver the envelopes against a signed receipt.
- The institution will return the amount of uncollected cash in addition to a list of those households that did claim the payment, to begin the reconciliation process.
- The program begins the next payment settlement process.

### **Recommendations**

In our opinion, this should be used as a complementary solution to the main system chosen to make transfer payments, except in those cases where special circumstances with respect to the nature of the company make it possible to implement this system cheaply and rapidly in comparison with other available alternatives.

The most important aspects are related to security and to the costs involved in taking out insurance policies to guarantee cash handling and potential mismanagement, and risks in the delivery process. Other important issues to be defined relate to the joint procedures to be carried out between the program and the institution, as well as the internal processes that the institution must complete in order to comply with the objectives of the agreement. This mainly involves a staff training strategy as these institutions often lack experience in transfer payments.

Finally, the program should strengthen the monitoring mechanisms and establish monitoring procedures for the entire payment process with the external auditors.

### ***E. COMPARATIVE ANALYSIS***

For the purpose of the present study, the banking system is assumed to be the best payment option for this type of program. Within this option, the use of over the counter services or more advanced technologies specified above will depend on each country's local conditions.

The summary in table 10 compares the options and their costs for Colombia. A qualitative analysis of each payment option to inform a final decision is provided in Table 11.

**Table 10: COMPARISON OF PAYMENT OPTIONS**

<b>PAYMENT OPTION</b>	<b>NUMBER OF MUNICIPALITIES COVERED</b>	<b>UNIT COST US\$</b>
DEBIT CARD	131	0.60
BRANCH NETWORK	622	1.74
NEIGHBORING MUNICIPALITY	10	1.74
VOUCHERS	**NA	1.74
TRANSPORTER OF VALUABLES	731	2.50
TRUST COMPANY	30	3.83
SMART CARD	**NA	NA
ACH	622	*5.48
TRAVELING BANK	**NA	*4.24
TELECOM	**NA	NA

Notes: \*Estimated costs: ACH includes transfer costs and the maintenance of a current or savings account. The costs of the traveling bank includes the transporter of valuables and transfer payments.

\*\*NA. Coverage depends on the agreement reached with the paying institution. However, when this study was conducted none of these options was available in Colombian Municipalities.

The comparative analysis suggests that the following options, in this order, are the most feasible for the Colombian municipalities:

- The network of bank branch offices
- The prepayment debit card
- The bank branch office of the nearest municipality
- The transporter of valuables



**Table 11: QUALITATIVE ANALYSIS OF PAYMENT OPTIONS**

<b>OPTIONS</b>	<b>EXPERIENCE AS PAYER</b>	<b>PROCESS COMPATIBILITY</b>	<b>GEOGRAPHICAL COVERAGE</b>	<b>RISK FACTOR</b>	<b>CREDIBILITY</b>
<b>TRUST COMPANY</b>	The trust business is restricted to payment management through the banking system.	Processes are compatible and could be easily customized.	Only covers principal cities	Low. Insurance policies are in place to cover the risks.	Good credibility. The beneficiary population is not familiar with them.
<b>NETWORK OF BANK BRANCH OFFICES</b>	Ample experience in third-party payments through their network of branch offices	Processes are compatible and could be easily customized.	Covers 85 percent of the program's eligible municipalities.	Low. Risks are undertaken by the bank responsible for making the payments until the cash is delivered to the beneficiaries at the counter.	Good credibility. The beneficiary population is familiar with them.
<b>STATE INSTITUTIONS (TELECOM)</b>	No experience in third-party payments.	The institution must develop all operational arrangements required by a payment process.	High, since Telecom is present in most of the country's municipalities.	Loss, burglary or fraud insurance must be taken out.	Telecom is a highly credible institution among the Program's beneficiaries.

<b>BANK OF THE NEAREST MUNICIPALITY</b>	Ample experience in third-party payments through their network of branch offices	Processes are compatible and could be easily customized.	Coverage depends on the distance to the nearest municipality. In Colombia, this system could be implemented in 10 of the 74 municipalities without a bank.	Low. Risks are undertaken by the bank responsible for making the payments until the cash is delivered to the beneficiaries at the counter. Beneficiaries take some risk as they need to travel to their own municipality with the cash.	Good credibility. The beneficiary population is familiar with them
<b>PREPAYMENT DEBIT CARD</b>	Ample experience in third party payments through ATMs.	Processes are compatible and could be easily customized.	The network of Colombian ATMs covers 20 percent of the program's eligible municipalities.	Low. A personal code is required to access ATMs.	The target population is not familiar with this system. Intensive training is required to ensure acceptance.
<b>SMART CARD</b>	No experience as payer. The system is still being piloted in the network and is not widely used.	System implementation requires large and costly technological customizations.	No coverage at present. Pilot schemes have been developed in only five principal cities.	Low. It operates in special terminals with a secret personal code.	It is still unknown by the general public.

<p align="center"><b>ACH (Automated Clearing House)</b></p>	<p>Banks have experience in third party payments through the ACH system.</p>	<p>High process compatibility. Most processes, including reconciliation, are carried out directly by the banks.</p>	<p>Similar to the banking network, but beneficiaries are required to open a savings or checking account in the local bank.</p>	<p>Low. Similar to keeping a savings or checking account in a bank.</p>	<p>Beneficiaries generally do not have bank accounts and cannot afford the costs involved in holding a savings and/or checking account in Colombia.</p>
<p align="center"><b>TRAVELING BANK</b></p>	<p>Banks have experience as payers, but this is not a widespread system. It only operates in principal cities.</p>	<p>Processes are compatible and could be easily customized.</p>	<p>Geographical coverage would complement the network of banking branch offices.</p>	<p>Although the banks assume the risks, threats of road attacks are high.</p>	<p>Not a widespread system. Program beneficiaries are not familiar with it. However, since it is associated with a banking image, it would be easy to implement.</p>
<p align="center"><b>VOUCHERS</b></p>	<p>Ample experience as payers. They compete with banks in specific segments, such as food, transportation, clothing.</p>	<p>Highly compatible. No reconciliation is required since the program makes cash disbursements after the payments to the beneficiaries.</p>	<p>Low. It operates mainly in non eligible municipalities with over 100,000 inhabitants.</p>	<p>Low, since the vouchers become active only after being delivered to the final beneficiaries.</p>	<p>The population is not familiar with the system, therefore intensive training is required.</p>

<p><b>TRANSPORTER OF VALUABLES</b></p>	<p>Ample experience in payments to population who do not have bank accounts.</p>	<p>A degree of compatibility, however, some processes need customization and monitoring should be strengthened.</p>	<p>Transporters of valuables cover all municipalities since they traditionally handle the electoral process for the General Voters' Register.</p>	<p>Transporter of valuables assumes the risks until delivery of moneys to the Mayor's Office. As from there, the municipal office must hire a cash management policy that covers any loss up until the delivery of the envelopes to beneficiary households.</p>	<p>The participation of local municipal officials raises concerns in terms of the credibility of the process, as they could be subject to pressure in some isolated cases.</p>
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The following are the options discarded, along with their reasons:

- The Trust Company: this option adds no operational value, increases process times, and results in an additional cost of 6 percent for the program.
- The Intelligent Card: given the lack of experience and the high costs involved in technological adaptations, it is not viable in Colombia.
- The ACH payment system: payment beneficiaries must open checking and/or savings accounts which adds high service and management costs. An alternative would be for the program to bear these costs, however, it would be comparatively more costly than making the payments through the branch office network.
- Vouchers: They are not a cash payment system, which contravenes the philosophy of the program.
- Governmental institutions – TELECOM (the Colombian Telephone Company): Legal restrictions prevent the development of an agreement. However, it would still be discarded on account of its limited experience in third party payments.
- The Traveling Bank: this option was discarded from the beginning given the impossibility of traveling on Colombian roads for security reasons (armed conflict). The Colombian banks did not offer this service due to the high risks and costs involved.

#### **IV. CONCLUSIONS**

Based on the detailed analysis of this study, there are general conclusions referred to the overall features of the environment involved in this type of program; and specific conclusions related to the decisions that must be made to review specific payment process arrangements. We will first address the general conclusions:

##### **Macroeconomic Conclusions**

Programs that involve social policy options and which are funded with government resources –either domestic or credit funds– are subject to economic policy guidelines, which include decisions related with monetary, exchange and fiscal policies. Such programs are also ruled by in force national regulations for the management and control of public resources.

Therefore, such implications on program development must always be clear and be included in the design itself, in order to anticipate any exogenous events that may have an impact on the program. Early mechanisms must be found to guarantee the permanent flow of resources to the beneficiaries, as defined in the original design.

We have shown how the freezing of the budgetary resources for the Colombian program left beneficiary families without their grants during approximately eight months. An impact assessment of this circumstance will show the effects with greater detail, but clearly, if one of the goals of the program is to improve the quality of life of the population such delay will have major implications.

If we look at the performance of the payment cycle during their entire effectiveness we will see that other fiscal policy variables have had an impact on the payments' schedule.

### **Market Behavior**

The payment mechanisms supported by this type of program and which have been discussed in this study generally perform under a free market scheme. Therefore, it is extremely important to deeply assess the behavior of the sectors involved to define features, participants, development level, geographical coverage and costs. This will help in the negotiation process once one or several payment systems have been chosen and will achieve an appropriate cost structure that matches the actual market setting.

### **Logistics And Support**

Transfer programs must rely on a careful analysis of the operating mechanisms, so as to assure appropriate implementation and commissioning. Therefore, aspects such as structure, staff profiles, and technological development must be carefully defined based on multiple former experiences of similar programs. This shall guarantee an appropriate implementation support. Building the program on solid basis guarantees a smooth implementation of the multiple cycles involved.

Greater program development efficiency can be expected if the implementation has been completed with a successful arrangement of all the resources involved.

The following are specific conclusions to inform the decision-making regarding payment mechanisms that can be implemented for cash transfer programs.

### **Key Implementation Issues**

The Program made the decision to provide a payment mechanism through a banking network formed by seven banks: Banco Agrario, Bancolombia, Bancafe, BBVA- Banco Ganadero, Banco de Bogotá, Banco Popular, and Banco de Occidente. This decision was based on the fact that network guaranteed a 89.4 percent coverage of the total eligible municipalities and that the cost (US\$ 1.31 – US\$ 1.74) was below the amount anticipated for each payment (US\$2), a reasonable sum regarding the program's budget.

In addition, the trust company arrangement considered in the program's initial design was removed. This resulted in savings of about US\$ 7 million and a process improvement that reduced the payment cycle in 7 days.

Taking the costs and qualitative analysis of the multiple payment options assessed as a reference, the banking system continues to be the most feasible scheme. This is mainly on account of its broad coverage, extensive experience as payer, lower risk factors, and competitive costs .

This is certainly the best option considering the historical moment lived by Colombia. However, the study of optional tools to complement the geographical coverage should have been carried out from the program's design phase, and not as a result of the implementation process or the executors' concern for covering remote areas. In other words, the comparison of options should have been an effort of the design team and not of the executing team.

In our opinion, if the possibility of reaching remote municipalities –which were left out on account of their lack of a bank– with optional mechanisms would have been available from the outset, the equity of the beneficiary selection process would have greatly improved.

Finally, given the fast development of the banking system, the market now offers an innovative mechanism through the prepayment debit card. If adopted, this option would improve the cost structure as it provides lower rates for the 131 municipalities that operate on ATMs.

Alternative payment systems that use advanced technologies through the banking system should be considered under each country's market conditions. In our opinion, the most feasible option is the debit card, followed by the ACH and the traveling bank. Options such as the intelligent card have not been implemented yet in developing countries and require considerable technology investments. However, an issue that must always be considered is the development of the banking platforms in order to assure an efficient payment system that matches the needs of the program.

Arrangements such as the trust company must be totally left out as they add unjustified extra costs with no additional value for the programs' operations.

Other options such as the transporters of valuables or delivery through governmental or non-for-profit institutions could be sought in those countries with poorly developed banking sectors or whose market conditions make the banking alternative unaffordable.

Finally, a mixed arrangement is also feasible to guarantee an extensive geographical coverage and to improve the equity of the beneficiary selection process.

## **ANNEX 1. Terms of Reference**

1. Is the banking network public or private? How many banks are used? Is there a consortium of banks?
2. How much does it cost to transfer cash from the central institution to the branch office in charge of delivering the money to the beneficiary? Does this depend on variables such as distance, location or others?
3. How effective is the delivery system for poor people who live in remote areas? What is the coverage of the banking system in remote areas and cities?
4. How and with what frequency do beneficiaries receive the funds? Do these people have bank accounts, booklets, electronic cards or other types of mechanisms to withdraw the funds?
5. What type of documents do the beneficiaries receive? A card or a different official document?
6. Who can collect the transfer? Only the main beneficiary or someone else in his/her place?
7. Describe the procedures established to minimize fund diversion upon delivery and to prevent the collection of fees on behalf of governmental officials, program managers, etc.
8. Can security issues arise that may prevent poor people from collecting their grants? For instance, the elderly being subject to some type of intimidation?
9. Can evolved technologies be used to improve delivery efficiency, such as electronic transfers, debit cards, electronic purses? Regarding this issue, it is important to determine the best network for the availability of tellers and money. In addition, some of these technologies will rely on electrical power, others will need to operate on batteries.



## **ANNEX 2. Colombia's Economic Policy for 2000 – 2003**

Government programs cannot ignore the impacts of the prevailing macroeconomic policy, and therefore, of monetary and fiscal decision-making on behalf of the applicable governmental agencies. For such reason, we will briefly summarize the main aspects of the Colombia's economic performance during the implementation and development of this cash transfer program. This summary is provided as a conceptual framework for further analysis.

Policymakers have become increasingly concerned about fiscal unbalance. A macroeconomic plan was prepared during the June-December 1999 period, which served as a basis for the agreement reached with the International Monetary Fund (IMF) under the Extended Fund Facility (EFF). This agreement was effective until year 2002.

By the end of year 2000, two regulations were approved, namely: the Tax Reform Act (Act 633 of 200) and the Fiscal Territorial Reorganization Act (Act 617 of 2000). The financial implications of these reforms began as from year 2001. The first reform establishes a permanent tax on financial transactions; and the second reorganized the departments and municipalities according to the number of inhabitants and non-earmarked current receipts.

The economic performance of year 2001 shows a gradual reduction of the annual inflation rate during the first months of the year, mainly as a result of the Monetary Policy, and additionally, due to the unused installed capacity of several economic industries. The balance of payments shows a deficit during the first quarter of 2001, which result from large export increases, the fall of oil exports, and lower coffee prices. Unemployment is still the most severe problem of the Colombian economy, in spite of a small reduction during the year.

Several options were implemented during 2001 aimed at reducing the fiscal deficit. One of these was legislative measure No. 1, and Act 715, and additionally, the enforcement of Act 617 of 2000. As a result of the persistent unbalance of public finances –mainly at the central government level– the public debt continued to increase, although at a slower rate. This required an additional effort to prevent indebtedness increases, as part of the agreements reached with the IMF.

In order to control fiscal unbalance, the government proposed budgetary cutbacks for year 2003, which were approved by the congress. This resulted in a very tight budget where spending other than interests was increased below expected inflation. Additionally, a one time basis tax on equity was levied and on December, the Congress approved pension, labor and tax reforms. The GOC also launched the implementation of a civil service streamlining program, and has made progresses in a public finance reform plan. The government has also secured Congress approval for a bill that will introduce several economic and political measures after a national referendum to be voted by midyear.

By the beginning of year 2003, the IMF approved a stand-by agreement with the GOC. The agreement includes the design of a program for years 2003 and 2004, in order to strengthen macroeconomic policies and reduce vulnerabilities. Colombia currently faces complex external conditions in addition to the challenge to improve economic growth, provide better social benefits, and enhance domestic security.

The GOC is clearly determined to strengthen the internal security. This is a crucial issue to regain the confidence in economic performance. However, this goal will not be pursued at the expense of macroeconomic stability, as evidenced by the equity tax which will amount to approximately 1 percent of the GDP. Such resources will be allocated to fund additional security needs not financed in years 2002 and 2003. Through a fiscal consolidation, the GOC attempts to gain firm control of the public debt and reduce exposure to external shocks, thereby helping to promote economic growth, employment and social equity.

The monetary policy is being managed under an inflation goal scheme with a floating rate arrangement. To meet this purpose, the Board of the Banco de la República has set gradually decreasing inflationary goals.

Based on this program, Colombia will recover its fiscal consolidation path during 2003 through sound and lasting policies that guarantee public debt sustainability. Fiscal measures and a solid structural agenda will ensure that these goals are met within a stable macroeconomic scenario, supported by prudent monetary policies and a strengthened financial system.

Strengthening public finances is a key component of the program agreed with the IMF. The program has been designed to reduce the public deficit which stood at 4.0 percent of GDP in 2002, to 2.5 percent of the GDP in 2003, and then continue consolidating the process during the following years.

Resources for the fiscal program will be raised from an appropriate mix of domestic and foreign funds. The GOC is committed with prudent debt management policies and will reduce the non-financial public debt as a percentage of the GDP during its administration. The GOC expects higher confidence rates, better credit ratings, and lower borrowing costs as a result of a sustained debt reduction, constant improvement of economic vulnerability indicators, and sound economic management.

Since 1999, Colombia has been reducing the fiscal unbalances that threatened with undermining economic growth and social progress. Inflation has been abated and financial stability has been restored. However, recent events have slowed down the economic activity and poverty alleviation efforts have been unsuccessful. The GOC's main priorities are internal security and economic recovery. Therefore, the new administration is fully committed with the fiscal consolidation and structural reforms required to complete the changes needed, so that all Colombians can benefit from the opportunities of a revitalized economy.

## ANNEX 3. Main Features and Players of the Colombian Banking System

### 1. TYPES OF BANKS

#### Private Commercial Banks:

**National:** Banks with 100 percent Colombian capitals. There are currently 14.

**National Mixed:** Those with domestic private and public capitals. There are no such banks in Colombia.

**Foreign:** Banks with 100 percent foreign capitals. There are currently 11.

**Official Banks:** Those banks with fully state-owned capitals, as from their date of establishment or which have been later nationalized by the State. There are 4 banks of this type, but one of them (BANESTADO), is currently undergoing a winding-up process.

*Table 12: “COLOMBIAN BANKING INSTITUTIONS”*

BANK NAME	CLASS	TYPE
BANCO DE OCCIDENTE	PRIVATE	NATIONAL
BANCO DAVIVIENDA	PRIVATE	NATIONAL
BANCO POPULAR	PRIVATE	NATIONAL
BANCO DE BOGOTA	PRIVATE	NATIONAL
BANCOLOMBIA	PRIVATE	NATIONAL
BANCAFE	OFFICIAL	NATIONAL
BANCO SUPERIOR	PRIVATE	NATIONAL
BANK NAME	CLASS	TYPE
BANCO CAJA SOCIAL	PRIVATE	NATIONAL
*BANESTADO	OFFICIAL	NATIONAL
CONAVI	PRIVATE	NATIONAL
COLMENA	PRIVATE	NATIONAL
GRANAHORRAR	OFFICIAL	NATIONAL
MEGABANCO	PRIVATE	NATIONAL

MULTIBANCA COLPATRIA	PRIVATE	NATIONAL
BANAGRARIO	OFFICIAL	NATIONAL
BANCO AV VILLAS	PRIVATE	NATIONAL
BANCO ALIADAS	PRIVATE	NATIONAL
BANCO CORFINSURA	PRIVATE	NATIONAL
BANCO UNION COLOMBIANO	PRIVATE	FOREIGN
BANCO TEQUENDAMA	PRIVATE	FOREIGN
BANCO DE CREDITO	PRIVATE	FOREIGN
BANCO SANTANDER	PRIVATE	FOREIGN
BBV GANADERO	PRIVATE	FOREIGN
STANDARD CHARTERED	PRIVATE	FOREIGN
BANK BOSTON	PRIVATE	FOREIGN
BANCO SUDAMERIS	PRIVATE	FOREIGN
LLOYDS TBS BANK	PRIVATE	FOREIGN
CITY BANK	PRIVATE	FOREIGN
ABN AMOR	PRIVATE	FOREIGN

*SOURCE: SUPERINTENDENCY OF COLOMBIAN BANKS*

*(\*) Bank under a winding-up process.*

## **2. OPERATIONS CARRIED OUT BY BANKS**

The following are the operations currently carried out by the Colombian banking system:

- Discount and negotiation of payable notes, drafts, bills of exchange and other debt related securities.
- Checking accounts, savings accounts and term deposit certificates.
- Collecting portfolio and making payments and transfers.
- Purchasing and selling bills of exchange and currency.
- Delivering credit.
- Accepting bills of exchange for payment at a future date, originated either from national or foreign purchases-sales.

- Expediting letters of credit.
- Receiving movable property in custody and renting safes.
- Taking loans within the country and abroad.
- Acting as a transfer agent of any person or institution and as such, collecting and delivering monies; transferring, registering, and countersigning stock certificates, bonds or other evidence of debt.
- Agreeing into credit agreements.
- Providing collateral and guarantees.
- Intermediation in exchange operations.

### **3. GOVERNMENTAL INSTITUTIONS RELATED WITH THE BANKING SYSTEM**

#### **3.1. Banco de la República**

This is a public law institution with its own legal status that acts as the Central Bank. Its purpose is to maintain the currency's purchasing power in compliance with the provisions of the National Constitution. Its Executive Board is the monetary, exchange and credit authority. The related tasks are carried out in accordance with the overall economic policy foreseen in the macroeconomic program approved by the COMPEP (National Council of Economic and Social Policy), as long as this does not threaten the constitutional duty of keeping the currency's purchasing power.

#### **Functions:**

- To issue the legal currency, in the form of paper money and coins.
- To act as a banker and last resort lender for private and public credit institutions: provides temporary cash support through discounts and rediscounts; intermediates in external credit lines for their placement through credit institutions; and provides trust related deposit, clearance and draft services, and others as determined by the Executive Board.
- To act as a fiscal agent in the agreement of foreign and national credits; provides credits or guarantees to the benefit of the State; receives domestic and public funds as deposits; acts as a government agent in the issuance, placement and management of public debt securities in the market; and provides the government with technical assistance on related issues.
- To manage international reserves in compliance with the public interest, to the benefit of the national economy and with the purpose of facilitating the country's payments abroad.
- To act as the government's agent before international financial institutions in which it has made or makes capital contributions accounted as international reserves.

### **3.2. Superintendency of Banks**

An administrative and technical institution under the Ministry of Finances and Public Credit, which supervises financial and insurance operations.

#### **Functions:**

- To assure the reliability of the financial system and to oversee the financial soundness and appropriate liquidity of the financial institutions.
- To fully supervise the activities of the institutions under its control and surveillance regarding financial and exchange regulations.
- To supervise that the financial institutions under its control and surveillance provide adequate financial services under conditions of security, transparency and efficiency.
- To prevent that unauthorized individuals perform those activities that are exclusive of the institutions under its control and surveillance.
- To prevent those conditions that may result in the loss of public reliability by protecting the general interest and particularly, that of bona fide third-parties.
- To ensure that financial institutions do not incur in practices that may restrict free competition.

### **3.3. Fund for the Guarantee of Financial Institutions – FOGAFIN**

#### **3.3.1. Juridical Nature**

The Fund for the Guarantee of Financial Institutions was established under article 1 of Act 117, 1985, as an autonomous public law juridical person under the surveillance of the Superintendency of Banks.

#### **3.3.2. Purpose**

The general purpose of the Fund for the Guarantee of Financial Institutions is to protect the confidence of depositors and creditors of member financial institutions, thereby maintaining economic balance and equity and preventing financial or any other type of unjustified benefits, on behalf of shareholders or managers that may cause damages to such financial institutions.

#### **3.3.3. Duties**

- To act as a tool for the capital consolidation of member institutions;
- To temporarily own part of the capital of its member institutions;
- To support member institutions in the availability of liquidity for their financial assets and for the property received as payment;

- To organize and develop a deposit insurance system, and, as a complement thereof, a system to purchase liabilities on behalf of member institutions under liquidation or the funding for savers;
- To promote the winding-up processes originated from administrative measures taken by the Superintendency of Banks;
- To appoint special financial agents for take-over processes.

### **3.3.4. Member Institutions**

All banks, financial institutions, commercial funding companies, savings and housing credit unions, pension funds administrators, and other organizations which have been approved to operate by the Superintendency of Banks and which, as required by the law, must have the guarantee of the FOGAFIN, are required to register under the Fund for the Guarantee of Financial Institutions after the applicable qualifications have been completed (Article 30, Law 510, 1999).

### **3.3.5. Deposit Insurance**

- a) The Executive Board of FOGAFIN may arrange the deposit insurance in compliance with the following principles:
- To provide appropriate guarantee for bona fide savers and depositors, in compliance with the ceilings provided by the Executive Board. The guarantee cannot exceed seventy five percent (75%) of the ceilings set.
  - To comply with austerity and efficiency principles in term of risk taking.
  - To establish premiums on a differentiated basis or to provide a payback system, relying in both cases on the financial and credit standing indicators of the member institution, and based on the technical criteria as timely determined by the Executive Board.
  - To suspend the payback of the applicable deposit when there are circumstances that point to a relationship or participation of a depositor in the causes that motivated the bankruptcy of any financial institution, during the term of the judicial investigation to clarify such alleged relationship or participation.
  - Mandatory premiums to be paid by member institutions cannot exceed an annual amount equal to zero point three percent (0.3%) of the liabilities they hold with the public
- b) Events not covered by the deposit insurance will be specified, including deposits or splitting made by the financial institution against the express prohibition of the Superintendency of Banks, as long as such prohibition has been timely disclosed to the public;

- c) The obligations of the FOGAFIN related to the deposit insurance or to a guarantee may be met through the direct payment of the amount to the depositor or through other mechanisms that enable the depositor to collect a sum equivalent to the amount covered;
- d) Depositors may be paid an amount equivalent to the deposit insurance or the applicable guarantee as from the taking-over. Similarly, credits may be provided on behalf of the FOGAFIN to the institution subject to the measure, so that it may meet the deposit insurance's deductible;
- e) Conditions will be provided as to prevent that a single person can directly or indirectly collect a payment in excess of the amount covered by the insurance;
- f) A financial cutoff date will be established in order to determine the payment of the deposit insurance or the guarantee.

### **3.4. Superintendency of Securities**

A technical agency under the Ministry of Finances and Public Credit, whose main purpose is to promote, organize, and regulate the public securities market.

#### **Functions:**

- To regulate the public securities market.
- To determine the requirements to list and negotiate securities at the stock exchanges.
- To set the management conditions for the members of the stock exchanges.
- To set mandatory criteria for the operations carried out at the stock exchanges.
- To set the general conditions that approve the public listing of securities.
- To determine the minimum capital for the stock exchange.

### **3.5. Ministry of Finances and Public Credit**

The National Government's agency in charge of defining and developing national fiscal, taxing, customs, public credit, budgetary, treasury, exchange, monetary and credit policies, in compliance with the power conferred by the Executive Board of the Banco de la República.

#### **Functions:**

- To define the central government's policies for the regulation of financial, securities and insurance activities, as well as any other activity related with the management, benefit and investment of resources collected from the public.



## **ANNEX 4. Fund for the Reconstruction and Social Development of the Coffee Cluster (FOREC)**

### **BACKGROUND**

On January 25, 1999, an earthquake destroyed the villages of five Departments of the so called Colombian Coffee Cluster. To support the reconstruction of the damaged areas, the National Government created a special fund called “FUND FOR THE RECONSTRUCTION AND SOCIAL DEVELOPMENT OF THE COFFEE CLUSTER”, pursuant to Decree Law No. 197 of 1999. This special Fund –with headquarters in the capital city of Armenia, Department of Quindío– was to operate under the administrative structure of the Presidency of the Republic but with patrimonial and financial autonomy. The Fund was temporary in nature and would be dismantled once its objective were met.

The Fund was led by an Executive Council formed by nine representatives from the public and private sectors. This Council is headed by an Executive Director and a team of professionals work in the National Technical Committee and in the Land Management, Technical Information, Departmental and Municipal Management Units.

### **POLICY GUIDELINES**

This model uses an interdisciplinary scheme with the participation of the government and the civil society, under the following guidelines:

- Through the FOREC, the Government sets the national policies, strategies and technical guidelines. The specific components were decided at the Local Administrations, which defined land management plans to ensure project sustainability.
- Governmental resources allocated to the FOREC were managed under a trust scheme, in compliance with the applicable requirements. Hiring procedures were ruled by private law, but those activities funded with foreign credits complied with the standards provided by the Inter-American Development Bank and The World Bank.
- The execution of programs and resources was in charge of Non Governmental Organizations under a delegated management system.
- Ethical codes were adopted to ensure transparent resource management and prevalence of common interests. They also provided some distance regarding electoral political activities. Additionally, recruiting procedures prioritized the hiring of regional competencies and skills.
- Community participation was an extremely important factor for the operation of this model.

## **TERMINATION**

Once the activities were completed and the objectives were met, the National Government approved the decree 111 of January 25, 2002, which provided for the termination of the FOREC.

Hence, the FOREC became a relevant and innovative initiative of government intervention supported by the civil society and with strong community participation. The experience was highly successful and is considered a model for replication.

## **ANNEX 5. Key Aspects to Consider during the Negotiation Process**

The negotiation process of specific agreements with the banks are based on profitability models that consider the financial business (intermediation margin) and the related operational costs.

A critical issue considered by the bank in the analysis of the intermediation margin is the volume of monthly average deposits that a customer can keep in the account. Such deposits are used to make loans and to keep the bank's investment portfolio. On this issue, it is important to keep in mind that, for every US \$100 deposited, the bank is only entitled to lend a percentage. The bank must comply with mandatory reserve investments provided by the law in order to guarantee the liquidity required to meet customer withdrawals. Currently in Colombia, the required reserve amounts to 13 percent. Therefore, banks can lend 87 percent of their checking account deposits.

Once the intermediation margin has been estimated, the bank will subtract related operational costs to achieve a minimum required gross profitability. Based on that, the bank defines the average cost per transaction that it must charge to achieve a desired net profitability.

The following is one sample model that could be used by the bank to estimate an intermediation margin.

The banks' financial costs are defined by:

- The checking account's cost, which for Colombia amounts to (0%). This means that in Colombia, customers do not collect any type of income from the deposits they make in their checking account.
- The savings account's cost, which in average amounts to (12%) in Colombia.
- The cost of the fixed term deposit certificates (CDTs) which in average amount to (15%) in Colombia.

The banks' financial income is defined by:

- The profitability of reserves, which in Colombian amount to (0%)
- The profitability of short term treasury investments, which in Colombia amount to an average of (5%)
- The portfolio profitability, which can be an average of 22% over the current portfolio. The overdue portfolio of a typical bank can amount to (5%) and it accrues no interest pursuant to the provisions of the Superintendency of Banks, which sets forth that bank portfolios must suspend the accrual of interest and even make provisions for potential losses.

The intermediation margin is defined as the receipts from loan and investment interests less the costs of the interest from deposits in checking and savings accounts and CDTs. For clarity purposes, the example assumes a bank that does not handle additional businesses.

$MI = (\text{Receipts from portfolio interests} + \text{receipts from investment interests} + \text{receipts from legal reserve interests}) - (\text{costs of checking account interests} + \text{costs of savings interests} + \text{costs of CDT interests}).$

$\text{Receipts from portfolio interests} = (\text{Amount of the portfolio as a \% of loans}) \times (\% \text{ of current portfolio}) \times (\text{average loan interest rate})$

$\text{Receipts from investment interests} = (\text{Amount of investments as a \% of loans}) \times (\text{average investment interest rate})$

$\text{Receipts from reserve interests} = (\text{Amount of the reserves as a \% of loans}) \times (\text{average reserve interest rate})$

$\text{Disbursements from checking account interests} = (\text{Amount of the checking account as a \% of the credit}) \times (\text{average checking account interest rate})$

$\text{Disbursements from savings account interests} = (\text{Amount of the savings account as a \% of the credit}) \times (\text{average savings accounts interest rate})$

$\text{Disbursements from CDT interests} = (\text{Amount of the CDT as a \% of the credit}) \times (\text{average CDT interest rate})$

Average portfolio interest rate: The bank is assumed to have an average loan rate of 22 percent.

Average interest rate of temporary investments: The bank is assumed to have an average credit rate of 5 percent.

The average interest rate for reserves in Colombia is 0 percent.

The average interest rate for checking accounts in Colombia is 0 percent.

Average interest rate for savings account: The bank is assumed to have an average rate of 12 percent.

Average CDT interest rate: The bank is assumed to have an average rate of 15 percent.

The bank is assumed to have credits by US\$100,000 with the following distribution: 50 percent in checking accounts; 35 percent in savings and 15 percent in CDTs; the portfolio holds 55 percent of the resources, with a 95 percent current portfolio; 32 percent in temporary investments; and 13 percent in legal reserves for the three types of credits.

Therefore, figures would be as follows:

**Disbursements:**

- Checking account interests	0.50 x 0.00 = 0
- Savings account interests	0.35 x 0.12 = 0.042
- CDT interests	0.15 X 0.15 = 0.0225
? <b>TOTAL DISBURSEMENT</b>	<b>= 0.0645</b>

**Receipts:**

- Portfolio interests	0.55 x 0.95 x 0.22 = 0.11495
- Investment interests	0.32 x 0.05 = 0.016
- Reserve interests	0.13 x 0 = 0.0
? <b>TOTAL RECEIPTS</b>	<b>= 0.13095</b>

**Intermediation Margin = Total Receipts – Total Disbursements**  
**0.13095 - 0.0645**  
**= 0.06645 ~ 6.6%**

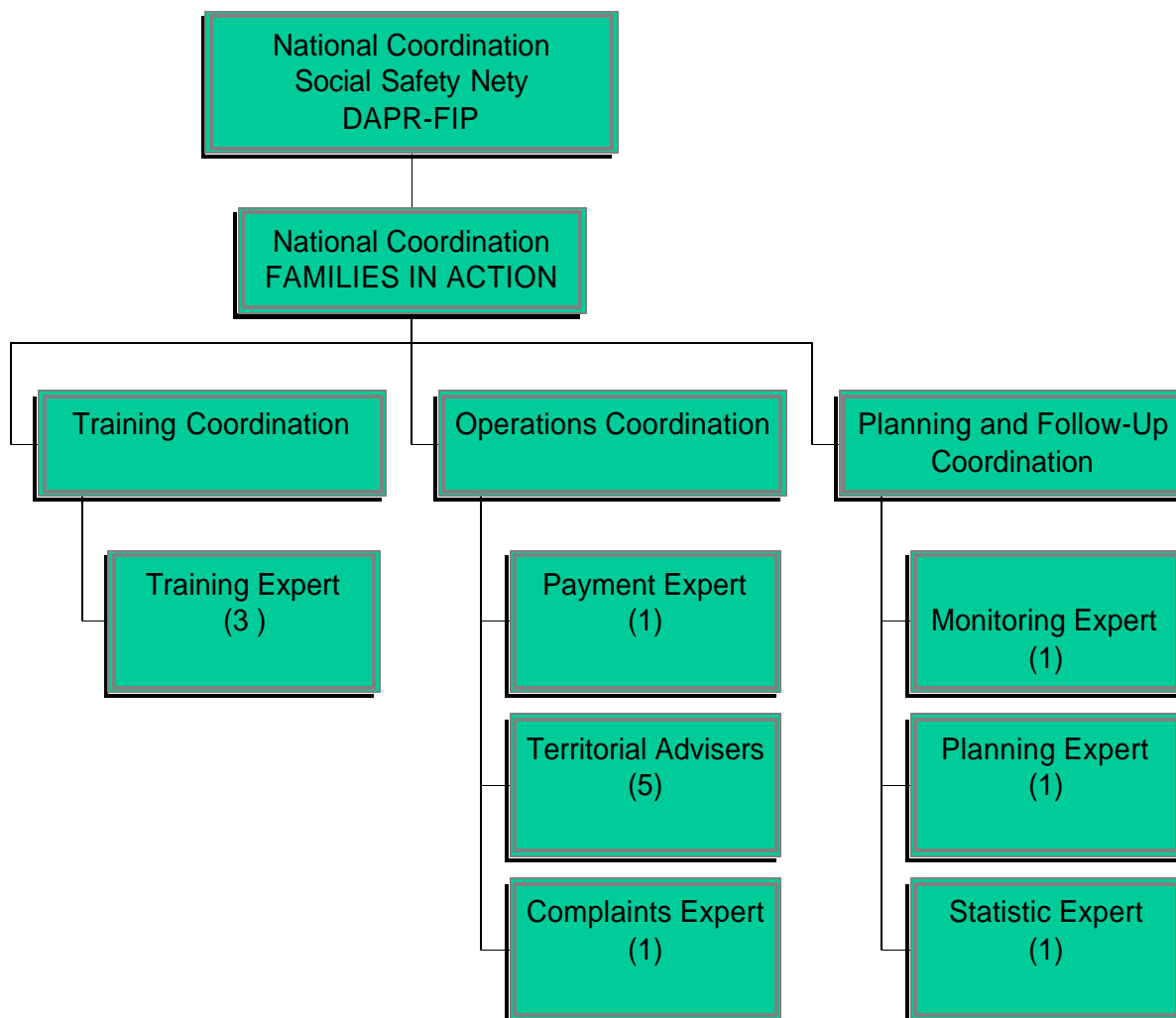
Banks always carry out this type of analysis when reviewing the intermediation margin of any transaction, which includes a payment agreement for a transfer program. Therefore, leaving deposits in the checking account is extremely important to assure the bank's financial profitability. Otherwise, when there are no deposits in checking accounts involved, the banks will only assess the impact of the operational costs related with providing the service, which considerably increases the cost per transaction.

As provided in Chapter 2, the first quote sent by a bank for the delivery of the transfer service in Colombia amounted to US\$10, since banks assumed that there would be no reciprocity in the checking account. However, when the program experts clarified that the total funds would be available in the checking account during five (5) days every two months, and that from such date on they would keep the floating amounts unpaid during the payment process, the rate charged dropped to US\$ 1.74 in the Banco Agrario, to US\$1.72 in commercial banks, and to US\$1.31 in the Banco de Occidente.

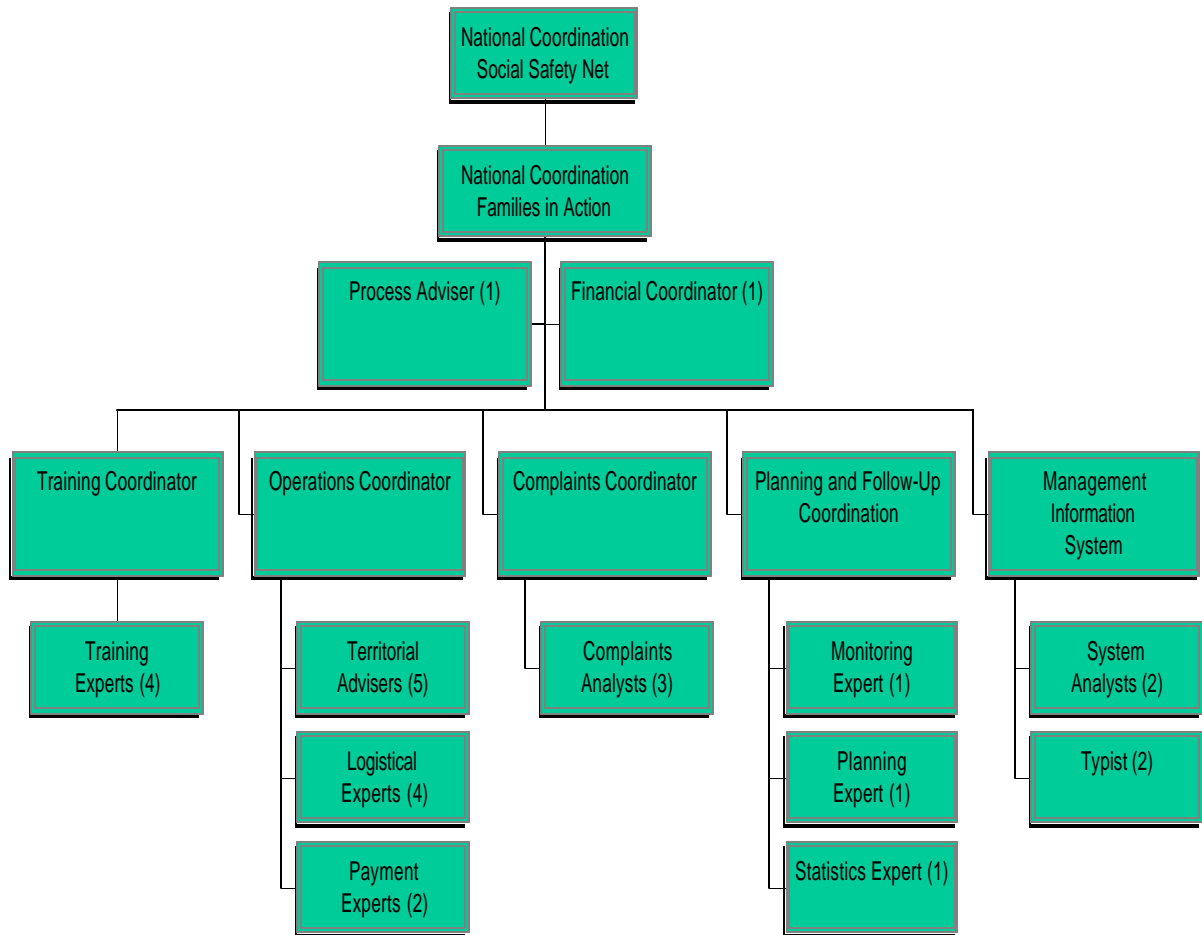
Having an in-depth knowledge on banking negotiation becomes a strong competitive advantage. Therefore, we stress on the need to rely on banking experts to monitor the negotiation process.

**ANNEX 6. Organization Chart of the Families in Action program**

**INITIAL ORGANIZATION CHART**



**APPROVED ORGANIZATION CHART OF THE FAMILIES IN ACTION PROGRAM**



## **ANNEX 7. Important aspects about VISA**

### **Background**

We think it is important to provide a historical background of the development of the payment system through debit and credit cards, in addition to providing information about the magnitude of the so called Visa Payments Network, both at the world level, as in Latin America and Colombia:

The history of banking cards goes back to 1914, when Western Union issued the first consumer credit card. These first cards provided a number of special services, among them deferred payments free from charges, and were delivered to the company's preferential customers.

During the first decades of the 20<sup>th</sup> Century, a large number of other firms, such as hotels, department stores and gas stations issued credit cards for their customers. However, it was not until 1950 that a single credit card was accepted by multiple businesses; this was the DINERS cards.

In 1951, the Franklin National Bank of Long Island, New York, issued a card that was accepted by local businesses and soon, about 100 other banks also issued their own cards. They charged no fees or interests to the cardholders, who paid the total amount upon the reception of the bill. However, businesses were charged a fee on the basis of the transactions made with the card.

The Bank of America had the entire state of California as a potential market. Therefore, the issuance of the BankAmericard in 1958 was a complete success. Just like other bank cards available then, BankAmericard offered users a new feature: the credit.

By 1965, the Bank of America had entered into license agreements with a group of banks outside California, pursuant to which they were entitled to issue BankAmericard. At the same time, another group of banks in Illinois, the East Coast of the United States, and California, joined to create Master Charge (now called Master Card).

With the increasing success of these two large bank card partnerships, most regional banks left their independent programs behind and joined one of the programs. By 1970, more than 1,400 banks offered BankAmericard or Master Charge, and the total balance of cards amounted to US\$3.8 billion.

In 1970, the Bank of America waived to the control of the BankAmericard program, which was passed to the banks that issued the cards who established the National BankAmericard Inc. (NBI), a non-stock independent corporation that would manage, promote and develop the system within the United States. Subsequently, IBANCO was established in 1974 as a multinational non-stock member corporation that would manage the international BankAmericard program.



Taking into account that many banks in other countries were unwilling to issue a card associated with the Bank of America, even if it was a nominal relationship, in 1977 BankAmericard became the VISA card, and changed its name to VISA USA; at the same time, Ibanco became VISA International.

The Regional Office for Latin America and the Caribbean provides services to more than 39 countries with over 490 million people. There are also sub-regional offices in São Paulo, Brazil; Caracas, Venezuela; Mexico City, Mexico; Santiago de Chile, Chile and San Juan, Puerto Rico.

### **Product Description**

The VISA Credit and Debit Card System has developed a product for Colombia called the VISA prepayment platform, which is offered by all the financial institutions that participate in the system. The service has the following features:

- A service provided by VISA COLOMBIA to financial institutions which involves the management of third-party payments for corporate or business customers, through a debit VISA ELECTRON card and using the VISA PREPAYMENT PLATFORM.
- The largest advantage of this service lies on the fact that payment beneficiaries are not required to open a bank account.
- Payments can be made directly with the card in business establishments through dataphones (POS) and ATMs. Since the platform is based on parameters, the paying institution can request that payments be exclusively made at some business establishments and/or at automatic teller machines previously identified as payers.

#### **1.2. Justification**

- Banks need to offer their customers comprehensive solutions that include, among other services, payments to third-unbanked-parties.
- Third-parties do not necessarily meet the customer profile previously defined by the banks as a banking target.
- Corporate and business customers allocate a large amount of operational costs to third-party payments.
- Branch offices are extremely crowded during the days when the third-party payment service is provided, resulting in higher operational burdens.

#### **1.3. Most Common Applications**

- Third-party payments on behalf of a corporate customer

- Pension and unemployment payments
- Replaces cash payments in high risk sites
- Massive payroll payments
- Expenditure advances
- Payment of dividends
- Delivering of awards
- Petty cash fund management
- Management of temporary workers
- Payment of remittances

#### **1.4. Product Features**

- **The Product:**  
A VISA ELECTRON debit card issued by member banks with a magnetic band, which operates with on-line and real time authorizations and the use of secure PIN. Each bank will have its own identification code to optimize control, parameter setting and transaction routing.

- **Authorization System:**  
Visa Colombia receives the information provided by the corporate customer, listed by bank, corresponding to the amount to be transferred to each payment beneficiary.

Visa Colombia is the institution that approves –on line and on a real time basis– the requests made by beneficiary cardholders, through:

- Point of sale terminals.
  - Automatic teller machines of the different banks and teller networks.
- **Customer Service:** Visa Colombia provides beneficiary cardholders with an 800 line to assist in the following:
  - Blocking cards.
  - Last transactions.
  - Promotions, if any, and additional information.
- POS terminals available in Colombia are listed in Table 13 “Available Visa System Dataphones”

**Table 13: AVAILABLE VISA SYSTEM DATAPHONES**

LOCATION	NUMBER OF DATAPHONES	CASHIERS	AUTOMATIC PAYMENT	TOTAL
ARMENIA	467		7	474
MANIZALES	532		9	541
MEDELLIN	2902	139	159	3200
PEREIRA	819		21	840
BOGOTA	8706	313	1042	10061
BARRANQUILLA	1674		40	1714
CARTAGENA	981		36	1017
SAN ANDRES	292		7	299
SANTA MARTA	619		7	626
CALI	3202	61	113	3376
IBAGUE	693		4	697
NEIVA	381			381
PASTO	275		6	281
BUCARAMANGA	1408		32	1440
CUCUTA	440		2	442
TUNJA	355		6	361
VILLAVICENCIO	327			327
<b>TOTAL POS.</b>	<b>24073</b>	<b>513</b>	<b>1491</b>	<b>26077</b>

SOURCE: VISA COLOMBIA

### 1.5. Latest Technological Developments

In compliance with the requirements of each third-party payment agreement, the prepayment platform provides the following parameter based features:

- Management of business establishments so that the debit cards can be approved only on locations considered as relevant in the agreement. In case of demand grants, some examples could be grocery stores, school equipment stores, drug stores, convenience stores, etc. The institution can also decide to activate the cards only for their use in ATMs.
- Customer Service that operates in AS400, which allows for the parameterization of the information provided to the cardholder, in compliance with the needs of the bank and of the corporate customer that controls the payments.
- Card activation with the first use of the magnetic band.
- Automatic creation of the plastic card number.
- Automatic charges of business-related rates, for improved control.
- Can be activated for special agreements.

The following is the list of banks that are part of the VISA System in Latin America:

- **Antigua** [CIBC West Indies Holdings](#)

- **Dutch Antilles & Curacao**
  - [Maduro & Curiel's Bank N.V.](#)
  - [RBTT Bank Antilles NV](#)
  
- **Argentina**
  - [Citibank](#)
  - [Visa Argentina](#)
  
- **Bahamas**
  - [Barclays Bank PLC](#)
  - [CIBC West Indies Holdings](#)
  - [Royal Bank of Canada](#)
  
- **Barbados**
  - [Barbados National Bank](#)
  - [Barclays Bank PLC](#)
  - [CIBC West Indies Holdings](#)
  - [Royal Bank of Canada](#)
  - [The Mutual Bank of the Caribbean](#)
  
- **Bermuda**
  - [Bank of Bermuda](#)
  - [Bank of Butterfield](#)
  
- **Bolivia**
  - [Banco Nacional de Bolivia](#)
  - [Banco Santa Cruz](#)
  
- **Brazil**
  - [Bancos](#)
  
- **Cayman Islands**
  - [Bank of Butterfield](#)
  - [Cayman National Bank](#)
  - [CIBC West Indies Holdings](#)
  
- **Chile**
  - [ABN AmroBank](#)
  - [Banco Bice](#)
  - [Banco de A. Edwards](#)
  - [Banco de Chile](#)
  - [Banco de Crédito é Inversiones](#)
  - [Banco del Estado de Chile](#)
  - [Banco Santander](#)
  - [Banco Santiago](#)
  - [Banco Security](#)
  - [Banco Sud Americano](#)
  - [BBVA Banco Bhif](#)
  - [Citibank](#)
  - [Corpbanca](#)
  
- **Colombia**
  - [ABN Amro Bank](#)
  - [Bancafe](#)
  - [Banco Caja Social](#)
  - [Banco Davivienda](#)
  - [Banco de Bogotá](#)
  - [Banco de Crédito](#)
  - [Banco Popular](#)
  - [Banco Santander](#)
  - [Banco Sudameris](#)
  - [Banco Superior](#)
  - [Banco Tequendama](#)
  - [Banco Unión Colombiano](#)
  - [Bancolombia](#)
  - [BBVA Ganadero](#)

- [Citibank](#)
  - [Conavi](#)
  - [Interbanco](#)
  - [Lloyds TSB Bank](#)
  - [Megabanco](#)
  - [Red Multibanca Colpatría](#)
  
- **Ecuador**
  - [Banco de Guayaquil de Ecuador](#)
  - [Filanbanco](#)
  - [Filancard](#)
  
- **Jamaica**
  - [CIBC West Indies Holdings](#)
  - [RBTT Bank Jamaica Ltd](#)
  - [National Commercial Bank Ltd](#)
  - [The Bank of Nova Scotia Jamaica Ltd](#)
  
- **Mexico**
  - [Banamex](#)
  - [Banco del Bajío](#)
  - [Banco Industrial](#)
  - [Bancrecer](#)
  - [Banjercito](#)
  - [Banorte](#)
  - [Bansi](#)
  - [BBVA Bancomer](#)
  - [BITAL-Banco Internacional](#)
  - [Citibank](#)
  - [Inbursa](#)
  - [IXE](#)
  - [Mifel](#)
  - [Santander](#)
  - [Scotia Bank Inverlat](#)
  - [Serfin](#)
  - [Visa México](#)
  
- **Paraguay**
  - [Banco Amambay](#)
  - [Banco del Parana](#)
  - [Banco Sudameris](#)
  - [Financiera Itacua](#)
  
  - [Interbanco](#)
  - [Multibanco](#)
  
- **Peru**
  - [Banco Continental BBVA](#)
  - [Banco de Crédito del Perú](#)
  - [Banco Santander Central Hispano](#)
  - [Citibank](#)
  - [Interbank](#)
  
- **Puerto Rico**
  - [BBVA Puerto Rico](#)
  - [Banco Popular](#)
  - [Citibank](#)
  - [Doral Bank](#)
  - [Eurobank](#)
  - [FirstBank](#)
  - [Oriental Group Bank](#)

[RG Premier Bank of Puerto Rico](#)  
[Banco Santander de Puerto Rico](#)  
[Scotiabank Puerto Rico](#)  
[WesternBank](#)

- **Dominican Republic**

[Asociacion La Nacional de Ahorros](#)  
[Banco BHD](#)  
[Citibank](#)  
[Banco de Reservas](#)  
[Banco Intercontinental](#)  
[Banco Mercantil](#)  
[Banco Nacional de Credito](#)  
[Banco Popular](#)  
[Banco Progreso](#)

- **Saint Vincent**

[CIBC West Indies Holdings](#)

- **Saint Lucia**

[CIBC West Indies Holdings](#)

- **Trinidad and Tobago**

[First Citizens Bank Limited](#)  
[Intercommercial Bank](#)  
[RBTT Bank Limited](#)  
[Republic Bank Ltd](#)

- **Turks and Caicos**

[CIBC West Indies Holdings](#)

- **Uruguay**

[Banco Comercial](#)  
[Banco de Crédito](#)  
[Banco La Caja Obrera](#)  
[BankBoston](#)  
[Citibank](#)  
[Discount Bank](#)

- **Venezuela**

[BancoCaracas](#)  
[Banco Exterior](#)  
[Banco Federal](#)  
[Banco Mercantil](#)  
[Banco Sofitasa](#)  
[Banco Venezolano de Crédito](#)

## ANNEX 8. Colombian Municipalities with ATMs

No	DEPARTMENT	MUNICIPALITY	PROGRAM MUNICIPALITIES
1	ANTIOQUIA	APARTADO	
2	ANTIOQUIA	BELLO	
3	ANTIOQUIA	BRICEÑO	
4	ANTIOQUIA	CALDAS	
5	ANTIOQUIA	CAREPA	
6	ANTIOQUIA	CARMEN DE VIBORAL	
7	ANTIOQUIA	CHIGORODO	
8	ANTIOQUIA	COPACABANA	
9	ANTIOQUIA	DON MATIAS	FAMILIES PROGRAM
10	ANTIOQUIA	DOS QUEBRADAS	
11	ANTIOQUIA	ENVIGADO	
12	ANTIOQUIA	FRONTINO	FAMILIES PROGRAM
13	ANTIOQUIA	GIRARDOTA	
14	ANTIOQUIA	GUARNE	FAMILIES PROGRAM
15	ANTIOQUIA	ITAGUI	
16	ANTIOQUIA	LA CEJA	FAMILIES PROGRAM
17	ANTIOQUIA	LA ERMITA	
18	ANTIOQUIA	LA ESTRELLA	
19	ANTIOQUIA	MARINILLA	FAMILIES PROGRAM
20	ANTIOQUIA	MEDELLÍN	
21	ANTIOQUIA	PUERTO BERRIO	FAMILIES PROGRAM
22	ANTIOQUIA	RIONEGRO	FAMILIES PROGRAM
23	ANTIOQUIA	SABANETA	
24	ANTIOQUIA	SANTUARIO	FAMILIES PROGRAM
25	ANTIOQUIA	URRAO	FAMILIES PROGRAM
26	ANTIOQUIA	YARUMAL	FAMILIES PROGRAM
27	ANTIOQUIA	YOLOMBO	FAMILIES PROGRAM
28	ARAUCA	ARAUCA	
29	ARAUCA	TAME	FAMILIES PROGRAM
30	ATLÁNTICO	BARRANQUILLA	
31	ATLÁNTICO	GUATAPURI	
32	ATLÁNTICO	MALAMBO	
33	ATLÁNTICO	SABANALARGA	FAMILIES PROGRAM
34	ATLÁNTICO	SOLEDAD	
35	BOLIVAR	CARMEN DE BOLIVAR	
36	BOLIVAR	CARTAGENA	
37	BOLIVAR	MAGANGUE	
38	BOLIVAR	MOMPOS	FAMILIES PROGRAM

No	DEPARTMENT	MUNICIPALITY	PROGRAM MUNICIPALITIES
39	BOLIVAR	TURBACO	
40	BOYACA	CHIQUINQUIRÁ	FAMILIES PROGRAM
41	BOYACA	DUITAMA	
42	BOYACA	GARAGOA	FAMILIES PROGRAM
43	BOYACA	GUATEQUE	
44	BOYACA	MIRAFLORE	FAMILIES PROGRAM
45	BOYACA	MONQUIRA	FAMILIES PROGRAM
46	BOYACA	PAIPA	FAMILIES PROGRAM
47	BOYACA	PUERTO BOYACA	FAMILIES PROGRAM
48	BOYACA	SAMACA	FAMILIES PROGRAM
49	BOYACA	SOGAMOSO	
50	BOYACA	TUNJA	
51	BOYACA	VILLA DE LEYVA	FAMILIES PROGRAM
52	CALDAS	AGUADAS	FAMILIES PROGRAM
53	CALDAS	ALBANIA	FAMILIES PROGRAM
54	CALDAS	ANSERMA	FAMILIES PROGRAM
55	CALDAS	ARANZASU	FAMILIES PROGRAM
56	CALDAS	CHINCHINA	
57	CALDAS	LA DORADA	FAMILIES PROGRAM
58	CALDAS	MANIZALES	
59	CALDAS	MANZANARES	FAMILIES PROGRAM
60	CALDAS	MARQUETALIA	FAMILIES PROGRAM
61	CALDAS	NEIRA	FAMILIES PROGRAM
62	CALDAS	PACORA	FAMILIES PROGRAM
63	CALDAS	PENSILVANIA	FAMILIES PROGRAM
64	CALDAS	RIOSUCIO	FAMILIES PROGRAM
65	CALDAS	SAN VICENTE DEL CAGUAN	FAMILIES PROGRAM
66	CALDAS	VILLAMARIA	FAMILIES PROGRAM
67	CAQUETA	FLORENCIA	
68	CAQUETA	LA ARANDIA	
69	CASANARE	AGUAZUL	FAMILIES PROGRAM
70	CASANARE	PAZ DE ARIPORO	
71	CASANARE	TAURAMENA	FAMILIES PROGRAM
72	CASANARE	VILLANUEVA	FAMILIES PROGRAM
73	CASANARE	YOPAL	
74	CAUCA	POPAYÁN	
75	CAUCA	SANTANDER DE QUILCHAO	FAMILIES PROGRAM
76	CESAR	AGUACHICA	FAMILIES PROGRAM
77	CESAR	BOSCONIA	
78	CESAR	CHIRIGUANA	
79	CESAR	CODAZZI	



No	DEPARTMENT	MUNICIPALITY	PROGRAM MUNICIPALITIES
80	CESAR	CURUMANI	FAMILIES PROGRAM
81	CESAR	EL COPEY	
82	CESAR	PAILITAS	
83	CESAR	SAN ALBERTO	FAMILIES PROGRAM
84	CESAR	VALLEDUPAR	
85	CHOCO	ITSMINA	
86	CHOCO	QUIBDO	
87	CORDOBA	CERETE	FAMILIES PROGRAM
88	CORDOBA	CHINU	FAMILIES PROGRAM
89	CORDOBA	LORICA	
90	CORDOBA	MONTELIBANO	FAMILIES PROGRAM
91	CORDOBA	MONTERIA	
92	CORDOBA	SAHAGUN	
93	CUNDINAMARCA	AGUA DE DIOS	FAMILIES PROGRAM
94	CUNDINAMARCA	ANOLAIMA	FAMILIES PROGRAM
95	CUNDINAMARCA	CAJICA	
96	CUNDINAMARCA	CAZUCA	
97	CUNDINAMARCA	CHIA	
98	CUNDINAMARCA	CHIPAQUE	FAMILIES PROGRAM
99	CUNDINAMARCA	CHOACHI	FAMILIES PROGRAM
100	CUNDINAMARCA	COTA	
101	CUNDINAMARCA	EL COLEGIO	FAMILIES PROGRAM
102	CUNDINAMARCA	FACA	FAMILIES PROGRAM
103	CUNDINAMARCA	FUNZA	
104	CUNDINAMARCA	FUSAGASUGA	
105	CUNDINAMARCA	GACHETA	FAMILIES PROGRAM
106	CUNDINAMARCA	GIRARDOT	
107	CUNDINAMARCA	GUADUAS	FAMILIES PROGRAM
108	CUNDINAMARCA	LA CALERA	FAMILIES PROGRAM
109	CUNDINAMARCA	LA PALMA	FAMILIES PROGRAM
110	CUNDINAMARCA	LA VEGA	FAMILIES PROGRAM
111	CUNDINAMARCA	MADRID	
112	CUNDINAMARCA	MOSQUERA	
113	CUNDINAMARCA	NEMOCON	FAMILIES PROGRAM
114	CUNDINAMARCA	PACHO	FAMILIES PROGRAM
115	CUNDINAMARCA	PUERTOSALGAR	FAMILIES PROGRAM
116	CUNDINAMARCA	SESQUILE	FAMILIES PROGRAM
117	CUNDINAMARCA	SIMIJACA	
118	CUNDINAMARCA	SOPO	FAMILIES PROGRAM
119	CUNDINAMARCA	SUBACHOQUE	FAMILIES PROGRAM
120	CUNDINAMARCA	TOCAIMA	FAMILIES PROGRAM

<b>No</b>	<b>DEPARTMENT</b>	<b>MUNICIPALITY</b>	<b>PROGRAM MUNICIPALITIES</b>
121	CUNDINAMARCA	TOCANCIPA	FAMILIES PROGRAM
122	CUNDINAMARCA	UBATE	FAMILIES PROGRAM
123	CUNDINAMARCA	VIANI	FAMILIES PROGRAM
124	CUNDINAMARCA	VILLETA	FAMILIES PROGRAM
125	CUNDINAMARCA	ZIPAQUIRA	FAMILIES PROGRAM
126	DISTRITO CAPITAL	BOGOTA	
127	GUAJIRA	FONSECA	FAMILIES PROGRAM
128	GUAJIRA	RIOHACHA	
129	GUAJIRA	SAN JUAN DEL CESAR	FAMILIES PROGRAM
130	GUAJIRA	VILLANUEVA	FAMILIES PROGRAM
131	GUAVIARE	SAN JOSE DEL GUAVIARE	
132	HUILA	CAMPOALEGRE	FAMILIES PROGRAM
133	HUILA	GARZON	FAMILIES PROGRAM
134	HUILA	GIGANTE	FAMILIES PROGRAM
135	HUILA	LA PLATA	FAMILIES PROGRAM
136	HUILA	NEIVA	
137	HUILA	PALERMO	FAMILIES PROGRAM
138	HUILA	PITALITO	FAMILIES PROGRAM
139	MAGDALENA	CIENAGA	
140	MAGDALENA	EL BANCO	FAMILIES PROGRAM
141	MAGDALENA	FUNDACION	FAMILIES PROGRAM
142	MAGDALENA	PIVIJAY	FAMILIES PROGRAM
143	MAGDALENA	PLATO	FAMILIES PROGRAM
144	MAGDALENA	SANTA MARTA	
145	META	ACACIAS	FAMILIES PROGRAM
146	META	GRANADA	FAMILIES PROGRAM
147	META	SAN MARTIN	FAMILIES PROGRAM
148	META	VILLAVICENCIO	
149	NARIÑO	IPIALES	FAMILIES PROGRAM
150	NARIÑO	LA UNION	FAMILIES PROGRAM
151	NARIÑO	PASTO	
152	NARIÑO	TUMACO	
153	NORTE DE SANTANDER	CHINACOTA	FAMILIES PROGRAM
154	NORTE DE SANTANDER	OCAÑA	FAMILIES PROGRAM
155	NORTE DE SANTANDER	PAMPLONA	FAMILIES PROGRAM
156	NORTE DE SANTANDER	TIBU	FAMILIES PROGRAM
157	NORTE DE SANTANDER	CUCUTA	
158	PUTUMAYO	MOCOA	
159	PUTUMAYO	SIBUNDOY	FAMILIES PROGRAM
160	QUINDÍO	ARMENIA	FAMILIES PROGRAM
161	QUINDÍO	CALARCA	

<b>No</b>	<b>DEPARTMENT</b>	<b>MUNICIPALITY</b>	<b>PROGRAM MUNICIPALITIES</b>
162	QUINDÍO	LA TEBAIDA	
163	QUINDÍO	MONTENEGRO	
164	QUINDÍO	QUIMBAYA	
165	RISARALDA	APIA	FAMILIES PROGRAM
166	RISARALDA	BELEN DE UMBRIA	FAMILIES PROGRAM
167	RISARALDA	LA VIRGINIA	FAMILIES PROGRAM
168	RISARALDA	MARSELLA	
169	RISARALDA	PEREIRA	
170	RISARALDA	QUINCHIA	FAMILIES PROGRAM
171	RISARALDA	SANTA ROSA DE CABAL	
172	RISARALDA	SANTUARIO	FAMILIES PROGRAM
173	SAN ANDRES	SAN ANDRES	
174	SANTANDER	BARBOSA	FAMILIES PROGRAM
175	SANTANDER	BARRANCABERMEJA	
176	SANTANDER	BUCARAMNGA	
177	SANTANDER	CIMITARRA	
178	SANTANDER	FLORIDA BLANCA	
179	SANTANDER	GIRON	
180	SANTANDER	LEBRIJA	FAMILIES PROGRAM
181	SANTANDER	MALAGA	FAMILIES PROGRAM
182	SANTANDER	OIBA	FAMILIES PROGRAM
183	SANTANDER	RIONEGRO	
184	SANTANDER	SAN GIL	FAMILIES PROGRAM
185	SANTANDER	SAN VICENTE DE CHUCURI	FAMILIES PROGRAM
186	SANTANDER	SOCORRO	FAMILIES PROGRAM
187	SANTANDER	VELEZ	FAMILIES PROGRAM
188	SANTANDER	PIE DE CUESTA	
189	SUCRE	COROZAL	FAMILIES PROGRAM
190	SUCRE	SAN MARCOS	FAMILIES PROGRAM
191	SUCRE	SAN PEDRO	FAMILIES PROGRAM
192	SUCRE	SINCE	FAMILIES PROGRAM
193	SUCRE	SINCELEJO	
194	SUCRE	TOLÚ	FAMILIES PROGRAM
195	TOLIMA	CAJAMARCA	
196	TOLIMA	CHAPARRAL	FAMILIES PROGRAM
197	TOLIMA	ESPINAL	FAMILIES PROGRAM
198	TOLIMA	FRESNO	FAMILIES PROGRAM
199	TOLIMA	HONDA	FAMILIES PROGRAM
200	TOLIMA	IBAGUE	
201	TOLIMA	LERIDA	FAMILIES PROGRAM
202	TOLIMA	LIBANO	FAMILIES PROGRAM

<b>No</b>	<b>DEPARTMENT</b>	<b>MUNICIPALITY</b>	<b>PROGRAM MUNICIPALITIES</b>
203	TOLIMA	MARIQUITA	FAMILIES PROGRAM
204	TOLIMA	MELGAR	FAMILIES PROGRAM
205	TOLIMA	ORTEGA	FAMILIES PROGRAM
206	TOLIMA	PLANETA RICA	FAMILIES PROGRAM
207	VALLE DEL CAUCA	ANDALUCIA	FAMILIES PROGRAM
208	VALLE DEL CAUCA	BUENAVENTURA	
209	VALLE DEL CAUCA	BUGA	
210	VALLE DEL CAUCA	BUGA LA GRANDE	FAMILIES PROGRAM
211	VALLE DEL CAUCA	CAICEDONIA	
212	VALLE DEL CAUCA	CALI	
213	VALLE DEL CAUCA	CANDELARIA	FAMILIES PROGRAM
214	VALLE DEL CAUCA	CARTAGO	
215	VALLE DEL CAUCA	CHIPICHAPE	
216	VALLE DEL CAUCA	EL CERRITO	FAMILIES PROGRAM
217	VALLE DEL CAUCA	FLORIDA	FAMILIES PROGRAM
218	VALLE DEL CAUCA	GINEBRA	FAMILIES PROGRAM
219	VALLE DEL CAUCA	GUACARI	FAMILIES PROGRAM
220	VALLE DEL CAUCA	JAMUNDI	FAMILIES PROGRAM
221	VALLE DEL CAUCA	LA UNION	FAMILIES PROGRAM
222	VALLE DEL CAUCA	LA VICTORIA	
223	VALLE DEL CAUCA	PALMIRA	
224	VALLE DEL CAUCA	RESTREPO	FAMILIES PROGRAM
225	VALLE DEL CAUCA	SEVILLA	
226	VALLE DEL CAUCA	TULÚA	
227	VALLE DEL CAUCA	YUMBO	
228	VALLE DEL CAUCA	ZARZAL	FAMILIES PROGRAM
229	VICHADA	PUERTO CARREÑO	
230	VILLAVICENCIO	MAIZARO	
<b>TOTAL MUNICIPIOS</b>		<b>230</b>	<b>131</b>

**ANNEX 9. Municipalities Eligible for the Colombian Transfer Program without a Bank**

	DEPARTMENT	MUNICIPALITY	POTENTIAL HOUSEHOLDS
1	ANTIOQUIA	ABRIAQUI	72
2	ANTIOQUIA	BELMIRA	88
3	ANTIOQUIA	BRICEÑO	284
4	ANTIOQUIA	BURITICA	196
5	ANTIOQUIA	CACERES	2.932
6	ANTIOQUIA	CONCEPCION	75
7	ANTIOQUIA	DABEIBA	2.198
8	ANTIOQUIA	ENTRERRIOS	25
9	ANTIOQUIA	GIRALDO	131
10	ANTIOQUIA	MURINDO	273
11	ANTIOQUIA	MUTATA	1.522
12	ANTIOQUIA	OLAYA	125
13	ANTIOQUIA	SAN FRANCISCO	526
14	ANTIOQUIA	SAN JUAN DE URABA	1.980
15	ANTIOQUIA	VEGACHI	1.249
16	ANTIOQUIA	YALI	559
17	ATLANTICO	GALAPA (AREA METROP)	814
18	ATLANTICO	PIOJO	249
19	ATLANTICO	POLONUEVO	524
20	ATLANTICO	SABANAGRANDE	832
21	ATLANTICO	SUAN	476
22	ATLANTICO	TUBARA	543
23	ATLANTICO	USIACURI	406
24	BOLIVAR	CORDOBA	1.265
25	BOLIVAR	SOPLAVIENTO	574
26	BOLIVAR	TALAIGUA NUEVO	565
27	BOLIVAR	VILLANUEVA	1.565
28	BOYACA	BRICEÑO	50
29	BOYACA	SAN EDUARDO	145
30	BOYACA	SATIVASUR	127
31	CAQUETA	SOLITA	871
32	CASANARE	CHAMEZA	66
33	CASANARE	RECETOR	190
34	CASANARE	SACAMA	73
35	CAUCA	ROSAS	605
36	CAUCA	SOTARA	395
37	CAUCA	VILLA RICA	319
38	CESAR	CHIRIGUANA	1.618
39	CESAR	EL PASO	753
40	CESAR	SAN MARTIN	752
41	CHOCO	ATRATO	100
42	CHOCO	BOJAYA (BELLAVISTA)	304
43	CHOCO	CANTON DE SAN PABLO	97
44	CHOCO	CERTEGUI	240
45	CHOCO	JURADO	113
46	CHOCO	LLORO	186
47	CHOCO	MEDIO SAN JUAN	394

	DEPARTMENT	MUNICIPALITY	POTENTIAL HOUSEHOLDS
48	CHOCO	NOVITA	239
49	CHOCO	RIO QUITO	485
50	CHOCO	SAN JOSE DEL PALMAR	131
51	CHOCO	SIPI	237
52	CHOCO	UNION PANAMERICANA	316
53	CUNDINAMARCA	ALBAN	103
54	CUNDINAMARCA	ARBELAEZ	168
55	CUNDINAMARCA	CABRERA	303
56	CUNDINAMARCA	PARATEBUENO	428
57	CUNDINAMARCA	SAN ANTONIO DEL TEQUENDAMA	139
58	META	EL DORADO	304
59	NARIÑO	COLON (GENOVA)	356
60	NARIÑO	CORDOBA	375
61	NARIÑO	LA FLORIDA	677
62	NARIÑO	POTOSI	140
63	NARIÑO	SAN BERNARDO	817
64	NORTE DE SANTANDER	LOS PATIOS (AREA METROP)	1.637
65	SANTANDER	ENCISO	273
66	SANTANDER	PALMAR	132
67	SUCRE	EL ROBLE	662
68	SUCRE	SAN ANTONIO DE PALMITOS	922
69	SUCRE	SAN JUAN DE BETULIA	881
70	TOLIMA	DOLORES	874
71	TOLIMA	VILLARRICA	107
72	VALLE	DAGUA	1.546
73	VALLE	VIJES	183
74	VALLE	YOTOCO	156
<b>TOTAL HOUSEHOLDS</b>			<b>40,037</b>

## **ANNEX 10. Financial Cycle of the Cash Transfer Payment Process**

### ***A. ANALYSIS OF THE RESOURCE MANAGEMENT SYSTEM - OPERATION AND PROBLEMS.***

#### **1. Resource Management Process in Colombia**

This section describes the program's financial cycle which impacts the transfer payment process. However, the entire program's cycle is not described. We will stress the most relevant aspects that have an incidence upon the process efficiency as well as those factors that are critical for success.

- In compliance with the annual investment plan approved by the Program's Executive Council, resources are allocated on an annual basis. This plan serves to define the budget to be performed, which can be adjusted during the execution of the program in accordance with its progress. Applicable adjustments must be agreed with the lending banks.
- Credit resources which are scheduled to be disbursed on an annual basis must be included in the Budget Law and in the Financial Plan of the Presidency's Administrative Department, which runs the Social Safety Net that coordinates this program.
- The flow of credit resources is channeled through special credit accounts that operate at the Banco de la República.
- When resource needs arise for a certain program, the DAPR-FIP processes the Disbursement Request to claim the fund draft from the Multilateral Banks. The World Bank approves the disbursement requests and draws to the Special Accounts opened by the Treasury Directorate of the Banco de la República for each loan.
- The Banco de la República certifies the receipt of the disbursement through the issuance of an account statement, which is permanently inquired by the National Treasury. This information is entered into the Integrated System of Financial Information (SIIF).
- The DAPR-FIP verifies the receipt of resources on the screen and prepares the payment order for earmarked resources, considering its PAC, against which the National Treasury draws from the bank accounts of the DAPR-FIP.
- Once the National Treasury has placed the funds in the commercial banks, each financial institution, through its municipal offices, makes the payments to the beneficiaries.
- To request new disbursements from the banks, the DAPR-FIP must justify its use. Disbursement requests are processed through the Ministry of Finances and Public Credit and begin the new cycle described above.

As from the seventh month of foreign credit execution, the procedures with the World Bank will follow the new disbursement modality, i.e. through a Project Management Report (PMR) or a Financial Management Report (FMR).

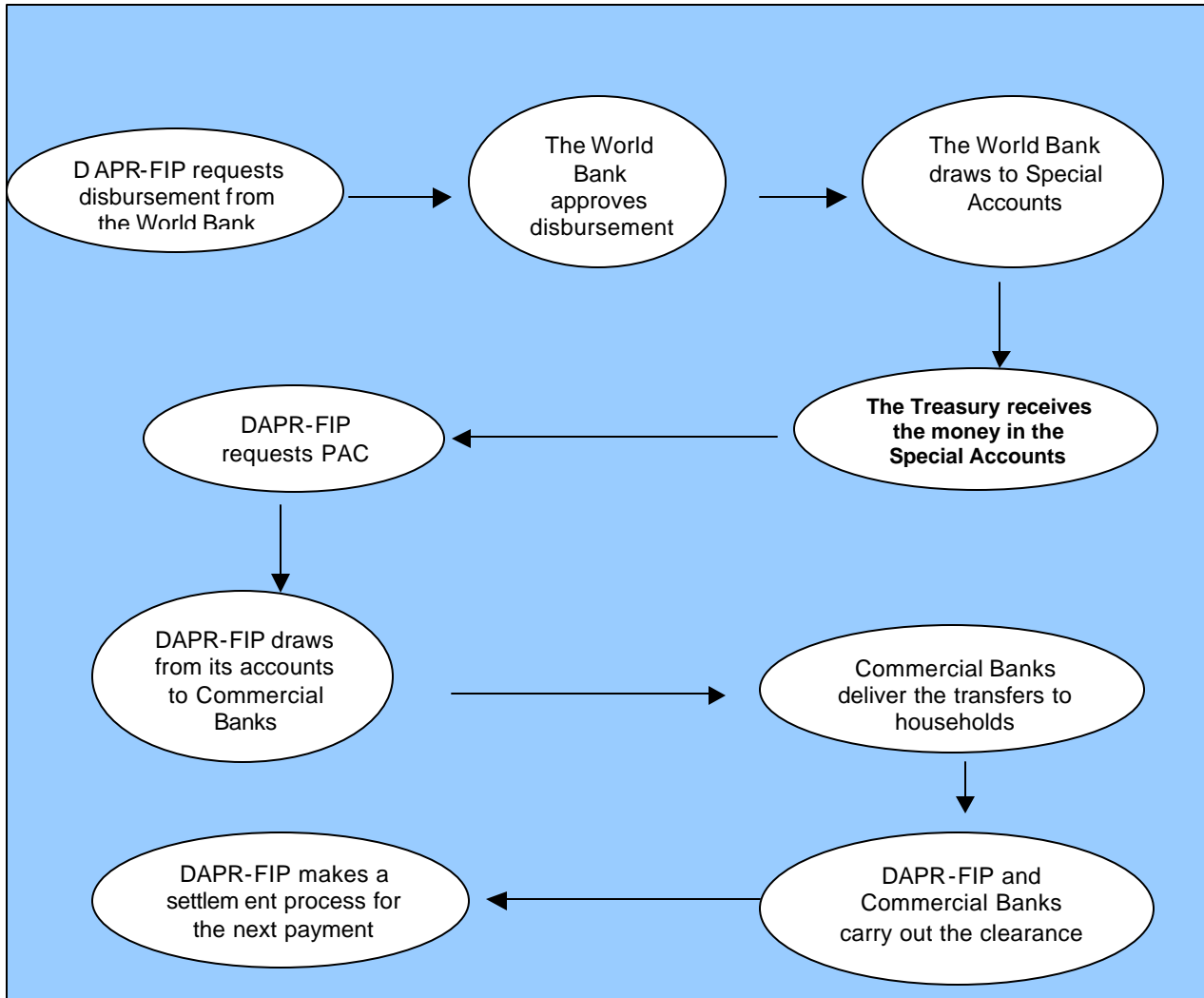
Chart 2 describes in detail the transfer payment process through the banking system. The figure shows all the players that take part in the process and illustrates the exogenous variables that are beyond the Program's direct control, but which have a major impact on the payment process. These variables have an impact on the execution times and therefore on the payment schedules to the beneficiary households.

The removal of the Trust Company eliminated three unnecessary steps. This means an 8 day reduction of the payment cycle; less operational burden by removing double reconciliation; lower chances of errors; and a 6 percent savings in transaction costs.

Working on controllable variables is extremely important, as there are aspects which are beyond the control of the executors. The program does face exogenous variables that have an impact on payment processes, and which are related to the national budget and the fiscal adjustment measures agreed with the IMF. For instance, by mid 2002 there was a delay in the budget which forced a freezing of the funds for the Families in Action program until the beginning of year 2003, reason for which the 350,000 households registered in the Program went without their grants during four consecutive cycles.



**Chart 7: PAYMENT CYCLE THROUGH THE BANKING SYSTEM**



The fiscal adjustments agreed with the IMF also resulted in budgetary cuts for year 2003, due to which only four of the six cycles corresponding to the period will be paid.

The PAC also faces frequent temporary closures which delay the money draft process thereby affecting the payment cycle. This also causes delays in the payments made to the families.

One of the lessons learnt is that the financial cycle must be reviewed as from the program's design phase to find out those variables that act upon the financial flow. The Bank's financial consultants must seek alternative mechanisms with the program's executors in order to protect the cycle from these types of events.

### **3. Relevant Aspects of the Payment Process through the Financial System**

- Beneficiary mothers are responsible for responding to the request made by the Municipal Link, who, on the date scheduled to make the payment, will identify them by their Citizenship card or ID card (for the underage), find them in the payment settlement list to provide them with a household code and the amount settled. This amount must match exactly with the amount to be paid by the teller of the banking Institution.
- The Municipal Links must solve any questions posed by the beneficiary mother regarding the payment, the detail of which can be found in the FS1 list. The beneficiary mother signs the list to acknowledge that she has been notified of the amount she will receive.
- The beneficiary mother must go personally to the bank with her ID card, whose number and name will be checked by the teller. If the amount paid by the bank does not match what was provided in the FS1 list, the beneficiary mother must submit a complaint with the Municipal Link.
- Once the ID card has been verified with the banking system, the teller makes a receipt and gives the beneficiary the amount of money set forth therein. The beneficiary mother signs the receipt. This receipt must remain in the files of the financial institution.
- Under no circumstance will the teller hand the money over to a person other than the beneficiary, even in front of an authorization. The bank will be responsible before the Program for any amount of money so delivered, pursuant to what has been agreed in the contract.
- Beneficiary mothers that fail to request their payment may do so on the next cycle, as long as the commitment compliance is verified. The system only accrues payments settled during the immediately previous cycle.

### **2. Payment Process to Beneficiary Mothers**

- The payment process begins with the payment settlement which must comply with the following sub-procedures:
  - Closing the Commitment Verification process
  - Closing the register of new events and complaints
  - Reconciliation of previous payments
- The Program's Financial Department coordinates the payment process, which includes: the management of agreements with the paying banks; the control of disbursements by source of funds; the scheduling of the payment cycle and payment dates; and the municipalities that will receive payments.
- The Program's Financial Department provides this information to the System Department to proceed with the payment of the grants.
- The Colombian Cash Transfer Program (Families in Action), completes the payment process through its software and develops the following products:

**a) Magnetic File for each Bank**

The negotiation process with each Banking Institution also addressed the way in which the information was to be provided to proceed with the applicable payments. The program then made the required technical customizations and designed an automatic magnetic file development system for each Banking Institution. During the negotiation process carried out with the banks, it should be kept in mind that flexibility regarding this issue is extremely important, since subsequent modifications to banks' technological platforms are not easy to implement.

**b) Household Grant Payment Form - FS1**

This is a list that includes all the households that received payment. It includes the household code, the ID number of the beneficiary mother, and the amounts paid to each household.

This list is sent to the Municipal Link to inform beneficiary mothers about the amount they will receive from the bank. This list provides full details about household payments. It must be signed by the beneficiary mother – or her fingerprint stamped– when she receives the payment notice. The Municipal Link must keep this list in the file as a backup document for the Multilateral Banks and other controlling agencies.

**c) Summary of Household Payments – FS2**

The cash transfer program generates a summary form of household payments - FS2 (in original and one copy), in order to inform the beneficiary mother about the amount of the grant paid for the applicable cycle. The form also includes the description of each grant paid per child.

This form is sent to the Municipal Links to be provided to the beneficiary mothers before the actual payment is made. This is also the document that the mother must submit before the paying institution to receive the grant.

**d) List of Households Paid per Cycle**

The Municipal Link will post a list in a visible place calling beneficiary mothers to receive their payment. This list shall not include the amounts to be paid.

The amounts are not disclosed to avoid the public knowledge of the payments made and to protect the safety of beneficiary mothers.

The Municipal Links informs the mothers about the payment period and agrees on the logistical arrangements with the bank office.

The logistical arrangement agreed between the Municipal Link and the bank office includes the number of households who will receive

payment. The information calling the mothers is organized either in alphabetical order, by ID number, blocks or neighborhoods.

During the first five (5) days after the payment process, the Municipal Link must submit a report to the Payment Technician of the UCR, detailing the actual term in which payments were made; any problems raised during the process; and a list of household codes that did not show up to receive payment. This report is used to verify the reconciliation made with the Central Banking Office.

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