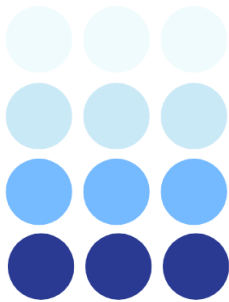




IADI Fintech Briefs provide high-level overviews and key takeaways on Fintech topics of relevance to deposit insurers.



NO. 16

FINTECH BRIEF

E-MONEY AND DEPOSIT INSURANCE
IN URUGUAY

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June 2023

IADI Fintech Briefs are written by Members of the IADI Fintech Technical Committee (Fintech TC), and from time to time by other authors, and are published by IADI. They provide high-level overviews and key takeaways on fintech topics of relevance to deposit insurers. The views expressed are those of the author(s) and do not necessarily represent the views of IADI or the institution to which the authors are affiliated. The author is grateful to Rachel Youssef (FDIC) for coordination, Bert Van Roosebeke for guidance, and Ryan Defina (IADI), Kazuaki Hara (DICJ Japan) and the Fintech TC for helpful comments.

The editor of the IADI Fintech Brief series is Bert Van Roosebeke (IADI).

This publication is available on the IADI website (www.iadi.org).

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E-MONEY AND DEPOSIT INSURANCE IN URUGUAY

Executive Summary

Electronic money has been increasing its market share steadily in recent years in Uruguay, after being regulated by law in 2014. Individual electronic money accounts are not included in the Deposit Insurance System and therefore do not have coverage in the event of bankruptcy of the bank where the deposit that supports the electronic money is located. Currently, this issue is under analysis of the financial system's safety net, based on a proposal made by COPAB.

Electronic money used for the payment of salaries, pensions and other related payments also has an impact on the deposit insurance system, since there is a special scheme for this type of payments, in which these accounts must be paid immediately when a bank falls, outside the deposit insurance payment.

Additionally, COPAB is implementing an electronic payment system, to be used both for the guarantee payment, and for the funds recovered from an eventual bank liquidation. This system is based on the digital identification of the depositor, who will be able to choose where to receive the money, for example in another bank or in an e-money account.

1 E-Money in Uruguay

1.1 The Financial Safety Net in Uruguay

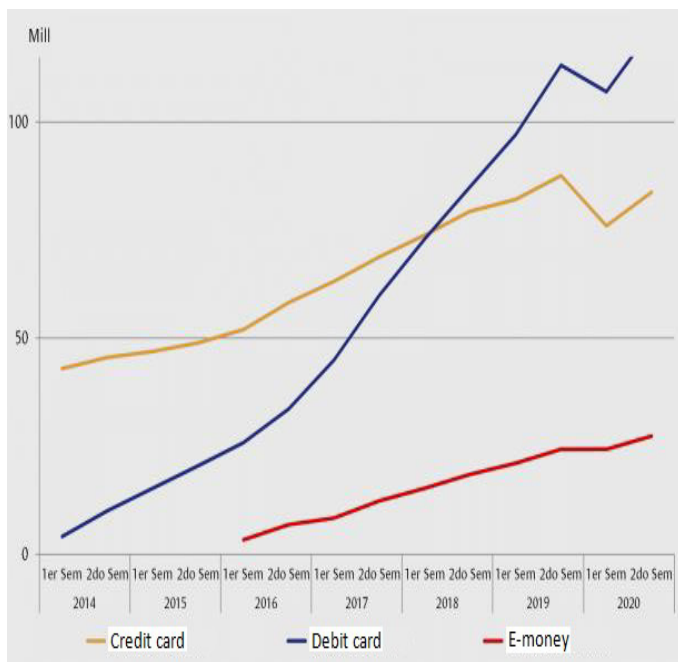
Uruguay is a small country with just over 3 million inhabitants. Its financial system is small too¹; currently, the deposit insurance system includes 11 banks and 1 financial intermediation cooperative.² In Uruguay, the financial safety net is composed by the Ministry of Economy (MEF) – issuer of banking licenses; the Central Bank of Uruguay (BCU) – lender of last resort and regulator of the payments system; the Superintendence of Financial Services (SSF) – financial supervisor; and by the Bank Savings Protection Corporation – (COPAB) – deposit insurer and resolution authority.

1.2 Evolution of the use of electronic money

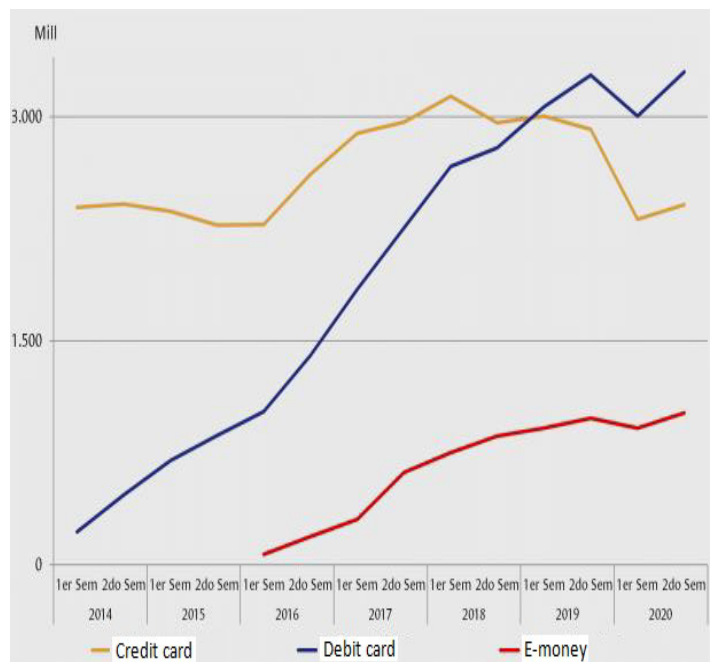
Payments made with electronic money have been increasing steadily in recent years, both in terms of number of operations and in amounts transferred. In 2020, for the first time, electronic payments (made through debit cards and electronic money, transfers, payments via the web, applications and automatic debits) surpassed traditional payments (cheques and cash).

¹ Eligible deposits as at Dec-21: 36.674 US\$ million

² These cooperatives are similar to banks, but have associated members instead of depositors. They also have lower equity requirements.



Graph 1 - Number of operations (in million)



Graph 2 - Amount (USD millions)³

1.3 Legal treatment of e-money

In Uruguay, the use of electronic payment methods is promoted by law (Law 19.210 of 04/29/2014). This law promotes the use of electronic payment tools, such as debit cards, credit cards, e-money instruments, electronic transfers of funds for payments through ATMs, over the internet, by cell phones or other means. The main use of electronic money is to carry out transactions in a simple way.

What is electronic money according to the law?

Electronic money is a way of representing cash, for example, through prepaid cards, electronic wallets or similar instruments. It is accepted as a means of payment, convertible into cash, does not accrue interest and its value is stored in electronic media, such as the chip of a card, on a cell phone or on a computer.

Requirements for issuers of electronic money

In addition to financial intermediation institutions such as public and private banks, electronic money issuing institutions (IEDEs⁴) authorised by the Central Bank of Uruguay may issue e-money. IEDEs cannot carry out financial intermediation operations, capture deposits or grant credits. In the Uruguayan legal scheme, an e-money account does not hold deposits.

IEDES must keep all the fiat currency that backs e-money in bank accounts other than those of the issuing company. This account, that backs e-money, must be always (even if the IEDE is a bank) an independent estate, similar to a trust. These funds must also be separated from the issuer's funds. The IEDE is the administrator of this account

Its activities are regulated by the previously mentioned Law, its regulations and by the rules of the Central Bank of Uruguay. Sanctions are established for cases of non-compliance.

As of December 2021, e-money in Uruguay is issued by one commercial bank, 13 other IEDEs (the owners of these IEDESs are mostly collection agencies⁵ with a significant presence throughout the country and a credit card company, with a significant presence in the Uruguayan market). There are no mobile phone companies or big tech companies issuing E-money.

³ Source: <https://www.bcu.gub.uy/Sistema-de-Pagos/Paginas/Reporte-Sistema-Pagos-Minorista.aspx>

⁴ IEDEs is the general term for all issuers of e-money (including banks).

⁵ Private companies organised in networks that carry out collection of utility bills, transfers between people and similar services.

1.4 Handling of Salaries, Pension Plans and Others

In 2002 there was a major financial crisis in Uruguay, in which four large private banks failed. This crisis generated many inconveniences in the economy, and in particular, the payment system. In order to prevent similar situations, on June 15, 2007, Law No. 18,139 was passed, establishing special treatment for the payment of salaries and pension plans in the event of suspension of activities or liquidation of financial intermediation institutions. This Law establishes that in the event of bankruptcy of a bank or financial intermediation cooperative, the resolution authority (COPAB) must immediately execute the payment of pending salaries, pension plans and social plans. Likewise, it establishes that the funds corresponding to salaries, retirement plans and social plans (paid in the last 30 days) existing in the deposit accounts, must be delivered to its holder, independently of the deposit insurance framework.

The previous scheme implies an operational problem for COPAB, since it must be prepared to make this payment immediately after intervention of the failed bank. This law also applies for operations carried out with e-money through an IEDE. Therefore, in the event of a bank bankruptcy, where an IEDE has accounts, COPAB must also release the funds backing the e-money originating from payment of salaries and others.

2 Impact on Deposit Insurer

The fiat money that backs the e-money must be deposited in one (or several) local banks. Electronic money accounts are not considered a deposit. As a consequence (and safe for the special case mentioned above), electronic money is not directly covered by the deposit insurance system. Also, the failure of an IEDE is not covered by COPAB.

According to Uruguayan regulations, if the bank where the IEDE account is located fails, the deposit insurer will pay the general coverage: US\$10,000 for deposits in foreign currency and 250,000 indexed units for deposits in national currency. As this coverage applies to the totality of the fiat money backing the e-money, and not to fiat money provided by individual users, a significant part of the e-money will not be compensated. To avoid this situation, COPAB is currently analysing the pass-through option, i.e. covering each individual's e-money account with deposit insurance. This could imply that the IEDEs would also have to contribute to the bank deposit guarantee fund (if Uruguay decides to cover each individual e-money account). From a formal point of view, the analysis has been carried out within the scope of the Financial System Stability Committee (CEF), in force in Uruguay since 2012 (composed by the Minister of Economy, the President of the Central Bank, the Superintendent of Financial Services and the President of COPAB). The CEF has entrusted the analysis to a technical commission made up of members of the four organisations.

As a consequence, Uruguay is facing two challenges. First, if the initiative for deposit insurance to cover individual e-money accounts were to progress, some legal and operational changes will be required. Coordination between all members of the financial safety net is therefore important, since they all have different powers in the regulation of e-money. This challenge is similar to the one faced by other deposit insurers considering pass-through for e-money, as information on the individual balances is required. Second, and specifically for Uruguay, in order to offer the special, immediate coverage for specific use cases of e-money (salary and others), COPAB requires detailed information on e-money corresponding to salaries and others. This requires regulatory changes that must be made by the payment system department of the BCU.

3 Impact on Depository Institutions

IEDEs are regulated by the BCU, which also controls that regulation. The main control that is carried out, is the presence of fiat money backing e-money in bank accounts. From a business point of view, the main advantage of e-money is that it is easy and simple to operate. For example, collection agencies, which are widely distributed in the main cities of the country, are used to carry out transactions with e-money, making the loading of e-money accounts easier. This situation implies strong competition for banks in relation to their services related to transactions and with it the loss of commissions of handling services.

4 Impact on Depositors

For depositors, the introduction of e-money has meant access to more practical and accessible financial services. The main purpose of e-money is to carry out payment transactions. A significant portion of e-money users were previously unbanked, so the promotion of e-money has contributed to financial inclusion. There is minimal public awareness in the system about the possible risks in the use of electronic money. As such, it is understood that the eventual bankruptcy of a bank where the backup money is deposited would imply a significant damage to the system, and a possible setback in the operation of e-money.

5 Potential Next Steps

The main challenges for the future include relevant technological changes and the development of new products in order to maintain adequate control over the financial system. An important issue for e-money users is the unbanked population. It is important to inform them about the risks and characteristics of the product, in particular that e-money is not a deposit and is therefore not covered by the deposit insurance system. Depending on the analysis carried out, and in consultation with other financial system safety net members, a decision is expected on the coverage of individual e-money accounts. For COPAB, an important challenge is to have the information on salaries and others in a timely and comprehensive manner, to be able to comply with payment obligations in a possible bankruptcy.

6 Other Fintech Issues

Related to fintech issues, COPAB is currently working on the establishment of an electronic payment system, both for deposit insurance reimbursement, and for the distribution of money recovered from a failed bank. The project is based on establishing a platform through the COPAB website, in which the depositor can register, confirm his identity in a digital way, and subsequently give instructions on where to receive the corresponding payment. For example, an account in another bank or in an IEDE.

This operation will be based on digital identification of the client. In Uruguay, there are currently several possible ways to electronically identify a person: one option is through the state-issued identity documents, that have a chip, allowing identification and development of digital signatures. There are also private companies that provide this service, such as telephone companies, or companies that work with tokens for digital signatures. Although it is clear that these kinds of operations are currently not applicable to the entire population (especially the elderly), it is expected that the project will advance as a way of facilitating an important part of the operation.

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