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Issues in Fintech Regulation: What can Peru learn from other countries?

Maria Gabriela Coloma

Relationship Manager and Researcher at The Credit Bank of Peru
magaby.coloma@gmail.com

Abstract. Today, Peru is witnessing an exponential growth in Fintech, both in number local start-ups being founded and international scale-ups arriving to the country. However, the lack of government regulation on the topic slows down the growth of Fintech because it depletes such industry of consumer and investor confidence. This research aims to explore what regulatory framework Peru should adopt as a response to the unstoppable growth in Fintech within the nation. The study takes a comparative approach, analyzing Fintech regulation in three different countries: Mexico, Brazil and the United Kingdom. The study finds that Peru should follow Brazil's footsteps in enacting strong, detailed and strict regulation which will result in improving local consumer trust and in attracting foreign investment into the Peruvian Fintech industry. Plus, the study suggests that Peru should centralize Fintech regulation with one single authority, such as the Financial Conduct Authority in the case of the United Kingdom.

Keywords. Fintech, Financial Regulation, Peru

1. Introduction

The World Bank defines Fintech as “technologically enabled innovation in financial services that could result in new business models, applications, processes, or products affecting financial markets, institutions, and the provision of financial services.” [1] In the past five years, the world has witnessed an exponential growth in Fintech companies, characterized by agile innovation, disruptive technologies, and an emphasis on User Experience (UX). Fintech companies offer a plethora of financial services, the most popular ones being crowdfunding, lending, digital payments, remittances, and currency exchange. Naturally, governments have struggled in determining how regulation ought to be shaped for such a new and unknown industry. Proponents of regulation seek to protect the end customer's money and data, while critics of regulation defend the liberty of a regulation-free system where companies can safely be disruptive.

There is significant literature on Fintech, yet not widely known enough nor socialized enough to be used by regulators. My work seeks to complement this literature with a special focus on regulation, thus rendering suitable to put into practice. This is a comparative review of Fintech regulation across the world and an extraction of regulatory best practices that the Peruvian authorities can adapt to design the new Fintech regulatory framework.

Brazil, Mexico, and the United Kingdom host a vast number of Fintech companies, apart from an organized civil society that understands and promotes their use. Further, they have

advanced Fintech regulation the most. This essay will explore the distinct approaches these countries have taken and evaluate what can apply to the Peruvian Fintech context. The scope of this essay will not include regulation concerning Blockchain and Insurtech.

2. The Context:

2.1 Peru

To set the context, Peru is a country with 33 million people and a GDP of \$232 billion (2018). For the past ten years, Peru has hosted sustained economic growth, propelled by the increase in commodity prices, investment in mining, and the agricultural and fishing export industries. The financial industry in Peru is active, in a similar fashion to its regional peers. However, the Peruvian financial system has been historically dominated by one single institution, Banco de Crédito del Perú (BCP), which holds a market share of 40% [2]. With a couple of other tier-one banks such as BBVA and Scotiabank, the Peruvian financial system has not historically been a competitive environment where banks are forced to innovate. Comfortable with high interest rates and bureaucratic procedures, amidst widespread complaints by their customers, banks had little incentive to change their business model, lower their prices or invest in new technology.

Thus, with such a gap in financial innovation, plus an emerging middle class with growing purchasing power and access to information, Fintech arrived at the Peruvian market in 2015 and harvested enormous success. With only 24 of these entities by 2017, by November 2019, Peru hosted 127 Fintech institutions, according to Finnovating [3]. Most of these are local start-ups, where tech driven Peruvians found solutions that would solve dire problems in a

country with such low financial inclusion. Further, Peru is the 3rd country in Latin America with the fastest growing Fintech ecosystem. The most popular Fintech companies are currency exchange platforms, which have become extremely appealing to individuals due to the historically high spreads that banks charged to customers in the exchange of currency.

Comparably, in Latin America, the most predominant Fintech companies carry out crowdlending and digital payments. According to Finnovista Radar, approximately 40% of the Fintech companies in Latin America target the unbanked public, mostly composed by small and family enterprises and individuals [4]. Thus, recognizing how the Fintech industry can help governments advance nationwide financial inclusion, the Mexican and Brazilian have become invested in the regulation and promotion of Fintech.

2.2 The need for regulation

Before addressing the concerns on financial regulation, it is vital to highlight why there is a need to regulate Fintech organization. According to a recent report by the IADB and Finnovista, Fintech regulation ought to protect the consumer, guarantee efficiency and transparency of financial competition, and decrease operational risk [5]. A primary concern amongst consumers is that of their personal and financial data, given how common cyberattacks are. Further, consumers fear the risk of Fintech default, given that start-ups have a default rate of around 20%. In the case of crowdfunding or crowdlending, an erroneous business model or lax borrower analysis would put in danger the deposits of its clients. Moreover, a significant risk for society as a whole is that of money laundering because the client onboarding is immediate.

3. Comparative Approach: Regulation in other countries

3.1 Mexico

Mexico was the first country in Latin America to implement a law specifically designed and targeted towards Fintech. In 2018, the same year in which such law was enacted, the Fintech ecosystem had grown by 23% in comparison to 2017, hosting a total of 300 Fintech enterprises within Mexico [6]. It is a comprehensive law that regulates all types of Fintech companies, regardless of the specific service provided. The Mexican Fintech Law is based on six principles: financial inclusion, consumer protection, promotion of financial competition, preserving financial stability, and preventing money laundering. Mexico also implemented the British concept of sandboxes, further explained in this essay.

Further, most differently to other governments, Mexico has enacted regulation which makes Open Banking mandatory. The law gives regular banks up to two years to establish Application Program Interfaces (APIs), which will allow the sharing of their customers' data with third-party providers. The idea behind Open Banking is for services to become specialized to customers with the information provided. If customers approve having their data shared by their bank, they can use such data to leverage better financial conditions when applying for credit outside the banking system. This is the most revolutionary aspect to the Mexican Fintech regulation, because it will open the door for extensive competition for Mexican banks.

3.2 Brazil

On the other hand, Brazil has enacted progressive regulation that targets a specific type or group of Fintech in every distinct law approved. With over 400 Fintech enterprises, Brazil hosts one of the most diverse Fintech ecosystems in Latin America, apart from one of the most prominent digital banks in the world: NuBank. In 2017, Brazil started regulating equity crowdfunding, most specifically digital platforms which allow customers to trade stocks and bonds. Further, in 2018, Brazil started regulating crowdlending Fintech enterprises: both peer-to-peer (P2P) and business-to-peer (B2P) [7]. For instance, crowdlending companies now need to have a minimum amount of equity in order to operate. Though some state that the Brazilian Fintech regulatory framework is excessively restrictive, Brazil has successfully attracted 70% of the total investment in Fintech in Latin America [8].

Further, apart from engaging in Fintech regulation, the Brazilian government has also been heavily invested in promoting technological innovation. There are vast digital laboratories, many of which are publicly funded, such as the Financial Innovation Laboratory or the Small and Medium enterprise development channel. There are government-born Fintech competitions, such as "BNDES Fintech Challenge," where BNDES is the Brazilian National Development Bank.

3.3 United Kingdom

The United Kingdom is the global leader in Fintech regulation, owning the creation of the "Sandbox" regulatory system, which has been implemented in several other countries after the successful experience of the British. Sandboxes are regulatory spaces where entrepreneurs can test out new, disruptive products in the market with extremely lax regulation. Overall, the idea behind the Sandbox is to provide a safe space, which encourages protected innovation [9]. However, the little regulation they ought to respect allows the government to keep track of these endeavors and ensure consumer protection, especially critical upon a nascent enterprise. Moreover, Britain specifically created the "Financial Conduct Authority" (FCA) in 2013 as a response to the different Fintech companies being founded, and which lowered the barriers of

entry for these companies in the UK. Throughout 2019, the FCA has advocated for a worldwide Fintech regulatory framework, stating that, as different countries seek to attract nascent Fintech start-ups, they could lure them with flexible regulation, that could risk the consumers' best interest and safety of their investments.

4. Attempts at Fintech Regulation in Peru

Peru has witnessed efforts towards Fintech regulation in 2019, with the proposed crowdlending law. Unfortunately, the law was not enacted because as it was being discussed, the congress was dissolved. Nevertheless, such regulation was very limited in scope. There are still many issues that complicate the elaboration of a more comprehensive law, such as determining what is Fintech and what is not, or establishing regulation which is flexible enough to adapt to constant innovation. The Peruvian Government is a slow, bureaucratic entity. Since the dissolution of congress, laws have been swiftly enacted through executive orders by the president, yet such complex and delicate regulation as Fintech should be discussed and voted with a plethora of actors before it is enacted. Moreover, another latent issue is the fact that Peru hosts three different organizations which are in charge of regulating finance-related activities: i) The Ministry of Economics ii) The Stock and Bond Organization (SMV) and iii) The Bank and Insurance Organization (SBS). Regulation ought to be coordinated and agreed upon these three different entities, and it should also clearly give the chosen entity the faculty to enforce the rules.

5. Conclusion

Peruvian lawmakers have much to learn from the experiences of these three countries regarding Fintech regulation. Through the enforcement of Open Banking, Mexico is promoting financial inclusion by making it easier for the underbanked to obtain credit. With a financial inclusion rate below 50%, Peru would most surely benefit from implementing such policy. The case of the United Kingdom is also exemplary, especially because of the creation of a specific authority that deals with Fintech. Upon replicating such entity in Peru, issues on responsibility of law enforcement would be overcome. However, the regulatory framework which Peru should most closely attempt to replicate is the Brazilian one. First of all, Brazil is a country similar to Peru in that both host high informality, inequality and a lax rule of law which leads to the mistrust of both local and foreign investors. Brazil holds detailed regulation which is specific to each sub-segment of Fintech and which demands certain criteria to be met before obtaining authorization to operate. Although burdensome, these requirements and strict supervision give both the investor and the consumer the confidence to trust Fintech as much as regular banking. Such is why NuBank has harvested such enormous success and why Brazil has been the recipient of most Fintech foreign investment in Latin America. Peru, as any emerging economy in Latin America, is sometimes mistrusted by foreign investors for the same reasons as Brazil. However, upon strict regulation, Peru would give credibility to its Fintech industry and attract investment, which is what the industry today is missing and which local investors are capable of supplying. Finally, both Brazil and Peru are countries plagued with fraud, illegal drug trade and money laundering. Small technology companies which need no permission to exist and seek to lure customers into working with them will raise suspicion upon the population. Upon knowing Fintech, many people hesitate to join because of fear of being victim of fraud and have no enforcement authority to turn to when seeking justice. Thus, the second yet not less important need for strict and detailed regulation in Peru is to raise consumer trust. Only when customers trust Fintech as much as they trust banks will Fintech be able to truly compete with all financial entities present in the

market. And this will never be possible unless the Peruvian consumer knows that all Fintech entities in operation have been revised by the government and granted permission to work. Further, Peruvian customers will demand that upon any fraud, there is an authority and law that protects the Fintech consumer. Such credibility, which has slowly been built in Brazil, will only be built in Peru with similarly Fintech regulation and with strong regulatory body such as the United Kingdom's FCA.

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