PROYECTO CAPITAL

insHort

Number 60 / October 2016

Innovative Financial Services in Peru and their Regulation

Ljubica Vodanovic
Maria del Carmen Yuta

Introduction

As a result of globalization and technological development, all over the world, financial services are experiencing a fast-paced and wide-scoped growth. In Peru, these services have also been developed in both the banking sector (i.e.: banks, financial entities) and in companies within the real sector (e.g.: technological entrepreneurships) has recently started to develop financial services as well. These new forms, agents and channels through which financial services are being provided generate greater financial inclusion, something that governments can take advantage of.

In order to further develop such financial services, the government's involvement—especially that of regulatory entities—is highly important. Efficient regulatory schemes that focus on the risks associated to these services are the only way to ensure a formal and efficient growth that reaches the population not yet served by the financial system.

This InShort aims to show how regulation plays a fundamental role in the development of new and inclusive financial services in Peru. It also underscores the importance of aligning regulation with the objectives that the State needs to accomplish in order to promote the growth of financial services and financial inclusion, independently of the provider offering the service. In order to achieve this, this InShort will present, first, the scope and types of inclusive financial services that have been developed around the world in general, and in Peru in particular. Then, it will put forward general and specific criteria that should be taken into account when developing suitable regulation for financial services in Peru. Finally, as a conclusion, it will present the text's key ideas.

Scope and Types of Financial Services

We will distinguish two types of financial services: those that comprise financial intermediation and those that take on the role of facilitating financial transactions.

Intermediary services must be solely provided by companies in the financial system, as they are subjected to a number of liabilities imposed by financial regulations. In this case, the objective of regulation is to assure solvency and protect the public's savings, given that companies in the financial system operate with such funds—assuming ownership and risk of the acquired money—in order to provide loans or make investments.

In the case of financial services that do not carry out any financial intermediation operations, the financial agent does not operate with the public's funds and only serves as **facilitator of financial transactions**. Therefore, it is not necessary for this agent to be a company within the financial system. In this case, the focus of regulation is to ensure the protection of consumers and to make sure that the service providers manages the risks involved in their operations properly.

The following are among the most common financial services:

- **Making payments:** It is important to distinguish between payment instruments and financial channels through which payments are made. There are two types of payment instruments: those considered traditional, such as credit and/or debit cards, checks and others; and those considered non-traditional such as electronic payments, pre-paid physical cards, mobile payments, etc. The same distinction applies to financial channels. For instance, the traditional channels are bank agencies or offices and ATMs, while non-traditional channels are correspondent agents, platforms for online payments, mobile phone networks, electronic banking, etc.
- **Granting credits:** under different modalities, but not funded by public resources also provides innovative solutions, which constitute an additional alternative to traditional banking schemes. An example is the so-called peer-to-peer (P2P) lending platforms.

1. Financial Services for Making Payments: Description of the Main Instruments and the Evolution of Channels

a. Electronic Payments

Over the last years, paper payment instruments (e.g.: cash, checks) have been increasingly substituted by electronic payment channels. This is a result of technological development, which makes possible to carry out payment operations and transfers—national and international—from anywhere and with no need of going to a financial agency.

In this sense, electronic payments are a particular type of payment services, and they also have their own instruments and channels. (See Figure 1).

Figure 1.
Classification of payment methods

Pre-paid cards	Online Payment Services	Mobile Banking Services
– Require the availability of the users' funds. – It is not necessary to have a deposit account in the financial system. – Do not capture the public's funds so they do not need to be issued by a company within the financial system (prudential regulation of savings is not applied). – Allow to make and receive payments, to use traditional service channels (ATMs) and to make transfers.	– Electronic payment channels – May be used with different instruments: credit and debit cards, pre-paid cards, payment bills, cash. – Financial services that can be accessed (GAFI, 2010): Electronic banking, online pre-paid payment products, digital coins or metals.	– A mobile channel that is becoming the main device for making transactions ⟶ favoring financial inclusion. – Three categories of financial services can be provided through mobile phones (World Bank, 2008): Mobile financial information services (no transactions), mobile banking, and mobile wallet (monedero móvil).

Source: GAFI 2010, World Bank, 2008

Among the available electronic payment services, the most significant are:

- **Open-loop pre-paid cards** that allow to make different transactions and access cash. They can be anonymous and have no value limit. Therefore, it is important to take into account that the more they look like classic payment instruments, the more concerns it raises related to the risks involved (operational risks,[1] Money Laundry (ML) risks[2]).
- **Withdrawal of cash at ATMs** without the need of a physical card, only using access codes.
- **Services for transferring funds, through which third parties may send, receive, and withdraw money of clients who use mobile payment services.** These services can be provided by companies in the financial system and by non-financial companies (e.g.: mobile network operators - MNOs, companies that issue electronic money).

1 Operational risks: possibility of loss on the side of the service provider due to inadequate processes, staff error, technological errors or to events external to the service provider.

2 LAFT risks: risks associated to the crime of asset laundering or financing of terrorism.

Chart 1.

Electronic Payments in Latin America

Pre-paid Cards	Online Payment Services
This type of electronic payment does not need the participation of a financial entity. This is why it has become an increasingly popular option in Latin America. In Colombia, this service is called Trajeta Prepago de Bancolombia (Pre-paid Card of Bancolombia) and it creates a rechargeable Mastercard card number that can be refilled using a bank account or a checking account. This card is linked to other bank accounts of different nature that, in practice, serve the same refilling purpose. In countries like Peru, this mechanism is not as developed and therefore, there is no special regulation applicable to this service. As a result, it is subjected to the general norms that apply according to their purposes within the market.	According to the most recent reports of Tecnocom and AFI (2013, 2014), in Latin America, the volume of e-commerce sales has grown considerably over the last years. As a result, the indexes of financial inclusion (through banks and the insertion of electronic payment methods) have improved, as has the channel's security. In 2012 and 2013, the higher volume of sales corresponded to Brazil, followed by Mexico, Colombia, Chile, and Peru. In Peru, the e-commerce industry in particular has witnessed a growth of approximately 200 million USD. However, the banked segment is the one that still uses these services the most.

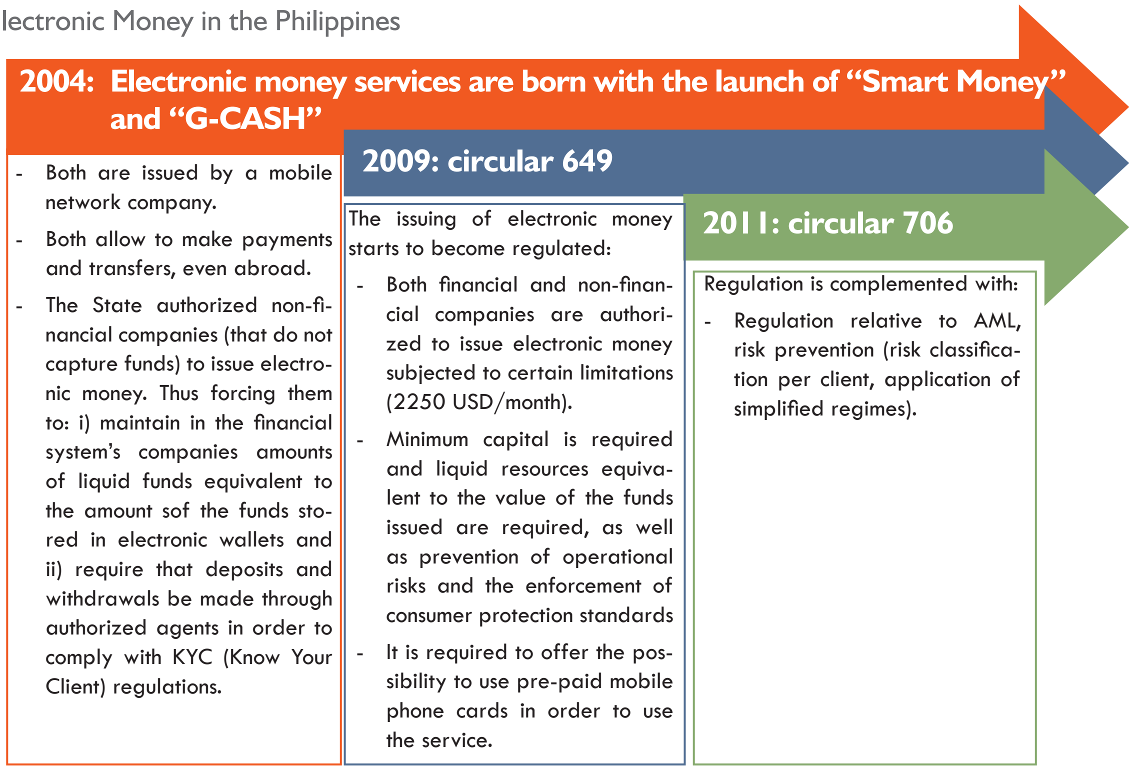
- **Card to card transfers activated from a mobile phone** though accounts that could be managed by financial and non-financial companies.
- **The electronic wallet service** that allows to convert physical money into electronic money up to a limited value. Therefore, it is associated to physical money which is stored in a monetary account that can be linked to any device such as cards and cell phones (mobile wallets). This service can be created and managed by companies in the financial system, by non-financial companies (e.g.: MNOs) or by both.
- **Electronic accounts** are accounts (not necessarily bank or financial accounts) managed through an Internet channel. Generally, this service, also known as virtual accounts, is managed by non-financial companies and by platforms belonging to companies that provide payment services.

b. Electronic Money (e-money)

Electronic money is a monetary value represented by a claim on the issuer that is (i) stored on an electronic device, (ii) issued on receipt of funds of an amount not less in value than the monetary value issued, (iii) accepted as a means of payment by parties other than the issuer, and (iv) convertible into cash. The main objective of electronic money is to carry out payments and transfers, which makes it a financial service of transactional character. According to the particular regulatory model assumed by each legislation, the activity of issuing electronic money might be reserved to financial entities, to non-financial companies subjected to regulation, and even to non-financial companies not subjected neither to regulation or State supervision.

Kenya and the Philippines are two important examples in matters of regulation of electronic money, as in both countries, the population's experience with this financial service has been successful (See Figure 2). Meanwhile, in Peru, regulation of electronic money was issued in 2012, allowing its expansion among the population (See Chart 2).

Figure 2.
Electronic Money in the Philippines



Source: Vodanovic et al.
Prepared by the authors.

Chart 2.

Regulatory implications relative to electronic money legislation in Peru

Legal Nature	Financial service subjected to commission payment. Does not have the nature of a passive operation (deposit) or an active operation (credit). Regulated by Law N° 29985
Electronic Money Issuers	Companies in the financial system authorized by the SBS to operate with electronic money and companies that issue electronic money
Permitted operations	Issuance, redemption, transfers, payments, and other operations authorized by the SBS (Peru's regulatory entity).
Operative devices	Pre-paid cards, cell phones, and other devices authorized by the SBS.
Interoperability and interconnection	The law guarantees equality of access and conditions to all companies that provide financial services.
Operational risks	Transaction limits are established according to the category of electronic money accounts (general and simplified). Companies are responsible for providing the security and continuity of the operations. It is required that contracts establish the client's absence of responsibility in the case of cloning of the electronic support, malfunction of channels and systems, and the impersonation of the client in an agency.
Consumer protection and information transparency	It establishes a simplified information disclosure regime for clients that ensures the provision of a minimal amount of information: limit of operations, commissions, conditions for reconversion and use of means of payment and other available channels. In person and electronic agreements are permitted.
AML regime	In the case of generic e-money accounts, a general regime with regard to Know Your Client (KYC) is applicable. In the case of simplified e-money accounts, a simplified KYC regime is applicable.
Guarantee over resouces	A trust is a recognized form of guarantee. Issuers are responsible for guaranteeing that the physical money in trust be equal or more than the electronic money in circulation, at least at the end of each day.

Source: Prepared by the authors.

c. Correspondent and agent banking (branchless banking)

Correspondent and agent baking are service points used, in general, by financial system companies and that operate in fixed or mobile establishments belonging to an operator other than the above mentioned companies, such as convenience stores, hardware stores, and pharmacies. These establishments allow to make certain financial transactions while carrying out their usual activities, widening the availability of transaction channels and contributing to the generation of a greater bank and/or financial presence. Figure 3 presents the key aspects of correspondents banking operations:

The growth of the correspondent financial services at the network structure level has been significant in different parts of the world, in particular in the countries of the sample analyzed below (See Figure 4), which also reveals a considerable narrowing of the financial services access gap through transactional channels. However, the correspondent financial service has developed unevenly in the analyzed countries.

Figure 3.

Characteristics associated to the operations of correspondent agents

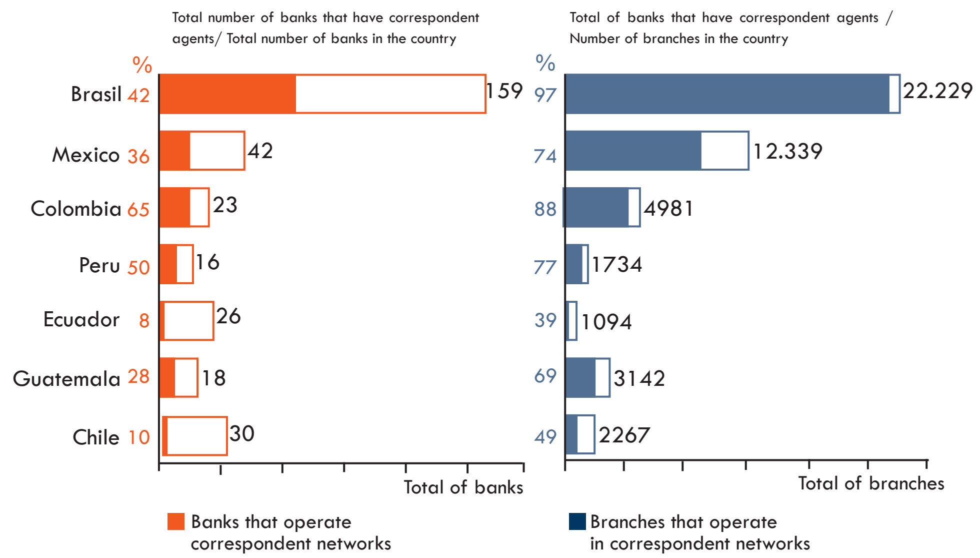
TARGET MARKET	NATURE AND CHARACTERISTICS	ENTITIES USING CORRESPONDING BANKING SUBJECT TO REGULATION
– They have great potential as formula for inclusion, in the measure that the applied regulation seeks to prioritize the satisfaction of non traditional markets. – A significant contribution of correspondent agents to financial inclusion is made visible in the satisfaction of marginalized populations.	– It is a channel for carrying out financial operations and/or transactions. – It allows the use of different payment instruments: debit cards, prepaid cards, bank vouchers, cash. – Acording to the regulatory model adopted, its use could be promoted only in the banked sector, allowing to make payments and basic transactions (withdrawals, consultations and transfers). Its use could also be promoted in the non-banked sector, if it allows, at the same time, to hire or implement financial and non-financial products and services (opening accounts, receiving wires or remittances, accessing credits, hiring insurance, etc.).	– Brazil: banks and other financial entities. – Mexico: banks and credit unions. – Colombia: banks and other popular financial entities supervised by the Superintendence of the Solidarian Economy – Peru: banks and other type of supervised intermediaries. – Ecuador, Guatemala and Chile: only banks.

Source: FOMIN, BID and CAF 2013

Prepared by the authors.

Figure 4.

Ratio of banks that operate in branch networks by country, in number of banks and branches they represent - 2012



Source: Reports published by the websites of the regulatory entities in each country; interviews with regulators; research and Akya analysis (data corresponds to the most recent available month in 2012).

In Peru, control over correspondent banking agents is in charge of the SBS, which authorizes that the offer of this service be provided not only by banking entities but also by financial entities, rural and municipal credit and savings banks and companies that issue electronic money. It is a flexible regulation with the objective of reinforcing other financial channels, namely channels different from traditional ones.

The use of correspondent agents represents a rather extended reality in the main Peruvian cities and it has gained larger presence throughout the country. The number of correspondent agents as of September 2014 reached almost 38.700[3] service points, which represents a growth of around 25% in comparison to 2013. This shows the efforts and concerns for reaching a greater number of people throughout the country. Likewise, the strengthening of this service has been such that only eight years after its creation, the number of monthly transactions carried out through this channel has significantly surpassed the number of over the counter transactions.

2. Granting of credits

a. Peer-to-Peer (P2P) Lending Platforms

Person to person (P2P) lending platforms are collaborative networks or virtual platforms through which people who need funds for a set purpose and people looking to invest their funds get in touch. It emerged as an alternative to obtaining financing from banks and the stock market, ideal for individuals and start-ups. In this type of "person-to-person" financing, investors assume the risk of getting repaid by their debtors. The advantages and disadvantages of this service are presented in Chart 3.

Chart 3.

Advantages and disadvantages of P2P platforms

Advantages	Disadvantages
– Allow people to access financial resources at low cost, promoting financial inclusion (they are a financing option for SMEs). – Allow investors to access interesting profit options. – Are potential engines for economic growth.	– Loans do not have guarantees, which makes necessary a thorough previous evaluation of the debtors' payment capacity. – They should be massive in order to diversify risks and reduce loss probability for investors. This implies adopting protective measures for other types of risk: protection of consumer rights, safety in the management of the funds, properness of the agent managing the platform.

Source: Vodanic et al.
Prepared by the authors, 2015.

3 Service points that operate in establishments managed by a natural or legal person other than companies within the financial system.

Since their creation in 2006, these lending platforms have been implemented in different jurisdictions, and since 2009 they have expanded in China and Southeast Asia. Most of these platforms have been implemented over the last five years, reaching countries such as Argentina, Estonia, India, among others.

Many countries in which these lending platforms operate have not yet developed a specific regulation. Figure 5 presents regulation improvements in some countries around the globe.

Figure 5.

Regulation Improvements relative to P2P Credit Platforms

United Kingdom	Credit platforms are regulated since 2014.
Australia, Argentina and Brazil	Platform agents are considered financial services intermediaries. Requirements applicable to agents vary from country to country. They can even be asked to apply for a license prior to offering their services.
France, Grmany and Italy	A banking license is required for the platform to operate.
United States	Two levels of regulation: Federal level and state level. At the federal level, some regulations are more flexible than others but they all require that platforms and loans be registered in the SEC.

Source: OICU-IOSCO Crowd-funding: An Infant Industry Growing Fast. Staff Working Paper. February 2014.
Prepared by the authors.

We must point out that in Peru, person to person lending platforms do not have a specific regulation, but they are not forbidden either.

Regulation Proposals Applicable to Inclusive Financial Services in Peru

A. Relative to the need of developing a risk based regulation

There are two types of criteria that legislations adopt in order to set regulation parameters for the offer of financial services:

Regulation Proposals Applicable to Inclusive Financial Services in Peru

A. Relative to the need of developing a risk based regulation

There are two types of criteria that legislations adopt in order to set regulation parameters for the offer of financial services:

- Parameters relative to the quality of the agent or commercial operator offering the service, which only authorize financial entities to offer financial services in order to ensure the proper protection of clients and their money.
- Risk Bases Regulation (RBR) sets risk parameters relative to the offer of financial services, regardless of the offering agent. This regulation proposes more flexible norms that allow the industry to innovate when developing new services and new agents that offer such services.

At the light of these definitions, a risk based regulation is the best option insofar:

- No all financial services entail activities of financial intermediation, therefore it should be permitted that other type of agents also be able to provide innovative services that do not imply capturing the public's funds.
- A conservative regulation that concentrates the provision of financial services among certain agents without a clear reason may become an obstacle for the development of a greater financial inclusion.
- Regulation can be cataloged as discriminatory when it does not focus in the inherent risks of the service and instead focuses in the quality of the agent offering the service.

B. General criteria applicable to risk based regulation

Regardless of the financial service involved, the following regulatory objectives must be considered (see Chart 4 for specific recommendations):

- Consumer protection: through transparency of the information provided and the guarantee of a proper service.
- Prevention of ML (PLAFT, in Spanish): prevent financial services from being a means for channeling illegal operations.
- Safety and reliability of the service: through the proper management of operational risks (in the case of innovative products mostly linked to technological malfunction and fraud).

Chart 4.

Specific Recommendations for Peruvian Regulation

	How are we doing in Peru?	Recommendations
Consumer protection	- It is regulated by the Consumer Protection and Defense Code. - It is the duty of the financial system's companies to disseminate their rates before any agreement. - When signing a contract, it is required to hand the client a copy of the contract with the general clauses that will regulate the financial operations. - After signing the contract and during the execution of the contract there are notice periods in case of any unilateral changes in the agreed conditions. - Absolute presumption of non-responsibility of clients in cases of payment platforms cloning without a minimum requirement of diligence on their part.	- In the case of innovative financial services, a simplified regime such as the one that regulates electronic money is the best option. - In a context where service companies and mobile phone operators coexist, it is important to have a clear legislative scheme that guarantees the users' safety when making transactions and that defines responsibility schemes in any scenario. In the first case, responsibility areas should correspond to the degree of participation in technology and the service's operations without stopping to guarantee transactions' protection and security. In the users' case, clear parameters of due diligence when using information channels and classifying sensitive information should be in place, and the events that may constitute a threat for the security of its operations should be reported.
AML Prevention	- List of individuals required to provide information to the Financial Intelligence Unit (FIU), of individuals of the SBS in charge of the analysis, treatment and transmission of the information necessary for AML and who are required to inform the Justice Department. - SBS Resolution N°2660-2015: norms AML risk management (includes a general regime for the clients' knowledge and due diligence as well as a simplified regime for the design of products, services, and distribution channels that mitigates AML risks).	In the case of innovative financial services, the advantage of having a simplified AML regime, regardless of who the offeror company is, the wisest option in terms if expanding services and promoting greater financial inclusion—an objective also contemplated in the case of e-money. At the light of this, the design and characteristics of the financial products, including the associated channels, could consider de following criteria: - Establish clear quantitative limits to the agreed amounts to reduce ML risks, using as a reference the electronic money regulation. - Establish the profile of the targeted clients. - Targeted geographical/market criteria should be part of the regulatory objectives, such as the promotion of greater financial inclusion. - The use of certain means of payment and support for carrying out operations in electronic money and electronic payment services could be additional regulation criteria. - Minimum security measures should be established for the use of digital or electronic platforms, as is the case with credit and debit cards.

	How are we doing in Peru?	Recommendations
Safety and reliability of the service through adequate management of operational risks	- SBS Resolution 6523-2013: according to the Peruvian regulation, credit and debit cards are required to have an integrated circuit or chip for storing and processing users' information as well as that of their operations. - SBS Circular G- 140-2009 establishes that in the case of fund transfers to third parties through electronic channels, companies will have to implement a scheme of dynamic assignment for client authentication.	- Minimum security measures should be established for the use of digital or electronic platforms, as is the case with credit and debit cards. - For example, in the use of cell phones as means for operating accounts in general through the Contactless Payment technology. - In the case of authentication mechanisms in transfer operations, SBS legislation regulates a general treatment, without distinguishing among cases that require greater authentication in relation to others that might require less authentication. To this extend, it should be considered the treatment established by the European Banking Authority that distinguishes strong authentication of clients and alternative authentication measures (for example, blank lists, operations among accounts in the same entity, small payments, etc.).

Prepared by the autor.

C. Specific criteria of regulation applicable to financial services

Relative to Electronic Money and Electronic Payments

– Interoperability and interconnection: Implies the possibility of a mobile financial service being operated by clients from any telecommunications operator, regardless of the operator involved in the service. This feature allows to reduce the operations' transaction costs, promoting financial inclusion through the following criteria:

- Granting tax benefits (exonerations, deductions or special tax treatments) aiming at a shared promotion of the financial structure in general—which includes ATMs and correspondent agents.
- Total interconnection—gradually achieved—in order to promote investment in rural areas that lack mobile infrastructure.
- Intervention of the supervisor only in strictly justifiable circumstances.

– Guarantee on resources delivered when providing electronic payment services: a trust is the ideal scenario because:

- Bankruptcy risk[3] is isolated, in the measure that the funds are placed in an autonomous equity independent to the service provider.

3 Bankruptcy is translated into insolvency, dissolution or liquidation risk of the fiduciary that manages the trust and the settlor.

– **Systemic Risk in Payment Systems:**
  - Regulation that allows the Central Reserve Bank of Peru (BCRP, in Spanish) to identify when these electronic payment services acquire systemic importance.[5] This follow up should be carried out not only by the BCRP but also by the SBS.

– **Regulation of the Electronic Money Service:**
  - Correspondent agents should be the ideal channel for carrying out operations with electronic money. In this extreme, regulation should foster this mechanism in situations which present a low ML risk.
  - Our regulation should contemplate the possibility that companies issuing electronic money be able to use channels other than those regulated. For example, companies could be able to hire quality personnel as "mercantile commission agents" or through "outsourcing services" that make visible recruitment outside the agencies or offices and/or complementary channels (establishments for basic operations or banking agents).

Relative to Correspondent Agents

– It should be analyzed which legal and bureaucratic barriers in the regulation prevent wider coverage by correspondent agents. To achieve this, coordination between different suppliers of financial services and agents is required as well as coordination among the authorities that participate in the authorization chain, in order to carry out proper and efficient operations.

Regarding P2P Lending Platforms

Considering that in Peru such platforms are not regulated (but not forbidden), if they ever became regulated, it is key that it be RBR, in the measure that it considers the following risks particular to this type of service.

– **Operational risks particular to the platform:** regulation should promote the use of mechanisms that allow to distinguish clients' accounts from agents' account so that if the platform were to fail or the agent that manages the platform went bankrupt, clients' accounts would not be affected and will be managed by another agent.

– **Guarantee of investors' funds:** the regulator should not demand a specific guarantee mechanism, but, instead allow different alternatives as long as they effectively protect investors' funds and ensure that they achieve the goals envisioned for such funds.

5 Systemic importance is attributed when the efficacy of the financial markets depends significantly on the proper operation of the system or in cases in which it operates independently to other participants in the financial system and others.

– **Credit default risks:** in order to mitigate this risk, the proposed regulation will have to be flexible enough to allow any of the following alternatives:

- Only accept borrowers with good repayment capacity, according to risk information centrals (credit bureaus).
- Establish contingency funds (a type of insurance) that cover losses on the side of the investor that were generated by the debtor's default. The cost of this insurance is generally covered by the investors themselves.
- Require liquid guarantees from debtors that may be liquidated in case of defaulting.
- Have mechanisms for accessing information about risks associated to the most vulnerable population.
- Promote channeling productive support funds for less favored sectors.

Conclusions

The development of financial services at the international level is due, greatly, to globalization and the use of technology. In Latin American countries financial services are achieving important results and contributing to financial inclusion.

Regulation cannot be indifferent to the technological development behind financial services in the measure that technology is critical to the evolution of the financial services industry and to achieve greater financial inclusion.

In order to get evidence from different regulation processes carried out around the world, many experiences were observed throughout the globe, and this made it possible to distinguish two types of regulation criteria. One based on the quality of the subject providing the financial service; and another based on the risk that emerges when providing such services (RBR). One model of the latter type of criteria, considers technology as decisive factor in the design of regulatory formulas linked to consumer protection, ML prevention, as well as to the security and reliability of the service.

Finally, in Peru, the main conditions for the development of innovative financial systems already exist and regulation plays a key role in it. However, regulation by itself is not enough: it needs to be coupled with joint efforts and permanent coordination among the regulatory entities of the different sectors involved and the different private agents, all of which coalesce in the financial services market.

Bibliography

FOMIN, BID AND CAF. 2013 Banca Corresponsal e Inclusión Financiera: modelos de negocio en América Latina. https://www.microfinancegateway.org/sites/default/files/mfg-es-documento-banca-corresponsal-e-inclusion-financiera-modelos-de-negocio-en-america-latina-9-2013.pdf

TECNOCOM AND AFI. 2013. Informe Tecnocom sobre tendencias en medios de pago 2013. http://www.tecnocom.es/documents/10181/27549/Informe_Tecnocom13_WEB.pdf

TECNOCOM AND AFI. 2014 Informe Tecnocom sobre tendencias en medios de pago 2014. http://www.siliconweek.com/wp-content/uploads/2015/07/Informe_MediosPago_2014.pdf

Ljubica Vodanovic, Maria del Carmen Yuta,
Experts in financial regulation.

This publication is possible thanks to the support of the Ford Foundation and the IDRC - International Development Research Centre

PROYECTO CAPITAL
Opportunities for inclusion in the financial system in Latin America and the Caribbean
A woman who saves changes lives