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Fintech: Opportunities and Challenges

By Raúl Real and Grecia Rosal

A wide range of technological innovations, often enclosed under the term 'Fintech', are transforming the financial system. Fintech impacts the delivery of financial services, including key bank functions such as the provision of loans and payment systems, and may result in completely new types of products and services like crypto assets. These developments may bring many opportunities for the financial system and its users.

However, they also generate new challenges and risks for the financial regulation and supervision. Rapid changes in this area require regulatory authorities to carefully manage trade-offs between maintaining financial stability without inhibiting innovation. In the face of these challenges, the regulatory and legal principles to oversee fintech need to be modernized, and the authorities could adopt new supervisory skills.

Recognizing the impact of Fintech, the Center organized a virtual workshop that provided to the Central America, Panama and the Dominican Republic (CAPDR) authorities an overview of the main challenges for supervision and regulation of Fintech. The four-day virtual event covered fintech developments and regulatory responses on new activities and entities regarding electronic money (e-money), crypto-assets, and the expansion of BigTech in financial services. This article briefly delves in the presentations of two topics that are particularly important for the CAPDR region: BigTechs and e-money. Both issues are relevant to the CAPDR region, given the young population, the difficulties in accessing traditional financial services, and the importance of remittances in their economies.

1. Bigtechs [1]

Fintech developments have unbundled and decentralized the delivery of financial services. This essentially means that smaller firms, usually fintech start-ups, have innovated in the delivery of financial services, unbundling services by large financial institutions and delivering greater consumer choice (Bains, Sugimoto, & Wilson, 2022). This innovation in financial services represents regulatory challenges, and authorities have intended to maintain financial stability while enabling an environment for innovation.

New regulatory and supervisory challenges come in the picture with the expansion of BigTechs in the financial system. The term BigTechs usually refers to technology conglomerates with large customer networks of mainly retail users. Entities include Amazon, Alibaba, Meta, among others. In recent years, BigTechs have expanded into financial services. For example, Amazon has dabbled into various financial services: Amazon Pay provides a payment service for customers; Amazon Lending provides financing options for small-sized businesses; credit cards provided by Amazon. See Figure 1 for more examples. BigTechs are taking advantage of their existing large data sets and economies of scale to deliver new services (Bains, et.al., 2022). These has allowed BigTechs to reverse the decentralization of services delivered by Fintech start-ups.

[1] For more information on this topic check IMF's paper: BigTech in Financial Services: Regulatory Approaches and Architecture.

Figure 1. Examples of financial services provided by Big Techs

	Payments	Lending	Credit Cards	Insurance
Alibaba.com	Alipay	借呗 JIEBEI		
Tencent 腾讯	WeChat Pay	WeBank	微信支付 WeChat Pay	
	pay	a		

BigTech expansion to financial services brings new risks to the financial sector. Regulators and supervisors should keep some key aspects in their approach to regulating BigTechs. The IMF recommends a mixed approach towards regulating these entities (Bains, Sugimoto, & Wilson, 2022). Essentially what these means is that the main financial activities are covered by entity-based regulations, applied to entities with a specific license to engage in a regulated financial activity, and activity-based regulation, applied to all institutions offering a financial service. Both approaches have policy trade-offs that won´t be discussed here. Nevertheless, the bottom-line message is that a holistic policy response is needed to address the potential systemic risks caused by BigTechs.

The expansion of BigTechs in financial services has been evident in Latin America. In the workshop, the participants discussed the pilot project of Novi Wallet, a digital wallet from Meta. In October 2021, Novi launched a pilot program to transfer money internationally. It uses Pax Dollar (USDP), a stablecoin, to store and transfer money. Novi Wallet's pilot program is currently available to limited users in the United States and Guatemala with a maximum amount of US$1,000 per wallet. The workshop offered elements to support the capacities of Guatemalan authorities to address these challenges.

2. E-money [2]

The workshop focused on discussing e-money regulatory regimes, especially on the best practices for prudential regulation and supervision of e-money issuers (EMIs). It is important to begin by establishing that there are different definitions of e-money. There are some shared characteristics among definitions: 1. Electronic store of monetary value; 2. Expressed in an existing official monetary unit; 3. Value can be fully claimed against the e-money provider; 4. Accepted as means of payment. Electronic money has been growing rapidly, in hand with mobile networks and internet access. In developing countries, EMIs have delivered efficient and cheap digital financial services to a large number of customers. The rapid adoption of EMIs has brought important benefits, for instance, in terms of financial inclusion. However, it represents a potential systemic risk in the financial system, given the importance of the day-to-day services they provide.

The regulatory framework and practices must evolve with these new business models. Among other topics, the workshop deepened the discussion of prudential regulation and supervision of EMIs. There are no international standards for EMIs, but best practices are developing (Dobler, Garrido, Grolleman, Khiaonarong, & Nolte, 2021):

1. Generally, EMIs conduct activities as a legal entity separated, for example, from a mobile network operator. There is segregation from other activities and financial flows.
2. A pool of liquid funds, at least equivalent to the aggregate balance of the clients' e-wallets, in commercial banks, short-term securities, or reserve account at the central bank.
3. Segregation of the pool of liquid assets from the EMI's own assets limits the risk of the loss of client funds.
4. Strong internal control framework for fund safekeeping and segregation.
5. Initial capital requirements should be sufficient to sustain the proposed activities.

[2] Para obtener más información sobre este tema, consulte el documento del FMI: E-Money: Prudential Supervision, Oversight, and User Protection.

Other considerations were discussed in the workshop, including supervisory approaches, payments system oversight for e-money, and user protection and contingency planning[3]. The topic is relevant for the CAPDR region since mobile network companies are currently offering e-wallet services and it is important to have a regulatory framework that addresses the new challenges.

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[3] For further details, see: https://www.imf.org/en/publications/departmental-papers-policy-papers/issues/2021/12/13/e-money-prudential-supervision-oversight-and-user-protection-464868

Central Bank Digital Currencies

By Daniela Gallardo and José Castañeda

The COVID-19 pandemic has accelerated the digitization of economies, which is impacting central banks. User needs have rapidly evolved, driving innovation in financial services. This technological innovation has prompted further debate on implementing Central Bank Digital Currencies (CBDCs). A CBDC is a digital form of central bank money that agents could use as a means of payments and value store. These new central bank liabilities could create new opportunities for payments and the way the Bank maintains monetary and financial stability (Bank of England, 2020).

Before delving into CBDCs and how they differ from other means of payment, such as conventional forms of money or assets such as cryptocurrencies, it is necessary to establish a conceptual framework with their attributes. Four characteristics of means of payment are highlighted: type, value, backstops, and technology (Adrian & Mancini-Griffoli, 2019).

Means of Payment Attributes

1.Type: The two types of means of payment are either an object or a claim. The cash used to pay for a product, such as coffee, is an example of an object-based means of payment. The transaction is settled immediately as long as the parties deem the object valid. No exchange of information is necessary.

The second option available would be to transfer a claim on value existing elsewhere. That is the case when using a debit card to pay. Swiping the card transfers ownership of a claim on bank assets from one person to another.

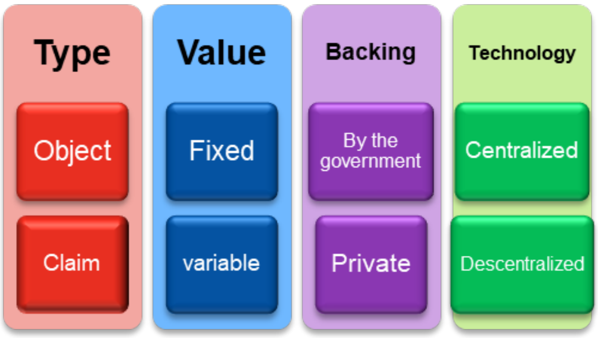
2. Value: This attribute refers only to claim-based means of payment. The relevant characteristic is whether redemption of the claim in currency is at fixed or variable value. Fixed value claims guarantee redemption at a pre-established face value. For instance, a claim on a bank in the form of deposits for 100 Quetzals can be exchanged for 100 Quetzals worth of bills.

Other types of claims may be exchanged for currency at variable value, i.e., the current market value of the assets that back the claim. Such claims thus resemble equity-like instruments with an upside or downside risk.

3. Backing: The question is whether the redemption guarantee is backed by the government or relies merely on prudent business practices and legal structures put in place by the issuer. In the latter case, we call the backing "private." The distinction is important as it can affect users' trust in the different forms of money and the regulatory response.

4. Technology: Finally, the technology assesses whether a settlement is centralized or decentralized. Transactions leveraging centralized technologies go through a central proprietary server. Decentralized transactions using decentralized ledger technologies (DLT) or blockchain are settled among several servers.

Figure 1. Means of Payment Attributes



Differences between Central Bank money, cryptocurrencies, and other means of payment

The above attributes help us distinguish among different means of payment, such as (i) central bank money; (ii) crypto-currency; (iii) b-money, which banks currently issue; and (iv) e-money, offered by new private sector providers (see Annex 1). (Adrian & Mancini-Griffoli, 2019).

The most recognizable is central bank money: notes and coins. Cash is an object-based means of payment, and its digital counterpart is the CBDC. Unlike cash, CBDC would likely not be anonymous, although it could protect users' data from third parties. Its validation technology could be centralized or decentralized, offering interest (Adrian & Mancini-Griffoli, 2019).

The other object-based means of payment is cryptocurrency. It is denominated in its own unit of account, is created by nonbanks, and is issued in a blockchain (Adrian & Mancini-Griffoli, 2019).

The most widespread use of claim-based money is b-money or bank money, typically covering commercial bank deposits. The key distinguishing feature of b-money is that the government backstops its redemption guarantee. A prudent business model helps meet potential redemption requests, but the public policy also plays an important role. Banks are regulated and closely supervised. When regulation is effective, banks cannot take excessive risks and must maintain ample liquidity (Adrian & Mancini-Griffoli, 2019).

Electronic money or e-money is a prominent new player. Its single most crucial innovation regarding cryptocurrencies is to issue securities redeemed in currency at face value upon demand. It is like b-money except that governments do not backstop redemption guarantees. They merely rest on prudent management and legal protection of the assets available for redemption. The so-called "stablecoins" are also included in this category. Stablecoins are blockchain-based forms of electronic money, such as Gemini, Paxos, TrueUSD, and Coinbase (Adrian & Mancini-Griffoli, 2019).

Potential benefits of CBDC

The implementation of central bank digital currencies is strongly motivated by its potential benefits, such as resilience, efficiency in implementing public policies, citizens' rights, financial inclusion, innovation and growth, and cross-border payments (Mancini-Griffoli, 2022).

In many countries, a few private-sector firms centralize payments and, therefore, central banks are concerned about the security and resilience of their systems. The introduction of CBDC would improve market discipline and enhance payment system resilience. Besides, CBDCs capacities may be used to improve the efficiency of public policies. For instance, they would enable government transfers (Mancini-Griffoli, 2022).

The potential benefit for the general public is based on their sovereign right to use money. Cash or physical money is used less frequently, or it is no longer used, when it does not satisfy the needs of digital societies. Therefore, the Central Bank assumes an obligation to introduce a digital form of money (Mancini-Griffoli, 2022).

Financial inclusion is also promoted as one of the potential benefits of CBDCs as they may be available at lower costs and are accessible for groups in society that were previously excluded (Mancini-Griffoli, 2022).

Finally, the introduction of CBDCs may be a catalyst for innovation opportunities and growth as a new cross-border payment platform. CBDCs can reset standards and facilitate round-the-clock, cross-border, and potentially streamlined payments (Mancini-Griffoli, 2022).

Progress in the implementation of CBDCs

Most central banks are exploring CBDCs, and local circumstances shape their interest. Financial inclusion and payment efficiency objectives drive the use of CBDCs in emerging markets and developing economies, where central banks report relatively stronger motivations. A testament to these motives is the launch of the first "live" CBDC in the Bahamas. In 2020, 86% of the 60 central banks surveyed by the Bank for International Settlements (BIS) were now exploring the benefits and drawbacks of CBDCs (Boar & Wehrli, 2021).

Soderberg (2022) collected the experiences of six countries in their assessment of CBDCs. These case studies identified the following challenges: technological uncertainty, lack of precedent, legal issues, lack of resources, cybersecurity, and lack of willingness of the population to adopt digital payments. Exploration of CBDCs is still at an early stage. Its design and implementation are a decision for each jurisdiction based on its circumstances and objectives. There are still open questions, and CBDC remains an unchartered territory, posing opportunities and raising challenges. Increased international information-sharing and cooperation will be important going forward (Soderberg, 2022).

International Monetary Fund and CAPTAC-DR Role

In the last fiscal year (May 2021-April 2022), there has been a growing demand for IMF technical assistance from Central Banks on CBDCs. More than 100 IMF member countries are exploring CBDCs. Twenty-nine technical assistance sessions have been provided in 5 different regions. (Sun, 2022).

In February 2022, the IMF's Monetary and Capital Markets Department, together with the Secretariat of the Central American Monetary Council and in collaboration with CAPTAC-DR, organized a virtual seminar on CBDCs in the Americas region. More than 200 officials from Central America, Panama, the Dominican Republic (CAPTAC-DR member countries), Bolivia, and Paraguay participated.

The seminar sought to facilitate knowledge exchange between country officials and IMF staff, and share views on the opportunities and risks from new forms of digital payments, focusing on CBDCs. Seminar presentations dealt mainly with design issues and use cases, macro-financial implications, legal, and governance frameworks, and cyber security considerations related to new forms of digital payments and CBDCs.

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Annex 1: Characteristics of the Different Means of Payment

		Type		Value		Backing		Tecnology	
	Mean of payment	Object	Claim	Fixed	Variable	By the government	Private	Centralized	Descentralized
Central Bank money	Cash	✓		✓		None			✓
	CBDCs	✓		✓		None		?	
Private money	Bank money or b-money		✓	✓		✓		✓	✓
	Electronic money or e-money		✓	✓			✓	✓	✓
Not money	Criptocurrency	✓			✓	None			✓

Nota: CBDCs refer to Central Bank Digital Currencies.
Source: Own elaboration with information from Adrian, T. & Mancini-Griffoli, T. (2019).

Gender Equality in Customs Administrations of the Region

Por Selvin Lemus, Grecia Rosal y José Castañeda

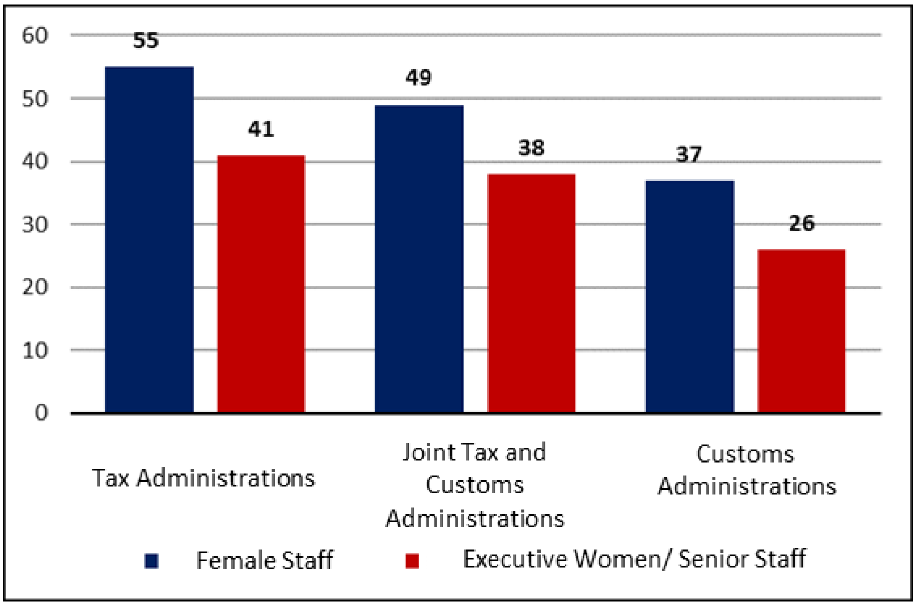
There is broad evidence, including several International Monetary Fund studies, of the notable positive effect that gender diversity has on organizational performance (for instance, Lone et al., 2016; Fernandez, Isakova, Luna, & Rambousek, 2021). First, greater representativeness suggests heterogeneity of values, beliefs, and attitudes in a more inclusive decision-making process. Secondly, gender diversity also encompasses the differences in preferences and behaviors that develop creative and critical thinking, thus influencing the organization's management styles. Thirdly, increased participation of women in leadership roles strongly impacts productivity (Lone et al., 2016; Fernandez, Isakova, Luna, & Rambousek, 2021). Fostering gender-balance is crucial to avoid policies that can disproportionately affect women.

Globally, achieving gender equality and empowering women and girls is the United Nations Sustainable Development Goal 5 by 2030. In this regard, the customs administrations of the region have recognized that gender equality is fundamental in ensuring the performance of the basic functions of customs. This recognition reflects in the Declaration on Gender Equality and Diversity of the World Customs Organization (WCO), which call on customs administrations to implement comprehensive and sustainable policies, procedures, and activities to promote gender equality and diversity. Regionally, this priority is set in the Regional Policy on Equity and Gender Equality of the Central American Integration System (Sistema de Integración Centroamericana, SICA), which also highlights the importance of women's participation in public institutions.

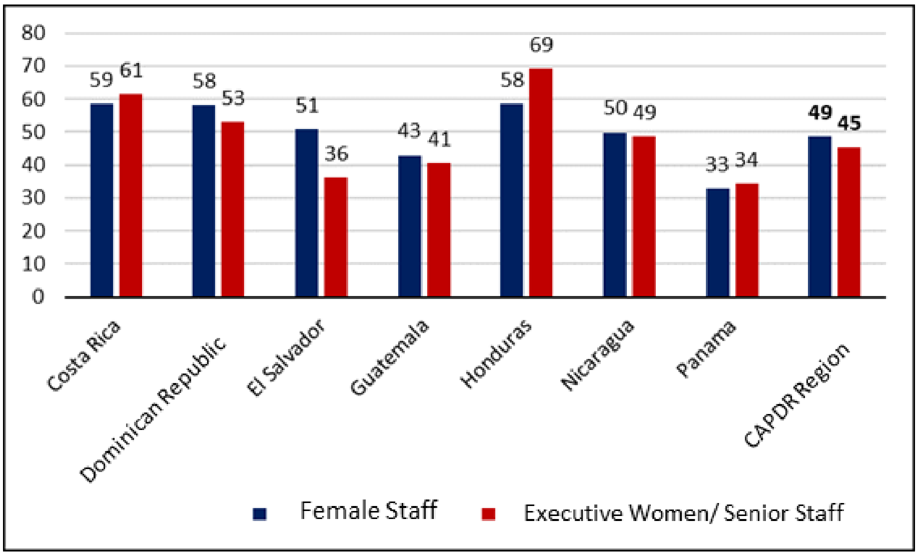
The need for gender equity policies is evident in the substantial differences in women's participation in revenue administrations. More than 150 countries participated in the IMF's International Survey on Revenue Administration (ISORA) for fiscal year 2019. The survey shows that female participation in tax administrations is higher than male participation; however, the opposite occurs in customs administrations because only 37% of the staff are female. This relationship is also observed in customs executive and senior positions, where only 26 percent are women (see Figure 1a). Male participation in revenue administrations is also predominant in the CAPRD region, both at general and executive levels (see Figure 1b). This relationship gives the first impression of the challenges that gender equity presents for the region. It is necessary to analyze this disparity in customs administrations in-depth.

Figure 1. Women's Participation in Revenue Administrations in 2019 (in percentages)

a. Countries surveyed in the ISORA (156 countries)



b. CAPDR Region



Note:
1. The definition of "officer" is not standard in all tax administrations.
2. CAPDR region includes Central America, Panama, and the Dominican Republic.
3. A weighted average for all staff and senior management was used to calculate the percentage of women's participation within the CAPDR region.

Sources: International Survey on Revenue Administration (ISORA) for FY 2019 - ADB, CIAT, IMF, IOTA, OECD; 2020 WCO Annual Report

The revenue administrations continued to address gender equity. They identified different areas of opportunity, such as the need to segment staff and operators by their volumes of operations or revenues and gender. While there are several areas of opportunity, revenue administrations have developed good practices in the new normality context, such as digitizing their processes, so women now perform the jobs that used to be male-dominated. These findings emphasize implementing internal and external policies to address current gender equity needs better.

Progress in this area has been modest, as there is a lack of national and regional studies that reveal the current situation of customs and reflect existing gaps. Therefore, CAPTAC-DR incorporated in its work plan for FY 2022 a Regional Study on Gender Equity in the Customs Administrations of the Region, which has been endorsed by the Directors of Customs of Central America. This study is developed in coordination with the Regional Vice-Chair of the World Customs Organization for the Americas and the Caribbean, the WCO Secretariat, and the Spanish Institute of Fiscal Studies.

This study's results, which are expected to be presented this year, will show the situation on gender equity in the customs administrations of the region and identify gaps at the national and regional levels in this area. This study will use the WCO Gender Equality Organizational Assessment Tool (GEOAT) to raise awareness of the importance of gender equality in the region, including women's participation at the management level in customs administration and the aspects that need to be addressed to overcome the current gaps. The study will also serve as an input to design and implement future actions that bridge the gaps that are identified, both by CAPTAC-DR and other international cooperating agencies and technical assistance providers wishing to support regional customs administrations.

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Summary of Capacity Development Activities

Tax Administration

- The Tax Administration area carried out three technical assistance missions during this trimester. In Panama, Nicaragua, and El Salvador the activities gave continuity to the strengthening of the control of large taxpayers, the assessment and identification of tax compliance risks, and the ability to identify potential taxpayers.
- Three webinars were held, sharing good practices from other Latin American tax administrations to strengthen the knowledge of officials in the region on topics such as compliance risk management and debt recovery and collection.

Customs Administration

- During the second quarter CAPTAC-DR supported the Dominican Republic on the implementation of a methodology for the identification of risk-sensitive sectors. Also, Guatemala was assisted on the modernization of customs processes, with emphasis on air cargo. Honduras continued to strengthen the post-clearance audit. A workshop was organized for Panama to analyze the gaps in the Integrated Customs Management System. For Costa Rica, a webinar on international experiences on the traceability of alcoholic beverages was held, featuring speakers from Spain, Ecuador, Mexico, and Brazil.
- Regarding regional training, a webinar was held (Customs Coffee - 2022) on Paraguay's one-stop shop for foreign trade, with representatives from the World Bank, the WCO Regional Consultative Group for the Private Sector, as well as close to 600 customs officials from 24 different countries.

Public Financial Management

- CAPTAC-DR's Public Financial Management area carried out missions to Costa Rica, Honduras, Nicaragua, El Salvador, and Guatemala. The main topics of the technical assistance provided were improvement in fiscal risk determination, strengthening modern treasury management, implementation of International Accounting Standards for the Public Sector, budget management of public trusts funds, fiscal sustainability, and budgeting with a gender approach.

Central Banking Operations

- In the third quarter of the year, the Center provided technical assistance to the central banks of Nicaragua and Honduras to strengthen their monetary policy instruments and liquidity forecasts to support the calibration of monetary operations. The Central Bank of Honduras was also trained in Financial Derivatives. In November, the Central Bank of Costa Rica was assisted in preparing for the introduction of currency swap operations.

Real Sector Statistics

- CAPTAC-DR provided three virtual bilateral technical assistance sessions during the last quarter (Panama, El Salvador, and Costa Rica) in the area of real sector statistics. In Panama, assistance was provided in a project to update the Consumer Price Index; in El Salvador, the assistance was for the project of expanding sectoral accounts to the financial account. In the case of Costa Rica, training on the Producer Price Index was provided to INEC officials.

- A course with a theoretical-practical approach to seasonal adjustment was developed in quarterly accounts and short-term indicators, involving central bank officials and statistical institutes.

Government Finance Statistics

- Three bilateral technical assistance missions were carried out by the GFS area. Together with the team from the Ministry of Finance of El Salvador, work was done on Public Sector Debt Statistics (PSDS) in a D4D (Data for Decisions) mission. In Honduras, a two-week event was held in support of the Honduran Ministry of Finance (SEFIN), comprising a GFS course and technical assistance.

- Towards the end of 2021, a regional seminar was held for the central banks and finance ministries of the region, on specific GFS and PSDS issues.

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