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CONCEPT NOTE

Regular meeting of

Inter-American Council for Integral Development (CIDI)

AUGUST 29, 2023

**THEME: NEOBANKS AS A TOOL FOR DEVELOPMENT**

1. **Background/Justification**

Across Latin America and the Caribbean, nearly 60 percent of all transactions are in cash and seven in 10 people are unbanked or underbanked. This has fueled one of the world’s highest rates of income inequality.[[1]](#footnote-1)/

Over the last decade, neobanks have emerged as part of innovative fintech solutions to increase financial inclusion in the region. Customers access their accounts at neobanks through mobile apps and online portals. These new players do not have physical branches and therefore do not have expenses such as rent, electricity, and infrastructure investments which constitute a significant percentage of the traditional banking expenses. As a result, neobanks offer lower fees to their customers.

Typically, neobanks do not hold a traditional banking license and their offerings remain limited (current accounts, money transfers, debit cards) in comparison to traditional banks. However, when partnering with licensed banks, neobanks can offer a wider range of financial services (such as credit cards, loans, etc.) to their customers.

Neobanks have compelled traditional banks to become leaner, faster, and better, and to respond with their own digital banking initiatives to serve new segments and markets. In fact, one in three neobanks in the region now comes from a spinoff of traditional banking. This increased competition from neobanks is reducing the cost of financial services.

Neobanks have hence played a central role in improving financial inclusion in the region. Over 80 million Latin Americans were neobank customers in 2021. Three quarters of the 60+ neobanks in Latin America and the Caribbean are unbanked and underbanked consumers. In a recent study, the International Monetary Fund (IMF) highlights that the entire fintech industry is associated with reduced income inequality, a lower Gini coefficient, and a higher level of female employment,[[2]](#footnote-2)/ thereby contributing directly or indirectly to the attainment of the Sustainable Development Goals (SDGs), in particular Goals #1, #5, #8, and #10.

Neobanks are also affecting and changing the way people think about banking. They are offering services to educate customers about the importance of budgeting, savings, and investing. They are empowering their customers and making it easier for them to manage their finances.

Neobanks have also played a major role in experimenting with new technologies, such as artificial intelligence, biometrics, and blockchain to help make banking more secure and efficient.

Nonetheless, many neobanks have significant room to innovate. Relatively few offer products and loans to micro, small and medium-sized enterprises (MSMEs), even though the customer experience for MSMEs at traditional banks is often significantly worse than for consumers.[[3]](#footnote-3)/

The expansion of neobanks, and more importantly the entire fintech industry, has also increased systemic risks, creating challenges for both regulation and supervision. As noted by the IMF, “while some of the risks are particular to fintech, many others are linked to underlying products and institutions similar to those faced by the traditional financial system. In particular, fintech can heighten operational risks and those related to data and consumer protection.”[[4]](#footnote-4)/

When choosing the regulatory framework, four possible options exist. First, a country can take no concrete action. Second, it can decide to test and learn through tools such as innovation hubs and regulatory sandboxes to understand new developments and make regulatory changes based on the outcomes. A third option is to expand the perimeter by adopting new rules to regulate fintech companies, including by the adaptation of existing norms. The fourth option is *bespoke* regulation, which recognizes the particularities of fintech and creates new regulations for each innovation.[[5]](#footnote-5)/

In Latin America, fintech tends to be regulated most often by the type of activity of firms rather than by the type of firms providing services.

1. **Purpose of the Meeting**

 The purpose of the meeting is to discuss the role of neobanks as a tool for development in OAS member states, and more specifically how expanding access to financial services to those who have historically lacked it, the unbanked and underbanked, contribute to the financial empowerment of these underserved communities, thereby better positioning them to fully participate in the economy.

 The meeting will provide member states with an opportunity to present their experiences in the digital banking industry and will address issues related to the challenges and solutions for expanding and strengthening this nascent sector.

 Questions for member states will feature:

1. How important is the digital banking sector as a tool for development in OAS member states?
2. What are the key strategies for promoting greater access to financial services in member states, including as it relates to micro, small, and medium-sized enterprises (MSMEs)?
3. Based on your country’s experience, are neobanks contributing to the attainment of the SDGs?
4. What role should governments play to regulate and supervise neobanks?
5. **Relevance to SEDI**
* Promote access to finance as a tool for increasing financial inclusion, creating employment opportunities, contributing to poverty reduction, and enhancing livelihoods
* Strengthen the implementation of 2030 Agenda for Sustainable Development and its Sustainable Development Goals (SDGs)
* Foster regional dialogue, cooperation and knowledge sharing on access to finance for individuals and MSMEs, including mechanisms for sharing good practices and lessons learned
1. **OAS mandates**

 Under the strategic line “promoting inclusive and competitive economies,” the 2021 OAS General Assembly resolution “AG/RES. 2967 (LI-O/21) Advancing Hemispheric Initiatives on Integral Development: Promoting Resilience” establishes the following mandates:

1. “Acknowledging that the COVID-19 pandemic has severely impacted micro, small and medium-sized enterprises (MSMEs) and accelerated the digital transformation of the region, and that the MSMEs digital gap has increased inequalities among people, countries and firms, to instruct SEDI to continue building local capacity in OAS member states to support MSMEs in their efforts to fully participate in the digital economy and increase their opportunities for reaping the benefits afforded by the digitization process underway.”
2. “To urge member states, with the support of SEDI, to continue exchanging good practices and experiences on the priorities for MSME post-COVID-19recovery identified at the VII Inter-American Dialogue of High-Level MSME Authorities on: 1) Financial Solutions including a gender perspective; 2) Digitization, E-commerce and Other Technological Solutions; 3) Courier Services and International Shipping; and 4) Women’s Economic Empowerment.”

At the VII Inter-American Dialogue of High-Level MSME Authorities “Public Policies, Programs, and Solutions for the Post-COVID Economic Recovery of Micro, Small and Medium-sized Enterprises (MSMEs),” held on September 9-10, 2021, member states identified among their priority areas of action the following:

“Sharing the latest developments on financial solutions to support the survival and improve the resilience of MSMEs.”

1. **Structure of the meeting**

 For the purposes of the meeting, various speakers will be invited to explore the role of neobanks in development as well as their potential to contribute significantly to the economic recovery and the attainment of the SDGs in OAS member states. Member states will have an opportunity to take part in an interactive dialogue guided by the Chair of CIDI.

 After a question-and-answer session with the guest speakers, the Chair will invite delegations to share their practices on expanding access to financial services and explore opportunities for cooperation in this area for MSMEs.

 Invited Panelists -TBD

1. **Outcome of the meeting**
2. Better understanding of the role of neobanks in development in OAS member states.
3. Specific challenges faced and solutions identified by member states in promoting access to finance as a tool for development shared.
4. Opportunities for cooperation on access to finance for MSMEs identified.
5. Contribute to the dialogue and support member states’ efforts to reach attainment of the SDGs.

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1. . <https://latinamericareports.com/the-importance-of-fintech-for-the-future-of-latin-america/7223/> [↑](#footnote-ref-1)
2. . Bakker, Bas B., Beatriz Garcia-Nunes, Weicheng Lian, Yang Liu, Camila Perez Marulanda, Adam Siddiq, Mariusz Sumlinski, Dmitry Vasilyev, and Yuanchen Yang. 2023. “The Rise and Impact of Fintech in Latin America.” IMF Fintech Note 2023/003, International Monetary Fund, Washington, DC. <https://www.imf.org/en/Publications/fintech-notes/Issues/2023/03/28/The-Rise-and-Impact-of-Fintech-in-Latin-America-531055> [↑](#footnote-ref-2)
3. . In recent years, it is rather the alternative finance industry which has served MSMEs in the region. This industry comprises (1) debt-based platforms, such as peer-to-peer (P2P) lending platforms; (2) equity-based platforms that allow investment in unlisted shares; and (3) reward-based or donation-based crowdfunding. See Ziegler, Tania, Felipe Ferri de Camargo Paes, Cecilia López Closs, Erika Soki, Diego Herrera, and Jaime Sarmiento. 2022. “The SME Access to Digital Finance Study: A Deep Dive into the Latin American Fintech Ecosystem.” Judge Business School, University of Cambridge, UK. <https://www.jbs.cam.ac.uk/faculty-research/centres/alternative-finance/publications/sme-access-todigital-finance-study-latam/>. [↑](#footnote-ref-3)
4. . Bakker and others (2023). [↑](#footnote-ref-4)
5. . Bains, Parma, Nobuyasu Sugimoto, and Christopher Wilson. 2022. “Bigtech in Financial Services: Regulatory Approaches and Architecture.” IMF Fintech Note 2022/002, International Monetary Fund, Washington, DC. <https://www.imf.org/en/Publications/fintech-notes/Issues/2022/01/22/BigTech-inFinancial-Services-498089>. [↑](#footnote-ref-5)