

Chile's Fintech Law Project – Advancements Towards Innovation, Competition and Financial Inclusion

By Valentina Novoa | Universidad de Chile



Edited By María Fernanda Vicens & Esteban Manuel Greco

Chile's Fintech Law Project – Advancements Towards Innovation, Competition and Financial Inclusion

By Valentina Novoa¹

The global financial architecture has changed. Indeed, the entry of new *Fintech* companies across the world has spurred the need for new regulation frameworks that can adapt to this new scenario by promoting innovation, competition, and financial inclusion. As is the case with digital platforms more generally, data has become an essential component for competition in this sector. Only last year the OECD warned that it would be essential for regulators to recognize the ability of users (current and potential) to allow their financial data to be exchanged with other institutions, financial or otherwise, in order to give a boost to innovation in finance.²

Latin America has not escaped this financial revolution, or the need to establish regulation frameworks that will allow it to develop. As far as the implementation of open finance regulation models goes, Mexico and Brazil have taken the lead, the former launching its own model in 2020, and the latter having partially launched the first stages of its 4-stage implementation model on the same year. Meanwhile, on September 3rd, 2021, Chile sent to Congress a draft for a financial innovation law that would regulate the financial sector with a clear focus on promoting competition and financial inclusion in the market.³

Given the global context with regard to Open Banking regulation⁴ and seeing as we have only recently entered the stage of drafting the legislative proposal, many might believe that Chile has lagged behind in adopting this kind of

regulation. However, the report entitled “Guidelines for the Development of an Open Banking Framework in Chile, Focused on Competition and Financial Inclusion” (“Lineamientos para el Desarrollo de un Marco de Finanzas Abiertas en Chile, con Foco en Competencia e Inclusión Financiera”),⁵ by economist Ana María Montoya and attorney Rosario Celedón, shows that this delay has not been in vain. While Chile may not have been among the first players in this Open Banking game, it has had the opportunity to observe the strategies and results of other countries. Thus, the report is able to deliver these guidelines precisely through the observation and comparison of experiences. Here, rather than a “delay,” it would appear that Chile has realized the advantages of being able to analyze what those further ahead in the race are doing as they build robust regulations.

A simple reading of this project makes clear the public policy fundamentals that underlie it: financial inclusion, and promoting competition and innovation. Likewise, we may notice the inclusion of principles such as protections for financial customers, the safeguarding of financial integrity and stability, and the prevention of asset-laundering or financing terrorism.

It should be noted that the project presented to the Chamber of Deputies includes many similarities to the proposal made by the Commission for Financial Markets (Comisión para el Mercado Financiero, CMF), published in

¹ Valentina Novoa is an attorney at the Universidad de Chile. She holds an LLM from King's College London, UK. She is a Counsel at Chilean law firm NLD Abogados. She is also a member of the ProCompetencia network.

² OECD, “Digital Disruption in Banking and its Impact on Competition” (2020) <http://www.oecd.org/daf/competition/digital-disruption-in-financial-markets.htm>.

³ Chile Chamber of Deputies, Newsletter No. 14570-05: “Promueve la competencia e inclusión financiera a través de la innovación y tecnología en la prestación de servicios financieros.”

⁴ To date, many countries are discussing the possibility of implementing an Open Banking model, while others have done so already, as is the case with Open Banking in the UK, the Payments Systems Directive 2 (PSD2) in Europe, as well as cases in Australia, Brazil, Singapore, Canada, Mexico, and Japan, among others. See Ariadne Plaitakis y Stefan Staschen, “Banca Abierta: El diseño al servicio de la inclusión financiera” (2020).

⁵ Ministerio de Hacienda de Chile, “Lineamientos para el Desarrollo de un Marco de Finanzas Abiertas en Chile, con Foco en Competencia e Inclusión Financiera” (2021) <https://www.hacienda.cl/noticias-y-eventos/noticias/ministerio-de-hacienda-anuncia-el-ingreso-del-proyecto-de-ley-de-innovacion>.

February, 2021.⁶ It seeks to set up guidelines for companies whose services are based on technology (*Fintech*), such as (i) Crowdfunding platforms, (ii) alternative asset exchange systems and financial instruments (invoicing, derivatives, virtual financial assets, among others), (iii) Order routers and financial instrument intermediaries, (iv) safeguarding of financial instruments, and (v) credit and investment consultants. To this end it establishes a Financial Services Provider Registry (Registro de Prestadores de Servicios Financieros), where these actors must register as a prerequisite for starting their operations in the market. Additionally, they are to be audited by the regulators in Chile's Financial and Stock markets.

Looking specifically at the changes to the financial architecture, the project foresees an open banking system as the condition that will allow for a boost to innovation, competition, and financial inclusion. Thus, in order to set it up, it has proposed a series of principles and regulations that aim towards "various providers of financial services being able to exchange customers' financial information, in an expeditious and secure manner, using automatic remote access interfaces, with the customers' explicit consent." Likewise, it indicates the market actors who would take part in this open banking system, specifically those that qualify as: (i) institutions providing information (including banks, credit card issuers, pay cards with funding provisions, or any other system similar to the payment measures mentioned above and that are authorized by the CMF), (ii) institutions providing information-based services, (iii) Account providing institutions, and (iv) payment initiation service providers.

With regard to the public policy objectives announced by the Executive, the system's mandatory nature is the right move. Indeed, the project establishes a regulatory framework that forces certain agents to adopt the necessary measures to allow consultation, access, delivery and exchange of information, as the case may

be, pertaining to certain data belonging to their financial customers, in an explicit and secure way. It mentions that, in order to achieve the above, participants in this open banking system must maintain one or more remote and automatic access interfaces (Application Programming Interface, ("API."))

This aspect of the project is fundamental for reducing the barriers to entry for new actors who would try to compete with incumbent banking institutions, as this would allow them to reduce the information asymmetries that exist between different actors in the market, as well as the advantages enjoyed by the incumbent owners of financial data pertaining to Chile's banking customers. Certainly, a voluntary system would not have created incentives for the Banking sector to open itself to competition, as demonstrated by the fact that no significant initiatives have been proposed by local banks in this regard.

Another remarkable issue contained in the open banking proposal relates to the definition of the kind of information that must be shared by the actors mentioned above, which adopts international guidelines that focus on facilitating the processes for Compliance and Onboarding. Thus, the project considers the exchange of transactional data on consumers, consumer identification data, and communications between service providers in order to facilitate financial portability, among others.

Additionally, in line with the *open banking* model installed in the UK, the proposal from Chile's Ministry of the Economy includes the standardization of remote access and automatic interfaces, leaving it up to Chile's stock market regulator to establish said standards. This is fundamental in terms of facilitating the entry of competitors who can offer new and better products and services, directed both at those who already use banking services, as well as that section of the population that has been marginalized from many of the banking system's benefits so far. In this sense, not having common rules or standards for the communication interfaces can make the entry of

⁶ Draft bill. Fintech en los ámbitos del Mercado de Valores, 2021.

new actors very costly, so each incumbent could develop their interfaces using different characteristics and standards, forcing new entrants to adapt to each one.

Along with the points above, the regulator has also been assigned with establishing minimum standards for safeguarding information, cybersecurity, and developing internal risk management and control policies in order to safeguard the confidentiality and integrity of data. It will be up to the regulator to evaluate these aspects at length in order to establish criteria that will diminish any risks that could arise from the increased flow and exchange of user data.

The above will represent a triple challenge for Chilean authorities. They must establish the minimum conditions and standards that will make new entry by competitors affordable, while guaranteeing the safety of user data and establishing standards that do not prevent or reduce innovation. Here, Montoya & Celedón recommend that standardization should pick up on functional aspects, such as requests for user authentication and consent, applicable to interfaces for communication, information security, data protection, and consumer protection.

Likewise, the report establishes the responsibilities of those taking part in the open banking system with regard to safeguarding the integrity, availability, safety and confidentiality of the data involved in every transaction, as well as the necessary confidentiality of customer data. Both the setting of minimum-security standards and the responsibilities of participants in the open banking market are regulatory successes that will lay the groundwork for developing user's confidence in the system, a vital aspect in its proper operation.

Indeed, in two-sided markets “innovators” must solve their “Chicken-and-egg” problem: they have to attract users to their innovative business

model without having a well-established group of providers, but ¿how can they get these providers without first showing there's a group of users willing to try their platform? There is no better example in Chile today than the controversy involving Fintech firm Khipu and the incumbent Banco Estado. In short: Banco Estado unilaterally blocked the e-payment service offered by Khipu SpA to the bank's customers as a result of their implementation of anti-bot technology through at least one specialized provider, as the bank hoped to raise their cybersecurity and fraud prevention standards.⁷

The complexity of certain payment models introduced by the new Fintech firms and, above all, the increased flow of user information may lead to an increase in the risk of fraud, embezzlement, and customer errors as they delve into using these new services. The risks can be mitigated through the establishment of rules pertaining to responsibilities in cases of fraud, theft, technical or customer errors, and by establishing a conflict resolution system available to consumers.⁸ The phrasing of Article 24 in the draft bill is rather broad, making it unclear whether these actors will also be held responsible for customer errors. This could eventually become a barrier to entry for newcomers who lack the financial backing to take on such responsibility.⁹

On the other hand, the establishment of an exchange infrastructure, such as through APIs, implies significant costs related to installing, updating, and maintaining said structures. Determining who should bear this cost will depend on each market, and must be pondered while also considering that any answer must allow for the open banking model to be sustainable over time. The project considers, in article 25, the distribution of these costs, pointing out that information-providing institutions may not charge information-based service providers for communicating the client

⁷ Because of this Khipu presented a protection suit that is still being considered in the Santiago Court of Appeals, registered under Rol No. 37034 -2021.

⁸ Plaitakis & Staschen, *supra* note 4.

⁹ See Article 24, in Cámara de Diputados de Chile, Boletín No. 14570-05: “Promueve la competencia e inclusión financiera a través de la innovación y tecnología en la prestación de servicios financieros.”

data requested through APIs, except for the reimbursement of direct incremental costs that must be incurred in order to deal with the increased number of information requests that may exceed the threshold set by the regulator. It will therefore be interesting to see the discussion regarding this issue, and whether the resulting model will be sustainable in the long term.

The project also introduces a wide reach for actors, which will allow them to diversify their new services and create greater opportunities for competition and contestability in the financial market. This way, the entry of new Fintech companies and other authorized actors in the payments segment will be beneficial, insofar as it will increase the variety of products while access to data will allow them to be designed to fit the various kinds of consumers, including people with low incomes, women, and migrants

– those who have so far been outsiders to the system.

The main dispositions of this project definitely respond to the public policy goals set forth by the legislature, and no doubt will lead to the entry of new and better financial systems for Chileans, especially for currently underserved segments of the population. It is clear, from looking at the main dispositions – its mandatory nature, the standardization of API's, the responsibility regime for safeguarding user information, inter-operability and non-discrimination – that financial inclusion was a vital element in designing the system, and will be key during the discussion phase in Chile's Parliament.