TECHNICAL COOPERATION (TC) ABSTRACT

I. Basic project data

▪ Country/Region:	Regional
▪ TC Name:	Digital Finance 2025: Institutions and Innovation for Financial Inclusion in LAC
▪ TC Number:	RG-T2506
▪ Team Leader/Members:	Sylvia Gabriela Andrade (IFD/CMF), Team Leader; Gloria Lugo (IFD/CMF); Antonio Garcia (IFD/ICS), Monica Lugo (LEG/SGO), and Stephanie Suber (IFD/CMF)
▪ Operation Type	Client Support
▪ Date of TC Abstract:	June 4, 2014
▪ Beneficiary:	Latin America and Caribbean countries (LAC)
▪ Executing Agency and contact name	Inter-American Development Bank, through IFD/CMF
▪ IDB Funding Requested:	250,000
▪ Disbursement period	36 months
▪ Required start date:	September 31, 2014
▪ Types of consultants:	Firms and individual consultants
▪ Prepared by Unit:	IFD/CMF
▪ Unit of Disbursement Responsibility:	IFD/CMF
▪ Included in Country Strategy or CPD:	No
▪ GCI-9 Sector Priority:	Growth and Social Equity

II. Objective and Justification

2.1 The catalytic role of technological innovations and new business models to facilitate financial inclusion has by now been widely accepted and documented[1]. The agent banking model has been successful in several countries in LAC, allowing banks to expand formal financial services into areas where formal branches are deemed unfeasible. Innovations in digital payments can further facilitate access, notably thorough mobile payments, which offer the greatest potential for reaching the unbanked population thanks to the high penetration rates of mobile phones and the implied reduced transactions costs. The ability to transact digitally provides enhanced security and convenience for the users, facilitating transfers and payments of good and services, including basic public services and taxes, thereby increasing transparency and promoting formalization. More importantly, digital payments platforms represent the mechanism through which digital financial services can be offered and, therefore, financial inclusion delivered[2].

2.2 LAC still shows low levels of access and use of digital payments. According to FINDEX (2012), less than 2% of adults in LAC report having used a mobile phone to pay bills or receive money, whereas this percentage reaches 16% in Sub-Saharan Africa. Similarly, out of the 219 mobile money services, defined as the use the mobile phone to transfer money and make payments to the underserved, that existed by the end of 2013 in 84 countries, only 13% were in LAC. Regulatory

[1] Promoting technological and institutional innovation as a means to expand financial system access and usage is even one of the priorities of the Global Partnership for Financial Inclusion (GPFI) by G20 leaders.

[2] An expansion in the use of digital payments does not necessarily entail financial inclusion, which implies the access and use of a set of financial services provided with quality and at reasonable cost.

barriers have been one of the key factors hindering mobile payments, and the extent of services available in each country reflects existing regulations. Nonetheless, the Region experienced a 53% increase in these services during 2013, and 19 new services will be launched in the short term[3], reflecting in part regulatory reforms that are becoming more enabling. A few countries in LAC, such as Peru and Paraguay, have already established clear regulatory and institutional frameworks for mobile money, but many countries are still discussing what the most appropriate model is. Nonetheless, new regulations and reforms are generally only addressing mobile payments ("first stage") but not the provision of digital financial services ("second stage"), which entail even more complex regulatory and institutional issues that will need to be nonetheless addressed in the next 10 years along with the advances in digital innovations (hence "Digital Finance 2025") .

2.3 The objective of this TC is to enhance financial inclusion in LAC by supporting the identification and design of institutional structures and regulatory combinations that promote digital payments and financial services while ensuring that stability is preserved and consumers are protected. The objective would be achieved via: (i) deepening the knowledge of existing business models and the innovations expected in the next 10 years, (ii) analyzing institutional and regulatory frameworks to identify relevant reforms or new regulations or arrangements, and (iii) supporting two countries in the application of these activities. By supporting the expansion of access to financial services to low income households, this TC supports the Growth and Social Equity GCI-9 Priority. This TC will also contribute to IFD/CMF's Financial Inclusion Support Program and to the objective of improving the quality of services for citizens of the Special Program for Institutional Development.

III. Description of activities and outputs

3.1 **Component 1. Analysis of business models and the regulatory and institutional arrangements.** This component will include three activities: (i) a Background Paper analyzing the main existing business models for providing digital payments and digital finance, including experiences in other regions, the major advantages, challenges and perspectives for the next 10 years in the LAC context, and the regulatory landscape deemed appropriate for their development; (ii) An in-depth analysis of the institutional and regulatory frameworks needed to support countries still in the phase of implementing digital payments (stage 1); and (iii) An in-depth analysis of the institutional and regulatory considerations that would be required for digital financial services, including the new round of reforms that it would entail (stage 2). Validation workshops will be included as part of each activity. This component will fill the knowledge gap related to existing and future business models, and will provide specific recommendations related to the appropriate institutional organization and regulatory frameworks to foster digital transactions, which in turn, will provide citizens with more efficient and secure ways of paying public basic services and taxes, thereby allowing for an innovation in the relation between governments and citizens.

3.2 **Component 2. Support to the implementation in two countries.** This component will provide technical assistance to two countries to (i) diagnose their situation on the basis of the knowledge generated in component one and analyze the specific business models (both existing and expected), to provide specific recommendations for the institutional and regulatory arrangements needed; and (ii) support the implementation of the recommendations. Two countries facing a different stage will

[3] Source: GSMA's Mobile Money for the Unbanked Programme (2013).

be supported: one country where digital payments and the accompanying institutionally and regulations are still in early stages (Stage 1 countries, such as Nicaragua), and one country where digital payments are already regulated and more widely used, and thus digital financial more relevant (Stage 2 countries, such as Paraguay). This component will result in two clear interventions aimed at improving the delivery of digital payments and services to citizens, especially the unserved and underserved populations and firms.

3.3 **Component 3. Knowledge Dissemination**. This component will include the preparation of dissemination material and a Regional Conference where policy makers in LAC and industry leaders can discuss about the way forward given the intelligence generated through this TC.

IV. Indicative Budget

Activity/Component	Description	IDB/Fund Funding	Total Funding
Component 1		**130,000**	**130,000**
Background Paper	Preparation & validation	60,000	60,000
Stage 1 analysis/paper	Preparation & validation	35,000	35,000
Stage 2 analysis/paper	Preparation & validation	35,000	35,000
Component 2		**90,000**	**90,000**
Support country 1	Study & Implementation	45,000	45,000
Support country 2	Study & Implementation	45,000	45,000
Component 3		**30,000**	**30,000**
Dissemination material	Production & distribution	5,000	5,000
Regional Conference	Organization	25,000	25,000
TOTAL		**250,000**	**250,000**

V. Executing agency and execution structure

5.1 The IDB will be the executing agency, through IFD/CMF, a division with considerable experience executing similar types of programs. For the second component, a public sector entity involved in financial inclusion will be the counterpart and will be expected to organize and coordinate the participation of other relevant public sector entities. While all contracting will be conducted by the Bank, the counterpart will provide information on the execution of Bank-supported activities.

VI. Project Risks and issues

6.1 The main risk foreseen for this project relates to the countries' demand for participation. Nonetheless, as part of policy dialogue activities, notably in a Financial Inclusion conference organized by IFD/CMF in April 2014, several policy makers in LAC have stated that promoting the adequate regulation and institutional framework for the development and use of new technologies for financial inclusion is part of their policy agenda. Moreover, several countries are preparing a national strategy for financial inclusion, where typically regulatory and institutional aspects for technological innovations in financial services are included.

VII. Environmental and Social Classification

7.1 There are no environmental or social risks associated with the activities outlined in this TC. Therefore its environmental classification according to the Environment and Safeguards Compliance Policy (OP-703) is "C". See Safeguard Policy Filter Report (SPF) y Safeguard Screening Form (SSF).