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DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK
MULTILATERAL INVESTMENT FUND

REGIONAL

REGULATION FOR RESPONSIBLE AND COMPETITIVE FINANCIAL SECTOR INNOVATION

(RG-M1257)

DONORS MEMORANDUM

This document was prepared by the project team consisting of: Sergio Navajas (MIF/KEC), Alberto Bucardo (MIF/CME), Verónica Trujillo (MIF/KEC), Diego Herrera (IFD/CMF), Olver Bernal (IFD/CMF), Ignacio Barragán (GCL/LSO), Enedina Reyes (MIF/CME), and Paola Zorrilla (MIF/KEC).

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PROJECT SUMMARY

REGULATION FOR RESPONSIBLE AND COMPETITIVE FINANCIAL SECTOR INNOVATION

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Rapid technological development is having an impact on the structure of financial markets and traditional ways of doing business. New technologies are changing the structure of the financial sector on at least three levels: new services and distribution channels (online marketplace lending); the use of new back office technologies (cloud computing, blockchain, APIs); and the emergence of nontraditional actors such as the so-called "fintech" companies. The efficiency gains delivered by these new technologies cannot be ignored by a financial sector that has been facing lower rates of return and greater public scrutiny. However, the regional financial market cannot leverage the opportunities (e.g., greater efficiency, openness to other market segments), unless issues such as inadequate supervision and the persistent gaps in the existing regulations are overcome.

This project seeks to address the lack of regulation and supervisory practices by developing regulatory recommendations to facilitate the incorporation of business models, products, and services produced by financial innovation into the regional market in a stable, transparent, and competitive manner. The aim is to support the development of a regulatory framework attuned to regional market characteristics, so as to broaden market coverage and boost the contribution from productive activities by segments of society whose access to the financial market is either limited or only possible on uncompetitive terms.

To achieve these objectives, activities are proposed in four components. Firstly, the project will finance a survey of the business models, products, and services being offered based on technology platforms, in order to identify those with greatest potential for the region. Secondly, it will look at marketing practices, customer information and protection to ensure good conduct. Thirdly, information from the first two components will be used as an input for regulatory and supervisory recommendations contributing to the incorporation of new technologies in a stable, transparent, and competitive manner in the Latin American and Caribbean region's financial market. Lastly, a training and outreach program will be run to relay the project's recommendations to a wider audience. Drawing on experience from other regions, various working groups comprising experts in regulation and supervision will draw up detailed recommendations to speed up the rate of adoption of new technologies and so ensure that the region's markets remain competitive.

As these technologies are customer-facing, it is essential for the work done to address market conduct. The aim must be to match forms of selling to the needs of customers and investors in the sector. The project will therefore analyze issues including public information management, sales strategies, and consumer protection to complement the risk management topics that will be reviewed with the prudential oversight teams.

Lastly, seminars will be held to raise public awareness of the project outcomes and outputs. These will allow both public and private sector involvement, and a communication strategy will be developed that will make it possible to measure the impact of the recommendations over time. The project has a total cost of US$855,407,

and the MIF will contribute US$360,000 of that amount. The executing agency is the Association of Supervisors of Banks of the Americas (ASBA), which has 41 member institutions from 36 countries of the region.

ANNEXES

APPENDICES

AVAILABLE IN THE DOCUMENTS SECTION OF THE MIF PROJECT INFORMATION SYSTEM

ABBREVIATIONS

API	Application programming interface
ASBA	Association of Supervisors of Banks of the Americas
COF/CME	Country Office in Mexico
IDB/CMF	Capital Markets and Financial Institutions Division

REGIONAL
REGULATION FOR RESPONSIBLE AND COMPETITIVE FINANCIAL SECTOR INNOVATION
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EXECUTIVE SUMMARY

Country and geographical location:	Regional.
Executing agency:	Association of Supervisors of Banks of the Americas (ASBA).
Coordination with other donors/Bank operations:	The MIF will coordinate this work with the IDB Capital Markets and Financial Institutions Division (IDB/CMF) and particularly technical cooperation operation RG-T2631, which seeks to contribute to the development of an alternative finance regulatory framework in the region.
Direct beneficiaries:	41 supervisory agencies from 36 countries.
Indirect beneficiaries:	(i) Regulated and unregulated financial institutions; (ii) senior officials and general staff general staff of these financial institutions; (iii) current financial system consumers; and (iv) those unserved or underserved by the formal financial system.
Financing:	Technical cooperation: US$360,000 42% **TOTAL MIF CONTRIBUTION: US$360,000** Counterpart: US$495,407 58% **TOTAL PROJECT BUDGET: US$855,407 100%**
Execution and disbursement timetable:	Execution period: 36 months Disbursement period: 42 months
Special contractual clauses:	The following will be conditions precedent to the first disbursement: (i) approval of the Operating Regulations; and (ii) appointment of the project coordinator.
Environmental and social impact review:	This operation has been assessed and classified according to the requirements of the IDB's Environment and Safeguards Compliance Policy (Operational Policy OP-703). Given that the impacts and risks are limited, the proposed category for the project is "C."

Unit with disbursement responsibility:	The Bank's Country Office in Mexico (COF/CME).

I. BACKGROUND AND RATIONALE

A. Diagnostic assessment of the problem to be addressed by the project

1.1 The banking industry faces a variety of challenges in the post-2008 financial crisis scenario. These include an environment of low interest rates, implementation of new rules in line with international standards, and the presence of dynamic new competitors.[1] This environment is also jeopardized by highly uncertain macroeconomic conditions.

1.2 A new array of business models (or lines) and financial products and services influenced by technological innovation has emerged in recent years, such as online marketplace lending platforms and digital payments and deposits and support services (blockchain, APIs, cloud computing), seeking to change the way in which individuals and businesses access financial services.[2] Thus, for example, the platform-based finance industry grew from US$11.68 billion in 2014 to US$36.49 billion in 2015, equivalent to annual growth of 212%. Similarly, between 2013 and 2014 the funding attracted by financial technology, or "fintech," companies tripled from US$4 billion to US$12 billion.[3]

1.3 Additionally, the more competitive environment faced by the industry is leading it to explore the use of new technologies to achieve greater operational efficiency. One such technology is the blockchain. This is a database of blocks of user-created transaction records linked together in chronological order. The key feature of the blockchain is the way it keeps a record of all past transactions. Financial institutions are currently studying how to use blockchains to replace some of their current systems. Thus, for example, Banco Santander estimates that by 2022 this technology could save banks US$22 billion. Over 50 internationally active financial institutions recently set up a consortium called R3CEV (www.r3cev.com) to develop this technology.

1.4 Cloud computing, which allows users to access computing services (e.g., hardware, software, and services) on demand over the Internet, is another significant technology that can have a significant impact in terms of lowering the cost and improving the efficiency, flexibility, and speed with which financial activities are developed. However, it raises challenges such as information security and service reliability.[4]

1.5 Application programming interface (APIs) are sets of rules that information technology applications can follow to communicate with one another. They act as a secure interface between different programs without jeopardizing the integrity or confidentiality of customer information. The potential is huge, as it may be the first step on the way to the banks becoming platforms interacting with a wider ecosystem, and it may allow extremely flexible products to be designed. Regulators are aware that providing digital financial services has the potential to boost the financial sector's productivity and allow people wider access to, and use

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1 Wall Street Journal. "After Crisis, Banks' Model Faces Disruption." January 2016.

2 Cambridge Centre for Alternative Finance. "Breaking New Ground. The Americas Alternative Finance Benchmarking Report." April 2016.

3 Accenture. "The future of FinTech and Banking; Digitally Disrupted or Reimagined" 2015.

4 Banking Technology. "Six Reasons Why Cloud Computing Will Transform the Way Banks Serve Clients and the Five Hurdles to Overcome." July 2014.

of, financial services.[5] Opportunities exist to generate lower cost, faster, more flexible and efficient financial services that are better tailored to consumers.[6]

1.6 The use of new supporting technologies, such as blockchain, cloud computing, or APIs, can help financial businesses operate more efficiently. For their part, technologies such as cloud computing represent a means of optimizing resource use not just in the supervised sector but also in market supervision.

1.7 However, these new technologies also carry new risks[7] in such areas as:

- Financial crime and illegal transactions;
- Risks affecting information storage, handling and use (including confidentiality issues); and
- Technical issues that may affect reputation, interrupt or impact business, or even create the conditions to trigger a systemic crisis.

The growth of these models, products, and services raises the potential for crises emanating from cyberspace. The risks include the possibility of a series of attacks on financial institutions[8] or their users, the use of the technology for illegal purposes, etc.

1.8 Technological progress and the widespread use of the Internet have led to a new type of entity generically referred to as fintech companies. There have been various attempts at a classification of fintech companies based on the type of service they offer (P2P, crowdfunding, etc.) or the different underlying internal structures. However, one common feature is they offer financial services that until recently were the exclusive domain of financial institutions. They also offer entirely new services, such as peer-to-peer (P2P) lending, or online loans that did not previously exist or were limited.

1.9 What role should financial regulators play in this new scenario of technologies, players, and services? What should the new perimeter of regulation be? What is the role of the stock market regulator? Innovation has always existed in financial markets, but the pace of change today is clearly different.

1.10 As well as the pace of change, another differentiating factor in this new wave of innovation is its growth potential. In principle, it is easier to replicate and scale up these innovations because many of them share some form of online platform. In the recent past, expanding a service took time, as it required, for example, new branches to be opened, or agreements and systems with a correspondent bank. Yet it is now possible to distribute services using technology without the need for branches or agreements between operators.

1.11 The rapid rate of technological innovation in the financial sector poses a challenge for financial sector regulators. This challenge is due to the fact that new regulations must take a number factors into account, such as each country's legal tradition, the

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5 Menon, Ravi. "A Smart Financial Center." June 2015.

6 Dombret, Andreas. "Totally Digital? The Future of Banking Business." November 2015.

7 Menon, Ravi. "A Smart Financial Center." June 2015.

8 Comments by Greg Medcraft, Director of the International Organization of Securities Commissions (IOSCO) reported in "Totally Digital? The Future of Banking Business" by Andreas Dombret.

number and significance of the new players, customer identification, the technologies deployed, etc. Regulators must also look at whether they have the necessary authority, analysis capacity, and responsiveness to serve this segment of the market. An interesting approach is that taken by the United Kingdom, which has created confined regulatory spaces in order to understand the possible risks of an operation or business model based on technological innovation. These so-called "regulatory sandboxes" are an interesting option in which to try out new alternatives in a controlled environment. This is particularly important to prevent unacceptably risky operations and avoid regulators investing scarce resources in unpromising initiatives.

1.12 In any event, it is important that any new financial market players take into account a series of requirements, such as minimum institutional strength, transparency, and customer protection. The case of the Lending Club in the United States offers a recent example of the importance of proper regulation and supervision. This fintech company, a leader in online loans, found itself in trouble after having sold a portfolio of loans in which information had been manipulated fraudulently. The irregularity was detected by the entity and led to the resignation of its CEO, raising questions about this new industry.[9] This is the first case of this kind concerning these technologies, but it cannot be ruled out that there will be more, with the potential erosion of trust in the financial system in general (reputational risk).

1.13 In response to a growing market and with potential risks such as that alluded to in the preceding paragraph, regulatory efforts have been seen in some jurisdictions concerning the control and monitoring of financial innovations. The world's largest financial market based on new technology is in the United States, where the Office of the Comptroller of the Currency (OCC) is exploring regulations for fintech and their responsible, competitive, transparent, and sustainable incorporation into the financial system.[10] Along the same lines, the U.S. Department of the Treasury has issued recommendations for public and private sector players in the online lending market.[11]

1.14 In China, the world's second largest online lending market,[12] the banking regulator has established specific licenses for banks that operate solely online, and has granted licenses to large companies specializing in the Internet, such as Alibaba (an online shopping portal) and Tencent (social networks).[13]

1.15 The Monetary Authority of Singapore (MAS) has taken a proactive approach to the subject, in which coordination with the banking industry plays an important part. It has therefore partnered with the industry to create the Smart Financial Centre,

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[9] Wall Street Journal. "Lending Club CEO Resigns Following Loan Sales Review." May 2016.

[10] Office of the Comptroller of the Currency "Supporting Responsible Innovation in the Federal Banking System: An OCC Perspective." March 2016.

[11] U.S. Department of the Treasury. "Opportunities and Challenges in Online Marketplace Lending." May 2016.

[12] Zhang, B., et al., "Harnessing Potential: The Asia Pacific Alternative Finance Benchmarking Report." 2016.

[13] Wall Street Journal. "Alibaba Affiliate Launches Online Bank Despite Regulatory Hurdles." June 2015.

which will promote innovation and technology to make risk management sounder and more efficient.[14]

1.16 In the United Kingdom, regulation of technology-based finance is the responsibility of the Financial Conduct Authority (FCA), whose regulations envisage exceptions for marketplace lending schemes (including crowdfunding). In this regard, it allows the operation of collective investment platforms when the total average funds managed by the site remain below 5 million euros a year.[15]

1.17 In Latin America regulatory efforts aimed at mobile financial services (El Salvador), e-money (Bolivia, Brazil, Colombia, Ecuador, Paraguay, Peru and Uruguay), and crowdfunding (Mexico) have been reported.[16]

1.18 Despite these efforts, at the regional level, awareness of new technologies and the business models being developed is still inadequate. Regulation could therefore be developing in a partial way or focusing on operators rather than operations. It is therefore essential to understand the technologies, business models, and potential risks for the financial sector in order to develop standards allowing them to enter the financial sector in a stable, transparent, and competitive way.

1.19 The work of developing supervision methods and standards cannot be done without an active and open dialogue with both regulated entities and the players in the fintech market segment. This would make it possible to develop proposals allowing the objectives of this project to be achieved.

1.20 For the reasons noted, this project comes in response to technological innovations in the financial sector that entail new risks and the need to consider regulating them. The objective of this initiative, therefore, is to establish regulatory guidelines for incorporating innovative technologies responsibly, sustainably, transparently, and competitively.

B. Project beneficiaries

1.21 The direct beneficiaries are 41 supervisory agencies of 36 countries. The indirect beneficiaries include institutions and individuals: (i) regulated and unregulated financial institutions; (ii) senior officials and general staff of these financial institutions; (iii) current financial system consumers; and (iv) those unserved or underserved by the formal financial system.

C. Contribution to the MIF mandate and IDB Strategy

1.22 The financial sector's development and stability is fundamental for economic growth. This being the case, the introduction of new technologies in the sector, with the potential to raise efficiency and provide services to different segments of the population, is clearly an important opportunity. However, when committing third-party funds that, in many instances, come from segments of society with limited resources, the State is obliged to establish standards to safeguard market stability and transparency, and to ensure the market develops on a level playing field and the financial sector retains a sense of customer service.

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[14] Menon, Ravi. "A Smart Financial Center." June 2015.

[15] Crowdfund Insider. "Equity Crowdfunding in Europe: Where it Stands." June 2013.

[16] Expansión CNN. "Crowdfunding, listo para regularse en México" [Crowdfunding Ready to be Regulated in Mexico]. April 2016.

1.23 Expanding opportunities for access and management of financial resources will not only attract significant investment growth in the sector, but also contribute to expanding economic activities. Seed capital for the development of financial sector applications has grown exponentially in the past five years. Moreover, ease of access and use of new technologies has made it possible for users to find financial services that meet their needs, regardless of their production segment.

1.24 Expanding opportunities for access and management of financial resources will not only attract significant investment growth in the sector, but also contribute to expanding economic activities that cannot currently achieve scale due to their lack of access or lack of financial products and services matching the income generating profiles of economic agents in different production segments.

1.25 This project will help the MIF meet its objective of testing new models that contribute to the economic development of Latin America and the Caribbean. Specifically, it will help strengthen the business and financial system innovation ecosystem by working directly with the association bringing together the region's regulators.

1.26 Other arms of the IDB Group clearly also have a mandate to work with regulators. One of the most important is the Capital Markets and Financial Institutions Division (IDB/CMF), which supports the strengthening of financial supervision and regulatory frameworks to improve transparency and create an environment conducive to investments and wider access to credit. This project will coordinate its actions with this office to avoid duplicating efforts, and, at the same time, to achieve a consistent vision for the IDB Group. Although collaboration will be ongoing, the explicit points of coordination will be the launch workshop and six-monthly reviews of the project.

1.27 To ensure consistency, collaboration, and feedback there are two major activities in the IDB/CMF's work that will be used as input when implementing this project. The first activity is a technical assistance operation administered by IDB/CMF to develop an alternative finance regulatory framework in the region (RG-T2631). The second major activity is the public/private sector regional dialogue organized by IDB/CMF with the Association of Supervisors of Banks of the Americas (ASBA) and the Latin American Federation of Banks (FELABAN), to be held in September 2016.

II. OBJECTIVES AND COMPONENTS

A. Objectives

2.1 New technologies are changing the structure of the financial sector on at least three levels: new services and distribution channels; the use of new back-office technologies (cloud computing, blockchain, APIs); and the emergence of nontraditional actors such as fintech companies. This project seeks to contribute to financial innovation processes by developing regulatory and supervisory guidelines for the incorporation of stable, transparent, and competitive business models, products, and services deriving from innovation in the financial sector.

2.2 Developing regulatory and supervisory frameworks that work well for financial development based on new technologies in the region's markets has a number of

advantages. In particular, the ease of access and use of these new technologies should increase market coverage.

B. Description of the model/solution/intervention

2.3 Three intervention models will be implemented to achieve these objectives: technical analysis, promotion of dialogue, and training activities. As part of the technical analysis, the project will support: (i) discussions by working groups of experts from the association's member entities; and (ii) consulting services.

2.4 To ensure the relevance and adoption of recommendations on prudential and nonprudential (e.g., consumer protection) regulation, the project will support: (iii) high-level technical discussions on policy and regulation; (iv) stakeholder workshops; (v) high-level meetings with standards issuers or financial stability advisors; and, (iv) public-private dialogues.

2.5 Lastly, for practical knowledge transfer to implement the project's guidelines and recommendations, the project will support: (vii) regional training activities and (viii) programs to disseminate the project outcomes.

2.6 The final outputs of these activities will be reports and guides that give interested audiences access to the conclusions and resulting recommendations.

2.7 As can be seen, components 1 to 3 will rely on the work of experts specifically engaged to support the working groups. Component 4, however, is part of the dissemination of recommendations at the regional level.

C. Components

2.8 This project will be implemented as a series of activities distributed over four components. Experts' services will be contracted in all four components, while the first three will be complemented by the work of supervisors from the region, organized into expert groups. Input will also be sought from industry representatives in discussions organized specifically for such purpose.

Component I: Identification of regulatory gaps and opportunities in financial innovation (MIF: US$85,720; Counterpart: US$81,109)

2.9 The objective of this component is to identify regulatory gaps and opportunities, both with traditional financial system actors (incumbents) and with new entities. The first part of the work in this component will be to review those technologies with greatest potential to change the structure of the financial sector in the regional context. The aim will be to cover, by way of introduction, at least three key topics: cloud computing, blockchain, and APIs.

2.10 Thus, this component will: (i) review the relevance of new technologies for financial sector infrastructure; (ii) describe business models, products, and services powerfully influenced by new technologies, whether used by traditional financial institutions or new players; (iii) systematically document regulatory and supervisory know-how; and (iv) identify regulatory gaps and opportunities and discuss them with the private sector to find practical answers.

2.11 The discussions with the private sector will aim to ensure a level playing field by identifying potential undesired impacts of the recommendations being drafted. To this end, proposals will be shared in structured discussions addressing them from

the point of view of the regulations, the desired impact, potential undesired impacts, and proposals for mitigation.

2.12 To achieve the objectives mentioned above, with the MIF's support, the services of experts on the analysis of business models, products, and services based on technological innovation will be engaged, in order to: (i) produce a descriptive reference framework (short inventory); (ii) analyze the risk profile (credit, operational, market, liquidity, and reputational risk) of those they consider most widely used and which entail the greatest risk for customers or the market; and (iii) identify the regulatory challenges and opportunities for their management. This analysis will provide input to a regulators' working group that will identify the regulatory gaps and opportunities to address them with the industry at a technical discussion event.

2.13 These efforts will lead to documents that: (i) describe the technologies with the greatest potential in the region; (ii) analyze the business models, products, and services based on technological innovation; and (iii) identify the areas requiring regulatory development or changes in supervision mechanisms. The documents must also show how the proposals advanced in them will contribute to competitive, transparent, and sustainable incorporation of new technologies in the region's financial markets. These analyses will reflect the opinion of all parties with an interest in the development of this market segment.

Component II: Financial market conduct and transparency (MIF: US$78,220; Counterpart: US$100,089)

2.14 The development and incorporation of business models, products, and services based on technological innovation through unregulated providers targets a broad customer population whose main feature is its heterogeneity in terms of familiarity and sophistication in the management of financial products and services.

2.15 An initial review of the description of some of the products and services, the technologies used for their development and management, and the forms of marketing will make it possible to identify the key issues to ensure fair treatment and quality services for customers. The issues giving rise to most concern with the introduction of these innovations include:

- The lack of transparency in product characteristics and marketing practices, especially the handling of customer information (i.e., What is public and what is private? What limitations can it lead to on access to credit? What mechanisms are there to correct information? What options does the customer have for recourse?)
- Potential for regulatory arbitrage (i.e., how can regulated financial sector consumer guarantees be applied to these new service providers?) What type of rules apply to agents or marketers of these products? and dispute resolution issues.

2.16 Consequently, this component will look at market conduct in relation to at least three of the most widely used products or services and the potential for their use in the region to establish minimum regulatory conduct guidelines. These products will be directly related to those identified in Component I, so as to ensure project consistency.

2.17 To achieve the aforementioned objective, experts on the analysis of financial sector market conduct will be engaged with a view to bringing financial services to customers with limited access and market analysis capacity. These experts will prepare a report describing marketing practices, communication, understandability of the information provided to customers, and the sale of products and services. One key factor to be taken into account in this work is the delivery of financial services through digital media, since customers can enter into a relationship with a financial institution (or financial services provider) without having to go to the service providers' offices or even needing to know where they are based.

2.18 The information obtained will allow an expert working group in market conduct analysis to develop conduct regulation and supervision guidelines to ensure this innovative market's transparency, customer focus, and stability. This group will also have to address the potential reputational risks that may arise due to the impossibility of dealing directly with customers in many cases and following the movement of funds in electronic mediums.

2.19 The guidelines developed will be addressed at a technical discussion workshop with the industry, to ensure their coordinated implementation and to share responsibility for incorporation of financial operations originating in financial innovations based on transparency and due attention to demand from financial sector customers.

Component III: Regulation for responsible and competitive innovation in the financial sector (MIF: US$69,940; Counterpart: US$139,309)

2.20 The development of regulatory frameworks incorporating financial innovations in the regulated market will support the development of the financial sector in the region. The lack of stable, flexible regulatory frameworks adapted to risk and, in particular, to the risks that financial innovation may give rise to, have a dual effect. The first effect is the emergence of shadow banking activities (unregulated financial services and entities). Having a regulatory framework would make it possible to establish the limits, responsibilities, and risks entailed by the delivery of financial services outside the regulated sector without hindering their development, but getting a true sense of the scale of their implications. The lack of regulation makes this impossible at present. The second effect is the limitation of market development due to the legal uncertainty investors face given the absence of a regulatory framework.

2.21 This component ties together the outcomes of Components I and II, to propose a series of regulation and supervision recommendations enabling the region to adopt stable practices sensitive to market structures for the incorporation of new technologies.

2.22 The services of an expert in regulation will be engaged to perform the work described in the preceding paragraph. This expert will compile the accumulated knowledge and develop recommendations on regulation and supervision procedures that are based on principles of risk sensitivity, proportionality, stability, and transparency. These recommendations will be geared toward the sustainable incorporation of business models, products, and services deriving from financial innovation in the region.

2.23 The expected outcome of this component is a document with recommendations for the development of standards on the incorporation of business models, products, and services supported by technological development. This document will also contain recommendations for the supervision of the aforementioned activities.

Component IV: Dissemination and training (MIF: US$59,620; Counterpart: US$174,900).

2.24 The systematic documentation of knowledge gained from this initiative will be disseminated through training seminars and an outreach program specifically developed for the purpose.

2.25 The objective of this component is to organize the material and the outcomes achieved to implement a training program on regulation and supervision of the business models, products, and services based on, or deriving from, financial innovation.

2.26 This component's activities include the documentation of materials, development and implementation of a training program, and development of materials and media for the dissemination of project outcomes, in order to achieve the widest possible public awareness and adoption of them in the region.

D. Project governance and execution mechanism

2.27 The ASBA General Secretariat will be the project executing agency and will be responsible for coordination and implementation of the tasks set forth in the project work plan. It will also lead and execute the processes of contracting goods and services and organizing work groups. This work will be done through its three area divisions responsible for the management of financial and nonfinancial resources, operation coordination and execution, and technical analysis.

2.28 The ASBA General Secretariat will conduct its tasks in accordance with its consultation processes and internal oversight mechanisms by coordinating with two senior bodies: (i) the Board of Directors; and (ii) the Technical Committee. The Board of Directors will act as the governing body for the Secretariat. To do so, it will review and authorize the project work plan and access its information to conduct the relevant control and monitoring.

2.29 The Technical Committee will be responsible for ensuring that the technical work meets the region's needs and is aligned with best practices in financial sector regulation and supervision. It will therefore review the terms of reference for the procurement of services, review preliminary and final reports, and ensure that working groups meet the established objectives.

2.30 For goods and services procurement processes the executing unit has a procurement mechanism specifically developed to comply with IDB/MIF policies and procedures.

2.31 The outputs of each component will be approved by the Board of Directors, which will recommend their adoption to the ASBA members, as best practice recommendations for the incorporation of new technologies in the regional financial sector.

E. Sustainability

2.32 A sustainability workshop will be held six months after the end of execution with all entities involved, to identify the measures necessary to ensure the continuity of the project activities once the funding has ended.

2.33 The project's governing body will also strengthen the ASBA's capacity to reach agreements for the standardization of regulatory practices and supervision strategies, and their adoption across much of the region. This will ensure both the sustainability of the project and the usefulness of its outcomes.

F. Lessons learned from the MIF and other institutions in project design

2.34 The recommendations of previous successfully implemented projects have been taken into account in the design of this project. These recommendations refer to the setting of achievable intermediate targets and the definition of objectives whose fulfillment is readily measurable. As a result, the intermediate targets are smaller, and the indicators derive from the tasks and budget executed.

2.35 In order to run several activities in parallel successfully, the executing agency has a project management system that allows scheduling, resource management, activity monitoring, identification of intermediate targets, and timely oversight of incomplete tasks.

2.36 Lastly, the procurement system for goods and services makes efficient use of time and provides certainty in the monitoring of activities, so that procurement activities can start on schedule.

G. MIF additionality

2.37 **Nonfinancial additionality.** Over the years in which ASBA has worked with the MIF, significant progress has been made on strengthening the regulatory framework for microfinance, access to financial services, transparency, and due attention to the sector's customers, enriching the supervisory dialogue, and coordination with the region's financial sector.

2.38 Projects conducted with MIF support have had a progressive impact on the development of the financial sector in the region. This allowed the consolidation of a training program that has been operating highly successfully for sixteen years. It has also guided the development of microfinance in the region, whose growth and contribution have been widely reported and is partly explained by the stability and soundness of the regulatory framework. Subsequently, the MIF supported the incorporation of new prudential recommendations mainly regarding capital management and liquidity that emerged from the financial crisis and led to the development of nonprudential regulation (e.g., consumer protection, financial education, and market transparency), strengthening financial inclusion activities in the region. This project is part of this progression, in that it aims to take technological development in finance to incorporate it in regulation and supervision as means of giving it stability, transparency and a level playing field for competition in the financial market.

2.39 In view of the foregoing, the ASBA benefits strongly from its reputation, technical capability, cumulative knowledge gained on the subjects it deals with, and the

experience of its technical team on matters of financial sector inclusion and development for economies such as those of the region.

2.40 The ASBA also benefits from the MIF's drawing power in the financial sector. This facilitates technical discussions with the sector, where topics causing particular tension can be dealt with in an atmosphere conducive to arriving at solutions allowing both parties to achieve their specific goals.

2.41 Furthermore, the MIF makes it possible to enrich the knowledge acquired in the region through its work in coordination with other IDB units that have built a body of highly valuable work, information, and knowledge.

2.42 **Financial additionality.** The ASBA is funded by its members. Since these funds are of public origin, they are executed within a strict control framework to address multiple demands for knowledge development, training, representation of regional positions before standard-setting bodies, etc. As a result, external funding is essential for special projects such as the one described here. The ASBA therefore has turned to the MIF as cofinancier and key partner for this initiative to address one of the biggest challenges now facing the financial sector.

H. Project outcomes

2.43 The expected outcomes of this project will be verified through (i) the sustained growth of financial transactions based on new technologies; (ii) the adoption of its recommendations in at least five countries of the region, especially in the Central American and Caribbean region; (iii) improved market transparency and attention to customers' needs; and (iv) training of at least 60 officials in the region on regulation and supervision of new financial technologies.

I. Project impact

It will be possible to verify the project's impact through the stable, competitive, and transparent development of the region's financial markets based on new technologies; reduced tension between innovative and traditional business models; more focused attention on the various financial market segments, particularly those with limited access to financing opportunities or that make relatively little use of the system.

J. Systemic impact

2.44 The project's systemic impact will be significant. Incorporating new financial technologies in effectively regulated and transparent environments will keep the high-risk inorganic growth that this can entail in check, enabling the region's financial systems to become more diverse, and deepening its markets.

2.45 Considering the rate and volume of growth in financial transactions based on new technologies, as well as analyzing their forms of promotion and placement, it is important to establish a reasonable number of rules to safeguard financial market stability, promote transparency, and maintain a level playing field.

III. MONITORING AND EVALUATION STRATEGY

3.1 **Monitoring.** The General Secretariat of the Association of Supervisors of Banks of the Americas (ASBA) will establish a series of surveys to monitor the degree of

adoption of the project's recommendations, impacts on market development, and measurement of the strength of market conduct.

3.2 The training programs will allow the data provided by the surveys to be confirmed, and roundtables will be supported to analyze possible defects or shortcomings in the recommendations made.

3.3 Lastly, through predefined interviews, supervisors will be contacted to compare opinions on the effectiveness of recommendations or supervisory approaches.

3.4 **Evaluation.** In view of the amount and scope of the project, final evaluation is expected to be conducted after project implementation, as well as two ex post evaluations. These will not only be financial in nature, but also evaluate operations to confirm adherence to procurement policies and execution commitments. These evaluations will be conducted by technical staff engaged by the MIF in agreement with the IDB Capital Markets and Financial Institutions Division (IDB/CMF).

3.5 **Closing workshop.** The executing agency will organize a **closing workshop** at the appropriate time in order to evaluate the outcomes achieved, jointly with other agents involved, and identify additional tasks necessary to guarantee the sustainability of the actions begun by the project, and identify and disseminate the lessons learned and best practices.

IV. COST AND FINANCING

4.1 The project has a total cost of US$855,407. Of that amount, US$360,000 (42%) will be contributed by the MIF, and US$495,407 (58%) by the counterpart. Part of the counterpart contribution will be in kind (15%), and the difference (43%) in cash. The cash contribution will come from the ASBA members. The program execution period will be 36 months, and the disbursement period, 48 months.

	MIF (US$)	Counterpart (US$)		Total (US$)
		Cash	Kind	
Project components				
Component 1: Identification of regulatory gaps and opportunities in financial innovation	85,720	39,220	41,889	166,829
Component 2: Financial market conduct and transparency	78,220	58,200	41,889	178,309
Component 3: Regulation for responsible and competitive innovation in the financial sector	69,940	97,420	41,889	209,249
Component 4: Dissemination and training	59,620	170,300	4,600	234,520
Execution and supervision				
Executing agency/administration	40,500			40,500
Final evaluation	10,000			10,000
Ex post review/audits	12,000			12,000
Contingencies	4,000			4,000
Total	**360,000**	**365,140**	**130.267**	**855,407**

V. EXECUTING AGENCY

5.1 The project executing agency will be the Association of Supervisors of Banks of the Americas (ASBA), which will sign the agreement with the Bank. The ASBA is a nonprofit civil association governed by its bylaws and headquartered in Mexico City, Mexico. The ASBA is an umbrella association for 41 financial sector regulation and supervision agencies from 36 countries in the Americas plus Spain. The ASBA's origins date back to 1982 with the creation of the Commission of Banking Supervision and Regulation Agencies of Latin America and the Caribbean, which was replaced in 1991 by the Association of Banking Supervision Agencies of Latin America and the Caribbean (ASBALC). The ASBA was formally established on 14 May 1999.

5.2 The ASBA's main strengths are that it is a forum for information exchange, a center through which to channel cooperation, and to circulate information between its members. It plays a strategic role in coordinating relationships between its members. Additionally, it produces regulatory standards facilitating the approval of local regulations, and coordinates liaison with other organizations outside the region, such as the Bank for International Settlements (BIS). As regards one potential weakness, it should be noted that the agreements promoted by the ASBA take time, as every proposal has to be approved by all 41 members. However, this weakness becomes a strength at the time of implementation, as the members implement what they have previously agreed.

5.3 The ASBA's mission is to help strengthen banking regulation and supervision and financial system stability in the region by actively sharing information and disseminating outcomes; providing support and services to build technical capacity and leadership; adopting healthy supervision practices; and promoting relevant and timely international dialogue.

The ASBA is financed with contributions from its members, who provide a significant sum in counterpart resources. Financing is key to the development of the ASBA's work and only covers essential expenditure to carry out technical work not covered by member contributions. Training is the priority for many countries, so the bulk of the ASBA's funds are devoted to it. However, part of the ABSA's technical agenda is research into topics relevant to the region's financial systems, for which additional financing is sought.

5.4 In terms of past experience with the MIF, the following outcomes can be cited from the final evaluation of the most recently executed technical cooperation operation, which included a financial inclusion component: (i) 98% of respondents considered the recommendations/guides to be useful for their day-to-day work; (ii) 78% have implemented at least one of the recommendations in their jurisdiction; (iii) 54% plan to implement the recommendations/guides in the near future; (iv) 95% consider that the ASBA's work has an impact on their jurisdiction.

The ASBA will maintain its General Secretariat as the executing agency. The General Secretariat has the necessary structure and experience to implement the activities effectively and efficiently and to manage the project resources. The ASBA will also be responsible for delivering status reports on project implementation.

VI. PROJECT RISKS

6.1 The following risks for the effective and timely execution of the project can be identified from prior experience:

- Likely insufficient information.
- Few experts on the topics to be analyzed.
- Lack of interest from the industry in technical dialogues.
- Insufficient interest from regulatory agencies in training their professional staff.

6.2 A number of the risks mentioned may be controlled through the project governance system. The involvement of the Board of Directors and the Technical Committee will ensure that members are engaged and that activities of interest, and for which there is a pressing need in the region, will be analyzed.

6.3 The involvement of third parties, particularly from industry, is expected to be backed by the MIF to manage its involvement in project implementation.

VII. ENVIRONMENTAL AND SOCIAL IMPACT

7.1 This operation has been preassessed and classified according to the requirements of the IDB's Environment and Safeguards Compliance Policy (Operational Policy OP-703). Given that the impacts and risks are limited, the proposed category for the project is "C."

VIII. FULFILLMENT OF MILESTONES AND SPECIAL FIDUCIARY ARRANGEMENTS

8.1 **Results-based disbursements and fiduciary arrangements.** The executing agency will commit to the MIF's standard arrangements for results-based disbursements, procurement, and financial management as specified in Annex 6.

IX. ACCESS TO INFORMATION AND INTELLECTUAL PROPERTY

9.1 **Access to information.** Project information is not confidential under the IDB's Access to Information Policy.