

## Technical Cooperation Document

### I. Basic Information for TC

Country/Region:	Latin America and the Caribbean region
TC Name:	Support to the Development of Alternative Finance in LAC countries: ICT and Regulatory Approach
TC Number:	RG-T2631
Team Leader/Members:	Diego Herrera (IFD/CMF, Team Leader), Gloria Lugo (IFD/CMF), Emilio Laguillo (IFD/IFD), Alison Arauz (IFD/CMF) and Escarlata Baza (LEG/SGO)
Taxonomy	Research and Dissemination
Date of TC Abstract authorization:	June 8, 2015
Beneficiary:	Latin America and Caribbean borrowing country members
Executing Agency:	Inter-American Development Bank, Capital Markets and Financial Institutions Division (IFD/CMF)
Donors providing funding:	Special Program for Broadband Services, Broad Band Fund (BBD)
IDB Funding Requested:	US\$220,189
Local counterpart funding, if any:	N/A
Disbursement period (Execution Period):	24 months (36 months)
Required start date:	January, 2016
Types of consultants:	Firms and individuals
Prepared by Unit:	IFD/CMF
Unit of Disbursement Responsibility:	IFD/CMF
TC Included in Country Strategy:	N/A
TC included in CPD:	N/A
GCI-9 Sector Priority:	Institutions for growth and social equity

### II. Objectives and Justification of the TC

- 2.1 **Alternative Finance.** Alternative finance<sup>1</sup> (AF) or Crowdfunding<sup>2</sup> is described as the evaluation and use of small amounts of money coming from a large group of individuals, sometimes hundreds or thousands of them, to fund projects or existing businesses of all sizes in the form of equity (equity-based) or personal and corporate loans (lending-based). Issuers and borrowers place an open call through internet-based or mobile platforms and applications to offer their projects, most of the times in a social-media fashion. To understand AF, it is useful to tear apart the definition in two. First, the large group of individuals is “the crowd”, individuals who are surfing the internet looking for investments. Second, there is financial and non-financial crowdfunding, depending on the expectation that individuals from the crowd have on their investments. For the sake of simplicity, this TC is about the former, when the crowd is looking for financial returns in the form of equity and dividends or interests and capital.

<sup>1</sup>Peter Baeck, Liam Collins and Bryan Zhang. (2014) “Understanding Alternative Finance: The UK Alternative Finance industry Report 2014”. University of Cambridge.

<sup>2</sup>Eleanor Kirby and Shane Worner (2014): “Crowd-Funding: An Infant Industry Growing Fast”. IOSCO, Madrid.

Third, this is perfectly possible because of technology and the existence of crowdfunding platforms, websites and social media, where the “campaigns” or offerings are advertised.<sup>3</sup> In addition, these platforms are receiving and holding contributions from investors, distributing them to issuers and later reimbursing interests or dividends to investors. Finally, the so-called campaign is just the proposal of all the activities associated, which are posted in the internet as an offering.<sup>4</sup>

- 2.2 **AF Categories.** AF has opened space for alternative ways for lending and building equity, mainly, to individuals and Small and Medium Enterprises -SMEs<sup>5</sup>-, giving a chance for innovations and for borrowers and entrepreneurs to obtain funds at lower costs and alternative forms of income generation for investors. As said before, this document will focus on financial return AF. This category includes both equity-based and loans-based AF. The former is the type of AF where a project is posted in a platform, hoping to get funding, the crowd funds the project awaiting for financial return in the manner of equity and dividends. The most prominent example of this type of AF is CircleUp.<sup>6</sup> The latter is the fastest growing type of AF, consisting mainly of people borrowing money for a large list of causes, from small business to education, from consumption to medical procedures, and the crowd willing to fund projects for the sake of a periodical return in the form of interests and capital. This looks simple, but the model has evolved in a million of different versions, being the most popular: (i) the denominated Peer-to-Peer, where the platform is simply meeting borrowers and their projects and individual lenders; and (ii) the securities-based model, which is based on the issuance of loan-backed notes.<sup>7</sup>
- 2.3 **Ecosystem and Broadband.** The AF ecosystem consists of all the platforms and technological and financial services that allow it to work well such as credit scoring, marketing, data analysis, origination software, trading, custody and administration tools, to mention a few. Hence, ecosystem requires proper access and performance of broadband, since these are technological platforms offering services for investments and lending through the internet or mobile applications. Furthermore, as it is non-existent in most of the countries, an institutional framework and dedicated regulation covering both ITC and financial services are required.
- 2.4 **Growing Business.** Alternative finance is a growing business worldwide,<sup>8</sup> accounting for almost US\$16,2 billion in money raised to fund projects through platforms as of the end of 2014.<sup>9</sup> According to BBVA, the Spanish banking group, by the end of 2013, these platforms were financing 1

<sup>3</sup>For more information/example see link: [www.kiva.com](http://www.kiva.com).

<sup>4</sup>Inter-American Development Bank (2014) “Crowdfunding in Mexico: The Power of Digital Technologies to Transform Innovation, Entrepreneurship & Economic Inclusion. Multilateral Investment Fund, Access to Markets and Skills. Washington, DC.

<sup>5</sup>Caveat Emptor Banking: Peer-To-Peer Lending Challenges Too-Big-To-Fail Status Quo. *Forbes Magazine*. Retrieved February 11, 2015.

<sup>6</sup>[CircleUp.com](http://CircleUp.com)

<sup>7</sup>A detailed description of the models can be found in: Kirby and Worner (2014).

<sup>8</sup>Agrawal, Catalini & Goldfarb (2011). The Geography of Crowdfunding. NBER Working Paper N° 16820.

<sup>9</sup>[Global Crowdfunding. The Economist.](#)

cent per every US\$100 financed through traditional channels.<sup>10</sup> Although its size is not systemic yet, at the current size of growth, industry could reach more than ten times its current size by 2020.<sup>11</sup> These numbers can vary according to the source of information, and since regulation is reaching the AF ecosystem, data is in the process of consolidation. Looking to the statistics available in their websites for the US three largest participants can give a hint of the size of the industry, mainly that of marketplace lending. First, Lending Club affirms that they have funded US\$13 billion in more than a million loans since 2008. Statistics show quarterly loan issuance growing up to US\$4 bln for the third quarter of 2015.<sup>12</sup> OnDeck,<sup>13</sup> which is a platform devoted to lend to small and medium enterprises accounts for loans reaching around US\$3 billion, Prosper Marketplace<sup>14</sup> has funded US\$5 billion. This data does not count the dozens of existing originators, which could increase the current lending amount.

- 2.5 **Latin America and The Caribbean (LAC) and AF:** Latin America and the Caribbean countries are not excluded of this new phenomenon, the appearance and growth of these platforms all across the region, posing a challenge for ICT and financial regulators, since this business, although still small in size, is new and different to traditional banking, based on disruptive technologies, complicated, and not regulated. In 2012 Chilean platform *Cumplo* was born as the pioneer in LAC region. Today *Cumplo* funds US\$51 million in 1,508 credit operations from 2,000 investors.<sup>15</sup> *Afluente* in Argentina promotes itself as the “collaborative finance network of Latin America” and currently holds US\$55 million in loans in 2,527 operations funded by 213,735 investors.<sup>16</sup> *Prestadero*<sup>17</sup> and *Ku-bo Financiero*<sup>18</sup> in Mexico are among other internet based platforms all along the region adding up some other US\$8 million for this growing business. It is important to remark that many of these platforms lend to individuals and SMEs<sup>19</sup> in LAC. There are at least 50 different platforms across LAC region working as of the writing of this document.<sup>20</sup> Currently, Mexico is in preparation of its primary AF regulation and some other countries such as Brazil, Peru, Chile and Argentina are exploring the possibility of issuing new regulations.
- 2.6 **Justification.** Crowdfunding has been growing up through LAC countries without a specific regulation. Alternative Finance can be an excellent complement to traditional bank credit, particularly for projects with a high level of risk or in the

<sup>10</sup> Carmen Cuesta, Santiago Fernández de Lis, Irene Roibas, Ana Rubio, Macarena Ruesta, David Tuesta, Pablo Urbiola (2014): “Crowdfunding en 360º: Alternativa de financiación en la era digital. BBVA Research, Observatorio de Economía Digital.

<sup>11</sup> Crowdfunding Seen Providing US\$65 Billion Boost to the Global Economy in 2014 (Infographic). Entrepreneur. Retrieved February 11, 2015.

<sup>12</sup> Lending Club Statistics, November 3, 2015.

<sup>13</sup> OnDeck, November 3, 2015.

<sup>14</sup> PROSPER.com, November 3, 2015.

<sup>15</sup> Cumplo.cl Retrieved November 3, 2015.

<sup>16</sup> Afluente S.A Retrieved November 3, 2015.

<sup>17</sup> Prestadero.com retrieved November 3, 2015.

<sup>18</sup> Kubo Financiero

<sup>19</sup> Since every LAC country has its own definition of SME, we will use the local definition as provided by the ministry of finance, development bank or any other policy-making institution. In case where a public definition does not exist we will use any academic or private reference to classify enterprises as SMEs locally.

<sup>20</sup> A list of 50 verified platforms is and Annex to this document.

early stages of development. This TC can help AF ecosystems to grow with a balance of financial consumer protection, anti-money laundering regulations and financial system stability. This TC will create the proper ground for these initiatives to develop, with a balance of growth, sustainability and regulation. Countries with relatively advanced AF ecosystems or those with previous regulatory advances will have priority: those countries where AF has any level of development or where governments are taking actions to regulate or to foster the activity are preferred. No cluster analysis, in terms of geographical, hierarchical, or any other type of concentration of platforms is included, since every ecosystem varies in every jurisdiction. As of the time of the writing of this document, Mexico is in the process of writing primary regulation for Alternative Finance.

- 2.7 **Objective.** The objective of this TC is to provide support to Governments across Latin America and the Caribbean (LAC), with an emphasis on the Caribbean countries, to move towards the creation and implementation of an Alternative Finance (AF) regulatory framework, including Information and Communication Technologies (ICT) and financial components. This TC will also foster the development of the adequate public policies and governance mandates for AF sustainable growth and development. In this order, the TC will create sufficient institutional capacities, in both regulatory, supervisory and policy-related government agencies, to properly develop both topics. The TC translates, initially, into an assessment of the current AF ecosystems, namely, financial return crowdfunding ecosystems in every eligible country. Secondly, the TC aims for an assessment of the best practices applicable to the ecosystem, including its ICT framework, relating mainly to broadband size, access and use, infrastructure, among others. Finally, TC will support Governments in creating a regulatory framework, including systemic and idiosyncratic risks and investor protection concerns, also ICT regulations associated to AF and the possibility of assessing platforms creation.
- 2.8 **TC Alignment.** This TC is aligned with the Broad Band Fund (BBD) prioritizing criteria of promoting dialogues about strategic regulation in Broad-Band related topics regionally and at country level and to suffice the demand of applications which foster the use and adoption of Broad Band.  
In addition, by expanding lower income household and smaller firms access to financial services the project supports the Growth and Social Equity GCI-9 Priority.
- 2.9 **TC eligibility.** All LAC countries and regulatory agencies which are planning to issue regulations on AF, developments banks planning to use AF in their business lines, public entities overseeing AF, ICT regulatory agencies or institutions are eligible for the TC resources. Countries with relatively advanced AF ecosystems or those with previous regulatory advances will have priority. Such eligible countries and institutions can request any of the activities described below.

### III. Description of activities/components and budget

- 3.1 **Component 1 - Assessment of size, number, typology of existing AF platforms and ecosystems.**

- 3.1.1 **Activity 1.1: Study of AF ecosystems.** This comprehensive study will include: (i) the description of the project approach and a clear definition of the methodology to identify current AF ecosystems. This includes a technological and financial comprehensive perspective; (ii) detailed findings of the analysis for each country and the identification of possible opportunities and risks; and (iii) policy recommendations for the ICT and financial sectors and regulatory agencies.
- 3.1.2 **Activity 1.2: Undertake best practices study.** To extract the best experiences in the international ground to find the proper ICT and regulatory frameworks, and, if required, best practices in AF platforms.
- 3.2 **Component 2 - Elaboration of comprehensive guidelines for governments and AF sectors to address issues in the identified ecosystems**
- 3.2.1 **Activity 2.1: ICT and Broadband solution.** This activity will have as a result guidelines for each government to undertake the best feasible and sustainable solutions in terms of ICT and broadband policies to help fostering AF ecosystems. This includes a dissemination and information plan for the country. Also, this activity will focus in the development of policies fostering a sustainable AF ecosystem for each eligible country, including the possibility to assess AF platforms creation.
- 3.2.2 **Activity 2.2: Regulations.** This activity will have as a result regulatory guidelines for AF in each eligible country, including ICT and financial components, extensive to financial risks, consumer protection, anti-money laundering and systemic risks. This activity can extend to the development of a tailor-made and principles-based proposal for regulations with the intention of creating a sustainable framework, if requested by Governments.
- 3.3 **Component 3 – Dissemination and Results Communication Plan.** Each beneficiary institution or institutions must create a communication plan with two dimensions: internal and external.
- 3.3.1 **Internal.** On the internal dimension, the institution must create an internal communication plan including but not restricted to meetings, presentations and information about the new regulation or implementations to the relevant authorities and decision-makers within the organization.
- 3.3.2 **External.** On the external dimension, the plan should include meetings with the AF private institutions, country's Congress or Assembly, other public institutions dealing with AF, and so forth. Also, press reports on the regulations and public events to socialize the advances and results of the TC must be included in the plan. Executing agency can collaborate with dissemination through seminars, documents, or any other appropriate means.

**Indicative Results Matrix (Per eligible country)**

Indicative Results Matrix		Baseline		End-of Project		Expected Completion Date	Data Source
	Unit	Value	Year	Planned	Actual		
Outcomes							
AF Regulatory Framework proposed by regulatory agency	Issued Regulation	0	2015	1		1/31/2018	Regulatory Agencies Documents

<b>Outputs: Component 1. Assessment of size, number, typology of existing AF platforms and ecosystems</b>							
1.1 Study of AF ecosystems delivered by the consultant	Studies	0	2015	1		1/31/2018	Project Documents
1.2 Best Practices study delivered by the consultant	Studies	0	2015	1		1/31/2018	Project Documents
<b>Outputs: Component 2. Elaboration of comprehensive guide of recommendations for governments and AF sectors to address the challenges related to the proper ICT and regulatory solutions</b>							
2.1 ICT and Broadband solution Report	Reports	0	2015	1		1/31/2018	Project documents
2.2 Platform Creation assessment delivered by the consultant	Studies	0	2015	1		1/31/2018	Project documents
2.3 Report on regulatory recommendations	Reports	0	2015	1		1/31/2018	Project documents
<b>Outputs: Component 3. Dissemination and Results Communication Plan</b>							
3. Dissemination and Results Communication	Reports	0	2015	2		1/31/2018	Meetings, reports, presentations, etc.

**Budget.** The Project is estimated to have a total funding of US\$220.189.

**Indicative Budget (US\$)<sup>21</sup>**

Activity/Component	Description	IDB/Fund Funding	Counterpart Funding	Total Funding
<b>Activity 1.1</b>	Study of AF ecosystems	50,000	0	50,000
<b>Activity 1.2</b>	Best practices study	50,000	0	50,000
<b>Activity 2.1</b>	ICT and Broadband solution Report / Platform Creation	50,000	0	50,000
<b>Activity 2.2</b>	Report on regulatory recommendations	50,000	0	50,000
<b>Component 3</b>	Dissemination and Results Communication Plan	20,189	0	20,189

- 3.4 **Monitoring and Evaluation of TC Results.** A local, independent consultant will be in charge of carrying out monitoring of progress made, based on the documents and other outputs generated, and for preparing a final evaluation report of the TC by its conclusion.
- 3.5 **Sustainability.** Since this TC has the intention to create Crowdfunding regulations, and eventually assessments for the creation of platforms, its sustainability is based on the fact that its resources will fund long-term initiatives such as Laws and its rules or implementations of such acts. Executing agency and hired consultants will assess each agency to guarantee that primary and secondary regulations suit the country's ecosystem and their legal technique is broad enough so rules can be adapted to technological or financial changes through time.
- 3.6 **Learned Lessons in AF Regulations.** Since AF is a very new industry, existing regulations are also very recent. Some countries opted for no regulation, such as in China, where platforms are growing up in number and lending and equity

<sup>21</sup>This is an estimate per activity. Depending on the requirements from eligible countries, the proportion of each amount in each category may vary in time. In the same order, amounts per activity may change with the number of countries requesting the resources from the TC.

amounts and the Government will see how the business evolves to regulate it in the near future.<sup>22</sup> Other jurisdictions have non-dedicated regulatory bodies but can, in theory, practice enforcement. Such is the case of the USA. This country has just recently started to issue regulations to implement the Jumpstart Our Business Startups Act (April 5, 2012). The Act creates the playground for AF to exist, focusing in job creation and economic recovery. Regulation A+<sup>23</sup> was just recently issued by the Securities and Exchanges Commission –SEC-, and a regulatory body for equity crowdfunding was issued in October, 2015.<sup>24</sup> These important steps are backed by the operation of the Consumer Financial Protection Bureau, an independent agency focused in the protection of the consumer within the financial sector. This office has functions such as rule creation, supervision and enforcement, consumer complaints, financial education and the monitoring of new risks, among others. In fact, AF companies fall within their large and very broad scope.

- 3.7 **Other lessons.** Other jurisdictions such as New Zealand<sup>25</sup> and Ontario in Canada,<sup>26</sup> just to mention a couple of examples, have created dedicated AF regulations. New Zealand's regulation, in particular is preferred within members of the industry: AF is treated as a new intermediary, there are conditions for fair dealing, disclosure, licensing, and capital requirements are basically clear. Spain<sup>27</sup> has recently issued Law 5/2015, which regulates entrepreneurship financing, having as main objective AF, in terms of direct or indirect non-bank financing. This regulation determines a cap for each Project by platform of €2.000.000 to the general public and €5.000.000 for accredited investors. Furthermore, National Securities Commission (Comisión Nacional del Mercado de Valores) is explicitly designated for supervision. This supervision is shared with the Central Bank for the case of online lending. An important case is United Kingdom, where many of the companies started. The country just recently reviewed the originally issued regulations<sup>28</sup> and issued a report on the effects of creating the new financial intermediary category with capital requirements, resolution procedures, issuance, among other topics. In their findings, they show how, despite regulation, the industry kept on growing to £84 million in 2014. Another group of countries treated online lending as banks and issued regulations for equity-based crowdfunding which are to some extent, restrictive. Such is the case of France<sup>29</sup> or Italy.<sup>30</sup>

#### IV. Executing agency and execution structure

- 4.1 **Executing Agency.** The TC will be executed by the IDB through its Capital Markets and Financial Institutions (IFD/CMF). The Bank has the experience to coordinate institutions within and across countries and will use learned lessons

<sup>22</sup> Peer-to-Peer Lending Takes Off in China. The Wall Street Journal

<sup>23</sup> Securities and Exchange Commission

<sup>24</sup> <http://www.sec.gov/news/pressrelease/2015-249.html>

<sup>25</sup> Financial Markets Conduct (Phase 1) Regulations 2014. Jerry Mateparae, Governor-General

<sup>26</sup> OSC Exempt Market Review. Considerations for New Capital Raising Prospectus Exemptions

<sup>27</sup> Ley 5/2015, de 27 de abril, de fomento de la financiación empresarial.

<sup>28</sup> A review of the regulatory regime for crowdfunding and the promotion of non-readily realisable securities by other media.

<sup>29</sup> Cadre pour faciliter le developpement du financement participatif

<sup>30</sup> Equity Crowdfunding

from the region and from abroad to optimize the results of the TC. The Bank will coordinate the execution of this TC with ICT and financial regulatory agencies, central banks or any other government agency related to its objectives and activities. Such coordination will be upon request of the abovementioned public entities, which will provide technical support to carry out the project activities, including the studies, assessments and reports under the present TC.

- 4.2 **Executing Plan.** Eligible institutions will deliver a timetable detailing dates and activities to be executed during the duration of the TC.
- 4.3 **Government Request.** Each country will submit a Request specifying its regulatory or operational requirements to be eligible for the resources of the TC. Prior to the initiation of the project activities in any of the participating countries, the corresponding non-objection letter from the Bank's liaison entity in each of the countries will be obtained. Coordination within the Bank and each of the involved institutions from each eligible country will be direct or shared with the specialized consultants to be hired depending on each case.
- 4.4 **Procurement and financial management.** The Bank will contract individual consultants, consulting firms and non-consulting services in accordance with Bank's current procurement policies and procedures.
- 4.5 **Complementarities with other operations.** This TC reinforces other Broadband Program initiatives such as RG-T2083 (Broadband Index and Balance Score Card), since its results could complement the already existing indices adding up digital access to alternative financial services. Also, it will complement results from RG-T2463 (Development of a Comprehensive Broadband Policy Toolkit), adding up recommendations for countries to adopt best practices for AF regulation and implementation. Furthermore, complementarities exist with RG-T2461 (Broadband Training Center), where results obtained from this technical cooperation can be shared and disseminated through the training center (CEABAD). Finally, strong complementarities exist with RG-T2550 (Guidelines on Government Digital Payments to Foster Financial Inclusion) because of its financial contents and the possibility of creating access to financial services to unbanked population.

## V. Major issues

- 5.1 **Opportunity:** Since both technological and financial innovations in terms of AF are evolving very fast, it is a risk to run long studies that can get out-of-date really fast. So, Activities 1.1 and 1.2 must be run in a short span of time and cover the vast majority of topics related to the proper implementation of AF. The other two activities must have the most comprehensive results in terms of technology and regulations.
- 5.2 **Priority:** Another risk will be the priority of AF for the countries. This risk is mitigated reducing adverse selection picking countries with advanced or developing AF ecosystems or the intention to develop regulations on the topic.

## VI. Environmental and Social Strategy

- 6.1 According to the Environment and Safeguards Compliance Policy (OP-703), the TC has been classified as category C. No potential negative environmental and/or social impacts of the TC were identified and therefore no mitigation strategy is required to address any impact.



**Required Annexes**

- Annex I: Terms of Reference
- Annex II: Procurement Plan

**Additional Annexes**

- LAC AF Platforms

## RG-T2631

### Support to the Development of Alternative Finance in LAC countries: ICT and Regulatory Approach Best Practices Study

#### Terms of Reference

#### I. Background

- 1.1 **Alternative Finance.** Alternative finance<sup>1</sup> or Crowdfunding<sup>2</sup> is described as the evaluation and use of small amounts of money coming from a large group of individuals, sometimes hundreds or thousands of them, to fund projects or existing businesses of all sizes in the form of equity (equity-based) or personal and corporate loans (lending-based) using an open call placed by issuers and borrowers through internet-based or mobile platforms and applications.
- 1.2 **Breaking the definition.** This long definition can be just torn apart to understand its meaning. First, the large group of individuals is often called “the crowd”, individuals who are surfing the internet for investments. Second, there is financial and non-financial crowdfunding, depending on the expectation that individuals from the crowd have on their investments. For the sake of simplicity, this TC is about the former, when the crowd is looking for financial returns, which could be obtained in the form of equity or loans, mainly the latter. Third, this is perfectly possible because of technology and the existence of crowdfunding platforms, websites and social media, where the “campaigns” or offerings are advertised.<sup>3</sup> Also, these platforms are receiving and holding contributions from investors, distributing them to issuers and later reimbursing interests or dividends to investors. Finally, the so-called campaign is just the proposal of all the activities associated, which are posted it in the internet as an offering.<sup>4</sup>
- 1.3 **AF Categories.** AF has opened space for alternative ways for lending and building equity, mainly, to individuals and Small and Medium Enterprises -SMEs<sup>5</sup>-, giving a chance for innovations and for borrowers and entrepreneurs to obtain funds at lower costs and also alternative forms of income generation for investors. As said before, this document will focus on what is commonly known as financial return AF. This category includes both equity-based and loans-based AF. The former is the type of AF where a project is posted in a platform, hoping to get funding, the crowd funds the project awaiting for financial return in the manner of equity and dividends. The most prominent example of this type of AF is CircleUp.<sup>6</sup> The latter is the fastest growing type of AF, consisting mainly of people borrowing money for a large list of causes, from small business to education, from consumption to medical procedures, and the crowd willing to fund projects for the sake of a periodical return in the form of

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<sup>5</sup> <http://www.forbes.com/sites/billfrezza/2013/08/13/caveat-emptor-banking-peer-to-peer-lending-challenges-too-big-to-fail-status-quo/> retrieved February 11, 2015.

<sup>6</sup> <https://circleup.com/>

interests and capital. This looks simple, but the model has evolved in a million of different versions, being the most popular: (i) the denominated Peer-to-Peer, where the platform is simply meeting borrowers and their projects and individual lenders and (ii) the securities-based model, which is based on the issuance of loan-backed notes.<sup>7</sup> For the sake of simplicity, and since marketplace lending (as a broad category of online lending) compels not only securities, but also loans, it is useful to explain the simplest form of AF ecosystem.

- 1.4 **Ecosystem and Broadband.** For the AF ecosystem to be developed, proper access and performance of broadband are required, since these are technological platforms offering services for investments and lending through the internet or mobile applications. Also, as it is non-existent in most of the countries, an institutional framework and dedicated regulation covering both ITC and financial services are required. Services offered through the AF ecosystem include not only credit and equity origination but also credit scoring, custody and administration, marketing, data analysis, among others.
- 1.5 **Growing Business.** Alternative finance is a growing business worldwide,<sup>8</sup> accounting for almost US\$16,2 billion in money raised to fund projects through platforms as of the end of 2014.<sup>9</sup> According to BBVA, the Spanish banking group, by the end of 2013, these platforms were financing 1 cent per every US\$100 financed through traditional channels.<sup>10</sup> Although its size is not systemic yet, at the current size of growth, industry could reach more than ten times its current size by 2020.<sup>11</sup> These numbers can vary according to the source of information, and since platforms are starting to be regulated, data is in the process of consolidation. Taking a look to the statistics available in their websites for the US three largest participants can give a hint of the size of the industry, mainly that of marketplace lending. First, Lending Club affirms that they have funded US\$9,2 billion in 726,472 loans since 2008. Statistics show quarterly loan issuance growing up to US\$1,6 bln in the first quarter of 2015.<sup>12</sup> OnDeck,<sup>13</sup> which is a platform devoted to lend to small and medium enterprises accounts for loans reaching around US\$3 billion, Prosper Marketplace<sup>14</sup> has funded US\$2 billion. This data does not count the dozens of existing originators, which could increase the current lending amount.
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<sup>8</sup> Agrawal, Catalini & Goldfarb (2011). The Geography of Crowdfunding. NBER Working Paper N° 16820.

<sup>9</sup> <http://www.economist.com/news/economic-and-financial-indicators/21647603-global-crowdfunding>

<sup>10</sup> Carmen Cuesta, Santiago Fernández de Lis, Irene Roibas, Ana Rubio, Macarena Ruesta, David Tuesta, Pablo Urbiola (2014): “Crowdfunding en 360º: alternativa de financiación en la era digital. BBVA Research, Observatorio de Economía Digital.

<sup>11</sup> <http://www.entrepreneur.com/article/230912> . Retrieved February 11, 2015.

<sup>12</sup> <https://www.lendingclub.com/info/statistics.action>

<sup>13</sup> <https://www.ondeck.com/company/>

<sup>14</sup> <https://www.prosper.com/about>

<sup>15</sup> <http://cumplo.cl/> retrieved February 11, 2015.

operations funded by 96,134 investors.<sup>16</sup> Prestadero<sup>17</sup> and Ku-bo Financiero<sup>18</sup> in Mexico are among other internet based platforms all along the region adding up some other US\$6 million for this growing business. It is important to remark that many of these platforms lend to individuals and SMEs in LAC. There are at least 60 different platforms across LAC region working as of the writing of this document. Currently, Mexico is in preparation of its primary AF regulation and some other countries such as Brazil, Colombia, Argentina and Peru are exploring the possibility of issuing new regulations.

## II. Objectives

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## III. Activities

- 3.1 **Component 1 - Assessment of size, number, typology of existing AF platforms and ecosystems.**
- 3.1.1 **Activity 1.1: Study of AF ecosystems.** This comprehensive study will include: (i) the description of the project approach and a clear definition of the methodology to identify current AF ecosystems. This includes a technological and financial comprehensive perspective; (ii) detailed findings of the analysis for each country and the identification of possible opportunities and risks; and (iii) policy recommendations for the ICT and financial sectors and regulatory agencies.

## IV. Products (Spanish/Per component and activity).

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- i. Proposed Outline of Report and Workplan. 1 month after signing of contract.
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**V. Payments**

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**VI. Supervision**

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## RG-T2631

### Support to the Development of Alternative Finance in LAC countries: ICT and Regulatory Approach

#### Terms of Reference

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- 1.2 **Breaking the definition.** This long definition can be just torn apart to understand its meaning. First, the large group of individuals is often called “the crowd”, individuals who are surfing the internet for investments. Second, there is financial and non-financial crowdfunding, depending on the expectation that individuals from the crowd have on their investments. For the sake of simplicity, this TC is about the former, when the crowd is looking for financial returns, which could be obtained in the form of equity or loans, mainly the latter. Third, this is perfectly possible because of technology and the existence of crowdfunding platforms, websites and social media, where the “campaigns” or offerings are advertised.<sup>3</sup> Also, these platforms are receiving and holding contributions from investors, distributing them to issuers and later reimbursing interests or dividends to investors. Finally, the so-called campaign is just the proposal of all the activities associated, which are posted it in the internet as an offering.<sup>4</sup>
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interests and capital. This looks simple, but the model has evolved in a million of different versions, being the most popular: (i) the denominated Peer-to-Peer, where the platform is simply meeting borrowers and their projects and individual lenders and (ii) the securities-based model, which is based on the issuance of loan-backed notes<sup>7</sup>. For the sake of simplicity, and since marketplace lending (as a broad category of online lending) compels not only securities, but also loans, it is useful to explain the simplest form of AF ecosystem.

- 1.4 **Ecosystem and Broadband.** For the AF ecosystem to be developed, proper access and performance of broadband are required, since these are technological platforms offering services for investments and lending through the internet or mobile applications. Also, as it is non-existent in most of the countries, an institutional framework and dedicated regulation covering both ITC and financial services are required. Services offered through the AF ecosystem include not only credit and equity origination but also credit scoring, custody and administration, marketing, data analysis, among others.
- 1.5 **Growing Business.** Alternative finance is a growing business worldwide,<sup>8</sup> accounting for almost US\$16,2 billion in money raised to fund projects through platforms as of the end of 2014.<sup>9</sup> According to BBVA, the Spanish banking group, by the end of 2013, these platforms were financing 1 cent per every US\$100 financed through traditional channels<sup>10</sup>. Although its size is not systemic yet, at the current size of growth, industry could reach more than ten times its current size by 2020.<sup>11</sup> These numbers can vary according to the source of information, and since platforms are starting to be regulated, data is in the process of consolidation. Taking a look to the statistics available in their websites for the US three largest participants can give a hint of the size of the industry, mainly that of marketplace lending. First, Lending Club affirms that they have funded US\$9,2 billion in 726,472 loans since 2008. Statistics show quarterly loan issuance growing up to US\$1,6 bln in the first quarter of 2015.<sup>12</sup> OnDeck,<sup>13</sup> which is a platform devoted to lend to small and medium enterprises accounts for loans reaching around US\$3 billion, Prosper Marketplace<sup>14</sup> has funded US\$2 billion. This data does not count the dozens of existing originators, which could increase the current lending amount.
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## **III. Activities**

- 3.1 **Component 1 - Assessment of size, number, typology of existing AF platforms and ecosystems.**
- 3.1.1 **Activity 1.2: Undertake good practices study.** To extract the best experiences in the international ground to find the proper ICT and regulatory frameworks, and, if required, best practices in AF platforms.

## **IV. Products (Spanish/Per component and activity).**

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## III. Activities

- 3.1 **Component 2 - Elaboration of comprehensive guidelines for governments and AF sectors to address issues in the identified ecosystems**
- 3.1.1 **Activity 2.1: ICT and Broadband solution.** This activity will have as a result guidelines for each government to undertake the best feasible and sustainable solutions in terms of ICT and broadband policies to help fostering AF ecosystems. This includes a dissemination and information plan for the country. Also, this activity will focus in the development of policies fostering a sustainable AF ecosystem for each eligible country, including the possibility to assess AF platforms creation.

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Mexico are among other internet based platforms all along the region adding up some other US\$6 million for this growing business. It is important to remark that many of these platforms lend to individuals and SMEs in LAC. There are at least 60 different platforms across LAC region working as of the writing of this document. Currently, Mexico is in preparation of its primary AF regulation and some other countries such as Brazil, Colombia, Argentina and Peru are exploring the possibility of issuing new regulations.

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- i. Type of Consultancy: Enterprise or Individual
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  - iii. Duration and Location: Max. 24 months
  - iv. Requirements: (a) Regulatory and research experience in Alternative finance or related topics. (b) Experience in ICT and financial services (c) Experience in the financial services industry.

## III. Activities

- 3.1 **Component 2 - Elaboration of comprehensive guidelines for governments and AF sectors to address issues in the identified ecosystems**
- 3.1.1 **Activity 2.2: Regulations.** This activity will have as a result regulatory guidelines for AF in each eligible country, including ICT and financial components, extensive to financial risks, consumer protection and systemic risks. This component includes a dissemination and information plan. This activity also relates to the development of a tailor-made and principles-based proposal for regulations with the intention of creating a sustainable framework.

## IV. Products (Spanish/Per component and activity).

- i. Proposed Outline of Report and Workplan. 1 month after signing of contract.
- ii. Draft Report

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<sup>17</sup> [www.prestadero.com](http://www.prestadero.com) retrieved February 11, 2015.

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- iii. Presentation of key finding and recommendations.
- iv. Final Report.

**V. Payments**

30% upon signing of contract. 30% upon presentation of draft report. 40% upon approval of final report.

**VI. Supervision**

Will be responsibility of IDB or else if asked by country.

## RG-T2631

### Support to the Development of Alternative Finance in LAC countries: ICT and Regulatory Approach

#### Terms of Reference

#### I. Background

- 1.1 **Alternative Finance.** Alternative finance<sup>1</sup> or Crowdfunding<sup>2</sup> is described as the evaluation and use of small amounts of money coming from a large group of individuals, sometimes hundreds or thousands of them, to fund projects or existing businesses of all sizes in the form of equity (equity-based) or personal and corporate loans (lending-based) using an open call placed by issuers and borrowers through internet-based or mobile platforms and applications.
- 1.2 **Breaking the definition.** This long definition can be just torn apart to understand its meaning. First, the large group of individuals is often called “the crowd”, individuals who are surfing the internet for investments. Second, there is financial and non-financial crowdfunding, depending on the expectation that individuals from the crowd have on their investments. For the sake of simplicity, this TC is about the former, when the crowd is looking for financial returns, which could be obtained in the form of equity or loans, mainly the latter. Third, this is perfectly possible because of technology and the existence of crowdfunding platforms, websites and social media, where the “campaigns” or offerings are advertised<sup>3</sup>. Also, these platforms are receiving and holding contributions from investors, distributing them to issuers and later reimbursing interests or dividends to investors. Finally, the so-called campaign is just the proposal of all the activities associated, which are posted it in the internet as an offering<sup>4</sup>.
- 1.3 **AF Categories.** AF has opened space for alternative ways for lending and building equity, mainly, to individuals and Small and Medium Enterprises -SMEs<sup>5</sup>-, giving a chance for innovations and for borrowers and entrepreneurs to obtain funds at lower costs and also alternative forms of income generation for investors. As said before, this document will focus on what is commonly known as financial return AF. This category includes both equity-based and loans-based AF. The former is the type of AF where a project is posted in a platform, hoping to get funding, the crowd funds the project awaiting for financial return in the manner of equity and dividends. The most prominent example of this type of AF is CircleUp.<sup>6</sup> The latter is the fastest growing type of AF, consisting mainly of people borrowing money for a large list of causes, from small business to education, from consumption to medical procedures, and the crowd willing to fund projects for the sake of a periodical return in the form of interests and capital. This looks simple, but the model has evolved in a million of

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<sup>1</sup> Peter Baeck, Liam Collins and Bryan Zhang. (2014) “UNDERSTANDING ALTERNATIVE FINANCE: The UK Alternative Finance Industry Report 2014”. University of Cambridge.

<sup>2</sup> Eleanor Kirby and Shane Worner (2014): “Crowd-Funding: An Infant Industry Growing Fast”. IOSCO, Madrid.

<sup>3</sup> See for example, [www.kiva.com](http://www.kiva.com)

<sup>4</sup> Inter-American Development Bank (2014) “Crowdfunding in Mexico: The Power of Digital Technologies to Transform Innovation, Entrepreneurship & Economic Inclusion. Multilateral Investment Fund, Access to Markets and Skills. Washington, DC.

<sup>5</sup> <http://www.forbes.com/sites/billfrezza/2013/08/13/caveat-emptor-banking-peer-to-peer-lending-challenges-too-big-to-fail-status-quo/> retrieved February 11, 2015.

<sup>6</sup> <https://circleup.com/>

different versions, being the most popular: (i) the denominated Peer-to-Peer, where the platform is simply meeting borrowers and their projects and individual lenders and (ii) the securities-based model, which is based on the issuance of loan-backed notes.<sup>7</sup> For the sake of simplicity, and since marketplace lending (as a broad category of online lending) compels not only securities, but also loans, it is useful to explain the simplest form of AF ecosystem.

- 1.4 **Ecosystem and Broadband.** For the AF ecosystem to be developed, proper access and performance of broadband are required, since these are technological platforms offering services for investments and lending through the internet or mobile applications. Also, as it is non-existent in most of the countries, an institutional framework and dedicated regulation covering both ITC and financial services are required. Services offered through the AF ecosystem include not only credit and equity origination but also credit scoring, custody and administration, marketing, data analysis, among others.
- 1.5 **Growing Business.** Alternative finance is a growing business worldwide,<sup>8</sup> accounting for almost US\$16.2 billion in money raised to fund projects through platforms as of the end of 2014.<sup>9</sup> According to BBVA, the Spanish banking group, by the end of 2013, these platforms were financing 1 cent per every US\$100 financed through traditional channels.<sup>10</sup> Although its size is not systemic yet, at the current size of growth, industry could reach more than ten times its current size by 2020.<sup>11</sup> These numbers can vary according to the source of information, and since platforms are starting to be regulated, data is in the process of consolidation. Taking a look to the statistics available in their websites for the US three largest participants can give a hint of the size of the industry, mainly that of marketplace lending. First, Lending Club affirms that they have funded US\$9,2 billion in 726,472 loans since 2008. Statistics show quarterly loan issuance growing up to US\$1,6 bln in the first quarter of 2015.<sup>12</sup> OnDeck<sup>13</sup>, which is a platform devoted to lend to small and medium enterprises accounts for loans reaching around US\$3 billion, Prosper Marketplace<sup>14</sup> has funded US\$2 billion. This data does not count the dozens of existing originators, which could increase the current lending amount.
- 1.6 **Latin America and The Caribbean (LAC) and AF:** Latin America and the Caribbean countries are not excluded of this new phenomenon, the appearance and growth of these platforms all across the region, posing a challenge for ICT and financial regulators, since this business, although still small in size, is new and different to traditional banking, based on disruptive technologies, complicated, and not regulated. In 2012 Chilean platform Cumplo was born as the pioneer in LAC region. Today Cumplo funds US\$44 million in 1,111 credit operations from 1,784 investors.<sup>15</sup> Afluenta in Argentina promotes itself as the “collaborative finance network of Latin America” and currently holds US\$27 million in loans in 1,342 operations funded by 96,134 investors.<sup>16</sup> Prestadero<sup>17</sup> and Ku-bo Financiero<sup>18</sup> in

<sup>7</sup> A detailed description of the models can be found in: Kirby and Worner (2014).

<sup>8</sup> Agrawal, Catalini & Goldfarb (2011). The Geography of Crowdfunding. NBER Working Paper N° 16820.

<sup>9</sup> <http://www.economist.com/news/economic-and-financial-indicators/21647603-global-crowdfunding>

<sup>10</sup> Carmen Cuesta, Santiago Fernández de Lis, Irene Roibas, Ana Rubio, Macarena Ruesta, David Tuesta, Pablo Urbiola (2014): “Crowdfunding en 360º: alternativa de financiación en la era digital. BBVA Research, Observatorio de Economía Digital.

<sup>11</sup> <http://www.entrepreneur.com/article/230912> . Retrieved February 11, 2015.

<sup>12</sup> <https://www.lendingclub.com/info/statistics.action>

<sup>13</sup> <https://www.ondeck.com/company/>

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## III. Activities

- 3.1 **Component 3 – Dissemination and Results Communication Plan.** Each beneficiary institution or institutions must create a communication plan with two dimensions: internal and external.
- 3.1.1 **Internal.** On the internal dimension, the institution must create an internal communication plan including but not restricted to meetings, presentations and information about the new regulation or implementations to the relevant authorities and decision-makers within the organization.
  - 3.1.2 **External.** On the external dimension, the plan should include meetings with the AF private institutions, country's Congress or Assembly, other public institutions dealing with AF, and so forth. Also, press reports on the regulations and public events to socialize the advances and results of the TC must be included in the plan. Executing agency can collaborate with

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dissemination through seminars, documents, or any other appropriate means.

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**SUPPORT TO THE DEVELOPMENT OF ALTERNATIVE FINANCE IN LAC COUNTRIES: ICT AND  
REGULATORY APPROACH**

**RG-T2631**

**CERTIFICATION**

I hereby certify that this operation was approved for financing under the Broadband Special Program (BBD) through a communication dated October 28, 2015 and signed by Su Hyun Kim (ORP/GCM). Also, I certify that resources from said fund are available for up to **US\$220,189** in order to finance the activities described and budgeted in this document. This certification reserves resources for the referenced project for a period of four (4) calendar months counted from the date of eligibility from the funding source. If the project is not approved by the IDB within that period, the reserve of resources will be cancelled, except in the case a new certification is granted. The commitment and disbursement of these resources shall be made only by the Bank in US dollars. The same currency shall be used to stipulate the remuneration and payments to consultants, except in the case of local consultants working in their own borrowing member country who shall have their remuneration defined and paid in the currency of such country. No resources of the Fund shall be made available to cover amounts greater than the amount certified herein above for the implementation of this operation. Amounts greater than the certified amount may arise from commitments on contracts denominated in a currency other than the Fund currency, resulting in currency exchange rate differences, for which the Fund is not at risk.

Original Firmado

12/02/2015

\_\_\_\_\_  
Sonia M. Rivera  
Chief  
Grants and Cofinancing Management Unit  
ORP/GCM

\_\_\_\_\_  
Date

**APPROVAL**

Approved:

Original Firmado

12/02/2015

\_\_\_\_\_  
Juan Antonio Ketterer  
Division Chief  
Capitals Markets and Financial Institutions Division  
IFD/CMF

\_\_\_\_\_  
Date