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TECHNICAL NOTE

DIGITAL FINANCIAL INCLUSION

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This Technical Note was prepared in the context of a joint IMF-World Bank Financial Sector Assessment Program (FSAP) mission in Chile during October 2021 led by Charles Cohen, IMF and Miquel Dijkman, World Bank, and overseen by the Monetary and Capital Markets Department, IMF, and the Finance, Competitiveness, and Innovation Global Practice, World Bank Group. The note contains the technical analysis and detailed information underpinning the FSAP assessment's findings and recommendations. Further information on the FSAP program can be found at www.worldbank.org/fsap.

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Acronyms and Abbreviations

API	application programming interface
BCCh	Banco Central de Chile (Central Bank of Chile)
BEME	BancoEstado Microempresas
BFA	IMF/WBG Bali Fintech Agenda
BIS	Bank of International Settlements
CBDC	central bank digital currency
CDD	customer due diligence
CMF	Comisión para el Mercado Financiero (Financial Market Commission)
CLP	Chilean peso
CPBV	Clearinghouses for Low-Value Payments
CPMI	Committee on Payments and Market Infrastructures
CSIRT	Computer Security Incident Response Team
DFS	digital financial services
eKYC	electronic know-your-customer
EFT	electronic funds transfer
FATF	Financial Action Task Force
FSP	financial service provider
G2P	government-to-person
GCI	ITU Global Cybersecurity Index
GDPR	EU General Data Protection Regulation
IMF	International Monetary Fund
LAC	Latin America and the Caribbean
M&E	monitoring and evaluation
MDR	merchant discount rate
MFI	microfinance institution
MoF	Ministry of Finance
NBFI	non-bank financial institution
NFIS	National Financial Inclusion Strategy
MoF	Ministry of Finance
OECD	Organization of Economic Co-operation and Development
PISP	payment initiation service provider
PSP	payment service provider
RAN	Recopilacion Actualizada de Normas (Updated Collection of Rules)
SBIF	Superintendencia de Bancos e Instituciones Financieras de Chile (Superintendency of Banks and Financial Institutions)
SDD	simplified customer due diligence
TDLC	Tribunal for the Defense of Free Competition
UMI	upper middle income
USD	United States dollar
WB	World Bank
WBG	World Bank Group

EXECUTIVE SUMMARY[1]

1. **Chile has achieved high levels of financial inclusion relative to its level of economic development across a number of headline indicators.** Account ownership has increased significantly over the past decade, due in large part to Cuenta RUT (a simplified demand account) as well as the recent introduction of prepaid cards issued by both banks and non-banks. Unlike in other countries, gaps in account ownership between men and women, rich and poor, older and younger consumers, and rural consumers are not pronounced. Both ownership and usage of accounts and cards (debit and credit) are on par with or above the average for upper middle income (UMI) countries and above the average for the Latin America and Caribbean (LAC) region, but below average for Organization of Economic Co-operation and Development (OECD) countries. Use of digital payments is also above the UMI average.

2. **Remaining challenges in financial inclusion include pockets of underserved segments and opportunities to further increase in online payments and digital financial services (DFS).** Consistent gaps in financial inclusion metrics exist for those out of the labor force or with a primary education or lower, as well as for migrants. There are opportunities to continue advancing the shift from cash to digital payments. For example, the 2017 Household Financial Survey from the Central Bank of Chile (BCCh) indicates that use of non-cash means of payment increases with income. Use cases for online payments could be expanded to provide consumers with greater convenience and utility.

3. **There is also opportunity to improve the availability of savings, credit, and account products that are appropriately tailored to meet the needs of underserved consumers.** Chile scored lower than peer countries in the number of adults that cited financial services being too expensive as the reason for not having an account. With respect to credit, while much access to consumption credit exists, there is more limited access to productive credit for microenterprises. Gaps also remain in the usage of savings products, indicating a lack of availability of appropriate savings products.

4. **Greater digitalization of the financial sector can help Chile to address some of the remaining challenges for financial inclusion in Chile.** DFS can help financial service providers (FSPs) to reach consumers they were previously incapable of serving due to cost or inaccessibility, while increasing convenience for consumers. FSPs have already started offering digitally-oriented products and consumers have increased usage of digital channels during the pandemic. Some FSPs are introducing DFS to encourage savings behavior or to build up history with new clients, partly to address the lack of consolidated credit information in the market.[2]

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[1] This Technical Note has been prepared by Jennifer Chien, WBG. Note that the scope of this note does not include SME finance. The majority of laws, regulation, reports, websites, and powerpoints cited in this note were reviewed using informal translation into English and not in the original source language (Spanish).

[2] For example, BCI has introduced a "Piggy Bank" initiative to encourage consumers to save into a "savings pocket" within a current account via commitments and challenges, while Banco Santander has launched a "life account", a simple account which can be opened digitally and is aimed at building up a longer-term relationship with a customer.

5. **Several key elements of a well-functioning DFS ecosystem could be strengthened.** Barriers and uncertainties, such as the lack of legal clarity regarding appropriate processes for electronic know-your-customer (eKYC) and digital authentication of customers, currently prevent full digital onboarding. Regulatory guidance on appropriate eKYC processes and means of digital identification that are risk-based and balance facilitating access with addressing AML/CFT and other security risks would be beneficial. This could be combined with enhanced infrastructure to support digital ID and robust digital authentication. In addition, remaining limitations on when e-signature and electronic documentation can be used should be removed.

6. **At a broader level, the Fintech Bill[3] should be passed to allow for greater innovation and competition in the financial sector.** Fintechs can help to expand outreach to more small and medium enterprises (SMEs) with tailored, lower cost products and services. The fintech market has experienced steady growth in recent years, particularly in payments and remittances and alternative finance (invoice trading, peer-to-peer (P2P lending), and crowdfunding), but lacks a clear legal framework. The Fintech Bill would provide legal certainty to fintech companies, which would help to address some conflicts with incumbent banks that have arisen. The bill would need to be followed by regulatory frameworks for fintechs that balance fostering innovation with mitigating risks. The Fintech Bill also introduces an Open Finance System allowing for the exchange of data on clients with express consent, which can help expand the range of tailored products available to consumers.

7. **Moving forward on DFS and fintech would benefit from updates to the legal frameworks for data privacy and protection and cybersecurity.[4]** These are important building blocks to protect consumers and to avoid uncertainty and inconsistency in the market. An updated data privacy and protection law should be developed that, among other issues, addresses new forms of data processing, alternative data, and algorithmic scoring; incorporates new principles and approaches to data privacy, including greater focus on legitimate use; includes updated data protection standards; and clearly designates an authority to enforce the new law. Similarly, cybersecurity rules could be strengthened in line with new technologies and business models.

8. **A range of opportunities exist to build off of Chile's relatively advanced national payments infrastructure to help further expand in low-value retail payments and digital payments.** Expanding accessibility and use cases for digital payments and low-value retail payments could benefit lower-income Chileans who continue to rely on cash, a priority that was recognized in BCCh's 2018-2022 Strategic Plan. Expanded merchant acceptance infrastructure, particularly in remote areas and with smaller merchants, increased interoperability, and appropriately calibrated interchange fees could all help to achieve these objectives. Fostering the entry of new, innovative payment service providers (PSPs) and ensuring equitable access to payments infrastructure could help to further expand online payments, as could addressing conflicts with interbank transfer fees. Several initiatives are already in progress to address some of these issues. More broadly, closer coordination in implementing a long-term strategic vision for development of the retail

[3] Bill to Promote Financial Competition and Inclusion Through Innovation and Technology in the Provision of Financial Services

[4] As of April 2022, a draft data protection bill (Bill No. 11144-07) is currently being discussed in Congress and has made significant progress.

payments ecosystem to enhance digital financial inclusion would be beneficial, particularly given the number of ongoing initiatives that impact various elements of the retail payments ecosystem.

9. **There are indications that interest rate caps have inadvertently constrained access to finance for Chilean microenterprises.** Lending to micro and small enterprises (MSEs) requires higher operational costs, and hence higher interest rates, due to the informality of such enterprises and higher labor costs required in servicing such clients. Such clients often fall victim to credit rationing due to interest rate caps. Indeed, it appears that the majority of FSPs (banks as well as savings and credit cooperatives) have withdrawn from microenterprise lending, with the exception of a few microfinance institutions (MFIs).[5] Chilean FSPs consistently indicated that serving this segment was unfeasible due to lack of credit information, higher costs, and interest rate caps. FSPs are now primarily focused on consumption lending, with the attendant risks to consumers.

10. **It is recommended that interest rate caps be removed and replaced with affordability and suitability requirements.** Interest rate caps are a blunt instrument that often do not have a net benefit. Caps in Chile have clearly curtailed the availability of productive microfinance, while potentially driving some consumers to use informal lenders with even more exorbitant rates.[6] Affordability and suitability requirements, combined with strong disclosure and transparency, can be more effective in trying to protect consumers, without the distortionary effects that accompany interest rate caps.

11. **The current credit information system in Chile also impedes access to finance.** The current system is fragmented across different registries, with unequal access to registries and gaps in coverage and in the types of credit information available to lenders. Due to legal barriers, existing registries do not include historical data and alternative data cannot be shared. The existing system poses an obstacle to FSPs seeking to assess the creditworthiness of prospective customers. The system also limits access to finance for consumers who could benefit from their positive repayment histories.

12. **The credit information system in Chile should be strengthened to have more comprehensive coverage and to include more positive, alternative, and historical data.[7]** Credit information should be made accessible to all types of appropriately regulated credit providers. The types of credit information that may be reported and shared should also be expanded to comprise historic positive as well as negative credit information. Authorities should consider including alternative data such as payment histories from utilities and telecommunications providers and similar sources.

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[5] While Banco Estado and a few savings and credit cooperatives do serve SMEs, they generally do not serve microenterprises.

[6] For example, see Cuesta, Jose Ignacio and Alberto Sepulveda. Price Regulation in Credit Markets: A Trade-off Between Consumer Protection and Credit Access. Stanford Institute for Economic Policy Research, September 2021. The results of this research show that interest rate regulation “mostly harmed credit access and overall welfare.”

[7] A Consolidated Debt Registry Bill currently in Congress addresses some of the issues noted above, including increasing reporting entities and expanding to include positive information, but has yet to be passed.

13. **Legal and regulatory reforms could be considered to encourage microsavings.** The current regulatory framework only contemplates a limited set of formal savings products with restrictive policies and reportedly high administrative costs for FSPs. While there are several factors contributing to the low level of savings in Chile (including a lack of a savings culture), research shows a clear a gap between savings practices and preferences of consumers and available products in the market, which are not user-friendly and do not meet the needs of underserved consumers looking for flexibility. Indeed, some FSPs refer consumers to investment products instead, which are not appropriate for low-income, low-literacy consumers. Regulatory reforms could be undertaken to enable the provision of a broader range of flexible microsavings products at lower operational costs to FSPs.

14. **Banco Estado has played a huge role in advancing financial inclusion in Chile.** In addition to Cuenta RUT, which has been taken up by 83% of the adult Chilean population and contributed to the high number of debit cards in Chile, Banco Estado has also established a large network of agent outlets in rural areas (Caja Vecina) and operates a subsidiary supporting SME finance. While Banco Estado's achievements are significant and laudable, the dominant role it has played in financial inclusion in Chile presents potential tradeoffs. Over the long-term, it is not ideal to have the vast majority of financial inclusion advancements hinge on one entity. Noticeably, Banco Estado's initiatives have not been emulated by other FSPs at scale, raising the question of whether such models are sustainable. Banco Estado arguably operates on a quasi-commercial basis, which poses some indirect but potentially negative side effects. Cuenta RUT was known to be unprofitable since it launched, only becoming profitable in 2020.[8] Banco Estado's successes, particularly if implicitly subsidized, may have inadvertently deterred other market-based players from developing their own strategies for reaching low-income segments.

15. **Over the longer term, it would be beneficial to seek to diversify the range of stakeholders contributing to financial inclusion.** At the same time, Banco Estado should be encouraged to modernize its infrastructure. It has been noted that Banco Estado runs on legacy infrastructure, which contributes to its higher operational costs and resulting reliance on interchange and interbank transfer fees. Given the major role it will inevitably continue to play in financial inclusion, more advanced infrastructure would also better position Banco Estado to innovate in DFS.

16. **Greater support could also be provided to the savings and credit cooperative and MFI sectors given the unique role these provider types play in serving underserved segments.** Obstacles have been cited regarding potentially excessive reporting and documentation requirements that impose heavy compliance burdens on such entities. Policymakers could explore whether supervisory approaches could be further tailored to the unique aspects of such entities, while still serving core supervisory objectives.

17. **To move to the next stage of financial inclusion, it is recommended that a national financial inclusion strategy (NFIS) be developed that is holistic and comprehensive.** Given the high levels of financial inclusion Chile has already achieved, further advancing beyond this

[8] From Banco Estado ppt "Case Study: Analysis and experience of Cuenta RUT" by Pablo Correa, Executive Vice President, June 2021.

will pose a more complex task. Reaching "last mile" of consumers, addressing gaps in microsavings and microenterprise finance, increasing usage of online payments, and improving quality pose complicated challenges. Addressing remaining challenges in an impactful manner requires developing a multi-dimensional approach that considers market dynamics, balancing innovation with new risks, harnessing competitive forces, addressing long-standing supply-side barriers (such as interest rate caps and lack of credit information) and demand-side constraints (such as low financial literacy), and enhancing financial infrastructure to support long-term, sustainable advances in financial inclusion. A NFIS can provide a useful vehicle to develop and implement a holistic and systemic approach and ensure coordinated action across both public and private stakeholders. Such efforts were already initiated via the Advisory Commission for Financial Inclusion, though activities were paused during the pandemic and are only now relaunching. Coordination is all the more critical given the various ambitious initiatives already currently underway with respect to fintech and retail payments as well as digital transformation more broadly.

Table 1. Summary of Recommendations

Recommendations		Responsible Authorities	Time
Products	Remove interest rate caps due to net negative impacts on consumer welfare and microenterprise	MoF	NT
	Consider developing definition for microenterprise finance to more clearly distinguish between consumption lending and productive lending and allow for targeted policy initiatives to support microenterprise finance	MoF, CMF	NT
	Prioritize develop of a consolidated credit registry	CMF, MoF	I
	Expand credit information system to include more positive, alternative, and historical data	CMF, MoF	I
	Consider undertaking efforts to raise consumer awareness regarding the importance and use of their credit history and credit score	MoF, CMF	NT
	Over the longer term, explore possibility of providing data platforms to facilitate easy access by FSPs to government data such as data on business registration, tax, land, and court records	MoF	NT
	Revise the regulatory framework to enable provision of a broader range of flexible microsavings products at lower operational costs to FSPs	MoF, CMF	NT
	Encourage development of products and services designed to stimulate digital microsavings	MoF	NT
	Expand upon targeted financial literacy efforts to raise the overall propensity to save	MoF, CMF	NT
	Consider conducting an analysis on remittance pricing to identify factors contributing to high costs	MoF, CMF	NT
Providers	As a longer-term strategy, work to diversify the range of stakeholders contributing to financial inclusion	MoF	NT

Recommendations		Responsible Authorities	Time
	Encourage Banco Estado to modernize its infrastructure and work in a cooperative manner with other market players	MoF, Banco Estado	NT
	Explore whether supervisory approaches towards savings and credit cooperatives and MFIs could be further adapted for microfinance methodologies without negatively impacting supervisory objectives	CMF	NT
	Provide greater policy support to savings and credit cooperatives and MFIs given their unique role in serving underserved segments	MoF, CMF	NT
Enabling Environment for DFS	Provide clearer guidance on digital onboarding, remote identification and authentication	CMF	NT
	Issue clear guidelines on appropriate, risk-based use of digital ID	CMF	NT
	Consider establishing a unified digital ID solution	MoF, MoE	NT
	Consider leveraging existing infrastructure such as clave unica, which will require amending existing rules on access and usage and upgrading systems	MoF, MoE	NT
	Amend law on e-signature and electronic documents to remove barriers to using e-signature and digital documents in financial transactions	MoF, MoE	NT
	Clarify regulatory framework for third-party agents, particularly use of agents by NBFIs and permitted activities of agents; consider allowing agents to facilitate opening of simplified accounts	CMF	NT
Fintech	Pass Fintech Bill to address lack of legal certainty for fintech companies	MoF	I
	Establish appropriate licensing/registration requirements and develop proportionate regulatory frameworks (and/or adapt existing regulatory frameworks) for fintech activities, balancing fostering innovation with mitigating stability, integrity, and consumer protection risks[9]	CMF	NT
	Enhance supervisory capacity and resources to oversee new fintech companies and activities, including enhancing coordination[10]	CMF	NT
	Establish Open Finance System via passage of Fintech Bill and develop more in-depth regulatory frameworks to further establish technical standards and mitigate risks; consider developing standardized, common API	CMF, MoF	I
	Explore appropriate innovation policies to support Chilean fintech industry	MoF, MoE	NT
Data Privacy and Protection and Cybersecurity	Pass bill to enhance data privacy and protection framework that adequately covers issues and risks arising from DFS and fintech	MoF, CMF	I
	Establish a data protection agency with adequate resources and capacity	MoF	NT
	Pass cybercrime bill to update and strengthen national legal framework for cybersecurity	MoI	NT

[9] Contingent on passage of the Fintech Bill.
[10] Contingent on passage of the Fintech Bill.

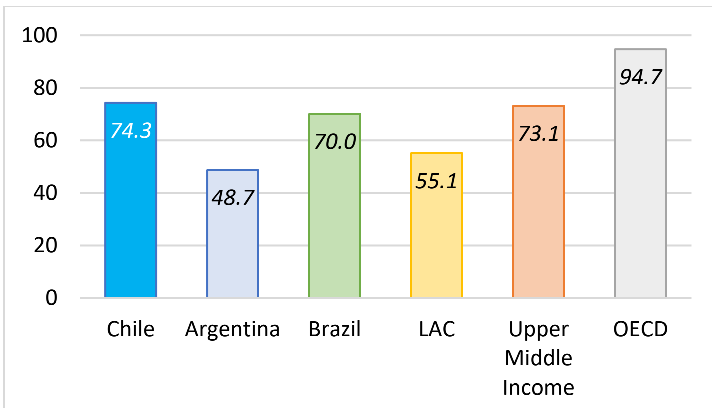
Recommendations		Responsible Authorities	Time
	Update cybersecurity requirements for the financial sector as needed and ensure application to new fintech entities	MoF, CMF, BCCh	NT
Retail Payments Ecosystem	Gather and track more granular data on merchant acceptance infrastructure and conduct analyses to identify remaining gaps among small merchants and in rural areas	BCCh, CMF	NT
	Consider appropriate policy incentives for expanding electronic payment acceptance as necessary	MoF, BCCh, CMF	NT
	Monitor and encourage interoperability, including potentially establishing standards for QR codes	BCCh, CMF	NT
	Monitor newly established interchange fees to determine if market issues are resolved and policy objectives are achieved	BCCh	NT
	Pass Fintech Bill to foster innovative new types of payment services and PSPs, including PISPs	MoF	I
	Explore effective and efficient options to expand access to retail payments infrastructure for non-bank entities	BCCh	NT
	Assess whether current t interbank transfer fees pose barriers to growth in electronic payments	BCCh	NT
	Conduct in-depth assessment on financial inclusion barriers and opportunities with respect to retail payments ecosystem	FNE, BCCh, CMF, MoF	NT
	Ensure that assessment results are integrated into broader initiatives to enhance digital payments as well as broader initiatives on financial inclusion	MoF, BCCh, CMF	NT
	Consider establishing a mechanism to ensure sustained, on-going inputs from private sector stakeholders and coordination among public sector stakeholders on retail payments ecosystem and financial inclusion	MoF, BCCh, CMF	NT
National Strategy and Coordination	Shift/expand role of government from direct financial inclusion initiatives to a greater focus on removing barriers and obstacles and providing an enabling environment and financial infrastructure	MoF	NT
	Develop a holistic, comprehensive strategy to address remaining financial inclusion challenges via a NFIS with active participation from private and public sectors	MoF, CMF, BCCh, other relevant stakeholders	NT
	Develop M&E system for NFIS with indicators tailored for digital financial inclusion	MoF	NT
	Enhance data infrastructure as needed to support NFIS M&E system	MoF, BCCh, CMF	NT

Note: "I=Immediate" is within one year; "NT=Near Term" is 1–3 years.

CURRENT STATE OF FINANCIAL INCLUSION

18. **Chile has achieved good levels of financial inclusion relative to its level of economic development across several key metrics, starting with strong levels of account ownership.** According to the World Bank's Global Findex, account ownership among adults was 74.3% in 2017, an increase from 63.3% in 2014. This figure is on par with the average for upper middle income (UMI) countries (73.1%) and higher than the Latin America and Caribbean (LAC) average (55.1%) (see Figure 1). The 2019 SBIF Financial Inclusion Report similarly reported that 77% of adults had a cash management product in 2017, with the majority consisting of demand accounts.[11] Adults on average had two cash management accounts each.[12] While some gaps exist in account ownership between men and women, rich and poor, older and younger consumers, and rural consumers, such gaps were not substantial.

Figure 1. Account ownership (% age 15+ who report having an account at a bank or other type of financial institution)



Source: Global Findex 2017

19. **However, opportunity remains for further improvement as well as pockets of underserved segments.** Account ownership lags behind the average in OECD countries (94.7%) and high-income countries (93.7%), indicating there is still room for growth. In addition, consistent gaps in financial inclusion exist for those out of the labor force or with a primary education or lower. Such underserved segments had noticeably lower levels of financial inclusion across various metrics, including account ownership, credit, savings, debit card ownership, and use of digital payments. Migrants also remain an underserved segment in Chile. The 2019 SBIF Financial Inclusion Report estimates that there were close to 1M migrants in Chile as of the end of 2017, with only 33% owning a financial instrument (either a cash management, savings, or credit product) compared to 97% for all Chilean adults.

20. **There is also opportunity to further improve the availability of account, savings, and credit products that are appropriately tailored to meet the needs of underserved consumers.** For

[11] For example, 67.4% of men had demand accounts compared to 18.6% with current accounts. Demand accounts are transaction accounts with fewer requirements for opening compared to current accounts. Current accounts are transaction accounts typically with lines of credit and checkbooks.
[12] 2019 SBIF Report on Financial Inclusion in Chile

example, Chile scored worse than peer countries in the number of adults that cite financial services being too expensive as the reason for not having an account (54.3% of Chilean adults without accounts). Unlike other financial metrics, this score was much higher than the UMI average of 28.3% and higher than peer countries such as Argentina and Mexico. In addition, 44.9% of Chilean adults without an account cite a lack of trust in financial institutions as the reason, a figure that was again much higher than the UMI average, Argentina, and Mexico.[13]

21. **Gaps remain in usage of formal, non-contractual savings products, suggesting a lack of availability of appropriate savings products such as microsavings.** The 2019 SBIF Report on Financial Inclusion in Chile indicates that 69% of adults have a savings product, consisting mainly of deferred draft savings accounts followed by savings accounts for housing. However, 20% of term savings account had a zero balance.[14] According to Global Findex, 21.1% of Chilean adults reported saving at a financial institution, much lower than the OECD average (56.5%) and lower than the UMI average (26.9%). The BCCh Household Financial Survey 2017 reported somewhat higher results, indicating that 36% of households saved in the past 12 months.

22. **With respect to credit, while much access to consumption credit exists, there is limited access to productive microenterprise finance.** The number of adults who had borrowed money in the past year was 45.4%, similar to UMI (44.4%) and higher than LAC (37.9%).[15] The most popular credit product was non-bank credit cards, followed by bank credit cards and lastly installment credit, suggesting a heavy emphasis on consumption credit.[16] While Chile scores higher than the UMI average in % of adults that borrowed from a financial institution or used a credit card, it scores lower than the UMI average in % of adults that borrowed for their business (see Figures 2 and 3).

Figure 2. Borrowed from a financial institution or used a credit card (% age 15+)

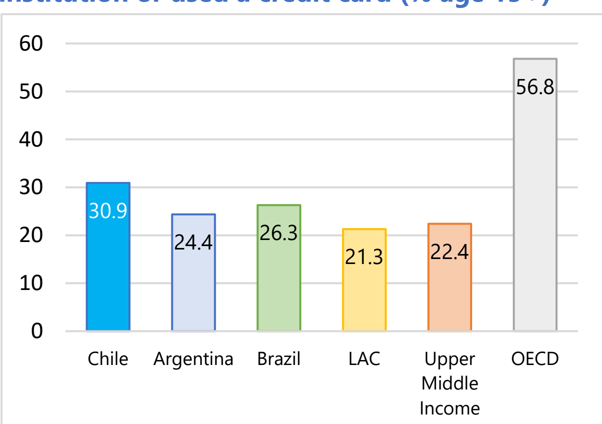
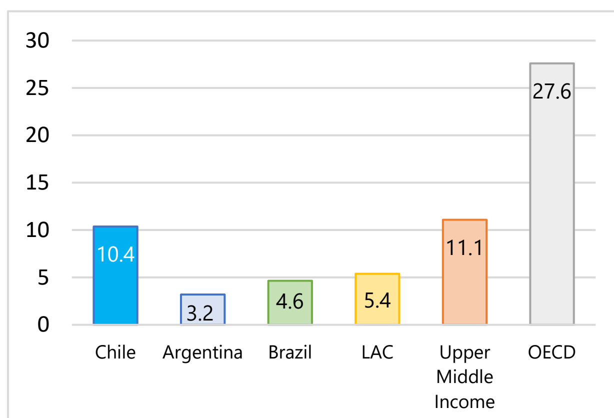


Figure 3. Borrowed to start, operate, or expand a farm or business (% age 15+)

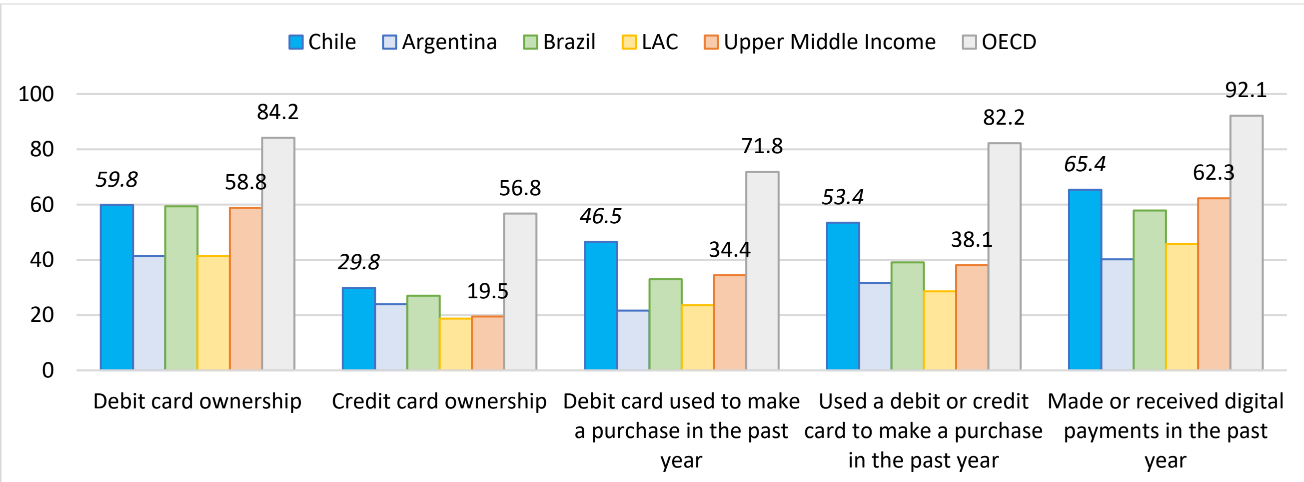


Source: Global Findex 2017

[13] World Bank Global Findex 2017
[14] 2016 SBIF Report on Financial Inclusion in Chile
[15] World Bank Global Findex 2017
[16] 2019 SBIF Report on Financial Inclusion in Chile

23. **Usage of accounts and ownership and usage of debit and credit cards have achieved relatively high levels, on par with or higher than UMI averages.** According to Global Findex, 11.8% of adults with accounts had no deposits or withdrawals in past year, a lower level of dormancy than UMI and LAC averages, though higher than the OECD average. Debit card ownership was 59.8%, similar to UMI and higher than LAC. Credit card ownership and the % of adults who had used a debit or credit card to make a purchase in the past year were both higher than UMI and LAC averages (see Figure 4).[17] Debit cards were the main payment instrument in 2017 (excluding cash), with 57% of transactions by number and 22% by value, with an average amount per transaction of CLP 31,000 Chilean pesos (~USD 38.5).[18]

Figure 4. Ownership and usage of digital payment instruments (% age 15+)



Source: Global Findex 2017

24. **Digital transactions increased significantly during the pandemic.** According to Global Findex, use of digital payments was already slightly higher than the UMI average in 2017 (65.4% vs 62.3%), though below the OECD average of 92.1%. During the COVID-19 pandemic, debit transactions increased substantially from 83.6M transactions in June 2020 to 177.4M transactions in June 2021.[19] More broadly, e-commerce also grew by 55% in 2020, with credit cards as the main payment method for e-commerce followed by debit cards and then wire transfers.[20]

25. **Further opportunities remain to expand in digital payments, particularly for underserved segments and online payments.** Reliance on cash persists among the Chilean population, with preference for use of cash at 75% (though on a downward trend) compared to 55% for debit cards and 16% for internet payments, particularly for smaller payments under CLP 15,000 (USD 17.6).[21] Of note for financial inclusion objectives, the 2017 Household Financial Survey from the

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[17] Domestic data sources suggest that figures for card ownership and usage may be higher than indicated in Global Findex. However, for consistency and comparability, Global Findex is used in this report for headline indicators.
[18] 2019 SBIF Report on Financial Inclusion in Chile. Exchange rate of 1 CLP = 0.0012 USD used throughout this note.
[19] https://www.best-cmf.cl/best-cmf/#!/cuadros/SBIF_TDEB_TATM_OPER_TXDEB_NUM?from=category&vista=grafico
[20] Outlook on E-Commerce 2021. Chamber of Commerce of Santiago.
[21] Statistics as of 2019 from Cash Use and Preferences Survey from *Why do we keep talking about cash?* BCCh powerpoint, 2020.

Central Bank of Chile (BCCh) indicates that use of non-cash means of payment increases with income. As with account ownership, there are opportunities to further increase use of digital payments to reach OECD levels as well as to continue to expand access to digital payments to underserved segments. BCCh data highlights that cash remains important for transportation and retail payments,[22] and Global Findex data indicates that a high percentage of adults pay utility bills using cash only while the % of adults paying online for internet purchases is lower than the UMI average.

26. Digital channels have been increasing in importance and represent a growth opportunity. The 2019 SBIF Report on Financial Inclusion in Chile reports that there are 14.9 branch offices, 51.9 ATMs, 2,136 POS devices, and 151.5 correspondents[23] per 100,000 adults. Recent trends show a decline in branches and ATMs per capita, with corresponding increases in POS devices and correspondents. POS devices were the most used channel by number, comprising 46% of total transaction by number and 14% by value, with an average transaction value of CLP 24,467 (USD 30.4). The internet was the second most common channel, comprising 19% of total transactions by number and 42% of total value. Some communes (the smallest administrative subdivision in Chile) and rural and remote areas lack any branch offices or ATMs, relying solely on POS devices and correspondent banking (in particular, Banco Estado's network of Caja Vecina agents). Global Findex data indicates room for further growth in digital channels, as 34.4% of adults indicated using a mobile phone or the internet to access a financial institution account in the past year, still lower than the UMI average of 41.1% and the OECD average of 56.5%.

[22] Use of cash was 55% in transportation and 52% in retail stores. From *Why do we keep talking about cash?* BCCh powerpoint, 2020.

[23] Note that these are bank correspondents and not mobile money agents, as the mobile money ecosystem in Chile is limited.

PRODUCTS

27. **While Chile has made significant progress in financial inclusion to date, there are opportunities to improve the availability of particular financial products to better meet the needs of underserved consumers.** Product-specific barriers and opportunities with respect to microenterprise finance and savings are explored below.

Microenterprise finance

28. **Consumption credit has increased steadily in recent years, particularly from non-bank lenders.** Non-bank lending has grown rapidly, particularly lending from retailers and auto loan companies, contributing to increasing concerns of indebtedness of lower-income households. Many low-income consumers have limited access to credit from banks and therefore turn to retailers, auto loan companies, or informal lenders, often at higher rates and with poorer consumer protection practices.[24] Use of credit cards has also experienced steady increases, including credit lines associated with credit cards.

29. **At the same time, microenterprise finance has decreased.** Traditional banks have generally withdrawn from productive microcredit over the past decade, instead focusing on consumption credit (for higher-income consumers). For example, Banco Santander previously had an arm of the bank focused on serving microfinance clients, but was forced to close this business due to the impact of interest rate caps. Savings and credit cooperatives, some of whom used to serve microenterprises, have mainly withdrawn from this market and turned to consumer loans and payday lending. While some banks do serve SMEs, in particular Banco Estado via BancoEstado Microempresas (BEME), they generally do not serve microenterprises and usually rely on partial credit guarantee programs such as FOGAPE or FOGAIN in order to be able serve SMEs. Only a few microfinance entities appear to be serving microenterprises currently, with operations on a small scale. As a result, there has been both a decrease in the quality of lending combined with a withdrawal from productive microenterprise finance, leading to a gap in finance for micro and small enterprises (MSEs).

Interest rate caps

30. **Two of the main factors contributing to the withdrawal from productive microenterprise finance are: (1) interest rate caps and (2) lack of credit information.** Long-standing interest rate caps were most recently tightened in 2013. Law No. 20,715 of 2013 on Protection of Money Credit Debtors changed the definition of loan size brackets for interest rate caps and the

[24] For example, 36.7% of households in the bottom 50% in terms of income level hold consumer credit with non-bank lenders (excluding credit unions and *cajas de compensación y asignación familia*), while only 16.3% of the same households held consumer credit with banks (a significantly lower percentage than households with higher income). Retail store finance has been one of the main drivers in consumer credit for lower income segments, and anecdotal evidence suggests that retailers can employ aggressive sales practices and poor lending practices. In addition, the "informal" lending sector has been growing and targets more vulnerable, lowest income consumers with very high rates. For further information, see the FSAP Technical Note on Household Indebtedness and Consumer Protection.

formulas for their calculation.[25] For the smallest loan size bracket, interest rates cannot exceed 21 percentage points above a reference rate, while for the next larger loan size bracket, loans cannot exceed 14 percentage points above 1.5x the reference rate. These changes led to a significant reduction in interest rate caps by 17 percentage points to 24 percentage points for loans smaller than USD 8,000.[26]

31. **Interest rate caps in Chile have been found to have negatively impacted access to credit and overall consumer welfare.** Recent research on the impact of Chilean interest rate caps indicates that while interest rate caps decreased market rates overall, they also curtailed access to credit, with the total number of loans falling by 19%.[27] Interest rate regulation was found to have mostly harmed credit access and overall consumer welfare, as the negative effects due to more restricted credit access (such as limiting consumption smoothing and increasing financial distress) exceeded the positive effects on consumer protection (which only accrue to those still in the market). A 2017 SBIF report similarly indicated that an estimated 151,000-227,000 consumers were excluded from access to credit due to the increased tightening of interest rate caps in 2013.[28] Excluded consumers may have potentially been driven to using informal lenders with even more exorbitant rates.

32. **In addition, interest rate caps have curtailed the availability of productive microfinance.** MSE lending by nature requires higher operational costs, and hence higher interest rates, due to the informality of such enterprises, the higher labor costs required in servicing such clients, and the limited availability of collateral, among other factors. Such rates are not predatory, but often fall victim to credit rationing due to interest rate caps. Interest rate caps are a blunt instrument no matter how they are calculated, as it is difficult to differentiate between different types of credit which warrant different types of interest rates. FSPs consistently indicated that serving the MSE segment has become unfeasible due to higher costs, lack of credit information, and interest rate caps. The microenterprise segment is also reportedly too small to fall under FOGAPE and FOGAIN programs, resulting in gaps.

33. **It is recommended that interest rate caps be removed due to negative impacts on consumer welfare and microenterprise finance.** In addition to posing net negative effects on consumer welfare, interest rate caps have severely restricted microenterprise finance. Advancements in DFS and fintech can help to partially address gaps in MSE lending, but it will be challenging to fully address such gaps without addressing the two primary obstacles to MSE finance posed by interest rate caps and lack of credit information. For example, it appears that interest rate caps may already be preventing growth in digital consumer lending, as there is a noticeable lack of consumer fintech lenders in the Chilean market utilizing innovative models such as algorithmic scoring to reach consumers with thin credit files or no credit history. These

[25] This law modified Law No. 18,010 of 1981, the underlying law on interest rate caps in Chile.
[26] Cuesta, Jose Ignacio and Alberto Sepulveda. Price Regulation in Credit Markets: A Trade-off Between Consumer Protection and Credit Access. Stanford Institute for Economic Policy Research, September 2021.
[27] Cuesta, Jose Ignacio and Alberto Sepulveda. Price Regulation in Credit Markets: A Trade-off Between Consumer Protection and Credit Access. Stanford Institute for Economic Policy Research, September 2021.
[28] Third annual report on the effects of the application of Law No. 20,715 on Conventional Maximum Rate. SBIF, March 2017.

are typically some of the first types of fintech entities to enter a market, but are missing in Chile presumably due to interest rate caps.

34. **Enhanced financial consumer protection requirements can help to address concerns with predatory lending in a more direct and less distortive manner.**[29] Responsible finance rules and product affordability and suitability requirements, combined with strong disclosure and transparency, can be more effective in trying to protect consumers, without the inevitable distortionary effects that accompany interest rate caps. Alternatively, the methodology for caps on smaller loans could be revised to be less restrictive. This could be done by raising the cap for smaller loans to a non-binding level by increasing the constant mark-up or by changing the constant mark-up into a proportional mark-up.

35. **On a separate but related note, policymakers could also consider more clearly distinguishing between consumption lending and productive lending in order to allow for better analysis.** It is difficult to ascertain the full effects of interest rate caps on different types of lending without being able to more clearly distinguish between different types of credit. One of the clear goals among Chilean policymakers in moving to the next stage of financial inclusion is to improve the quality of products. To do so will require more granular data that allows for more targeted analysis, in order to more clearly identify and quantify remaining gaps. For example, a clear definition of productive microenterprise finance may be beneficial. Being able to identify and segment such finance will allow for the design of more targeted policy initiatives to support microenterprise finance, for example via tax breaks or differentiated regulatory requirement for microenterprise finance portfolios.

Credit information

36. **Incomplete and fragmented credit information systems are the second major obstacle for microenterprise finance, as well as posing a barrier to access to finance in general.** The current state of the credit information system is described in detail in the Technical Note on Household Indebtedness and Consumer Protection, so will only be briefly summarized here. The current system is comprised of two public credit registries and several commercial credit bureaus. The first public credit registry (administered by the CMF) contains positive and negative credit information on CMF-regulated entities, but lacks historical information and is only accessible to CMF-regulated credit providers. The second public credit registry (operated by the Santiago Chamber of Commerce) collects only negative credit data from banks and retailers, among others. The General Data Protection Law restricts sharing of alternative data, such as related to utilities or telecommunications, as well as storing of historical data once a debt is paid off. As a result, credit information is fragmented across different registries, lacking in positive data, historical data, and alternative data, and not accessible to all relevant entities.

37. **The current system poses significant obstacles to access to finance (as well as issues for financial stability, competition, and consumer protection).** FSPs have a limited ability to easily assess the full credit history of a prospective customer, both positive and negative. Fintechs and other credit providers do not have access to what credit information does exist in

[29] As discussed in the FSAP Technical Note on Household Indebtedness and Consumer Protection.

the CMF system. Prospective borrowers do not benefit from positive histories, including with respect to utilities and telecommunications payments. Reforms to develop a consolidated credit registry have been discussed for years, but limited progress has been made due to opposition from various parties. The combination of interest rate caps along with the lack of full credit information results in major obstacles to adequately assess and serve MSEs. Some banks indicated they developed digital products aimed at developing longer-term customer relationships specifically to gather more information on customers in order to be able to provide more appropriate products. While such innovative developments are beneficial for financial inclusion, they are also clearly work-arounds to existing structural obstacles.

38. **Policymakers should prioritize the development of a consolidated credit registry.** A Consolidated Debt Registry Bill (Bulletin No. 14743-03) is currently under discussion in Congress, but its expected progress is uncertain. The bill is intended to provide more complete and integrated credit information and leaves space for fintechs and other entities to access the registry. Efforts should be made to pass the bill and to continue to make credit information more accessible to all types of appropriately regulated credit providers.

39. **In addition, efforts should be made to expand the credit information system to include more positive, alternative, and historical data.** While partly addressed by the Consolidated Debt Registry bill, broader expansion will likely require revisions to the General Data Protection Law (which needs to be comprehensively updated regardless, as discussed previously). Revisions to the data protection framework may be needed to allow for the reporting and sharing of historic positive as well as negative credit information, as well as alternative data such as from utilities and telecommunications providers and similar sources. Such revisions would benefit consumers who may have thin credit files but otherwise positive repayment histories from alternative sources.

40. **In parallel with such efforts, it may be useful to undertake targeted financial literacy initiatives to raise consumer awareness regarding the importance of their credit history and credit score.** It appears that consumer understanding regarding such topics is limited. More broadly, with the planned introduction of the Open Finance System, it will be beneficial to increase consumer awareness regarding the potential benefits and responsibilities involved in leveraging their data and credit history.[30]

41. **Over the longer term, it may also be worthwhile to explore the possibility of expanding access to government data to support microenterprise finance and financial inclusion.** Government agencies hold a wide range of data, including data on business registration, tax, land records, and court records, that are relevant to MSE finance. Accessing such data can often be time-consuming, costly, and difficult for FSPs. Improving access to such data in an efficient manner, such as via automated interfaces, could provide substantial benefits to financial inclusion. For example, automated access to government data platforms has enabled banks in

[30] The Fintech Bill includes disclosure requirements to consumers regarding the purpose and use of data. While such requirements are obviously vital, disclosure of information to consumers is not always sufficient and does not always successfully translate into consumer comprehension. Such requirements would therefore benefit from being complemented by broader efforts to raise consumer awareness.

India to approve MSME and personal loans online in under an hour from over 20-25 days in the past.[31] A data-sharing platform was piloted in Guiyang City, China in 2017, making data available from 51 different government bodies. As part of broader, extensive initiatives with respect to digital transformation of the state in Chile,[32] there are already plans in the works for Chilean government agencies to share data among themselves using APIs. Policymakers could consider leveraging such initiatives and eventually expanding access to external actors (such as FSPs) via data platforms.

Savings

42. **As noted previously, the overall level of (non-contractual) savings in Chile indicates there is room for improvement to reach OECD levels.** While the 2019 SBIF Report on Financial Inclusion in Chile indicates that 69% of adults have a savings product, it was noted that 20% of term savings account had a zero balance.[33] According to Global Findex, 21.1% of Chilean adults reported saving at a financial institution, much lower than the OECD average (56.5%) as well as lower than the UMI average (26.9%). The BCCh Household Financial Survey 2017 reported somewhat higher results, indicating that 36.2% of households saved in the past 12 months. The propensity to save increased with income and level of education. The top reason why households save was to face unexpected expenses (51% of households).

43. **A variety of multi-dimensional factors have been cited as contributing to the lower levels of savings in Chile.** The main factor cited by a range of stakeholders is the overall lack of a savings culture in Chile (as well as in LAC more broadly), combined with the present-day bias of consumers and the easy accessibility of credit to purchase consumer goods. In addition, consumers may feel that they already save sufficiently due to mandatory pension contributions. Other multi-dimensional factors cited include low income levels among consumers, low yields of savings products due to broader macroeconomic factors, and lack of incentives for FSPs given other easily accessible sources of liquidity. Notably, the vast majority of FSPs perceived that there are sufficient savings products in the market and did not cite this as a factor for low savings levels.

44. **While a range of factors may be preventing increased savings in Chile, there may be a gap between the savings practices and preferences of consumers and available products in the market.** For example, BCCh research highlights a discrepancy between households that have savings practices versus households that declare that they have accumulated savings in financial instruments (which is lower), indicating that part of savings are being kept informally.[34] The BCCh Household Financial Survey 2017 reported that 62.4% of families prefer to save on a monthly basis (as opposed to an annual or quarterly basis), suggesting that consumers would like to save on a relatively frequent basis. Research by ACCION similarly found that microentrepreneurs

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[31] Digital Financial Services. World Bank, 2020.

[32] This includes a Digital Transformation Law (Law No. 21,180 of 2019) and a Strategy for Digital Transformation of the State (2018-2022) that included elements related to enhancing data infrastructure of the state and open source principles such as "open data by default".

[33] 2016 SBIF Report on Financial Inclusion in Chile

[34] Marshall, Henry. Reflections on the practice of saving in Chile. BCCh, March 2015.

wanted to increase savings, but were more comfortable with informal savings as they found opening a savings account to be difficult.[35] While compulsory pension contributions are obviously beneficial for long-term savings, they do not address consumers' shorter term savings needs.

45. **Existing savings products may not be sufficiently user-friendly, particularly for meeting the needs of underserved consumers.** Existing regulation on savings accounts was noted to be quite old and rigid. Retail savings products in Chile are generally limited to time deposits and fixed-term savings accounts, with a variety of restrictions with respect to number of withdrawals, transfers, adjustments, etc. In addition, there has been little innovation in savings products to date, particularly for lower income segments, as well as a clear lack of a customer-centric approach towards product design. In fact, when asked what products they had available for savings, many FSPs referred to investment products, which are clearly not appropriate to meet the microsavings needs of low-income, low-literacy consumers.

46. **Improving product design to provide more flexible microsavings products could help to address the gap between those who want to save but lack appropriate products to do so.** It is overly simplistic to say that there is a lack of a savings culture in Chile. There are clearly underserved consumers who do have a desire to save. A range of simpler, user-friendly products are needed that are better tailored to meet the needs of underserved consumers, such as for easier account opening and more flexible withdrawals in order to address the high priority consumers place on using savings to address emergency needs.

47. **The regulatory framework for savings could be reviewed and revised to enable the provision of a broader range of flexible microsavings products at lower operational costs to FSPs.** While this step will obviously not resolve all the underlying factors behind lower non-contractual savings in Chile, it will at least provide a potential opportunity to increase savings further. The existing regulatory framework poses multiple practical constraints. Only a limited set of formal savings products are recognized by law, with the many restrictions on deposits and withdrawals as noted above. The existing framework results in reportedly high administrative costs for FSPs and inconvenience for consumers. For example, procedures for opening accounts, making deposits and withdrawals, and sending letters and communications to clients were all noted to be cumbersome and excessive,[36] which is particularly problematic for low-income consumers who prefer to make more frequent small deposits (and withdrawals) into microsavings accounts.

48. **Some FSPs have begun to offer digital products designed to encourage and facilitate savings, which should be further supported.** A few FSPs are leveraging the opportunities provided by DFS and behavioral approaches to encourage saving in small increments. However, FSPs noted that such savings were going into current accounts or mutual funds and not actual savings products, again pointing to the need to enable the provision of more appropriate savings

[35] https://www.accion.org/five-reasons-small-merchants-arent-using-financial-services-in-chile

[36] Marshall, Henry and Fernando Ochoa. Household savings in Chile: Diagnosis and policy recommendations. May 2021.

products.[37] Regardless, leveraging digital channels and behavioral economics is beneficial to encourage greater savings behavior among consumers, as such initiatives may help to begin addressing the broader lack of a savings culture in Chile.[38] In fact, BCCh launched a public consultation in January 2022 to revise the regulatory framework for savings accounts to facilitate digital savings accounts and remove certain restrictions and limitations on savings accounts. The Fintech Bill also facilitates the provision of a wider range of savings products by fintech providers. Such regulatory reforms would be beneficial to address existing savings constraints and should be actively pursued.

49. **In parallel with regulatory reforms, policymakers may wish to consider expanding upon financial literacy initiatives targeted at raising the overall propensity to save.** The National Financial Education Strategy of 2018 included initiatives to promote savings. Given the continued gaps in these areas and the importance of savings to overall consumer welfare, expanding efforts to encourage more of a savings culture in Chile would be beneficial.

Remittances

50. **Migrants are one of the remaining underserved segments in Chile, which is unsurprising.** Despite having accessibility to Cuenta RUT, migrants face a number of inherent challenges in accessing financial services. It was noted that many new migrants have arrived illegally so may be lacking a RUT and resorting to using unregulated providers. It is beyond the scope of this technical note to conduct a full analysis of financial inclusion aspects of migrants, given that the issue goes beyond the financial sector and involves broader public policy concerns. However, one area that financial sector authorities could further explore is with respect to remittances.

51. **Remittances are an important financial product for migrants.** Anecdotal information suggests that remittances in Chile have high fees and issues such as lack of confirmation of receipt. According to the WB's Remittance Prices Worldwide database, the average cost for sending remittances from Chile in 2020 was 7.8%.[39] The general benchmark for remittance costs as established in the United Nations Sustainable Development Goals is 3% of transaction value.[40] It may be worthwhile for policymakers to conduct an analysis on the current costs of remittances and the factors that are contributing to high costs, in order to determine if steps can be taken to help lower costs.[41] A few FSPs have begun developing innovative mobile apps to help facilitate sending remittances at lower costs. Further strengthening the broader DFS ecosystem, as

[37] In fact, one bank providing an innovative digital savings service indicated that customers would be steered from their current account to an investment product, as there were no better options currently.
[38] For further ideas on policy initiatives to encourage digital savings, see Financial Inclusion Beyond Payments: Policy Considerations for Digital Savings. World Bank, 2019.
[39] Average transaction cost of sending remittance from a specific country is the average of the total transaction cost in percentage of the amount sent for sending USD 200 charged by each single remittance service provider included in the Remittance Prices Worldwide database from a specific country.
[40] Target 10.c of the UN Sustainable Development Goals is as follows: By 2030, reduce to less than 3 percent the transaction costs of migrant remittances and eliminate remittance corridors with costs higher than 5 percent.
[41] For data and tools that may be useful for such analysis, see Remittance Prices Worldwide at https://remittanceprices.worldbank.org/en.

explored in depth below, could help to foster a conducive the environment for more such innovations.

Summary of recommendations:

- ***Remove interest rate caps due to net negative impacts on consumer welfare and microenterprise and instead enhance responsible finance and product suitability rules***
- ***Consider developing definition for microenterprise finance to more clearly distinguish between consumption lending and productive lending and allow for targeted policy initiatives to support microenterprise finance***
- ***Prioritize development of a consolidated credit registry via passage of the Consolidated Debt Registry Bill***
- ***Expand credit information system to include more positive, alternative, and historical data***
- ***Consider undertaking efforts to raise consumer awareness regarding the importance and use of their credit history and credit score***
- ***Over the longer term, explore possibility of providing data platforms to facilitate easy access by FSPs to government data such as data on business registration, tax, land, and court records***
- ***Revise the regulatory framework for savings to enable the provision of a broader range of flexible microsavings products at lower operational costs to FSPs***
- ***Encourage the development of products and services designed to stimulate digital microsavings***
- ***Expand on targeted financial literacy efforts to raise the overall propensity to save***
- ***Consider conducting an analysis on remittance pricing to identify factors contributing to high costs***

PROVIDERS

52. **It is also useful to consider the main provider types that contribute to financial inclusion in Chile, the challenges they face, and the opportunities they present.** In general, the majority of banks in Chile focus on serving enterprises and wealthier consumers. The sole (but large) exception is Banco Estado. In addition, there are savings and credit cooperatives and a few MFIs that are located in more rural areas and focus on underserved segments.

Banco Estado

53. **Banco Estado is a state-owned bank operating under commercial banking rules whose primary purpose is to provide banking and financial services to promote the development of national economic activities in Chile.** It has undertaken several significant initiatives specifically to advance financial inclusion, including launching Cuenta RUT in 2006. Cuenta RUT is a demand account with simplified procedures for opening, no income requirements, and no maintenance fees, which were all novelties in the market at the time (and still not particularly widespread practices). Banco Estado also operates Caja Vecina, an extensive network of agent outlets. In addition, a subsidiary BancoEstado Microempresas (BEME) was created in 1996 to provide credit services to microenterprises, targeting low-income entrepreneurs in both urban and rural areas.

54. **Banco Estado has played a huge role in advancing financial inclusion in Chile.** In fact, the majority of achievements in headline indicators in financial inclusion in Chile can be attributed to Banco Estado. Cuenta RUT currently has 13.2M customers (including 1.1M foreign residents), which represents 83% of the adult Chilean population. Cuenta RUT helped to close gender gaps in account ownership that previously existed in Chile, with women making up 51.1% of Cuenta RUT customers.[42] In addition, Cuenta RUT has contributed to the high number of debit cards in Chile, with 46 percent of debit cards in Chile linked to Cuenta RUT accounts.[43] Banco Estado also has 10.2M customers with savings accounts, representing 65% of the adult population. Caja Vecina is now comprised of 21,000 outlets, 35% of which are located in rural areas.[44] BEME is considered to be highly successful in serving SME clients.

55. **While Banco Estado's achievements are laudable, there are tradeoffs that should be considered with respect to the dominant role it has played in financial inclusion in Chile to date.** Over the long-term, it is not ideal to have the vast majority of financial inclusion advancements hinge on one entity, even an entity as successful as Banco Estado. In theory, Banco Estado's initiatives should have served as models for other commercial FSPs to emulate. However, for the most part, this does not appear to have occurred. A few banks launched their own simplified accounts after Cuenta RUT's introduction,[45] but these appear not to have gained

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[42] From *Case study: Analysis and experience of Cuenta RUT*, presentation by Pablo Correa, EVP of Banco Estado, June 2021.
[43] Financial Inclusion in a Middle-Income Country: The Case of Chile. Banco Estado, December 2017.
[44] From *Case study: Analysis and experience of Cuenta RUT*, presentation by Pablo Correa, EVP of Banco Estado, June 2021.
[45] Such as Banco Santander, Banco de Chile, and BCI.

nearly as much traction. Neither the BEME model nor the Caja Vecina model are emulated at scale. This raises the question of whether Banco Estado's model is fully sustainable. If not, there are risks that its financial inclusion achievements are also not fully sustainable.

56. **Banco Estado arguably operates on a quasi-commercial basis, which poses some indirect but potentially negative side effects.** For example, many stakeholders have indicated that Cuenta RUT was an unprofitable product when first launched. Representatives from Banco Estado themselves have stated that Cuenta RUT generated significant losses for the bank for many years.[46] In fact, it was not until 2020 that Cuenta RUT stopped being a deficit for Banco Estado.[47] To be clear, not every product within a commercial enterprise will necessarily be profitable. But the fact that Cuenta RUT achieved such high uptake while being unprofitable raises two possible concerns regarding deterring innovation and impeding competition.

57. **Banco Estado's success may have deterred participation from other market-based players.** It would obviously be difficult to compete with a product such as Cuenta RUT that meets the needs of underserved consumers and is essentially subsidized by Banco Estado. Again, Cuenta RUT's achievements in advancing account ownership and usage stand on their own. However, they may have prevented other players from entering the market with similar but somewhat more expensive products, or may have delayed advancements by other FSPs to develop lower cost digital accounts to compete for this market.

58. **Banco Estado's model has also appeared to lead it to engage in behavior that may limit competition.** For example, Banco Estado indicated that interchange fees currently make Cuenta RUT sustainable and that lower interchange fees would damage its feasibility.[48] Some stakeholders also noted that Banco Estado's objections to webscraping arise not solely due to security issues (discussed later in the DFS Ecosystem section), but also from its desire to avoid incurring interbank transfer fees. While such fees have similar negative impacts for other banks, Banco Estado's dominant market position naturally gives it greater influence in maintain such fees, at the potential expense of deterring new entrants, innovation, or greater competition that could benefit financial inclusion.

59. **As a longer-term strategy, it is suggested that policymakers build off the strong foundation that Banco Estado has achieved while actively working to diversify the range of stakeholders contributing to financial inclusion.[49]** Over the long-term, relying on Banco Estado (with its implicit subsidies) for the majority of further advances in financial inclusion may not be the most efficient or sustainable approach. An enabling environment should be provided so that a broader range of actors can play a larger role in financial inclusion, helping to foster greater innovation and competition to solidify the gains already made and make further advancements in a sustainable, market-based manner. For example, the recommendations in the

[46] https://www.latercera.com/pulso/noticia/bancoestado-perdio-cerca-10-000-millones-la-cuentarut-2018/476615/

[47] From Banco Estado ppt "Case Study: Analysis and experience of Cuenta RUT" by Pablo Correa, Executive Vice President, June 2021

[48] Based on WB conversations with Banco Estado staff during the FSAP mission.

[49] In fact, efforts have already been made to move in this direction, such as the issuance of regulation on pre-paid cards.

next section regarding development an enabling environment for DFS will help to work towards these goals, as such advancements will benefit all FSPs.

60. **Banco Estado should also be encouraged to modernize its infrastructure and to work in a more cooperative manner with other market players.** Banco Estado will obviously continue to play a critical role in financial inclusion, even if the scope is broadened to involve other stakeholders. It has been noted that Banco Estado runs on legacy infrastructure, which contributes to its higher operational costs and resulting reliance on interchange and interbank transfer fees. Upgrading its infrastructure would therefore help Banco Estado to lower its operational costs while also improving its security. Given the major role it plays in financial inclusion, more advanced infrastructure would also better position Banco Estado to innovate in DFS. In parallel with upgrading its infrastructure, Banco Estado could be encouraged to work in a more cooperative manner with other market players.

Savings and credit cooperatives and MFIs

61. **Savings and credit cooperatives and MFIs are two provider types that primarily focus on serving underserved segments.** As highlighted in the 2019 SBIF Report on Financial Inclusion in Chile, savings and credit cooperatives provide services to underserved segments including women and the elderly. In addition, 80% of cooperative branches are located outside of the Metropolitan region (the Santiago administrative region). There are 40 savings and credit cooperatives in total, of which the largest seven are subject to CMF supervision and represent 95% of the sector's total assets.[50] The remaining savings and credit cooperatives fall under the supervision of the Ministry of Economy, Development and Tourism. Savings and credit cooperatives provide small loans, typically payday loans, as well as savings products, helping to address the lack of savings in Chile. A few savings and credit cooperatives also still provide microenterprise finance. While a much smaller sector, MFIs focus on underserved segments as well, using traditional group lending methodologies to provide microenterprise finance.

62. **However, both savings and credit cooperatives and MFIs note that they face some supervisory challenges that hinder their ability to operate and contribute to financial inclusion.** Supervision was reported to be overly strict and not proportionate to the risks posed by such entities or the realities of their operations. For example, it was mentioned that frequent updates and documentation are required on MSE clients, posing an overly burdensome requirement, while there have been instances of additional provisioning required. MFIs, which are regulated by CMF with respect to interest rates, similarly indicated excessively heavy auditing and high-frequency reporting requirements that are not realistic for MFIs or appropriate for their type of productive microenterprise product. While such requirements obviously have important supervisory objectives, any potentially excess compliance costs impose a heavy burden on already thin operating margins for both provider types.

63. **Policymakers may wish to explore whether supervisory approaches towards savings and credit cooperatives and MFIs could be further adjusted to better match the profiles of such entities, without conflicting with important supervisory objectives.** Given the unique role

[50] From CMF presentation to FSAP team

that both provider types play in serving underserved segments, removing any undue burdens to such provider types would be beneficial for financial inclusion. CMF indicates that proportional supervision is already utilized for savings and credit cooperatives. While effective supervision is obviously required to safeguard consumer funds in the case of savings and credit cooperatives, it may be useful to further explore whether supervisory approaches can be further adapted to the unique aspects of microfinance methodologies for both savings and credit cooperatives and MFIs, for example by distinguishing between consumption lending and productive microenterprise finance. The Basel Committee on Banking Supervision has issued guidance on supervising non-bank financial institutions (NBFIs) relevant to financial inclusion, which highlights certain adjustments that may be warranted in the case of microfinance. For example, "regulators and supervisors should set simple loan administration and documentation standards that are efficient and feasible to maintain relative to the nature of the customers and their businesses, which may differ from those of conventional retail lending."[51]

64. Given their contributions to financial inclusion, both savings and credit cooperatives and MFIs could be provided with greater policy support in general. For example, policymakers could consider a more gradual transition from supervision under the Ministry of Economy, Development and Tourism to the CMF, with support and training provided to cooperatives to strengthen operational and risk management systems. Such a transition would require additional resources for CMF. The MFI sector could also be provided with further policy support, including exploring appropriate pathways towards becoming deposit-taking MFIs (which would require changes to the legal framework).

Summary of recommendations:

- ***As a longer-term strategy, work to diversify the range of stakeholders contributing to financial inclusion***
- ***Encourage Banco Estado to modernize its infrastructure and operate in a more cooperative manner with other market players***
- ***Explore whether supervisory approaches towards savings and credit cooperatives and MFIs could be further adjusted to unique aspects of microfinance methodologies without negatively impacting supervisory objectives***
- ***Provide greater policy support to savings and credit cooperatives and MFIs given their unique role in serving underserved segments***

[51] See Guidance on the application of the Core Principles for Effective Banking Supervision to the regulation and supervision of institutions relevant to financial inclusion. Basel Committee on Banking Supervision, September 2016. The Guidance also notes that "a clear regulatory definition of microcredit as distinguished from other loan types is necessary for adequate supervisory oversight of microcredit risk."

DFS ECOSYSTEM

65. **At a broader level, digital financial services (DFS) can be leveraged to help Chile further advance in financial inclusion and increase the availability of convenient products and services for underserved segments.** The previous sections focused on gaps with respect to specific financial products and opportunities to strengthen the enabling environment for particular FSPs. Enhancements to the DFS ecosystem can provide a range of positive benefits to financial inclusion more broadly by allowing FSPs to reach more consumers at lower costs. Digital channels can increase accessibility to "last mile" consumers in remote areas. The lower operational costs and greater scalability of DFS can enable FSPs to develop new products better tailored to meet the needs of underserved segments and at more affordable costs to consumers, for example with respect to microsavings or remittances products. Fostering greater innovation and competition is particularly beneficial in Chile given the consolidated market power in a few key incumbents. Digital platforms can be leveraged to build up relationships with new customers, allowing FSPs to gather much needed information on customers that is currently lacking due to limitations in the Chilean credit information system. Fintech innovations can help to address gaps in SME finance and expand the range of digital payment options. In essence, DFS and fintech can help to bridge remaining gaps between supply and demand in financial services in Chile.

66. **The Chilean financial sector appears to be at a critical transition stage, with steady and increasing expansion in DFS and fintech offerings.** In the past few years, FSPs have started to leverage digital channels more broadly while introducing more innovative, digitally-oriented products such as basic accounts offered digitally. The introduction of prepaid accounts, which are easier to open online than other types of transaction accounts, experienced rapid uptake from 0 to 4 million such accounts in the two years since such products were introduced.[52] Fintech companies and new payment service providers (PSPs) have also increased in the market.

67. **However, regulatory gaps and other barriers are currently impeding the growth of a vibrant, robust DFS ecosystem.** For example, fintech companies and payment service providers (PSPs) are currently operating without a legal and regulatory framework. There is a lack of clarity regarding appropriate policies for digital onboarding. Key infrastructure that is needed to enable expansion of DFS, such as digital ID and open banking, is currently lacking. Strong frameworks to mitigate against the enhanced risks that arise from DFS and fintech, such as in the areas of data privacy and cybersecurity, are also lacking. Opportunities exist to enhance the retail payments ecosystem to further expand digital payments and DFS. Many of these issues are closely linked – open banking requires close consideration of digital IDs and data privacy and protection, while opening up the market for innovative PSPs requires consideration of how conducive the retail payments ecosystem is to growth and innovation. Such issues therefore should ideally be tackled in a holistic and integrated manner.

[52] From WB meetings with CMF.

68. **Over the long-term, well-functioning DFS ecosystems require that range of related elements be put in place in order to foster innovation and competition while mitigating risks.** These elements can be grouped into the following three categories:[53]
    - Conducive legal and regulatory frameworks (e.g. enabling regulatory framework for DFS providers, fintech companies, non-bank PSPs; simplified customer due diligence (CDD); agent networks; consumer protection; competition policy; data protection and privacy; open banking)
    - Enabling financial and digital infrastructure (e.g. well-functioning and interoperable payments infrastructure; credit infrastructure; digital connectivity infrastructure)
    - Ancillary government support systems (e.g. digital ID; digitization of G2P; digitized government data platforms)

69. **While some of these elements are already in place in Chile, other elements are missing or could be strengthened.** For example, existing digital connectivity infrastructure appears quite conducive to DFS, with a reported 28.7M mobile phones in the country (nearly 1.5 phones per person), 80% of which are smartphones. An estimated 98.6% of the population are covered by 3G/4G/LTE.[54] Such infrastructure provides a strong foundation to expand in mobile payments and mobile financial services. Elements such as legal frameworks for agents, simplified CDD, and data privacy and protection are in place, but would benefit from updating and enhancement. Elements that are currently lacking include an enabling framework for fintech providers and PSPs, digital ID, open banking, etc, although many initiatives are currently in progress to address these areas. The following sections explore the key gaps and constraints in Chile with respect to such elements.

Enabling environment for DFS

Digital onboarding

70. **A foundational element to enabling DFS is facilitating digital transactions and in particular digital onboarding.** Digital onboarding can vastly shorten the time required to onboard new customers and allow for greater outreach to unserved consumers. Facilitating digital transactions and digital onboarding requires that enabling regulatory frameworks and infrastructure are in place to support electronic know-your-customer (eKYC), digital ID, digital verification, e-signature, and digital documentation.

71. **FSPs in Chile are starting to conduct digital onboarding, but lack of regulatory clarity and infrastructure may be impeding the widespread use of full digital onboarding.** Banks and fintech companies are currently developing their own digital onboarding and eKYC procedures based on their respective risk tolerances. Those FSPs conducting digital onboarding appear to mainly rely on scanning of ID cards along with selfies, which are then verified against existing databases, along with obtaining multiple pieces of personal contact information and validating such information. Some FSPs are also utilizing clave unica, a unique key issued by the

[53] Examples of policy actions and enablers for DFS drawn from Digital Financial Services. World Bank Group, April 2020. See Annex I for an illustration of these policy actions and enablers.
[54] Statistics provided to FSAP team by Chilean authorities.

Identification and Civil Registry Service of Chile that consumers can sign up for and use to access government services.

72. **The current policy approach towards AML/CFT, including towards digital onboarding and eKYC, is to allow FSPs to determine their own risk-based identification processes and then review such processes during supervision activities.** Such an approach has its benefits as it allows for flexibility and innovation based on assessed level of risk. However, this approach also creates a certain degree of uncertainty in the market, particularly as new DFS and fintech entities enter the market. For example, in the past, it appears that there was limited uptake of simplified customer due diligence (SDD) measures for accounts by other FSPs beyond Banco Estado, as Cuenta RUT was the sole simplified account product for many years.[55] Current digital onboarding processes also appear to vary across FSPs. Inconsistent approaches towards digital identification and verification could lack robustness and create inefficiencies. FSPs have indicated that barriers to digital verification and authentication due to lack of digital ID are "not insurmountable," suggesting that while alternative approaches are available, there is room for improvement to facilitate such processes.

73. **In order to provide greater clarity and certainty to the market, policymakers may wish to consider issuing guidance on digital onboarding and remote identification and authentication.** It may be preferable to proactively provide guidance on digital onboarding and eKYC (including potential applications of simplified eKYC) to encourage greater usage by market participants, including new entrants.[56] For example, Bangladesh issued specific guidelines on eKYC that clarify the digital onboarding process, create classifications for simplified and regular eKYC, and include mobile financial services providers, PSPs, and fintech companies in eKYC processes. The Open Finance Scheme in the Fintech Bill also provides for the possibility of sharing data related to KYC, another avenue which could be pursued to more broadly facilitate eKYC.

74. **Clarifying digital identification and facilitating digital ID infrastructure would also be useful to enable more widespread digital onboarding.** Digital ID can make customer verification easier, cheaper, and more secure. Digital ID will also be useful to facilitate open banking models which rely on strong customer authentication.

75. **Policymakers should consider issuing clear guidelines or clarifications on the appropriate, risk-based use of digital ID.** The Financial Action Task Force (FATF) notes that *"authorities should consider clarifying that non-face-to-face on-boarding may be standard, or even low-risk for CDD purposes, when digital ID systems with appropriate assurance levels are used for remote*

[55] It is also worth noting that Chile is the only country in a review of regulatory practices for financial inclusion in LAC that does not have a regulatory framework for simplified accounts. Argentina, Brazil, Colombia, Mexico, Paraguay, Peru, and Uruguay all have a simplified account product establish by law or regulation. See Liliana Rojas-Suarez and Lucía Pacheco. 2017. "An Index of Regulatory Practices for Financial Inclusion in Latin America: Enablers, Promoters, and Preventers." CGD Working Paper 468. Washington, DC: Center for Global Development.

[56] For example, see Policy Model for Digital Identity and Electronic Know Your Customer (eKYC). Alliance for Financial Inclusion, September 2021. This paper provides guidance on improving digital ID systems and leveraging them for eKYC, including guiding principles for regulatory frameworks for digital ID and eKYC and guidelines for digital onboarding.

customer identification/verification and authentication."[57] FATF has also issued extensive guidance on digital ID assurance frameworks and technical standards which can be used to assess the reliability of digital ID systems for AML/CFT purposes.[58]

76. **In addition, Chilean policymakers should consider the merits of establishing a unified digital ID solution.** Developing a common, industry-wide digital ID and strong customer authentication infrastructure can be more beneficial, efficient, and robust than developing different processes at each FSP. Countries such as India and Peru have developed digital IDs and leveraged such systems to expand uptake of bank accounts and mobile money services. For example, India's JAM (Jan Dhan Aadhaar Mobile) trinity approach integrated the Aadhaar ID system and payment applications to facilitate opening and accessing accounts, with the Aadhaar ID system including an eKYC service to facilitate customer verification.[59]

77. **Policymakers could consider what existing ID infrastructure could be leveraged for purposes of a unified digital ID solution and what regulatory reforms and enhancements would be required.** Clave unica has been put forth as a good basis for a digital ID and existing initiatives are already being undertaken to use it as a single authentication channel for all procedures between Chilean consumers and the state.[60] If leveraged to also serve as a digital ID for DFS purposes, existing rules regarding the use of clave unica would need to be revised in order to enable use by FSPs for digital onboarding purposes and to ensure that all relevant entities have access to the registry's database for verification and authentication purposes. Existing systems would likely need to be upgraded to ensure safety and robustness. Policymakers should consider how widespread clave unica currently is among the Chilean population, particularly among underserved consumers.[61] Coordination will be required between various authorities, including beyond the financial sector.

E-signature and electronic documentation

78. **E-signature and electronic documentation are also key elements for enabling digital transactions and DFS.** To be beneficial for DFS, e-signature must have legal recognition and also be accessible and easy to use for consumers.

79. **While e-signature is legally recognized in Chile,[62] several barriers limit the accessibility of e-signature and electronic documentation for financial consumers.** As noted in the bill to amend the existing e-signature law introduced in 2012, e-signature has experienced very limited uptake with only around 15,000 users of advanced e-signature certification services in Chile. Several aspects of the existing legal framework excessively limit the applicability of e-signature and electronic documentation. For example, e-signature cannot be used for bills of exchange or

[57] Digital Identity. Financial Action Task Force, March 2020.
[58] Digital Identity. Financial Action Task Force, March 2020.
[59] For further country examples of digital IDs and their uses in the financial sector, see G20 Digital Identity Onboarding. World Bank Group/GPFI, 2018.
[60] See Presidential Instruction for Digital Transformation at https://cms-dgd-prod.s3-us-west-2.amazonaws.com/uploads/pdf/Instructivo-N%C2%BA001-Transformacion-Digital-2019.pdf
[61] Data provided to the FSAP team by Chilean authorities indicate that 12.9M people currently have a clave unica.
[62] Law No. 19,799 of 2002 on Signature and Electronic Documents

promissory notes, limiting the ability to utilize e-signature for certain loans as well as for accounts with guarantees for lines of credit associated with the account. In fact, there were conflicting opinions on whether e-signature could be used for such accounts, highlighting the uncertainty and lack of clarity regarding the ability to use e-signature. As a result, while FSPs may initiate enrollment of new customers online, customers may still be required to visit branches in person to sign final documentation. In addition, there is limited judicial recognition of electronic documents, creating obvious uncertainty for all parties. From a practical perspective, e-signatures are also expensive for average consumers to obtain.

80. **As noted, a bill was introduced in 2012 to amend the law on e-signature and electronic documents to address its deficiencies.** However, the bill has not advanced since then. Policymakers should work towards advancing the bill to amend the law on e-signature and electronic documents in order to facilitate use of e-signature and electronic documents, including for DFS.

Agents

81. **While not directly related to digital transactions, agent networks typically play a critical role in DFS as they provide a low-cost channel to reach consumers in remote and underserved areas.** While the role of agent networks in advancing financial inclusion may be decreasing to some degree due to the shift towards digital channels and mobile financial services, agent networks will still inevitably be needed to reach consumers in remote and underserved areas. Some underserved consumers will still need physical access points for withdrawals, bill payments, etc, including in those locations without branches or ATMs (both of which are trending downwards). For example, while Banco Estado reports that total transactions via digital channels have increased 18.5x in the past 10 years, transactions via Caja Vecina, its agent network, have also increased 8x over the same time period.[63]

82. **The agent network in Chile is primarily comprised of Banco Estado's Caja Vecina outlets.[64]** According to the World Bank's Global Payment Systems Survey, there were 38,406 agents in Chile in 2015. Banco Estado reported having 31,932 Caja Vecina outlets in 2021, an increase from 25,400 outlets in 2018.[65] Caja Vecina agents are typically small local retailers, 35% of which are located in rural areas. They provide transactional services such as money orders, deposits, transfers, balance inquiries, and credit payments.

83. **The regulatory approach towards agent regulation appears to be general and open-ended.** Agents are not formally defined in Chilean law. RAN[66] Chapter 20-7 on Outsourcing of Services provides the only rules related to banks contracting external service providers to carry out operational activities. The content of Chapter 20-7 is quite general, with responsibility left to FSPs to manage risks related to outsourcing as they deem appropriate. For example, there are no rules

[63] From Banco Estado ppt "Case Study: Analysis and experience of Cuenta RUT" by Pablo Correa, Executive Vice President, June 2021

[64] There are also some agents of other private banks as well as of Servipag, a PSP.

[65] From Banco Estado ppt "Case Study: Analysis and experience of Cuenta RUT" by Pablo Correa, Executive Vice President, June 2021

[66] CMF's Updated Collection of Rules, or Recopilacion Actualizada de Normas (RAN)

regarding minimum requirements for agents, authorization, or permissible activities. This approach is in contrast with LAC peers, where regulatory frameworks generally specify which regulated financial institutions may use agents (including cooperatives, PSPs, and e-money issuers) and what activities agents are permitted to undertake. In particular, agents are allowed to open simplified accounts or collect and deliver documentation for account opening in Brazil, Colombia, Mexico, Paraguay, Peru, and Uruguay, which is not permitted to be outsourced in Chile.[67]

84. **The lack of a clear regulatory framework for agents could potentially hamper greater use of agent networks.** While the lack of specificity in the regulatory framework does in theory give FSPs greater flexibility, ambiguity may also be a deterrent to innovation. The lack of clarity regarding what activities agents are permitted to conduct may be discouraging other FSPs from utilizing agents. Given that the Caja Vecina network is already established, other FSPs should in theory be able to utilize them as agents as well. However, this practice does not seem to be widespread. It is also unclear whether PSPs, fintech entities, or other NBFIs can leverage agents, posing a barrier to such entities reaching remaining underserved segments.

85. **Policymakers should consider providing clearer guidance regarding the use of agents.[68]** In particular, greater clarity would be beneficial regarding what types of entities are permitted to use agents and what are permitted activities of agents. It would also be useful to allow agents to either open simplified accounts (which would need to be defined) or to collect and deliver documentation to open standard accounts, given that there remain pockets of consumers in Chile without accounts.

Summary of recommendations:

- ***Provide clearer guidance on digital onboarding, remote identification and authentication and pursue approaches to facilitate shared KYC***
- ***Issue clear guidelines on appropriate, risk-based use of digital ID***
- ***Consider establishing a unified digital ID solution***
- ***Consider leveraging existing infrastructure such as clave unica, which will require amending existing rules on access and usage and upgrading systems***
- ***Amend law on e-signature and electronic documents to remove barriers to using e-signature and digital documents in financial transactions***
- ***Clarify regulatory framework for agents, particularly use of agents by NBFIs and permitted activities of agents; consider allowing agents to facilitate opening of simplified accounts***

[67] See Liliana Rojas-Suarez and Lucía Pacheco. 2017. "An Index of Regulatory Practices for Financial Inclusion in Latin America: Enablers, Promoters, and Preventers." CGD Working Paper 468. Washington, DC: Center for Global Development.

[68] For further information on the main topics that should covered in regulatory frameworks for agents and examples of different country approaches to such topics, see Kerse, Mehmet, Patrick Meagher, and Stefan Staschen. 2020. "The Use of Agents by Digital Financial Services Providers." Technical Note. Washington, D.C.: CGAP.

Fintech

86. **The fintech market in Chile has experienced steady growth in recent years.** FinteChile, the national fintech association, indicated that there are currently 218 fintech companies in Chile, 105 of which are members of the association. Finnovista reported 49% growth in the number of fintech startups from December 2017 to June 2019. As of 2021, 23% of startups are in payments and remittances, followed by enterprise financial management at 19% and lending at 13%.[69] This differs from regional peers such as Brazil, Mexico, and Colombia, where lenders typically make up the largest segment of fintech startups. Fintechs have an active user base of 4 million users.[70]

87. **Though lending may comprise a smaller percentage of fintech startups by number, alternative finance in Chile is the third largest by volume in LAC, behind only Brazil and Mexico.** The total volume of alternative finance in Chile was USD 150.7M in 2017, a 54% increase from 2016. Alternative finance includes invoice trading, P2P lending, and crowdfunding. Chile led the LAC region in terms of volume of business-focused alternative financing (as opposed to consumer-focused). In particular, invoice trading represented 79% of Chile's total volume of alternative finance.[71]

88. **Fintech can play a role in addressing remaining gaps in financial inclusion in Chile, particularly with respect to digital payments and MSME finance, and foster greater innovation overall.** Fintech companies are already introducing new types of digital payment products and services, as evidenced by the high number of fintech payments and remittances startups, helping to improve the availability and convenience of digital payment services. Anecdotal evidence suggests that fintechs are introducing more innovation than incumbent banks, which have generally been slow to innovate (for example, with respect to credit scoring models). Growth in the fintech ecosystem can therefore help to spur greater competition and innovation within the broader banking industry, further benefitting financial inclusion. Fintechs in Chile are also helping to address gaps in MSME finance. In contrast to other regions, 85% of the total volume of alternative finance across LAC was channeled to MSMEs.[72] In addition, 56% of consumers of alternative finance in Chile are unbanked while 15% are classified as underbanked, clearly demonstrating the role that alternative finance is playing in addressing remaining gaps in financial inclusion.[73]

89. **A number of gaps and barriers currently hamper the long-term growth of the Chilean fintech ecosystem.** The legal and regulatory approach to date has followed more of a wait-and-

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69 Finnovista Fintech Radar Chile

70 Finnovista Fintech Radar Chile

71 In 2017, total volumes by type of alternative finance were estimated to be USD 119M for invoice trading, USD 24M for marketplace/P2P lending, USD 4.7M for revenue/profit-sharing crowdfunding, USD 2.3M for equity-based crowdfunding, USD 200,000 for reward-based crowdfunding, and USD 50,000 for donation-based crowdfunding. See Reaching New Heights: The 3rd Americas Alternative Finance Industry Report. Cambridge Centre for Alternative Finance, December 2018.

72 Reaching New Heights: The 3rd Americas Alternative Finance Industry Report. Cambridge Centre for Alternative Finance, December 2018.

73 Reaching New Heights: The 3rd Americas Alternative Finance Industry Report. Cambridge Centre for Alternative Finance, December 2018.

see approach. Legal and regulatory frameworks have yet to be put in place for fintech, creating legal uncertainty for fintech companies, obstacles to accessing financial infrastructure, and an unlevel playing field between fintechs and banks. Such legal uncertainties may be contributing to conflicts between incumbent banks and fintechs, such as with respect to the use of webscraping by fintechs to initiate transactions on bank websites on behalf of their clients.

90. **As outlined in the IMF/WBG Bali Fintech Agenda (BFA),[74] policymakers should balance between enabling fintech and fostering competition and innovation while mitigating attendant risks.** Key enablers of fintech include a clear legal framework, appropriate regulatory and supervisory approaches, open banking, and supportive innovation policies. At the same time, risks arising from fintech (and DFS more broadly) should be mitigated, particularly regarding data privacy and protection and cybersecurity. Legal and regulatory approaches towards fintech vary across jurisdictions, but enabling fintech often requires updating existing laws, adjusting existing regulatory frameworks, and introducing new laws and regulations. Regardless of approach, policymakers should ideally seek to ensure that there are no gaps in regulatory coverage, an activity-based approach is utilized in order to create a level playing field, and regulatory and supervisory approaches are proportional and risk-based.

Legal, regulatory, and supervisory frameworks

91. **A broad Fintech Bill[75] was introduced to Congress in September 2021 covering a wide range of topics.** The objectives of the Fintech Bill are to promote and facilitate the adoption of technology to promote financial innovation, the entry of new actors and greater competition, and the development of new financial products and services with greater scope to reach underserved people and businesses. The bill establishes a legal framework for a number of different types of fintech activities, including collective financing platforms (equity or loans), alternative systems for the transaction of securities and financial instruments (including invoices, derivatives, virtual financial assets or crypto assets), and credit and investment advisers, which will now fall under the regulatory perimeter of CMF. Digital assets such as stable coins will be regulated by the BCCh as a payment service. The bill also establishes regulatory frameworks for an Open Finance Scheme and payment initiation service providers (PISPs).

92. **As a critical step forward, Chilean policymakers should pass the Fintech Bill to help address the lack of legal certainty for fintechs.** As highlighted in the BFA, legal frameworks should be modernized to provide greater legal clarity and certainty regarding fintech activities and support trust and reliability in financial products and services. Greater legal certainty will be particularly beneficial for collective financing platforms and new types of PSPs and allow for expanded growth in platform finance and online payments.

93. **A balanced regulatory framework will be needed in order to implement the Fintech Bill.** The Fintech Bill establishes a high-level legal foundation for a range of fintech activities and designates the CMF to develop more detailed regulatory requirements. Regulatory frameworks

[74] The Bali Fintech Agenda. IMF/WBG, October 2018.

[75] Bill to Promote Financial Competition and Inclusion through Innovation and technology in the Provision of Financial Services. As of April 2022, the bill is in its second constitutional stage of parliamentary discussion.

should be developed or existing frameworks adapted as needed to address new or enhanced risks posed by fintech companies in a proportionate manner that does not pose an undue burden on fintech companies. Regulatory frameworks should balance fostering innovation with mitigating risks to stability, integrity, and consumers. Clear and appropriate licensing, registration, and competency requirements and processes will need to be established. Minimum standards will need to be established for key topics such as product suitability, risk management and governance, cybersecurity, conflicts of interest, insolvency, platform reliability, etc. that are well-tailored to the unique aspects of fintech activities.[76] This is in addition to standard requirements for financial consumer protection (on disclosure and transparency, fair treatment and business conduct, dispute resolution, etc), which should also be applied to fintechs.

94. Supervisory capacity will also need to be enhanced to effectively supervise new fintech entrants and activities. Supervisory practices will need to be adapted for new types of fintech activities, including use of innovative technologies at incumbent FSPs, to address new types of risks or enhanced risks. There will likely be need to more closely coordinate supervisory activities across existing units given the hybrid nature of certain fintech activities, such as platform finance.

Open banking

95. Open banking can foster increased competition and innovation, allowing consumers to access a broader range of more tailored financial services, potentially at lower costs. Open banking is defined by the Bank of International Settlements (BIS) as "the sharing and leveraging of customer-permissioned data by banks with third-party developers and firms to build applications and services and to initiate payments."[77] Customer-permissioned data includes retail customer data held by banks, such as data on customer transactions, personal identification data, and customer financial history. Types of third parties accessing customer data include data aggregators, PSPs, and financial and investment advisers. Services can include financial management tools, payment initiation, product comparison tools, and cross-selling of products.

96. Open banking could help to address the remaining challenges to financial inclusion in Chile, specifically regarding lack of customer data and the need for more tailored products and services. During the FSAP, FSPs and fintechs consistently highlighted lack of information as their main barrier to serving an expanded range of consumers. Open banking would allow authorized third parties to gain insights into potential customers and develop new and improved services for such customers that are catered to customers' specific needs. Customers would therefore have increased access to a broader range of appropriate products from a broader set of FSPs, including incumbents and new entrants. Greater transparency and competition may also help to lower pricing, one of the key barriers flagged by consumers in Chile. Having an established, secure system for sharing of data would also remove the necessity to use approaches such as webscraping.

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[76] For examples of the types of risks to consumers that can arise from P2P lending and crowdfunding, and emerging regulatory approaches being employed by financial sector regulators to mitigate such risks, see Consumer Risks in Fintech. World Bank, April 2021. For country examples of regulatory responses to fintech activities more broadly, see Policy Responses to Fintech: A Cross-Country Overview. Bank of International Settlements, January 2020.

[77] Report on open banking and application programming interfaces. BIS, November 2019.

97. **However, open banking raises a number of risks, particularly related to third-party liability, data privacy and protection, and cybersecurity.** Open banking increases the flow of customer data between various entities (including entities that may not have as robust risk mitigation measures as incumbent FSPs), increasing opportunities for cyberattacks and data breaches. Data privacy concerns can also arise, particularly regarding uninformed consent to use of personal information.

98. **Chilean policymakers should move forward with establishing an open banking initiative given the clear benefits to financial inclusion.** The Fintech Bill establishes the basic principles and rules for an Open Finance System which allows for the exchange of data on clients (with client consent) between different institutions. The bill specifies the participants of the Open Finance System[78] and the types of data that can be shared[79] and tasks the CMF with developing further technical standards on the exchange of information, obtaining consent, authentication of clients and participants, and security standards. The Fintech Bill also already incorporates several key provisions related to data protection and cybersecurity and the Open Finance System that go beyond existing requirements in the current Chilean legal framework.

99. **Once the Fintech Bill is passed, appropriate regulatory measures and safeguards should be developed.** Among other topics, regulatory frameworks should expand upon the provisions included in the Fintech Bill to address risks related to third-party liability, data privacy and protection, and cybersecurity in more depth as needed. This could include addressing topics such as informed consent and legitimate use of consumer data, appropriate risk management at third parties, and the responsibility of regulated entities to conduct due diligence.[80] Existing safeguards regarding fraudulent or erroneous transactions should be applied to open banking and may need adaptation. Appropriate, proportional standards will also need to be established for the registration of information-based service providers. Policymakers may also wish to consider whether a standardized, common application programming interface (API) would be beneficial. Some banks are already using partner/private APIs to share information with third-party service providers. Open APIs could improve competition and efficiency.[81]

Policy initiatives to support innovation

100. **A range of policy initiatives can be employed to help support the fintech industry.** Innovation facilitators such as innovation hubs/offices, accelerators, and regulatory sandboxes

[78] Participants include information provider institutions (banks, issuers of credit cards and payment cards, and potentially payment card operators, savings and credit cooperatives, and a range of other entities), information-based service provider institutions, account provider institutions, and PISPs.

[79] Such information includes information on general terms and conditions of financial products and services, identification and registration information of clients, information on commercial conditions contracted and history of transactions carried out by clients, etc.

[80] For example, the Fintech Bill contemplates CMF issuing further rules regarding how express consent mechanisms will work within the Open Finance System. The recent WB publication on The Role of Consumer Consent in Open Banking may be useful in developing such rules.

[81] The approach towards open APIs varies across countries. For example, in Hong Kong, the Hong Kong Monetary Authority (HKMA) published an Open API Framework in 2018 to encourage banks and third parties to work together to develop innovative banking services to improve customer experience.

can help foster innovation.[82] Innovation hubs/offices typically take the form of a central contact point within a financial sector authority that can provide support, advice, or guidance for fintech entities (regulated or unregulated). Regulatory sandboxes are more formal initiatives, providing a virtual environment to live test new products or services in a controlled manner, while regulatory accelerators typically involve partnerships between innovative firms and government authorities to innovate on a particularly technological use case.[83] For example, both Mexico and Colombia have innovation offices and sandboxes to support the fintech industry.

101. **There are currently some government programs in place to support Chilean start-ups and/or technology, but few initiatives specifically targeting fintechs.** For example, the Corporation for the Promotion of Production (Corporación de Fomento a la Producción or "CORFO"), operates Start-Up Chile, the leading business accelerator in Latin America. In addition, Chile is expected to launch a regulatory sandbox on artificial intelligence (AI) in 2021 which will allow for experimentation in new AI applications and business models. However, it appears there is a lack of policies or initiatives that are targeted to support fintech specifically. Fintech entities noted that the lack of clear communication channels with authorities can pose an obstacle.

102. **Chilean policymakers may wish to consider developing policy initiatives that are the most useful and appropriate for the stage of development of the fintech Chilean ecosystem.** The aforementioned approaches could be explored, preferably in coordination with fintech industry bodies.[84] Policymakers should be clear about the objectives of selected policy initiatives and ensure adequate legal mandates and resources to undertake any particular initiative. In addition, existing or planned programs to support start-ups or new technology could be expanded to ensure coverage of the financial sector and fintech specifically.

Summary of recommendations:

- ***Pass Fintech Bill to address lack of legal certainty for fintech companies***
- ***Establish appropriate licensing/registration requirements and develop proportionate regulatory frameworks (and/or adapt existing regulatory frameworks) for fintech activities, balancing fostering innovation with mitigating stability, integrity, and consumer protection risks***
- ***Enhance supervisory capacity to oversee new fintech companies and activities, including enhancing coordination***
- ***Establish Open Finance System via passage of Fintech Bill and develop more in-depth regulatory frameworks to further establish technical standards and mitigate risks; consider developing standardized, common API***
- ***Explore appropriate innovation policies to support Chilean fintech industry***

[82] For country examples and comparisons of some of these innovation facilitators, see How Regulators Respond to Fintech: Evaluating the Different Approaches—Sandboxes and Beyond. World Bank, 2020.
[83] For case studies and lessons learned from 73 sandboxes in 57 jurisdictions around the world, see Global Experiences from Regulatory Sandboxes. World Bank, 2020.
[84] It was noted by policymakers that regulatory sandboxes may not be feasible in Chile due restrictions in the Chilean legal system.

Data Privacy and Protection and Cybersecurity[85]

Data privacy and protection

103. **New methods of data sharing, data portability, and data analytics have numerous potential benefits for financial inclusion.** Many DFS and fintech business models are driven by an exponential increase in the volume of data being collected, stored, processed, and exchanged by a variety of ecosystem players. Big data analytics, algorithms, artificial intelligence (AI), and machine learning (ML) are increasingly being employed for fintech products such as digital credit, robo-advisory services, and insurtech. Such innovative uses of consumer data can expand the range of underserved consumers that can be served at scale and with lower cost, including those with thin credit files.

104. **However, advances in data collection and data analytics introduce new and enhanced issues and risks related to data privacy and protection.** With respect to data privacy, personal data may be used without a consumer's consent or used inappropriately. More commonly, consumer consent may be technically obtained, but such consent is often not informed, particularly when it comes to consumers with low financial literacy. Algorithms can lead to biased outcomes or discriminate based on sensitive attributes. With respect to data protection, data sharing among a broader ecosystem of actors, some of whom may fall outside of the financial sector regulatory perimeter, combined with increased reliance on outsourcing and cloud computing increase potential vulnerabilities to data breaches and cyberattacks.

105. **Enhanced data privacy and protection are important complements to advancements in DFS and fintech and a key component of a well-functioning DFS ecosystem.** As highlighted in BFA, policymakers should develop robust financial and data infrastructure to sustain the benefits of fintech. Such infrastructure should be resilient from disruptions, including cyberattacks, and support trust and confidence in the financial system by protecting the integrity of data and financial services. Regulatory authorities worldwide have started to introduce updated laws and regulations on data privacy and protection, including the EU's General Data Protection Regulation (GDPR).[86]

106. **While Chile has a data privacy law in place, it is generally considered to be quite weak and poorly enforced.** Chile's data privacy law dates from 1999.[87] While the law addresses the basic concepts regarding the transmission, treatment, and storage of personal data, it has many inherent limitations. For example, the law included a number of exceptions which allow personal data to be processed without a data subject's consent, lacked details on violations and set very low fines, and did not designate an authority for enforcement.

[85] Both data privacy and protection and cybersecurity are broad topics that extend beyond the financial sector. The following sections discuss data privacy and protection and cybersecurity focused primarily on those elements that relate to digital financial inclusion.
[86] Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data
[87] Law No. 19,628 of 1999 on the Protection of Private Life

107. The data privacy and protection framework should be enhanced to adequately cover the issues and risks to data privacy and protection that may arise from DFS and fintech.[88] As both DFS and fintech activities increase in the Chilean financial sector, it will be important to ensure that the data privacy and protection framework keeps pace with such advances. For example, the data privacy and protection framework should enhance requirements for informed consent, such as introducing concepts like active, tiered, and dynamic consent.[89] Limitations could also be placed on what qualifies as legitimate use of personal data, regardless of consent. Expanding the definition of personal data to incorporate alternative data and introducing measures to foster algorithmic accountability would also be beneficial.[90] Data security standards should be strengthened to prevent unauthorized access, destruction, use, or disclosure of data. Liability for non-compliance should also be clarified and enhanced, including with respect to third-party service providers.

108. A bill to update the data privacy and protection framework is currently being discussed in Congress and has recently made significant progress.[91] The bill includes many updates to bring the data privacy and protection framework in Chile closer in line with the GDPR approach, while also establishing a data protection agency.[92] Chilean policymakers should work towards passage of the bill and ensure that it adequately covers the elements discussed in the above paragraph.

109. To ensure effective oversight of the new enhanced data privacy and protection framework, a data protection agency should be established. The new agency will require sufficient resources and capacity to undertake its broad mandate. Coordination will also be required across a range of relevant authorities, including financial sector authorities.

Cybersecurity

110. As with data privacy and protection, DFS and fintech introduce new and enhanced cybersecurity risks. As DFS relies heavily on data infrastructure and third-party service providers, heightened risks can arise due to cyberattacks and system failures. Fintech may introduce new challenges due to the use of new technologies and the involvement of new entities that may not be covered by existing cybersecurity requirements nor have the same degree of sophistication in terms of risk management as regulated entities.

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[88] Note that passage of a data privacy and protection bill is not a necessary precondition for passage of the Fintech Bill. These two efforts can proceed separately.

[89] Tiered consent generally refers to separate consents for processing of different types of data for different purposes, as opposed to broad consent. Dynamic consent refers to consent based on ongoing communication between consumers and data processors.

[90] The Fintech Bill includes provisions related to algorithmic accountability, but application appears to focus primarily on the securities sector.

[91] Bill No. 11144-07 Regulating the Processing and Protection of Personal Data and Creating the Data Privacy Authority

[92] In addition, as previously noted, the Fintech Bill includes enhanced data privacy and protection rules primarily relating to the Open Finance System. The Fintech Bill also contemplates CMF issuing further rules regarding how express consent mechanisms will work within the Open Finance System. The recent WB publication on The Role of Consumer Consent in Open Banking may be useful in developing such rules.

111. **Chile currently has the elements of a cybersecurity framework in place.** There are various laws and regulations that include cybersecurity-related provisions[93] as well as a National Cybersecurity Policy 2017-2022. A Computer Security Incident Response Team (CSIRT) has been established and state administrative bodies are required to report all cybersecurity incidents to it. In 2020, Chile scored 68.83 out of 100 on ITU's Global Cybersecurity Index (GCI).[94] The GCI scored Chile higher on legal measures and lower on technical measures (i.e. effective mechanisms and institutional structures at the national level to reliably deal with cyber risks and incidents) and capacity development.

112. **However, there have been recent incidents of cyberattacks and high-level recognition that the cybersecurity framework could be further strengthened.** High-profile cyberattacks have included attacks on Banco de Chile, Banco del Estado, and Falabella. As mentioned previously, there is also conflict currently between incumbent banks and fintechs utilizing webscraping to initiate transactions on bank websites on behalf of clients. Objections from banks regarding use of such technology are primarily based on cybersecurity concerns. Strengthened standards and greater clarity and consistency regarding application of such standards could partially help to resolve such conflicts (as would passage of the Fintech Bill in order to allow for safer mechanisms such as APIs).

113. **A cybercrime bill was introduced in 2018[95] that would update and replace the current law on computer crimes from 1993.** The bill would update and strengthen the cybersecurity framework in Chile to bring it in line with the Budapest Convention on Cybercrime,[96] which provides an international guideline for the development of comprehensive national legislation against cybercrime. In particular, the bill increases the responsibility of legal entities to take reasonable measures to prevent cybercrimes and increases liability if such measures are not taken. The Fintech Bill also includes enhanced cybersecurity provisions, again primarily related to the Open Finance System.

114. **Chilean policymakers should pass the cybercrime bill to update the national framework for cybersecurity.** Bringing the high-level legal framework in line with the Budapest Convention would provide a stronger foundation to address emerging cybersecurity issues in the country.

115. **Financial sector authorities should ensure that regulatory frameworks for cybersecurity in the financial sector are also updated and strengthened as needed.** International financial sector organizations have issued an increasing range of guidance on cybersecurity specific to the financial sector that can be drawn from. This includes high-level policy considerations on

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[93] This includes Law No. 19,223 of 1993 on computer crimes; Supreme Decree No. 533 which created the Inter-Ministerial Committee on Cybersecurity and includes a definition of cybersecurity; Presidential Instructive No. 8 which directed public bodies to implement urgent measures with respect to cybersecurity, and sectoral regulation such as RAN 20-10 on Information Security and Cybersecurity Management and Resolution No. 1318 from the Undersecretary of Telecommunications on Technical standard on general cybersecurity fundamentals for the design, installation and operation of networks and systems used for the provision of telecommunications services.

[94] Within the Americas region, Chile scored 7th out of 35 countries. Chile ranked below Brazil, Mexico, Uruguay, and the Dominican Republic, but ahead of Argentina and all other LAC countries.

[95] Bulletin No. 12192-25

[96] ETS No. 185 of 2001

financial cybersecurity from the BIS,[97] research reports on cyber resilience from the Financial Stability Board (FSB),[98] and cyber resilience oversight expectations from the European Central Bank (ECB).[99] In particular, it will be important to ensure that new fintech entities are covered by existing cybersecurity requirements (such as RAN 20-10) and that such requirements are appropriately adapted for any new risks arising from DFS and fintech, such as strengthening risk management, governance, and reporting requirements. Supervisory frameworks and activities will likely need to be updated and strengthened to complement new laws or regulation on cybersecurity.

Summary of recommendations:

- ***Prioritize passage of bill to enhance data privacy and protection framework that adequately covers issues and risks arising from DFS and fintech, including strengthening informed consent, qualification on legitimate use, algorithmic accountability, data security standards, and liability***
- ***Establish a data protection agency with adequate resources and capacity***
- ***Pass cybercrime bill to update and strengthen national legal framework for cybersecurity***
- ***Update cybersecurity requirements for the financial sector as needed and ensure application to new fintech entities***

Retail Payments Ecosystem[100]

116. The retail payments ecosystem plays a critical role in digital financial inclusion. As highlighted in the G20 High-Level Principles for Digital Financial Inclusion, policymakers should "*expand the digital financial services ecosystem—including financial and information and communications technology infrastructure— for the safe, reliable and low-cost provision of digital financial services to all relevant geographical areas, especially underserved rural areas.*" In particular, the G20 High-Level Principles highlight the need for working in partnership with the private sector to ensure a robust, safe, efficient, and widely accessible retail payments infrastructure that provides all users with convenient, reliable points of service for sending and receiving payments and conducting other digital financial services. In addition, digital platforms that are instantaneous and accessible to all service providers can significantly reduce the cost of digital transactions for both service providers and consumers, encourage innovation and new players to enter the market, and improve interoperability and widen consumer choice.

117. Chile's relatively advanced national payments infrastructure and recent and ongoing changes in the retail payments ecosystem provide a strong foundation. As highlighted previously, the levels of ownership and usage of cards and usage of digital payments in Chile are on par or above UMI averages, though below OECD averages, and have increased during the pandemic. As of August 2021, there were 23.6M debit cards and 13.9M credit cards in the

[97] Regulatory approaches to enhance banks cyber-security framework. BIS, August 2017.
[98] See FSB's Cyber Resilience Archives.
[99] Cyber resilience oversight expectations for financial market infrastructures. ECB, 2018.
[100] The following section only covers select aspects of the retail payments ecosystem as relevant to digital financial inclusion.

Chilean market.[101] A 2016 law[102] opened the door for issuance of payment cards (digital or non-digital) by non-bank entities with simpler authorization and identification requirements. There are now an estimated 4M prepaid cards in the market, with the rapid uptake suggesting there were previously unmet needs among consumers that were not fully met by banks (and potentially re-emphasizing the lack of clarity regarding the use of SDD measures). Fintechs have entered the market providing innovative new online payment solutions, particularly compared to incumbent banks that have focused on more traditional offerings to date. Chile also recently transitioned from a three-party to a four-party card scheme, in which Transbank is no longer the sole acquirer.

118. A range of opportunities exist to advance these trends and further enhance the retail payments ecosystem to help expand DFS and address remaining gaps in financial inclusion. Expanding accessibility and use cases for digital payments could benefit lower-income Chileans who continue to rely on cash. In fact, BCCh's 2018-2022 Strategic Plan includes an explicit focus on incorporating technological change into its work, particularly with respect to low-value retail payments, and includes important initiatives on instant payments and central bank digital currencies (CBDCs). Expanded merchant acceptance infrastructure, particularly in remote areas and with smaller merchants, increased interoperability, and appropriately calibrated interchange fees could all help to achieve these objectives. Fostering the entry of new, innovative PSPs and ensuring equitable access to payments infrastructure could help to further expand online payments, as could addressing conflicts with interbank transfer fees. More broadly, closer coordination in implementing a long-term strategic vision for development of the retail payments ecosystem to enhance digital financial inclusion would be beneficial, particularly given the number of ongoing initiatives that impact various elements of the retail payments ecosystem. The following section will discuss each of these opportunities in turn.

Merchant acceptance infrastructure

119. Opportunities remain to expand merchant acceptance infrastructure, particularly among smaller merchants and in remote areas. As highlighted by BCCh, one of the remaining weaknesses/ challenges in Chile is the significant proportion of retailers and service providers that don't operate with cards or electronic payments, as well as unbanked segments of the population.[103] Official statistics in terms of merchant acceptance points were unavailable. However, relatively consistent anecdotal evidence emerged from FSAP meetings. Transbank reports having 200,000 merchants, equating to roughly 25-30% coverage of the market. Other estimates suggest that 900,000 merchants lie outside Transbank's coverage,[104] suggesting much room for further growth. In particular, acceptance of electronic payments is lower in rural areas and with smaller and informal merchants.

120. Chile has recently undergone a transition from a three-party to four-party card scheme. Transbank previously had a monopoly as the sole acquirer by mandate of bank and

[101] https://www.best-cmf.cl/best-cmf/#!/welcome

[102] Law No. 20,950

[103] Priorities for the Central Bank of Chile's payment schedule. Presentation by Mario Marcel to Senate Finance Committee, September 27, 2021.

[104] https://www.bnamericas.com/en/features/taking-digital-payments-to-the-far-flung-reaches-of-chile

non-bank card issuers. With the transition to a four-party model separating issuers and acquirers into two separate entities in order to increase competition and foster innovation, new acquirers and sub-acquirers have entered the market (such as Banco Estado's Compraqui and Banco Santander's GetNet).

121. **Anecdotal evidence suggests that new acquirers and sub-acquirers have rapidly added 150,000 merchants, greatly expanding the reach of the retail payments infrastructure.** Transbank's market share by volume of sales has decreased from 95% to 85% and is expected to decrease further to 60%,[105] while at the same time the overall volume of card payments has increased. New acquirers in some cases have focused on target verticals/niches (such as the restaurant business). New acquirers are also investing in new technologies and solutions such as mPOS and QR codes, which are particularly beneficial for financial inclusion as they are lower cost for merchants than renting a traditional POS. mPOS devices have been taken up by an estimated 80-90,000 merchants, primarily smaller merchants. For example, Banco Estado's Compraqui focuses on small businesses including in remote areas. It has added 30,000 merchants since November 2020,[106] with a stated goal of servicing 150,000 merchants within the next 5 years and with a particular focus on mPOS and QR codes.

122. **In order to continue positive trends in expanding electronic payment acceptance to smaller merchants and rural areas, it is recommended that more granular data be tracked and analyzed to monitor trends.** Official, granular, and up-to-date data appears to be lacking currently or not easily accessible, which hampers efforts to identify remaining gaps and opportunities. In particular, it would be useful to track both the total increase in number of merchants with electronic payment acceptance infrastructure as well as more granular data such as the size and location of the merchant and the type of acceptance infrastructure. For example, it is currently unclear whether expansion of acceptance infrastructure to new merchants is primarily via verticals or via smaller or remote merchants. With more such data available, analyses could be conducted to determine more precisely what is the size of remaining gaps among small merchants and where there are pockets of geographic areas with less coverage of infrastructure. Geospatial mapping could be considered to identify specific areas where gaps still remain in coverage.

123. **After remaining gaps are identified, policy incentives could be considered to expand electronic payment acceptance where necessary to address such gaps.** A range of approaches have been utilized in other countries to encourage electronic payment acceptance, such as merchant fiscal incentives, subsidized POS terminals, encouraging merchant formalization, addressing interchange fees and merchant discount rates (discussed further below), and awareness campaigns.[107] In order to determine whether such incentives would be needed, policymakers would need to have a fuller view of rapidly evolving market trends and then determine which incentives may be appropriate to address remaining gaps.

[105] From WB meetings with Transbank staff during the FSAP mission.

[106] From Banco Estado ppt "Case Study: Analysis and experience of Cuenta RUT" by Pablo Correa, Executive Vice President, June 2021.

[107] For example, see Electronic Payments Acceptance Incentives: Literature Review and Country Examples. World Bank, April 2020.

124. One incentive that could be considered is policy action to encourage interoperability. Interoperability is a key element to enabling DFS ecosystems. As highlighted in the G20 High-Level Principles for Digital Financial Inclusion, policymakers should encourage service providers to enable interoperability of access points and channels, further expanding the reach of consumer service access points and the overall convenience to holders of transaction accounts. The principle of interoperability is referenced several times in the Fintech Bill. Interoperability is particularly relevant with respect to transaction channels such as ATMs, POS terminals, and agents.

125. There appear to be emerging issues in Chile specifically with respect to the interoperability of QR codes. QR codes are not currently interoperable between different QR code providers. While this is not unusual during the early stages of development of a new solution in a country, there are potential concerns if proprietary solutions gain significant market share and impose de facto market standards, creating challenges to competition, as well as decreasing efficiency and convenience for consumers. In some countries, policymakers have taken steps to foster interoperability of QR code payments, such as in India and Japan.[108]

126. Chilean policymakers should continue monitoring the development of QR codes and consider taking stronger action if needed to establish standards to ensure interoperability. Some private sector stakeholders in Chile indicated that more clarity from regulatory authorities regarding security standards for QR would be helpful in ensuring greater interoperability. Given the potential that QR codes have to facilitate electronic payments at low costs, expanding the use of such technology should be encouraged and facilitated.

Interchange fees

127. During the transition to a four-party card system, issues arose regarding interchange fees and merchant discount rates (MDR). The transition from a three-party to four-party system resulted in the introduction of interchange fees (fees paid by the acquirer to the issuer), which increased MDRs (fees paid by the merchant to its acquirer, the largest component of which is the interchange fee). Larger merchants are now paying increased MDRs (they previously benefitted from lower, subsidized rates), while MDRs have decreased for smaller merchants.

128. This situation resulted in a number of issues in market development. Up until September 2021, Transbank's pricing had been frozen pending approval of its pricing structure by the Tribunal for the Defense of Free Competition (TDLC). As Transbank's pricing had been frozen at a low level, new acquirers may have been deterred from entering the market due to difficulties in competing with low pricing. More broadly, the situation created uncertainty in the market and may have hampered the issuance of new cards. Many banks indicated they were waiting to see how the situation evolved. At the same time, widespread issues have arisen with respect to

[108] For example, in Japan, one of the first actions of the Commission for the Promotion of Cashless Settlements was the standardization of QR code payments. For further details, see Electronic Payments Acceptance Incentives: Literature Review and Country Examples. World Bank, April 2020. Also see Payment aspects of financial inclusion in the fintech era. CPMI/WBG, April 2020.

prepaid cards being rejected. Large retailers have begun rejecting prepaid cards (except for their own branded cards) due to higher MDRs.

129. **A law was passed in August 2021 to regulate interchange fees for payment cards and a committee has been established to set interchange fees.**[109] The Committee for the Setting of Limits on Exchange Rates was given the task of determining the limits to interchange fees applicable to card transactions every three years. Limits are to be set with the objective of fostering a competitive, inclusive, transparent, and highly penetrated card market. The committee recently issued its first ruling in February 2022.[110]

130. **Policymakers should monitor whether the newly established interchange fees, as well as fee levels going forward, resolve the market issues noted above and help to achieve policy objectives.** For example, for financial inclusion purposes, it may be useful to establish lower fees for small and micro merchants or those operating in remote areas, thereby expanding access to electronic payments for underserved consumers. At the same time, fees should not be established at so low a rate as to make business unsustainable for issuers. It will be necessary to balance between various competing policy objectives, including the fact that there is still opportunity to expand in ownership of cards.

131. **Policymakers may also wish to consider taking action regarding the rejection of prepaid cards if such issues continue to occur widely.** Establishing interchange fees may partially address this issue, though not completely. Policymakers should continue to monitor the situation to determine if further guidance or encouragement may be required to address the issue, as it poses an obvious inconvenience to consumers and goes against interoperability principles, hampering further growth of the market.

Fostering innovation in electronic payments

132. **More broadly, there is significant opportunity to foster greater innovation in electronic payments beyond cards.** As highlighted previously, there is still room for growth in online payments in Chile. Opening the market to new types of PSPs would help to foster innovative new payments products and services. In parallel, this would need to be accompanied by greater access to retail payments infrastructure. The G20 High-Level Principles on Digital Financial Inclusion notes that one of the key actions that can be taken to expand a country's digital financial ecosystem is to establish open payments platforms linked to clearing and settlement systems that provide safe and efficient access to banks, non-bank financial institutions, and emerging service providers. In addition, interbank transfer fees may be hampering growth of electronic payments.

133. **Policymakers should pass the Fintech Bill to foster innovative new types of payment services and providers, including PISPs.** The current draft of the Fintech Bill modifies the law on prepaid cards to allow for electronic transfer of funds between accounts by non-banking

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[109] Law 21,365

[110] As stated in Exempt Resolution No. 1 dated February 4, 2022, maximum interchange fees are now set at 0.6% for debit cards, 1.48% for credit cards, and 1.04% for prepaid cards.

entities, opening the door for new innovative payment products such as e-wallets and person-to-person mobile payments. The bill also establishes PISPs as participants in the Open Finance System with the capacity to initiate transfers from payment accounts to third parties on behalf of customers. Both components of the bill would help to increase competition and innovation in the retail payments ecosystem, particularly with respect to electronic payments. The bill would also provide greater legal certainty to payment initiators than in the existing market, where they operate without a legal or regulatory framework, and would presumably address some of issues underlying the webscraping conflict.

134. In parallel, policymakers should work towards expanding access to retail payments infrastructure for non-bank entities. Non-bank entities currently have limited access to retail payments infrastructure, which has hampered competition and innovation as a result. The Open Finance System would partly help to address this barrier. Policymakers should explore further initiatives to expand access to retail payments infrastructure. BCCh has already identified developing faster/instant retail payments and further expanding electronic funds transfer (EFT) between interbank accounts by expanding participation of non-bank entities and maximizing interoperability as key components of its current agenda. In particular, BCCh recently issued a circular that authorizes the creation and regulation of clearinghouses for low-value payments (CPBV).[111] Such clearinghouses would be encouraged to be open to new participants and would provide space for experimentation with new types of services.[112] However, it should be noted that market reaction to the initial proposal to create CPBV appeared to be mixed. Some entities stated that CPBV would be helpful, others noted that the initiative would be ineffective if not scalable or interoperable with other clearinghouses, while some believed the idea had potential but only if developed appropriately. It is suggested that policymakers carefully consider a variety of options to expand access to retail payments infrastructure for non-bank entities in a manner that is effective and efficient, whether by creating new open infrastructure or expanding access to existing infrastructure.

135. It may also be worthwhile for policymakers to assess current levels of interbank transfer fees. As noted by the BCCh, there are currently operational obstacles to and limited use of ETF.[113] Several entities highlighted that interbank transfer fees pose an obstacle to interbank transfers and that banks have little incentive to expand in such transfers as they bear the cost of such fees. It may be worthwhile for policymakers to examine the current pricing structure and incentives more closely, in particular to ensure that current pricing arrangements do not impede other initiatives to expand electronic payments, including via PISPs.

Ensuring a holistic and coordinated approach

136. The retail payments ecosystem is clearly undergoing rapid change in Chile. New players have entered the market and new types of payment solutions and infrastructure are being introduced. At the same time, a variety of important government initiatives are underway to

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[111] BCCh Circular No. 3013-898, issued on January 20, 2022.

[112] It should be noted that market reaction to the initial proposal to create CPBV appeared to be mixed. Some entities stated that CPBV would be helpful, others noted that the initiative would be ineffective if not scalable or interoperable with other clearinghouses, while some believed the idea had potential but only if developed appropriately.

[113] *Priorities for the Central Bank of Chile's payment schedule.* Presentation by Mario Marcel, September 2021.

further expand the retail payments ecosystem. While many of these initiatives will likely have benefits for financial inclusion, they are not necessarily being pursued with financial inclusion as the main objective.

137. It may be worthwhile to conduct a more detailed assessment specifically on financial inclusion and the retail payments ecosystem. As can be seen from the issues highlighted above, advancing digital financial inclusion will require taking a holistic approach and addressing barriers along multiple dimensions, including infrastructure, pricing, interoperability, competition, market dynamics, and legal and regulatory frameworks. Further research is warranted on topics such as merchant acceptance infrastructure and interbank transfer fees. In addition, demand-side topics such as financial and digital literacy of consumers as well as small merchants should be considered, as well as opportunities to leverage large-volume recurrent payment streams to increase usage of electronic payments.

138. An in-depth assessment focused specifically on digital financial inclusion, such as an assessment based on the PAFI[114] framework or a more targeted study, could be beneficial to policymakers to help ensure that all relevant dimensions from a digital financial inclusion perspective have been fully considered. The results of such an assessment could then be integrated with broader strategies to develop the retail payments ecosystem. For example, the BCCh has already established a high-level working group on digital means of payments, with the objective to create a medium-term strategy covering retail payment methods as well as a range of broader topics. The results of the assessment could feed into such a strategy. The results should also feed into broader financial inclusion efforts, including the development of a National Financial Inclusion Strategy (NFIS).

139. Further enhancing the retail payments ecosystem and addressing key barriers to digital financial inclusion will also require closer coordination and inputs from a range of stakeholders. Given that the retail payment ecosystem is in a transition stage and the desire to reshape market dynamics going forward, it will be critical to ensure buy-in and input from the full range of market participants, including new entities, into development plans. Private sector input on plans to enhance the retail payments ecosystem appears to be limited to date. Policymakers could explore mechanisms to allow for more sustained on-going input from private sector stakeholders, whether through a forum, working group, or task force. Closer coordination would also be beneficial between relevant government authorities, including BCCh, CMF, and the TDLC, to further ensure that a consensus vision and a holistic, coordinated strategy is pursued.

Summary of recommendations:

- ***Gather and track more granular data on merchant acceptance infrastructure and conduct analyses to identify remaining gaps among small merchants and in rural areas***
- ***Consider appropriate policy incentives for expanding electronic payment acceptance as necessary***
- ***Monitor and encourage interoperability, including potentially establishing standards for QR codes***

[114] Payment aspects of financial inclusion. CPMI/World Bank, 2016.

- ***Monitor new interchange fees to determine if market issues are resolved and policy objectives are achieved***
- ***Pass Fintech Bill to foster innovative new types of payment services and PSPs, including PISPs***
- ***Explore effective and efficient options to expand access to retail payments infrastructure for non-bank entities***
- ***Assess whether current interbank transfer fees pose barriers to growth in electronic payments***
- ***Conduct an in-depth assessment on financial inclusion barriers and opportunities with respect to the retail payments ecosystem***
- ***Ensure that assessment results are integrated into broader initiatives to enhance digital payments as well as broader initiatives on financial inclusion***
- ***Consider establishing a mechanism to ensure inputs from private sector stakeholders and coordination among public sector stakeholders on retail payments ecosystem and financial inclusion***

NATIONAL STRATEGY AND COORDINATION

National financial inclusion strategy

140. **Chile has achieved high levels of financial inclusion on core metrics, particularly in account ownership and usage and the availability of retail credit.** Further advancing in financial inclusion beyond this will likely pose a more complex task. Reaching the "last mile" of consumers, addressing gaps in particular products such as savings or microenterprise finance, increasing usage of online payments, and improving quality pose more complicated long-term challenges.

141. **To tackle the remaining financial inclusion challenges in Chile, it will be necessary to take a holistic and systemic approach.** The Government of Chile has already achieved substantial gains through ambitious initiatives such as the establishment of Banco Estado, FOGAPE and FOGAIN, Chile Cuenta,[115] and other key initiatives. Moving forward, it would be beneficial to shift (or expand) the government role from focusing on direct initiatives to providing a more enabling environment. Addressing remaining challenges requires developing a multi-dimensional approach that considers market dynamics, balancing innovation with new risks, harnessing competitive forces, addressing long-standing supply-side barriers (such as interest rate caps and lack of consolidated and comprehensive credit information) and demand-side constraints (such as low financial literacy), and enhancing financial infrastructure to support long-term, sustainable advances in financial inclusion.

142. **A national financial inclusion strategy (NFIS) is a good vehicle to develop and implement a holistic and systemic approach and ensure coordinated action across stakeholders.** An initiative is already underway to develop a NFIS, led by the Advisory Commission for Financial Inclusion. The Advisory Commission for Financial Inclusion was created in 2014[116] with the mission to advise the President of Chile on the design and implementation of public policies that improve and balance the levels of financial inclusion. The Commission's main pillars are: (i) financial education, (ii) consumer protection, and (iii) access and use of financial products and financial services. The Commission published a National Financial Education Strategy in 2018 and has recently relaunched efforts on developing a NFIS after experiencing COVID-related delays.

143. **To be forward-looking and effective in advancing digital financial inclusion, the NFIS should take a more systemwide, market-based approach.** Currently, the main pillars of this initiative appear to focus on financial consumer protection, financial education, and access and use of products, with a focus on suitability. With respect to access and use, there is some reference to addressing issues such as POS expansion, consolidated credit information, and incentives. However, there is limited reference to issues related to the broader DFS ecosystem or enabling regulatory reforms, for example with respect to savings or NBFIs. It is recommended

[115] Chile Cuenta is an initiative by the Ministry of Social Development intended to increase availability and promote the adoption of electronic payments.
[116] Via Presidential Decree No. 954

that the NFIS' focus be expanded in a systematic manner to include the broader range of topics discussed in this technical note, such as enhancements to the retail payments ecosystem, credit infrastructure, the enabling environment for innovative new players, and the impact of interest rate caps. As several initiatives are already underway on these topics, the NFIS provides a timely vehicle to ensure synergies and coordination across initiatives and across responsible authorities.

146. **The NFIS should be developed with active participation from all relevant stakeholders, including across government agencies and from the private sector.** The development process of an NFIS is a critical opportunity to develop consensus across stakeholders regarding what are the key remaining challenges and barriers to financial inclusion and what are the shared objectives for advancing financial inclusion. The Advisory Commission for Financial Inclusion is coordinated by the MoF and already includes representatives from a range of various ministries.[117] It is unclear if the Advisory Commission currently includes representatives from authorities relevant to digital transformation and the digital economy. Given the need to focus on DFS within the NFIS as well as the need to align with the many broader initiatives related to digital transformation that are currently ongoing in Chile, expansion of the Advisory Commission to additional relevant stakeholders could be considered. In addition, efforts should be made to ensure that the private sector is actively involved throughout the development of the NFIS as well as in broader initiatives related to financial inclusion.[118] Many of the issues and recommendations discussed in this technical note will benefit from the buy-in and input the private sector in order to be addressed and implemented effectively.

Indicators and data infrastructure

147. **Key indicators will need to be selected to monitor progress in digital financial inclusion.** Establishing a set of digital financial inclusion indicators (and respective targets) is another opportunity to build consensus around financial inclusion priorities across stakeholders and to focus on policy efforts. Global guidance exists on best practices for developing a core set of financial inclusion indicators, including indicators on DFS.[119] Examples of indicators specific to digital financial inclusion are listed below, drawn from the G20 Financial Inclusion Indicators:

- Retail cashless transactions per 1,000 adults
- Made or received digital payments (% age 15+)
- Made payment using mobile phone (% age 15+)
- Made payment using the internet (% age 15+)
- SMEs that send or receive digital payments from an account (%)

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[117] The Advisory Commission is made up of the Ministries of Education, Social Development, Economy, Labor and Social Welfare, and the Ministry of Women and Gender Equity. The BCCh participates as an advisor, while CMF and the Superintendence of Pensions and Superintendence of Social Security participate as permanent observers. The Social Welfare Institute, the Social Solidarity and Investment Fund, and the National Consumer Service also participate. Additionally, representatives of the private sector, civil society, and Banco Estado have joined, as well as foundations that work in the field of financial education.

[118] Anecdotal evidence from FSAP mission meetings seemed to suggest that the private sector has not been actively involved to date in initiatives that have relevance to financial inclusion.

[119] For example, see G20 Financial Inclusion Indicators. GPFI (Global Partnership for Financial Inclusion), 2016. See also Measuring Digital Financial Inclusion in Emerging Market and Developing Economies: A New Index. IMF, 2021. See also Digital Financial Service Indicators. Alliance for Financial Inclusion, July 2019.

- Agents of payment service providers per 100,000 adults
- POS terminals per 100,000 adults
- SMEs that have a POS terminal (%)

148. Data infrastructure may need to be enhanced to systematically track financial inclusion indicators. Data can often be drawn from existing supply-side and demand-side data sources, such as existing regulatory reporting and national household surveys.[120] Efforts may be needed to expand on the indicators included in such sources for financial inclusion purposes, and to make regulatory reporting more granular, timely, and in user-friendly formats in order to feed into monitoring and evaluation (M&E) systems for the NFIS.

Summary of recommendations:

- ***Shift/expand role of government from direct financial inclusion initiatives to a greater focus on removing barriers and obstacles and providing an enabling environment and financial infrastructure***
- ***Develop a holistic, comprehensive strategy to address remaining financial inclusion challenges via a NFIS***
- ***Utilize NFIS process to bring together relevant stakeholders across government agencies and from both private and public sectors***
- ***Develop M&E system for NFIS with indicators tailored for digital financial inclusion***
- ***Enhance data infrastructure as needed to support NFIS M&E system***

[120] For guidance on operationalizing NFIS M&E systems, and more broadly on the entire process for developing and operationalizing a NFIS, see Developing and Operationalizing a National Financial Inclusion Strategy. World Bank, June 2018.

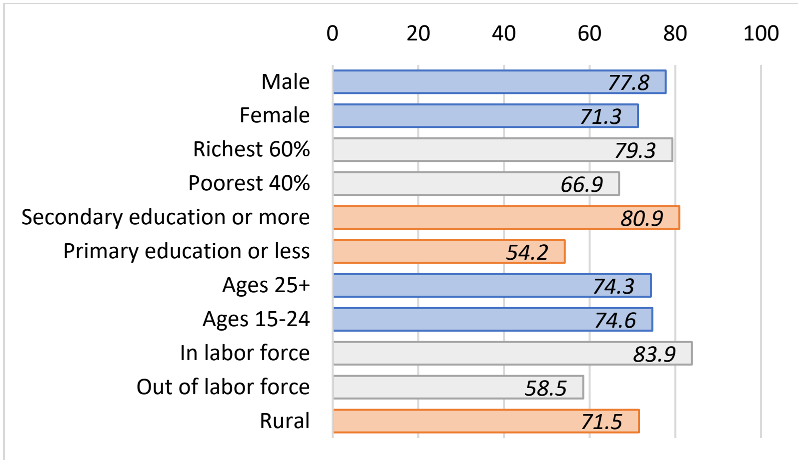
Annex I: Policy Actions and Enablers for DFS

Policy Actions and Enablers by Development Stages				
Policy Actions and Enablers	**Stage 1**	**Stage 2**	**Stage 3**	**Stage 4**
Enabling financial and digital infrastructures	• Foster good penetration of mobile phones and connectivity	• Well functioning payment systems and enabling interoperability	• Establish credit infrastructure and enhance coverage of credit relevance data	• Support universal broadband connectivity • High penetration of smartphones
Ancillary government support systems		• Enhance financial management system to support intensive shift of G2P payments to digital	• Establish and expand coverage of digital ID	• Enable automated access to digitized Government data platforms
Conducive legal and regulatory frameworks	• Allow non-bank insurance of e-money • Implement simplified CDD • Enable development of widespread agent network	• Adopt payment systems law • Enable non-banks access to payment systems • Robust consumer protection framework in place • Develop and implement competition policy	• Establish comprehensive regulatory framework for DFS providers • Adopt comprehensive legal measure for data protection and privacy • Enable DFS providers to expose and use APIs	• Adopt legal measures to enable Open banking

Source: Digital Financial Services. World Bank, April 2020.

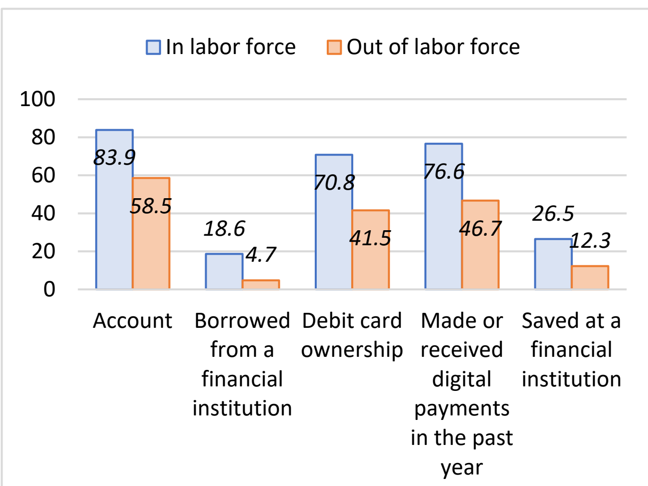
Annex II: Additional Financial Inclusion Metrics in Chile

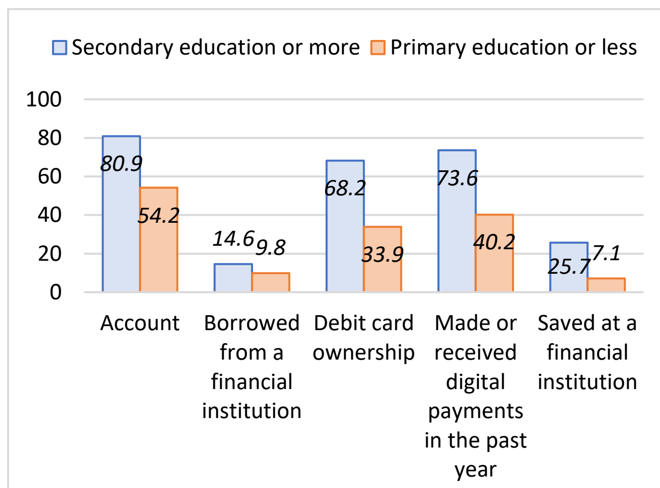
Account ownership by demographic segment



Source: Global Findex 2017

Gaps for adults outside of labor force and less educated





Source: Global Findex 2017