Creating the regulatory framework for Fintech in Costa Rica

Abstract
This article will describe the elements of the FinTech roadmap that the Superintendencies, the National Council for Supervision of the Financial System (CONASSIF), and the Central Bank of Costa Rica (BCCR), have been implementing for the design of a regulatory framework for FinTech in the country. Special attention will be given to the recently created “Centro de Innovación Financiera (CIF)” and the description of a possible vision for the future.

The views and opinions expressed here are those of the author and do not necessarily reflect the official position of any of her associated institutions.

Keywords:
FRAMEWORK, FINTECH, REGULATORY.

Résumé
Cet article décrit les éléments de la feuille de route FinTech que les surintendances, le Conseil national de supervision du système financier (CONASSIF) et la Banque centrale du Costa Rica (BCCR) ont mis en œuvre pour la conception d’un cadre réglementaire pour FinTech dans le pays. Une attention particulière sera accordée au “Centro de Innovación Financiera (CIF)” récemment créé et à la description d’une vision possible pour l’avenir.

Les points de vue et opinions exprimés ici sont ceux de l’auteur et ne reflètent pas nécessairement la position officielle des institutions qui lui sont associées.

Mots clés:
CADRE, FINTECH, RÉGLEMENTATION.

Resumen
Este artículo describirá los elementos de la hoja de ruta FinTech que las Superintendencias, el Consejo Nacional de Supervisión del Sistema Financiero (CONASSIF), y el Banco Central de Costa Rica (BCCR), han venido implementando para el diseño de un marco regulatorio para FinTech en el país. Se prestará especial atención al recientemente creado “Centro de Innovación Financiera (CIF)” y a la descripción de una posible visión de futuro.

Las opiniones y puntos de vista aquí expresados son los de la autora y no reflejan necesariamente la posición oficial de ninguna de sus instituciones asociadas.

Palabras clave:
MARCO, FINTECH, REGULACIÓN.

Resumo
Este artigo descreverá os elementos do roteiro da FinTech que as Superintendências, o Conselho Nacional de Supervisão do Sistema Financeiro (CONASSIF) e o Banco Central da Costa Rica (BCCR) vêm implementando para a criação de uma estrutura regulatória para a FinTech no país. Será dada atenção especial ao recém-criado “Centro de Innovación Financiera (CIF)” e à descrição de uma possível visão para o futuro.

As visões e opiniões expressas aqui são de responsabilidade da autora e não refletem necessariamente a posição oficial de nenhuma de suas instituições associadas.

Palavras-chave:
ESTRUTURA, FINTECH, REGULAMENTAÇÃO.

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THE FINTECH CONTEXT

The incursion of institutions that seek to develop technological improvements in the financial sector (FinTech) has grown at a great speed around the world. Globally, FinTech has expanded in scope, now covering the full spectrum of finance and financial services.

As explained in the taxonomy developed by the jointly effort of the Cambridge Center for Alternative Finance, the World Bank, and the World Economic Forum (2022), the FinTech activities can be allocated into 12 verticals: digital lending, digital capital raising, digital banks and/or savings, digital payments, exchange services, digital custody, insurtech, wealthtech, regtech and/or suptech, alternative credit and/or data analytics, digital identity and enterprise technology provisioning. The following figure presents a sample of the composition of these verticals around the world.

Figure 1. Survey sample composition according to primary fintech vertical (total number, percentage of total)

Source: Cambridge Center for Alternative Finance, the World Bank, and the World Economic Forum (2022)

In the case of Costa Rica, there has been an increase of this type of FinTech companies in the recent years. According to the latest data that the Misión Lunar project has compiled in their radar, as of June, 2022, there are at least 55 FinTech related enterprises in the country, this number contrast to the identification of 25 FinTech players made by the IADB and Finnovista report in 2019, representing a growth of around 120% during that period.
As part of the ecosystem it is important to mention that there are in the country other related participants, for example the Asociación FinTech de Centroamérica y el Caribe, the Asociación Blockchain de Costa Rica, the Capítulo FinTech of the Cámara de Tecnologías de Información y Comunicación (CAMTIC) and labs or innovation teams within regulated financial entities.

Additionally, it is important to mention that Costa Rica has made significant efforts to expand banking services for the population, and sindicatos point to a high level of financial inclusion for individuals; in this country nearly 80% of adults have an account in a financial institution, which is above the average for Latin America and the Caribbean. With that in mind, the main challenges come not too much with inclusion but with the level of use and deepness of the new technologies in the market.

In accordance to the mentioned IADB and Finnovista report in 2019, and the more recent report of the Promotora de Comercio Exterior de Costa Rica (Procomer) in 2022, regarding FinTech in Costa Rica, the country has good conditions and a positive outlook for the evolution of FinTech companies, but the funding mechanisms are one of its weaknesses. They also pointed to the need of regulation that can allow to have legal certainty for the projects and initiatives.
THE IMPORTANCE OF A REGULATORY FRAMEWORK FOR FINTECH

The market size is a good indicator to see when an industry is big enough to begin to be more relevant to the regulator. According to the CFA Institute Research Foundation, the stages for company growth and the relation with the regulatory supervision can be shown in the following figure.

Figure 3. Regulatory Stages and Company Growth Stages

![Graph showing regulatory stages and company growth stages](Source: CFA Institute Research Foundation)

In this regard, it is always important for a country to be aware of the FinTech movement, because it presents an exponential growth behavior, so this condition limits the ability to predict the moment in which they will be too large to ignore.

On the one hand, a relevant part of the necessity for the construction of the regulatory framework for FinTech is because it can drive to risks to the financial stability and consumer protection. And on the other hand, the regulation is also necessary because it is understood that the FinTech firms have the natural intention to solve market failures and provide a faster and better financial service, and then, there are opportunities to increase the efficiency and competition of the financial system.

In the case of Costa Rica, the approach has been one that follows the described criteria; in this regard, the strategy consists of having a vigilant attitude from the regulator side, always with the intention of letting innovation flourish by having some degrees of tolerance in tandem with a surveillance of the industry.

THE FINTECH ROADMAP OF THE SUPERVISORS AND REGULATORS IN COSTA RICA

With the intention of integrating efforts to develop a common FinTech agenda within the four Superintendencies, the National Council for Supervision of the Financial System, and the Central Bank of Costa Rica, a FinTech Working Group was created in 2019.

This group begin to study the concepts around FinTech, communicate with national and international stakeholders, participate in working groups, workshops and studies related the topic, and with that, a roadmap was design; considering not only the stage of the FinTech industry but also the particularities of this country (see the box below). The roadmap recommended by the group in 2020, included:

- FinTech Working Group: continuation of the group’s work, maintaining synergies, deepening coordination, expanding knowledge, improving capacities, and strengthening cooperation between the entities represented in the group.
- FinTech Innovation Hub: creation in the system of regulation and financial supervision a space for communication, orientation, and knowledge of the FinTech industry. This hub has named by his translation to Spanish as Centro de Innovación Financiera (CIF).
• Legal and regulatory reforms regarding FinTech: aiming to face the challenges that the FinTech phenomenon can impose into the regulatory system and financial supervision, with a modern approach based on activities and proportionally.

The first two points of the roadmap are already implemented, and the last one can be seen, as a third step that nowadays is under analysis, to consider the approach, need and opportunity to perform regulatory adjustments.

WHAT IS THE CENTRO DE INNOVACIÓN FINANCIERA (CIF)?

The CIF is a space for dialogue and consultation between those who wish to develop technological innovation initiatives in financial products or services and the regulatory and supervisory entities of the Costa Rican financial system. It is made up of a group of experts in different disciplines, created with the purpose of clarifying and guiding financial innovators in the process of developing and inserting their initiative within the framework of financial regulation.

The objective is to facilitate dialogue, consultation, and exchange of information between financial regulation and supervision entities and initiatives for technological innovations in financial products or services, to ensure their development in accordance with the regulation of the financial sector and, at the same time, identify needs for possible improvements and regulatory changes related to financial innovation for the benefit of Costa Ricans. The CIF seeks to collaborate in the improvement of:

• Efficiency, competitiveness, and transparency of the financial sector.
• Financial inclusion
• Financial stability.
• Financial consumer protection.

Figure 4. Organization of the CIF

On April 2022, this center was launched and from that time to now, the team has been addressing the queries submitted by the innovators, having meetings with them, designing and implementing a communication plan and making connections with key stakeholders.

The main task of the center is the one related to attending the innovators, as indicated in figure 5. The practice is to always have a virtual meeting with the innovators to understand the project or initiative, and to can give the
required advice and guidance. In this part is important to highlight that all the answers and information that the CIF gives to the innovators is not binding and, in the cases, where the propose activities or projects have already a regulation in place, the CIF provides the information and guidance required to direct the innovator to the respective regulator in charge.

**Figure 5. The process of attending innovators at CIF**

![Diagram](source: Centro de Innovación Financiera, Costa Rica)

**A VISION FOR THE FUTURE**

This section proposes some key elements that can help to build a FinTech National Strategy in Costa Rica, it aims to create the environment for the digital transformation of the financial system in the country.

The model going forward should be one that seek to generate innovation while preserving consumer protection and market stability. The idea presented here for Costa Rica is for the regulator to take advantage of the knowledge and advance in their FinTech strategy, to lead the movement. With that, it can be a reduction of the regulatory risks for new entrepreneurships and a good accelerator of the financial technological development in the country.

**Figure 6. Elements of a possible FinTech National Strategy: the digital transformation of the financial system in Costa Rica**

![Diagram](source: Author’s analysis)

1) The leading role of the regulator. The regulator needs to adopt a proactive attitude towards innovation that will help them not only to better overcome current challenges but also to anticipate future changes while decreasing excessive risks. It is understood that today the financial authorities must overcome so
many other issues, however leading the financial technological change needs to be of a key relevance in these times. Here are some reasons why this top-down approach is desired:

- There is a solid base within the regulator, studying and building capacity in this topic since 2019, and there is already in place a consolidated vision within the Superintendencies, the National Council for Supervision of the Financial System, and the Central Bank of Costa Rica regarding FinTech.

- Leading the movement can assure the involvement of the regulator since the beginning in the transformation process, which is an advantage in the sense that open the possibility to collaborate in the design and implementation of the future of the financial system in the country.

- It also can be useful to foster innovation and competitiveness within the country, that can benefit the population in terms of inclusion and the provision of faster and better financial services. In this part a clear mandate for the central bank regarding competitiveness will be key.

- There are also experience in place in leading national financial strategies in the country, for example, the case of the development of the National Payment System (SINPE) that is lead by the Central Bank of Costa Rica. (See the box below).

- Today there are examples of other central banks and financial regulators leading national strategies related to FinTech that can be used to learn and improve.

2) 2. Strategic long-term view: It is crucial to think strategically and avoid adopting an approach without having an overarching long-term view of where financial innovation strategy should be focus-on when dealing with FinTech. The collaborative attitude proposed in the next component should be of help in this regard.

3) 3. An open discussion: There is a need to understand the technologies and business models that can be applied in the FinTech arena, and that is why collaboration and mutual learning must be at the top of the process. Understanding and monitoring these types of developments could be done through closer engagement with industry players, including currently unregulated FinTech firms and regulated financial institutions. In this regard, the CIF is a key element for making these conversations happen.

4) 4. A parallel development of SupTech & Digital Transformation: The regulator roadmap for regulating this revolution must be done in the frame of a parallel approach. It is not limited to create the regulation for FinTech companies: it needs to also include the utilization of the technology in its advantage. This means that the regulator must be aware of how the introduction of RegTech (Reg for regulatory) could transform regulatory compliance and risk management for financial institutions, while also how SupTech (Sup for supervisory) could be used to increase supervisory effectiveness and efficiency.

The new era in supervision and regulation is framed in the use and combination of many technologies. There is a need for the understanding of the challenges that new technologies impose to the financial system and the way the central banks and regulators handle data.

Specifically, there is a need for a focus on improving data management within all the regulatory bodies, to have the capacity to analyze the data of the financial system today and the future new actors. This must be a jointly effort in Data Governance for both the Superintendencies and the Central Bank. There is a need to go to a know your data approach, with a focus on digitization and datafication of regulatory compliance and reporting processes. This will allow the regulator to be efficient in their responses, knowing what is happening in the financial sector in a timely manner and reacting correspondingly.

5) 5. Policy enablers and data are key: Apart from regulation, there are other challenges that need to be handle at a national level. In this regard there are many policy enablers that need to be developed in coordination within the respective governmental agencies that have a task to perform on that as part of the National Digital Transformation Strategy. For example:

a.) Digital Identity

b.) Financial and Digital Literacy

c.) Internet coverage
d.) Open Finance

e.) Cybersecurity

f.) Data Protection

g.) Development of digital capabilities

h.) Financing for entrepreneurs

6) 6. Risk based approach: In general, it is important to focus on the financial processes that technology enables and understanding where the different risks are. Defining regulation by activity and in a proportional manner, will be key in this regard.

7) 7. Coopetition: All the elements that where described need to be framed in an environment that will push collaboration & competition in a sustainable and healthy way among the participants.

On the one hand, the banks and traditional regulated financial institutions are the ones that have the customers, licenses, and the experience in banking and financial markets; and on the other hand, the start-ups can provide fresh new ideas, new technologies and skills. An alliance between the two can increase the probabilities for the former to accelerate their digital transformation and for the latter to subsist.

Coopetition will be key to let parties focus on competition where the company have more advantages for a market segment, and on collaboration in the segments and topics that can enhance the efficiency of the financial system and their own value chain, and for the good of the costa ricans.

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**Box: Central Bank of Costa Rica: doing FinTech from before it was cool**

Over the last two decades, the Banco Central de Costa Rica (BCCR) has offered to the public the National Payments System (SINPE), which is a systemically important electronic platform that provides many services, including instant payments facilities 24/7; and it represents a strong network of security which has the trust of all participants, institutions, and agents.

During this time, all the efforts made by the central bank, with the collaboration of the national banking system, have allowed the gradual reduction of the use of cash and the expansion of financial inclusion in the country.

Moreover, as part of the SINPE’s services, since 2015, the Bank provided a digital payment platform called Sinpe-Móvil, which allows people to make money transfers in real time at no cost to any account in the country, just using a phone number and the amount. In times of pandemic, these efforts have also allowed the Costa Rican population to protect their health through flexible, affordable, fast, safe and hygienic means of payment.

At this point, it is important to highlight two key differentiators of the service, which are also part of the causes of its success. On the one hand, Sinpe-Móvil represents a country-level solution, led by the central bank; in which part of the challenge was the fact that the Bank had to promote that all the banking system in the country agreed to use the SINPE infrastructure to create the service. And on the other hand, this payment innovation is integrated and interoperable within the national payment system; so, it implies for the consumers that they can make use of the money they already have in their respective bank’s accounts, without the need to make a transfer to a wallet (differentiating itself from some of the private wallets and solutions in other countries for example).

Therefore, the country experienced many efficiency gains both in terms of costs and speed, as well as increased inclusivity. This situation has also been part of the analysis of why in Costa Rica we already have reached some of the main objectives that are normally pursued by a CBDC: financial inclusion, provision of safe, agile, and low-cost digital payments, and stimulation of financial innovation. In this sense the BCCR continues to monitor the possible motivations and problems a CBDC can solve, to see when it will be convenient of necessary to prioritize efforts on that topic.

So far, the payments strategy continues to focus on deepening of SINPE and digital means of payment, with the concomitant reduction in the use of cash and cross-border payments development. In this regards it is also important to highlight the big contribution that the BCCR has made in recent years in the adoption of electronic payment in public transport, called SINPE-TP.

Finally, the innovative and pioneering role that the central bank, and specially its Payments System Division, led by Mr. Carlos Melegatti, had allow the country to be prepared to respond to the digital payments challenges in an accelerated way, moving towards a more inclusive and digital economy in Costa Rica.