FINANCIAL INCLUSION & ALTERNATIVE DATA IN LATAM:

EXPERT INSIGHTS INTO 2020 WINS & IMPROVEMENTS

CredoLab
Better Credit Decisions

PROVENIR

FINANCIAL CHALLENGES IN THE COVID ERA

During 2020, the discussion around a more inclusive financial economy was at the center of the fintech conversation. New potential solutions have been introduced to address this situation, such as the use of alternative data to assess creditworthiness. Faced with the current banking landscape, and the destabilization that the Pandemic brought, the possibility arises of not only transforming the credit market, but also working towards financial inclusion in social terms.

The financial ecosystem in Latin America excludes a large segment of the population who today find themselves unbanked. These potential customers do not have the established credit history required by traditional credit scoring models, and are thus marginalized as risky. The pandemic put a spotlight on this situation and enlarged the existing social gap.

Banks and fintechs are trying to solve the financial inclusion situation by integrating with new technology capabilities like Artificial Intelligence. The use of alternative data for credit scoring as a potential solution presents a great opportunity for growth for fintech institutions in the region. This new technology introduces new ways to evaluate financial product risk levels by applying alternative scoring platforms that complement the use of traditional methodologies for a more accurate evaluation.

We will explore how the fintech industry has transformed during the past year and how 2021 begins with a positive and challenging new perspective for financial inclusion. Through the expertise of financial experts in the region we offer a better approach to how traditional banks and financial services organizations enhance their credit scoring and compliance requirements in order to achieve financial and social inclusion. Following you will see insights from experts Clementina Giraldo, Marcel Van Oost, Marcial Gonzalez Fraga, Ignacio Carballo, Bruno Diniz, and Sebastián Olivera who have helped contribute to this research.

CredoLab
Better Credit Decisions

PROVENIR

IGNACIO CARBALLO: RESEARCH ECONOMIST AND DIRECTOR FINTECH ECOSYSTEM & DIGITAL BANKING AT UCA

This year has been a unique opportunity for digital financial inclusion in Latin America. We cannot measure with certainty the magnitude of the impact that Covid has had on the banking industry in the region but, it has certainly been an unprecedented one. Much of this phenomenon was a consequence of the emergency aid that the States brought to their citizens in a context of mandatory preventive confinement and isolation.

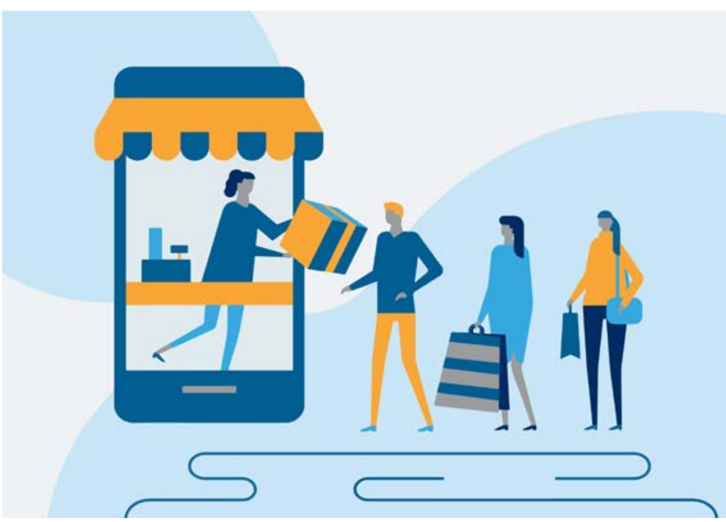
The “Coronavaucher” implemented in Brazil, paid through Caixa Tem, the Caixa Econômica Federal App reached 66 million people, of which some 36 million were estimated to be unbanked. That is 17% of the unbanked population in the region according to the World Bank. In Colombia, the Ingreso Solidario program reached 3 million families, 19% of the population, of which 1.5 million were unbanked. In Argentina, the Emergency Family Income is estimated to have reached 3 million unbanked people.

Before Covid, it is estimated that 45.6% of the adult population in Latin America was excluded from the financial system. That is, 207 million people did not have access to a savings account. Now, almost 20% of the unbanked population in the region is able to access a savings account, counting only 3 economies from March to August. It is a simply impressive number.

These figures mark a before and after for our region, and provide new opportunities and challenges for financial inclusion tools as we know them. Just thinking that more than 40 million people now have access to the financial system and are generating formal data around their financial life implies a very relevant opportunity for alternative data systems. Let’s look at a representative example of many companies.

Mercado Crédito provides financing to those citizens who are excluded from the traditional banking system. In their alternative scoring model, the past credit received through their platform and the MercadoLibre purchases are the most valuable information, but it also includes data from the Bureau, navigation, collections, among others. However, if they do not know the client because they do not use traditional financial services or are new to Mercado Libre, they offer lower credit amounts at a higher interest rate. As they gather more data and their repayment capacity measure improves, the system identifies them as a lower risk and in turn lowers the interest rate and increases the credit limit. With this logic, as of June 2020, Mercado Crédito granted 3.2 million credits to 450,000 users in Argentina for $11,000 million pesos. At least 80% do not have access to financing (they know this because they crosscheck data with Nosis). Not to mention, the small and medium companies, the federalization of their services and the credit amount that they ask for again.

How should alternative risk analysis be adjusted in the face of this immense population that now "does bring data'' on financial use and consumption? Undoubtedly, the door to financial inclusion is wider, not only because of effective access to the financial system but also, because the new data generated helps other lenders assess their risk.



2020 will leave a new floor in terms of access to the financial system, a source of formal registration that alternative scoring companies will not be able to ignore. Without a doubt, the best practices will come from the synergy that the alternative data generates with this new registry.

MARCEL VAN OOST: FINANCIAL ADVISOR AND FINTECH STARTUP FOUNDER WITH COLLABORATION OF MARCIAL GONZALEZ FRAGA

Latin America, in contrast to Europe, is facing a once in a lifetime duality in regards to fintech (Financial Technology). On the one hand, the main countries of LATAM are still lacking financial inclusion metrics across the board (debit card penetration, account penetration, and bank branches per every 100k citizens are clear KPIs). On the other hand, the technology tools available spread around the world at a much faster pace, creating a gap for financial creativity and new players in the region.

With this intro in place, the use of alternative data in Latin America for credit scoring has seen major breakthroughs both for consumers as well as for merchants. Maybe not known as a fintech, but Mercado Credito has used its e-commerce Big Data as a competitive advantage to make lending decisions. Shipping addresses and postal codes, in combination with frequency of purchases on the platform, were key drivers. The use of smartphone data in **Brazil**, (one of the largest users of mobile per capita around the world) provides for interesting credit scoring approaches with regards to app usage, Facebook contacts, and other scraping info.

In **Argentina**, players are applying technology with the banks' approach to fund and lend money to the bottom of the pyramid. It is interesting how usually an individual would establish a savings account first and then eventually add credit, but fintechs have reversed this traditional approach.

If we look at **Mexico**, more than three quarters of the population does not have traditional financial products like credit cards. Additionally, in combination with it being the largest Hispanic speaking economy in LATAM, its strategic location makes the country a paradise for fintechs that are willing to look beyond the limited financial information available and search for alternative data.

In conclusion, it comes down to the proper use of Machine Learning and common sense. Machine learning algorithms usually rely on black-box results, so, isolating one clear variable should not be the goal. With a big data approach, experimenting with set variables, ratings and timeframes will provide the insights that companies need to iterate and make credit scoring decisions.

CLEMENTINA GIRALDO: DOTS & TECH CEO AND FOUNDER

Latin America has historically been part of the conversation around reducing the use of cash and as an effect of Covid-19, digital financial services have been the protagonists of the reactivation of different economic sectors. Throughout 2020, greater adoption of payments, digital transfers and electronic commerce was evident in the region.

The Latin American FinTech universe has more than 2,000 companies of different degrees of maturity, with Brazil, Mexico, Argentina and Colombia being the countries that lead the development of the industry. In the region, digital payment and transfer companies predominate, followed by digital credit and the offer is completed with collective financing solutions, regtech, factoring, insurtech, wealthtech, neobanks, blockchain and crypto-asset platforms.

Colombia has about 250 fintech companies and the industry is led by the digital credit segment, with Lineru, RapiCredit, Sempli and Finaktiva as relevant players. Regarding the digital payments ecosystem, Colombia counts with 5 Specialized Companies in Electronic Deposit and Payments (SEDPE); Movii, Powwi, Ding, Coink and Dale, as well as Rappi's digital banking. Together they have reached more than 20 million users, representing a 300% growth in the country. This growth has been motivated, among other things, by the government using electronic payments (fintech) to deliver subsidies.

For its part, **Argentina**, has 268 fintech companies (such as Argentine Chamber of FinTech, BID, Afluenta, Deloitte 2020), led by the digital payments segment with 64 companies in this vertical, which includes 27 digital wallets, payment processing services, aggregators, gateways and international payment companies, among others. The industry is led by Mercado Pago, followed by Ualá, which has also opened operations in Mexico during this year. The set of fintech wallets exceed 8 million users without counting bank digital wallets. Additionally, some initiatives adopted by the BCRA (Central Bank Argentine Republic) reached greater adoption in 2020, such as immediate fund transfers and immediate debit accompanied by other measures to move towards a 3.0 payments ecosystem in favor of interoperability.

Regarding **Mexico**, the industry is made up of more than 500 fintech companies, of which 60 from the 85 companies that delivered their application before the National Commission of Banking and Values (from the Fintech Law), belong to electronic payment funds, indicating the high presence of companies within the segment. In addition, they have implemented the CODI which has facilitated the operability between payments and digital transfers.

The rise of these digital products and services has positive effects on financial inclusion and consequently the region has witnessed the expansion of unicorns from different segments. On one side, Nubank from Brazil, has already entered Mexico and is planning its entry to Colombia. Additionally, Rappi has overgrown their services, being an ally of micro, small and medium sized companies in their commercial activity during the months of lock down. Finally, Mercado Libre leads ecommerce in the region, reaching 76 million active users in its different business units, which represents a growth of more than 92% year-on-year. It should be noted that over 17 million new users were registered during the third quarter of 2020. Its ecosystem is complemented by Mercado Pago, which comes through digital payments with 4.2 million transactions per day (Mercado Libre, 2020) and Mercado Crédito, which offers credits to businesses in Argentina, Brazil and Mexico, with plans to expand its credit to Colombia.

The above scenario shows that in a region with greater adoption of services through digital means and an expanded FinTech offering, the use of alternative data sources to analyze behavior and trends, and mitigate risks in the financial sector, becomes more relevant. In this way, expanding the access and use of digital financial products in the population with the use of technologies that allow mitigating risks could play a relevant role in an inclusive economic reactivation in the region.

BRUNO DINIZ: FINTECH ADVISOR, MANAGING PARTNER AT SPIRALEM AND BOOK AUTHOR: "THE FINTECH PHENOMENON"

The fintech phenomenon has advanced considerably in the last 5 years in Latin America, promising to reduce high costs in the local market, increase competitiveness in the sector and bring solutions to a greater portion of the population that is still excluded from the financial system. Each country has advanced at its own pace and, in some cases, imported some models from more mature environments, such as the UK. **Brazil** and **Mexico** are standing out for having more ambitious agendas and for aligning with the British benchmark. In addition to these elements, we have seen how the adoption of digital financial solutions in the region increases year after year and, at the same time, there is a growing interest from foreign investment funds in fostering potential unicorns in LATAM.

The year 2020 promised a different record and progress scenario for the fintech segment, however, many doubts arose as Covid-19 spread in the region. Contrary to the negative market sentiment, we are witnessing an interesting boost in the business of a good part of the players, especially from those who knew how to expand their customer base due to the rapid transition of behavior towards the adoption of digital solutions. One of the most surprising cases was that of the fintech Brasileira Picpay, which signed agreements with some state and municipal governments for the distribution of emergency aid and made its payment technology available via QR Code to enable donations to dozens of charities around the country.

The digital portfolio had 12 million customers in December 2019, and that number increased to 20 million in May 2020 (in the first few months of isolation) and reached an impressive 30 million in August 2020. With this, the company started to develop a broader range of solutions,

such as credits and paid accounts, to serve its huge base of newly acquired clients, many of whom are unbanked. Talking about progress within the unbanked, we have the incredible example of Caixa Economica Federal, which was used by the Brazilian government to distribute emergency aid and managed to open 109 million digital accounts through its Caixa Tem application, representing 7 out of 10 adults in Brazil. Thus, a large part of the population that may have never used the smartphone to carry out financial transactions has come into contact with a new world of possibilities, something that will undoubtedly increase their propensity to use local fintech services or even other digital solutions offered by banks.

Further digitalization of the market and the expansion of financial inclusion should also be facilitated by the advancement of instant payment solutions, such as CoDi in Mexico and Pix in Brazil, which reduce the costs of accepting payments from tenants (which still represents a barrier to use, especially in Mexico) and the costs of transfers between people. Even with the pandemic, open banking is still under construction in these countries, taking the financial market to other levels in terms of financial data used to customize solutions for audiences of different social classes, in addition to expanding the competition market between players that operate in the provision of financial services.

We can easily say that 2020 is a major turning point for Latin America, helping to strengthen the foundations of a fintech revolution that has already demonstrated its anti-fragility in the face of one of the largest crises ever seen. The challenges that still lie ahead in the region are great and will not be resolved overnight, however, with all these movements that we have witnessed in recent history, we can expect to advance more in the next 5 years than in the past 20 years from a financial point of view.

SEBASTÁN J. OLIVERA: MONTEVIDEO FINTECH FORUM FOUNDER AND WEFINTECH CO-FOUNDER, THE IBEROAMERIC WOMEN NETWORK

According to the World Economic Outlook's June Update, Latin America and the Caribbean's economy is estimated to shrink by 9.4 percent in 2020, with a mild recovery of 3.7 percent projected by 2021. The effects of this unprecedented crisis and its uncertain recovery will be worse for countries suffering from high degrees of exclusion, social and political instability, low quality and penetration rates of financial education, as well as a lack of adequate infrastructure. A huge debt remains unpaid and we have not been able to create a verifiable, refined and consistent information system for making better financial decisions. This is a direct result of the deficiencies, especially in infrastructure areas, and has particular impact on identity validation and access to risk adjusted financial products (especially for the excluded and for SMEs). This vulnerability, unfortunately, will result in an increase in the levels of exclusion and availability of credit, at levels of which it is impossible to quantify the volume under current conditions.

On the other side, the high birth rates, existence of a young population eager to adopt technology solutions, and the availability of entrepreneurial talent with global networks, offer the possibility to solve the lack of access to fair, efficient and useful financial solutions and products for the vast majority of the population. But, only 42% of adults in the region declare they have access to financial services, in many cases of poor quality.

It is precisely the lack of this consolidated information system and the new reality imposed by Covid-19 that generates the need for the adoption of digital developments to adjust the risk equations in financial products through the use of alternative scoring systems complementary to traditional methods. But this is only half of the equation, as the promise of fintech is only valid when there is effective financial inclusion. In other words, it is not enough just to generate large data processing and analysis systems, it becomes imperative to address the economic and social reality of the clients; understand which are the insights that drive the decision processes. This is why we guarantee that new financial products must consider the level of financial knowledge of their users, and contribute with their design to increase their financial education. Those who do so will be able to massively scale their value proposition, proving that financial inclusion is not only morally correct, but that it is also big business for the economy.

Here is where the true potential of fintech lies, as an enabler to the financial inclusion for an important segment of population in an efficient way.

LOOKING AHEAD: 2021 IN THE FINANCIAL INDUSTRY

2020 has seen an accelerated use of alternative data to generate a positive social impact for the creation of sustainable businesses. Information available from economic relief measures implemented throughout the pandemic allowed for a broader integration of new customers into the financial system. These people, previously excluded from financing, are creating their own businesses and thus collaborating in the growth of the economy.

Given these great advances for the region, the upcoming years are going to have an incalculable and more powerful impact in society than the last decade in the financial industry. The impact does not only look forward to bigger changes in the system, but into society. 2020 has arrived to change the paradigm in countries where social inclusion has always been a big issue, a matter that needed its own attention and special care.

Despite the destabilization of the financial system brought up by the Pandemic we find new customers with valuable data previously ignored. Big data and machine learning advancements are ready to provide the appropriate insights that companies require to contribute to access to credit. This framework has become an opportunity for 2021, a challenge for the industry with the chance of reactivating the economy and introducing previously unthought innovative ways to achieve the final goal, financial inclusion.

CredoLab
Better Credit Decisions

PROVENIR