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FinTech

Mexico: Trends & Developments

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Trends and Developments

Contributed by Creel, García-Cuéllar, Aiza y Enríquez, S.C.

Creel, García-Cuéllar, Aiza y Enríquez, S.C. has deep knowledge of all legal aspects of financial technology matters in Mexico, including the newly issued FinTech legislation about crowdfunding, peer-to-peer, e-wallets, payments, open banking, virtual assets and regulatory sandbox, but also financial regulation applicable to the use of digital channels by financial entities, means of disposition, online lending, money transmitters, and the use of technology in financial services in general. Recent work includes: advising PayPal Mexico in regulatory matters related to withdrawal methods networks, tax advisory and consumer protection; advising Emergent Payments in regulatory matters related to payment processing solutions in Mexico and in the use of its crypto asset GCoin; and advising stREITwise in Mexican regulation matters related to fund-raising through crowdfunding in accordance with United States Regulation A (Reg A+); advising IBM during the execution and implementation of technology services agreements with financial entities. Apart from the FinTech sector, Creel helps clients with all their legal needs in Mexico, ranging from incorporation of companies and capital raising, to tax issues, M&A, anti-money laundering and IT registration, antitrust and competition, TMT and intellectual property.

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Eduardo Flores Herrera is a partner in the firm's Financial Services practice group. His key practice areas are capital markets and banking/finance. In July 2014, Mr Flores was appointed vice-president for Securities Supervision of the National Banking and Securities Commission (CNBV). In this position, he was in charge of the supervision of all securities market participants, including issuers, broker-dealers, mutual funds, rating agencies, introducing brokers, exchanges, central counterparties, central deposits, and price vendors; he was also in charge of authorising all public offerings of securities in Mexico and the incorporation of mutual funds, in addition to participating in the drafting of all securities-related secondary regulation. He is a member of: Committee 2 (Secondary Market), the Inter-American Regional Committee and the Infrastructure Working Group – all from the International Organisation of Securities Commissions (IOSCO); the Credit Rating Agencies Supervisory Core Colleges of Moody's, Standard & Poor's and Fitch; the Pacific Alliance supervisors' committee, comprised by securities regulators from Chile, Peru, Colombia and Mexico. Additionally, Mr Flores represented Mexico at the Ibero-American Securities Institute.

The New Path Ahead for FinTech in Mexico

In 2018, Mexico became one of the first countries to have a FinTech Law (*Ley para Regular las Instituciones de Tecnología Financiera*). While the path to reach that important milestone was not without its setbacks, the existence of this legislation is widely regarded as a bold step by the Mexican government towards the digitalisation and innovation of financial services. In addition, the FinTech Law has drawn attention to the potential of the Mexican market for digital financial services.

Mexico presents great potential for financial services due to the need to increase financial inclusion. According to the latest Financial Inclusion Report 9 (*Repote Nacional de Inclusión Financiera 9*) published by the National Financial Inclusion Board (*Consejo Nacional de Inclusión Financiera*), while there has been an increase in all the financial inclusion metrics (deposit products per adult, credit product per adult, etc), Mexico still lags behind many Latin-American countries, such as Chile, Argentina, Peru and Colombia. The potential for new ways to render financial services, especially digitally, is evident and many entrepreneurs are eager to grab this low-hanging fruit.

Mexico currently has one of the most solid and well-capitalised banking sectors in emerging markets. However, there is still a long way to travel in order to reach the full potential of Mexico in the use of financial services. FinTech companies represent a new player in that market that can create a competition that is destined to result in better offerings for financial services users.

Looking forward, there are different challenges for entities looking to innovate in the provision of financial services. First, the adoption of the provisions of the FinTech Law by the different entities and activities covered by it (peer-to-peer and crowdfunding, payments and wallets, cryptocurrencies and open banking), which were sectors that were not particularly regulated up until the legislation was issued. Second, the proliferation in the use of digital solutions to provide other financial services, which could include: payments (aggregators and other card payment services companies); money transmitters, personal loans, insurance, wealth management, investments, etc. Third, new risks and areas of attention derived from the use of technology, like the use of biometrics, identity theft, anti-money laundering and terrorism financing (AML) regulations, among others.

Adoption of FinTech Law

On the adoption of the FinTech Law, it is important to understand the purpose of the law. It tries to balance several concepts that at times can be opposite: on the one hand it promotes financial inclusion, innovation and competition to traditional financial institutions – but, on the other hand, it seeks to set a framework for supervision and stability of FinTech companies. In light of that, one important issue to keep in mind is that the FinTech Law treats financial technology companies (*instituciones de tecnología financiera* - ie, crowdfunders and wallets) as 'financial entities' with a material use of technology, and not as technology companies that engage in financial services. This distinction is relevant because it implies that financial technology companies are subject to the same amount of regulation and supervision as any other financial entity (ie, banks, broker-dealers, etc). This approach is aimed at providing certainty to users and preventing instability and excessive risk-taking practices, but results in a regulatory burden that might prove to be too much for start-ups to bear.

Currently, most financial technology companies are facing the challenge of adopting the new regulation as all those companies that were operating before 10 March 2018 have a September 2019 deadline to file their application to be licensed by the Mexican Banking and Securities Commission (*Comisión Nacional Bancaria y de Valores* – CNBV). This challenge (and FinTech entrepreneurs' inherently innovative mentality) are causing companies to look for creative and innovative ways to meet the high regulatory standards and, in some cases, to look for different ways to continue to develop their business in ways that are compliant with Mexican laws, but that allow them to be outside of the scope of the FinTech Law.

There is still an important round of regulation that needs to be issued on March 2019 (authorisation of third-party providers, regulatory reports, use of digital means to acquire financial services, authorised virtual assets, cybersecurity, among others) and March 2020 (liquidity requirements and open banking), pursuant to the FinTech Law. Some of the regulations could define the path forward of the whole sector, since regulatory requirements could prove to be too much of a burden to start-ups, while a very lax approach could put the stability of the sector in jeopardy.

Also, this new round of regulations could serve to tune-up some of the prior regulations that have proven to be a roadblock in the authorisation process of some of the new Financial Technology Companies: for example, the amount of information that is requested from shareholders of the companies requires a disclosure that is not common to venture capital and private equity funds, which could result in some of those international funds restricting their investments in Mexican FinTech start-ups.

However, other regulations that will be issued in the following months, mainly open banking regulation, could aid in the efforts to expand financial inclusion and competition in the financial services space. Well-regulated open banking could result in the proliferation of client-oriented financial services that allow clients to compare and choose financial services or to have all of its financial information in a single

platform, improving the user experience (aka, UX) and promoting the use of several financial products.

Another topic that has generated many discussions among regulators, market participants and users is virtual assets (ie, cryptocurrencies). There are a lot of expectations about how virtual assets regulation will shaped by Mexico's Central Bank (*Banco de México* – Banxico), as there seems to be a change of policy from the time the FinTech Law was issued to current dates. The FinTech Law granted broad authority to Banxico to regulate cryptocurrency exchanges and to authorise those virtual assets that would be eligible for use by authorised financial technology companies and banks; however, to date there has not been an official positioning by Banxico on which virtual assets will be authorised (if any) or how services related to such assets, like custody and trading, will be regulated.

Other FinTech activities

As mentioned above, FinTech is not limited to those areas regulated by the FinTech Law. Moreover, there are several activities that fall under the scope of other financial laws and regulations or general commercial laws in Mexico. The degree of innovation that has been experienced in areas such as personal loans, credit and debit card payments, money transmitters, personal finance, is certainly a cause for celebration. For example, amendments to means of disposition networks enacted in 2014, which introduced principles of no discrimination and transparency, have helped boost the digitalisation of the Mexican retail economy, expanding the use of credit and debit cards instead of cash. According to the Financial Inclusion Report 9, the number of point of sale terminals (aka, POS) has almost doubled from 2013 to 2017.

However, many financial activities have faced the challenge of regulation thought for traditional distribution, which has become a setback for the digitalisation of areas like wealth management, trading and credit. Current AML regulations require in-person interviews for clients of almost every level of accounts, which has made remote onboarding of clients difficult and, in some cases, makes digital models non-viable. In this respect, in December 2018 the Ministry of Finance and Public Credit (*Secretaría de Hacienda y Crédito Público*) issued drafts of AML regulations for, among others, banks, broker-dealers, mutual fund managers and distributors, non-bank banks (*sociedades financieras de objeto múltiple*), money transmitters and credit unions to allow for digital on-boarding of clients, which could result in the proliferation of online and app-oriented entities rendering all the services related to such financial entities. This new regulation will allow for fully digital origination of several types of financial transactions of up to 60,000 investment units (approximately USD19,500), including brokerage accounts, mutual fund accounts, personal loans, credit cards, among others. This regulation is expected to enter into effect in January or February.

New challenges

The increasing use of digital means to render financial services creates a new set of risks and focus areas for financial entities. Issues such as cybersecurity, data privacy, technological risk, business continuity plan, among others, will take a predominant role in the regulator's supervision, in order to insure that the use of technology does not affect the stability of the financial sector or affect the funds of clients.

In addition, while the changes to AML regulation could appear to be a softening of the regulation, Mexico's new administration has been very vocal about their focus on preventing money laundering. It is safe to expect that this approach will result in strengthened supervision of the compliance with AML regulations for financial entities and for other entities engaged in vulnerable activities which are not financial entities.

Another important challenge that will be faced by FinTech companies and financial entities alike is the adoption of biometrics in financial and commercial transactions. While banking regulation is at the forefront of financial regulation in Mexico with respect to the use of biometrics and identity theft-prevention, the validity of transactions authorised, or commercial acts executed through technologies like face recognition, retinal scan or fingerprint scan has yet to be contested in courts. Moreover, while the Commerce Code recognises the use of digital signatures, many commercial or financial acts, especially for credit transactions (ie, formalities of promissory notes) and creation of collateral, may not be compatible with new technologies. However, as the use of digital signatures and biometrics spreads in the new era of FinTech, Mexican courts will have to reach an understanding of such technologies and recognise their validity.

Regulatory sandbox

The FinTech Law introduces the concept of a regulatory sandbox (*modelos novedosos*), which consists of a temporary authorisation to provide financial services in an innovative way, without going through the whole licensing process. It is like launching a financial service in 'beta stage' to determine whether it would be successful or not, prior to incurring in material investments. The FinTech Law and the draft of regulation include general requirements for a project to be eligible for the regulatory sandbox, such as having a limited number of clients in a controlled environment; the key issue will be the determination of what will be considered as using tools or technologies to render financial services with different forms than those available in the market. In jurisdictions such as the UK or Malaysia, the regulatory sandbox has proven to be a very potent tool to promote innovation and has allowed highly innovative models to become a reality. Hopefully, the regulatory sandbox in Mexico has a similar effect that can help solve the lack of financial inclusion in several areas of the country.

Conclusion

The FinTech Law certainly sets a benchmark for Latin-American countries with respect to the approach to new technologies in financial services. Furthermore, recent regulatory changes to AML regulation also set the ground for an increase in the use of digital platforms to provide financial services, all of which will require a deep understanding of the regulatory framework and compliance culture that will be no minor task for technology enthusiasts.

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While stability is key to the development of any industry, an excess of regulation could prevent entrepreneurs and start-ups from reaching their full potential and bringing financial services to the general population. A balance must be found by regulators and market participants to promote the use of technologies and achieve the digitalisation of the Mexican economy.

The new regulatory environment presents a great challenge for attorneys, as we will be constantly put to a test to come up with new legal solutions to our innovative clients' endeavours to develop a new industry.