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FEATURED Q&A

Which Types of Fintech Will Thrive in Brazil?



Investments into digital disruption in Brazil's banking system are amounting to some \$1.5 billion per year, Moody's Investors Service said in a recent report. // Image: Creative Commons via pexels.com.

Q The growth of financial technology companies in Brazil is likely to cut into the market share of Brazilian banks, which operate in an extremely concentrated sector, Goldman Sachs said in a recent report. The more than 200 fintech companies in Brazil are expected to generate a revenue pool of some \$24 billion over the next decade, the report said. What types of fintech companies are best positioned to capitalize on this trend? How are financial consumers' habits and preferences changing, and how well are Brazilian fintech companies addressing them? What do these trends mean for the country's traditional banks?

A Ernesto Haikewitsch, marketing channels director for Latin America at Gemalto: "Even though Brazil's banking market is one of the most concentrated in the world, with the top five banks controlling almost 85 percent of the total loans, there are outstanding opportunities to provide services for the unbanked population, targeting millennial customers. Fintech can offer banks solutions to many problems, from cyber security to big data analysis. One area in which major banks are looking to fintech is app-only banking, taking advantage of Brazilian customers' adoption of new technologies. Biometric banking technologies, being integrated into mobile payments, have an amazing appeal to millennials. With mobile and wearable payments on the rise everywhere, and customers increasingly unlikely to visit a bank branch, demand for app-only banking is soaring. A recent study developed by the Brazilian Banking Federation, or Febraban, showed that mobile banking already represents 36 percent of all banking transac-

Continued on page 3

TOP NEWS

MONEY LAUNDERING

Citi to Pay \$97 Mn to Settle Banamex USA Investigation

Citigroup has agreed to pay \$97.44 million to settle allegations about inadequate anti-money laundering controls at its Banamex USA unit.

Page 3

REMITTANCES

Remittances to Nicaragua Rise 6.5 Percent

Money transfers to the Central American country rose 6.5 percent for the year through April. Families in Nicaragua received \$431.7 million in the period, according to the central bank.

Page 2

FINANCIAL SERVICES

Scotiabank Beats Estimates With 30% Rise in Net Income

The bank, led by CEO Brian Porter, said its Latin American markets helped boost returns. The bank's net income for the quarter ending April 30 rose to 2.06 billion Canadian dollars (\$1.53 billion).

Page 2



Porter // File Photo: Scotiabank.

FINANCIAL SERVICES NEWS

Scotiabank Beats Estimates With 30% Rise in Net Income

Bank of Nova Scotia posted a stronger profit for the second quarter of the fiscal year and beat expectations of more modest earnings following a strong first quarter, The Globe and Mail reported May 30. Scotiabank's earnings in the quarter ending April 30 were especially boosted especially by strong returns in its Latin

“We continue to see great short- and long-term potential across our Pacific Alliance countries.”

— Brian Porter

American markets, the Toronto-based lender said. “We continue to see great short- and long-term potential across our Pacific Alliance countries,” said Scotiabank CEO Brian Porter. The Pacific Alliance countries include the bank's operations in Mexico, Peru, Chile and Colombia. The bank exceeded expectations amid uncertainties over economic growth projections in countries like Mexico and uncertainties about potential changes in economic policy following the election of U.S. President Donald Trump. The bank's net income for the quarter rose 30 percent to 2.06 billion Canadian dollars (\$1.53 billion), or 1.62 Canadian dollars per share. Scotiabank said its growth was also due to strong performance in domestic retail and business banking and higher profits in capital markets. The bank's international arm, which drives its growth, saw international loans grow by 3 percent year-over-year and by 4 percent from the previous quarter, which is a “sign of improving commercial loan growth,” said Gabriel Delchaine, an analyst at National Bank Financial. Porter said that despite uncertainties surrounding housing markets and mortgages,

as well as talks from the Trump administration of renegotiating the North American Free Trade Agreement, the bank's goals will not change, “whether a housing markets shifts, [NAFTA] is modernized, regulatory changes are made or short-term matters emerge in the latest headlines.”

Latin America Helps Drive Experian's Annual Results

Financial information company Experian said May 18 that a strong performance in Latin America, particularly in Brazil, helped boost its annual results. “We delivered another year of strong progress in Latin America, with organic revenue growth of 9 percent,” Experian CEO Brian Cassin said in an earnings release describing results for its financial year ending March 31. “The performance of our business in Brazil has been outstanding,” he added. Experian reported \$730 million in revenue from Latin America for the year, as compared to



Cassin // File Photo: Experian.

\$631 million during the same period last year. The company has been putting “significant” investments into Brazil to position for economic recovery after two years of recession. The use of counter-cyclical products such as delinquency notifications helped achieve better performance in the Brazil market, and its expansion with a number of the largest Brazilian banks also contributed to gains, Cassin said. Looking ahead, Cassin added that regulatory changes are being considered in Brazil, which could accelerate the adoption of “positive data” by dropping the requirement for consumers to opt-in and instead allowing consumers to

NEWS BRIEFS

Brazilian Government to Sell Shares in IRB Brasil

Brazil's government is among the entities selling all or a portion of their shares in IRB Brasil Resseguros through an initial public offering, Reuters reported May 30, citing documents filed with the country's securities regulator, CVM. The FGEDUC state-owned fund, which guarantees subsidized college loans, will sell an undisclosed amount of common shares in IRB. The insurance units of Banco do Brasil, Banco Bradesco and Itaú Unibanco Holding are also unloading shares of the reinsurance provider. Bradesco's investment banking unit will act as lead underwriter of the transaction, the wire service reported.

Remittances to Nicaragua Rise 6.5 Percent

Nicaraguans living abroad sent home 6.5 percent more in remittances during the first four months of the year as compared to the year before, El Nuevo Diario reported May 25. Families in Nicaragua received \$431.7 million in the first four months of this year, according to central bank data. More than half of the money transfers, 56 percent, came from the United States, while nearly 20 percent came from neighboring Costa Rica. About 20 percent of Nicaragua's 6.3 million citizens live abroad. Remittances are estimated to account for some 10 percent of the country's GDP.

Chile's Stock Exchange to Use IBM Blockchain Technology

Chile's Santiago Stock Exchange will use blockchain technology from IBM in order to help reduce errors, possible fraud and processing time for transactions, the U.S.-based company said in a May 17 statement. The Chilean exchange, which built the technology with IBM, is the first in Latin America to use such a system, according to IBM.

opt-out of the positive data collection process. Advocates for positive data sharing believe it benefits people with a good credit history, and makes risk scores built on bureau data more predictive. Opponents cite concerns over privacy. "We believe this would benefit Brazilian consumers and would provide new opportunities for better credit risk assessment through more widespread use of data," Cassin said. In anticipation of this regulatory change, Experian plans to accelerate the development of products in Brazil that incorporate positive data, the company said. Including all its units globally, Experian reported \$4.3 billion in revenue for the year.

MONEY LAUNDERING NEWS

Citi to Pay \$97 Million to Settle Banamex USA Case

Citigroup has agreed to pay U.S. federal authorities \$97.44 million to settle allegations that inadequate internal controls at the bank's Banamex USA subsidiary may have allowed customers to engage in laundering money sent to Mexico, the Los Angeles Times reported May 22. Citi had established Banamex USA as a unit of Banco Nacional de México, another Citi subsidiary, to make it easier for businesses and individuals to transfer money across the border. As part of the settlement, the Justice Department agreed not to prosecute New York-based Citi. The deal follows a \$140 million civil penalty that Citi agreed to in 2015 with the Federal Deposit Insurance Corp. and the California Department of Business Oversight to resolve their investigations. Citi said as part of that earlier deal that it would close down Banamex USA, and it said May 22 that it anticipates that the division will be shuttered by the end of June. In the case, the Justice Department said that Banamex USA, based in Century City, Calif., between 2007 and at least 2012, processed more than 30 million remittances to Mexico at a value of more than \$8.8 billion. Those transfers led to more than 18,000 alerts

FEATURED Q&A / Continued from page 1

tions in 2016 (as compared to 20 percent in 2015). Banks possess market share and boast well-established relationships with their customers, often developed over many years. Fintechs, meanwhile, offer specialized technical knowledge, enabling them to speed up procedures and build agile digital solutions. By collaborating more and competing less, banks and fintechs can reap the rewards by leveraging their assets. Consumers should be empowered to create their own virtual digital identity, which they can use to make safe payments and engage with other services. For traditional banks, the challenge is to be able to support the demands of this new breed of consumer as well as more traditionally minded customers. For example, banks have to be able to enroll customers anytime, anywhere and on any device, with a fast smooth and consistent experience. They should also simultaneously enable all customers to be up and running quickly with whatever payment method they prefer—whether that's a traditional EMV card, digital card or mobile/wearable device. Brazilian fintechs have great opportunities to deliver even more innovation through mobile services and, for example, new distribution channels for other products, like insurance. The next trend will certainly be the 'insurtechs,' using new technologies like artificial intelligence, machine learning and blockchain."

A Lindsay Lehr, senior director at Americas Market Intelligence in Oakland, Calif.: "The most successful fintech companies in Brazil thus far have been focused on digital, branchless banking, designed for millennials. NuBank, Neon Bank and Banco Original are three such examples, whose value proposition lies in providing an experience rather than a product. Their banking solutions offer a completely mobile experience—from opening an account, to applying to a credit card, to saving, to managing their finances—and are low, or zero cost, to users. Nubank has

been one of the most successful Brazilian startups ever, raising an additional \$80 million last December, after receiving \$52 million from Goldman Sachs earlier in the year. Additionally, the credit industry offers huge potential to fintech companies, due to

“**The most successful fintech companies in Brazil thus far have been focused on digital, branchless banking, designed for millennials.**”

— Lindsay Lehr

Brazil's astoundingly high interest rates on credit cards, in many cases exceeding 400 percent annually. Companies offering alternatives to traditional credit cards, including crowdfunding loans, personal loans based on alternative credit scoring, and platforms/apps that improve the transparency of interest rates and fees to consumers are all leveraging the failure of banks to provide accessible credit terms."

A Marcelo Bradaschia, co-founder of FintechLab.com.br: "The fintech landscape in Brazil has been changing at a great pace for the last two years. Not only are we witnessing many startups being created in different areas, like invoice lending, personal lending, debt collection, personal and enterprise finance management, investments and insurance, but the ecosystem is growing fast. This means more prepared entrepreneurs, acceleration programs, access to capital, regulators more involved and new associations. The financial industry in Brazil is very concentrated with five main players, although there are more than 100 financial institutions in the market. The big geographical landscape of the country has made growth very expensive in the physical era,

Continued on page 6

about potentially suspicious transactions, but the bank conducted fewer than 10 probes into the suspicious activity, which involved approximately \$142 million in questionable transfers. The bank's compliance unit had only two employees, according to federal prosecutors. Citi said that it was pleased to resolve the allegations and said that having "the strongest possible system for anti-money laundering" was an important obligation.

DIGITAL PAYMENTS NEWS

Mastercard Unveils Second Generation of Masterpass in Brazil

Mastercard has introduced the second generation of its Masterpass digital payments platform in Brazil, ZDNet reported May 27. The newest generation of the service has a more responsive design for mobile devices and can also use SMS or email to recover lost passwords, according to the news site. The Masterpass platform includes an automatic digital wallet, which Mastercard says allows users to securely store payment and shipping information. It also includes a feature that displays information about a user's financial institution at the time of payment. The second generation of the service provides simpler access to the digital wallet, which users can access by entering a password and using it to authenticate purchases.

POLITICAL NEWS

Trump Eyeing Changes to U.S. Policy on Cuba

U.S. President Donald Trump may roll back parts of the Obama administration's thaw with Cuba as early as June, CNN reported May 31, citing a U.S. government official involved in

THE DIALOGUE CONTINUES

What Types of Pension Reforms Are Needed in Peru?

Q **Peru's pension system needs to be improved, President Pedro Pablo Kuczynski said in a May 1 speech. The statement followed actions last year by Peruvian lawmakers in which they voted to allow account holders to withdraw 95.5 percent of the money from their private pension accounts upon retirement, and also allow Peruvians to withdraw 25 percent of their accounts to repay mortgage loans. What are the effects of those measures on the country's private pension system, which includes a public system, known as ONP, and a private system, with providers known as AFPs? To what extent does the private system need reforms?**

A **Miguel Palomino, director of the Peruvian Economy Institute:** "Recent rules allowing retirees to immediately withdraw up to 95.5 percent of their retirement accounts and people in general to withdraw 25 percent from their accounts for mortgage loans certainly undermines the main objective of any pension system: to assure financially sustainable retirement. However, the main problem with the current pension system is not recent bad measures, but rather its limited reach. Given that both the private and the public pension schemes can only draw

their members from those who are formally employed (approximately 25 percent of the employed population), this precludes the pension system from reaching the majority of the population. This must change. And for those lucky enough to be part of the system, it also has room for improvement. While its average return on investment over the last two decades has been sound, the private sector still has high management fees, and its not clear what is the best solution to this problem. Furthermore, members do not tend to put a high value on the pension system (irrespective of the cost), which illustrates the lack of trust/financial education among the general population. As for the public system run by the ONP, it is due for a major overhaul. As a pay-as-you-go system where only 30 percent of contributors get any pension, the ONP requires permanent transfers from the government to keep afloat. Demographics shifts over the next decades will make this fiscal burden unsustainable. The current challenge is to transform the ONP's pay-as-you-go system into an individual capitalization scheme."

EDITOR'S NOTE: The comment above is a continuation of the Q&A published in the May 17 issue of the Financial Services Advisor.

the review of Washington's policy toward the island nation. By next month, Trump could announce that the United States will make no further unilateral concessions to Cuba, which the Obama administration was accused of doing, according to the official, as well as other current and former administration officials and Cuba experts. Trump is also expected to demand the extradition from Cuba of fugitives such as Assata Shakur, who escaped from a

U.S. prison and received political asylum in Cuba after being convicted of killing a New Jersey state trooper. Trump also is expected to prohibit U.S. companies from making deals with Cuba's military, which controls much of the country's tourism industry. While Trump is not expected to roll back all of former President Barack Obama's thaw with Cuba, he is expected to make symbolic gestures to the U.S. lawmakers who are staunch opponents of

NEWS BRIEFS

Assange a 'Hacker,' But Can Continue Living in Embassy: Moreno

Ecuador's new president, Lenín Moreno, on May 29 called Julian Assange, who has been holed up in the country's London embassy since 2012, a "hacker," his strongest comments to date against the founder of WikiLeaks, Reuters reported. Moreno did emphasize, however, that Assange would be permitted to stay at the embassy. Moreno's comment breaks with those of his predecessor, former President Rafael Correa, who called Assange a "journalist."

OECD Calls on Colombia to Boost Productivity, Improve Business Climate

The Colombian economy has been more resilient than other Latin American countries amid the recent fall in commodities prices, but the country needs to do more to increase productivity and improve the business climate, the Paris-based Organization for Economic Co-operation and Development said in a report released May 25. Reforming education, reducing informality and increasing work opportunities for women ought to be the focus of policymakers, according to the report. Colombia is among three countries being formally invited to become members of the OECD

Mexico's Retail Sales See Largest Monthly Drop Since 2013

Retail sales in Mexico dropped by the most in more than three years in March, Reuters reported May 23. Sales fell 1.3 percent, a lower figure than forecast, in March from February, according to the national statistics agency. Real GDP growth accelerated to 2.8 percent year-over-year in the first quarter of this year, up from 2.3 percent the prior quarter and the highest growth rate since 2015.

the Cuban government as well as conservative Cuban-American voters. "I'm 1,000 percent sure the president is going to deliver on his commitment," Rep. Mario Diaz-Balart (R-Fla.), recently told the National Journal. "I have no doubt that you're going to see in short order a different policy." Cuban officials have not publicly commented about the possible changes in U.S. policy toward the communist-run island. The developments come as Raúl Castro is expected to step down as Cuba's president. Castro has said that he will leave the post next February. While the United States still officially bans tourism to Cuba, the U.S. Treasury allows Americans to "self-license" under 12 categories of travel, including educational tours and participation in sporting events, a practice that allows virtually anyone to travel to the island. Trump could end that loophole, sources told CNN.

Brazilian Supreme Court Orders Temer to Testify in Writing

The Brazilian Supreme Court justice in charge of the massive "Car Wash" graft case on May 30 ruled that President Michael Temer would have to testify in writing "on the grounds of



Temer // File Photo: Brazilian Government.

the exceptionality of the investigation," the Financial Times reported. Temer would be required to respond within 24 hours once the questionnaire is delivered, the Supreme Court said. The order came nearly two weeks after the release of a recording in which Temer is allegedly heard endorsing the payment of bribes to jailed former Chamber of Deputies Speaker Eduardo Cunha by Joesley Batista, the former

chairman of meatpacking company JBS. Temer has denied the allegations.

Argentine Foreign Minister Malcorra Steps Down

Argentine Foreign Minister Susana Malcorra on May 29 resigned from her post to move to Madrid, saying she wanted to be closer to her family, Argentine President Mauricio Macri announced, Reuters reported. "She is leaving this crucial role for strictly personal reasons," Macri said. The country's ambassador to France, Jorge Faurie, has been appointed the new foreign minister, and Malcorra will continue to serve as an advisor to the government from afar. Malcorra is a businesswoman and diplomat who unsuccessfully ran for secretary-general of the United Nations last year. She led the Macri administration's efforts to strengthen diplomatic and trade ties with the United States and other Western countries.

ECONOMIC NEWS

Ecuadorian Gov't Raises \$2 Billion in Bond Offering

The Ecuadorian government raised \$2 billion from its most recent bond offering on May 30, indicating that investors were optimistic about the ability of new President Lenín Moreno to curb spending, Reuters reported. Moreno's narrow victory initially caused concern that he might not make the necessary policy moves to lower public spending, but investors say they have seen positive signs from his government. "Some market friendly people have been put into key posts of the central bank," said Sean Newman, a portfolio manager at Invesco. Citigroup priced the offering, with a \$1 billion six-year tranche carrying a yield of 8.75 percent, and a \$1 billion 10-year tranche with a 9.63 percent yield.

FEATURED Q&A / Continued from page 3

where branches used to be the only way to sell services. Fintechs are helping to break this barrier with different business models. Some of them are working in collaboration with financial institutions, while other smaller ones are selling their services in the digital era and competing in the market. There are opportunities in all areas. Areas like finance management (B2B and B2C), investment management and payments all have very solid initiatives. Fintechs are providing the customers ways to experience better services, with more transparency, that are easy to use and cheaper, in line with the digital revolution that all the industries are going through. As a response, traditional banks are being forced to innovate. That's a challenge. It involves culture, technology and making strategic choices that may affect their business lines. But there is no turning back."

A **Jordan McKee, principal analyst at 451 Research:** "The past decade has seen new entrants of all sizes set out to improve and democratize an ever-growing list of banking functions. Brazil, in particular, has been a hotbed for fintech activity, producing homegrown startups such as NuBank and Creditas while simultaneously attracting global interest from the likes of iZettle, Samsung Pay and SumUp. The rapid addition of such a diverse set of new players may at first create the illusion that the sky is falling for many of the country's well-established financial institutions. Upon closer inspection, however, the general aspirations of fintechs are more aligned with collaboration than disintermediation. Fintechs, unlike traditional financial institutions, have benefited immensely from growing up in a digital-first world. What they lack is access

to core banking infrastructure, licenses and customers—that's where banks come in. Banks must begin to look at the emergence of fintechs not as existential threats, but as new, potentially high-growth distribution

“Successful banks of the future will be those that operate more like platforms...”

— Jordan McKee

channels. Partnering with fintechs can allow both parties to focus on core competencies (for example, risk management for banks and design/digital experience for startups) while concurrently generating new customer value. The end result can oftentimes create a situation where one plus one equals far more than two. The next several years will require that financial institutions rethink how they add value for their own customers. Fintechs are well positioned to drive customer-facing innovations, meaning banks must focus more on enablement and interoperability. This will create both cultural and technological hurdles to be sure, but in many ways, it will be imperative to generating sustainable, long-term growth. Successful banks of the future will be those that operate more like platforms, offering customers access and ease of using third-party services, while providing the underlying infrastructure that fintechs operate on."

The Advisor welcomes comments on its Q&A section. Readers can write editor Gene Kuleta at gkuleta@thedialogue.org.

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