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Mexico: Trends & Developments

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Trends and Developments

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Market Overview and Introduction

In the short span between the enactment of the Law to Regulate Financial Technology Institutions (*Ley para Regular las Instituciones de Tecnología Financiera*, LRITF) – informally known as the “Fintech Law” – back in 2018 and today, Mexico has become a booming market for fintech companies.

This is confirmed by the fact that the number of fintech companies in Mexico grew from 441 to 512 in 2021 alone (source: Biz Latin Hub), making Mexico the second-largest player in the fintech sector in Latin America, behind Brazil.

It is important to highlight that fintech companies which fall within the regulation of the LRITF need a licence to carry out their activities or render their services. However, there are many fintech companies in Mexico which do not fall under this umbrella.

In 2021 the first authorisations for Financial Technology Institutions (*Instituciones de Tecnología Financiera*, ITFs) were granted. As of November 2021, the financial authorities had received 120 applications for ITF authorisations, out of which 58 were authorised (source: Mexican Central Bank – Banxico).

In addition, in 2021 Mexico saw a surge in “unicorns” (usually defined as a privately held “start-up” with a valuation of USD1 billion or more), many of them relevant players in the fintech sector. Such is the case of Bitso (a cryptocurrency exchange platform), Clip (a digital payment solutions company), Konfío (a lending platform with a focus on SMEs) and Clara (a corporate spending

management solutions company), according to the website LatamList.

The outlook of the Mexican fintech industry is positive, and the expectation is that it will continue to grow at an accelerated rate. This is the result of several factors, including that approximately eight out of ten Mexicans do not have access to formal banking services, the overall digitalisation of everyday life, and the COVID-19 pandemic which not only created the need to use digital channels for financial alternatives, but demonstrated their efficiency.

The fact that the Mexican population has been generally underbanked – with approximately 80% not having access to formal banking services – has driven a large customer base to seek alternatives in fintech companies. As a result, “traditional banks” have bolstered efforts to provide effective digital banking/financial products. One example is the joint venture between Rappi (a technology company in the e-commerce sector) and Banorte (one of Mexico’s largest banks) in which these two relevant players incorporated *Tarjetas del Futuro*, which not only seeks to add ITFs to its portfolio companies, but is also looking to become Mexico’s first 100% digital bank.

Overview of Legal Framework

The LRITF is the main statute applicable to fintech-related activities and is the result of a comprehensive and extensive effort by the private and public sectors, involving several financial authorities, including: the National Banking and Securities Commission (*Comisión Nacional Bancaria y de Valores*, CNBV), the Ministry of Tax and Public Credit (*Secretaría de Hacienda y*

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Crédito Público, SHCP), Banxico, the National Commission for the Protection and Defence of Financial Services Users (*Comisión Nacional para la Protección y Defensa de los Usuarios de los Servicios Financieros*), and the Mexican federal legislative branch.

Financial technology institutions or ITFs

The LRITF contemplates two kinds of ITFs: Collective Financing Institutions (*Instituciones de Financiamiento Colectivo* or IFCs), and Electronic Payment Funds Institutions (*Instituciones de Fondos de Pago Electrónico* or IFPEs).

Collective Financing Institutions

IFCs are authorised to carry out “crowdfunding” activities, which are defined by the LRITF as activities with the purpose of facilitating contact between members of the general public – as investing and requesting parties – in order for them to grant financing to each other through information applications or interfaces, or any other digital means.

The capital and financing transactions that may be carried out by the general public through IFCs are:

- collective debt financing – where the investing parties grant loans to the requesting parties;
- collective equity financing – where the investing parties acquire stock of the entities acting as requesting parties; and
- co-title or royalty collective financing – where the investing and requesting parties enter into participation arrangements in which the investing party will acquire part of the assets, income, profits or royalties of a project or activity carried out by the requesting party.

It is important to mention that IFCs are only meant to connect the demand and supply of financing and capital under the above transac-

tions, and are not meant to act as a counterparty (ie, a requesting or investing party).

Among other things, IFCs must:

- duly and clearly disclose to the investing parties the selection criteria of the requesting parties, the projects to be financed, and the information and documentation analysed for such purpose;
- analyse and inform the potential investing parties of the overall risk of the requesting parties and the related projects, including general performance and payment indicators; and
- report to credit information companies.

Likewise, the law sets limits to the transactions that may be carried out through an IFC, including the maximum amount of resources that may be requested by the receiving parties and the amounts that may be invested by a single investing party.

Agreements entered into by IFCs with their users, both investing and receiving parties, must comply with financial consumer protection laws aimed to provide transparency and certainty to all parties involved. The fees and costs must also be clearly disclosed and approved by the CNBV.

As of November 2021, the financial authorities had received 42 applications for IFCs.

Electronic Payment Funds Institutions

On the other hand, IFPEs are authorised to issue, manage, redeem and transmit electronic payment funds through information applications or interfaces, or any other digital means. In particular, IFPEs may, among other things:

- open and maintain electronic payment fund accounts for their clients (e-wallets) where deposits in electronic payment funds may

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- be made in exchange for a corresponding amount in money or other virtual assets;
- carry out transfers of electronic payment funds between clients; and
- facilitate the withdrawal of amounts in cash or other virtual assets by debiting electronic payment funds.

For such purpose, it is important to note that the LRITF defines electronic payment funds as funds that are accounted for in an electronic registry maintained by an IFPE and which:

- refer to an amount in money (either in Mexican or foreign currency) or in virtual assets;
- correspond to a payment obligation by their issuer;
- are issued upon receipt of the corresponding amounts in money or virtual assets; and
- are accepted by a third party as due receipt of such amounts in money or virtual assets.

As mentioned before, under the LRITF, IFPEs are authorised to handle virtual assets (eg, cryptocurrencies) and to facilitate their transfer between members of the general public. In this scenario, IFPEs would also hold virtual assets serving as a “crypto wallet”. Although the LRITF introduced such activities, Banxico has issued secondary regulations applicable to virtual assets restricting their use to internal transactions of IFPEs and banks.

As of November 2021, the financial authorities had received 78 applications for IFPEs.

Authorisation process

Companies carrying out activities reserved for ITFs must be authorised as such and must request a licence under the LRITF.

The requesting company will be required to submit to the CNBV, among other things, its operation/business model, business plan, shareholder

structure and information, board of directors’ integration and information, financial viability, and policies and manuals regarding anti-money laundering (AML).

The CNBV, with the prior favourable opinion of an inter-institutional committee (integrated by members of the CNBV, SHCP and Banxico), will review the relevant submission and decide if authorisation should be granted.

Finally, companies authorised as ITFs will be required to comply with minimum capitalisation requirements depending on the specific activities they carry out.

Cryptocurrencies

The second relevant matter contemplated under the LRITF are cryptocurrencies, which are referred to as virtual assets. For such purpose, the statute defines “virtual assets” as the representation of value registered electronically and used by the public as a payment method, and which may only be transferred by electronic means.

Secondary regulations on virtual assets are entrusted to Banxico, which has exercised its authority through the issuance of binding virtual assets rules as well as several non-binding opinions. The binding virtual assets rules issued by Banxico in September 2020 are very restrictive and are intended to limit the use of virtual assets by regulated financial institutions, which are only able to use virtual assets in internal operations (keeping clients remote from any related risks).

Through the non-binding opinions, Banxico has expressed that, notwithstanding the limitations included in the rules, “the regulations do not limit the services related to virtual assets that commercial companies can offer”.

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Additional rules are expected in the upcoming years. The existing framework has a very limited scope. Assets such as stablecoins, tokenisations, coin offerings and non-fungible tokens (NFTs) are not specifically included in the current regulation and are only addressed by Banxico in unofficial communications.

In addition to the LRITF, cryptocurrencies have seen an update in tax and AML legislation. From a tax standpoint, the Mexican authorities have decided that virtual assets should be treated like any other movable asset for tax purposes. As to AML, the applicable law has expressly included transactions with virtual assets as vulnerable activities and requires a compliance treatment consistent with international standards.

Regulatory sandbox

The LRITF defines an “innovative model” as a model which uses tools or technological means to provide financial services and which has different modalities to those of others in the existing market.

In this context, Mexican companies – unlike ITFs or other financial or regulated entities – may request temporary authorisation to carry out, through an innovative model, an activity otherwise requiring fully-fledged authorisation under the LRITF. This works as an exemption that allows companies to test out new models and alternatives to provide financial services in a controlled environment.

Open finance

Finally, the LRITF provides rules under which any party that is compliant with certain API technical requirements may request any financial entity in Mexico to provide information on their products and services, as well as aggregated statistical information or client transactional data.

At present, the regulator has only defined the characteristics such APIs must have to allow a third party to receive “open financial data” – defined as data that contains no personal information, such as details of products, branch locations, etc.

Specific rules for transactional data are expected, which will provide an independent and integrated offer of products and services to consumers (as opposed to the current information exchange which is privately negotiated).

Conclusions

To sum up, Mexico has become a reference in the Latin American fintech sector, being a leading country in regulated fintech services and activities. While impressive progress has been made, it will be up to both the public and private sectors to bolster the industry and ensure that regulation does not quickly become obsolete. The balance between effective regulation and protection of the sector versus innovation and inventiveness will be the key driver in Mexico’s success in the fintech industry.

It is probable that new regulations will come into play in the next couple of years to further regulate virtual assets and “blockchain” technology, to – if possible – eventually open the market for the public as seen in other countries around the globe.

The year 2022 is sure to see more Mexican companies requesting licences to act as IFTs, as well as relevant investment from domestic and foreign VC and PE funds coming into the sector. Hopefully, the fintech industry will continue to be a beacon of hope through “choppy waters” in many of the other Mexican economic sectors.

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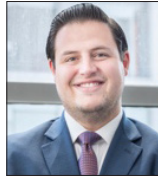
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