Development of crowdfunding initiatives in Chile*

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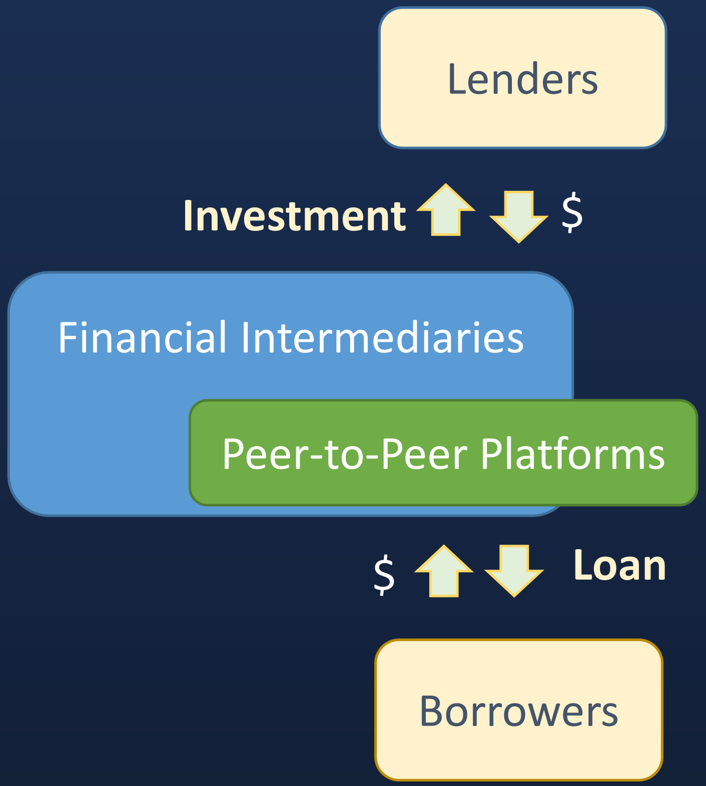
Central Bank of Chile, Aug 17th, 2019

Outline

1. Motivation



- Fintech benefits are almost a commonplace:
    - Access to several services
    - Speed, easiness and security
    - Cost reductions
    - Efficiency to deliver services

- Because of our hi-tech environment, people enjoy a vivid digitalization and availability of **financial services**

- **In terms of intermediation, crowdfunding is an alternative to fund projects or enterprises… In P2P crowdfunding, lenders and borrowers can connect, sharing benefits of an investment and simultaneous loan**

1. Context

Remarkable Crowdfunding Platforms

Chile?

- Using social networks and web pages, some **crowdfunding platforms successfully raise money from communities who want to profit**…
  - Lending-based: funders receive a debt instrument that pays a fixed interest and return on a specified schedule
  - Equity-based: funders receive equity instruments or profit sharing arrangements
- Donations and rewards are also two possible ways, but they are not relevant in terms of financial stability

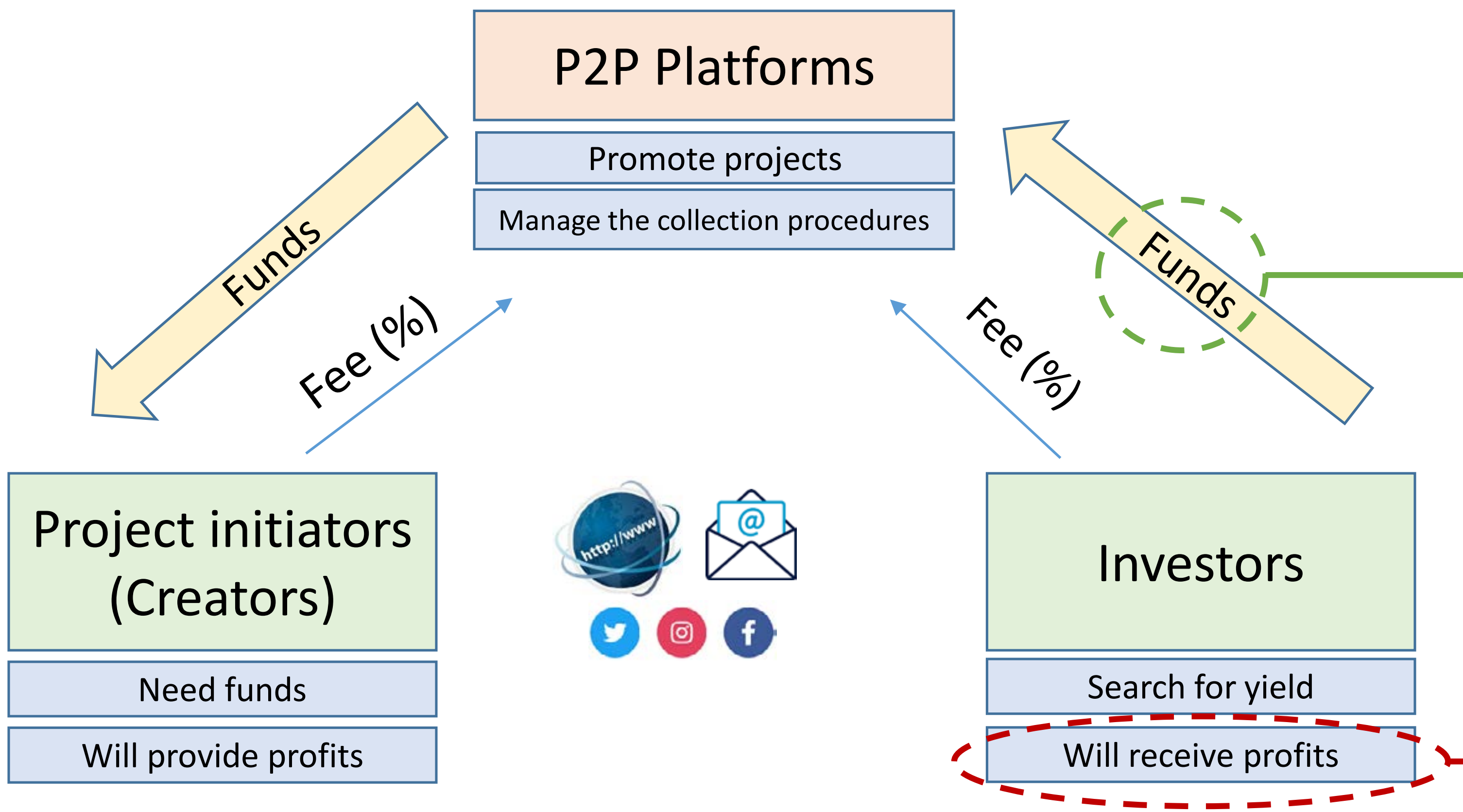
Annex 1

- In Chile, there is not empirical literature about crowdfunding activity…

Why? → If a policy were required, policymakers would know (at least) what they are talking about.

1. Context → Statistics and financial stability issues

- The common case is crowdfunding “for profit”:



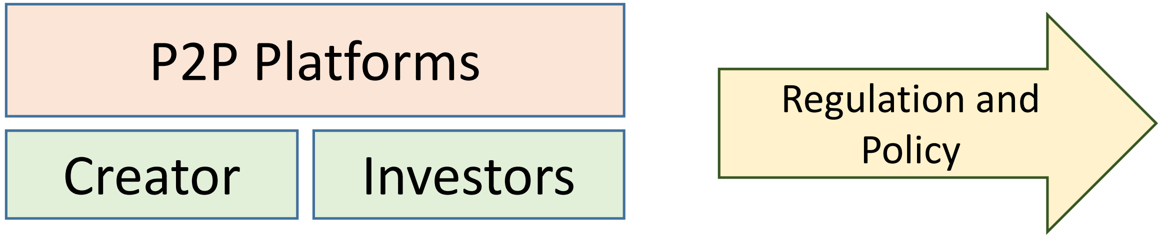
Data Issues

- Who are the main users?
- How much do they trade? (lend, borrow, invest…)
- How are the investment conditions?

Financial Stability issues

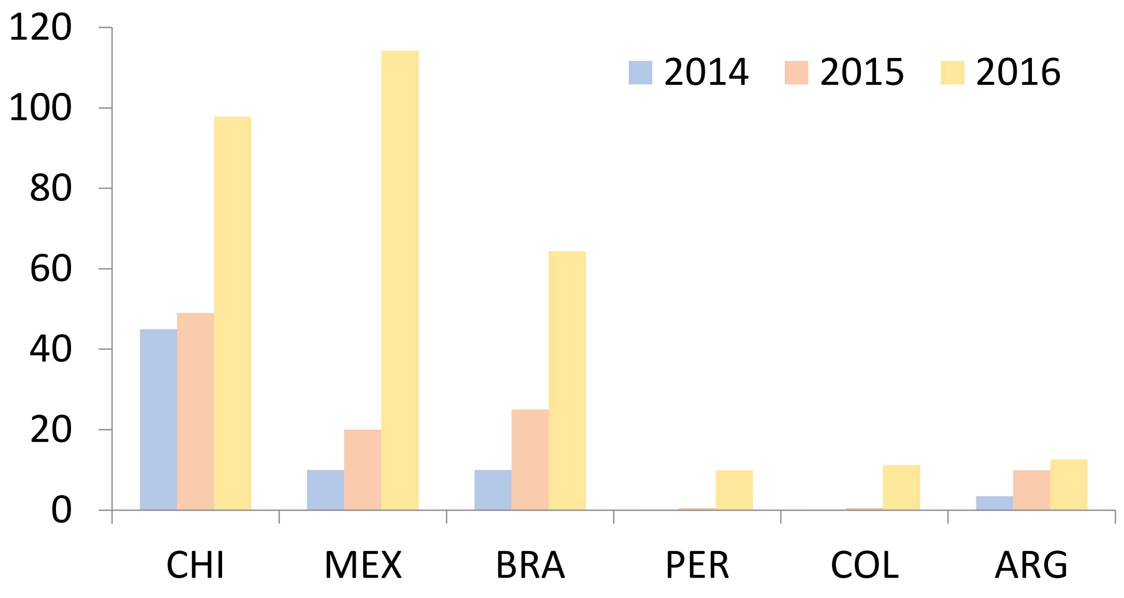
- What about credit risk?
- Is there a standard to protect consumers?
- Is it trustworthy?
- How is the cyber safety?

1. Context → Funding and regulation worldwide



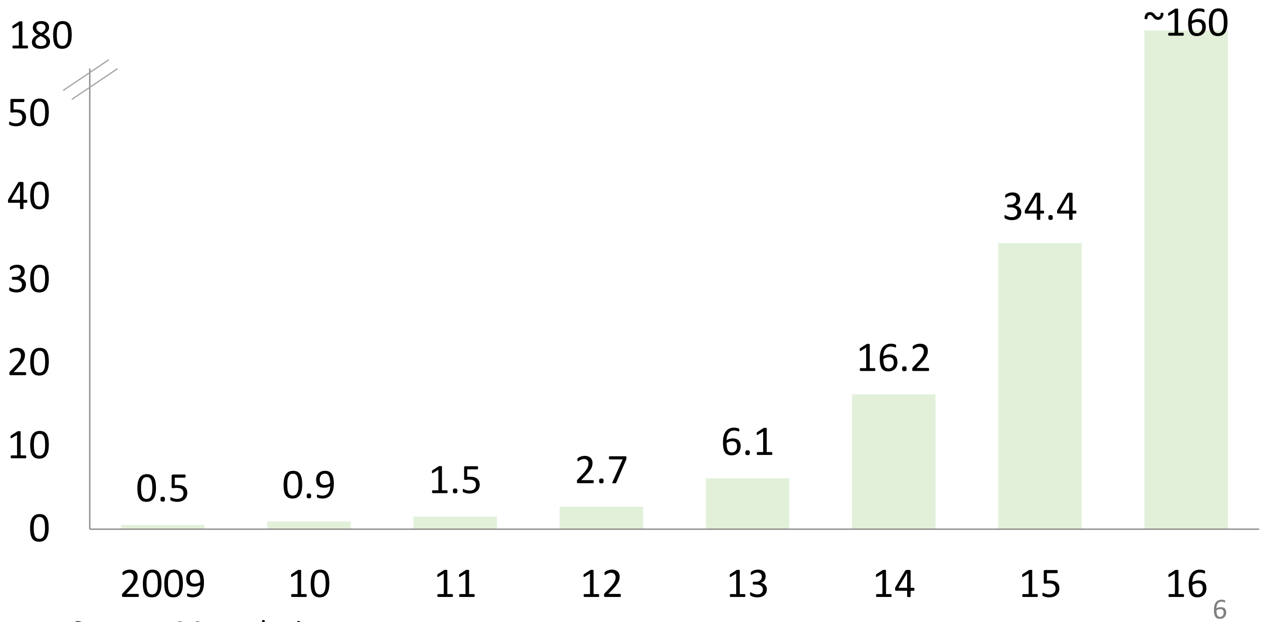
- Tax incentives
- Specific Rules
- Licensing / authorization
- Investor protection
- Risk management requirements
- Regulatory Sandboxes
- Innovation Hubs
- Accelerators

Crowdfunding raised per country (2014-16, USD million)



Source: Ziegler et al (2017)

Worldwide crowdfunding funds raised (2009-15, USD bn)



Source: Massolution

2. In Chile…

cumplo
broota
becual Move Forward
Facturedo

And many other Fintech companies

- In Chile *at least* 8 P2P crowdfunding platforms operate: they are self-regulated and define requirements to raise money, invest, donate, participate and so on…

- However, P2P platforms are not responsible neither for defaults, conflict of interests nor any operational risks
  - Almost 100% trust based → Reputational risks
  - Outside the regulatory perimeter → Legal but unsupervised

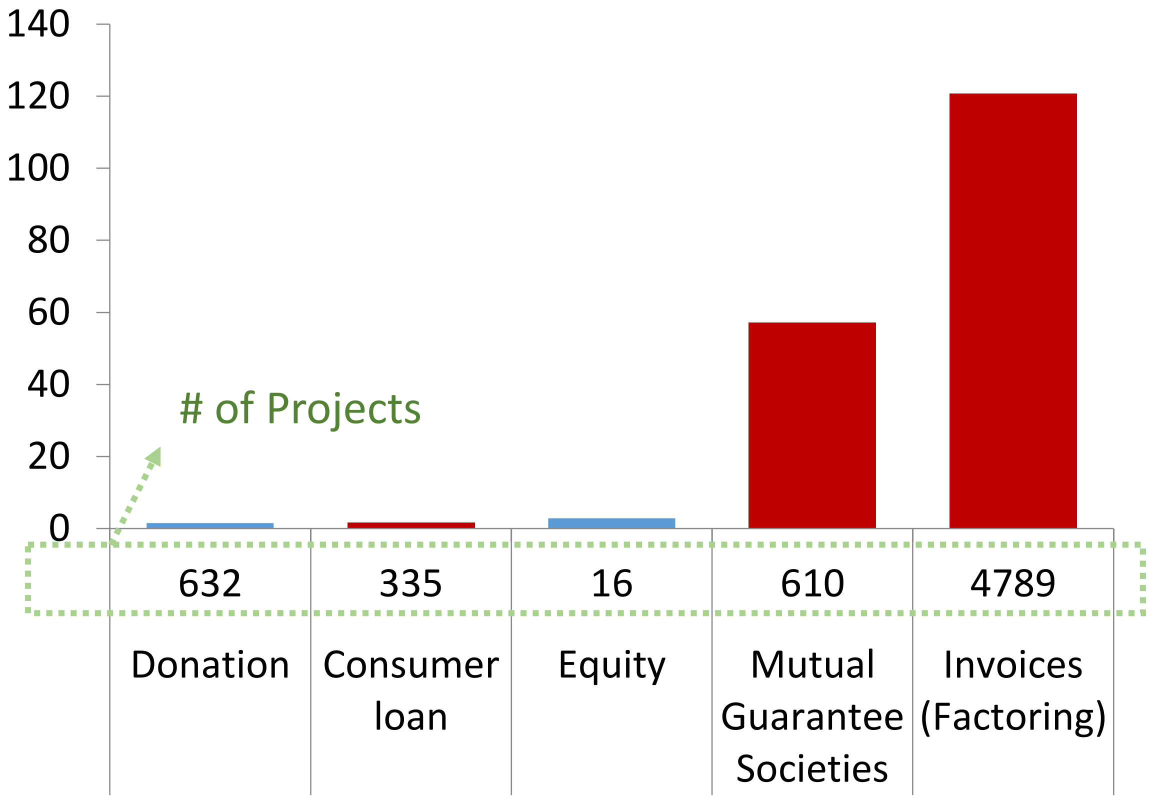
- Ultimately, they raise money and incentive donations, investments, loans and more
  - To some extent, there is a substitution of capital markets!

- What is next?
  - Restrict or hinder them? → Not desirable in terms of innovation
  - Understand them? → Ok, but data is required
  - Regulate them? → Ok, but we need know them better
  - All in all, it may be a financial policy concern

2. Crowdfunding in Chile: looking at the projects to extract data

- Projects imply funds from people
- Between 2012 and 2016 there were 6,382 projects, raising almost USD 180 million
- 95% of funds were allocated in small and medium enterprises (SME) as a P2P lending crowdfunding; 50% of which were financially backed by invoices (factoring)
- This could lead that crowdfunding opportunities involve sizable benefits to SME in terms of costs of lending

Distribution of Chilean crowdfunding (2012-16, MM USD)



Source: Abarca (2018)

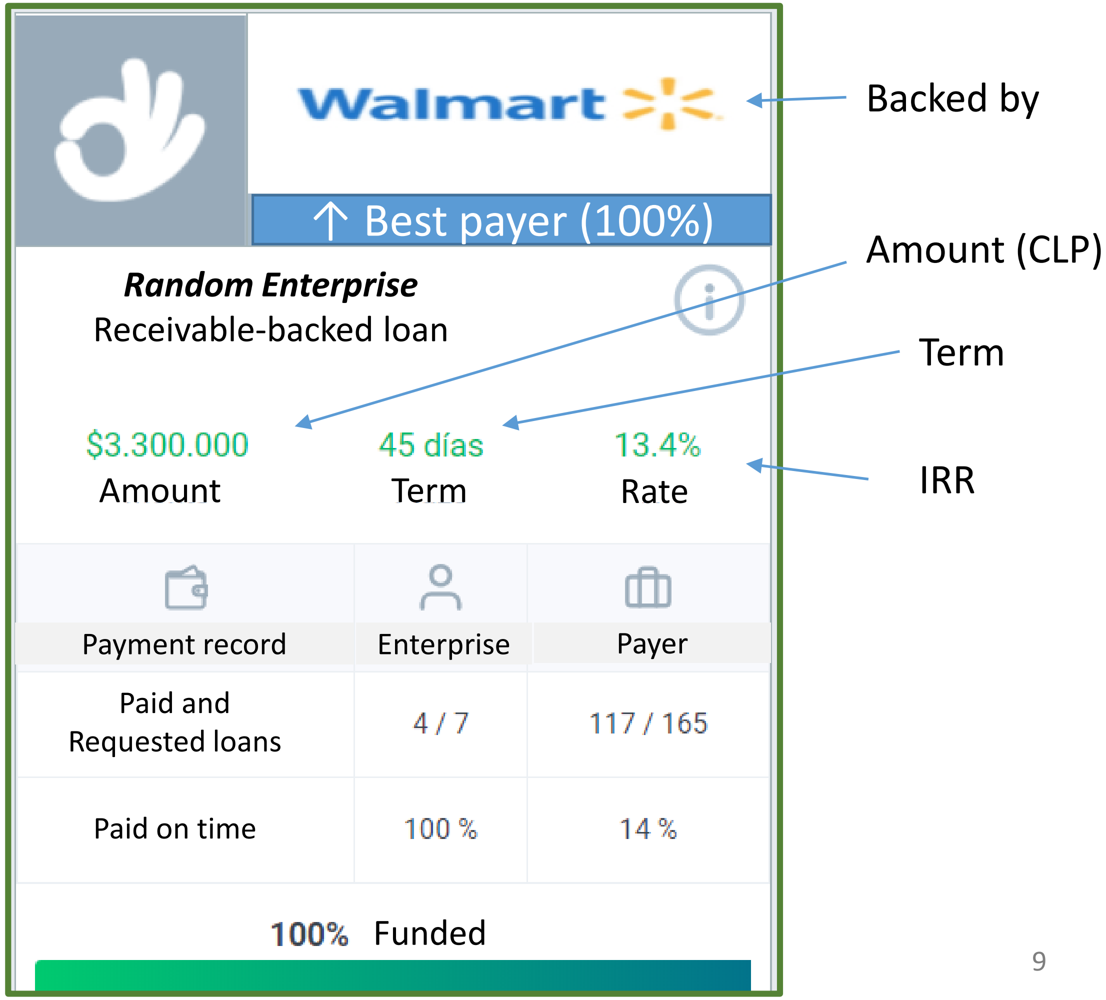
3. Lending crowdfunding in Chile: from webpages to data

- We generate a data base of loan requests
  - Public information
  - Details of amount, rate, term and guarantee
  - It takes a lot of time

- Thus, we can understand some facts. In terms of projects:
  - ~4,800 backed by invoices (factoring)
  - 610 backed by MGS
  - 335 unguaranteed (not issued since 2014)

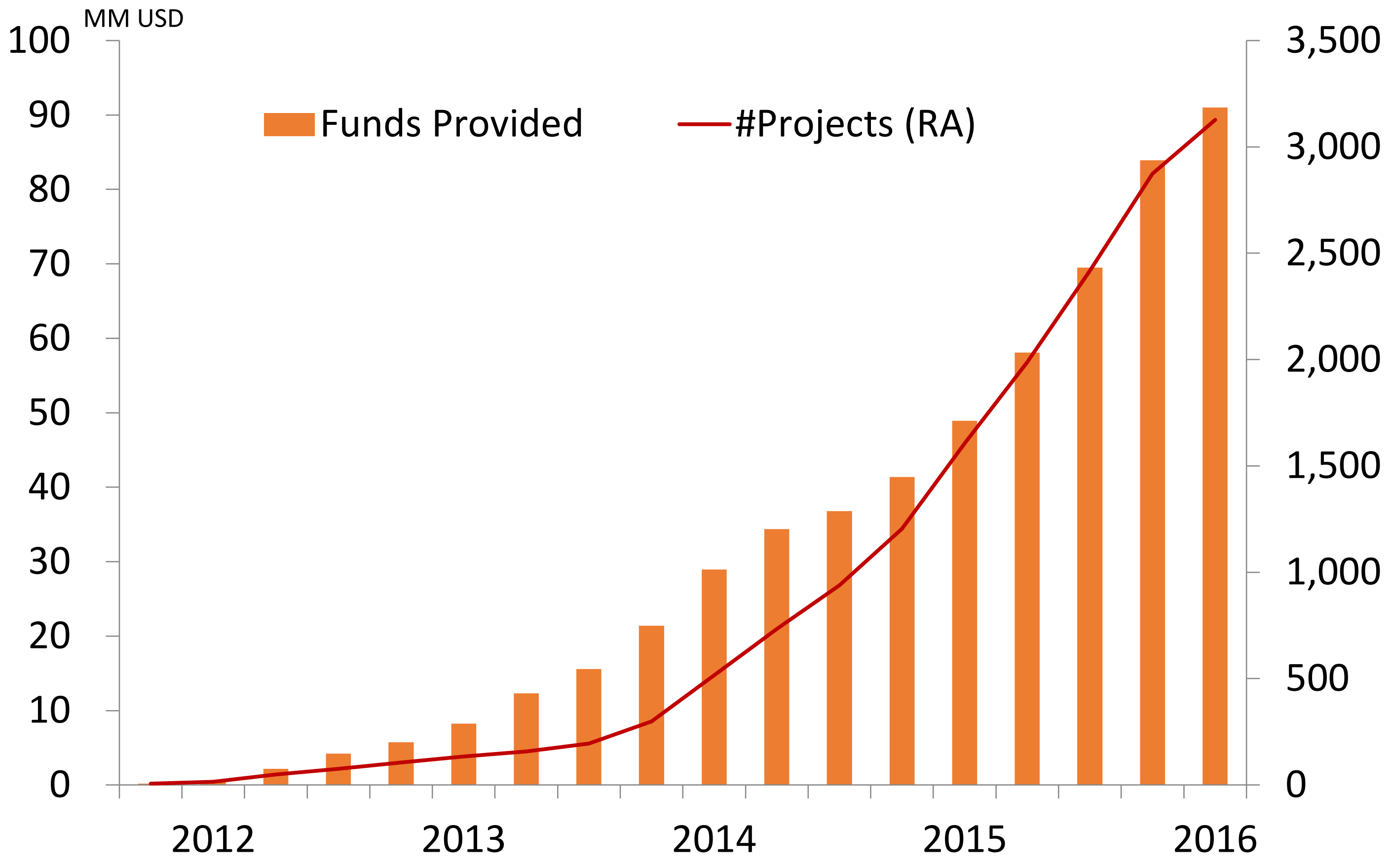
- Then…
  - Interest rate?
  - Is it competitive?

Example: Cumplo.cl random request (translated)



3. Lending crowdfunding in Chile: growth and SME's rates to look at

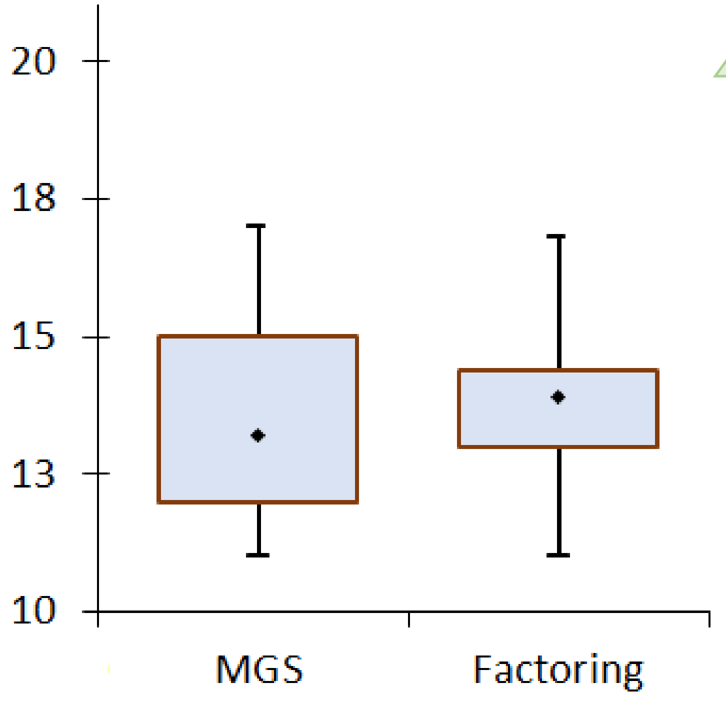
Amount and number of loan projects: 12-month rolling sum



Source: Abarca (2018)

Annual crowdfunding rates* (SME borrowers)

Annex 2



(*) Box represents Q1 and Q3, dot is median and line represents 5th and 95th percentile

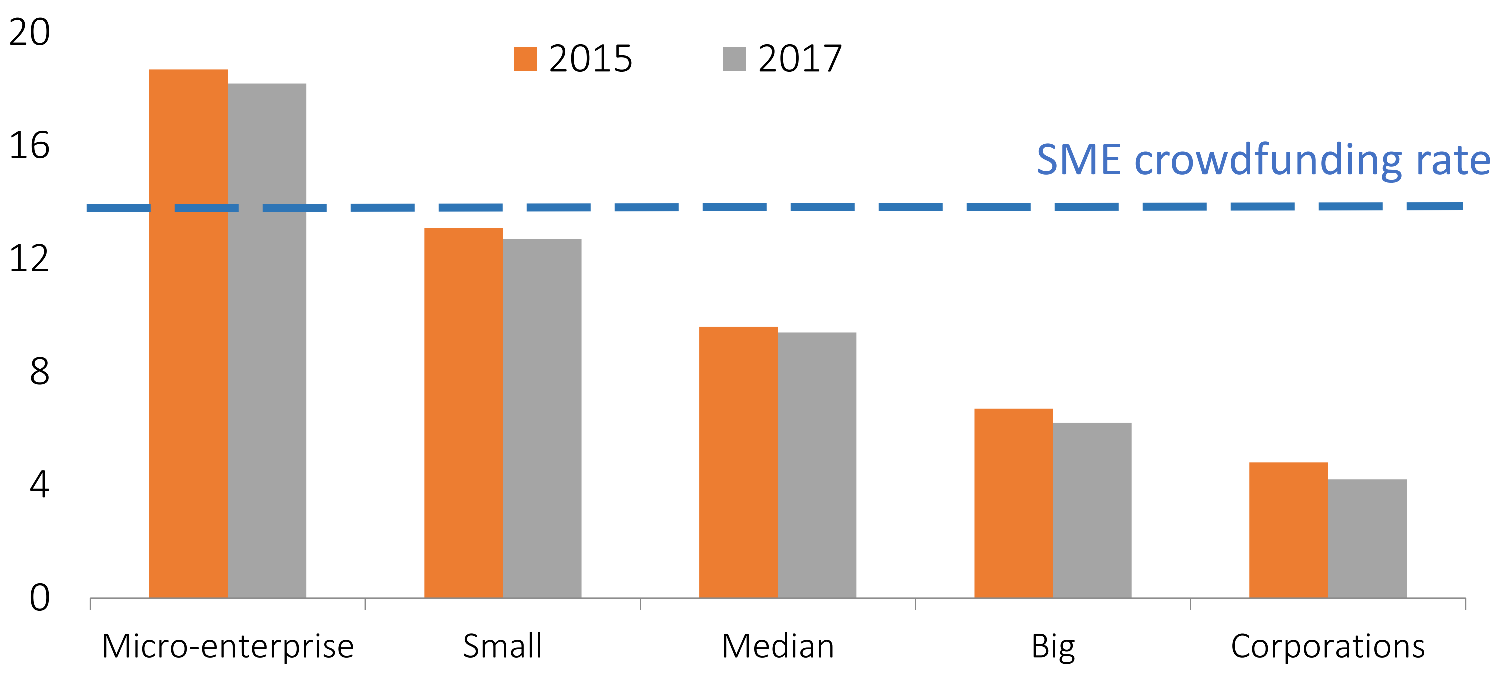
4. Discussion:

SME: Crowdfunding average annual interest rate of 13.4% nominal

Is it low or high?

- To compare the estimated rate, we should consider the lending crowdfunding average user → SME
- Despite platform fees (1-4%), we see that crowdfunding rates may be convenient, mostly in very small companies

Banking interest rates by companies' size



Source: CMF (former Superintendence of Banks and Financial Institutions)

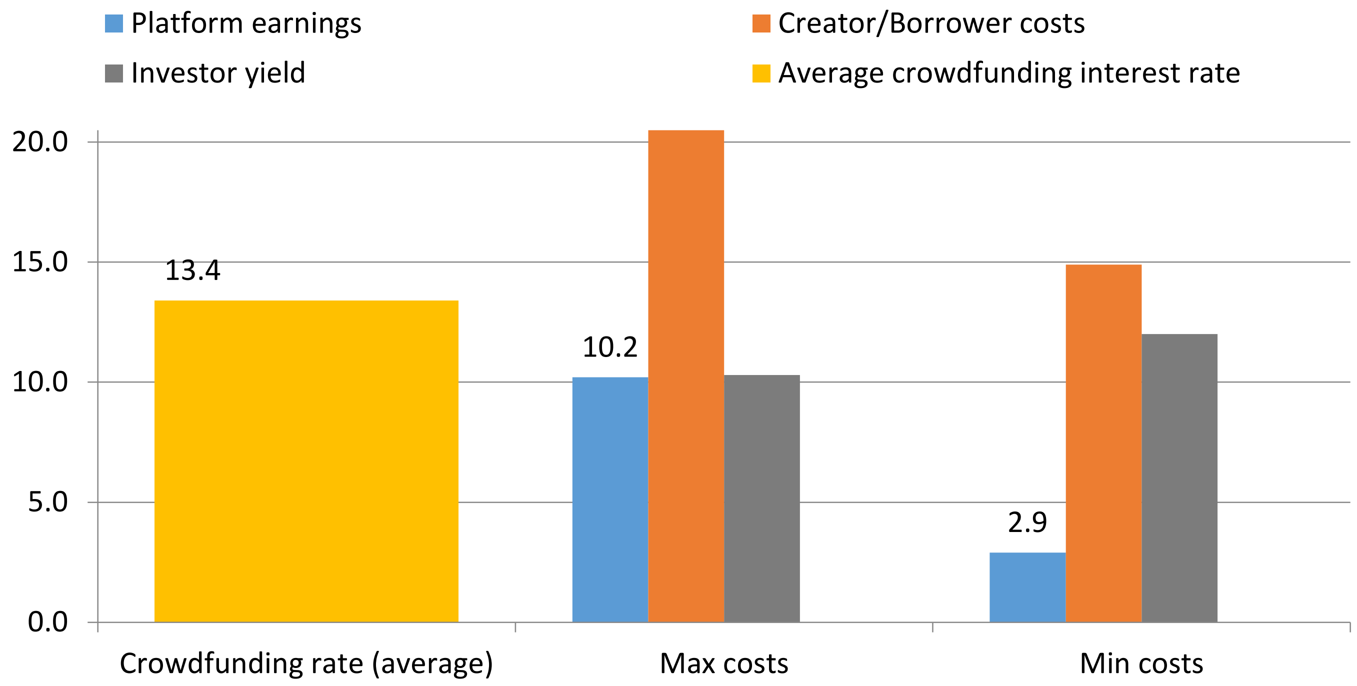
4. Discussion:

SME: Crowdfunding average annual interest rate of 13.4% nominal

Is the interest rate the cost of lending? …and the yield?

- On average, according to platforms, the cost to investors is 2.2% and the cost to borrowers is 4%
- We should compensate and add those costs
- Notwithstanding, it is not comparable with banking commercial loans since the credit standards are not equal

Average transaction costs and yields after platform fees



Source: Abarca (2018)

4. Discussion:

Do we need a regulation?

- Despite documented local development, and according to international experiences, the discussion of crowdfunding in Chile may lead to financial policy response

- Its inclusion in a regulatory framework that balances policies and standards of participation is something that ought to be evaluated

- Last February, the Financial Market Commission (CMF, in Spanish) published a "white paper" to discuss regulatory guidelines

- Balancing innovation and financial inclusion safeguarding financial stability is challenging


COMISIÓN PARA EL MERCADO FINANCIERO

White Paper

Lineamientos Generales para la Regulación del Crowdfunding y Servicios Relacionados

Febrero 2019

4. Takeaways

- Crowdfunding has many faces: equity, loans, donations… It is a worldwide phenomenon, proving its potential in alternative finance
- The demand for information deserves a measure of how crowdfunding works in Chile
  - It can be an issue of financial stability
- Highlights:
  - > 50% of crowdfunding projects are related to SMEs
  - > 95% of funds rely on lending; mostly guaranteed
  - From the statistic review, 13.4% is the observed interest rate
  - Platforms get between 2.9% and 10.2% of the transaction (from borrowers & investors)
- This diagnosis has motivated authorities to take action. Currently, the Chilean discussion considers these insights to comprehend crowdfunding as a practice to be regulated

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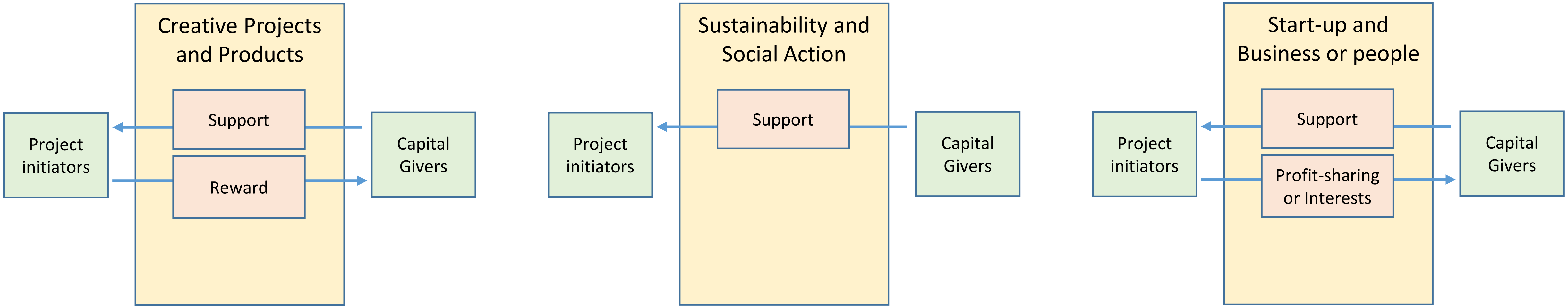
Annex 1

Overview of crowdfunding types

Hedonism

Altruism

For Profit



Source: Haas et al (2014)

Haas, P., Blohm, I., & Leimeister, J. (2014). "An empirical taxonomy of crowdfunding intermediaries". Conference Paper. https://www.researchgate.net/publication/265844619_An_Empirical_Taxonomy_of_Crowdfunding_Intermediaries

Annex 2

Descriptive statistics of nominal annual crowdfunding rates

	Consumer loans	MGS	Factoring
N°	335	610	4789
Min	9.6	8.0	6.7
P5	15.6	11.0	11.0
Q1	19.0	12.0	13.0
Median	**20.6**	**13.2**	**13.9**
Q3	22.0	15.0	14.4
P95	24.0	17.0	16.8
Max	26.0	27.6	30.3
Average	**20.4**	**13.5**	**13.7**
Weighted average	20.4	13.3	13.9
S.D.	2.5	2.0	1.7

SME

Source: Abarca (2018)