3 Boosting access to credit and ensuring financial inclusion for all

Having access to credit is essential for households to address the volatility of their personal finances over time and for firms to fund their investments. Accessing financial services at affordable cost on the other hand, is crucial to ensure financial security of all economic units. Despite recent improvements, there are still large financial inclusion disparities in Costa Rica, notably across regions, by gender, and size of firms. This chapter discusses policy reforms that would reduce these disparities. Some of the key policy priorities are to improve transparency by strengthening the credit registry and allocating the development banking credit more effectively. Enhancing financial literacy could help avoid excessive consumer indebtedness. Technological innovation would also help Costa Rica: granting FinTech start-ups direct and full access to the state-of-the-art electronic payments system would increase competition, reduce transactions costs and ensure financial inclusion for all.

Financial inclusion is defined as the effective access to financial services, which are offered at a cost affordable to the customers and sustainable for formal financial service providers. Financial inclusion is essential to both poverty reduction and economic growth: It helps households deal with the volatility of their personal finance, smooth consumption over time, and invest in their human capital. Financial inclusion also allows firms to fund their investments and, therefore, increase in size and improve their productivity. In OECD countries, modern payments systems and digitalised banking services have broadened the access to financial services. This chapter examines Costa Rica's disparities in financial access, using data from household and firm-level surveys as well as credit distribution data. It then discusses what can be done to get financial inclusion in Costa Rica closer to best OECD outcomes, with an emphasis on the role of financial literacy and on what the FinTech industry can do to boost access to credit for all.

Regional landscape and recent policy initiatives

In Latin American countries, such as Argentina, Brazil, Colombia, and Mexico, access to financial services is uneven, which can hamper people's livelihoods and hinder the creation of businesses, with a particular detrimental impact on women's entrepreneurship (Fareed et al., 2017[1]). To tackle financial exclusion, Central Bank of Brazil initiated the Financial Citizenship Programme in 2013, which integrates financial inclusion, consumer protection and financial education objectives (BCB, 2018[2]). Policy makers in Mexico established The National Council for Financial Inclusion in 2011 and finalised the National Strategy for Financial Inclusion in 2016 (OECD, 2017[3]).

Costa Rica has outpaced its Latin American peers in expanding financial access during the last decade. However, large gaps remain, notably across regions and by gender, which leave behind some of the most vulnerable populations. For those who can access credit, excessive indebtedness is sometimes a challenge. SMEs face difficulties in gaining access to finance and cannot realise their productive potential.

The Central Bank periodically documents the state of the national financial inclusion landscape focusing on SMEs and vulnerable populations in Costa Rica. The government of Costa Rica recently announced guidelines for state-owned banks to boost financial inclusion. These guidelines define loan issuance and intermediation margin targets, and they invite public banks to refinance the loans owed to over-indebted consumers and reduce their debt service burden. Finally, a National Financial Education Strategy, which mainly aims to reduce future excessive borrowing behaviour is launched in 2019 (PGR, 2019[4]).

Where does Costa Rica stand?

Costa Rica lags behind in terms of financial inclusion and financial market development

According to the World Bank's financial inclusion rankings, Costa Rica performed better than peer Latin American countries in account ownership rates in the last decade (Figure 3.1). Nonetheless, the recent improvements in account ownership have not been sufficient to bring Costa Rica to the levels of financial inclusion generally prevailing in the OECD. Only two OECD countries have lower account ownership rates than Costa Rica, Turkey and Mexico.

Figure 3.1. Financial inclusion in Costa Rica lags behind the OECD

A. Account ownership has increased since 2011
% aged over 15 with account at financial institution

2011 2014 2017

Costa Rica Latin America & Caribbean

B. However, Costa Rica lags behind OECD countries
% aged over 15 with account at financial institution, 2017

MEX LAC TUR CRI CHL HUN CZE LTU SVK GRC POL OECD PRT ISR USA LVA ESP ITA FRA KOR IRL GBR SVN EST AUT JPN CHE BEL LUX DEU

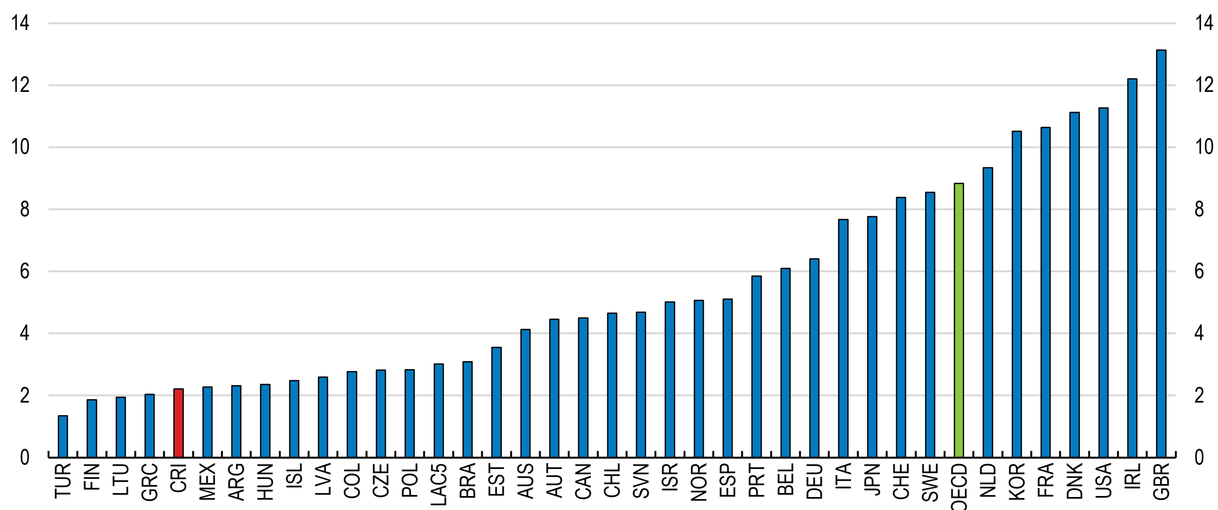
Note: Latin American and Caribbean (LAC) includes: Argentina, Belize, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru and Venezuela.
Source: World Bank Global Findex database (2017).

Insurance penetration, which is measured by the ratio of gross insurance premium payments to GDP is also very low (Figure 3.2) and has not increased since 1975, despite the sector was opened to private participation in 2008 (OECD, 2019[5]). It is also below penetration levels seen in other peer regional countries such as Chile or Colombia. Because of insufficient insurance coverage, households and small firms struggle when they are hit by economic or financial shocks.

Costa Rica fares better than most of its Latin American peers in the use of mobile or internet banking, internet-based purchases, and digital payments (Figure 3.3). The number of registered mobile phone lines per 100 inhabitants has increased by 20% between 2014 and 2017 (Finnovista, 2019[6]). Central Bank estimates that 90% of the population are using a mobile phone with an internet service provider and half of the non-cash transactions are executed by contactless bank cards. Members of the FinTech Association of Central America and the Caribbean further note that 82% of Costa Rican biometrics are submitted in the digital infrastructure of the country.

Figure 3.2. Insurance penetration is low

%, 2018



Note: Insurance penetration refers to the ratio of direct gross premiums to GDP. LAC5 country group includes Argentina, Brazil, Chile, Colombia and Mexico.
Source: OECD Insurance Indicators database.

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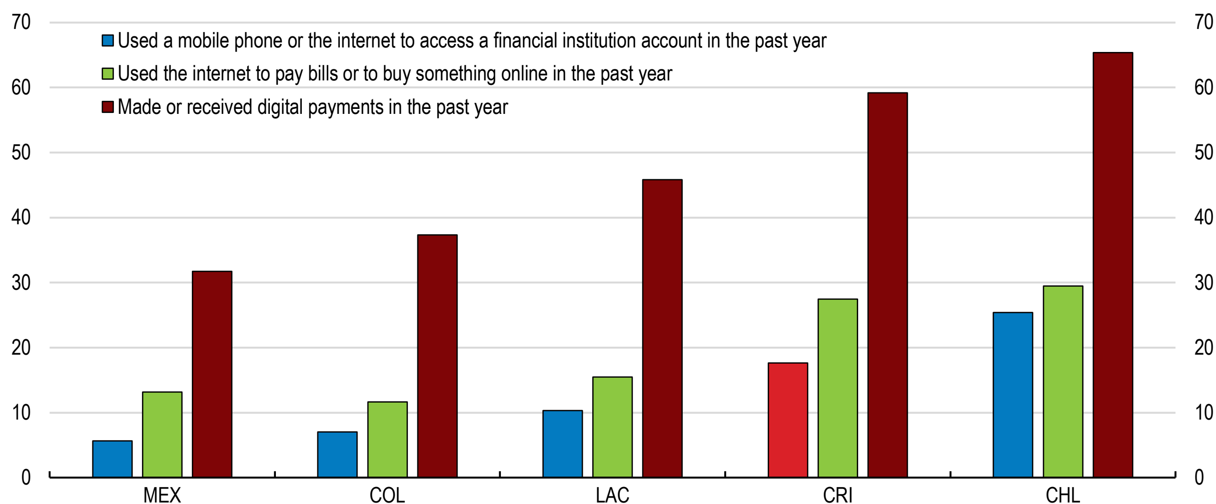
Figure 3.3. Mobile or internet-based financial services use is more frequent than the peers

% of population aged 15+, 2017



Note: Latin America and Caribbean (LAC) includes: Argentina, Belize, Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru and Venezuela.
Source: World Bank Global Findex database.

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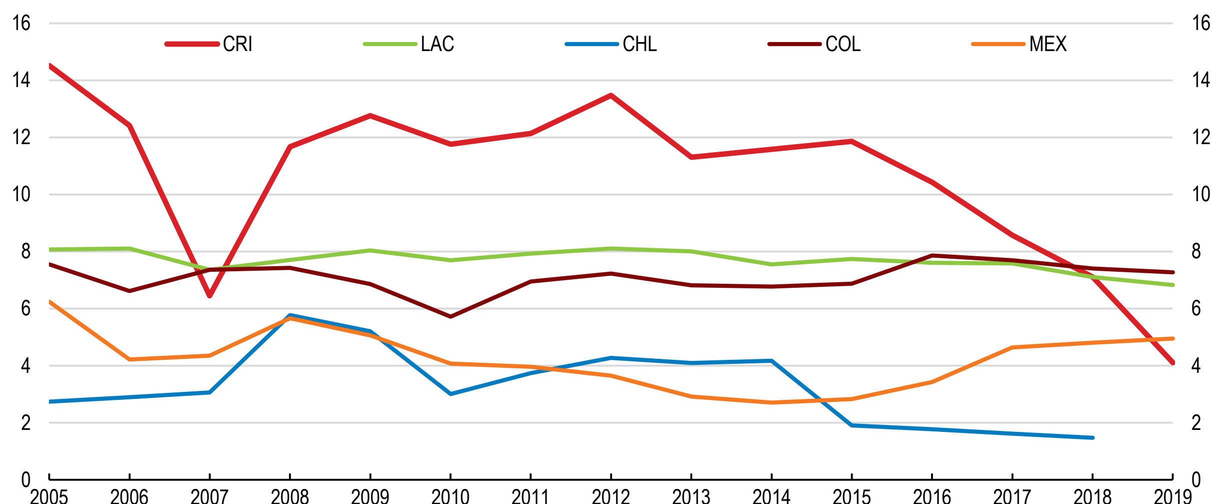
Despite the recent improvements in digital banking and the high quality of the payments system, Costa Rican financial markets display multiple inefficiencies. To give examples, intermediation margins have historically been high (Key Policy Insights) in comparison to peer Latin American countries (Figure 3.4). According to the authorities, electronic transactions cost 1.4% of annual GDP and credit card fees reach 4% of transaction amounts. Excessively high intermediation margins transfer wealth from consumers to banks and make households poorer. Higher transactions costs on the other hand, tax the consumption of goods and services and increase the prevalence of informal, cash-based trades.

Figure 3.4. Intermediation margins have historically been high

Interest rate spread, percentage points



Note: Interest rate spread is the interest rate charged by banks on local currency denominated loans to private sector customers minus the interest rate paid by commercial or similar banks for demand, time, or savings deposits. LAC refers to the World Bank Latin America and Caribbean (excluding high income) grouping of 25 countries.
Source: World Bank World Development Indicators.

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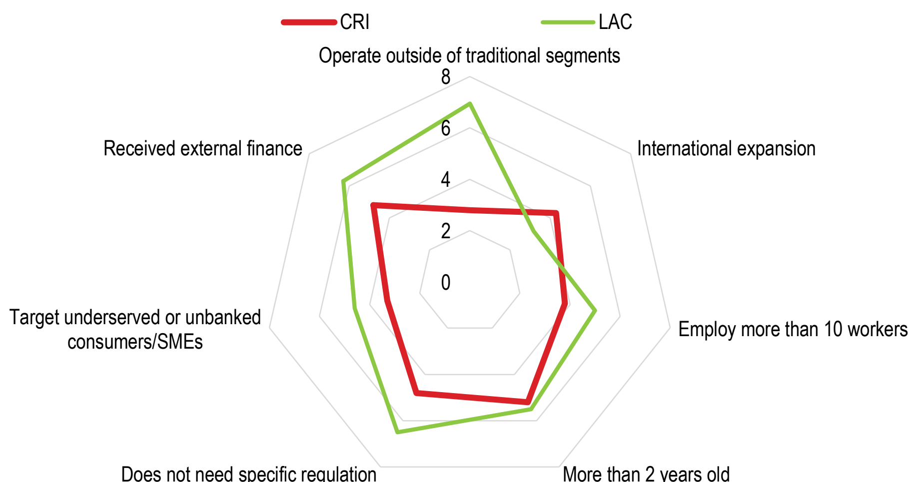
FinTech start-ups in Costa Rica lag behind their Latin American peers, especially in operating outside traditional segments of provision and targeting financially excluded parts of the population (Figure 3.5). In other Latin American countries, Fintech firms have been able to reach underbanked populations more effectively, including in terms of direct lending, financial management and crowdfunding: In Bolivia, El Salvador, Honduras, Nicaragua, Panama and Paraguay all FinTech start-ups target financially excluded households or SMEs (IDB/Finnovista (2018[7]). The regulatory framework in regional peers is also more in line with the demands of FinTech firms than in Costa Rica, which facilitates the faster growth of the industry in these countries.

Figure 3.5. Costa Rica's Fintech firms lag behind their peers

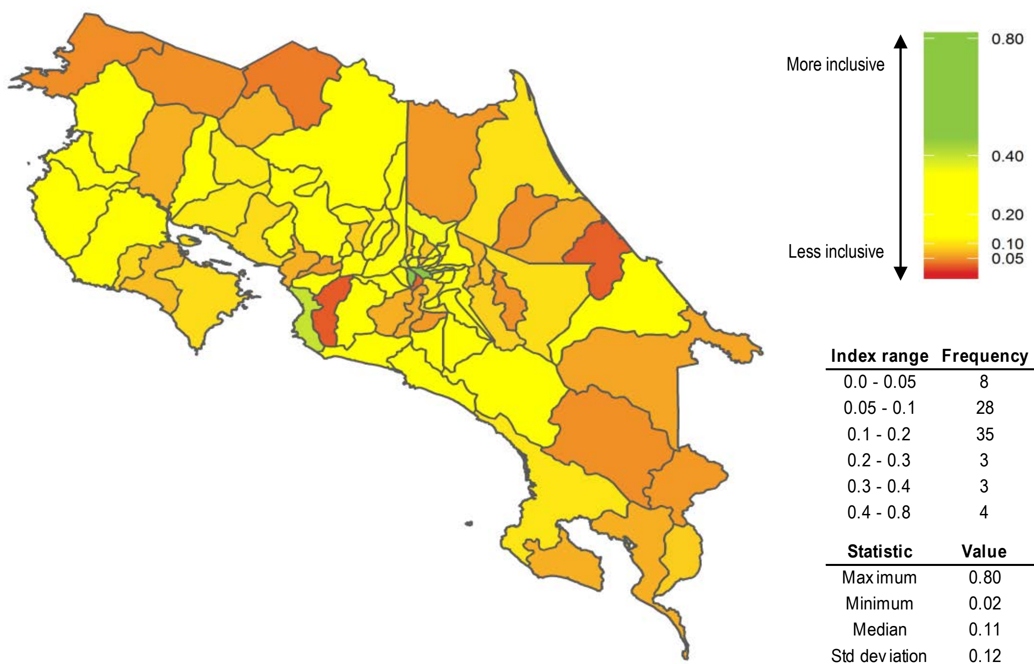


Note: Percentage of FinTech firms (normalised to an index number between 0 and 1) that satisfies the stated feature. LAC refers to the definition adopted in IDB/Finnovista (2018[7]).
Source: IDB/Finnovista (2018[7]); and Finnovista (2019[6]).

Regional disparities in financial inclusion are large

Income inequalities are large in Costa Rica (Key Policy Insights), and co-exist with regional disparities in financial inclusion. A county-level Financial Inclusion Index, especially compiled for this Economic Survey, points to large regional differences (Figure 3.6). The index takes into account the prevalence of financial services access points, credit operations, bank accounts and financial transactions (Box 3.1), following the methodology developed in the OECD Economic Survey of Mexico (Fareed et al., 2017[1]).

Figure 3.6. Regional disparities in financial inclusion are large



Index range	Frequency
0.0 - 0.05	8
0.05 - 0.1	28
0.1 - 0.2	35
0.2 - 0.3	3
0.3 - 0.4	3
0.4 - 0.8	4

Statistic	Value
Maximum	0.80
Minimum	0.02
Median	0.11
Std deviation	0.12

Note: The county of Rio Cuarto, which was created in 2017 is excluded from the analysis for consistency.
Source: Banco Central de Costa Rica; Instituto Nacional de Estadística y Censos; and Superintendencia General de Entidades Financieras.

This new index reveals that access to financial services is very limited in many counties. Costa Rica's geographical landscape is very diverse, causing sharp variations in population densities. Counties with a low financial inclusion score are mostly low population density areas. However, some counties, for example Alajuelita and Desamparados in the province of San José and San Rafael and San Pablo in the province of Heredia are highly populated and yet attain very low financial inclusion scores. Implementing urgent action plans to address the financial exclusion problem in these counties would improve the lives of many and help reduce regional disparities.

Box 3.1. Financial Inclusion Index

Financial Inclusion Index (FII) is built using data from the Central Bank of Costa Rica (BCCR), the General Superintendence of Financial Institutions (SUGEF) and National Institute of Statistics and Census (INEC) on a series of financial inclusion indicators regarding availability and usage of different financial services at the county level.

The Financial Inclusion Index takes into account five dimensions:

- Accessibility of financial services
- Depth of credit services
- Concentration of current accounts
- Concentration of savings accounts and
- Usage of financial channels.

Accessibility of financial services is measured by the total number of access points per 10 000 inhabitants. Access points include data on offices, branches, counters, kiosks or other physical spaces owned by all financial institutions regulated by the SUGEF and data on point-of-service (POS) terminals as well as automated teller machines (ATMs) provided by the Central Bank. Depth of credit services is based on the number of credit operations per 10 000 inhabitants in each county. These credit products include personal loans, car loans, housing loans, consumer durables loans and commercial loans. Concentration of current and savings accounts refers to the number of all types of current and savings bank accounts per 10 000 inhabitants in each county. Finally, usage of financial channels is measured by the number of transactions carried out using ATMs or POS terminals per 10 000 inhabitants in each county. Depth of credit services includes both consumer and commercial loans and concentration of accounts indicators do not differentiate between account owner types. Therefore, the FII would help measure the financial inclusion levels of both households and firms.

For each of the above-mentioned financial inclusion dimensions, an individual index is created at the county level, using the formula

$$f_{ic} = \frac{a_{ic} - min_i}{max_i - min_i}$$

where, f_{ic}= Normalised index value for indicator *i* and county *c*, a_{ic} = The actual value of indicator *i* for county *c*, min_i = Minimum value of indicator *i* across counties and max_i = Maximum value of indicator *i* across counties.

Following the methodology in Fareed et al. (2017[1]), the FII is computed by taking the arithmetic average of the dimension indices $F_c = \sum_{i=1}^{5} f_{ic}$ normalised to range between 0 and 1, where 0 refers to the lowest cross-county level of financial inclusion in the context of the relevant sub-index.

Note: Rio Cuarto, a county that was created in 2017 is excluded from the analysis for consistency. This results in 81 counties in total.
Source: Banco Central de Costa Rica, Instituto Nacional de Estadística y Censos and Superintendencia General de Entidades Financieras.

A virtuous cycle between financial inclusion and poverty reduction

Regions that show higher financial inclusion tend to display better human development outcomes and less poverty in Costa Rica (Figure 3.7). These patterns are similar to peer Latin American countries, such as Mexico, in which higher financial inclusion prevails in more affluent states (with lower poverty rates) (OECD, 2017[3]).

Figure 3.7. Poor and less-developed countries have lower financial inclusion

A. Human development and financial inclusion, 2014

B. Gender-focused human development and financial inclusion, 2014

C. Poverty and financial inclusion, 2014

D. Social development and financial inclusion, 2018

Note: FII levels in 2014 include sub-components of accessibility, credit service depth and financial channels. Social development index levels refer to year 2017 and include components on economic development, electoral participation, health, education and security.
Source: Banco Central de Costa Rica; Instituto Nacional de Estadística y Censos; Ministry of National Planning and Economic Policy; Superintendencia General de Entidades Financieras; University of Costa Rica; and the United Nations Program for Development.

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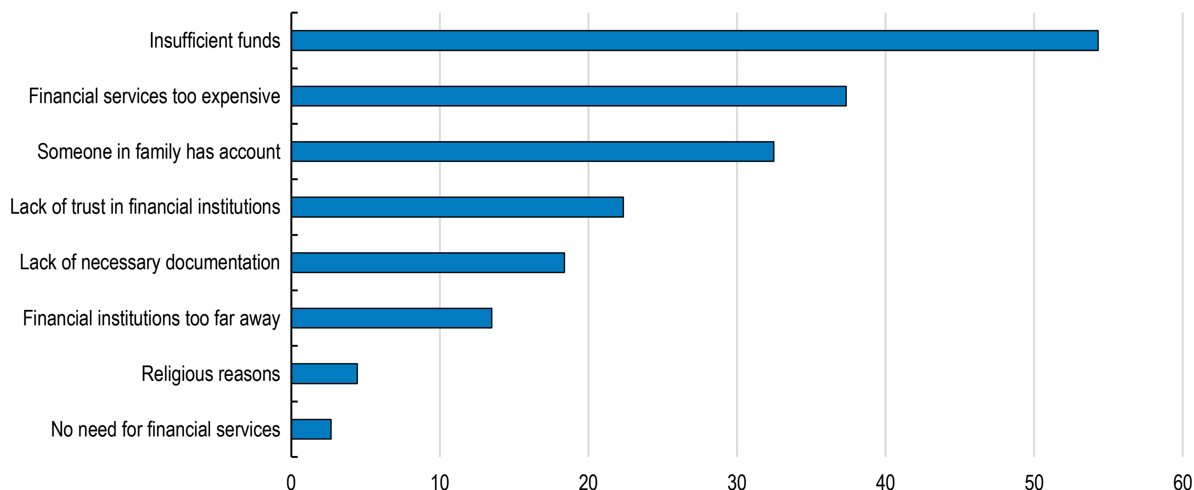
On the other side of the coin, poverty and low financial wealth reduce access to financial services (Figure 3.8) in Costa Rica. One way to alleviate the effect of poverty on financial inclusion is to reduce the cost of these services. For example, increasing competition in the Costa Rican banking sector could reduce loan intermediation margins and the cost of financial services. This would weaken the barriers to financial inclusion, as observed in emerging market and developing countries (Beck, Demirgüç-Kunt and Martinez

Peria, 2008[8]). Therefore, Costa Rica could benefit from a virtuous cycle of boosting financial inclusion, and at the same time, reducing poverty, which are interrelated and would support each other (Beck, Demirgüç-Kunt and Levine, 2007[9]).

Figure 3.8. Costa Rican consumers deem financial services to be expensive

% of population aged 15+, 2017

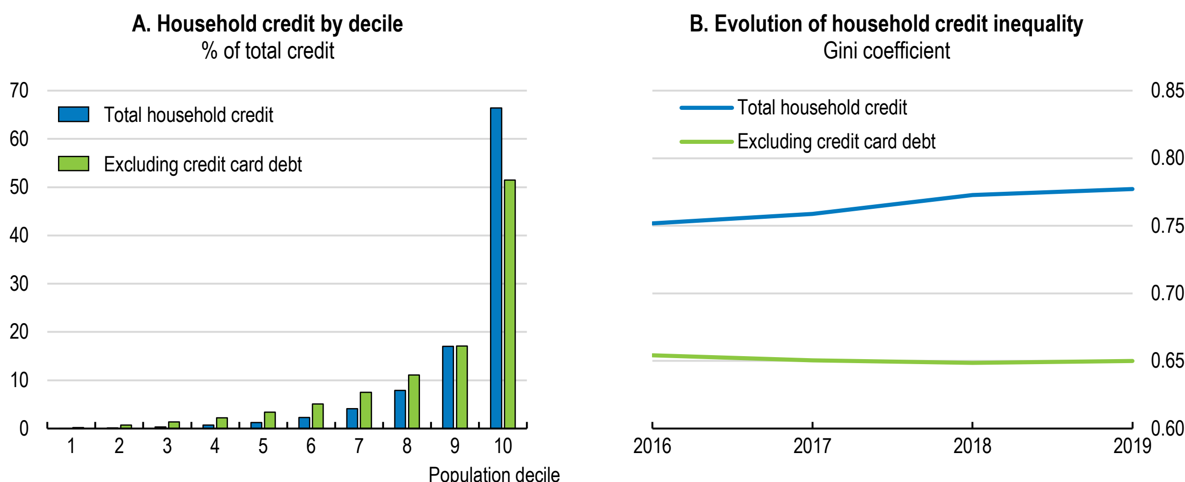


Note: Reasons quoted by individuals aged over 15, who do not hold an account.
Source: World Bank Global Findex database.

Credit is distributed unequally among households

Inequality in the distribution of household credit is high and has recently been increasing in Costa Rica (Figure 3.9). When low-income consumers have less access to credit, it becomes more difficult for them to address the volatility of their personal finances and maintain a stable consumption level. One factor that exacerbates the inequality in consumer credit distribution is the allocation of credit card debt among households (Figure 3.9). Unequal access to credit cards tilts the consumption basket of poorer households toward goods and services that are only purchased by cash. The increased prevalence of cash-based consumption expenditures then elevates informality and makes the consumption of the poor more vulnerable to inflation (Erosa and Ventura, 2002[10]).

Figure 3.9. The distribution of credit among households displays large inequality



Note: Data in Panel A refer to June 2019.
Source: Banco Central de Costa Rica.

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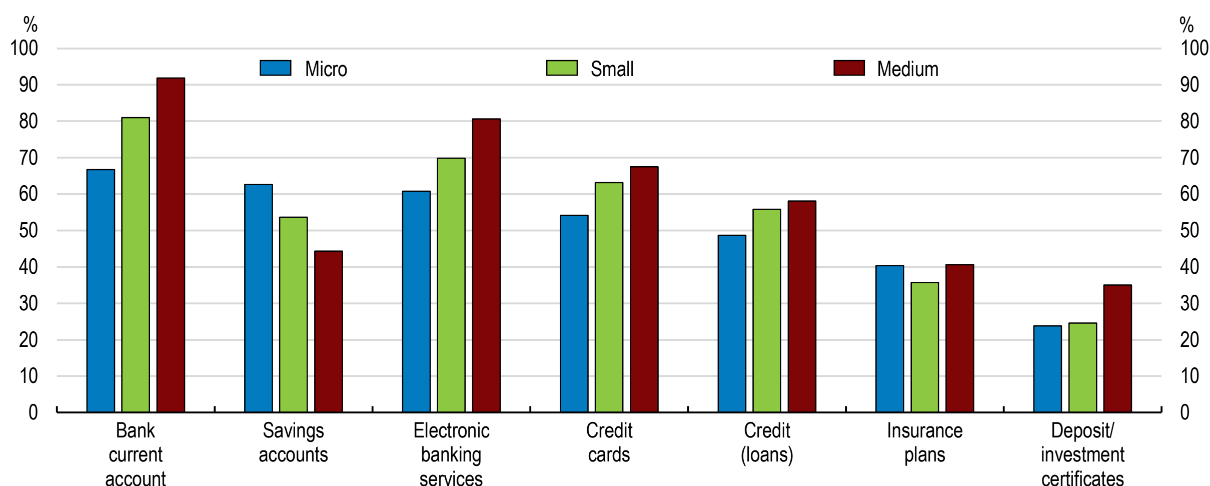
Financial inclusion of micro-entrepreneurs is low

Most SMEs have access to at least one financial service in Costa Rica. Within SMEs, micro-entrepreneurs have lower financial inclusion than larger firms but own more frequently savings accounts and insurance plans (Figure 3.10). This shows that they either try to self-insure or look for outside insurance.

Figure 3.10. Smaller SMEs face difficulties in having access to financial services



Note: Share of SMEs, who confirm the usage of the financial product of interest. Based on the results from the Survey of Performance and Business Outlook, conducted by the Central Bank. The survey has a sample of 612 Costa Rican SMEs, stratified by size.
Source: Survey of Performance and Business Outlook (2016) conducted by Banco Central de Costa Rica.

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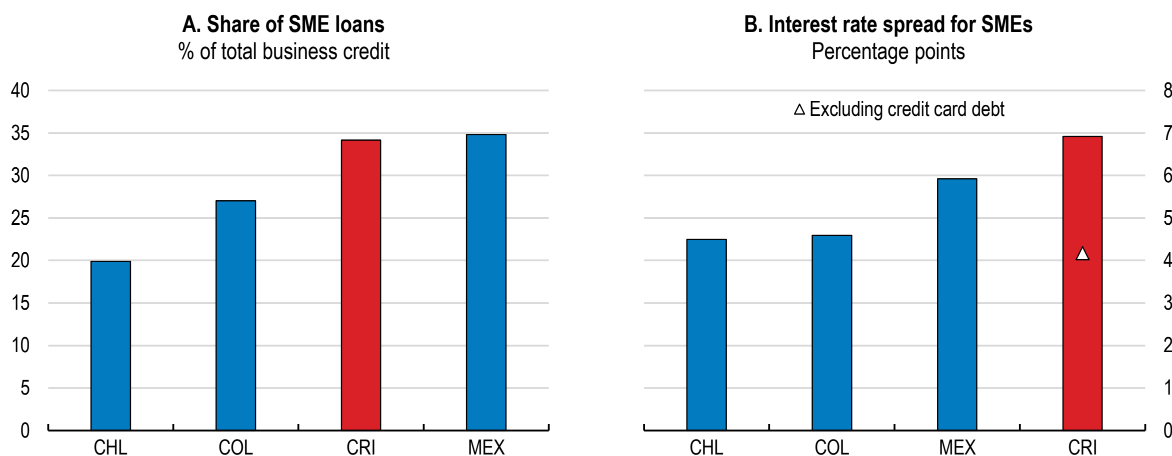
SME credit is considerably more expensive for smaller firms

SME credit corresponds to a larger share of total outstanding business loans in Costa Rica relative to peer countries such as Chile or Colombia. At the same time, compared with their regional peers, Costa Rican SMEs pay a higher excess interest on loans relative to large firms (Figure 3.11). One reason that makes the cost of credit disproportionately high for SMEs in Costa Rica is the use of credit card debt for productive activities (Table 3.1). Many micro-entrepreneurs operate informally and therefore find it difficult to receive commercial loans from the regulated banking system. This makes them use consumer loans on their personal account to finance commercial activities, which is more costly. The effect of using consumer loans for productive activity on the cost of credit is more pronounced when SMEs borrow from private banks (Table 3.1). This limits the availability of private bank credit for SMEs and hinders their growth potential.

Figure 3.11. The interest premium paid by smaller SMEs is higher than in peer countries



Note: Panel B denotes the difference between average SME and large firm loan rates. Data for Costa Rica refer to June 2019. Data for Chile and Colombia refer to 2018 and for Mexico refer to 2017 in Panel A. Data for Chile, Colombia and Mexico in Panel B refer to 2018.
Source: Banco Central de Costa Rica; Financing SMEs and Entrepreneurs 2019, An OECD Scoreboard (2019[11]); Financing SMEs and Entrepreneurs 2020, An OECD Scoreboard, (OECD, 2020[12]), forthcoming.

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Table 3.1. Using credit card debt for commercial activities hurts smaller SMEs more

SME credit scoreboard for Costa Rica

		2016	2017	2018	2019
Outstanding business loans, SMEs	CRC billions	2,553	2,681	2,789	2,712
Outstanding business loans, total	CRC billions	6,940	7,853	7,830	7,940
Share of SME outstanding loans	% of total outstanding business loans	36.8	34.1	35.6	34.2
Outstanding short-term loans, SMEs	CRC billions	128	122	98	87
Outstanding long-term loans, SMEs	CRC billions	2,425	2,558	2,691	2,625
Share of short-term SME lending	% of total SME lending	5.0	4.6	3.5	3.2
Interest rate, SMEs	%	20.7	21.7	23.7	24.9
Interest rate, large firms	%	13.1	14.8	16.8	18.0
Interest rate spread	Paid by SMEs, percentage points	7.7	6.9	6.9	6.9
Excluding credit card debt					
Interest rate, SMEs	%	9.8	9.4	10.0	10.4
Interest rate, large firms	%	6.3	5.9	6.1	6.3

Interest rate spread	Paid by SMEs, percentage points	3.5	3.5	3.9	4.2
Credit by state-owned banks					
Interest rate, SMEs	%	14.5	14.3	15.1	15.4
Interest rate, large firms	%	10.4	10.0	11.5	11.7
Interest rate spread	Paid by SMEs, percentage points	4.1	4.3	3.6	3.7
Credit by private banks					
Interest rate, SMEs	%	26.0	27.3	29.0	30.1
Interest rate, large firms	%	13.6	15.8	17.8	19.1
Interest rate spread	Paid by SMEs, percentage points	12.4	11.5	11.2	11.0
Credit by state-owned banks					
Excluding credit card debt					
Interest rate, SMEs	%	9.7	9.2	9.7	9.9
Interest rate, large firms	%	7.4	6.6	7.2	7.6
Interest rate spread	Paid by SMEs, percentage points	2.3	2.6	2.5	2.3
Credit by private banks					
Excluding credit card debt					
Interest rate, SMEs	%	8.5	8.5	9.8	10.3
Interest rate, large firms	%	5.8	5.4	5.5	5.7
Interest rate spread	Paid by SMEs, percentage points	2.7	3.1	4.2	4.6

Note: Indicator definitions follow Financing SMEs and Entrepreneurs 2019, An OECD Scoreboard (2019[11]).
Source: Banco Central de Costa Rica.

Boosting household financial inclusion

Addressing gender gaps

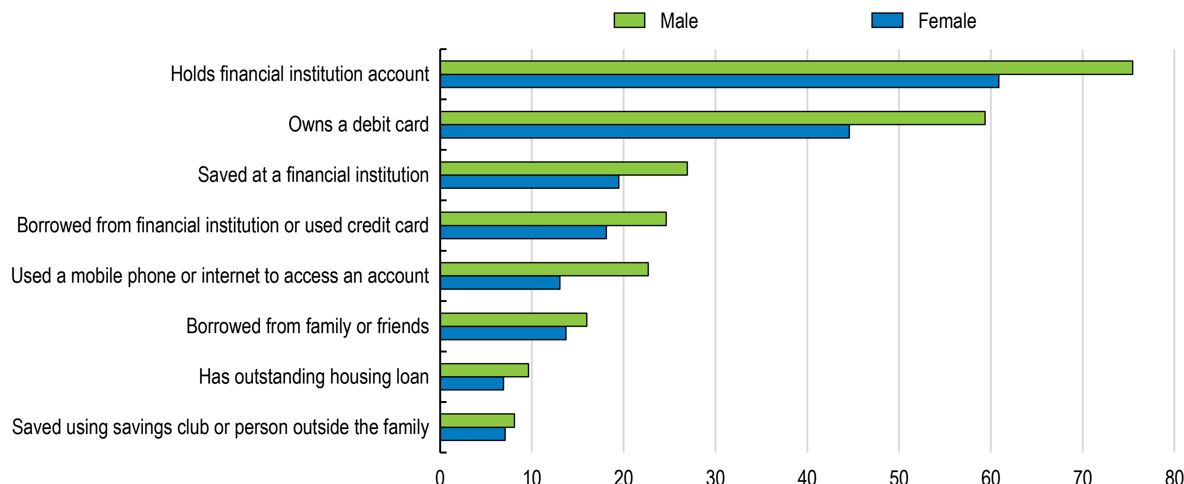
Women are less financially included than men in Costa Rica (Figure 3.12), in part due to low female labour market participation (Key Policy Insights). Tackling gender gaps in access to financial services requires action in two key areas: increasing the digitalisation of finance and enhancing financial literacy of women.

The high mobile phone penetration rates in Costa Rica (Finnovista, 2019[6]) creates room to utilise digitalisation of finance, which would help reduce gender gaps in financial inclusion. Digitalisation of finance would provide autonomy to women in their financial decision-making process and allow them to access services that are more suitable for their personality and individual needs (G20/OECD INFE Policy Guidance (2018[13])). Mitigating the necessity to travel to a physical point of service by the help of digitalisation would also benefit women asymmetrically more, as the majority of individuals who have caring responsibilities are females. In developing countries, the use of mobile money is found to be instrumental in reducing poverty and boosting women's transition from agriculture to the sectors of retail or services (Suri and Jack, 2016[14]). In addition, sending regular text messages to mobile phone users to remind them of their savings goals increased savings in Bolivia, Peru and the Philippines (Georgieva, 2018[15]).

Women's financial literacy could also be improved to tackle gender gaps in financial inclusion: A Financial Education Index recently published by the Central Bank reveals that financial literacy of women is below men in Costa Rica (BCCR, 2018[16]). South-Africa's experience shows that integrating financial education messages into mainstream entertainment media boosts the level of financial literacy of viewers and induces them to search for formal credit sources for productive use (Berg and Zia, 2017[17]). Using social media effectively would further increase these benefits. Teaching financial education to students early in their schooling life and employing women trainers would enhance financial literacy on a gender-equitable basis (OECD, 2013[18]).

Figure 3.12. Gender gaps in financial inclusion are large

% of population aged 15+, 2017



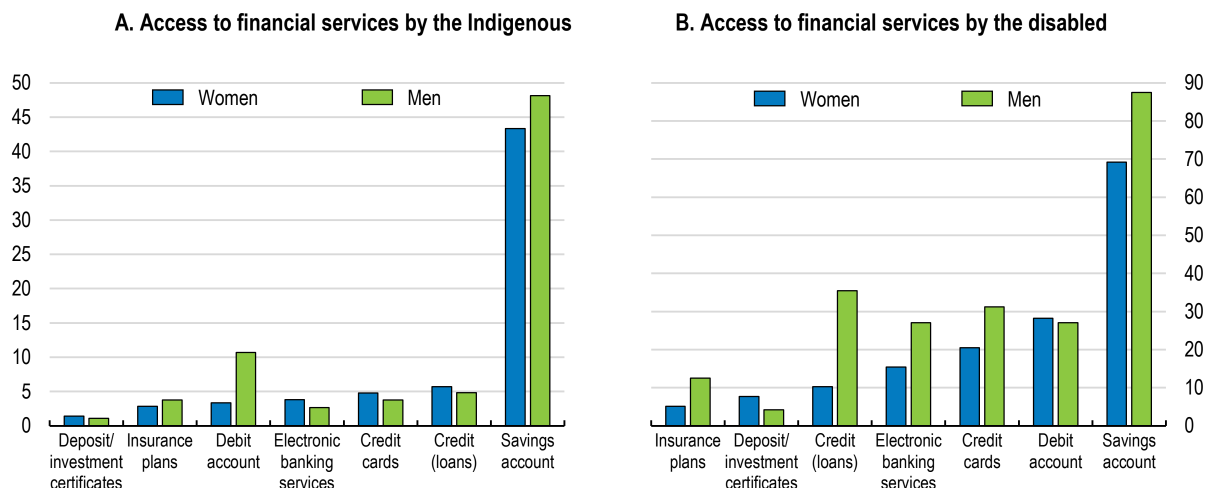
Source: World Bank Global Findex database.

Ensuring financial security of vulnerable minorities

Access of vulnerable minorities to finance is below that of the average Costa Rican citizen (Figure 3.12 and Figure 3.13). Complete financial exclusion is especially widespread among Indigenous populations coming from different ethnic origins (Figure 3.14). In addition, those that are barely linked with the financial system mainly own savings accounts, which are low cost to run but come with a low level of functionality. This makes addressing the volatility of personal finances extremely difficult for vulnerable minorities and creates poverty traps for them.

Figure 3.13. Priority groups mainly rely on savings accounts

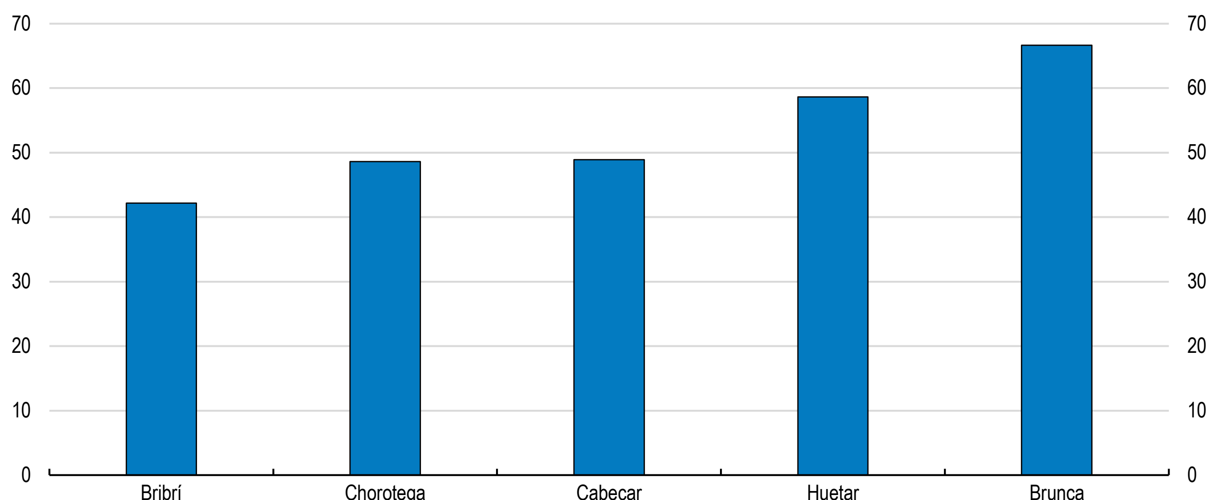
%, 2016



Source: Financial Inclusion Survey (2016) conducted by Banco Central de Costa Rica.

Figure 3.14. Indigenous populations suffer from severe financial exclusion

% of total population using at least one financial service, 2016



Note: The horizontal axis lists main Indigenous ethnic groups covered by the Financial Inclusion Survey (2016). Census data indicate that Costa Rica has around a total of 100 000 Indigenous people, which represent 2.4% of the country's population.
Source: Financial Inclusion Survey (2016) conducted by Banco Central de Costa Rica.

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Maintaining better human development outcomes of Indigenous populations have also been a challenge in OECD countries such as Australia, Canada, Mexico, New Zealand, and the United States. Lack of collateral, less credit history, information asymmetry, and discrimination are among main financial imperfections faced by these populations. In Costa Rica, the institute for social assistance, *IMAS*, has recently moved more than 14 thousand prepaid beneficiary accounts under the *Avancemos* programme (the largest conditional cash transfer programme) to debit card accounts. Covering more Indigenous groups in such programmes can increase savings account penetration among communities, such as the Bribri, in which complete financial exclusion is very high.

OECD countries implemented microcredit programmes and large loan facilities supported by the governments to boost the access of Indigenous populations to credit (OECD, 2019[19]). Nonetheless, permanent improvements in the financial capacity of Indigenous populations can only be realised if Indigenous people are given the chance to come up with their own solutions, autonomously (Box 3.2). Helping Indigenous populations to build their own banking networks would make it easier for these groups to reduce information asymmetries, pool their resources, and manage financial risks (OECD, 2019[19]).

Box 3.2. Boosting financial inclusion of the Indigenous

- The Business Development Bank of Canada, a government-backed financial entity for SME credit, makes loans to existing Indigenous businesses up to CAD 250 000. The credit limit for Indigenous start-ups is CAD 150 000. These loans fund the purchase of fixed assets, franchise fees, start-up costs, export requirements and working capital requirements.
- Indigenous Business Australia provides loans that range between AUD 10 000 and AUD 5 000 000 to Indigenous entrepreneurs. These loans can be used to fund working capital requirements, purchase of existing businesses, plant and equipment, and commercial assets. The loans also come with temporary periods with no interest payment and flexible repayment schedules that take into account seasonal factors. Larger loans are used to purchase equipment, which is a pre-requisite for public procurement in some cases.
- The United States established the Community Development Finance Institution Fund in 1994. This fund supports the Native American Community Development Finance Institution Programme, which provides financial assistance, technical assistance and capacity building support to native communities. There are currently more than 70 local Indigenous financial institutions in the United States.
- Aboriginal Financial Institutions were established in Canada in 1980s and are owned and run by Indigenous populations. These local financial institutions supported 500 start-ups and 750 existing businesses on average and helped create or sustain 4 000 full-time jobs in the last five years.

Source: OECD Rural Policy Reviews; Linking Indigenous Communities with Regional Development (2019[19])

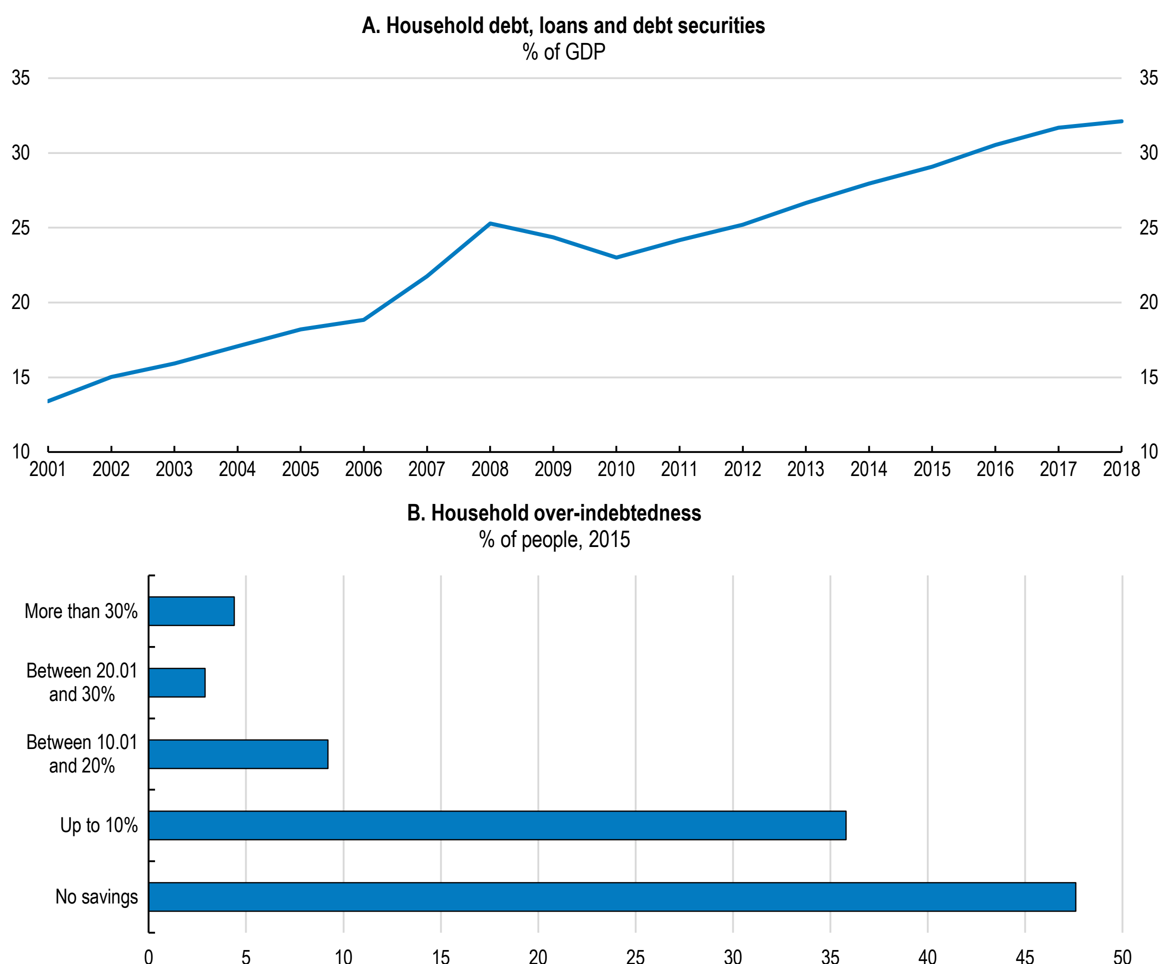
Tackling excessive household indebtedness

While many households cannot get any credit (Figure 3.9), some of the Costa Rican households who have access to the financial system find themselves at risk of excessive indebtedness (Figure 3.15), especially when they borrow large amounts through consumer loans. The Household Financial Survey conducted by the Central Bank reveals that almost half of Costa Ricans have no savings (Figure 3.15). In addition, the latest National Survey of Income and Expenses showed that around 68.9% of Costa Rican households are indebted (INEC, 2018[20]).

SME owners operating in informality sometimes finance their activity using credit card loans, which do not require pledging collateral and come with very high interest rates (Table 3.1). Failing to keep business and personal finances separate creates a snowballing effect in consumer indebtedness and jeopardises the financial security of households, when the expensive credit card debt is rolled over. The resulting excessive household indebtedness hampers consumer confidence, and therefore consumer spending, which undermines the momentum of aggregate demand.

In order to tackle the over-indebtedness problem, the government launched in October 2019, a debt exchange programme: *Creación del Programa de Créditos de Salvamento*. The initiative instructs Banco Popular and the two state-owned banks, Banco Nacional and Banco de Costa Rica to issue refinanced loans that would provide debt relief to households. The refinanced loans come with reduced interest rates and longer repayment periods. Recipients of the programme pledge at least 40% of their stable salaries as a guarantee, and are not able to borrow new loans until they repay half of their reduced balance. They will also have to enrol into a government-sponsored financial education programme during the three years that follow the receipt of the refinanced loan. All three banks have announced their version of the programme by the end of 2019.

Figure 3.15. Household indebtedness has increased rapidly



Note: Categories in Panel B refer to the ratio of savings to income.
Source: IMF Global Debt Database; and the Household Financial Survey (2015) conducted by Banco Central de Costa Rica.

Authorities consider interest rate ceilings as another measure to curb excessive indebtedness of Costa Rican households. The interest rate ceilings are to be set by the Committee on Tax affairs, the Central Bank and the General Superintendent. Final discussions led to a rate of about 3 times the average loan rate that prevails in the domestic financial system. The methodology of the General Superintendent takes into account the cost of financial intermediation, liquidity, average administrative expenses of all financial entities and the expected risk of losses on more than 1 million credit operations that took place between 2014 and 2018.

Interest rate ceilings are not effective in bringing debt relief to over-indebted borrowers (Zinman, 2010[21]). In particular, tight ceilings ration low-end borrowers in the creditworthiness distribution and direct them to informal credit markets. Recent Chilean experience shows interest rate ceilings that are similar to those discussed in Costa Rica excluded about 10% of borrowers from the credit market (Madeira, 2019[22]). In addition, the credit-rationed typically belong to the most vulnerable: the young, the least educated and the poor. Best international practices suggest long-term and structural remedies to debt build-ups. These include improving competition in the financial sector, strengthening consumer protection schemes (Box 3.3), enhancing financial education and strengthening credit registry offices (Maimbo and Gallegos, 2014[23]).

Box 3.3. Protecting financial consumers is essential to meaningful financial inclusion

Efforts to boost household financial inclusion and increase access to credit should be accompanied by an appropriate level of financial consumer protection in order to ensure that borrowers are treated fairly, that the risks of misconduct and exploitative practices are addressed and, overall, the likelihood of repayment problems, which result in over-indebtedness are reduced. In 2019, the OECD released an updated version of the OECD Council Recommendation on Consumer Protection in the field of Consumer Credit (2019[24]). The updated Recommendation sets out a framework of recommended measures to support the protection of borrowers and promote good outcomes in credit transactions. Some of the measures set out in the Recommendation relate to:

- Disclosure of key terms and conditions in contractual and pre-contractual information in a clear, accurate and not misleading manner
- Responsible lending including assessment of a consumer's ability to meet their repayment obligations
- Treatment of consumers who may be vulnerable or experiencing financial difficulty, within responsible conduct relating to debt collection
- Promoting financial education and awareness in rights and responsibilities relating to credit, including where to seek assistance with debt problems.

Source: OECD Council Recommendation on Consumer Protection in the field of Consumer Credit (2019[24]).

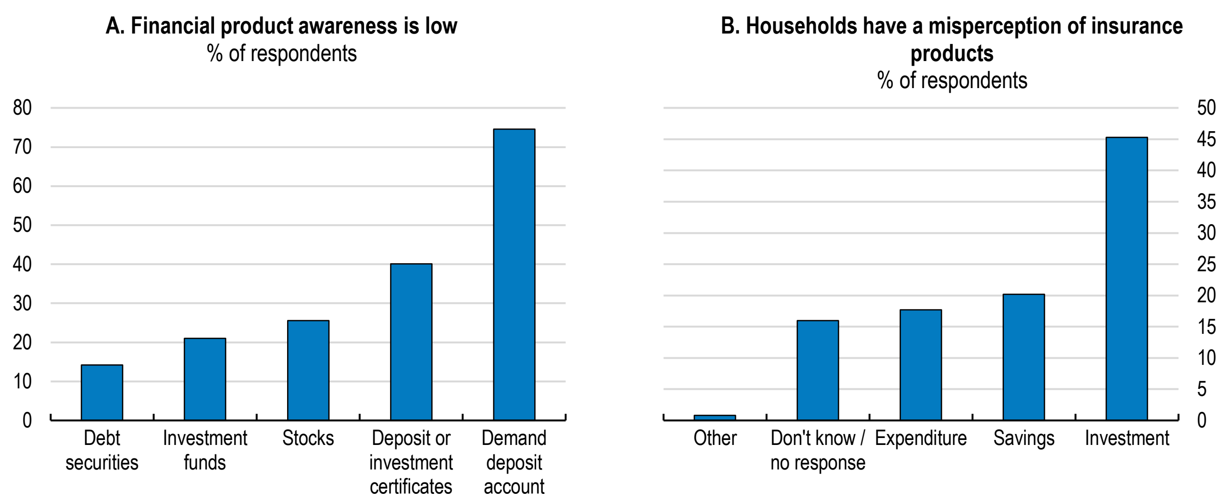
Promoting financial education to prevent excessive debt build-ups

Improving the financial literacy of households may help prevent large consumer debt build-ups (Figure 3.16) as low financial literacy is positively associated with the use of costly credit products by consumers (Gathergood, 2012[25]). Survey-based results compiled by the Central Bank reveal that financial literacy is low in Costa Rica (BCCR, 2018[16]): An assessment aimed to explore participants' understanding of basic financial concepts such as stock returns, inflation, interest rates, and the exchange rate resulted in nearly half of survey participants answering all questions of the test incorrectly. Therefore, teaching consumers how to make the right borrowing decisions emerges as a key priority to prevent excessive borrowing in Costa Rica.

Improving the financial literacy of Costa Ricans would also boost their financial inclusion. For example, many consumers think buying insurance is similar to consumption spending or saving (Figure 3.16), which partly explains low insurance penetration in Costa Rica (Figure 3.2). Cross-country evidence also shows that individuals who had recently made a financial product choice typically display higher financial literacy (Atkinson and Messy, 2013[26]).

The Ministry of Economy, Industry and Commerce (MEIC) launched the National Financial Education Strategy in January 2019, foreseeing collaborations with financial entities to boost financial literacy outcomes in Costa Rica (Box 3.4). MEIC and Banco Nacional de Costa Rica recently agreed on a financial management training programme within this initiative. The programme aims to reach out to 250 000 individuals by 2020 and entails provision of material, curriculum building and training logistics by financial entities under the supervision of the ministry.

Figure 3.16. Financial literacy outcomes are low



Note: Panel A reports percentage of respondents who stated that they are aware of the financial product in question. Panel B displays the popularity of the concept that is deemed to be most closely associated with buying insurance.
Source: The Household Financial Survey (2015) conducted by Banco Central de Costa Rica.

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Box 3.4. The National Financial Education Strategy of Costa Rica

The Government of Costa Rica issued the Executive Decree No. 41546-MP-MEIC (PGR, 2019[4]) on 30 January 2019, which provides the legal basis for the National Financial Education Strategy.

The policy objectives within the Strategy are as follows:

- Enhancing citizens' capability of applying basic financial concepts
- Boosting citizens' understanding of the effect of main macroeconomic indicators on the well-being of individuals
- Implementing actions that help the population make more autonomous and conscious financial decisions
- Promoting sectoral programmes in co-ordination with strategic partners

Target audiences of the Strategy include children, youth, public officials, women, SMEs, senior adults and vulnerable populations.

The educational topics of the Strategy focus in the following areas:

- Budgeting and personal finance
- Preventing over-indebtedness
- Savings, self-control and consumption behaviour
- Proper and responsible use of credit cards and loans
- Avoiding the misplaced use of consumer credit in commercial activities

Note: The working group that is established to define the National Financial Education Strategy of Costa Rica includes the Ministry of Economy, Industry and Commerce, the Ministry of Public Education, the Ministry of Culture and Youth, the Central Bank, the National Financial System Supervision Council, the National Council of Rectors, the General Directorate of Civil Service, the National Learning Institute, the National Women's Institute, financial sector superintendents and two representatives from the chambers and associations of the financial sector.
Source: Ministerio de Economía, Industria y Comercio de Costa Rica.

The financial education strategy in Costa Rica can be complemented with “Smarter Financial Education”, which highlights the impact of behavioural insights in improving financial literacy of individuals (Box 3.5). For example, access to a savings account or credit product can be combined with enrolment to a financial education programme; sliders and graphics can be used in lender websites, which would easily inform borrowers on their future debt repayment profiles; and consumers can be provided with practical tips, which remind them to switch off regular financial marketing notifications or to cancel subscriptions that would induce them to buy goods or services on credit.

Box 3.5. Smarter Financial Education

The OECD and the International Organisation of Securities Commissions identify the main pillars of Smarter Financial Education, focusing on behavioural insights to achieve enhanced financial education and compile good international practices:

- **Make the provision of financial educational content focused, straightforward and simple to understand.** The National Plan for Financial Education of Peru includes simple rules and short messages such as “Should I buy it?” or “Can you lend me money?” in financial education materials.
- **Make financial education programmes as personalised as possible.** The Securities and Exchange Commission of Brazil developed educational series on behavioural biases that affect investments, savings and consumption.
- **Design programmes that help people take actions.** The Financial Services Authority of Denmark has designed “The Banking Game”, which runs on a smartphone and helps boost consumers’ understanding of negotiation with banks and financial markets in general.
- **Use digital channels to facilitate the application of behavioural insights.** The Australian Securities and Investments Commission has designed “MoneySmart Financial Advice Toolkit”, an online tool that adopts a step-by-step approach in enhancing consumers’ understanding of getting professional advice in finance.

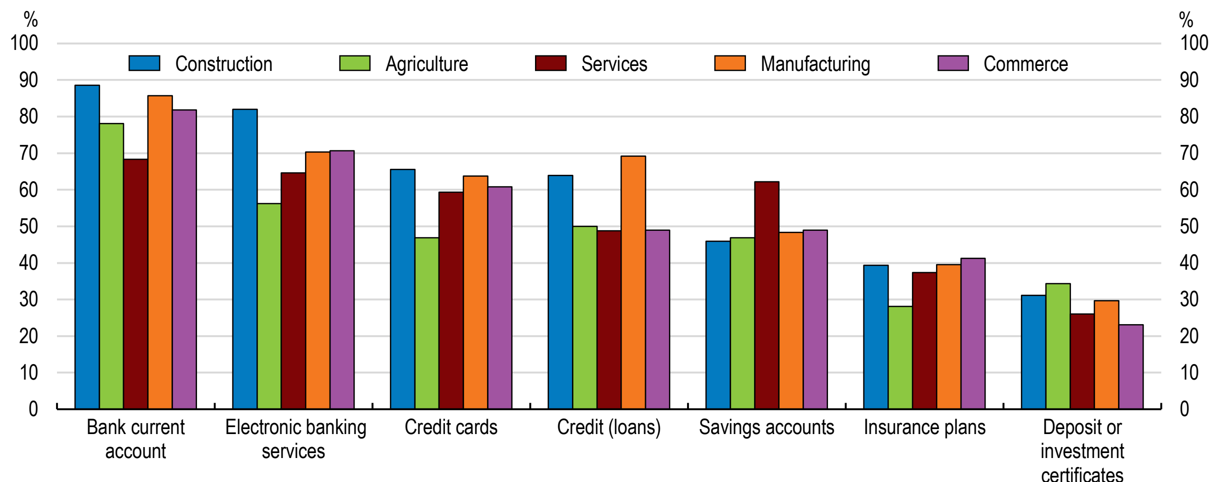
Source: OECD (2019[27]). Smarter financial education: key lessons from behavioural insights for financial literacy initiatives.

Boosting financial inclusion of SMEs

Improving insurance penetration in the agricultural sector

SMEs that operate in the agricultural sector are less financially included in Costa Rica (Figure 3.17). In particular, many farmers do not own an insurance plan, which is worrisome, as agricultural production is constantly subject to the weather risk. One factor that limits the supply of insurance in the agricultural sector is the absence of practical tools for insurers that could be used to measure farmers’ performance. This creates difficulties in designing insurance contracts and limits the prevalence of insurance (Karlan and Morduch, 2010[28]). The General Superintendence of Insurance has identified the limited insurance supply in the agricultural sector and is currently conducting technical studies, which explore the capability of Costa Rican insurance firms to provide products for farmers.

Figure 3.17. Financial inclusion of agricultural SMEs is low



Note: Share of SMEs, who confirm the usage of the financial product of interest. Sectors other than these five categories are excluded as they had negligible observation numbers.
Source: Survey of Performance and Business Outlook (2016) conducted by Banco Central de Costa Rica.

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Farmers also sometimes find it hard to see the benefit of buying insurance when their local weather measurements frequently deviate from a benchmark, such as a weather station. This makes it difficult for agricultural producers to relate the insurance premium that they would pay to the severity of the weather risk and reduces their insurance demand (Giné, Townsend and Vickery, 2008[29]).

Consequently, there is room to boost insurance penetration in the agricultural sector in Costa Rica. An initial step can involve learning from the experience of Argentina, in which insurance penetration covers more than 50% of all agricultural land (OECD, 2019[30]). Adding to the sector's dynamism, a major facilitator of developed insurance markets in Argentina is the lack of government intervention in insurance provision, which allowed the development of private sector initiatives. The Agricultural Emergencies Law for instance, has limited funding, which prevents the crowding out of market instruments by disaster assistance.

OECD Food and Agricultural Reviews recommend that making use of digital technologies would reduce administration cost of insurance, improve the processing of meteorological, sensor and satellite information and further increase insurance penetration (OECD, 2019[30]). To that end, mobile applications can be used by insurers to measure farmers' productive performance and at the same time, can improve farmers' understanding of weather-related risks.

Addressing the lack of credit demand by micro-entrepreneurs

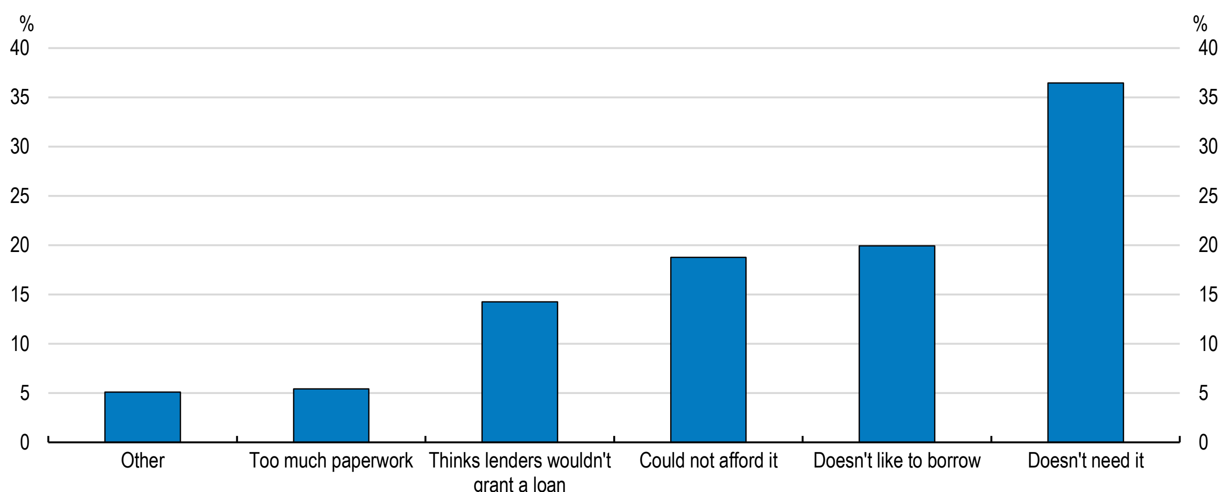
Micro-entrepreneurs account for 29% of national employment in Costa Rica, which is lower than the regional average of 41% in Argentina, Chile, Colombia, Ecuador, Mexico, Peru, and Uruguay (OECD/CAF, 2019[31]). Most micro-entrepreneurs are not registered in the national registry and do not have official accounting records (BCCR, 2018[16]). Therefore, micro-entrepreneurs face difficulties in having access to formal finance as they operate under high informality.

For example, a lack of faith in chances of getting credit or high borrowing costs create a "discouraged borrower" problem for many micro-entrepreneurs (one-quarter of all SMEs) in Costa Rica (Figure 3.18). Imperfect bank information on borrowing firms and higher loan application costs make the discouraged

borrowers problem more severe (Kon and Storey, 2003[32]). Therefore, reducing loan application fees can induce discouraged borrowers to demand credit.

Discouraged SMEs that especially refer to high borrowing costs are less transparent (Gama, Duarte and Esperança, 2017[33]). Consequently, a key priority is to boost the effectiveness and scope of the credit registry. According to the World Bank Doing Business Indicators, the credit registry in Costa Rica covered only 35% of the adult population in 2019. The coverage ratio was 50% in Chile and 79% in Brazil. This is partly linked to the fact that credit granted by non-supervised entities are not covered by the registry in Costa Rica and those entities' lending activities have increased substantially. Strengthening the credit registry system can minimise information asymmetries between borrowers and lenders and reduce interest rates. This would allow micro-entrepreneurs that previously found borrowing expensive, to demand credit.

Figure 3.18. Micro-entrepreneurs are discouraged from applying for loans



Note: Share of survey respondents that explain the reason for not getting credit. Based on results from the National Survey of Household Businesses conducted by INEC. The survey provides data on 3,500 micro-entrepreneurs. Some of the regional counterparts of this study include Encuesta de Micro Emprendimiento conducted in Chile and Encuesta de micro-establecimientos conducted in Colombia.
Source: National Survey of Household Businesses (2018) conducted by Instituto Nacional de Estadística y Censos.

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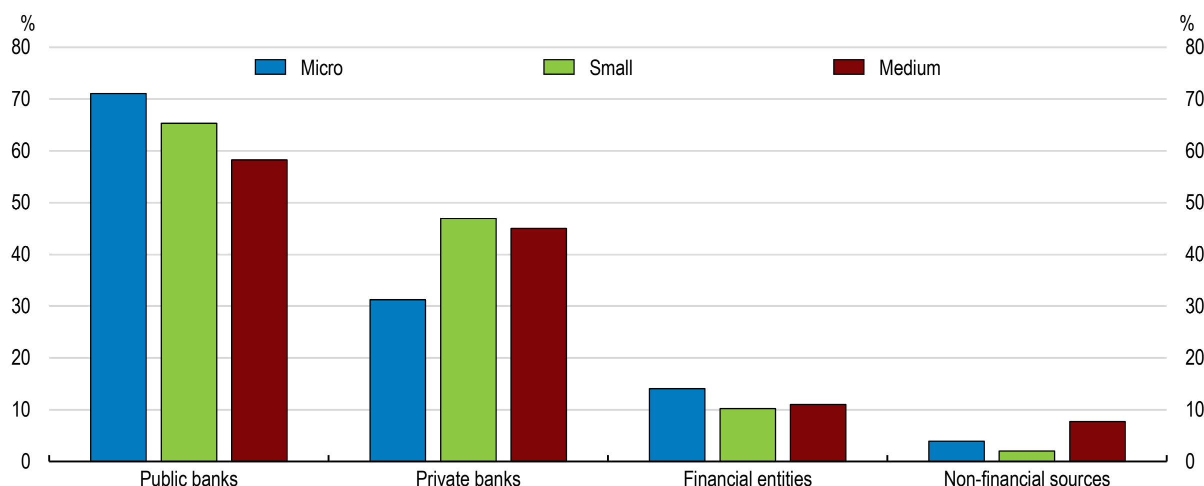
Provision of private bank credit to micro-entrepreneurs is limited in Costa Rica (Figure 3.19). This is a result of higher interest rates charged by private banks to SMEs (Table 3.1). Phasing out regulatory asymmetries between public and private banks (Loría and Martínez (2018[34]) and Key Policy Insights) would help reduce the excessive interest rates charged by private banks. This will then make private bank credit more accessible for micro-entrepreneurs.

Micro-entrepreneurs also borrow from informal sources paying unregulated and excessively high interest rates (INEC, 2019[35]). Access to formal bank credit is essential for the expansion of firms in emerging market countries (Ayyagari, Demirgüç-Kunt and Maksimovic, 2010[36]). Cost of being formal can be lowered by reducing high company registration fees (Chapter 2). In addition, microcredit programmes can be used to encourage the formalisation of micro-entrepreneurs (Straub, 2005[37]).

Figure 3.19. Smaller SMEs find it hard to borrow from private banks



Note: Financial entities include finance and loan companies, credit mutuals and credit cooperatives. Non-financial sources include private lenders, friends or relatives. Sum of financing source shares can be greater than 100% as firms use multiple sources.
Source: Survey of Performance and Business Outlook (2016) conducted by Banco Central de Costa Rica.

According to World Bank Doing Business Indicators, bankruptcy procedures take longer, produce lower debt recovery rates and are more costly in Costa Rica compared with the OECD average. Costa Rica also scores 3 (out of 10) in the strength of legal rights index, which is lower than regional peers such as Chile and Mexico, who score 6. These impediments make the overall collateral framework less effective and induce creditors to demand collateral amounts that can be as high as 250% of requested loans (Flamini et al., 2016[38]). As a result, majority of micro-entrepreneurs who could not get credit refer to the lack of guarantees as the main reason (INEC, 2019[35]).

A draft law reforming bankruptcy practices has recently been submitted to the Congress. The proposed law aims to streamline insolvency procedures by shortening the initial appeal periods, allowing early liquidation of assets and eliminating judicial auctions. These measures would reduce both the duration and the cost of bankruptcy procedures and increase debt recovery rates, which would make the collateral framework more effective. Better property registry, improved secured transactions law and stronger bankruptcy framework would reduce the collateral-to-loan ratios and allow banks to increase their lending to micro-entrepreneurs and vulnerable populations, especially in the agricultural sector.

Boosting the supply and reach of development banking credit

The development banking system administered by Sistema de Banca para el Desarrollo (SBD) aims to fund SMEs and farmers considering their risk profile and conformity of projects with the development targets of Costa Rica. SBD also provides services to its beneficiaries to support entrepreneurial activities and innovation (Box 3.6). A key objective of the system is to help unbanked beneficiaries build a financial background and credit history. To that end, SBD grants collateral to SMEs for credit applications and contribute to the development of a credit scoring mechanism for its beneficiaries in collaboration with the General Superintendent.

Box 3.6. Promoting entrepreneurial activities and innovation in Costa Rica

Almost all of the programmes that are administered by SBD are executed through third parties or accredited entities. Services provided by SBD in the area of entrepreneurship and innovation can be summarised as follows:

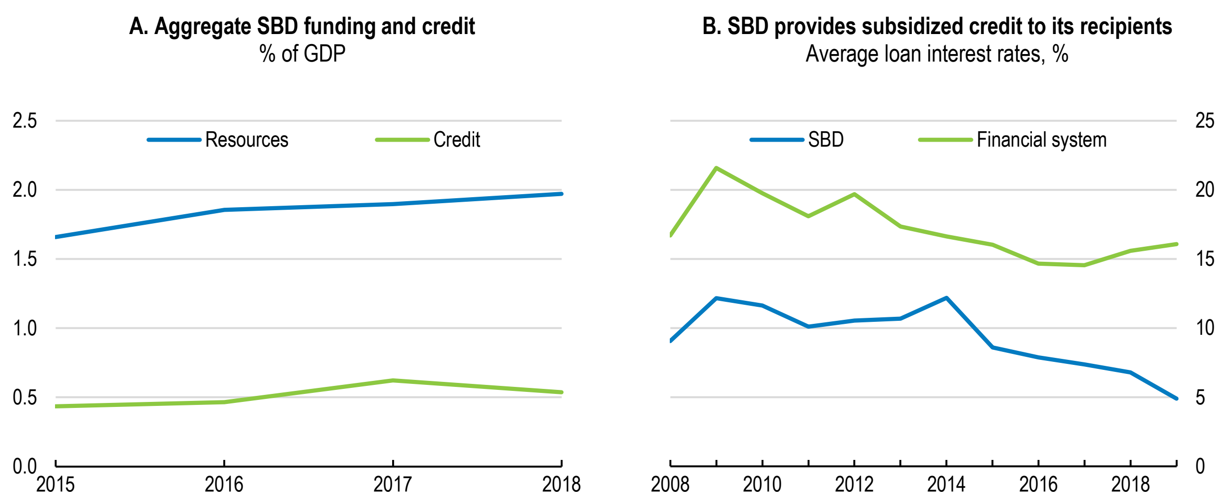
- **Promotion of an innovation and entrepreneurship culture.** SBD provides sponsorships to promotion activities, including domestic or international entrepreneurship contests and conferences with top tier expositors.
- **Business training.** In 2019, the Associative Innovation and Entrepreneurship Programme was approved and implemented. This programme aims to provide business training to entrepreneurs outside the San Jose Metropolitan Area, which will boost their incubation and acceleration capabilities.
- **Business development services.** SBD supports the *Descubre* programme, which is an initiative led by the Ministry of Foreign Trade, the Ministry of Agriculture and Livestock, the foreign trade promotion agency (PROCOMER) and includes the participation of the private sector and the universities. *Descubre* aims to increase the productivity of agriculture and fisheries by discovering new products and markets, and eliminating barriers to trade. Another example is the Coocique Business Support Programme, in which SBD provided general business consulting to more than 80 SMEs that are in the programme's credit portfolio.
- **Demand oriented support.** During the 2018-2019 period, SBD financed four participants of the innovation programme, "The Blueprint", managed by PROCOMER, in which an international company offered an innovation challenge to be solved by Costa Rican SMEs. The aim of these programmes is to link domestic SMEs to global supply chains.
- **Seed capital financing:** SBD provides seed capital by collaborating with academic institutions to emerging ventures in the form of grants or soft loans that have below-market interest rates. The seed capital financing so far targeted dynamic entrepreneurship projects aiming to promote fast growth rates for start-ups; and supported rural entrepreneurship programmes.

Source: Sistema de Banca para el Desarrollo.

SBD is integrated by three main pillars: assets from trusts and direct transfers from the public budget (The National Development Fund - FONADE); 5% of the annual net profits of the state-owned banks (The Financing for Development Fund - FOFIDE); and 17% of the demand deposits collected by the private banks (The Development Credit Fund - FCD), which are given to state-owned banks as a loan. Private banks can avoid giving this loan if they install four branches outside the San José Metropolitan Area and maintain 10% of their demand deposits directly channelled to SMEs in special lending programmes with preferential interest rates (Loría and Martínez, 2018[34]).

After the approval and full implementation of the Development Banking System Law 8634, nominal credit portfolio of SBD grew rapidly in the 2016-2019 period (PGR, 2014[39]). Nonetheless, 30% of SBD's loanable funds have not been lent, partly causing SBD credit to stagnate around 0.5% of GDP (Figure 3.20). Given that average delinquency rate of SBD's credit portfolio has been below 3% and SBD credit has been more affordable than borrowing from commercial banks (Figure 3.20), increasing SBD credit to SMEs would improve financing conditions of these firms without creating financial instability.

Figure 3.20. Development banking credit is scarce



Note: Panel B plots the evolution of weighted average interest rates that prevailed in all Sistema de Banca para el Desarrollo (SBD) programmes and the overall financial system.
Source: Banco Central de Costa Rica; OECD Economic Outlook 107 database; and Sistema de Banca para el Desarrollo.

Another way to utilise SBD credit in full capacity is to strengthen the synergies between SMEs and private banks (OECD et al., 2019[40]). Using private banks as explicit points of contact for development credit applications would support the incentives for private banks to reduce their mandatory contributions to SBD and boost SME access to credit at lower cost. Strengthening the partnership with the foreign trade promotion agency (PROCOMER) and building partnerships with the investment promotion agency (CINDE) would contribute to SBD's efforts of linking domestic SMEs to global supply chains. There is also ample room to use mainstream media outlets more effectively to disseminate information among borrowers about SBD: More than half of micro-entrepreneurs (INEC, 2019[35]) and around a third of all SMEs (BCCR, 2018[16]) have never heard of the development banking system. Among those borrowers who know about SBD, the news emerges as the most cited medium of information.

Embracing FinTech to boost financial inclusion

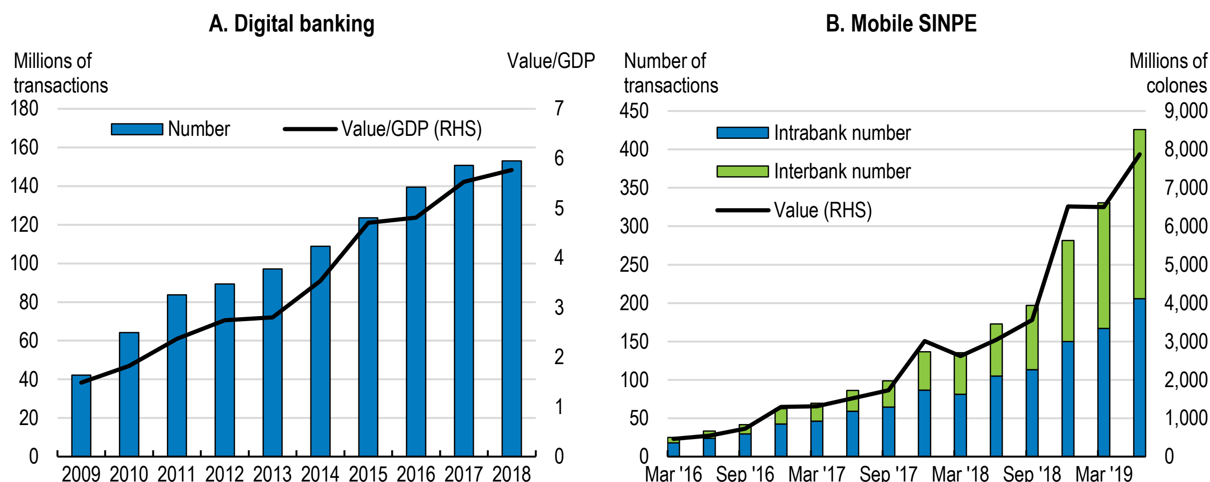
FinTech could help make the financial system more efficient

Both the digital banking (Figure 3.3) and the electronic payments system are of high quality in Costa Rica. The national payments system (SINPE) conveniently transfers colón, dollar, and euro-denominated funds without any interruptions. SINPE has also intermediated rapidly increasing numbers of digital banking and mobile transactions in the last decade (Figure 3.21). As a result, Costa Rica ranks third among Brazil, Honduras, Guatemala, Peru, Bolivia, Argentina, Colombia, and Uruguay in the real-time gross settlement transactions value-to-GDP ratio (World Bank, 2018[41]).

Nonetheless, there is ample room to make the most of the electronic payments system in Costa Rica. For example, Costa Rica takes the 37th place among 73 countries in The 2018 Government E-Payments Adoption Ranking (2018[42]). This assessment reflects the government's capability of receiving (sending) electronic payments from (to) its citizens and the businesses in a country. The increased availability of

electronic transfers between the government and the private sector would reduce costs for both consumers and firms and enhance productivity.

Figure 3.21. The payments system supports an increasing number of digital and mobile transactions



Note: SINPE covers 91 entities that include commercial banks, credit cooperatives, financial companies, mutuals, stock market firms, pension administrators, savings banks, remittance platforms, exchange houses, external liquidators, and government institutions. SINPE maintains standardised (IBAN) account operations, bank coin schemes (via SINPE Mobile) and digital signatures used by legal persons.
Source: Banco Central de Costa Rica.

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Embracing FinTech start-ups would elevate financial inclusion outcomes in Costa Rica. Given the broad-based use of mobile phones, FinTech start-ups might easily promote the use of mobile money in counties that lag behind in financial inclusion. This would reduce both regional disparities (Figure 3.6), gender gaps (Figure 3.12) and invigorate development (Beck et al., 2018[43]). Evidence from South-Asian countries indicates that returns to enhanced financial inclusion by means of improved digital finance can increase regional GDP between 2% to 6% and income of the poor between 10% to 30% (Asian Development Bank, 2017[44]). FinTech penetration can also increase competition in the financial system. Better competition in the financial markets would reduce intermediation margins (Figure 3.14) and transactions costs, resulting in higher consumer welfare.

Easing the regulatory burden would facilitate the growth of the FinTech industry

The lack of direct and full access to the electronic payments system is reported as the main regulatory barrier to FinTech entry in Costa Rica. In addition, there has been either weak or no dialogue between regulators and the industry (Finnovista, 2019[6]). Regulators acknowledge FinTech firms have to be integrated to the payments system and to that end, have initiated an agenda to make regulations more conformable for the FinTech ecosystem (Box 3.7). But, they also argue FinTech penetration would mainly promote the banking system efficiency, instead of raising the level of financial inclusion. Improving the communication between regulators and industry participants would contribute to closing the gaps between the FinTech ecosystem in Costa Rica and regional peers (Figure 3.5).

Box 3.7. Recent initiatives to promote FinTech in Costa Rica

The Central Bank, the General Superintendent and the General Superintendent of Securities have been in a dialogue in the last two years to define the roadmap to improve the integration of FinTech firms to the Costa Rican financial system.

- The Executive Board of the Central Bank approved the partial integration of FinTech firms to the national payments system as of May 2018. Currently, FinTech firms can only operate in the areas of transfer of funds to third parties, direct credit compensation, real-time debit, direct debit compensation, SINPE Mobile, fund reclaiming and automatic debit authorisation. However, any transfer service provided by a FinTech firm has to be associated with a bank account for consumer protection reasons.
- So far, 6 FinTech firms out of 65 applicants have been granted access to the payments system to operate in the areas defined by the new regulation.
- In April 2019, General Superintendent of Securities joined the launching of the regional project, "Towards the Regulatory Convergence for the Regional Fintech Ecosystem" led by the Inter-American Development Bank (IADB).
- In April 2019, the Central Bank and the IMF jointly held the international seminar "Balancing Fintech Opportunities and Risks, Implementing the Bali Fintech Agenda".
- Members of the joint group for FinTech from the Central Bank and superintendents have begun capacity building. An officer of Central Bank has enrolled in the "Asian Development Bank Institute-Cambridge University FinTech and Regulatory Innovation" online programme.
- The case study, "Overview of the Costa Rican case and the experience with identifying Fintech firms" has been sent to the Bank for International Settlements for publication in a forthcoming Fintech report.
- The Central Bank participated in the OECD Global Blockchain Policy Forum 2019 in September 2019.
- In October 2019, the Central Bank hosted an international conference on the implications of FinTech for central banking. Participants of the meeting included international central bankers, officials of international organisations, academics and private sector representatives from regional FinTech associations.
- The Central Bank has hosted informative sessions for 59 FinTech firms as of December 2019, on the IT requirements to connect to the payments system and the regulations governing it.
- In February 2020, the Central Bank received technical assistance from the Center for Latin American Monetary Studies with the participation of experts from the central banks of Chile, Spain and Mexico. These experts shared their experiences on the interaction between the FinTech industry, regulators and central banks.

Source: Banco Central de Costa Rica.

Legal, financial and operational risk management considerations constitute main parts of burdensome regulations in the FinTech industry. In particular, start-ups are expected to comply with money laundering and data protection legislations, regulations of the payments system and the registration requirements mandated by the financial supervisor. They are also required to demonstrate the ability to sustainably manage the electronic funds account within the Central Bank and comply with technical requirements. Introducing regulatory sandboxes would allow FinTech start-ups in Costa Rica to test their products temporarily, without having to comply with all regulatory requirements. Sandboxes were effectively used

by the United Kingdom and Singapore (Box 3.8), who rank very high in global competitiveness (WEF, 2019[45]).

Box 3.8. Regulatory sandboxes in FinTech

Sandboxes provide regulatory waivers and flexibility for firms and enable them to test new business models with less stringent regulatory requirements (OECD, 2018[46]). Sandboxes often ensure major regulatory objectives, most importantly including consumer protection, and are typically administered on a case-by-case basis by the relevant authorities. In Australia, Singapore and the United Kingdom, sandboxes in FinTech industry included safeguards (He et al., 2017[47]) in the form of

- Limits in customer number, transaction value or duration,
- Additional reporting requirements and closer monitoring,
- Additional consumer protection measures such as arrangements to compensate consumers and resolution of disputes,
- Risk management mechanisms to avoid cyberattacks or system disruptions,
- Definition of specific regulations, which the firms should comply at all times.

After ensuring that sandboxes entailed all types of the listed safeguards above, licencing requirements were relaxed in Australia; regulations were relaxed in Singapore and in addition to these benefits for participant unauthorised or unlicensed start-ups, explicit clarifications on regulatory expectations were provided in the United Kingdom. In Canada, Hong Kong SAR and Malaysia, regulations were relaxed and additional consumer protection or risk mitigation measures were implemented. Participants of the sandbox exercise in the United Kingdom quoted that they benefited from the close communication with the regulatory authority, which allowed them to offer more certainty to potential investors (FCA, 2017[48]). Indeed, at least 40% of sandbox exercise participants in the United Kingdom received new investment during their testing period.

Source: He et al. (2017[47]); United Kingdom Financial Conduct Authority (2017[48]); OECD Going Digital Steering Group Meeting (2018[46]).

There is also room to adapt regulations in Costa Rica to ensure the universal accession and practical use of digital certificates. Digital signatures can only be applied by the physical use of digital certificate cards, which are expensive and impractical to use (Chapter 2). Improving the digital signature mechanism would boost government, firm and consumer demand for digital tools and help the FinTech ecosystem expand, accordingly.

The investor base of FinTech start-ups is considerably smaller in Costa Rica than in its regional peers. Two angel investor networks are currently active, gathering a group of only 35 investors. Mexico on the other hand, hosts about 800 angel investors targeting the FinTech industry (Finnovista, 2019[6]). Members of the Costa Rican FinTech community report angel investors are more inclined to invest in the construction and medical devices industries, avoiding the regulatory burden faced by the industry. Levelling the regulatory playing field for FinTech start-ups would increase the profitability of the sector and reallocate finance toward it. Another obstacle regarding the FinTech investor base is the lack of venture capital. Costa Rica ranks 96th out of 141 countries in venture capital availability, with a score of 2.7 out of 7 (WEF, 2019[45]).

Tailoring the regulatory framework to the FinTech industry's needs will broaden both the client and the investor base of FinTech start-ups in Costa Rica. The synergy between FinTech companies and incumbent financial institutions could be strengthened to lay the ground for the expansion of FinTech start-ups, who face challenges that originate from scale effects and financing difficulties. This will help domestic FinTech firms catch up with their regional peers (Figure 3.5) and boost financial inclusion in Costa Rica.

MAIN FINDINGS	RECOMMENDATIONS
Improving financial inclusion of consumers with a gender-based and regional focus	
Insurance penetration is very narrow, buyers of insurance perceive it as a means of savings or consumption expenditure.	Improve consumers' understanding of insurance products via financial education.
Regional disparities in financial inclusion are large.	Increase the number of access points in densely populated counties of Alajuelita, Desamparados, San Rafael and San Pablo with very low financial inclusion.
Gender gaps are large in financial inclusion.	Improve digitalisation of finance via the FinTech industry to boost the financial autonomy of women. Integrate financial education messages into popular entertainment and social media. Use periodic text messages that remind savings goals to consumers.
Financial inclusion of vulnerable minorities lags behind the overall population.	Help Indigenous populations to build their own finance networks. Add priority groups to conditional cash-transfer programmes that are currently being transferred to debit card accounts.
Financial literacy is low and indebtedness is increasing.	Complement access to financial products with enrolment to financial education. Reinforce the recently announced financial education strategy with principles that benefit from behavioural insights.
Boosting the access of micro-entrepreneurs and SMEs to credit	
Many micro-entrepreneurs do not apply for a loan with the belief that their credit request will be rejected or because they cannot afford it.	Reduce loan application costs.
Current coverage of the credit registry lags behind regional peers.	Strengthen the credit registry framework to widen its scope.
Many micro-entrepreneurs borrow from non-institutional private lenders at unregulated interest rates.	Provide microcredit programmes for micro-entrepreneurs to help their formalisation.
Micro-entrepreneurs with rejected loan applications commonly refer to the lack of guarantees.	Approve the draft bankruptcy law and complement it with better property registry and improved secured transactions law to make the collateral framework more conformable with getting credit.
Agricultural sector SMEs lag behind in financial inclusion with particularly low insurance plan ownership.	Avoid crowding out of the private insurance market by aggressive disaster relief programmes. Enhance both insurers' and farmers' understanding of weather risks via the use of mobile applications.
Half of micro-entrepreneurs and third of SMEs have never heard of the development banking system. Credit-to-funding ratio of the development banking system is low.	Use private banks as explicit points of contact for development credit applications. Promote the dissemination of information on development banking via most commonly used media outlets. Increase the share of loanable funds in the development banking system. Strengthen the partnership of the development banking system with the foreign trade (PROCOMER) and investment (CINDE) promotion agencies.
Embracing FinTech to increase competition in the financial system	
High intermediation margins and fees in the banking sector create difficulties for both SMEs and households in access to finance.	**Grant FinTech companies full and direct access to the national payments system while preserving security and consumer protection.**
FinTech start-ups operate under burdensome regulations and lack of access to external finance.	Temporarily relax regulatory requirements on FinTech start-ups but explicitly clarify regulatory expectations in the testing period. Maintain safeguards such as limits on customer number, transaction value or duration to ensure consumer protection. Eventually tailor the regulatory framework for the FinTech industry's needs as in better performing peer Latin American countries.

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