



White Paper 2019

The next SMB lending frontier

Brazil

NEXOOS



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1. Foreword

Worldwide, FinTechs have rapidly penetrated developed economies, but we have always seen the greatest leaps of innovation mainly happening in developing economies. This tends to happen due to technological breakthrough in the core of the system, but when we deeply analyze the reason of these successful stories where the markets totally leaped frogs to an era and made huge advances in the economy, we start to see that these innovations not only come along with technology but rather with a set of incremental changes that happened in a short period of time changing the whole dynamics of the market. That is exactly what we are about to see happening in the Brazilian credit market. Where not only the technology is ready, but also the regulators are fostering new regulation to increase competition, the human capital is gaining momentum with more entrepreneurs looking to innovate within the financial industry, and customers have already experienced what it is like to operate and escape from the traditional banks that for long took advantage of the lack of access to capital creating an oligopoly in control of five institutions. The online SMB credit market grew more than 600% in the past three years, and it has only realized a fraction of its true potential, which is why we prepared this whitepaper on why we see Brazil as the next big credit frontier for SMBs, as it is a market on the ripe for disruption holding more than 65% of SMBs loans in Latin America. Furthermore, it is the more advanced and the only market today

market today where all stakeholders and structures are aligned to make it happen. Not only with implementation plans, but with actual regulations already in place and platforms that already gain sustainable momentum with customers ready to take action and regain the market by putting them in the center stage. I hope this paper gives you an overview of the opportunity that has emerged in Brazil and we welcome you full of energy to untap LATAMs largest market and unlock its full potential. Bringing a huge social-economical impact by helping SMBs to grow faster and better while generating employment and economic development.



Nicolas Arellaga
Co-founder

2. Introduction

The goal of this paper is to show why Brazil is the next small-and-medium business (SMBs) lending frontier. This study will cover the dynamics of the Brazilian economy, and how SMBs can unlock and foster further economic growth. For instance, SMBs represent 99% of all operating businesses in the country and mean a great deal of the country's gross domestic product (GDP). However, even though they play an important role within the Brazilian economy, these businesses are still not a priority for the traditional financial institutions as most of the credit lines offered to SMBs are expensive, difficult to access and not tailored to fulfill their business needs. Along with it, readers will be presented with a complete overview of the current status of SMBs and their field of operation - sector, size, revenue, ticket size and proceeds of the loans. As well as a study of the most common credit lines offered to SMBs by traditional financial institutions, how many of them used those lines in the past three years, the average cost of each line and the argument on how they been underserved by traditional banks all along. Furthermore, readers will learn about the dynamics of the online lending market in Brazil and the opportunity it holds for investors, especially when the yield is one of the highest in the region. At last, an overview of the Brazilian Central Bank agenda, and how it has been fostering the penetration of FINTECHs and innovative lending facilities to reduce banking concentrations, increase productivity, and improve market dynamics.



3 SMB lending in Brazil



3.1. Understanding the Brazilian economy

With a population of 209 million people, the fifth largest country in the world, Brazil's gross domestic product (GDP) is expected to grow by 2% in 2020. But not only that, Brazil is the ninth-largest economy in the world and the second-largest economy in the American continent, just behind the USA. Alongside this scenario, the country has become very well known among the top emerging economies in the world, but especially in Latin America as its policies, influence its neighboring nations due to its economic size and the impact Brazil has in the region.

Moreover, the latest research of the Brazilian Chamber of Commerce showed that the service sector represents more than 63% of the GDP. This has been a great leap forward in recent years; as the nation has been able to move away from an extraction-based economy similar to the ones found in neighboring countries to the one that is based on the service sector. This core change is helping Brazil to transition towards a new era; the era of the industry 4.0. This new framework holds an important role, as makes it possible to collect and analyze data and enables brisker, more malleable, and more efficient processes in order to achieve the goals of the businesses.

Furthermore, there are more than 20 million small-and-medium businesses (SMBs) in Brazil, which are responsible for 99% of all businesses operating in the country, resulting in 53% of the workforce. And when this number is isolated, it is accountable for 27% of the national gross domestic product. Needless to say that the SMB credit market holds a huge opportunity for capital to find very positive returns and yield in a market that just started to develop its full potential.

Market Opportunity

SMBs are vital to Brazilian economy...



3.2. SMBs are among the best assets to invest in Brazil

“SMBs play a critical role in the Brazilian economy but severely suffer from a shortage of funding alternatives for expansion”



Sole trader: Up to US\$20.000



Micro-business: Up to US\$90.000



Small: From US\$90.000 to US\$1.2M



Medium: From US\$1.2M to US\$25M



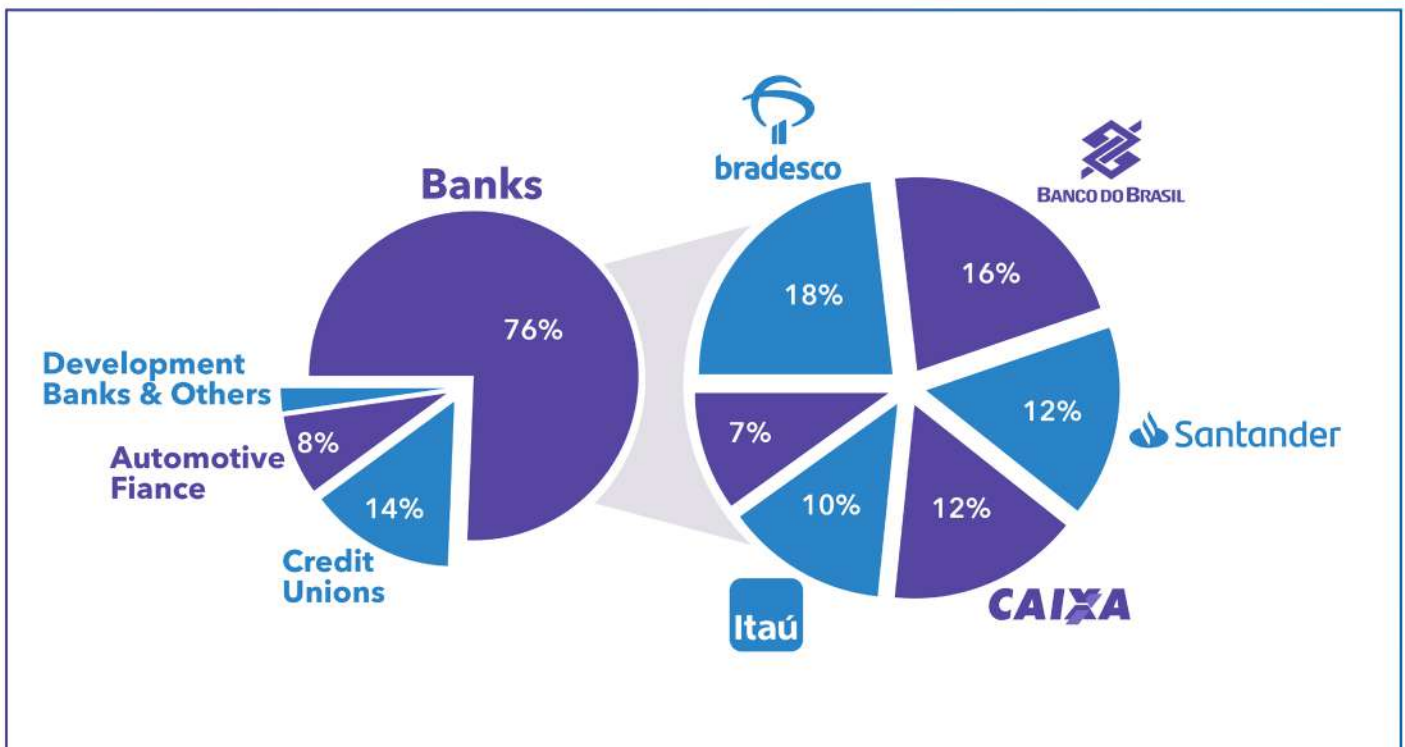
Corporate: US\$25 Million

Even though the Brazilian credit market is huge (>US\$ 700 billion), and meanwhile SMBs represent 99% of the business units of the country, SMB credit only accounts for 5% of all outstanding loans and 12% of all outstanding business loans. Furthermore, the loan balance for SMBs of traditional financial institutions has decreased almost by half since 2012.

3.2. SMBs are among the best assets to invest in Brazil

Moreover, Brazil has one of the highest market concentrations in the world, as 76% of all loans to small-to-medium businesses come from only five banks in Brazil (Itaú, Bradesco, Banco do Brasil, Caixa, and Santander). Representing an annual origination of more than fifty billion (US\$ 50B) dollars per year.

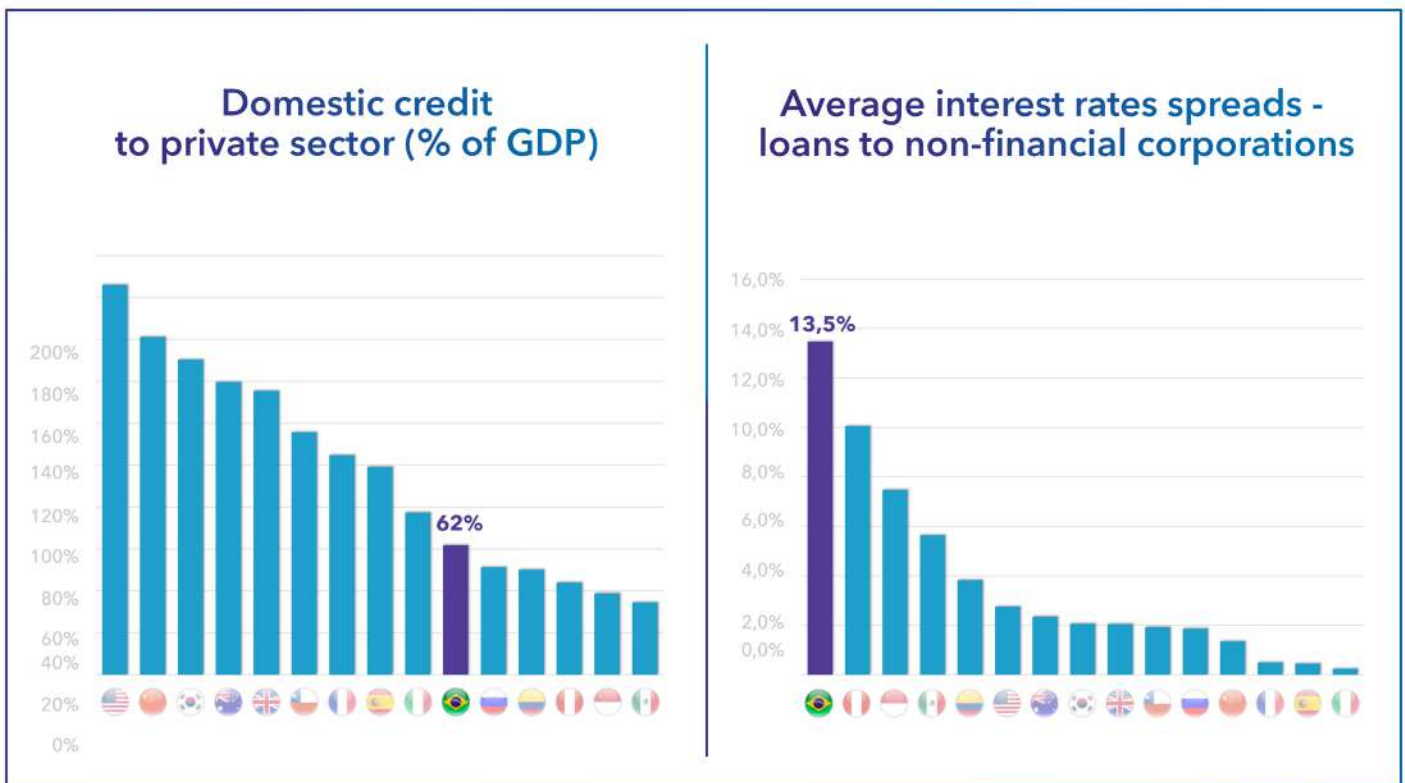
...and concentrated on the hands of five banks



3.2. SMBs are among the best assets to invest in Brazil

According to a FIS Global study carried out in 2018, SMBs continue to feel displeased with their banks. In alignment with the findings, Brazil is still behind other nations regarding credit penetration by international standards. At the same time, Brazil is the second country with the highest financial spread in the world (13.5%) which results in this discontent by SMBs.

**Domestic credit to private sector (% of GDP)
in the USA is 3 times higher than in Brazil**














Understanding SMBs in Brazil

SECTOR

-  **Servcies - 49.73%**
-  **Retail - 38.73%**
-  **Industry - 9.31%**
-  **Agriculture - 2.23%**

REVENUE IN US\$

-  **0.05%** (up to \$25k)
-  **0.04%** (between \$25k and \$50k)
-  **44.12%** (between \$50k and \$125k)
-  **24.92%** (between \$125k and \$250k)
-  **15.17%** (between \$250k and \$500k)
-  **10.01%** (between \$500k and \$1.2M)
-  **2.80%** (between \$1.25M and \$2.5M)
-  **1.48%** (between \$2.5M and \$5M)
-  **0.46%** (between \$5M and \$7.5M)
-  **0.29%** (between \$7.5M and \$12M)
-  **0.67%** (above \$12.5M)

SIZE

-  **81.59%** (2 - 10 employees)
-  **15.80%** (11 - 50 employees)
-  **2.02%** (51 - 200 employees)
-  **0.36%** (201 - 500 employees)
-  **0.12%** (501 - 1,000 employees)
-  **0.09%** (1,001 - 5,000 employees)
-  **0.01%** (5,001 - 10,000 employees)
-  **0.02%** (10,000 - employees)

REQUESTED AMOUNT IN US\$

-  **67.91%** (\$12.500)
-  **18.39%** (\$12.500 - \$25.000)
-  **8.20%** (\$25.000 - \$50.000)
-  **1.94%** (\$50.000 - \$75.000)
-  **0.64%** (\$75.00 - \$100.000)
-  **2.91%** (\$100.000 - \$125.000)

2019 Nexoos database

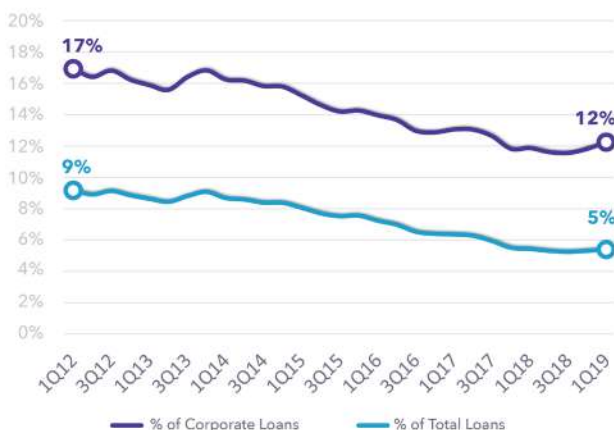
3.3. Brazilian SMBs have been underserved by banks

Yearly Brazilian financial institutions underwrite more than fifty billion dollars (\$50 B) of loans to SMBs. But since 76% of loans comes from only five traditional banks with the second-highest interest rate in the world, SMBs are being extremely underserved by banks. As the lack of competition leaves them with a handful of options and very expensive financial products.

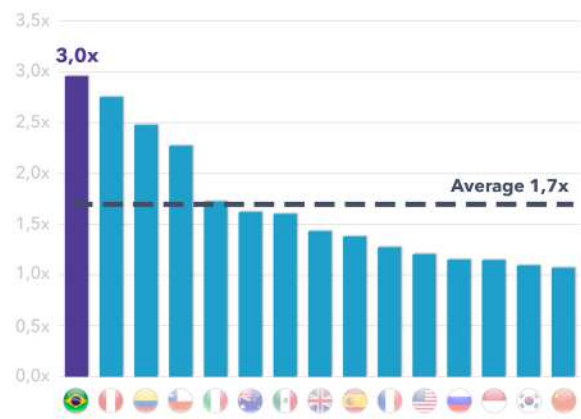
For instance, most of credit lines offered to SMBs are very limited, and does not allow them to structure their finances properly, neither to invest for growing their ventures.

- **Overdraft:** commonly known as “cheque especial” in Brazil (special check). It has nothing close to special, as on average SMBs pay 330% p.a for accessing the facility. Typically is used by SMBs as an unplanned short-term loan when the company falls behind receiving planned payments and their account balance goes below zero.
- **Corporate Credit Cards:** All banks require to open an account for at least 6 months before offering any kind of credit card, and in most cases, if the credit limit is approved it tends to be very low, which does not allow the businesses to cover even a minimum of their expenses.
- **Personal Credit Cards:** It's a common practice among SMBs in Brazil to use business owners' credit cards for business expenditures. This is mainly due to the lack of access to corporate cards offered to these businesses. Creating massive management and financial problems by mixing their company's cash flows with their individual expenses.
- **Secured & Unsecured Working Capital Loans:** Even though after years of trading with their banks, the majority of SMBs are offered very high-interest rates loans, and with processes that can take months to be approved.
- **Factoring / Invoice Advance:** Typically SMBs within the retail market use these lines of credit, as most systems are structured to serve this niche. The average cost of these lines varies by segment and is mainly being underwritten in the FIDIC market, moving close to US\$ 200 billion a year in invoice factoring.

This is the result of those traditional financial institutions preferring to focus on individuals and not on business credit. In addition to it, Brazilian SMBs are disproportionately charged high-interest rates in comparison to international peers through banks. Globally speaking, the interest rate is on average 1.7x. In Brazil, this number almost doubles reaching on average 3.0x.



It also blends with the fact that banks have limited interest in taking risks. The conventional credit loan performed by them does not support the net interest rate spread usually needed by SMBs.


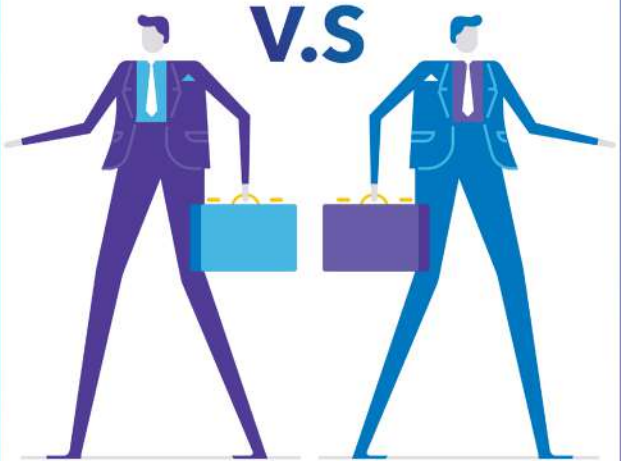



Source: OECD, BCB

3.4. Barriers faced by SMBs

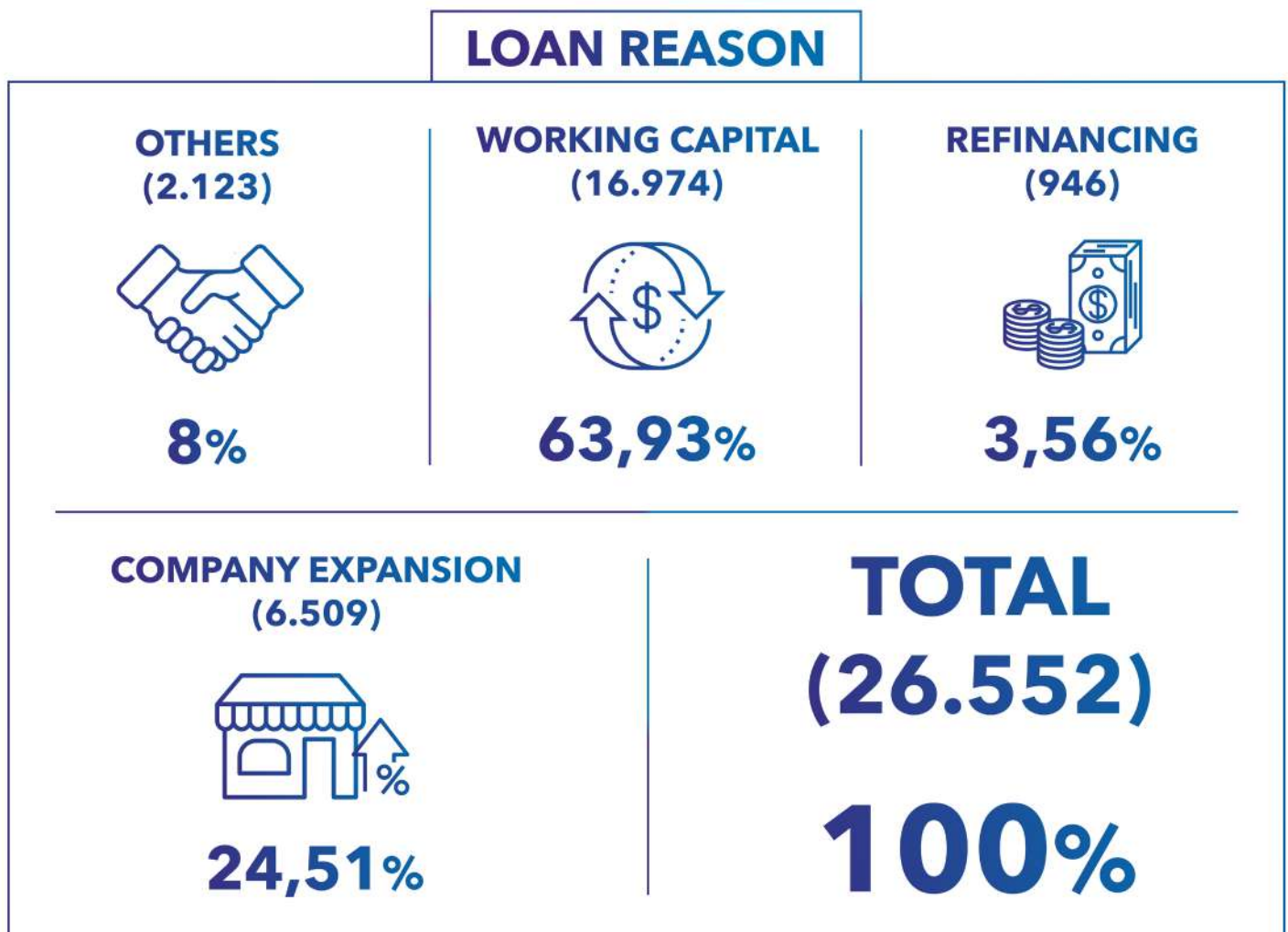
The lack of access to capital directly implicates the difficulty for small-to-medium businesses to grow and scale their businesses. However, with the reduction of capital for SMBs by almost half in the past 8 years, traditional financial institutions have shown little enthusiasm about finding a new and better product to serve SMBs, especially while offering sustainable credit lines with fair rates to SMBs. As we have seen most are investing deeply in consumer lines and higher-rate credit lines and trying to maximize their profits in the short-term with consumer loans.

SMBs are in a credit alley

Credit cards  450% p.a.	V.S 	Overdraft  330% p.a.
50%	% of SMBs that used this facility in the past year	78%

3.4. Barriers faced by SMBs

Of all loan requests made by SMBs in 2019, Nexoos mapped the main reasons small-to-medium businesses looked for capital. The majority of SMBs - 64% - seek working capital to fund their day-to-day operations, followed by 24.5% of companies seeking capital to expand their businesses, 3.5% pursue capital to refinance other expensive credit lines, and 8% look for capital to overcome other needs, such as launching new products or to restructure their business. It is expected that with the economy now taking a positive turn, the look for expansion loans will increase considerably.



4 SMBs Landscape



4.1. The Brazilian Central Bank is playing a key role to foster innovation and improve market dynamics

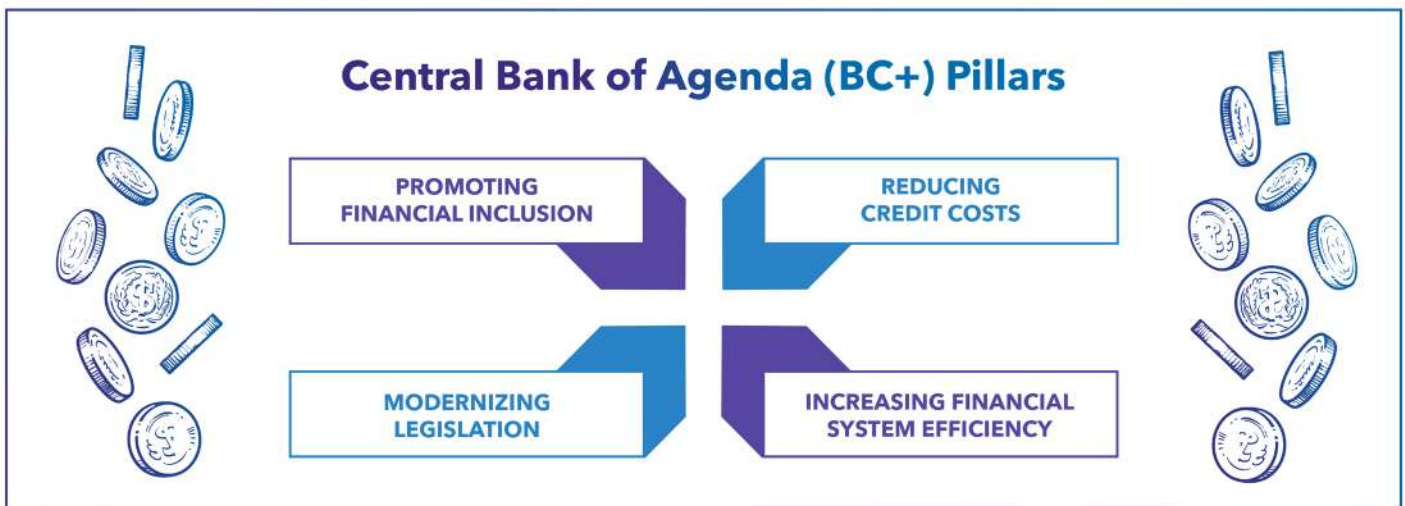
Up until September 2018, all Fintechs that wanted to operate within the credit ecosystem needed to partner with financial institutions to underwrite and formalize loans. This was mainly because when issuing a loan note with an interest rate higher than on average 12% p.a., lenders needed to be a regulated financial institution. So to participate in the market, fintechs needed to operate as a bank correspondent by partnering with financial institutions to formalize the operations. However, these structures did not favor the SMBs nor the investors, as many unnecessary and costly processes needed to be carried out by the fintech and the intermediary financial institution; resulting in more time spent in the underwriting process, with longer and higher costs to the operations. Besides the operational pitfalls, there was a double taxation inefficiency when the financial institution needed to offload the loans from their balance sheet into the fintech or the fund that was funding the loan parts.

The Credit and Banking Economics Report issued by the Brazilian Central Bank demonstrates that the majority of bank spread comes from their gross operating margins, errors, and omissions, and it is superior to non-payments and mandatory deposits. But even though those numbers support applying lower spreads, lowering the interest rate was not an option for larger banks. Thus, the Brazilian Central Bank based its agenda on four pillars to promote changes and reduce the extreme concentration that the credit market is on.

Together with it, the New Collections Platform was created to modernize the payment system bringing positive changes to society, such as safety and promptness. E.g. a preeminent shift that occurred was the ability offered to the debtors to pay their overdue slips (bills) at any platform that accepts payments, e.g. banks, ATMs, apps, and so on. Before this, any debtor who would for any reason delayed their payments would have to go physically to the bank responsible for issuing the bill to pay any outstanding debt.

4.1. The Brazilian Central Bank is playing a key role to foster innovation and improve market dynamics

In other words, this new platform was a system developed to modernize liquidation processes and compensation of bank slips, through safer and self-servicing tools to boost consumers' trustability and convenience. This change includes any slip issuers, such as lending platforms.



4.2. SMBs used the most expensive and unsustainable credit lines in 2019

Within those restrictions imposed by traditional banks, the only solution for small-to-medium businesses to access capital turns out to be through expensive financial solutions such as overdraft facilities, corporate or personal credit cards.

For instance, throughout a research carried out by Nexoos from the historical credit data of more than 38.000 SMBs with their historical credit data of the past three years, it was discovered that 78% of SMBs used the overdraft facility more than once in the past year. It is the most expensive facility in comparison to any other credit line, as stated in the latest published report from the Brazilian Central Bank, the average overdraft interest rate is at 330.2% p.a.

The second most used credit facility was corporate credit cards, the same research confirms that 50% of SMBs have used them. However, the problem backslides when these small-and-medium businesses use their entire credit limit and cannot afford to pay the full bill in the following month, resulting in high-interest rates to be paid back to the banks in the end.

It was impressive to discover that the two most expensive credit lines were on the top of the list of the small-to-medium businesses to access capital.

Working capital loans came in third place, notably, this line contained unsecured and asset-backed loans even though the average cost staying very high at an average of 47% p.a.



Total of SMBs that have used overdraft.

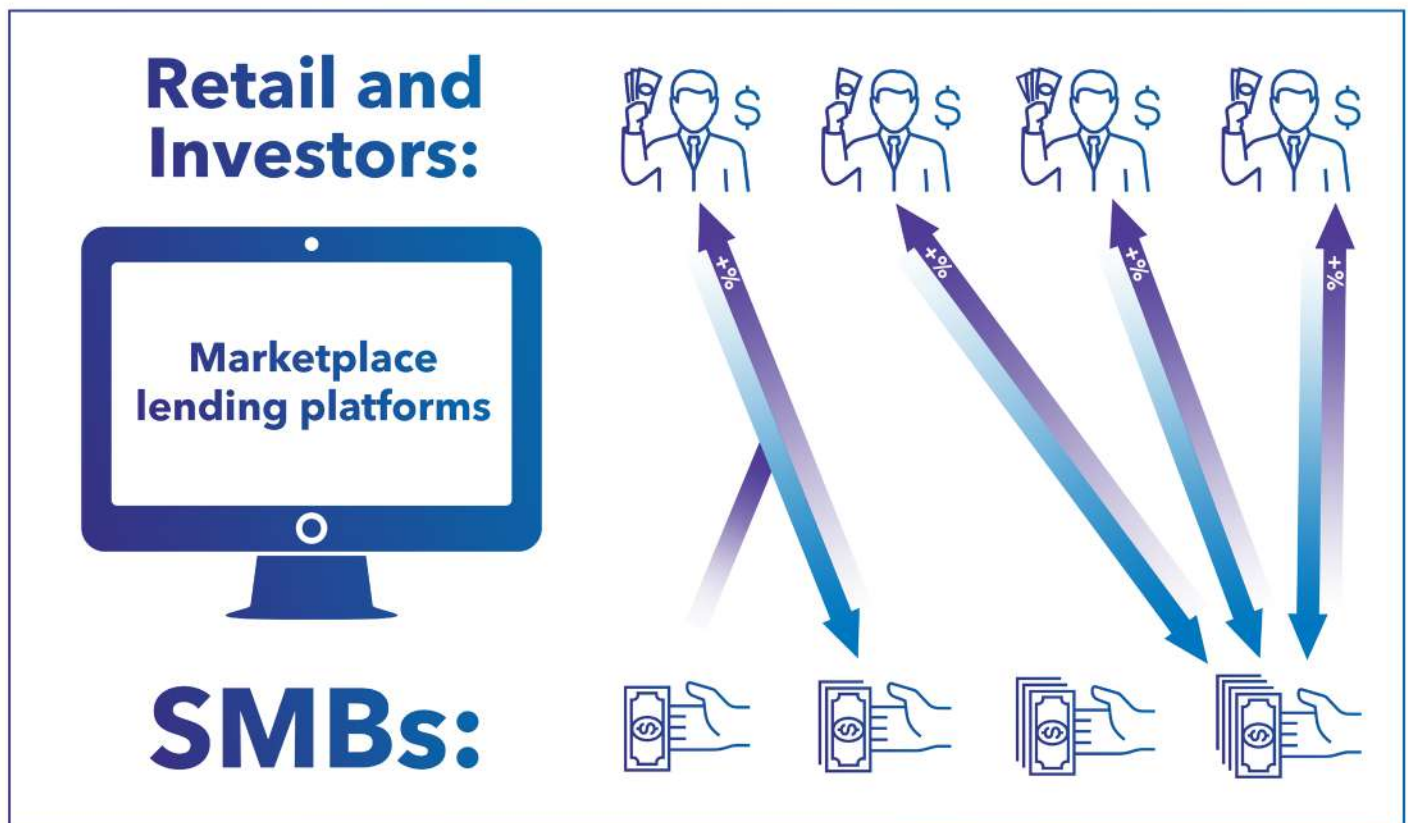
Nexoos database

Key Fact: Companies with revenues between US\$2.5 million and US\$ 125 million are the ones that mostly used their overdraft facilities, totaling 83% in the last 18 months.

4.3. New Financial License for FINTECHs

Not only the high-interest rates are a challenge for SMBs to access capital, but bureaucracy plays its part as well. When trying to borrow money from a traditional bank in Brazil, SMBs have to go through a long and tedious process. However, with the new Resolution 4,656 passed by the Brazilian Central Bank in 2018 which creates a new type of Financial Institution, allowing financial technology companies (fintechs) to underwrite and formalize credit directly to its customers with their own financial license. These changes made the process simpler, better and easier for both SMBs and investors to operate in the market. Minimizing paperwork, reducing costs and time. Helping borrowers with quicker, less costly and fully automated underwriting processes offering a true end-to-end digital credit experience.

The new regulation, created two types of licenses, SEP (as per its acronym in Portuguese, or "Sociedade de Empréstimo Entre Pessoas") for marketplaces which can operate with both retail and institutional investors through securitization vehicles, and SCD (as per its acronym in Portuguese, or "Sociedade de Crédito Direto") for platforms which can operate using its own balance sheet.



4.4. Introducing Brazilian Central Bank Resolution 4,656

The major change provided through the Resolution 4,656, also known as the “Fintech Regulation”, was the ability to avoid the former requirements, where the platforms needed to use traditional financial institution infrastructures to service the loans. This used to be a much more inefficient, and costly structure for all the parts involved such as the platforms, investors, and clients. Before this new financial license came along, only traditional financial institutions could formalize loans and issue a credit note or any other financial instruments.

Important to mention that this and other changes were possible because of the new Brazilian Central Bank innovation agenda (Agenda BC+) that foresaw an opportunity to stimulate financial inclusion, focusing on achieving a cutting-edge approach towards innovation to financial services, and create more competition in a market which was still very exclusive for few traditional institutions in Brazil.

As a consequence of the Resolution 4,656, the Central Bank managed to foster competition in the credit market as a whole. Nowadays, is possible to start seeing a more dynamic market with niches of digital lending initiatives being created that accelerate the development of new financial instruments; which in turn help to offer better credit offerings and a much more favorable environment for SMBs to grow, and for investors to earn better yields by removing traditional banks dependency.

Two new types of Financial Licenses were created: SEP - dedicated to Marketplace Lending platforms and SCD - dedicated to Balance Sheet Lending platforms. Moreover, both licenses allow regulated platforms to access the Brazilian payments system (the Central Bank settlement system). Thus, allowing them to offer proprietary accounts to its customers and handle their clients' money. Besides that, each fintech has to follow a group of different requirements to perform according to its category.

For instance, the SEP license has a very lean capital structure as it can marriage the borrower capital requirement with as many funding sources available. The financial institution has also the ability to take up to 5% of the credit risk with its own balance (although with no restrictions for a parent company of the Financial Institution). As well as the SEP license that suits both institutional and retail investors, and protects the retail investors of some of the most important risks of investing, such as over concentrating their capital, by limiting their exposure to US\$ 3.500 per SMB invested. Also according to the Resolution 4,656 SEP the Financial Institution have to respect the following:

4.4. Introducing Brazilian Central Bank Resolution 4,656








(i) carry out any Credit Transactions using its own financial resources, provided the exception provide above; (ii) hold equity of another financial institution; (iii) co-oblige or provide a guarantee or security for any of the Credit Transactions existing in its digital platform; (iv) pay its services or use the resources related to the Credit Transactions in its own benefit; (v) transfer financial resources to the Debtors before the resources be made available to the Creditors; (vi) transfer financial resources to the Creditors before the payment be made by the Debtors; (vii) keep the financial resources of both the Creditor and the Debtor on its own account, not related to the Credit Transactions; and (viii) link the performance of the Credit Transaction with the efforts of a third party or Debtor, in his capacity as an entrepreneur. An overview on the Brazilian Fintech Regulation" by Lexology.

As for investors operating with a SEP Financial Institution, they also can be referred to as Creditors and may be individuals, legal entities or investment funds. In this case, borrowers are the small-and-medium businesses domiciled in Brazil.

And at last, the SCD license that differently from the SEP license must use its own capital to fund the loans by raising capital for the institution for the funds. Another main difference of the SCD is that they are prohibited from raising funds from third parties to fund the loans. Meaning, their debtors will only borrow from the platform own balances (balance sheet lending). In addition to it, SCD fintechs can:

"sell and or assign the credits related to a certain Credit Transaction to (i) other financial institutions; (ii) Receivables/Credit Rights Investment Funds" (Fundos de Investimento em Direitos Creditórios - "FIDC"); and (iii) securitization companies that distribute the underlying assets exclusively to qualified investors, as defined by the CVM. Therefore, it is not under the SCD's role to help individuals or legal entities to join the financial market as Creditors without a proper vehicle that justify that initiative.". An overview on the Brazilian Fintech Regulation" by Lexology.

Advantages of operating with a SEP & SCD license

-  Faster underwriting processes
-  Access to the Brazilian payments systems (Settlement System)
-  Lean capital structure
-  Less bureaucracy
-  More security
-  Better rates due to the decreased of underwriting costs
-  Increase in efficiency and competitiveness

5 Performance



5.1. The credit ecosystem is certainly ripe for disruption

Fintechs have been a focal point in Brazil because they offer customer-centric and less bureaucratic services to their customers. And, with the Resolution 4,656 passed by the Brazilian Central Bank that created a new type of financial institution design for lending platforms, the credit market will now develop even faster and better than before. In parallel to this, the basic interest rate is at its all-time low which makes the Brazilian credit market very attractive to investors, especially investors who are diversifying their portfolios and looking for better yield.

Given that Brazilian base interest rates are currently at their all-time low...

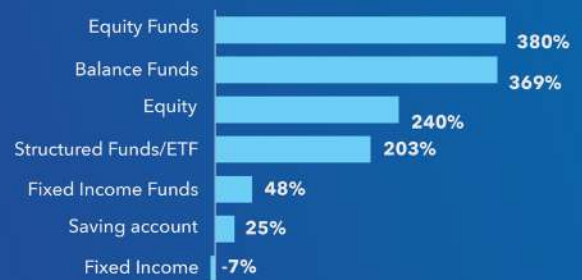


...investors are actively diversifying their portfolios and searching for higher yields

Change in funds assets under management (2019 x 2016)

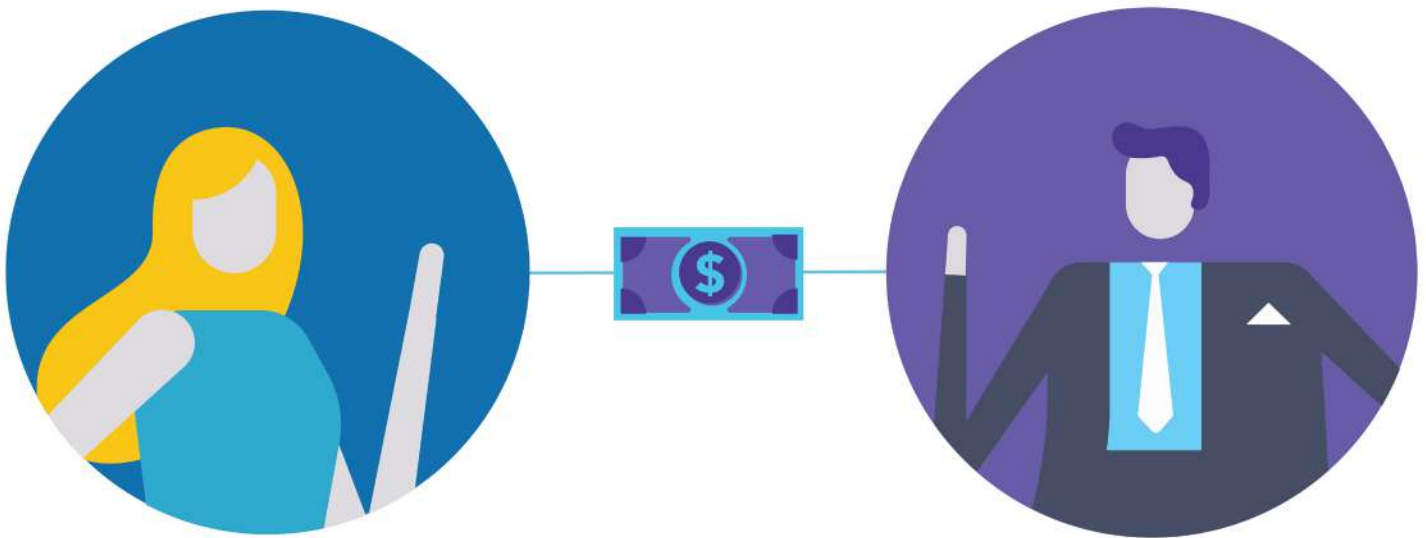


Change in retail investors savings pool (2019 x 2016)



5.1. The credit ecosystem is certainly ripe for disruption

Nexoos alongside regulators are pioneering the changes in the credit landscape in Brazil. By getting the leadership position in the SMB credit market as a regulated marketplace lending platform, Nexoos serviced the first loan as fully regulated SEP Financial Institution in August of 2019, and since the platform was launched in 2016 it has underwritten more than US\$ 70 million. Exciting times are about to come as the recent regulatory changes and improved market conditions we can see in the economy is about to enter a new era for financial services in the region.



Nexoos offers small-and-medium businesses sustainable credit facilities with monthly interest rates ranging from 1.14% to 4.19% per month. For SMBs is not only a cheaper capital option, but mainly a faster, easier, and more convenient approach to access capital through smooth underwriting processes. And for investors, it offers a wide range of companies to invest in and a platform that allows them to diversify their portfolio, with a proven track record and an Internal Rate of Return (IRR) of 18%.

In comparison to traditional banks, lending platforms operating with the newly created financial license have more efficiency, reduced operations costs, aligned interest with borrowers and Investors, and no requirement for a prior relationship by opening a bank account before accessing any kind of credit facilities.

5.2. SMB loans historical performance

Nexoos was the first marketplace lending platform to underwrite a loan under the SEP financial license issued by the Brazilian Central Bank in 2018. However, innovation began long before it. The platform has been servicing SMB borrowers since 2016 in Brazil, partnering with financial institutions to formalize the loans, throughout this period it helped more than 2.500 small-and-medium businesses achieve their financial stability by unlocking more than US\$ 70 million to foster their growth. Furthermore, through the Nexoos retail platform, more than 50 thousand investors have chosen to diversify their investments attaining higher yields than any other investment available in the market. As well as retail investors and institutional investors can now access new asset classes to diversify their funding strategies.

Investors can access investments yielding in the range of 30% to 70% per year with an average portfolio performance of over 18% Internal Rate of Return (IRR) taking into account an historical rate of 9,7% for nonperforming loans.

It's possible to reach performances like these through highly capable credit algorithms and a well-diversified portfolio. Nexoos, in over 3 years, has serviced loans to SMBs from all the 27 states in Brazil, with loans that start at US\$ 4.000 and go up to US\$ 125.000, with an average ticket size of US\$ 23.000.



5.2. SMB loans historical performance

Diversification in different segments and also historical operational time of the SMBs are very important factors to deliver a good portfolio performance. That is why Nexoos main strategy is to unlock capital to SMBs that currently are being underserved by traditional financial institutions with the lack of credit lines to support their cash flow capital requirements and growth strategies. Out of the Nexoos portfolio, 74% of SMBs are over 6 years old, with annual revenue that ranges from US\$ 60.000 to US\$ 20 million, being the mode between US\$ 500.000 and US\$1 Million. This strategy delivers investors a very well-diversified portfolio of companies able to replicate the best characteristics of SMBs in Brazil and at the same time deliver good yield, by taking advantage of a well-prepared screening process and offering an IRR of over 15% to more than 70% of the investors.



6 Cases



6.1. A peek into SMBs experiences

User cases and experiences of SMBs that got financed through Nexoos:

Rodrigo Borges is the CEO and founding partner at Verticore Group



"The loan we took with Nexoos allowed us to grow our response task force, and this increased our number of customers by 42%. (Working with Nexoos) I've only found positive factors, such as faster processes, unique customer engagement, and debureaucratization of the credit experience, because I was able to go through the whole process within the platform in a few minutes."

Rodrigo Borges.

https://player.vimeo.com/external/376419846.hd.mp4?s=a43499011a43ac609fa9ebbd9dd793d108dad67b&profile_id=175

Marcio Araujo is the founder and partner at Afrika Tecnologia



"We were looking for an option to expand our company, but we didn't want to use our business capital to fund it. So we've taken loans, more than once, from Nexoos. As turns out our revenue keeps increasing and allowing us to dream bigger. And the process of acquiring loans through banks takes too long, but with Nexoos your company can be approved in 3 days."

Marcio Araujo.

https://player.vimeo.com/external/376419787.hd.mp4?s=8a5bc43c099ba82efa42ce29f1f2ece8abcda923&profile_id=175

7 Future



7.1. Brazilian Central Bank Innovation Agenda (Agenda BC+)

The latest Brazilian Central Bank Financial Stability Report (Relatório de Estabilidade Financeira do Banco Central) revealed that the SMB credit market should at least maintain and even accelerate its growth in the upcoming years. This is going to be a consequence of these regulatory changes made recently, and also due to the increasing participation of the parts involved, the capital markets verticalizing and entering the credit markets in the search for yield. The direct penetration of funds into banking alongside fintech platforms accelerated owing to a scenery of low-interest rates in the past 5 years, as the SELIC rate (Brazilian Basic Interest Rate) reduced by almost half in a very short period of time. The SELIC rate is the basic interest rate of the Brazilian economy, defined by the Brazilian Central Bank; in October of 2019, it reached its all-time low at 5% and its expected to reduce even more, 4.5%, by the end of 2019.

The decrease of the basic interest rate was stimulated as an effect of the high inflation and low economic growth which Brazil experienced in the past 6 years mostly due to the political changes the country experienced. In addition to the Government changes to reduce Governmental expenses and Brazil's Pension and Social Security system reforms.

Besides the innovative approach the Central Bank took over the past few years, the Federal Government (Planalto) has also supported the innovation of the financial market by encouraging and endorsing the changes made by the Brazilian Central bank. For example, it is allowing foreign capital to own stakes in Financial Institutions. As in Brazil every single foreign investor that wanted to operate in the country with a financial license not only needed the approval of the Brazilian Central Bank but also of the President. However, with the new financial license for lending platforms (Resolution 4,656), the Federal Government passed a bill that automatically allows foreign participation on the Cap Table of the SEP & SCD financial Institutions, without needing to pass through a presidential approval as it is currently for traditional financial institutions.

These changes have been very favorable to fintechs to increase competition, reduce interest rates, and bring innovation to a market that up until recently was left at the mercy of an oligopoly of only five financial institutions that controlled the whole market.



The Brazilian Central Bank innovation agenda is based on four pillars:

- Promote Financial Inclusion
- Reduce the Cost of Credit
- Modernize Legislation
- Increase the Efficiency of the Financial System



7.1. Brazilian Central Bank Innovation Agenda (Agenda BC+)

Measures that were taken by regulators to foster financial innovation in Brazil

- New Financial License Regulation 4,656: The creation of two new types of financial institutions SEP & SCD allowing Fintechs to operate independently with its client base.
- Open Banking: The public consultation of the draft was officially launched in November 2019, and is expected to come into effect on the second semester of 2020. This will be one of the major driving forces that will stir market dynamics towards more competition and a new era of financial products.
- Faster Payments: In addition to the Brazilian Payments systems, that already allows to settle transactions almost instantly within all states in the country. The new settlements systems proposed by the Central Bank is going to increase competition in the country, improve the economics, and with even faster transactions that will allow the creation of new types of financial products that will better suit the needs of SMBs.
- New Electronic Credit Contracts: The Central Bank modified the resolution for issuing electronic credit contracts last October. Introducing a set of changes that for example allows to partition the credit contract. This is a great change for investors of marketplace lending platforms as it allows them to diversify their portfolio, distribute the risk even more, and potentially sell their positions to bring liquidity to the market.
- Credit portability: In order to foster competition, the Central Bank modified the legislation, allowing an easy, fast and hassle free credit portability between financial institutions. This modification will help to shift the stock of loans out of the hands of the main financial institutions that today hold more than 76% of the SMB market and will also foster the creation of new financial products delivering better rates for the customers.
- Regulatory Sandbox: The Central Bank alongside other regulators of the financial market in Brazil, launched a Laboratory of Financial and Technological Innovations that will increase the speed of implementation of new financial innovations.
- Creation of an electronic collateral registry: Brazilian Central Bank has also passed an agenda for improving the system for registering credit contracts. With the changes made, the market will now be able to transact on a much more secure and faster environment to operate with credit contracts.
- Positive Credit Score: A comprehensive credit reporting database for performing customers was created in 2018. Allowing the lenders not only to access negative historical data but also positive data about previous credit transactions.
- Central Bank and CADE Agreement to Curb Anti-competitive Behavior: To enforce the changes proposed to the market, the Central Bank has special agreements in place with the antitrust agency in Brazil (CADE) to decrease the time for processes to be resolved and even be prepared before a new bill is passed, in order to make sure traditional players will respect it.

7.2. What to expect from Marketplace Lending fintechs

This set of macroeconomics and microeconomics measures presented by the Brazilian Central Bank with its innovation agenda (Agenda BC+) it is promoting a very positive outlook on the credit market that will favor SMBs to access new financial products, enabling them to unlock their full potential, this will bring a positive impact on the economy as a whole and foster the increase of the GDP. Besides that, aligned to a more competitive market, they will directly impact credit offerings with lower banking spreads and, therefore, lower interest rates. On the other side, 60% of small-and-medium businesses are going to look for alternative means for technology services, according to IDC.

At the instance of gathering these measures to promote changes, they result in a market prone to lending platforms which are able to benefit both small-and-medium businesses with easier access to capital and lower interest rates, and investors with higher yield and a diverse portfolio of companies to invest in.

The online lending market has been growing at an impressive rate of more than 300% in the past four years, even during its development period before the regulatory improvements came along. With all the economics and regulatory measures passed in recent years, and being at the top of mind of customers that now understand that fintechs offer a much better experience than traditional financial institutions, it has reached its time to scale. By gaining sustainable momentum, penetrating a considerable amount of market share and even increasing the size of the market, with new financial products that were long awaited by SMBs to unlock their full potential. During the scaling period in the next five years, it is expected that online lending platforms are going to be able to untap more than US\$ 20 billion for SMBs.



8 Appendix



8.1. Research sources

ABBC: <http://www.abbc.org.br/analiseedestaquesview.asp?idAssessoriaEconomica=1733>

Banco Central: <https://www.bcb.gov.br/>

Bank Innovation:

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Nexoos Database

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Sebrae:

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For this paper, we took in consideration the dollar exchange rate at four reais per dollar.

About Nexoos

The first regulated Marketplace lending financial Institution designed for SMBs to unlock their full potential. Nexoos disintermediates the whole credit cycle with its end-to-end Marketplace lending platform, that act as a catalyst to foster investments flows. Unlike traditional banks, the platform provides a combination of extraordinary convenience, fair prices, and the best capital for SMBs. Making it a fast and affordable process to underwrite trustworthy businesses in LATAM.

Since its inception Nexoos has acquired a customer base of more than 300.000 SMBs and 50.000 Investors (Retail & Institutional).

About LendIt Fintech

LendIt Fintech is the World's Leading Event in Financial Services Innovation. LendIt Fintech hosts annual conferences in the USA, Europe, and China. These events bring together every major fintech, blockchain, lending and digital banking companies from around the world. Professionals in the financial services industry come to learn, network and do business.