ASIC

Australian Securities & Investments Commission

# Fintech: Opportunities, risks and challenges

*A speech by Greg Medcraft, Chairman,*
*Australian Securities and Investments Commission*

*Group of 100, National Executive Dinner (Sydney, Australia)*
*14 December 2016*

## *CHECK AGAINST DELIVERY*

## Introduction

I would like to focus today on the role financial technology (fintech) is playing in re-fashioning financial services and capital markets. This is something around the world that policymakers and regulators are squarely focused on.

Firstly, I will talk about the potential impact of fintech developments – and the opportunities, benefits and risks they bring. I will then outline the challenges that regulators and policymakers face in addressing these opportunities and risks – and how we are responding.

## Fintech developments

Globally, we have seen an explosion of investment in fintech activity over the last couple of years. In the third quarter of 2016 alone, global fintech funding activity reached a total of US$2.9 billion. Roughly 40% of this is in lending, around 20% in insurance, and 30% in payments.

Technology is enabling the development of new products and services that can meet financial consumer needs more efficiently and more cheaply. Fintech is touching all parts of the financial services and markets sectors we regulate.

# The impact of fintech

New fintech businesses have the potential to bring about significant change to financial services and markets. They create opportunities for regulators, and they also have the potential to benefit the broader economy.

There are three key changes that I think will flow from the increasing pace of fintech development.

## Changes to financial services and markets

The first is empowering financial consumers and investors to take greater control over their financial affairs. Not only will consumers and investors benefit from potentially more choice and cheaper products and services, they will be able to deal directly with product manufacturers, for instance, without going through an intermediary.

The second is the real opportunity for data to be used more effectively in better understanding consumer and investor needs and risks, and designing better tailored products and services.

The third is challenging the business models of incumbents. Although incumbents are reaping the cost and efficiency benefits of technology, they will also need to reflect on their business models. This is a particular challenge for incumbent banks, especially those reliant on legacy systems. They are facing real threats to their share of customers' wallets, as start-ups increasingly offer more direct access to particular products and services at a lower cost and/or a better service

## Benefits to regulators

There are also benefits for regulators. Regulatory technology (regtech) will offer us the opportunity to better detect misconduct. Through increasing access to data and more sophisticated analytical tools, we will be able to be more proactive and pre-emptive in understanding and addressing the risks we see.

## Broader economic benefits

Fintech can also offer macroeconomic benefits for emerging economies – in particular, through increasing financial inclusion and bridging the financing gap many economies face.

A recent McKinsey Global Institute report predicts widespread adoption and use of digital finance could increase the GDP of all emerging economies by 6%, or a total of $3.7 trillion, by 2025. This is the equivalent of adding to the world an economy the size of Germany, or one that's larger than all the economies of Africa. This additional GDP could create up to 95 million new jobs across all sectors of the economy.

The opportunities include making banking available for the first time to individuals through their mobile phones. Kenya is a great example of what is possible here. MPesa, which provides access to bank accounts and payment services through mobile phones, has led to a 300% increase in the number of adult Kenyans who are ‘banked’ – with over 75% of Kenyans now having access to formal financial services.

There are also real opportunities for fintech developments to address the inability of SMEs to access the finance they need to run their own businesses – for example:

- peer-to-peer lending, providing a way for SMEs to borrow capital outside the banks (e.g. Kabbage in the United States);
- Anti-Money Laundering (AML) and Know Your Customer (KYC) requirements for correspondent banking may be simplified using blockchain – for example, by R3, a distributed database technology company. The use of a common distributed ledger for Know Your Customer processes might offer the opportunity to link many banks’ information and streamline AML and KYC. In the future, it may be possible to change correspondent banking settlements and use blockchain technology rather than bilateral correspondent accounts; and
- payments and money transfer using the blockchain, such as Stripe and Ripple.

### Risks

However, with these great opportunities, there also come risks. Greater customer and investor empowerment – without appropriate understanding of the risks of the products and services they are accessing – raises the risk of investor and consumer harm. There will be new channels through which fraud may be perpetrated both within and across borders.

We also see risks arising from the increased use of technology to capture, store and analyse data. The obvious risk here is the increased risk of cyber attacks and the misuse of data. Consumers will also want control of their personal data. Clearly, in this space, trust will be critical.  So consumers will need to be comfortable with where data is being stored, how it is being used and who it is being shared with.

## Responding to the regulatory challenge

These benefits and risks define the regulatory challenges we face with development of fintech. As I have said, I see our challenge as being about creating an environment which encourages innovation, but does not compromise the way we want the financial system to work.  This means:

- ensuring investor and consumer trust and confidence is not put at risk;
- ensuring the fair and efficient operation of our markets is not put at risk; and
- being mindful of the systemic risks these developments might pose.

So, how is ASIC responding to this challenge?  We are approaching fintech in a number of ways.  Let me outline five.

The first is engaging with start-ups in our sector. In Australia we set up an Innovation Hub to do this in April of last year. Others – including the United Kingdom, Ontario, Hong Kong, Singapore and South Korea – have done the same.

These Hubs are an opportunity for entrepreneurs – with little experience of business and regulation and few resources – to understand how regulation might impact on them. They also help us to monitor and understand developments and how we should respond.

And we feel ours has been a success. In the last year alone we've engaged with 109 different entities – robo-advisers (25), marketplace lenders (22), payment system and credit providers (17 and 11) and equity sourced crowdfunders (9). In June we opened up the Hub to regtech entrepreneurs and we'll be engaging with them in a roundtable in the new year to better understand developments.

Our statistics on the licensing of fintechs indicate that – on average, without formal assistance – it takes 205 days for a licence applicant to receive a draft licence. However, fintechs who have engaged with the Innovation Hub prior to submitting their application get approved for a licence, on average, in 110 days – or nearly 45% faster than if they hadn't engaged with the Innovation Hub.

The second initiative is creating time limited 'safe – or light touch – regulatory environments', or regulatory sandbox, in which entrepreneurs can develop and test their ideas. We are in the final stages of the proposal to launch ours.

A key feature of the proposal we put out for consultation is reducing some of the requirements we impose on those we licence (such as financial resource requirements and relevant managerial experience) for a fixed period – requirements which might be challenging for and impede start-ups.

We are working through how best to balance this relative freedom with ensuring the financial consumers and investors they access have basic protections in place. The initiative will be unique in the world, as it will provide a legal right to businesses that fit certain criteria to validate their concepts without having a licence.

This is a white-list approach as there is no ASIC review of each proposed test. By contrast, sandbox proposals in other jurisdictions involved the regulator selecting applicants and negotiating individual testing terms. ASIC is pushing its existing regulatory tools in creating the sandbox as far as we can go. We understand that, in due course, the Government may consider whether even further action is warranted in this area.

The third initiative is developing regulatory guidance about how these new developments fit into our regulatory framework. In Australia we have developed guidance on robo-advice, issued guidance on marketplace lending and on cyber resilience measures.

The fourth initiative is building our skills and systems by rethinking the way we capture, store and access data and by making greater use of analytical packages to support our investigation and enforcement activity. We are also looking to hire staff with deep data analytical experience and, importantly, the skills to understand and assess the algorithms which market participants are developing and using, including machine learning for voice and text, which we are piloting.

The fifth initiative is working with other regulators to understand developments, and help entrepreneurs in expanding their target markets into other jurisdictions. We signed MoUs with Monetary Authority of Singapore in June, with the UK Financial Conduct Authority in March, and earlier this month with the Ontario Securities Commission, which not only provide for information sharing, but also for support for our home grown fintech start-ups in accessing markets in each other's jurisdictions.

We also recently concluded an agreement focused more on sharing information about developments with Kenya.

These formal arrangements build on regular and informal discussions we are having with counterpart authorities in Europe and the United States. As the fintech space knows no geographic boundaries, as initiatives in the region take off, we will need to expand these agreements to allow us to cooperate in the supervision of fintech entities.

## Conclusion

It is fair to say that there is much potential, much activity and much excitement about the development of fintech. However, we need to be aware of the ongoing challenges this will pose for us as regulators.

My three key messages in this space are that:

- fintech has the real potential to change the face of the financial services sector and markets both here and globally;
- we are currently at a tipping point where this potential is now translating into real action; and
- as regulators and policymakers, we need to work toward creating an environment which encourages – rather than stifles – these developments.

At the same time we must do this without compromising three things which make our financial system work:

- investor trust and confidence;
- the integrity and efficiency of our capital markets; and
- the stability of the system.