Developing Asia's capital markets: Fintech opportunities, risks and challenges

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CHECK AGAINST DELIVERY

Thank you Mark for the invitation to deliver this keynote speech. Before I do, I want to congratulate you and the Asia Securities Industry and Financial Markets Association (ASIFMA) on your 10th anniversary. You have been an important and influential contributor to the regulatory debate in this region. Your thought leadership and advocacy of your members' interests has been much appreciated.

I would like to focus today on the role financial technology (fintech) is playing in refashioning financial services and capital markets in this region. I will do so through the dual lens of a financial services and markets conduct regulator and a former investment banker. I will touch on three points:

- the first is to give you a sense of the level and type of fintech activity and developments in our region
- the second is to outline the potential impact of these developments – and the opportunities, benefits and risks they bring
- the third is to outline the challenges we as regulators and policymakers face in addressing these opportunities and risks, and how we are responding.

My message today has three elements:

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

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

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

So let me first turn to the developments we are seeing in our region.

Fintech developments in the Asia–Pacific

The Asia–Pacific region has seen an explosion of investment in fintech activity over the last couple of years. Last year we saw a 400% increase in the level of financing of fintech initiatives.[1] Measured by the level investment in fintech, we now rank behind the United States and ahead of Europe.[2]

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

The Asia–Pacific region offers fertile ground for these developments:

- we have some of the highest levels of internet usage globally[3]
- we have some of the highest penetration rates for mobile phone usage globally[4]
- we have high levels of broadband access[5]
- we have some of the fastest broadband speeds globally.[6]

The impact of fintech

Let me now turn to the impact of fintech – the opportunities and benefits it brings and the risks it poses.

[1] In 2015, 153 deals financing fintech initiatives were closed in Asia, totalling US$4.7 billion – a 400% increase in the previous year. This trend has continued in to 2016. KPMG and CB Insights data reports that as at end-Q1 2016, fintech funding has reached $3.4 billion across 86 deals. Asian fintech deals and funding activity is on track to surpass the benchmark set in 2015. See Slide 75 (https://assets.kpmg.com/content/dam/kpmg/xx/pdf/2016/08/the-pulse-of-fintech-q2-report.pdf)
[2] In Q2 2016 alone, global fintech funding activity reached US$2.5 billion. US$1.3 billion of this was in North America (centring in New York and San Francisco hubs), and US$0.8 billion was in Asia (centring in China).
[3] The following percentage of the adult population in each country use the internet: Japan, 93%; South Korea, 90%; Australia, 84%; Taiwan, 84%; Hong Kong, 80%.
[4] In terms of international ranking, Singapore is first, Japan second, South Korea fourth, Australia sixth and Hong Kong tenth, with the United States ranking ninth and Scandinavian countries ranking third, fifth, seventh and eighth.
[5] Almost 50% of global fixed broadband subscriptions and mobile broadband subscriptions are in the Asia–Pacific region.
[6] South Korea has highest average connection speeds globally, and Hong Kong ranks third, Singapore eighth and Japan ninth (Scandinavian countries rank second, fourth, seventh and tenth). On average peak connection speeds, Singapore ranks first, Hong Kong second, South Korea third, Indonesia seventh, Taiwan eighth and Japan ninth.

New fintech businesses have the potential to bring about significant change to financial services and markets. They create opportunities for regulators. 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

I see three changes to our 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 more choice and cheaper products and services, they will also 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, particularly 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. These businesses will need to consider whether they invest in their own technology to provide the products and services themselves, or look for alliances with fintech entrepreneurs.

Benefits to regulators

There are also benefits for us as regulators. Let me outline two:

- 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 that widespread adoption and use of digital finance could increase the gross domestic product (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. And the potential here, particularly in South Asia, is said to be huge.

The opportunities include making banking available for the first time to individuals through their mobile phones. Kenya is a fine 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 small-to-medium enterprises (SMEs) to access the finance they need to run their own businesses. Developments in trade finance are an example of what is possible here – for example, the current practice involving (physical) letters of credit will likely be replaced by an online solution.

Further down the road, the internet of things may allow for the real-time tracking of goods, eliminating numerous process steps and reducing the risks for the parties involved.

Risks

But 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.

As I have said, I see our challenge as being about creating an environment that 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
- being mindful of the systemic risks these developments might pose.

So, how should we as regulators and policymakers be responding to that challenge? At a high level we need to be doing four things:

- The first is moving from an analogue to a digital mindset. We need to be more flexible and adaptable both to the speed and content of change.
- The second is resisting the temptation to jump too quickly or too soon. We should not be impeding developments. Rather we should be watching, engaging, understanding and acting when we see risks emerging.
- The third is ensuring that, as far as we can, our regulatory responses are technology neutral – unless there is very good reason to encourage fintech developments. We should not be creating new arbitrage opportunities.
- And the fourth is ensuring we resource ourselves to address these challenges.

And we are applying this approach in a number of ways. Let me outline five.

Engaging with start-ups

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 in the region – including Hong Kong, Singapore and South Korea – have done the same. The United Kingdom and the Canadian province of Ontario are doing 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 to decide 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 crowd-sourced equity funders (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.

Regulatory sandbox

The second initiative is creating time-limited 'safe' or 'light touch' regulatory environments – or regulatory sandboxes – 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 for a fixed periods – requirements that 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 as far as they can go in creating the sandbox. We understand that, in due course, the Government may consider whether even further action is warranted in this area.

Developing regulation and guidance

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

Building our skills and systems

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 that market participants are developing and using – including machine learning, which we are piloting.

Working with regulators in other jurisdictions

The fifth initiative is working with other regulators to understand developments in their jurisdictions and help entrepreneurs in expanding their target markets into other jurisdictions.

We signed memorandums of understanding (MOUs) with the Monetary Authority of Singapore (MAS) in June, with the UK Financial Conduct Authority (FCA) in March, and with the Ontario Securities Commission earlier this month. These 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

In conclusion, there is much potential, much activity and much excitement in this region about the development of fintech. However, we need to be aware of the ongoing challenges this will pose for us as regulators.

Our key message, though, will be to encourage these developments, while at the same time ensuring our focus on investor trust and confidence and fair and efficient markets is not compromised.