

SOUTH AFRICA LAYS THE GROUNDWORK FOR FINTECH REGULATION

FINTECH

FINANCIAL TECHNOLOGY

BY CAROLINE DA SILVA - DIVISIONAL EXECUTIVE: REGULATORY POLICY

Financial Technology (FinTech) has become an increasingly popular phenomenon, with people familiarising themselves with crypto-currencies such as Bitcoin, SAFCoin and many others. The main issue with all these currencies is that they operate in a relatively unregulated environment; thus government is unable to either track or protect consumers from potential fraud that may be associated with these platforms.

According to an article published on the official site of Moneyweb (<http://www.moneyweb.co.za/>), "the South African Reserve Bank (SARB) issued a position paper on virtual currencies in 2014. At the time, the central bank opted not to oversee, supervise or regulate the virtual currency landscape as it posed no threat to financial stability. The SARB did, however, reserve its right to change its position, should the landscape warrant regulatory intervention."

Although this seemed like a positive paradigm shift, the financial risks involved when it comes to crypto-currencies and tokens and the fact

that they are not regulated and there are no legal requirements or standardised documents for the issuer to adhere to, made it necessary for a regulatory framework to be developed.

The SARB later announced the establishment of the FinTech programme, designed to assess the emergence and regulatory implications of FinTech. FinTech is simply the process of infusing technology into financial services, which will potentially yield benefits, including improving financial inclusion, this a definition adopted by the various policymakers and key industry players in SA.

The SARB has recently decided to establish a broader FinTech programme, with dedicated full-time staff members. Although it is at an early stage, this programme will be required to strategically review the emergence of FinTech and assess the related user cases.

According to Francois Groepe, Deputy Governor of the South African Reserve Bank, "The primary responsibilities

are expected to include the facilitation of the development of refreshed policy stances for the SARB across the FinTech domain. This will be done by robustly analysing both the pros and the cons of emerging FinTech innovations as well as the appropriate regulatory responses to these developments. A critical success factor of the programme will be the ongoing collaboration with our fellow regulators".

The newly established Inter governmental FinTech Working Group, which comprises the National Treasury (NT), the Financial Sector Conduct Authority (FSCA) and the Financial Intelligence Centre (FIC), introduced its inaugural market outreach workshop. The Working Group was formed to develop a common understanding among regulators and policymakers of FinTech developments and relevant policy and regulatory implications for the South African financial sector and economy. It also seeks to develop and co-ordinate an approach to FinTech policy making in the country.



The workshop focused on the following key areas.



1. PRIVATE CRYPTO-CURRENCIES: the session aimed to gain insight from the industry on broader crypto-currency activities such as the existing and emerging use cases, the role of crypto-currency exchanges and more specific activities relating to Initial Coin Offerings (ICOs). For the purposes of this document, crypto-currencies and tokens are referred to as separate concepts.



2. FINANCIAL INCLUSION: the session aimed to achieve greater understanding of the existing and potential future impact of FinTech on financial inclusion, as well as an understanding of risks, including consumer protection risks, regulatory challenges and possible policy or regulatory solutions. Innovations such as digital identity were also discussed.



3. INNOVATION FACILITATION: the session aimed to identify learnings from the experience of other regulators that have implemented innovation facilitators and/or policy positions conducive to innovation facilitation as well as improved engagement between regulators, FinTech providers and incumbents.



4. REGULATORY AND POLICY RESPONSES: the closed session aimed to provide the IFWG and its members with the opportunity to reflect on the feedback provided by workshop participants. During the session, policymakers and regulators considered the inputs that were received. Input received from participants was contrasted to work-in-progress on respective focus areas.

According to the National Treasury, the workshop brought regulators, policymakers and industry players together to develop a 'harmonised' approach to FinTech-driven innovation and consider appropriate policies and regulatory frameworks.

The conference conceded that a robust regulatory framework would be beneficial to protect and educate investors against bad actors. Regulators have an option to either amend existing laws by changing current definitions to cater for emerging innovation or create a new overarching regulation that would cater for FinTech. To monitor the quality and credibility of issuers it was proposed that registering all ICOs with a central body would be ideal.

The workshop discussion also brought up a few regulatory issues that may be hampering South Africa's progress on financial inclusion. Two debates emerged among the workshop delegates. Both sides of the debate recognised the role that technology must play.

A tangential question was where this innovation should be sourced from. The discussion emphasised the importance of understanding the financial service needs of the currently underserved consumers. The second major issue indicated by delegates was the difficult Know Your Client/Customer. (KYC) requirements that are placed on financial institutions, assigned by global Anti Money Laundering and Counter Terrorism Financing (AML/CTF) standards that South Africa subscribes to. These approaches would require regulatory changes in whatever kind of KYC due diligence is acceptable among financial institutions.

Going forward

The market participants, in particular, were excited that regulators were taking steps toward making the environment in South Africa more enabling for innovation, showing that South Africa was indeed 'open for business' to investors and entrepreneurs looking to make an impact in the local financial market.

The discussions that occurred throughout the workshop have influenced the production of a draft policy paper which will set out the policy position on FinTech and innovation in South Africa's financial sector by 2019.

The IFWG will host another industry workshop before the end of 2018. In this workshop there will be more discussion on issues that were not covered in the first workshop. The SARB National Payments Service Department will also host its payments and innovation workshop.

The National Treasury has indicated that a FinTech framework will form part of the much-anticipated Conduct of Financial Institutions (COFI) Bill, which may also include the introduction of a 'regulatory sandbox'-type initiative to encourage innovation within a controlled environment.

One of the FSCAs priority focus area in the newly released Regulatory Strategy is understanding new ways of doing business and

COVER STORY

disruptive technologies. This will assist the Authority to understand the impact this focus area will have on the consumers by institutions. Furthermore, research will need to be conducted to inform the FSCAs position in FinTech. There are discussions with the regulatory quarters to establish innovation hubs, acceleration hubs, and sandboxes,

where financial institutions can approach the conduct authority for direction on how regulation impacts on new innovative developments and to test new innovations in a safe environment.

The fact that regulators and supervisory bodies across the world are creating 'regulatory sandboxes'

as controlled environments within which innovation can occur is evidence that they acknowledge that FinTech presents both opportunities and challenges. Some of these challenges arise in the areas of risk and regulation.

SOME FINTECH BUZZWORDS

CRYPTOCURRENCY: A digital currency that relies on cryptography to validate and secure transactions. There are different types of cryptocurrencies - bitcoin and Ether are amongst the best known.

BITCOIN: A digital - or crypto - currency that enables payment in a decentralised peer-to-peer (P2P) network not governed by any central authority or middleman.

SANDBOXING: Is a process of allowing testing of new technologies in a managed space, affording customers appropriate protection and resolution should the FinTech initiative not deliver to expectations.

INSURTECH: Inspired by the term fintech, insurtech champions the use of technology to modernise and improve the insurance business.

REGTECH: Or regulatory technology. The term refers to software and other technology aimed at helping financial services businesses comply with regulations efficiently and inexpensively, or regulators enforce rules.

BLOCKCHAIN: Software that first emerged as the system underpinning bitcoin. Also known as distributed ledger technology (DLT), it is a shared record of information that is maintained and updated by a network of computers rather than a central authority. It is protected and secured by advanced cryptography.

ETHEREUM: A type of blockchain network. The bitcoin and Ethereum blockchains differ primarily in purpose and capability. While the bitcoin blockchain is used to track ownership of the digital currency bitcoin, the Ethereum blockchain can be used to build decentralised applications. The virtual currency associated with Ethereum is called Ether.

P2P LENDING: Also known as social lending, peer-to-peer lenders run websites where borrowers can secure money directly from lenders bypassing banks.

SMART CONTRACTS: Software that runs on blockchain technology and can automatically enforce the terms of an agreement. A "smart bond", for example would automatically make interest payments to investors.

ROBO-ADVICE: Financial advice given through the use of computer algorithms. Robo-advisors, also known as online investment managers, typically invest their clients' money in portfolios made up of low cost exchange-traded funds.

KYC: Or know your client/customer. A process to ensure businesses identify and verify the identity of their clients, for anti-money laundering (AML) purposes.

