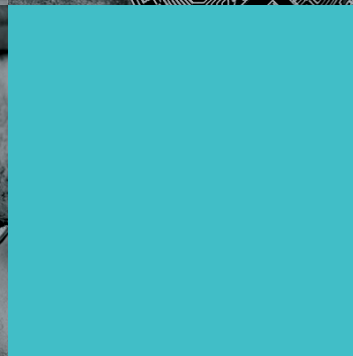
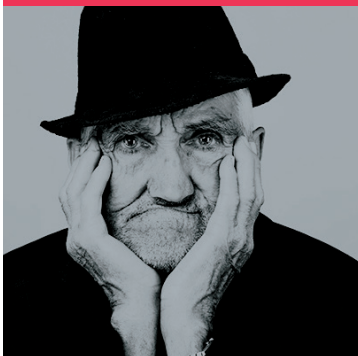


# IFWVG FINTECH WORKSHOP

19-20 APRIL 2018

INTERGOVERNMENTAL FINTECH WORKING GROUP



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# Pre-workshop note – Intergovernmental Fintech Working Group Workshop (19–20 April 2018)

## The Intergovernmental Fintech Working Group

The Intergovernmental Fintech Working Group (IFWG) was formed by members from National Treasury (NT), the South African Reserve Bank (SARB), Financial Services Board (FSB) and Financial Intelligence Centre (FIC) at the end of 2016. The objectives of the IFWG were to enable policymakers and regulators to understand, more broadly, the financial technology (fintech) developments and relevant policy and regulatory implications for the South African financial sector and economy in order that a co-ordinated approach could be developed and adopted. The overall objective was to foster fintech innovation while ensuring the continued efficient functioning of financial markets, financial stability and protecting the rights and interests of customers and investors.

## Developing a South African approach to fintech developments

The Financial Stability Board defines fintech as “technologically enabled financial innovation that could result in new business models, applications, processes, products or services with an associated material effect on financial markets and institutions, and the provision of financial services”.<sup>1</sup> Fintech can be applied to a wide range of areas, including electronic payments, automated advice, delivery channels, cybersecurity and peer-to-peer lending. It does not only refer to start-ups or new entrants, but can include scale-ups, maturing companies, and non-financial services companies such as telecommunication providers and e-retailers.

1 FSB (2017, June 27) “Financial Stability Implications from FinTech, Supervisory and Regulatory Issues that Merit Authorities’ Attention”.

These innovations present a challenge to policymakers and regulators who need to understand how to approach fintech matters so that the innovations do not create un-level playing fields or negatively affect competition. Importantly, consideration needs to be given to how customers understand and interact with innovative financial products and platforms, and what customer protection principles do and should apply in these circumstances.

Fintech does hold the potential to deliver benefits to consumers through improved access to financial products, greater flexibility, speed of delivery and service, and competitive prices. Regulators therefore need to carefully balance the risks and benefits that innovations can bring. However, regulation needs to be appropriate, proportionate, adaptable and co-ordinated across different regulators in order not to hinder innovation. According to the Organisation for Economic Co-operation and Development (OECD), the “goal for policy makers and regulators is to facilitate innovation where it has the most potential and to provide improved outcomes for consumers, to strengthen household economic resilience, while ensuring that risks are anticipated, understood and managed”.<sup>2</sup> Besides benefitting consumers, innovations also hold potential benefits for regulators, including improving interaction with regulated entities. This use of fintech by regulators, including supervisors, is referred to as supervisory technology or suptech. The use of fintech by regulated entities to meet regulatory requirements is referred to as regulatory technology or regtech.

2 OECD (2017) “Considerations for the Application of the G20/OECD High-level Principles on Financial Consumer Protection to Digital and Alternative Financial Services”.

Many countries as well as international standard-setting bodies are carefully considering their approach to fintech. The World Economic Forum (WEF) has developed key insights into innovation in financial services, including that “innovation in financial services is deliberate and predictable; incumbent players are most likely to be attacked where the greatest sources of customer friction meet the largest profit pools”.<sup>3</sup> Understanding this provides a point of reference both to financial institutions and to regulators on where innovation is likely to stem from. Given that this is a new area of regulatory focus, international developments have to be mindful of minimising duplications and overlaps in the development of international standards.

3 WEF (2015, June) “The future of financial services”.

In South Africa, further consideration is being given on how to approach fintech through a collaborative approach among regulators and NT as policymaker, collectively responsible for financial stability and soundness, market conduct, financial inclusion, market efficiency and integrity, and anti-money laundering.

## Fintech workshop overview

As part of this collaborative approach, the IFWG is hosting its inaugural fintech workshop on 19 and 20 April 2018, with the objective of providing a platform for regulators and policymakers to engage with industry, identify key considerations and develop a harmonised approach to fintech-driven innovations for the benefit of all South Africans. The workshop aims to identify risks and benefits involved in financial innovation driven by technology, allowing South African policymakers and regulators to develop appropriate policies and implement effective regulatory frameworks for specific focus areas.

The inaugural workshop will focus on three key areas resulting in three sessions plus the fourth being a closed session for the policymakers and regulators to consider their response. The four sessions are:

1. Private crypto currencies. The session will discuss privately issued crypto currencies, with reference to crypto currencies/assets/tokens such as bitcoin, ethereum, dogecoin, monero, and so on.
2. Financial inclusion. The session will not only focus on how fintech may extend financial inclusion, but on how it may be used for financial deepening and providing meaningful financial services.
3. Innovation facilitation. The session will deliberate on innovation facilitators, which is a collective term for innovation hubs, regulatory sandboxes and accelerators in the regulatory context.
4. Regulatory and policy responses, including a possible national policy on fintech will be the main focus of the session.

It is anticipated that the inaugural workshop will provide a platform for future regular engagements with industry on further focus areas such as artificial intelligence, crowdfunding, high-frequency trading, machine learning and open banking.

## Private crypto currencies

### Objectives

Crypto instruments have experienced unprecedented growth in volumes and values in addition to the emergence of new forms and uses thereof. A common understanding of the nature of these crypto instruments has not been reached as yet, since global participants such as practitioners, regulators and academia are reviewing these concepts, characteristics and terminology. The term crypto currencies, crypto assets and crypto tokens are the most general used terms when referring to these novel concepts.

The objective for the private crypto currency (PCC) session will be to gain insight from the industry/market, on broader crypto currency activities such as the existing and emerging use cases, including more specific activities relating to initial coin offerings (ICOs). In addition, further information on crypto currency exchanges are seen as integral entities when conducting crypto currency transactions. In realising these specific objectives, the IFWG will be better equipped to identify and understand the regulatory/policy challenges from an industry perspective. This will assist the supervisory authorities in the formulation of smart and appropriate policy positions and regulatory frameworks on PCCs.

### Outcomes

It is envisaged that the IFWG will gain a relevant and comprehensive assessment of the domestic crypto industry that will enable conscious policy positions and regulatory frameworks, informed by industry participants.

### Policy questions

The IFWG anticipates to address pertinent policy questions such as:

- What risks do crypto instruments such as PCCs hold?
- Is a new regulatory framework required for PCCs or are the existing policy frameworks and regulatory regimes appropriate?
- Is this area suitable for self-regulation, and if so which aspects?

- What are the implications of defining crypto instruments (tokens) as a currency/asset class/payment system?
- Should the technology, entities and/or the activity be regulated?

## Current position

During 2013, NT, the SARB, FSB, the South African Revenue Service (SARS) and the FIC issued a joint warning notice to users of crypto currencies, to warn them about the risks associated with the use of virtual currencies for either transactions or investments. Subsequently, the SARB issued a position paper on Virtual Currencies, in 2014, and this position has not changed and remains current and relevant. At present, there are no (specific) laws or regulations that specifically govern the use of PCCs in South Africa.

Private crypto currencies use encryption techniques to issue units of crypto instruments. The units that are generated are seen as tokens which can be used as a 'currency' as in the example of PCCs such as bitcoin, ether or litecoin. The PCCs are not recognised as legal tender in South Africa since only the SARB is allowed to issue legal tender, that can legally be offered as payment of an obligation and that a creditor is obliged to accept. Any merchant or beneficiary may refuse PCCs as a means of payment. Therefore, no legal protection or recourse is afforded to users, traders or intermediaries of PCCs and such activities are performed at the end-users sole and independent risk.

While PCCs can be bought and sold on various platforms, they are not defined as securities in terms of the Financial Markets Act 19 of 2012. The regulatory standards that apply to the trading of securities therefore do not apply to any virtual currencies. Other crypto instruments can also be used to represent a particular token, right or interest to an asset or utility, but has no legal value. Such can be seen through the issuance of an ICO as a means of capital raising. The legal classification or definition of such tokens is not yet defined and thus no regulatory framework exists in South Africa to regulate and oversee these instances. Collaboration is therefore required between the different regulatory authorities to define the regulatory scope of ICOs. Other activities relating to PCCs, such as services offered by a PCC 'exchange', are not within the regulatory scope and fall outside of the current regulatory mandate.

Pronounced emphasis is placed on monitoring developments in this area and authorities reserve the right to change position should the landscape warrant regulatory intervention. The SARB, through collaboration with other regulatory bodies such as the Financial Sector Conduct Authority (FSCA), FIC, SARS and NT will review the regulatory position on PCCs and develop an appropriate policy framework and regulatory regime.

## Financial inclusion

### Objectives

The objective of the session is to learn about different ways in which the South African fintech industry can extend financial inclusion and financial deepening. Risks to consumer protection should be clearly understood to ensure that financial inclusion efforts do not come with poor outcomes for customers, particularly vulnerable customers. In order to help inform possible regulatory/policy actions, the session will unpack challenges or constraints experienced by industry in seeking to extend good value financial services to unbanked and underserved citizens. This includes how industry views the role of the regulator going forward, and steps being taken to limit the potential for abuse.

### Outcomes

The session aims to assist participants 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. The outcomes of this session will feed into the closed discussion for policymakers and regulators regarding a possible national stance on fintech, including how best contribute to financial inclusion and deepening, while maintaining a strong consumer protection framework. The Global Partnership for Financial Inclusion (GPFI) principles on digital financial inclusion (available at [www.gpfi.org](http://www.gpfi.org)) provide a guiding framework.



## Policy questions

Policy questions expected to be addressed during the session include:

- How can financial inclusion be promoted through fintech by policymakers and regulators without compromising consumer protection?
- How applicable are traditional financial consumer protection measures in a fintech environment?
- Are new consumer protection frameworks required for fintech?
- To what extent should policymakers and regulators promote fintech versus creating an enabling environment?
- What steps can be taken to ensure that fintech supports competition rather than impede it?

## Current position

NT's 2011 policy paper "A safer financial sector to serve South Africa better" makes reference to the use of fintech, as it indicates that new technologies and innovative approaches that reduce costs and broaden access to financial services have benefitted and can continue to benefit previously unbanked and underserved South Africans. A NT financial inclusion policy paper, to be published in 2018, notes that any South African fintech policy should appropriately enable financial inclusion and be underpinned by financial inclusion as a key policy objective. The work of the IFWG, including the outcomes of this inaugural workshop, will be instrumental in developing such a policy approach. To ensure that the benefits of fintech innovations are properly leveraged for sustainable financial inclusion in an economy, the following policy considerations are important:

### Effective consumer protection oversight

Considerations include ensuring that financial products and services offered are appropriate to the needs of the target markets. Product approval processes should consider the average level of financial literacy and financial needs of the market they are targeting. New technologies and digital financial transactions also create opportunities for new approaches to committing fraud, and therefore attention must be paid to how best to properly guard against new types of fraud in a digital environment. Another key risk is that of digital exclusion, for certain segments of the population. Any policy supporting fintech must be aware of the risk of disenfranchising those who are digitally less-literate or who have no access to digital platforms. Financial exclusion can be driven by many factors, including lack of digital literacy, the complexity of the products and services being offered through digital channels, levels of financial experience or knowledge, infrastructure and demographics.

### Consumer education for a digital age

The Responsible Finance Forum VIII notes that, regardless of the channel through which customers access financial services, consumers need to be made aware of their rights and responsibilities in their engagement with financial service providers. Globally, there has been limited adaptation of consumer protection and financial education frameworks to the trends and challenges of fintech. Efforts to improve financial inclusion through use of fintech should ensure adequate attention is paid to strengthening customer empowerment, knowledge and risk awareness. Fintech also presents the opportunity to harness new technologies to improve consumer financial education and awareness, and this should be leveraged to the fullest extent possible.

### The role of regulation

Effective coordination between policymakers, central banks, financial supervisors, relevant regulatory authorities, financial ombudsmen and others, with responsibilities related to fintech, is key to ensuring consistent outcomes are achieved in the financial sector. Regulation has to be harmonised. Given the cross-border nature of digital services, coordination on a global scale is likely to be vital and the role of bodies such as the Group of Twenty (G20) is important in this regard.

In South Africa, the Twin Peaks model of financial sector regulation, currently being implemented, aims to put in place a regulatory framework that better responds to the dynamic nature of the financial sector, including fintech. The model places key emphasis on ensuring consistent, harmonised regulatory approaches to activities in the financial sector, such that similar activities face similar regulatory

requirements – regardless of whether the institution performing the activity is a traditional financial institution or a new fintech entrant. The approach is intended to better keep pace with changes in the sector, including those brought about by technological innovations. An example is the establishment of the IFWG, which is a positive step in driving a coordinated and consistent approach under the Twin Peaks model.

## Innovation facilitation

### Objectives

Objectives for the innovation facilitation session include learning from the experience of other regulators who have implemented innovation facilitators and/or policy positions conducive to innovation facilitation. Further, the session seeks to identify industry understanding, needs and expectations of innovation facilitation structures so as to inform policy/regulatory positions on the topic.

### Outcomes

The expected outcome is for the IFWG and its members to have updated policy positions and/or innovation facilitation policy positions which have been informed by global learnings and industry's requirements.

### Policy questions

Policy questions expected in this session include:

- Whether there is a need/demand for innovation facilitation in the South African industry?
- What innovation facilitation models and structures would the industry prefer?
- Which lessons from the international experience could inform local positions?
- Have any best practices emerged and what should be avoided?
- What is the reaction to the suggested South African models discussed during the workshop?
- How is accountability allocated between different regulators?
- Does local law allow for innovation facilitators?
- What are the eligibility criteria for obtaining assistance from innovation facilitators?

### Current position

Despite rumours and media reports to the contrary none of the IFWG members have yet implemented any innovation facilitators. The SARB announced during August 2017 that it will urgently review the need for, and appropriateness of, innovation hubs and regulatory sandboxes and take a firm decision within a year from the announcement. The SARB makes use of the Financial Stability Board's Financial Innovation Network (FIN) and Basel Committee on Banking Supervision's Task Force on Financial Technology (TFFT) working definition of innovation facilitators, which is a collective term for innovation hubs, regulatory sandboxes and innovation accelerators. The working definition was coined for a survey on the topic during 2016. The organisational design of the FSCA includes a dedicated fintech unit to facilitate the establishment of an innovation hub and sandbox. The IFWG members have seen increased adoption of innovation facilitators globally over the last two years.

The working definition of innovation facilitators describes an innovation hub as a point of contact that provides support, advice or guidance both to regulated and unregulated firms in order to help them navigate the regulatory framework or identify issues or concerns with supervision, policy or legislation. Innovation accelerators are described as partnerships between authorities, innovators/fintech firms and/or incumbent firms to 'accelerate' understanding and adoption of innovative solutions. Regulatory sandboxes are described as the use of a (controlled) testing environment to conduct live/virtual testing of new products or services, possibly through the extension of 'regulatory relief'. Regulatory relief is space provided in the regulatory framework to enable testing that would not otherwise be possible.