South African Reserve Bank

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The fintech frenzy: fad or financial sector transformer?

Ladies and gentlemen, good morning I would like to take the opportunity to heartily welcome you to South Africa: *sanibonani*.

We are certain that the deliberations over the next three days will result in robust debates and fresh insights on the financial technology (fintech) phenomenon. It's certainly a phenomenon that has attracted significant attention over the recent few years.

Given this growing interest in fintech, as well as the rapidly changing environment, I would like to focus my address on an emerging question and debate which may set the tone for this seminar: is fintech a fleeting occurrence, a fad, or is it a phenomenon that can transform financial services?

The above question is an important one. If fintech is merely a passing phenomenon, it may not warrant the kind of significant resources that are being dedicated to review, understand and manage it. This includes ongoing considerations on balancing innovation and regulation. This substantive effort is observed at both international and domestic levels, and involves all authorities within financial services. With only scarce resources and often also other serious emerging market challenges, authorities, including central banks, have to be selective over where to dedicate these scarce resources and focus their attention. We also have to ensure that we do not get caught up in the hype and frenzy of fintech; our efforts must be aligned with our respective institutions' core purpose and mandate.

On the other hand, if fintech offers the potential for addressing the very challenges that we face within financial services – such as the continually underserved or even non-served markets, inefficient or suboptimal financial market infrastructures, and concentrated provision of financial services – then directing efforts towards limiting the barriers to fintech innovation is of prime importance.

Let me now turn our attention to why some may argue that fintech is a fad and simply 'old wine in new bottles'[1].

The cynics' view: why a fad?

There is growing consensus that the crypto bubble has burst. As can be seen in the sharp drop of the price of the Bitcoin, this is indeed the case. Similar to other bubbles experienced in the past, such as the Tulip bubble or, more recently, the tech (or .com) bubble, the pattern has been the same. First, there is significant hype introduced by something novel, followed by a sharp rise in prices, an ever-increasing fear of missing out, a peak, and finally a collapse in the price, after the inherent or intrinsic value of the asset is critically appraised.

Some critics of crypto-assets point out that they are not currency. They argue that crypto assets have sharp and volatile price movements; they are not widely accepted as a medium of exchange; they have the characteristics of a sophisticated Ponzi scheme; they consume resources such as electricity, making them an environmental disaster[2]. Despite the significant efforts made by fintech players, and for all their promise, crypto-assets have yet to meaningfully shift or transform the monetary and payment systems. As a result, sentiments around fintech being a fad, are fuelled.

The recent crypto-exchange cyberattacks in Japan and other events, including the shutdown of a Vancouver-based crypto-exchange, highlight the risks and likely unsustainability of some fintech activity. The Canadian exchange was forced to close

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[1] Douglas, J L and Grinberg, R. 2017. *Old wine in new bottles: bank investments in fintech companies*.

[2] Carstens, A. 15 November 2018. Money in a digital age: 10 thoughts. Singapore: Lee Kuan Yew School of Public Policy.

after its Chief Executive Officer died while traveling in India. With him having sole access to the private keys of some US$170 million worth of crypto-assets, his sudden death left the company without access to the assets it held on behalf of its customers. This example again points to emerging alternate systems not being robust or sustainable, and being hailed as a passing phenomenon.

Fundamentally, while the decentralised nature of crypto-assets is hailed as one of their main strengths, it has also been shown to be one of their main weaknesses in what has been described as the 'distributed liability' conundrum.

A similar set of concerns has been highlighted with initial coin offerings (ICOs) that raise funds and then are discovered to be fraudulent. Last year, the Securities and Exchange Commission charged two co-founders of a purported financial services start-up with orchestrating a fraudulent ICO that had raised more than US$32 million from thousands of investors. Similar reports[3] highlight that '531 ICOs that have failed or are failing looked sketchy from the very start. These projects still raised more than US$231 million between them'.

The above examples I have mentioned notwithstanding, crypto-assets have nonetheless drawn attention to, and raised awareness of, their underlying technology, namely distributed ledger technology (DLT) or blockchains. The potential of the technology to transform financial market infrastructures and influence the issuance of central bank digital currencies is being increasingly discussed and debated. Critics, however, point to the many experiments that central banks and other authorities have been trialling, without seeing any major traction in the 'live' or production environment despite these efforts. Projects such as Ubin in Singapore, Jasper in Canada, and Stella between the Bank of Japan and the European Central Bank are being closely followed by other central banks and the broader financial services community.

You will also hear from my colleagues about the SARB's own efforts around DLT, labelled Project Khokha. Again, sceptics will point out that, for all the effort around exploring the potential of various assets or tokens on the blockchain, none of it has transformed into commercially viable products or processes. The natural conclusion is

[3] bitcoin.com

therefore that much of this is just a passing fad. DLT, like other technologies, is criticised as ‘a solution looking for a problem’.

The comparative benefits of alternative financial services ecosystems or platforms have not been demonstrated yet, which lends further credence to views that fintech is merely a passing trend. Central-bank-issued digital currencies that allow broad access to a central bank’s balance sheet for general purpose use is equally cited as a topic that has attracted much debate. However, the policy imperative, implications and unintended consequences are still largely unclear, and attention on these topics may equally pass. You will hear more from our colleagues from the Riksbank on the policy complexities of dealing with such topics and the careful consideration that central banks are giving to the impact of, for example, a declining cash base. Cynics will point to the interplay between the existing electronic payment systems, the general inexperience and lack of capacity and know-how of central banks to offer electronic retail payments, as well as the potentially disruptive effect to the two-tiered banking structure that could stall such issuance and make this, again, a ‘much talk but limited action’ passing fad.

Turning their attention away from crypto-assets, distributed ledgers and digital currencies, cynics cite that even fintech activity in payment systems, often referenced as the advancement and impact of fintech – such as paying seamlessly for ride-hailing services, booking B&B venues online, or paying for one’s coffee simply by tapping one’s mobile phone – relies on existing financial services platforms and infrastructure. But these are not examples of disruption or disintermediation of financial services. Rather, this is the leveraging of existing infrastructure. All that has morphed is the form factor – a shift, for example, from physical plastic to mobile devices. The underlying rail tracks or architecture remains the same.

In summary, the core argument from sceptics is that fintech is nothing new. It is merely innovation that is ongoing in financial services and that will continue to do so over time. New technological innovations and new form factors such as mobile devices will merely connect to long-standing infrastructure.

The proponents' view: why a financial sector transformer?

Let's turn our attention to the proponents' view.

From this perspective, fintech holds the potential to transform financial services. More generally, it has been touted that the innovation produced by fintech firms is intensely customer-centric. The innovation hones-in on customer 'pain points' and, through the use of technology, produces seamless, convenient, quick, simple, accessible, easy-to-understand, real-time and cheaper solutions. No more waiting in queues, filling in lengthy application forms, or having to provide paper-based personal information. All of this is done 'at your fingertips', in the comfort of your own space, at a fraction of the cost and time, compared to traditional solutions. What stands out from these claims is that today's innovation, unlike that of the past, is being produced by non-incumbents (i.e. fintech firms).

These are players that have typically not been long-standing financial institutions and, as part of their modus operandi and culture, are very comfortable to challenge the status quo. Why does a product or a service need to be delivered in the way that it has traditionally been delivered? Is there a better, simpler, easier, cheaper, more effective way to deliver this? These firms typically do not start with questions around the regulatory or compliance framework; they do not ask about the laws or processes that they must comply with. Rather, they attempt to solve real-world frustrations in novel ways.

What enables them is rapid shift in technological innovation, including combining new methods in unique ways. They use and combine mobile technology, global positioning systems and internet-based platforms such as social media and cloud platforms with data aggregation and analysis tools, including biometric capabilities, to produce something novel. Unlike in the past, they can scale their products and services quickly and across borders within short timeframes. From a fintech proponent's perspective, this is what is different from innovation in the past. This is equally what makes the cynics' claim that 'this time is no different' almost unpalatable to fintech proponents. Is there evidence, though, for these claims?

A cursory and anecdotal search of the top 10 or 15 fintech firms per year produces contrasting examples of fintech firms across the financial spectrum. Solutions span mobile savings wallets, new payment platforms, alternate lending models, emerging insurance platforms, investment platforms driven by robo-advisers targeted at low-income earners, and financial data aggregators that can find comparative financial products at the click of a button. To illustrate the proponents' evidence, these are but a few examples that have been presented at various global fintech outreach events. Of course, they are only illustrative and not meant to signal endorsement of any product or service. This highlights, though, the case for this time being very different.

According to thestreet.com, the following are 4 of the purported top 10 fintech firms in 2019 are in the investment, lending, remittance and payments domains.

In the investment domain, financial services company Robinhood allows customers to invest in publicly traded companies and exchange-traded funds listed on the United States (US) stock exchange without paying hefty commissions. The company, in turn, makes money from margin lending and a cash-balancing process. In a recent funding round, Robinhood raised about US$350 million at a valuation of US$5.6 billion. The service is especially popular among younger people, who admire the hassle-free stock trading, without commissions or fees.

In the lending domain, Avant provides personal loans using machine learning to evaluate borrowers' credit worthiness and establish interest rates. Launched in 2012, the company has raised almost US$1.8 billion in debt and investments. Back in 2015, it was ranked 6th on Forbes America's Most Promising Companies list.

In the remittances domain, TransferWise is one of Europe's fastest-growing fintech companies that helps its customers with a peer-to-peer money-transferring service worldwide. As a start-up, TransferWise received its seed funding of around US$1.3 million from a consortium and several individual investors as well. In 2013, Peter Thiel's Valar Ventures led a US$6 million investment round. Over the next three years, the company raised US$109 million. Last year, the company raised US$280 million. It plans to expand into Asian markets. Proponents of fintech share these numbers to highlight the potential of the technology.

Turning to the payments and investment domain, Ant Financial is acclaimed as the biggest fintech company in the world. Originally a subsidiary of the Alibaba Group based in China, Ant Financial owns Alipay (the largest mobile payment platform in the world?), Yu'e Bao (the world's biggest money market fund), and also a private credit-rating system known as Sesame Credit. By early 2017, Ant Financial had reached a US$60 billion valuation.

In summary, the proponents' perspective is that fintech should not be narrowly defined in relation to just crypto-assets or the use of distributed ledgers within a financial market infrastructure. Fintech activity spans across lending, payments, insurance and investments, as can be seen from the few examples above. Their view is aligned with the Financial Stability Board's definition of fintech: that fintech is technology-enabled innovation in financial services that could result in new business models, applications, processes or products with an associated material effect on the provision of financial services[4]. Proponents are, however, also quick to recognise that many fintech firms will fail. But numerous fintechs are going to make a significant contribution by challenging existing systems and conventions. The valuations from the above examples provide some evidence for the growth and potential impact of fintech. From this perspective, fintech is seen as a catalyst, a moderniser, and a transformer of financial services.

The South African Reserve Bank's perspective

Allow me to conclude with the SARB's perspective on the question posed: is fintech a fleeting phenomenon or a catalyst for financial transformation?

Aligned with the work of many global institutions and standard-setting bodies, such as the Financial Stability Board, the SARB and other regulators are of the view that fintech is not a passing phenomenon. Rather, fintech holds the potential to transform markets, likely leading to increased contestability and competition. There are certainly benefits,

[4] Financial Stability Board. 2017. *Financial stability implications from fintech supervisory and regulatory issues that merit authorities' attention*.

as can be seen from the cases offered by proponents, but there are equally new risks that are emerging.

In line with the elements highlighted in the International Monetary Fund's (IMF) Bali fintech agenda, there is a strong view that we should embrace the promise of fintech. We equally need to be close to the developments, monitor them, and adapt our regulatory framework and supervisory practices for orderly development and continued stability of the financial system. The ultimate aim is to safeguard the integrity of financial systems while creating enabling frameworks for innovation to thrive.

South Africa has thus adopted a balanced approach towards the development of fintech.

During 2017, the SARB established a dedicated Fintech Unit to assist with reviewing our policies and regulatory regimes that may impact on fintech. Of importance is determining if our frameworks remain appropriate and conducive to the emerging changes. The Fintech Unit has also been instrumental in co-creating collaborative structures internally, as well as with other policymaking and regulatory agencies. There is now an active Intergovernmental Fintech Working Group that comprises National Treasury, the Financial Sector Conduct Authority (FSCA), the Financial Intelligence Centre (FIC) and the South African Revenue Service (SARS). Together, we aim to cooperate and review stances on complex fintech developments such as crypto-assets, peer-to-peer lending and crowd-based funding. Importantly, we aim to collaborate on the establishment of an innovation hub. There is active work at present on the design of an innovation hub, which will comprise structures such as a regulatory guidance unit and a regulatory sandbox. These are important structural mechanisms that will progress the elements highlighted in the IMF's Bali fintech agenda.

You will hear much more about these developments from the colleagues participating in the sessions, from various jurisdictions. This is the age of platforms, collaboration and a shared digital economy. I would like to encourage all of us to take this platform created by the IMF to robustly engage, share openly and, through interaction, assist in creating awareness of any potential fads. However we equally need to surface what may be game-changing and transformational innovation being produced by fintech firms around the world. This is important so we can get the balance right between innovation and regulation, which remains our collective key challenge.

With this, I wish you well over the next three days.

Thank you.