IFWG FINTECH WORKSHOP

19–20 APRIL 2018

INTERGOVERNMENTAL FINTECH WORKING GROUP

Financial Intelligence Centre

national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

FSCA
Financial Sector Conduct Authority

South African Reserve Bank

The inaugural workshop of the Working Group will provide 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.

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Foreword

This inaugural Intergovernmental Fintech Working Group (IFWG) market outreach is a significant event for regulators of financial services in South Africa. It signals the importance of financial technology (fintech). This phenomenon has the potential to reshape the financial services industry by removing market inefficiencies. Novel solutions resulting from exploiting emerging exponential technologies such as application programming interfaces, big data, blockchain, cloud computing, distributed ledgers and emerging alternative internet-enabled platforms claim the potential to reduce frictional costs, lower information asymmetries (for consumers and providers) and decrease moral hazard. Improving overall social welfare may be one of fintech's greatest promise.

In recognising this potential, the Financial Intelligence Centre (FIC), Financial Sector Conduct Authority (FSCA), the South African Reserve Bank (SARB) and National Treasury (NT) have collaborated to ensure that this fintech potential can be fully leveraged. However, authorities are quick to note that innovation in financial services is best left to market forces and competitive dynamics. At the same time, authorities are fully aware that regulation needs to keep pace with innovation, due to equally potential risks. Regulators shoulder the responsibility to assess and manage these risks. Intermediation risks include consumer protection concerns, money-laundering considerations, general business risks which include more macro-level financial stability risks. Greater interconnectedness through growing made up of alternate financial services platforms may have impact on financial stability. Such platforms may grow quickly and may become too-large-to-ignore.

True to its nature, the fintech domain is in flux and morphing into never seen before services. The domain is complex and impacts every aspect of financial services: deposits, insurances, payments, lending and investments.

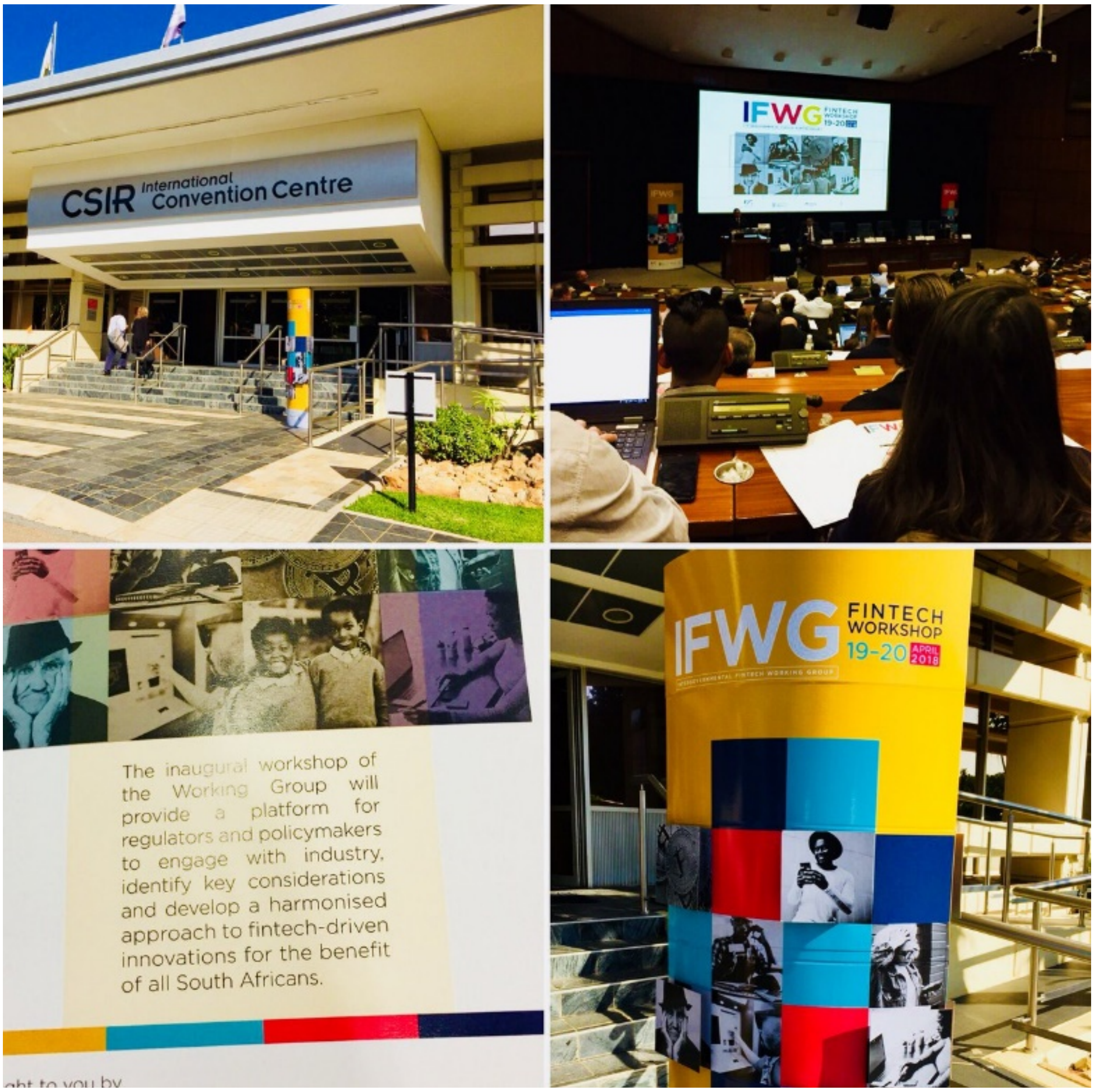
Given this complexity, the IFWG has put its focus on obtaining input on three significant topics. These include private crypto-currencies and initial coin offerings (ICOs), financial inclusion and innovation facilitators. The presentations, discussions and debates have drawn out and confirmed the major concerns and suggestions and these are well documented in this report. Your review of this report is mostly welcome and your recommendations are already being reviewed and taken into consideration.

The IFWG would like to thank all presenters, panellists and discussants for their input and forthrightness during the sessions. Without your contributions, the sessions would not have been a success. Success though is only achieved through tangible actions. For crypto, the SARB have taken the lead on this initiative and have created a working group where all regulators participate. The inputs received will be considered during the policy review process. Similarly, the support for innovation facilitators has been strongly voiced. The SARB and FSCA take this input on board.

Finally, aside from the work already in progress, there are two outcomes that will be pursued: another IFWG workshop during 2018, as well as an innovation policy framework during 2019.

With appreciation

Arif Ismail, Caroline da Silva, Kershia Singh and Pieter Smit



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Twitter photo credit: Blockchain Entrepreneurs Club South Africa (@BECSA_ZA)

Introduction

Financial technology (fintech) is rapidly transforming the financial services sector across the globe. It holds the potential to improve efficiency and reduce costs among providers, allow seamless customer transactions in real-time and can drive personalisation by improving the understanding of the needs and behaviour of customers. Fintech is being applied in a wide range of areas, including electronic payments, automated advice, delivery channels, peer-to-peer lending and cybersecurity, among others. This innovation in financial services, driven by technology, is not only being applied by start-ups, but by incumbent financial institutions and non-financial players such as telecommunication providers and online-retailers.

The infusion of technology within financial services presents significant benefits by potentially improving financial inclusion and enhancing the value of financial services to society, but creates potential risks. The opportunities for fraud and cybercrime are increasing as digital channels and products expand, and the rapid adoption of new technology by financial service providers may potentially introduce systemic and conduct risks on an ongoing basis. Financial regulators are therefore faced with the challenge of managing these trade-offs to best achieve their mandates.

South Africa's financial services sector is internationally recognised as one of the most sophisticated. In the last decade, this has been complimented by a small but fast-growing fintech community. While South African fintechs are world-class – three being listed in the 'Fintech 100' list in 2016 – many fintech start-ups in South Africa are still struggling to establish themselves. Along with an unsupportive funding environment and a shortage of entrepreneurial skills, the complexity of navigating the regulatory environment may also be a possible driver. Lack of clarity or guidance on how fintech firms fit into South Africa's existing financial regulation may be a barrier for fintech start-ups.

Some regulators in other jurisdictions are responding to this challenge by adapting their regulatory framework to include fintech firms, in conjunction with data and cybersecurity, and consumer protection laws. Some of these regulators are working closely with innovators to understand fintech developments and regulatory obstacles to innovation, and are supporting these start-ups in addressing possible barriers. Regulatory sandboxes, innovation hubs and cooperation agreements are some of the common tools the regulators are using to actively promote fintech development within their jurisdictions.

In South Africa, careful consideration is being given on how to approach fintech innovation in a way that meets the needs of the local market and to improve customer outcomes. This is being realised through a collaborative approach among regulators and National Treasury as policymaker – responsible for financial stability and soundness, market conduct, financial inclusion, market efficiency and integrity, and anti-money laundering – and private industry players. This inaugural Intergovernmental Fintech Working Group (IFWG) workshop is an important step towards achieving this objective of regulator and private sector engagement and collaboration.

Workshop overview and objectives

The IFWG was formed by members from National Treasury (NT), the South African Reserve Bank (SARB), Financial Services Board (FSB) – now the Financial Sector Conduct Authority (FSCA) – and the 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 fintech developments and relevant policy and regulatory implications for the South African financial sector and economy in order that a coordinated approach to fintech policy making could be developed and adopted. The overall objective was to foster fintech innovation while ensuring a continued efficient functioning of financial markets, financial stability and protecting the rights and interests of customers and investors.

As part of this coordinated approach, the IFWG hosted its inaugural 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 aimed to identify risks and benefits involved in financial services innovation driven by technology, the regulatory challenges faced by fintechs in South Africa, and input on the response regulators in South Africa should take to develop appropriate policies and implement effective regulatory frameworks for specific focus areas. The conference was attended by a mix of fintech firms, incumbent financial institutions, academic institutions, regulators and policymakers, and other stakeholders with a vested interest in the financial services sector in South Africa.

This inaugural workshop focused on three key areas, and the proceedings were structured into a session for each area, with a fourth closed session composed of policymakers and regulators at the end to consider inputs received. The four sessions were:

1. **PRIVATE CRYPTO-CURRENCIES[1]:** 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).
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. Input received from participants was contrasted to work-in-progress on respective focus areas.

1. Private crypto-currencies are still a relatively novel concept and therefore different interpretations and terminology have been used in the public domain. Some global standard-setting bodies such as the FSCA, prefer the term 'crypto-assets' or 'crypto-tokens'. This report uses both of these terms as reference to these financial technology innovations.


XRP

Private crypto-currencies

South Africa, like many other economies around the world, is experiencing a wave of early stages of research fuelled by blockchain innovation. The word crypto-currency is often in market jargon used synonymously to refer to blockchain, bitcoin and to describe ICOs. The importance of clarifying terminology and carefully classifying crypto-activities surfaced as a central theme throughout the workshop. For the purposes of this document, crypto-currencies and tokens are referred to as separate concepts.

Tokens and ICOs

Tokens make use of a crypto-currency's underlying blockchain platform but offer functionality over and above that of a digital currency. While there are large variations between the functions and features of tokens, there are five overarching token categories:

- Payment tokens, which act as digital currency;
- Security tokens, which derive their value from an external tradable asset;
    - Equity tokens, which are a subcategory of a security token that denotes ownership of an asset or company stock and derive their value from ownership of an underlying right;
- Utility tokens, which represent future access to a company's product or service;
- Asset tokens, which represent a physical asset or product; and,
- Reward tokens, which are similar to utility tokens and can be traded at a later stage.

In South Africa, most tokens tend to be either payment or utility tokens.

Tokens are far easier to create since they use the underlying code and protocol of an existing coin. They are distributed through a process known as ICOs or token sales, which is a form of crowdfunding for the further development of the token. Investors who 'get in early' stand the chance to gain from large profits; hence the excitement around this financial development.

ICOs or token sales are often likened to an initial public offering (IPO); but there are material differences in the two processes:

- IPOs are regulated and investors can expect companies to comply with standard documents and information, whereas ICOs are not bound by any regulation, and, although it is common for the issuer to release a white-paper that outlines key information, source code and the mechanics of the token, this practice is not yet standardised.
- IPOs involve a number of third parties performing extensive due diligence to ensure all listing requirements are met; a process that provides credibility to the investor. A stake in a company represents ownership and the value of the stock is derived from a right to a proportion of future earnings. In some cases it also represents the right to influence the direction of the company. In contrast, an investment in a token usually only grants the investor a right to the future utility of the token – the value of which is derived from the perceived future adoption of the token.

While not all members of the public may have access to an IPO, ICOs are accessible to anyone with a bitcoin or ethereum holding. A number of ICOs have taken place in South Africa, although the exact number is unknown as there is no central repository of ICOs and no requirement to report these to authorities. Notable ICOs include Newtown Partners who ran two ICOs in 2017 and also backed a crowdfunding token sale of Dala, a financial services utility token, on behalf of fintech start-up Wala. In 2017, a South African start-up, ProsperiProp, ran an ICO aimed largely at international investors looking to invest in international property, utilising a crypto-currency it created called ‘PROPX’.

Crypto-asset regulation

Crypto-currencies are not guaranteed by the SARB and investors in South Africa do not have access to any consumer recourse mechanisms or forms of regulatory protection. In its 2014 Position Paper on Virtual Currencies, the SARB states that all activities related to the acquisition, trading or use of virtual currencies are performed at the users’ sole risk. While the SARB recognised there was no significant risk to financial stability associated with virtual currencies at the time, it reserved the right to change this position as market developments changed. By virtue of the fact that crypto-currencies are not defined as a financial product or payment instrument, they also fall outside the current ambit of regulation by the Prudential Authority (which is part of the SARB) and the FSCA.

As activity in crypto-currency trading is increasing, so is the risk of exploiting these instruments for ambiguous or illegal purposes. Such innovations provide a potential platform for money laundering and the financing of terrorism, and may introduce a new set of unforeseen risks to consumers.

Crypto-currencies may offer a platform for money laundering, allowing transfers to be made directly between two individuals without requirements for identification or monitoring of transaction volumes. Participants are able to bypass the traditional anti-money laundering (AML) systems (i.e. know-your-customer (KYC) requirements) and have an extensive degree of anonymity over traditional payment methods. Crypto-currency transfers can be instantaneous and are irreversible; meaning that once a remittance is made, it cannot be withdrawn, converted or transferred. The recovery or interdict of an illicit financial outflow are impossible; exacerbated by the fact that crypto-currencies are expedient in transmitting value across national borders, free from government intervention or exchange control regulations.

Although crypto-currency transactions are not subject to KYC requirements, potentially increasing risk, the ability for crypto-currencies to be used for illicit activities was challenged during one panel discussion. Some delegates noted that crypto-currencies’ utility for money laundering was complicated as they offered no real liquidity and possessed high transaction costs. Regulators were again reminded that the potential risk for private crypto-currencies to be used to finance illicit activities was far smaller than that of cash.

A spectrum of regulatory options for crypto-currencies was discussed, including: no regulation; self-regulation; and direct regulation – including aspects of what a new regulatory framework could look like.

Many crypto-currency exchanges such as Luno called for some form of regulation, arguing that it provides the industry with clarity and confidence; attracts talent; improves data and security standards and reduces the potential for fraud – all important factors that help viable participants access funding and service providers. More detail on Luno's position is discussed in the case study alongside.[2]

2. This case study is illustrative of the complex debates held at the workshop, and is not a signal of support by regulators of any particular vendors or solutions.

Case study 1: Luno

Luno is a digital currency company with roots in South Africa, headquartered in London and with operations in Malaysia, Singapore, Indonesia, Nigeria and 35 other European countries.

Luno enables Bitcoin and Etherium storage and transactions, including buying, selling and paying through their Bitcoin wallet services. Luno serves as a platform that connects potential buyers and potential sellers allowing them to exchange digital currency. Luno does not buy or sell Bitcoin, neither does it set the rate of exchange. The company is simply the platform that connects buyers and sellers.

Luno was originally founded in 2013 under the name BitX and was an early participant of the regulatory sandbox supervised by the Financial Conduct Authority in the UK. The company is backed by Naspers, a multinational internet and media group and Balderton Capital, a European early stage venture capital investor.

Recognised as one of the fastest growing fintech companies, Luno has faced a number of regulatory challenges while setting up operations in various countries. Examples include the challenges of developing AML capabilities as start-up organisation, difficulty in securing service providers and banks, and the lack of regulation and guidance hampering the speed at which its product can be developed.

Luno's view on regulation is that the crypto-currency market would be improved with an appropriate regulatory framework; for regulation helps provide clarity and confidence, and ultimately improves the prospects of raising capital.

Note: As a neutral set of regulators, the IFWG does not promote or endorse any particular fintech firm. The above box is for information and illustrative purposes only.

Twitter photo credit: BlockStarters (@BlockStarters)

Some delegates were of the view that a self-regulatory organisation (SRO) model for regulating crypto-currency exchanges or platforms would have limited success. It would require strong controls and would likely have more success if applied to aspects of crypto-currency activity. A SRO model would be successful if SROs could only operate within a closed ecosystem; however, given the unrestricted nature of crypto-currency, this approach is unlikely to help the industry gain legitimacy.

Regulators were advised to not over-regulate during these nascent phases of development. The maturity of the crypto-currency industry was likened to that of being itself 'in a sandbox'; firms need to be given the space to experiment and try new technologies and applications without the burden and cost that regulation may impose. An example of New York State BitLicence, which required business license for virtual currency activities, issued by the New York State Department of Financial Services, was used to demonstrate the possible unintended consequences of early regulation. In this case, it was claimed that the regulation led to a large number of bitcoin companies ceasing to do business in New York State.

Many governments have nonetheless begun to regulate cryptocurrency activities in a bid to provide legal certainty and some protection to customers and investors. Japan is the largest bitcoin market, with about half of the digital currency volumes traded in Yen. As of April 2017 crypto-currencies are considered legal currency and exchanges are able to register with the Japanese financial services agency. A heist, early in 2018, that saw USD 530 million stolen from a Tokyo-based exchange raised the call for more regulation to protect users.

In Asia, South Korea is embracing strong oversight of crypto-currency trading. In a document published on 23 January 2018, South Korea's Financial Services Commission said it would only allow trade in crypto-currencies from bank accounts with clearly identified accountholders. These rules enable banks to comply with their KYC and AML obligations. In April this year, the Reserve Bank of India mandated financial institutions that fall within its regulatory purview to terminate any association and service provision to individuals or businesses dealing with virtual currencies. Investors in India will no longer be able to go through established financial institutions and transfer money from their bank accounts to their crypto-wallets to invest in crypto-currencies. In September 2017, China banned all ICO activities and ordered the closure of domestic crypto-currency exchanges.

Seven core issues that should be considered

While there seems to be no silver regulatory bullet, there are a few issues that should be considered when thinking about how to regulate crypto-currencies in South Africa:

1 **How crypto-currencies and tokens should be classified** is an important part of determining how to apply regulation. Delegates put forward a view that regulation should consider the activity and purpose of an underlying token. As tokens can perform a multitude of functions, the delegates are of the view that regulators would be ill-advised to regulate the blockchain technology. Delegates discouraged new definitions and new regulation as the technology is evolving at pace and this could make any new piece of regulation obsolete quickly. Advocacy bodies are helping to coordinate the industry and campaign for an aligned view on regulation, as discussed in the Bitcoin Foundation case study on page 12.[3]

3. Like the previous, this case study is illustrative of the complex debates held at the workshop, and is not a signal of support by regulators of any particular vendors or solutions.

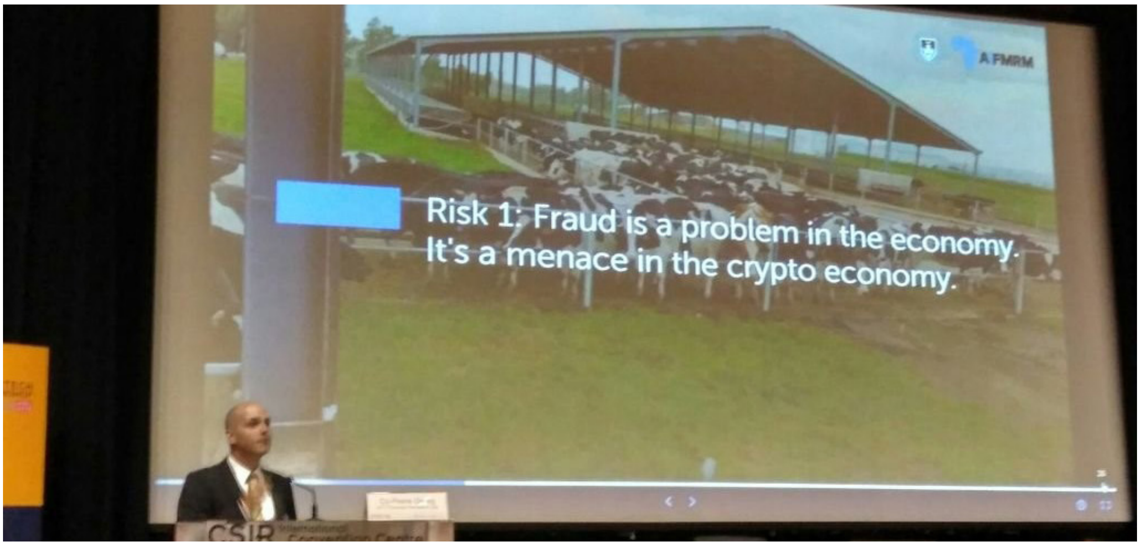
Case study 2: The Bitcoin Foundation

The Bitcoin Foundation is the first, the largest and the oldest crypto-currency advocacy organisation in the world. It is a technology project and community that coordinates the e¬fforts of the members of the Bitcoin community, helping to create awareness of the benefits of Bitcoin, how to use it and its related technology requirements for technologists, regulators, media and everyone else globally. The Foundation's vision is for Bitcoin to be a globally accepted method of exchanging and storing value which will operate without the need for third parties.

The Bitcoin Foundations objectives for 2018 were to:

- positively impact global regulatory policy and legislation around Bitcoin, other crypto-currencies and blockchain technology;
- educate the media and general public about blockchain technology, crypto-currencies (Bitcoin in particular), its benefits and how to get involved in creating the next generation decentralised financial system;
- raise the profile of the Bitcoin Foundation through speaking engagements; and
- facilitate communication and cooperation between the Bitcoin and other crypto-currency and blockchain communities, where interests are aligned.

2 **Regulation should also be proportional to the risk.** Regulators were encouraged to review the possibility of introducing thresholds. Key operational risks across the crypto-currency value chain should be identified and solved, including KYC, AML and the governance and processes around the conversion between crypto-currency and fiat currency.



Twitter photo credit: Aatish Ramkaran (@aatishZA)

3 **Consumer and investor protection is necessary.** There was immense support for the protection and education of investors. Exchanges were the most common touch-points for public investors in crypto-currencies and as such, should be accredited and regulated. It was suggested that a centralised platform, where all ICOs eligible for the South African public could be listed would be a starting point and an opportunity to standardise information flows and create a set of minimum expectations in terms of white papers published, disclosure of key information and source code. The idea of registering all ICOs with a central body was also put forward as a way to monitor the quality and creditability of issuers.

4 **Appropriate and purposive regulation.** During the workshop, the fintech firms present were calling for light-touch regulation that is clearly communicated. The South African Revenue Service (SARS) guidance note on the taxation of crypto-currency earnings was cited as a positive and effective example of communicating a regulatory position. Guidance notes defining what is considered acceptable and not acceptable in terms of ICOs were discussed as a favoured approach going forward.

Twitter photo credit: CoinEd.co.za (@Coin_Ed)

5 **Alignment and leverage of current legal frameworks versus new regulation.** South Africa has a well-established legal framework that governs the financial services industry. The role and impact of crypto-currencies was discussed in reference to the SARB Act; the National Payment Systems Act; the Banks Act; the Financial Markets Act; the Financial Adivisory and Intermediary Services Act 37 of 2002 (FAIS Act); the Financial Intelligence Act 38 of 2001 (FIC Act); tax laws; the Collective Investment Schemes Control Act 45 of 2002; and the Companies Act 71 of 2008.

Regulators have two options at their disposal: to either amend existing legislation by changing current definitions to cater for emerging innovation or to create new regulations.

Pursuing the former option requires significant coordination among regulators and there is a risk that changes to legal definitions could have material knock-on effects on existing financial instruments, products or services. While the crypto-industry is still budding, defining crypto-activities may risk limiting the extent of the regulation as the technology evolves.

Creating an altogether new piece of regulation aimed at start-ups or fintechs also risks creating a potential un-level regulatory playing field where existing or incumbent players involved in similar financial activities (perhaps using different instruments) are subject to more onerous regulation.

Some delegates at the workshop were of the view that the existing regulatory framework could sufficiently meet the needs of the crypto-currency industry. Regulators did, however, clarify that they needed to understand what they were trying to regulate, whether and how a fintech activity was covered in existing regulation, and where any regulatory adjustments were needed. Delegates discussed that these needs could be clarified through position papers or guidance notes on particular subjects.

6 **Beyond crypto-assets.** The application of blockchain technology in the wider financial services market and the impact of incumbent banks was also discussed. The South African Financial Blockchain Consortium (SAFBC) articulated some of the benefits of developing a blockchain ecosystem. These include improved convenience and efficiency, a decrease in the cost of transfers, and safety and privacy protection.

> “This is a new epoch. The changes we see may be significant and we may underestimate this revolution. It is not a given that banks or central banks may be here in the long-run.”

7 **The importance of perspective and balance, is this time different?** Crypto-currencies are often promoted as a way to transform financial services as it is known, as a way to improve inclusion and provide access to finance to the millions that are excluded. However, an important question debated at the workshop included whether crypto-currencies were an answer to financial inclusion? In providing some perspective to this question, workshop delegates were reminded that throughout history, whenever regulation is decreased or is not present, novel institutions and instruments emerge. A speaker noted that following the 2008 financial crisis, Basel III imposed additional costs on banks and possibly led to lowered intermediation activities. Fintech firms positioned themselves as a competing force to address underserved markets. As an example, ICOs have emerged as new financial instruments leveraging gaps in regulation, in the same way that credit default swaps emerged in the 1970s.

In summary, the key debates and questions posed around crypto-currencies include:

- **How to classify crypto-assets**

  The application of crypto-assets and tokens are important determinants on how to classify these instruments. It is likely that there is no single classification as there are a variety of functions and utilities provided by crypto-currencies and tokens, and when defining these innovations, one must be careful of their implication on existing assets. It may be necessary to create an entirely new definition for crypto-currencies, however, there is a danger that since the technology is still developing and applying definitions at this stage might be a risk as the innovation may evolve beyond the definitions.

- **The similarities between ICOs and IPOs**

  Although ICOs and IPOs are often compared, there are material distinctions between the two. IPOs are highly regulated with a number of third parties performing due diligence to ensure all listing requirements are met. An IPO offers investors ownership in the company; a right to a share in future earnings and potentially the ability to influence the strategic direction of the company. ICOs, in contrast to IPOs, are not regulated and there are no legal requirements or standardised documents for the issuer to adhere to. Investment in a token usually only grant the investor a right to the future utility of the token, the value of which is derived from the perceived future adoption of the token.

- **A spectrum of regulatory options (no regulation; self-regulation; and direct regulation).**

  Many of the workshop delegates agreed that an appropriate regulatory framework would provide the industry with clarity and confidence while protecting investors from bad actors. It was established that South Africa has a well-established legal framework that governs the financial services industry. 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.

- Few other issues that should be considered when thinking about how to regulate this space include ensuring that regulation is proportional and appropriate to the risk of the innovation or instrument and that the activity and not the entity is regulated, and that regulation is as far as possible technology neutral.

Financial inclusion

Although South Africa has a well-developed financial sector, the presenters in the financial inclusion section of the workshop identified four challenges that are preventing widespread access to affordable and responsibly-delivered financial services.

Financial inclusion challenges

Firstly, while the banking sector has high penetration, there is low usage of banking services among low-income consumers driven by issues of access (location, infrastructure, credit history, etc.) and cost. Most banking products remain fee-based, which is untenable for poor consumers and mobile money products have not managed to sufficiently address this cost issue. Secondly, cash remains the predominant method of payment in South Africa – some estimates are that 60% of all transactions are conducted in cash – and this reliance on cash at the bottom of the pyramid is a difficult behaviour to change. Thirdly, a strong digital divide means that poor consumers do not have access to financial innovation that makes use of technology. It is estimated that 19.4 million South Africans do not have access to mobile phones, not considering access to internet connections and data. Poor digital literacy may also be a significant barrier to accessing digital innovations. In addition, the perceived costs associated with digital transactions, for consumers and informal merchants, may also be a barrier to utilising digital services by the financially underserved.

Twitter photo credit: Langalethu (@Langa_Manqele)

> These are not good investments for unsophisticated consumers: the crypto economy is in much more trouble than the real economy, the money that has flowed in will flow out as interest rates rise.

Lastly, the emergence of some fintech innovations – with some likened to a form of shadow banking – presents new consumer protection challenges. The most contested example discussed in the workshop was crypto-currencies, the rise of which was attributed to exploiting gaps in the tightening regulation placed on the banking sector after the global financial crisis. Fraud was an area of concern given that questionable ICOs are raising tremendous amounts of money, a problem for consumers who are not financially literate and vulnerable to abuse. The price volatility of crypto-assets and lack of transparency among ICOs lend themselves to 'pump and dump' schemes. Some speakers noted that this was another area of concern for unsophisticated investors who do not have the skills to make informed investment decisions.

Finding appropriate solutions to complex problems

Given these challenges, two debates emerged among the workshop delegates: where would the solutions to these financial inclusion challenges come from; and what should these solutions look like? On the first challenge, some delegates believed that financial inclusion was about including as many people as possible in the formal banking system, while others were of the view that new players such as fintech start-ups would provide solutions. The delegates who placed their faith in the banking sector cited that working toward providing electronic payment solutions to merchants in the informal sector would later facilitate access to other services such as credit. However, others believed that the complex structure and operating models of traditional banks would never be able to adequately serve the bottom of the pyramid consumers, unless banks were mandated to offer zero-fee accounts.

Both sides of the debate recognised the role that technology must play. A tangential question was where this innovation should be sourced from – should South Africa be looking to local fintech firms to craft a solution, or should it be encouraging participation by fintech firms in other geographies through passporting arrangements to encourage competition?

Twitter photo credit: Aatish Ramkaran (@aatishrZA)

On the second debate around what these solutions should look like, the discussion emphasised the importance of understanding the financial service needs of the currently underserved consumers – is it transacting, saving, borrowing, risk-mitigation or a combination of all of these needs? Some delegates believed that more experimentation had to be conducted on savings and investment products for low-income consumers, rather than the traditional focus on credit. Other delegates advocated for a common set of principles which should be applied to all financial services designed for low-income consumers: zero-fee services offered in real-time, allowing for micropayments to be conducted across borders.

A concern was also raised among delegates whether adequate consideration was given to the use cases of new technologies and whether these use cases were well matched to the needs and capabilities of low-income consumers, given the digital divide. Although much of the workshop discussion was dominated by distributed ledger technology (DLT) and crypto-currencies, delegates expressed a concern as to whether these solutions were accessible to the bottom of the pyramid consumers. The Wala and Dala case study below describe some of the challenges and trade-offs of creating tech-enabled solutions for the financially underserved. As such, the use of other enabling technologies by financial service providers – such as Application Program Interfaces (APIs), open architecture, artificial intelligence (AI) and data analytics, and alternative credit scoring, among others – was suggested to be a more important focus for financial inclusion. Others thought that the focus should rather be on creating an enabling digital ecosystem, such as promoting access to computers and improving digital literacy, so that the financially underserved can fully participate in the digital economy.

Case study 3: Wala and Dala

Wala is a mobile financial platform that integrates the financial services from a variety of third-party service providers, including banks, on a single platform. Users can download the Wala App on a smartphone and fund their account by bank transfer, mobile money or other cash-in cash-out points. Wala performs digital KYC for the customer and provides accounts, micro-insurance, loans, bill and value-added service payments, and cross-border money transfers. Wala generates revenue through value created for its partners, for example, sharing interest revenue from loans issues on their platform or sharing transaction fees from airtime purchased on their platform.

Wala's goal is to offer zero-fee financial services to financially underserved consumers who struggle to access conventional financial services, as well as to move money across borders due to the high cost associated with operation and transaction fees. To do this, the founders of Wala established a crypto token running off the Ethereum blockchain called Dala, to enable cross-border value transfers at a very low cost. Participating in the Dala network incurs micro fees, so Wala covers the cost of these fees for Wala users. Customers can use the Wala App to purchase Dala to remit funds across borders or purchase value-added services with zero fees, and can earn additional Dala by using the app.

Wala has experienced the trade-offs of developing technology-enabled solutions for low-income consumers. In Uganda, it has partnered with a mobile point-of-sale service and e-commerce management platform for small merchants to offer their customers the ability to convert their Dala to cash. However, in South Africa, it has yet to establish a partnership with any merchant networks, meaning customers can only cash-in or out through a bank account. As such, in South Africa, Wala is currently serving the underbanked rather than the unbanked and the same issues of preference for transacting in cash apply. The other obvious issue is that Wala is a smartphone app, meaning that its use is limited to middle-income consumers who can afford smartphones. Wala has experimented with a USSD-based service in South Africa, Zimbabwe and Uganda to address this. However, converting its smartphone-based service to USSD has been difficult due to the limited functionality, and comes at the sacrifice of security which is critical to Wala's value proposition.

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Twitter photo credit: Aatish Ramkaran (@aatishrZA)

Enabling regulation for financial inclusion

The workshop discussion brought up a few regulatory issues that may be hampering South Africa's progress on financial inclusion. On the credit lending side, one presenter argued that the recent amendment to the National Credit Act was a restriction to the development of South Africa's peer-to-peer (P2P) lending industry, a form of crowdfunding with the potential to alleviate the finance gap among underserved individuals and small and medium enterprises (SMEs). The Act governs all lending activities and requires every credit provider to be registered with the National Credit Regulator. The Act was amended to include any entity that lends, regardless of the value or quantity of loans provided, meaning that each individual lender on P2P platforms had to be registered as credit providers, potentially creating a heavy administrative burden for P2P lending platforms.

The second major issue cited by delegates was the onerous KYC requirements placed on financial institutions, mandated by global anti-money laundering and countering the financing of terrorism (AML/CTF) standards that South Africa subscribes to. While the recent amendment to the FIC Act allows financial institutions to take a risk-based approach to conducting KYC, delegates still had a concern that KYC requirements were acting as a barrier to account ownership among the financial underserved. There was, however, a suggestion to investigate if unregulated fintech firms that did not have to comply with the FIC Act regulations were better able to address access among underserved consumers.

Twitter photo credit: Lucien Pierce (@lucienxp)

A common topic that emerged from this discussion was the need for digital identity to reduce the KYC compliance burden on financial institutions. A South African fintech firm, ThisIsMe Inc[6], shared its experience of using digital technology to speed up the KYC process and to avoid the need for customers to travel to a bank branch to have their identity verified. ThisIsMe uses face recognition software, machine learning, automatic address detection and verification, and APIs connected to public databases to perform customer due diligence seamlessly and in record time, with customers being able to submit information remotely through the app. The use of these technologies is not without risk – AI, for example, can be used to circumvent real-time face detection – but traditional methods of verifying a customer's identity using a physical identity document are equally prone to fraud or human misjudgement.

ThisIsMe's current solution was noted by delegates as progressive and the beginning of making use of technology to remove the barriers to access associated with KYC requirements. Two additional requirements were discussed by delegates in the South African context. The first approach would be to have a centrally-issued digital identity for all South Africans, following India's Aadhaar model where citizens' biometrics are captured and associated with a unique Aadhaar number which can be used to open accounts and authenticate payments digitally. While South Africa has since moved to a smartID system that captures biometrics, cooperation between the Department of Home Affairs and the private sector to make use of this database to authenticate identity digitally has not yet happened. The second approch could be to move away from centrally-issued identity towards federated or self-sovereign digital identity. This could either be achieved by pooling data on an individual from a variety of sources, such as financial transaction data collected by a bank or making use of Blockchain technology to allow individuals to manage their own digital identity. A presenter noted that these approaches would require regulatory changes in whatever kind of KYC due diligence is acceptable among financial institutions.

6. This reference is illustrative of the complex debates held at the workshop, and is not a signal of support by regulators of any particular vendors or solutions.

Six suggestions for regulatory consideration

In addressing these regulatory challenges and effectively making use of technology to drive financial inclusion, the workshop delegates put forward the following suggestions for regulators to consider:

1 **Consumer protection measures** for new kinds of digital assets like crypto-currencies. One presenter believed that the market conduct regulator should consider tools such as investor screening requirements or monitoring the authenticity of ICO white papers. There was significant debate among the delegates on whether such measures where necessary, with some viewing the current price volatility in the crypto market as a sign of its immaturity, similar to the price swings witnessed when global gold markets emerged, and the fact that these will reduce once the market matures.

2 **A digital identity for every South African.** One delegate argued that the key goal of regulation is to create the right market conditions for access and participation in the sector. In response, delegates were unanimous in recognising that a digital identity for every South African would level the playing field and allow all to participate in the future as new technologies become available.

3 **Open banking and APIs.** As most consumer data is held by banks, a delegate believed that mandating interoperability and open banking would have a significant impact on opening up the financial sector and encouraging innovation and competition. This includes supporting network effects by allowing fintechs to 'plug-and-play' within a more accessible payments environment.

4 **Central bank issued crypto-currency.** A presenter argued that a stable and trusted coin that does not have drastic price fluctuations could enable the many DLT use cases currently being discussed for financial inclusion (such as fractional ownership of assets, including land, and providing alternative forms of collateral to access finance). These opportunities are currently impractical due to crypto price volatility.

5 **Regulatory and private sector engagement.** The need to bring together all relevant stakeholders required to solve the financial inclusion challenges, including private sector and regulators (and non-financial regulators such as those issuing identity), was noted as critical by a number of delegates. Delegates were clear that the discussions initiated through this workshop should continue and were all in favour of a regulatory sandbox approach that would allow fintech firms to cooperate with regulators and share data.

6 **Beyond financial regulation – digital literacy and skills development.** A number of delegates noted that the challenges of the digital divide and income constraints among the financially underserved in South Africa required a broader focus than financial regulation. Education was cited as being critical – both in terms of financial and digital literacy and in terms of equipping the financial sector with the right skills for innovation – as well as building the broad ecosystem enablers such as low-cost access to computers and the internet.

A common thread throughout the financial inclusion discussion was the importance of having a clear policy objective in mind. A presenter noted that financial inclusion was not all that was required, but a means to improving the well-being of South Africans. As such, the conversation stressed that financial innovation was about more than providing people with access to financial services, but making sure that these services made a meaningful difference in people's lives. Regulators therefore have the difficult task of identifying what type of innovation best meets the objectives of improving the well-being of South Africans, and how best to encourage this innovation while keeping the financial system safe and inclusive.

In summary, the key debates and take-outs from the discussion on financial inclusion include:

The presenters and delegates identified a number of financial inclusion challenges that need to be solved:

- the high cost of, and poor access to, the formal banking sector;
- the reliance on cash as a transaction medium at the bottom of the pyramid;
- the digital divide excluding low-income consumers from accessing digital innovation; and
- consumer protection issues as some fintech firms operate outside a regulated environment.

The two key debates that emerged from the financial inclusion workshop delegates were:

- **Where will the solution to these financial inclusion challenges come from?**

  Will the banking sector or the new fintech players be able to address the currently underserved? Should South Africa be looking to the domestic industry to develop technological innovation or bring in innovation from other markets to encourage competition?

- **What will the solution to these financial inclusion challenges look like?**

  What are the key needs of the financially underserved? Are technology-based solutions appropriate for meeting these needs or should technology be used by financial institutions to deliver conventional products better?

Some of the regulatory considerations key to financial inclusion identified by delegates were:

- The need to consider the impact of consumer protection regulation, such as the NCA, on possibly stifling innovation that could aid financial inclusion, such as P2P lending; as well as balancing consumer protection concerns around crypto-currency investments with the potential for DLT solutions to drive financial inclusion outcomes.
- The importance of digital identity solutions that allow regulators to fill their AML/CTF requirements without creating a barrier to financial sector access.
- The role of interoperability and creating network effects in bringing in new players to the financial ecosystem and encouraging competition to bring about better consumer outcomes.


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Innovation facilitation

Financial services innovation, driven by technology, is happening at a pace and adoption rate not seen before. As the pace of change is rapidly increasing, the ability of policymakers and regulators to keep close to emerging trends and to create a conducive environment for innovation is being tested. However, it is too early to draw definitive conclusions on what approaches to employ and what not to, but a consensus is emerging around how regulation can 'run alongside innovation'.

> "The rules of game for the financial sector were framed when the game was played by handful of players on a desk board. Now the game is played online and in multiplayer mode."

Approaches to innovation facilitation

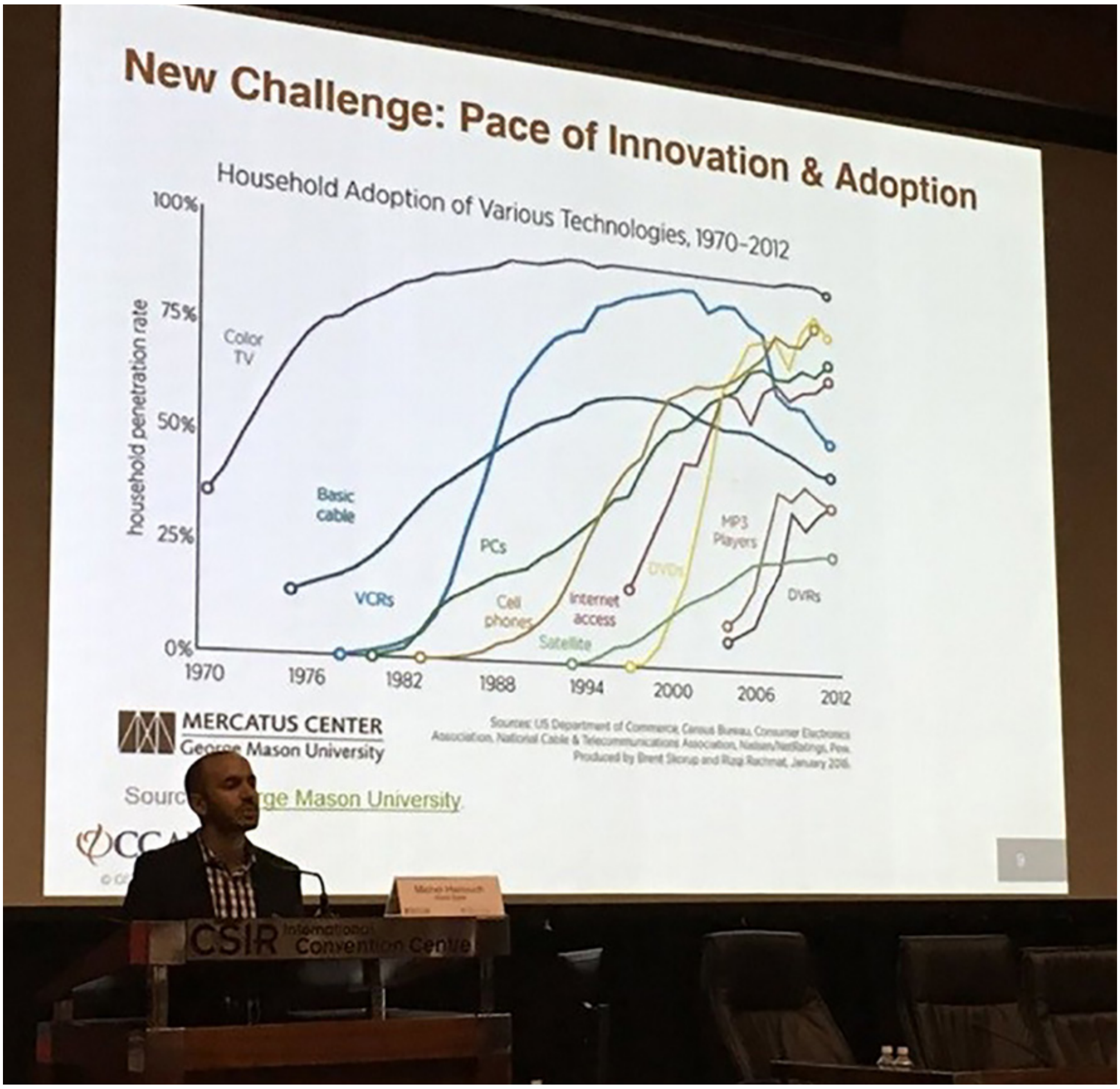
The approaches at the disposal of regulators are best viewed along a spectrum; distinguishing approaches that are more reactive from those that are more proactive or enabling. Presenting the results of research on the subject,[8] the World Bank's Consultative Group to Assist the Poor (CGAP) described four approaches along this spectrum. The first, and quintessentially reactive approach, is a 'wait-and-see' approach that delays regulatory intervention until the point at which a particular trend is fully understood. However, this laissez faire approach is not common since it potentially exposes consumers to possible conduct or prudential risks. It also runs the risk of stifling impactful innovation at the point of scale, if regulations emerge ex post facto. Hence, more enabling, but also more formal approaches are typically preferred. These range from the use of bespoke 'test-and-learn' frameworks to test new ideas in a live environment, to the introduction of tiered licensing regimes, to the use of innovation facilitators like innovation hubs, innovation accelerators and regulatory sandboxes.

8. CGAP (2017) Regulatory Sandboxes and Financial Inclusion.

Global experience

The introduction of innovation facilitators in South Africa was the focal point for much of the discussions on the second day of the workshop. Ultimately, most of the discussions focused on the kind of engagement model that is best suited to South Africa's unique context. The approach taken by the Monetary Authority of Singapore (MAS) provided a good starting point for the discussion and was dubbed as a success story in proactive regulation and industry engagement. Singapore's model is captured in the case study below.

The approach taken by the MAS was viewed as useful since it provided a view of what innovation facilitation could achieve. The MAS approach is also characteristic of the broader range of facilitation tools that regulators in other jurisdictions are deploying.



Twitter photo credit: Lucien Pierce (@lucienxp)

Case study 4: Singapore's Smart Financial Centre

Anchored on the Singapore's ambition to become a Smart Nation, the regulator developed a Smart Financial Centre framework that embraces fintech as a driver of innovation in financial services and as a source of competitive advantage for the broader economy. To date, this policy framework has nurtured the growth of 29 fintech companies operating in the wealth,

Twitter photo credit: Crypto Gran (@Crypto_Gran)

Case study 4: Singapore's Smart Financial Centre (continued)

payments, blockchain, B2B infrastructure, P2P lending and insuretech segments, among others. What is distinctive about this approach is that it is multifaceted and combines:

- a vibrant and connected fintech ecosystem that connects start-ups, tech companies, financial institutions, investors, research organisations, academic institutions and government agencies;
- cooperation agreements with international regulators, connectivity to international fintechs and partnerships with regional sandboxes and donor agencies focused on promoting financial inclusion;
- access to skills and finance for fintechs through a global fintech education centre and close linkages to start-up investment (from early through to mature stage finance);
- an open banking platform that leverages APIs to facilitate the integration of new and existing financial services technology;
- the use of regulatory sandboxes as a safe space 'of last resort' for testing innovative products or solutions whose regulatory coverage is uncertain; and
- a fintech office that provides a virtual one-stop entity for all fintech matters and coordinates various funding schemes administrated by local government agencies.

The regulator's facilitation toolkit also includes the use of industry hackathons, regular engagement in industry accelerators, annual recognition of impactful fintechs, and a series of graduated regulations to ease the growth of fintech start-ups.

Going 'glocal': tailoring international approaches to local context

Discussions around the merits of this kind of engagement approach for the South African context converged on a need for innovation facilitators and on the merit of tailoring international approaches to the local context. The discussion converged on four key lessons from global practice that are relevant for the engagement model proposed in South Africa.

Fit to local needs

Singapore's engagement approach was designed to galvanise innovation around the financial services sector and support Singapore's aspirations to be a leading financial centre. This policy objective is consistent with the structure of Singapore's local economy; where the financial services sector accounts for 13% of GDP and employs 6% of the population. The sophistication of financial services in Singapore is also reflected in the type of impactful experiments that are supported in the local sandbox; where, for example, experimentation is ongoing with interbank blockchain payments and collateral management platforms.

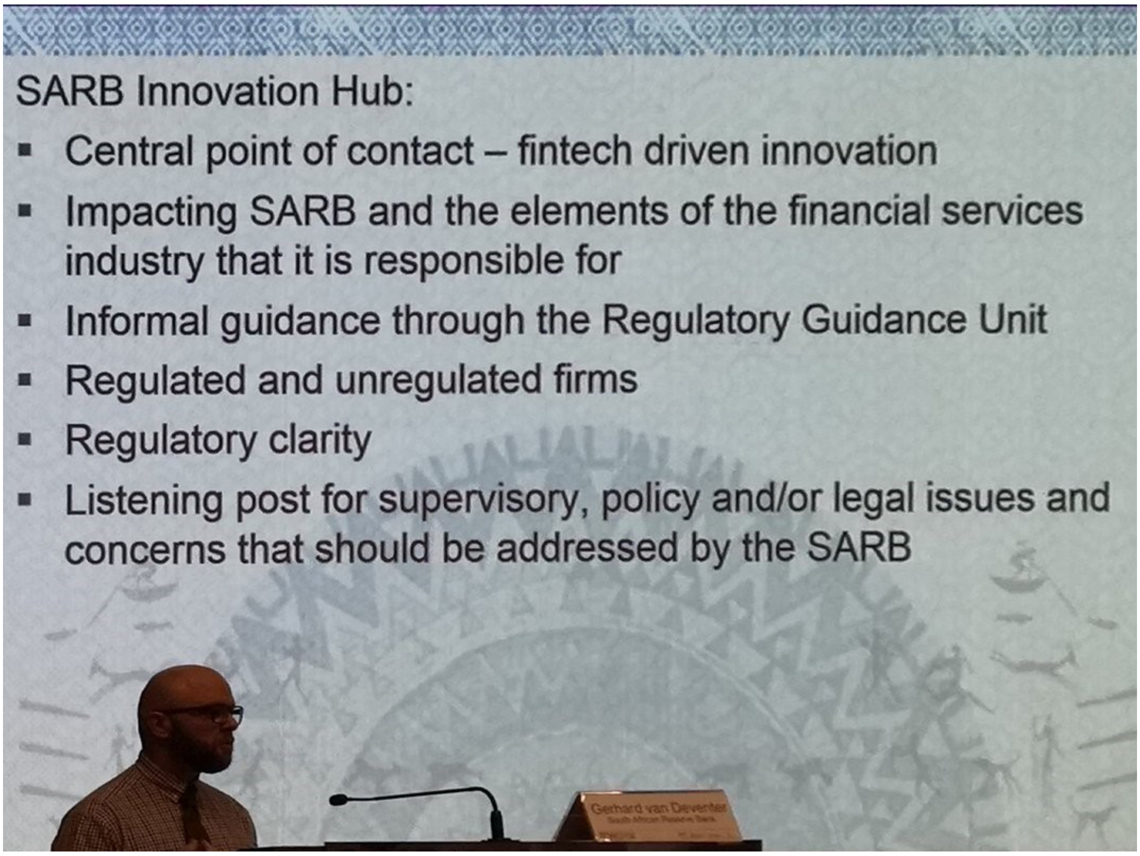
For South Africa to adopt this approach, it has to ensure that the approach is aligned to local needs and priorities. The lesson from international practice would be to build this policy prerogative into the design of the engagement approach in two ways. The first would be to leverage regulatory sandboxes for financial inclusion through appropriate segment targeting (at the testing and rollout stage, but potentially also setting key performance indicators for serving excluded customers). The second way would be to build through a preferential licensing or application regime, for providers whose solutions address inclusion.

Focus on supporting enabling technologies

What is distinctive about Singapore's approach is that it has broad coverage over enabling technology such as APIs and cybersecurity, and thematic coverage over technologies such as machine learning, big data, cloud computing, authentication and biometrics, blockchain and DLT, advanced sensors and digital and mobile payments. While the starting point of engagement with the industry is on blockchain and DLT, the regulators confirmed that the focus will shift, in time, to consider other enabling technology (such as digital identity) that has financial inclusion potential but also financial stability outcomes.

Public sector enablers and policy support

Much of Singapore's success in creating an enabling environment for fintech innovation is due to a combination of coordinated political and policy support as well as a range of ecosystem enablers that have created the necessary conditions for innovation facilitation to flourish. The key enablers include digital identity and authentication platforms, defined policy and regulation, linkages between innovation facilitators and private and public sector funding and investment opportunities and, finally, close linkages with academic and research institutions. However, since for South Africa these ecosystem linkages and public sector enablers are not in place, delegates agreed that the effectiveness of narrow innovation facilitation would be limited.



Twitter photo credit: Matt Owen (@MattOCrypto)

Sandboxes are necessary but not sufficient

The case for innovation facilitators is compelling, but a key learning from the workshop is that sandboxes are only part of the solution. Sandboxes are important innovation facilitators because they reduce the time and cost of getting innovative ideas to the market. Testing in a sandbox environment likewise facilitates access to finance for innovators. The sandbox also allows regulators to work with innovators to build appropriate consumer protection safeguards into new products and services. Regulatory sandboxes, however, have to be part of a broader ecosystem to enable innovation, including other (private sector) innovation facilitators, cross-sectoral legislative and regulatory reforms to ensure that not all use cases of fintech innovation are sandboxed, clearly defined policy objectives and targeted improvements in 'ease of doing business' indicators. Over and above these, delegates were of the view that for South Africa, other essential pre-requisites would include high-level political support, early consultation with the industry to secure buy-in, sufficient regulatory resources dedicated to implementation and strong intra- and inter-agency coordination.

Local approach

The South African approach to innovation facilitation is in its infancy, but already draws on international best practice. Following the establishment of a dedicated Fintech Unit in August 2017, the SARB shared with delegates that it was in the process of drafting a working paper that would consider how best it could support innovation in financial services. The other regulators are also in the process of doing so, with a focus on ensuring how best to coordinate regulatory efforts and to ensure alignment between innovation testing points.

Central to the SARB's draft position is a recognition that regulation has to keep pace with emerging innovation and be relevant to solving local needs. Keeping pace has two outcomes for the regulator. The first is to be able to identify, understand and manage the risks arising from innovation so as not to compromise financial stability. The second would be to ensure that the regulatory response does not hinder innovation. Said differently, the problem statement facing regulators is to find ways to safely leverage the opportunities offered by innovation to expand and deepen the reach of financial services.

In balancing these objectives, the SARB proposed three innovation facilitation tools:

1. **A Regulatory Guidance Unit** (RGU) that would provide an initial point of contact for enquiring fintech firms and to direct eligible applicants to the SARB **Innovation Hub**. The SARB proposed that the eligibility criteria for entry into its Innovation Hub would likely require demonstration of an innovative product, service, platform or business model, an understanding of the regulatory challenge, and a clear indication of consumer or industry benefit. The Innovation Hub would receive informal guidance through the RGU and provide an engagement mechanism for supervisory, policy and/or legal issues and concerns that should be addressed by the SARB or other regulators for regulated and unregulated firms.

2. Housed within the Innovation Hub would also be an **Innovation Accelerator** that would provide a space for working on, and learning about, emerging exponential technologies. It would also provide space for collaboration and testing of proof-of-concept use cases.

3. The Innovation Hub may also house a **Regulatory Sandbox** that would enable live testing of eligible new products or services within a controlled environment. Drawing on international practice, the regulatory sandbox would create a 'safe space' for live testing by possibly extending regulatory relief at the same time as enabling closer cooperation between the fintech provider, the SARB, the FSCA and any other affected consumer groups or industry participants.

Like the SARB, other regulators are also in the process of developing a position on how best to support innovation in financial services. As co-regulators of the financial sector, all regulators have an interest in ensuring that regulatory efforts to establish such structures are coordinated and where necessary integrated. As the respective regulatory positions are developed, these opportunities for coordination or integration will become clearer.

Industry reactions

The approach presented by the SARB generated a significant discussion on the second day of the workshop. Most delegates concurred that there was a need for much closer cooperation between the industry (both incumbents and fintech innovators) and regulators. Further, most delegates agreed to the need to deploy innovation facilitators to help guide new innovations through uncertainties in regulatory coverage. The fact that this feedback was near unanimous confirms a need and demand for innovation facilitation in the South African industry. It also confirms that the models and structures that are found in other jurisdictions are relevant to local industry and regulatory challenges.

The positive reaction to the regulators' proposed engagement model was not without some pushback. Indeed, most of the discussion arising after the presentation of the proposed engagement model was not about the choice or form of innovation facilitation, but on the need for policymakers and regulators to also consider other enabling conditions to allow innovation to flourish. The summary in the box below includes a series of supporting policy, regulatory and legislative reforms that would create a broader enabling environment for innovation in South Africa.

In summary, the key debates and takeouts arising from the discussion around innovation facilitation included the following:

- Delegates discussed at length the need for an overarching **national vision** and policy framework on which to anchor the proposed regulatory engagement model. Delegates also highlighted a particular need for policy to communicate a clear proposition for the country as it engages with fintech innovation, but also other innovations arising from the fourth industrial revolution.

- A possible need for **amendments to other supportive legislation** and cross-cutting regulation in order to create a conducive environment for innovation to flourish was highlighted. The most frequently cited areas of reform included KYC requirements (including FICA and RICA), labour law requirements affecting the ease of hiring skilled foreign nationality workers, tax requirements and incentives affecting investment in innovation, possibly protracted exchange control processes and requirements affecting cross-border payments and the treatment of intellectual property rights.

- Finally, the need for regulatory innovation facilitators to work closely with, and be integrated into, **existing industry structures** such as innovation hubs and accelerators, but also existing private sector technical support or financing mechanisms made available to fintech firms was also highlighted.

Regulatory and policy reflections

The closed regulator session considered the information that had been uncovered over the workshop as well as the implications for policymakers and regulators going forward. The conversation reflected three levels of delegate discussion and input:

- A philosophical level – focusing on, for example, whether crypto-currencies will challenge the current status quo and the role of emerging innovations in disrupting incumbents; and whether fintech firms should be regulated;
- A policy level – focusing on what objectives that regulation should be aiming to meet; what role regulation should play and what principles should be guiding it; and,
- A practical level – focusing on what tools should regulators be making use of to achieve these objectives.

Philosophical considerations

Regulators were in agreement that the view held by some delegates that fintechs should not be regulaed was not a tenable approach. The main discussion revolved around keeping to the principle of regulating activities rather than technologies. A continued focus on activity-based reviews would be pursued. A level playing field approach where similar activities required the same regulatory requirements would guide these reviews. However, the regulators recognised that these requirements need to be proportional to the risks involved; and more clarity had to be provided to fintech firms on how they fit into the existing regulatory framework. This will likely require a blend of existing regulation which can be amended, possibly supplemented by new regulation, where necessary. Regulators had a strong view that the regulation had to be principle-based, activity-based and technology neutral. However, some of these principles have already been captured in the Financial Sector Regulation Act, but a number of older pieces of legislation which take an entity- and sector-based approach to regulation may need to be reviewed and updated.

Policy considerations

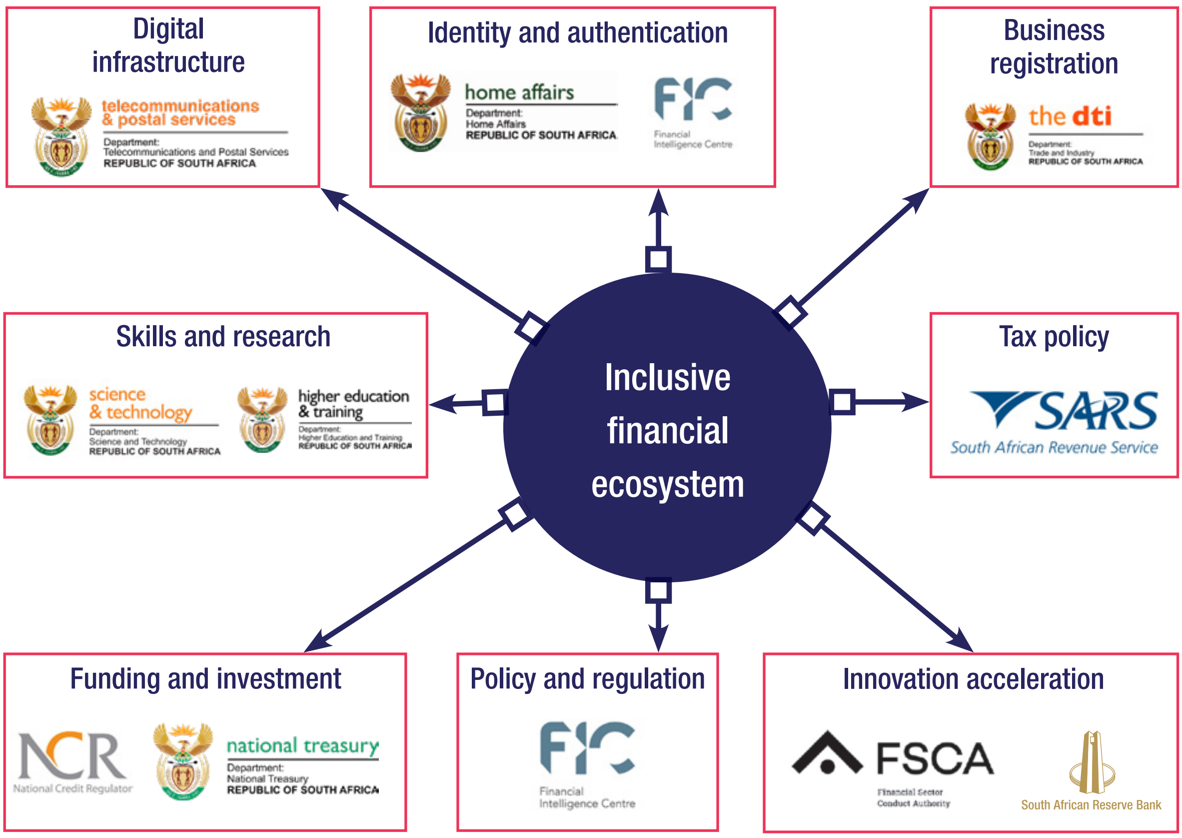
The regulators agreed that regulation needed to be crafted to address specific objectives, and that there was still work to be done on aligning these objectives among different regulators and government stakeholders. Two examples raised demonstrate the difficulty of aligning objectives on regulatory issues and forthcoming policy considerations:

- **Crypto regulation:** It was unclear as to what extent regulators should be stepping in to protect consumers and make the financial system safer, or if this would unnecessarily hamper innovation in the sector and undermine financial inclusion objectives. However, the continued focus on reviewing crypto-currency use cases jointly by authorities, including the review of risks and benefits, was confirmed to be the appropriate approach.
- **Central bank crypto-currency:** There was a strong call for a central bank-issued digital currency (CBDC) during the workshop. The regulators were of the view that while this may have a significant impact on financial inclusion outcomes, motivation for a CBDC needed to be embedded in well-defined policy objectives. As noted in a recently released note by the BIS, depending on the design of the CBDC, there may be a negative impact on financial market structure. The impact on monetary policy and financial stability has to be seriously considered.

In addition to these financial regulation issues, fintech development also touches on industrial policy issues, competition considerations and could also influence the broad structure of market. The regulators discussed the need for a broader macro-level response to fintech development, making sure that fintech regulation and support fits in to a broader policy picture in South Africa. However, this process also needs to be clear on how fintech will support South Africa's policy objectives. A concern was raised that other types of financial businesses were equally deserving of regulatory support, such as micro advisory firms or micro lenders, however, cautioned against the risk that fintech firms would receive special treatment. There was also a concern that not all types of innovation are desirable, for example, having bank branches disappear altogether might have poor outcomes for digitally illiterate consumers. Establishing South Africa as a fintech hub may entrench inequality if the innovation promoted was only accessible to relatively affluent and digitally-savvy consumers was raised as another concern.

In achieving this coordination and common agreement on objectives, it is critical to bring all the relevant stakeholders into one room. Through this workshop, the IFWG has already achieved good momentum, but continuing this dialogue and coordination among regulators, on an ongoing basis, is critical. Furthermore, including a broader set of policymakers and government stakeholders within the IFWG and beyond the financial sector is important. For example, the development of digital identity would be a huge aid to the work of the FIC, but this necessitates working closely with the Department of Home Affairs. For the fintech sector to grow, the development of basic digital literacy skills for consumers and advanced technical skills for the industry is essential. Similarly, for all consumers to be able to take advantage of these innovations, broad investments in digital infrastructure is needed. The figure below shows a selection of these cross-cutting ecosystem enablers, mapped to some of the government agencies responsible for their development.

Figure 1: Ecosystem enablers



Practical considerations

On a practical level, the regulators agreed that it was critical to find an effective way of engaging with, and monitoring fintech firms, as the industry is currently opaque, and a number of fintech firms do not understand what regulations apply to them. There are a number of misconceptions around what regulations fintech firms have to subscribe to – particularly if their service is based on blockchain or crypto-currency technology. Some of the suggestions put forward to achieve regulatory engagement are listed below:

Information portal

Delegates noted that the IFWG did not have a web presence or dedicated information portal where fintech firms could access information on regulatory support and guidance.

Directory

Some kind of self-announcement mechanism where fintech firms could disclose their operations to regulators, and the regulator could decide if they need to collect more information or not, could be useful for gaining a view of the industry. However, fintech firms may need an incentive for self-reporting, such as entry to an innovation hub or regulatory sandbox. The request by industry for a fintech directory seems to be aligned to the intent of the RGU process within SARB's innovation hub.

Licence

As an alternative to a directory, a base fintech licence with very low entry requirements might work since a number of fintech firms were willing to comply with regulations. A basic licencing scheme would legitimise a fintech's business and provide regulators with an easy channel of communication. However, this could create a risk of unlevel playing fields and a false sense of compliance.

Innovation hub

An innovation hub would provide fintechs with the incentive to declare themselves, and the added benefit of feeding data back to regulators. It would also be an easier way for regulators to keep up to date on technological advancements, given the pressure for regulators to hire people who have engaged with, and understand fintech. It would also be important to consider how a regulatory innovation hub connected with the number of industry hubs that had been developed, and how multiple regulatory innovation hubs could possibly be avoided.

Inter-regulatory fintech unit

Beyond the IFWG, there was also a suggestion for how to create a single point of entry into regulatory fintech units or innovation hubs and sandboxes. This would help by identifying a dedicated point of institutional contact that companies could have with the regulators, and would reduce the likelihood that regulators with overlapping mandates would provide contradictory guidance.

Overall, the regulators in the workshop recognised the importance of being clear on which objectives these tools were meant to address – is it gaining a view of the market, collecting data, assisting fintechs?

The second practical issue that the regulators addressed was how fit for purpose South Africa's existing legislation and regulations were. The general view was that the future legislative framework under Twin Peaks could be used, questioning whether a new regulatory framework was necessary. This is particularly so given the regulatory architecture shift to activity-based rather than sector-based regulation, meaning that a specific regulatory framework for fintech firms would not be required. In the interim period, existing sectoral laws could accommodate fintech firms by making amendments or issuing clear guidance on how these existing laws apply. Some of the suggestions on what amendments needed to be considered are listed below:

Banks Act

At present, the Banks Act provides a broad definition of deposit-taking and limits this to the business of banks, with potentially high entry requirements. A number of countries, including the UK, India and Switzerland, have created a tiered bank licencing model with lower prudential requirements, but limits on the size of transactions,. There may be scope for allowing this through the Cooperative Banks Act 40 of 2007 or the Mutual Banks Act 124 of 1993 – Bank Zero has recently used the mutual bank model to secure a mutual bank licence rather than a banking licence in terms of the Banks Act.

AML/CFT

To cover fintechs dealing in crypto-currencies but making cross-border payments or converting cryptos to fiat currency, a suggestion was made to extend the definition of accountable institutions under the FIC Act, to all entities, and then regulate on an activity and principle basis.

FAIS and FMA, CISCA or NCA. The FSCA has already conducted an extensive investigation to determine under which regulations crowdfunding platforms would fall. The outcome was that, FAIS should apply to their activities, but there is also potential for these activities to be covered by the Financial Markets Act, the Collective Investment Schemes Control Act or the NCA, if it is debt based. This would require careful amendments and explicit guidance to ensure that regulation is proportionate to the risk.

Twitter photo credit: Co-Pierre Georg (@co_georg)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Conclusion and next steps

The delegates at the workshop unanimously considered the inaugural IFWG workshop a success and a critical milestone for the development of South Africa's financial services sector.

The market participants and fintech firms present noted how fortunate they felt operating in a market where regulators were open to dialogue and were interested in hearing their views and challenges on regulatory issues. All agreed that the positive momentum generated by this inaugural workshop needed to continue on an ongoing basis, and the private sector was looking forward to being provided with more opportunities for dialoguing with regulators.

There was a sense of excitement throughout the workshop on the market-leading innovation that is taking place within South Africa, adding credence to the notion that South Africa remains a world-class financial hub in Africa. 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.

These sentiments were matched by the recognition that this inaugural workshop was just the beginning of this journey, and the issues discussed were only the beginning of understanding how fintech wass shaping South Africa's financial sector, and how regulation needed to adapt. In particular, a number of delegates noted that the conversation was dominated by a discussion of DLT and crypto-currencies, but that fintech was about a much broader application of technologies to financial services. The expectation was that many more workshops and engagements would be held to cover a fuller spectrum of fintech issues going forward.

The workshop was marked by constructive debates on a variety of issues, often with the only no consensus as the conclusion. The novelty of technological innovation and rapid pace of change within the fintech industry meant that ideas about how fintech could be used and should be regulated were not tried and tested. Even among market participants that understand and work with new technologies, there was significant debate on the meaning of technical concepts and their application within the market. This signals the complexity within many topics. There was similarly a wide spectrum of views among delegates on regulatory issues, from whether there should be regulation at all to what form the regulation should take. Among the policymakers and regulators, clear objectives of how fintech development supports South Africa's policy mandates remains to be determined.

A common theme running through the workshop was the need for building an inclusive financial ecosystem so that all South Africans could participate in and enjoy the benefits of financial innovation. Achieving this would require including, in the discussion, a broad array of stakeholders that have a vested interest in and influence over key ecosystem enablers. This would go beyond the set of financial regulators to all stakeholders in South Africa with a hand in improving education, international collaboration and digital infrastructure, among many other ecosystem enablers.

Singapore's experience of building a world-class fintech hub evidences the volume of challenges faced along the journey: getting different regulators to work together is difficult, incorporating the views and dynamic interests of the industry is challenging, and there will be many 'failure points' along the way.

The advice was simple: start small and be willing to fail quickly – the same kind of advice that is given to many fintech start-ups. Evolving technology requires regulators to adopt a similarly agile and responsive approach.

Two clear next steps emerged from the inaugural IFWG workshop:

1

The IFWG aims to produce a draft policy paper setting out the South African policy position on fintech and innovation in the financial sector by early 2019. The paper will take into account issues raised at this workshop and other workstreams underway.

2

The IFWG aims to host at least one other industry workshop by the end of 2018. The workshop will cover areas not discussed in the inaugural workshop. It is noted that the SARB National Payments Service Department will be hosting a payments and innovation workshop in August, the outcomes of which will similarly feed into the IFWG and so the second workshop will also not need to cover those issues.

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