

WHITE PAPER

Fintech in APAC - The Virtuous Circle

How regulatory and financial institutions are
bringing the fintech ecosystem together.

Asia-Pacific is a hotbed of fintech (financial technology). According to a report by IDC Financial Insights, 16 of the top 100 fintech vendors which gain more than a third of their revenue from financial institutions—and four of the top nine—are based in the regionⁱ.

Meanwhile, data from CB Insights shows venture capital investment in the sector had by the end of July last year reached USD9.62, outstripping the US's USD4.58 billion in the same periodⁱⁱ.

As in other regions, much of the talk about fintech focusses on its potential to disrupt conventional banking. Yet over the past few years there have been no signs—and no single instances—of banks disappearing due to tech interlopers.

Spinning the yarn

However, the rationale for fintech's emergence is more nuanced than this, according to Chris Foye, manager, market planning, at Lexis Nexis Risk Solutions:

“When the 2008 financial crisis hit and some banks started to restrict lending, small businesses were impacted along with other segments of society. This unmet market need coincided with changing customer expectations (i.e. customers were increasingly using digital channels) thus reducing the need for ‘bricks and mortar’ infrastructure,” he notes.

Indeed, in countries where the penetration of smartphones and even some social media is greater than that of conventional banks, fintech will be the financial system—the entire banking infrastructure—rather than an adjunct to it. And individual firms have the potential to be all, or part of that ecosystem.

“There are ‘challenger banks’ which have emerged in the UK and elsewhere to disrupt big banking institutions, crowdfunding/P2P, payment processors and lenders,” says Foye. “Then there are fintechs more focussed on the applicability of technology like blockchain, artificial intelligence, and biometrics, etc. Blockchain has attracted a lot of interest given its potential to serve as an immutable universal ledger.”

In terms of regulating such technology, according to John Price, fintech commissioner at ASIC (the Australia Securities and Investments Commission) the main aim is not only to supervise, but also to facilitate. For Price, “a key challenge is how to encourage and regulate digital disruption at the same timeⁱⁱⁱ.”

This is a valid concern, Foye believes: “There is concern within the industry that such a rapid pace of innovation could come at the cost of consumer protection. Moreover, some fintech companies are not adhering to the same regulatory/compliance standard of traditional banks.”

But there are solutions at hand, as he adds: “Banks themselves who have an intimate knowledge of the regulation and compliance obligations relating to their business have established innovation labs to experiment with new technologies and assess their applicability and suitability.”

Tying the strands together

On the regulatory front, the concept of a ‘sandbox’, wherein usual regulatory requirements for financial services firms are relaxed to allow them to experiment, has become the most popular approach. It has been deployed by regulators in Australia, Hong Kong, Singapore, and elsewhere in APAC.

“This concept is beneficial in several ways. Sandboxes can reduce time to market, provide greater choice to consumers and ensure consumer protection is factored in. Sandboxes also allow fintech companies to gain a better understanding of what is expected of them in terms of regulation and compliance,” Foye explains.

Indeed, when Indonesia outlined its fintech regime, including a sandbox, it said its objective was to “prioritise consumer protection and seek to integrate the application of technology across banks, non-bank financial institutions and capital markets^{iv}”.

As well as developing financial services, the sandbox concept can support regulators in doing their jobs, with HKMA (the Hong Kong Monetary Authority) saying its Fintech Innovation Hub, ostensibly set up to host “proof of concept trials”, could also allow the Authority to “explore the use of emerging technologies to enhance the efficiency and efficacy of the HKMA in discharging our duties”^v.

Nonetheless, Foye concurs: “There are other benefits worth noting like allowing regulators to understand new technologies and new business models which could impact how they regulate going forward. Some technologies are not easily understood thereby making it hard to gauge what regulation, if any, is required.”

Providing APIs (application programming interfaces) is another way regulators have sought to promote financial technology. MAS, when launching its first set of set of APIs, said the 12 data sets would allow financial institutions to benchmark themselves against peers, reduce the cost of data entry, and easily “automate the extraction of MAS data and illustrate trends”^{vi}. South Korea’s Financial Services Commission, meanwhile, announced earlier this year it will provide an API as part of its ‘open fintech platform’^{vii}.

The end objective is the same whatever the route, according to Foye:

“The emergence of fintech should be embraced as it promotes financial inclusion, targets segments which have been ‘de-risked’ and provides greater choice for the consumer.

“However, there is a need to ensure consumer rights are upheld and fintechs adhere to the same regulatory/compliance standards as the rest of the industry to ensure new risks are not introduced that undermines the integrity and stability of the financial system”.

Completing the circle

Indeed, just as regulators in APAC are casting their eyes towards the future role of technology in their financial systems, they are also increasingly looking at how it can actually improve their ability to perform their functions with greater incision.

Concepts such as big data, natural language processing and artificial intelligence are now commonly expected to play a key role in regulation—and meeting regulatory requirements—itsself, particularly in areas such as KYC.

On the first front, big data is increasingly used to gain a more complete picture of customers by trawling, and grouping together, disparate pools of data before extraneous, duplicated or multiplicated information is discarded.

Ultimately, this single picture of a customer from their deposit accounts, credit cards, home loans, insurance policies and other financial services provided by the same bank, saves KYC costs for the institution, and has potential commercial benefits in terms of identifying what to sell and whom to sell it to.

“Many financial institutions are taking this a step further through collaboration,” notes Foye. “In particular, this is happening in KYC where current processes are very time and resource intensive. FIs are recognising that matching headcount to the regulatory burden and customer volume is not a sustainable model and so they are looking at ways to derive efficiencies without compromising regulatory obligations.”

One way of doing this is through a shared utility, which can increase efficiency through standardised KYC, scrutinising big data inputted from a range of institutions, without the need to increase headcount.

Asia Pacific authorities are giving this opportunity much more credence, even to the extent of utilising government technology infrastructure and databases—Indonesia recently opened its national ID card database up to financial institutions; India is considering a similar move with its ‘Aadhar’ data; and Singapore has trialled a national KYC utility based on government-operated digital identity service MyInfo^{viii}.

“Utilities promise to provide the efficiencies FIs need—a degree of standardisation across the KYC process and a superior customer experience as the speed of on-boarding will increase and customer friction will reduce as customers will not be asked to provide the same documents to multiple institutions,” explains Foye.

Furthermore, financial technology can be extremely useful to regulators themselves—it should not be forgotten that they are facing a similar, if not greater, data burden than those they regulate.

With the use of big data analytics, banks can analyse their trends in compliance, cooperate with other financial institutions which do the same, and then present a market-wide picture of compliance to regulators so they can more completely understand areas of stress in the financial system, better-target their system-wide compliance monitoring/surveillance, and even inform how they should frame regulation itself.

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For more information: Visit <http://www.lexisnexis.com/risk/apac> or call

Toll free numbers

Singapore: 800 120 6351

China: 400 120 2848

Hong Kong: 800 964 868

Malaysia: 1800 817 621



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