Global regulation of FinTech

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Introduction

Earlier this year, MinterEllisonRuddWatts was approached by the New Zealand Treasury, as part of its review of the Reserve Bank of New Zealand Act 1989, to prepare a Report on approaches to regulating FinTech in other jurisdictions. Our firm was chosen as the external adviser for this project because of our established strength and reputation in the area of FinTech.

Our Report *Regulation of FinTech: Jurisdiction Analysis* (Report) is available here.

We welcome the Treasury's proactive approach in its consideration of the ways in which good regulation can lead to good outcomes for both FinTech businesses and their customers. In this note, we summarise some of the findings in our Report.

Jeremy Muir
Partner

What is FinTech?

In the Report, we adopted the Reserve Bank of New Zealand's definition of FinTech as "technology-enabled innovation in financial services that could result in new business models, applications, processes, or products with associated material effect on provision of financial services."

The nature of FinTech businesses means that there are numerous legal frameworks that apply in respect of their business. In addition to financial services regulations, businesses must also navigate other relevant regulated areas such as AML/CFT, data storage, privacy and IP.

Technology also makes it easier for FinTech businesses to cross borders easily. This means, however, that in addition to domestic regulation, they will also need to navigate a new set of laws and rules in each new overseas jurisdiction they enter.

What we looked at:

The countries we looked at for the Report were:

- Australia
- The United Kingdom
- Ireland
- Canada
- Hong Kong
- Singapore
- Estonia

This was not intended to be globally comprehensive.

A full analysis of a wider or an alternative selection of jurisdictions would increase the complexity and scope of the Report. However, we did take note of some key FinTech developments within other jurisdictions or across jurisdictions that are not the direct focus of the Report.

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New Zealand's current approach to FinTech

New Zealand can benefit from its small size and open market by providing an attractive environment to develop new products. However, New Zealand needs to better signal its commitment and engagement to FinTech to compete with other small open markets such as Singapore or Estonia that are currently more proactive.

We do not yet have Government-led sandboxes or innovation hubs to engage with businesses. We also heavily rely on international engagement and need to engage more deeply with other countries to align with them and provide greater ease of access to exporters and investors.

Here's a brief round-up of some New Zealand activity to date:

Public Sector

- There are no Government-led innovation hubs or accelerators specific to FinTech.
- State-owned Kiwibank, along with private sector participants, founded and sponsor a FinTech Accelerator Programme, that provides a working environment and start-up capital for new businesses to develop in the FinTech sector.
- Callaghan Innovation is a Government innovation agency that helps with general technology and product development, and can assist with experts and R&D funding.
- In addition, there are a number of other government agencies that provide different support services for businesses including New Zealand Trade and Enterprise, Ministry of Business, Innovation and Employment, Te Puni Kōkiri, and the Ministry of Foreign Affairs and Trade.

Private Sector

- The New Zealand Financial Technology Innovation Association (FinTechNZ) is a FinTech industry working group. It is funded by its members who come from across the FinTech sector and include financial services providers, technology innovators, investor groups, government regulators, and financial educators. FinTechNZ has also recently adopted the FinTech Regulatory Roundtable, set up by a number of interested private sector and regulator parties, to work on legal issues and roadblocks for FinTech.
- There are a number of additional incubators that support startups and established businesses.

What are New Zealand's options?

In the context of FinTech, prudential and conduct regulation tools and methodologies often cohabit within sandboxes, innovation hubs and new rule making. In many of the jurisdictions surveyed in the Report, there has been a focus on conduct regulation. In our view, the two must be examined together and changes introduced in a coherent and consistent manner.

The Report identified and surveyed a number of common approaches for the regulation of FinTech globally. It also identified that, of the jurisdictions assessed, most had moved towards a technology-neutral approach that regulates types of activities rather than specific institutions or models of delivery.

In developing options for New Zealand, it will be important to consider the costs and benefits of each in how they address the specific objectives.

Although the Report was not a comprehensive analysis, we identified four key approaches to FinTech regulation:

Adjusting the perimeter of prudential regulation (broadening or narrowing)

One approach to regulating FinTech is to adjust who is subject to prudential regulation and how they are treated. Regulatory oversight can be adjusted to deal with the risks that are most relevant to New Zealand.

Broadening the perimeter could mean expanding the types of activities that are regulated, for example by amending existing provisions to become technology-neutral in order to deal with FinTech businesses that are not provided by traditionally regulated market participants. In some areas, such as the regulation of virtual assets (from cryptocurrencies to security tokens), imposing clear and well-judged regulation may help robust and well-run businesses to flourish.

Narrowing the perimeter could be helpful where FinTech businesses already meet considerable compliance obstacles, for example complying with strict AML/CFT rules. Regulators could revisit, in some cases, whether existing rules are overly restrictive for certain FinTech businesses and create disproportionate costs to the risks that are posed. Regulators may also consider whether different levels of regulatory compliance may be appropriate, rather than a binary (all or nothing) approach. For example, Australia allows the creation of digital banks with restricted licences that do not require the same level of capital.

Flexibility is key. Regulators are likely to benefit from the power and discretion to “call in” or “exempt out” activities and businesses.

Regulatory sandboxes

In some respects, a sandbox is simply an example of narrowing the regulatory perimeter to dis-apply more onerous rules in certain cases. It is the creation of an alternative reality, where FinTech businesses can test the worth of their ideas more cost-efficiently and with fewer restrictions, and where regulators can experiment with prudential and conduct settings that may later evolve into the broader market. Regulators can gain experience with FinTech business models and understand risks, using this knowledge to produce guidance or publish exemptions in respect of the wider regulatory regime.

Sandboxes are also clearly being used as marketing tools in the race to be the destination of choice for smart FinTech businesses. In addition, they serve networking and knowledge-sharing purposes (where they cross over with innovation hubs, incubators and accelerators, as discussed below).

In a small and (relatively) lightly regulated jurisdiction such as New Zealand, where access to law makers and regulators is (relatively) straightforward, the need for a formal sandbox may be less. However, it is a tool that is available and should be considered carefully for New Zealand.

In designing the sandbox, global best practice suggests that flexibility is key, and that it should be open to a cross section of businesses, both start-ups and incumbents, that trial periods should extend as long as it remains beneficial for the parties, and processes should be in place for regulators and businesses to access as much data as they need for decision making and planning purposes.

Innovation hubs, incubators and accelerators

Innovation hubs, incubators and accelerators recognise that it can be difficult to grow new businesses or evolve new financial products, given a range of head winds from availability of capital through to the complexity of legal and regulatory arrangements for financial services businesses.

Access to information, services, mentors, capital, advisers and other necessary items is key to allowing FinTech to achieve its promise.

New Zealand already has some of these elements in place, but can afford to consider the best practices globally as there is little downside regulatory risk in helping people, in particular, understand and comply with regulation.

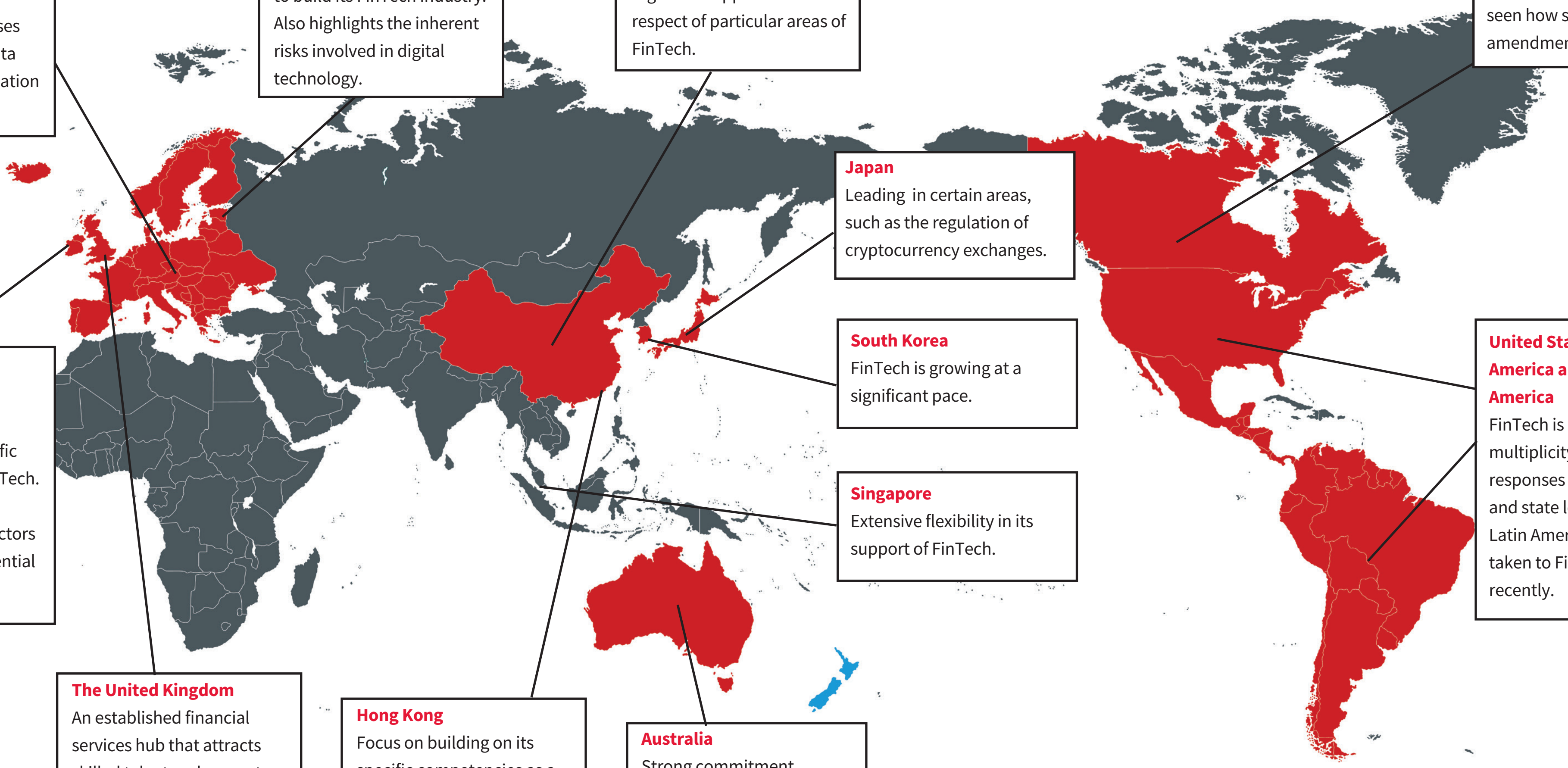
Cooperation agreements

Given New Zealand is a small market and the ease with which technology allows FinTech products and services to cross borders, it is important that New Zealand engage with international bodies and other countries to make these trans-jurisdictional interactions possible and subject to consistently good quality regulation. Accordingly, participation in institutions such as the Global FinTech Innovation Network (GFIN) and cooperation agreements with key trading partners appear to be obvious next steps for New Zealand to consider.

Each of these approaches was illustrated by the specific country studies that followed in the Report. We also drew out, where applicable, other approaches to FinTech including assistance in raising capital; incentive programmes; open banking initiatives (e.g. development of API standards and protocols); and specific guidance or changes in relation to cryptocurrencies and other virtual assets.

See the Snapshots from our Report at the end of this note.

Key findings



European Union
A number of initiatives and regulations that are being driven by the European Union of note for FinTech businesses is the General Data Protection Regulation (GDPR).

Estonia
Estonia benefits from developing a technology-astute population and supportive tech environment to build its FinTech industry. Also highlights the inherent risks involved in digital technology.

China
Mainland China is one of the largest and most established FinTech markets in the world. Takes a micro-regulation approach in respect of particular areas of FinTech.

Canada
Demonstrates a technology-neutral approach. Only recently regulating FinTech, and it remains to be seen how successful its amendments will be.

Japan
Leading in certain areas, such as the regulation of cryptocurrency exchanges.

Ireland
Relatively slow to provide and implement specific initiatives for FinTech. Highlights the importance of factors other than prudential regulation.

South Korea
FinTech is growing at a significant pace.

United States of America and Latin America
FinTech is subject to a multiplicity of regulatory responses at the federal and state levels. Latin America has taken to FinTech more recently.

Singapore
Extensive flexibility in its support of FinTech.

The United Kingdom
An established financial services hub that attracts skilled talent and promotes innovation. Highlights the importance of developing international cooperation and alignment.

Hong Kong
Focus on building on its specific competencies as a financial hub in the Asia-Pacific, building its B2B offerings and investing resources.

Australia
Strong commitment to developing FinTech. Australia’s prudential regime is its graduated response to certain types of FinTech.

Australia

- Australia demonstrates a strong commitment to developing FinTech with a number of initiatives in the form of sandboxes and innovation hubs.
- A unique aspect of Australia's prudential regime is its graduated response to certain types of FinTech, for example its model of allowing digital banks to acquire restricted licences before being granted a full licence and permission to operate as a bank. Accordingly, Australia provides different boundaries of prudential perimeters to develop and operate.

The United Kingdom

- The United Kingdom benefits from an established financial services hub that attracts skilled talent and promotes innovation. The United Kingdom goes further, however, and leads the world in providing support initiatives and incentives for FinTech.
- The United Kingdom also highlights the importance of developing international cooperation and alignment, recognising that FinTech cannot rely simply on domestic regulation.

Ireland

- Ireland has been relatively slow to provide and implement specific initiatives for FinTech, but benefits from its membership in the EU and strong corporate incentives that support innovation.
- Ireland highlights the importance of factors other than prudential regulation to support the development of FinTech.

Canada

- Canada demonstrates the importance of a technology-neutral approach. Regulation of specific types of entities results in market distortion and subsequent regulatory work to bring other entities within scope.
- Overall, Canada is only recently making advancements in regulating FinTech, and it remains to be seen how successful its regulatory amendments will be.

Hong Kong

- Hong Kong demonstrates a key focus on building on its specific competencies as being a financial hub in the Asia-Pacific region. Its strategy involves buildings its B2B offerings in the region and investing resources into areas that will have the greatest return.

Singapore

- Singapore benefits from offering extensive flexibility in its support of FinTech. For example, its sandboxes are open to all entities, and their conditions are determined on a case-by-case basis.
- More broadly, Singapore demonstrates how a small country can promote a strong finance sector by actively participating and promoting innovation.

Estonia

- Estonia shows that regulatory sandboxes are not necessary (although still desired) to have a strong FinTech sector. Estonia benefits from developing a technology-astute population and supportive tech environment to build its FinTech industry.
- On the other hand, Estonia also highlights the inherent risks involved in digital technology and the need to provide strong cybersecurity safeguards.

European Union

- There are a number of initiatives and regulations that are being driven by the European Union that Member States need to implement in their home jurisdictions. Also of note for FinTech businesses is the General Data Protection Regulation (GDPR). The GDPR was passed in April 2016 and sets out how user data must be treated by financial institutions and third-party providers.

United States and Latin America

- FinTech is big business in the United States and has been subject to a multiplicity of regulatory responses, both at the federal and state levels.
- Latin America has taken to FinTech more recently than many, but it has quickly taken root.

China

- Mainland China is one of the largest and most established FinTech markets in the world. China's policy approach of building a comprehensive regulatory system to cover FinTech does mean that it tends to take a micro-regulation approach in respect of particular areas of FinTech.

South Korea

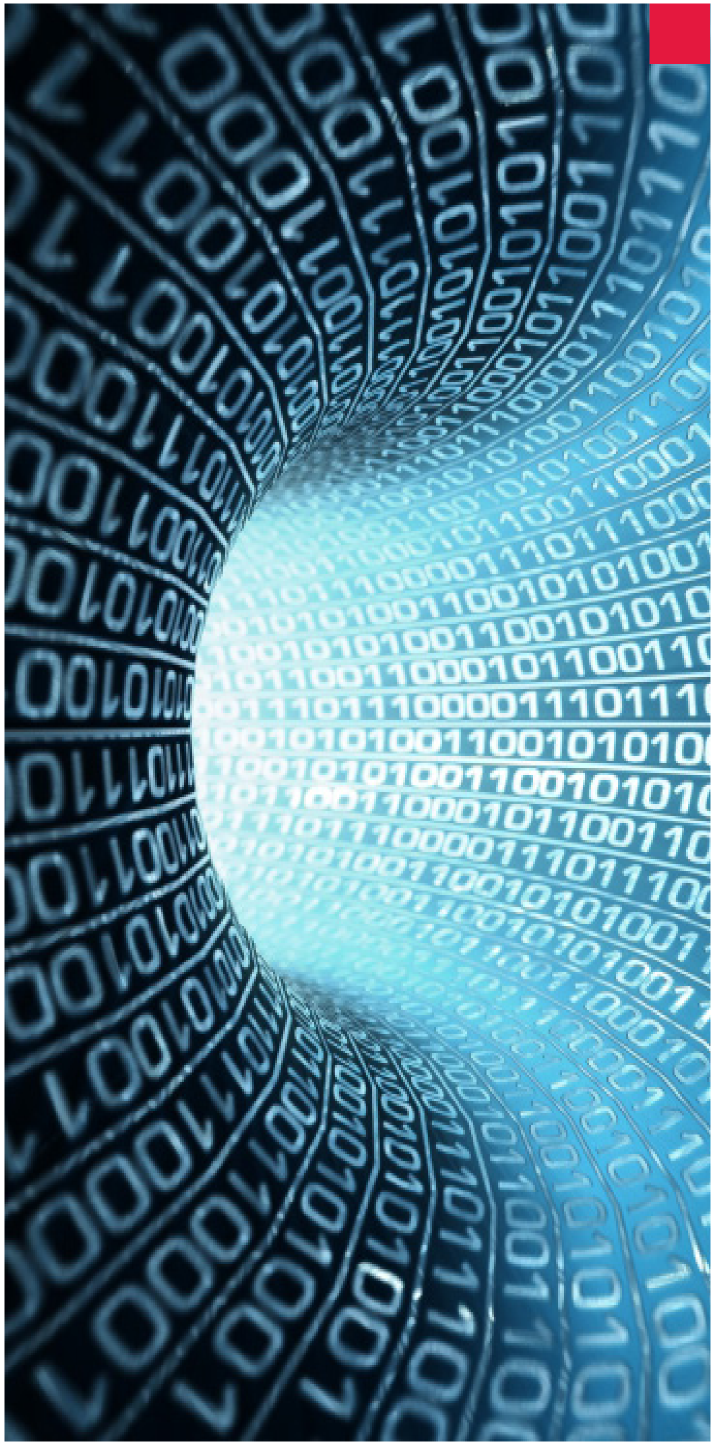
- FinTech in South Korea, which for a time was a surprisingly limited industry, has more recently been growing at a significant pace. It is now utilised by many of the large Korean technology companies and banks, significantly in the areas of payments and banking.

Japan

- Despite being one of the more advanced economies, Japan initially did not encounter the same level of development of FinTech as many of its peers. However, it has been recognised as something that could stimulate the wider economy, and accordingly a number of measures have been taken to encourage its rise. Japan is now even leading the pack in certain areas, such as the regulation of cryptocurrency exchanges (in which it was the first country to do so).

GFIN

- The Global FinTech Innovation Network was established by regulators in the United States, the United Kingdom, Australia, Ontario, Quebec, Hong Kong, Singapore, Guernsey, Abu Dhabi, Bahrain and Dubai, along with the Consultative Group to Assist the Poor. It is a collaborative policy and knowledge-sharing initiative aimed at advancing areas including financial integrity, consumer wellbeing and protection, financial inclusion, competition and financial stability through innovation in financial services, by sharing experiences, working jointly on emerging policy issues and facilitating responsible cross-border experimentation of new ideas.



What happens next?

We look forward to further consultation and development of proposals, both within the context of the review of the Reserve Bank legislation and beyond. In the meantime, we will continue our deep engagement with clients and associates in this space and if you want to talk FinTech we're keen to meet you.

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