31 October 2017

Bank for International Settlement
Basel Committee on Banking Supervision
Basel
Switzerland

Submitted via the online tool

Dear Sir/Madam

RE: Response to the consultation paper entitled "Sound Practices: Implications of Fintech on Banks and Bank Supervisors"

Introduction

The International Actuarial Association ("IAA") recently created a Banking Working Group under its Scientific Committee, noting the increasing involvement of actuaries in Banking in some jurisdictions. The Banking Working Group has taken this opportunity to respond informally to the Basel Committee for Banking Supervision's consultation paper entitled **"Sound Practices: Implications of Fintech on Banks and Bank Supervisors"** issued in August 2017 for response by 31 October 2017.

Different segments of the IAA have in the past always contributed on many industry developments in industries in which actuaries are involved, either formally or informally. This submission is, however, the first informal contribution by the Banking Working Group on banking industry development issues. The views are those of members of the Banking Working Group and not necessarily those of the IAA. These comments have not been subject to the due process required for them to constitute a formal view of the IAA. Thus, these comments do not represent an official view of the IAA.

Overview of the Banking Working Group

The growing demand for the actuarial skills set has seen the number of actuaries and actuarial students in the banking environment increase significantly over the past few years in some countries. In recognition of this, the Banking Working Group was established by the IAA in 2017 to consider the current and future actuarial involvement in banking at a global level.

Our response

The response to the Sound Practices consultation document is in line with the Banking Working Group's mandate to engage key supranational bodies such as the Bank for International Settlements on issues of common interest that have implications in industries in which actuaries operate. The sections below outline our responses.

.../2

Access to the market:
It may be worth considering the most appropriate licenses required for fintechs to operate in the same space as banks (or as third-party service providers). The existing banking licenses may not be appropriate and may not cater to the risk balance and checks that are now necessary for them to play a meaningful role, which is backed by agile innovation, whilst still operating within the spirit of regulation fortifying banks. The capital requirements to open and operate these Fintechs has not been discussed and although this may seem to impede innovation, this may need to be addressed, particularly in the case of rapidly growing Fintechs operating in volatile environments and without the support of established banks.

"Agile Regulation", Sandpits and Phases:
Traditionally, (financial) regulation has been predominantly reactionary. Given the pace with which new technologies and innovations are being introduced into the banking environment, the same agile methodology of developing products may be required to ensure that regulation stays ahead of, or at least keeps up with the pace of change. Banks now operate in environments where change is more rapid than ever and their competitors are not as encumbered to challenge their place in the market or follow the same rules. The idea of using sandpits provides a controlled environment for the supervisor and the fintech to interact whilst still 'piloting' the benefit. Another consideration would be to use a phased regulatory approach. This would allow new players to innovate without high hurdles to overcome and to increase the level of compliance required as a product reaches pilot stage and is ready for market.

IT and Finance Interdependencies:
The document referred to the role of banks as third-party suppliers. Particularly with reference to 'bigtech' firms (which have a broad global reach and exclusivity to any particular bank is unlikely), closer management of the interdependencies and the overall systemic risk may require greater supervision, at a global level.

Bank vs. Software Company:
Many banks are starting to see themselves as 'part-software-companies', much in the same way the large IT companies of this era started thinking two to three decades ago. Given this pivot in perspective and the greater role that IT has played in the past, and rapidly continues to do so, the regulation and/or standards required in a modern-day IT company may be of relevance in the development of future regulation. One could assume that between IT Security, Legal/Compliance and Governance teams, this would be covered. However, the nature of risks emerging from the establishment of fintechs requires IT professionals to be closely integrated both at a supervisory level for the industry and within banks themselves.

Banks – Changing Roles:
As indicated, the role of banks has already started changing. It is clear that they will play a greater role in intermediating between the customers and the fintechs as well as between the supervisors and the fintechs. Essentially, they could easily become administrators or sub-regulators, or both, depending on the approach of the regulator in each jurisdiction. What will need to be ascertained over time is the willingness of banks to fulfil these new roles, especially that of a 'sub-regulator'.

Reporting Requirements:
Given the expanding role of fintechs, more information may be required regarding their economic activities. Although the current reporting requirements for banks may be deemed onerous for a small fintech, it is essential to get a more holistic picture of the role they are playing in the economy. Additionally, banks may be required to provide greater transparency regarding their activities with fintechs in the reporting as the risks inherent in their partnerships (and competition) will become increasingly important to shareholders,

regulators and consumers. The manner in which they allow for these new risks may require disclosure as well.

New Statistical Tools and Black Boxes:
The use of "off-the-shelf" AI tools may need to be addressed. These are being considered for risk modelling, including the development of credit risk models. Standards or practice guidance may be required to ensure that these models are adequately understood, justified and appropriately utilized within banks and fintechs, particularly as far as supervisory risk assessment is concerned.

Fintechs as Data Aggregators:
Several fintechs have proven to be resourceful and efficient in collecting customer information that even the government and traditional banks have not had access to. This is particularly so in developing countries where there is sparse information regarding individuals and economic activity in highly informal/unbanked markets. This information could be useful in understanding the general population, financial activities and behavior; developing public benefits and policies. Fintechs are interacting with consumers at a level that allows them to collect more and better information, and in some cases, at a more frequent rate. Therefore, the approach to data sharing and security needs to allow for these potential benefits.

Conclusion
We welcome the Sound Practices consultation paper and the issues it has raised. In particular, the ten observations highlighted and the corresponding recommendations aim to achieve a balance between creating a safe and sound financial services industry whilst allowing and encouraging innovation that improves the banking customer experience. FinTech brings both opportunities and risks. We view the consultation paper as a proactive and less intrusive approach for banks and bank supervisors to take advantage of the opportunities presented whilst addressing the risks.

Banking Working Group
International Actuarial Association
31 October 2017