South African Reserve Bank

An opening address by Rashad Cassim,
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at the World Fintech Festival

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Challenges facing fintechs and opportunities to respond

Good day to our South African financial technology (fintech) community and to all our fintech colleagues connecting to the World Fintech Festival in South Africa.

The Intergovernmental Fintech Working Group (IFWG) is honoured to be part of this year's Singapore Fintech Festival. We would like to commend the Monetary Authority of Singapore for organising a virtual festival which is testament to the immense possibilities that are unlocked when we embrace technology in the way we work and interact. My understanding is that we are likely over 100 000 people connected to this event.

Before we begin today's programme, I would like to talk, very briefly, about the significance of fintech, particularly in the context of COVID-19[1], and reflect on some of the challenges that fintech continues to face. For fintech to continue making inroads into financial services, it may be important for the ecosystem to overcome some of these challenges. Many of these reflections will be explored further by esteemed expert speakers in the panel discussions.

I realise that any discussion of fintech raises a dilemma for many of us, given that it is a complex and multifaceted subject involving topics as diverse as, among others, regulatory barriers, the nature and use of technology, and its social and economic impact, be it economic efficiency or financial inclusion. COVID-19 has also opened up a whole new set of issues and challenges for fintech firms.

[1] coronavirus disease 2019

While I would like to focus my talk specifically on four challenges facing the fintech industry – drawing, in part, from the South African experience – let me say a few things about what COVID-19 means for fintech firms.

Although the pandemic has placed significant stress on all businesses, including fintech firms, many of them, specifically those with established consumer bases, have managed to pivot. There are growing examples of fintech firms helping small, micro and medium enterprises (SMMEs) in 'going online and digital'.

The 'going online and digital' phenomenon is propelled by the pandemic. This is not only as a result of waning demand during periods of lockdown, but also because of shifting consumer behaviour. Heightened consciousness of social distancing and avoidance of physical interaction has thrust fintech further into action, with more people adopting digital financial services. South Africa is no exception, with nearly 80% of surveyed South Africans reporting that they used contactless payment methods as a perceived safer way to pay since the COVID-19 outbreak.[2]

To meet the increased demand for digital payments, there has been a resurgence of innovation in digital payment products and channels, including cheaper and more convenient point-of-sale (POS) devices for small businesses as well as the strengthening of apps and platforms that enable consumers and businesses to make payments.[3, 4, 5] In addition to digitising payment at POS, merchants are also adopting online sales (or e-commerce), which provides more safety and convenience to customers while also expanding customer reach. In South Africa, for example, one of the largest payment gateways has reported a surge in online payments, recording a

[2] MasterCard, April 2020, *Global Consumer Study*, available at https://newsroom.mastercard.com/mea/press-releases/mastercard-study-shows-south-african-consumers-make-the-move-to-contactless-payments-for-everyday-purchases-seeking-touch-free-payment-experiences/.
[3] Tom Jackson, 14 September 2020, 'SA fintech start-up Ozow launches new payments platforms, zero-rates data costs', available at https://disrupt-africa.com/2020/09/sa-fintech-startup-ozow-launches-new-payments-platforms-zero-rates-data-costs/.
[4] Staff Reporter, 29 October 2020, 'Yoco launches new stand-alone card machine for small businesses', available at https://www.iol.co.za/business-report/companies/yoco-launches-new-stand-alone-card-machine-for-small-businesses-f59ed3e8-c60f-4333-908f-5254bae139e9.
[5] Ishani Chetty, 29 September, 'New payment tool launches for local SMEs', available at https://ventureburn.com/2020/09/new-payment-tool-launches-for-local-smes/.

year-on-year increase of almost 90% in total new business account registrations since the lockdown began.[6]

Possible structural challenges facing fintechs

Allow me to turn our attention to possibly more structural challenges facing fintech firms today.

I have distilled these challenges to the primary challenge of access, and have tagged it as challenges around four R's, namely:

i. access to *regulators;*
ii. access to *rule-making;*
iii. access to *resources;* and
iv. access to *refined financial services data.*

Access to regulators

Incumbent firms in financial services have a long history with regulators. By virtue of being regulated, and often highly regulated, incumbents have access to regulators. For these incumbents, when new products or services are conceived, it is often mandatory to ensure engagement with regulators to gain approval for new innovations. This is to assess fit with regulations and compliance frameworks. This required engagement has strengthened further after the 2008 global financial crisis, and especially as technology reshapes how financial services are delivered. New cloud propositions, robo-advice services and even the application of artificial intelligence (AI) often warrant deeper engagements with regulators.

In contrast to incumbents, fintech firms may operate on the regulatory periphery. They often create services different from existing platforms. Cases in point are crypto-assets, initial coin offerings, and Internet finance such as peer-to-peer lending and crowd-funding platforms. Fintechs tend to focus on services close to the front-end and the consumer interface. They are, again, likely to be on the outer periphery of highly

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[6] PayFast, 27 April 2020, 'PayFast sees spike in new business registrations spurred by COVID-19 lockdown', available at https://www.payfast.co.za/blog/payfast-sees-spike-in-new-business-registrations-spurred-by-covid-19-lockdown/.

regulated value chains such as payment systems. Unlike the core players in clearing and settlement that are highly regulated, fintechs may have ‘light touch’ or no regulations applied to them.

Based on this, our experience is that fintech firms may often not be in the direct regulatory purview of authorities, and may therefore have less formalised and less frequent meetings with regulators.

The first possible structural challenge, then, is access to regulators.

This is an important challenge to resolve.

Our laws and regulations have historically been crafted for financial services intermediaries, long in the domain. The legal and compliance frameworks may be hard to interpret for fintech firms who may be tech-savvy start-ups with limited compliance know-how or competencies.

Access to regulators, and know-how of which authorities to connect with for particular types of queries, is important. Our regulatory architecture can be complex, with multiple financial services authorities, ranging from prudential and conduct-focused, through credit-related, to financial intelligence-related regulators. Access to this network is important in order to reduce any potential barriers to entry from a legal, regulatory and compliance perspective. This is why we have seen a rapid emergence of innovation centres, hubs and guidance units across the globe: in recognition of the importance of increasing access to regulators, by fintech firms in particular.

Access to rule-making

Rule-making in financial services can be complex. The ‘rules of the game’ can be embedded in legislation and regulations, and through related instruments such as directives, position papers and standards.

A good example of this complexity can be seen in the regulation of payment systems. Often, primary regulations set the conditions or criteria based on which stakeholders can have access to clearing and settlement systems. Such primary regulations position the overarching principles and objectives of providing legal certainty, deepening financial inclusion, and ensuring the general safety and efficiency of payment systems.

However, at a ‘lower level’, rules related to how payment schemes operate are equally important in setting specific conditions or criteria related to a payment system. As an example: direct credit systems will define clearing time-frames, and debit systems will define charge-back rules or conditions. These types of rules are often called the ‘rule books’ in jurisdictions like Canada and the United Kingdom (UK). There are ‘rule books’ publically available for schemes such as the Single European Payments Area (SEPA) Credits in Europe or, in the UK, the Faster Payments Scheme.

In South Africa, we have found that, due to legacy reasons, some of the rule-making processes, especially in the payment system space, have traditionally been the domain of incumbents. Based on some of the cases reviewed, our sense is that broader input into the rule-making processes by those impacted across the value chain would benefit from obtaining a variety of competing perspectives. The voice of fintech firms in this process is important. This kind of ever-increasing access to influence rule-making is vital to ensuring that the best policy and regulatory stances are adopted.

Even more importantly, the ‘rules of the game’ must not create barriers to growth for fintechs. We have identified a few scenarios where this may be the case. Authorities have to ensure that the approach to, and governance of such processes, is transparent and robust.

Access to resources

Two significant resource challenges facing fintechs are access to capital and access to skills sets.

Unlike incumbents who generally have reasonable access to finance, fintech firms and specifically fintech SMMEs may experience significant additional challenges accessing finance. While consumer credit is likely well-served in South Africa, SMMEs continue to struggle to access critical funding to sustain themselves and even grow. This is despite the significant contribution that these businesses make to gross domestic product (GDP) and employment.

The inability of SMMEs to raise funds is caused by a number of demand- and supply-side factors, such as the lack of financial records and the inability of lenders to tailor their loan terms to match the business needs. According to a 2019 report by one of the large banks in South Africa, few fintechs manage to secure start-up capital, with the general sentiment indicating that funding seems to be readily, but not openly, available. More broadly speaking, SMMEs also operate in a mostly informal, invisible and cash-based economy. Addressing this challenge is related to the broader need to digitise these businesses and ensure that they are included in the digital economy.

Turning our attention to the importance of access to skills: although much emphasis is placed on the technologies in the fintech domain, it is the people, the skills and the talent that create the innovation and propel the change. This is evidenced across the fintech value chain: from the data scientists who unearth customer behaviour patterns, needs and 'pain points', through the software developers and engineers who develop the solutions, to the business heads who craft growth strategies based on an emerging technology.

However, similarly to most countries, particularly developing countries, South Africa has a shortage of technical skills. The 2019 *South African Information, Technology and Communication (ICT)*[7] *Skills Survey* found that the Fourth Industrial Revolution (4IR) has not had a significant impact on the South African ICT skills landscape yet. According to the report, the skills associated with the current set of emerging technologies – such as AI, the Internet of Things, blockchain, automation, data science and programming – were the scarcest.[8] This leads to a race for talented and skilled individuals such as data scientists, programmers, software developers and design thinkers. The challenge, of course, is not specific to fintech firms; it also affects us as regulators. However, based on our discussions with fintech firms, the race for acquiring such skills sets is pronounced for fintechs, especially if they are still in their

[7] Information and Communication Technology
[8] Johannesburg Centre for Software Engineering (JCSE) (Wits University) and the Institute of Information Technology Professionals South Africa (IITPSA), 2019, *South African ICT Skills Survey*

early phases of development and/or maturity. It is less so for big-tech firms with well-established markets.

Access to refined financial services data

Finally, we turn to the importance of data, specifically refined and granular data.

It has become cliché to say that 'data is the new oil of the economy'. As the digital economy continues to be embedded through the use of mobile devices, the use of social media platforms, and generally increasing activities over the Internet and online commercial platforms, we will increasingly create and leave behind 'digital bread crumbs' of unprecedented volumes. Never before have we seen such volumes of data. And for the first time in human history, we also now have evolving tools and techniques at our disposal through cloud-computing, AI and machine-learning methods to handle such volumes of data.

However, in this new digital economy, the availability of, and access to, data related to, for example, transactional payments or specific customer behaviour, has become a key competitive driver. Access to both structured and especially unstructured data can provide significant competitive advantages to those who own it. Fintechs in particular are exploring the use of Big Data to produce new services such as product comparisons and tailored solutions based on consumer-specific data. While Big Data presents new opportunities, the scope of available data, and how to govern access to that data, poses new challenges for the financial services industry and regulatory authorities around the world.

As a result of the above, access to refined data is a key issue that regulatory authorities have to deal with. Examples of addressing it through Open Banking and Open Finance efforts are increasing in many jurisdictions.

For South Africa, it is important to land on the policy imperatives for such efforts. There are a number of open questions for authorities. These include (but are not limited to):

- Should incumbents be required to share their data with fintechs?

- Should the standards for sharing data be developed by the regulators or by the market?

- How is customer data protection being ensured, and what commercial arrangements might arise from owning that data?

- When dealing with such large data sets, what measures are in place to detect, respond to and recover from cyberattacks?

Addressing these and other open questions is important in moving the fintech dial forward.

In South Africa, numerous fintech firms applied for our Regulatory Sandbox process to trial new Open Banking models. To make progress within this space, we require incumbents and fintech firms to work together to shape our policy thinking and policy stances. Any unaddressed solutions will possibly continue to see fintech firms using methods that may pose an increased operational risk. The solutions of open Application Programming Interfaces (APIs) are therefore pressing. The industry should actively engage with fintech firms on this long-standing matter. We also need to learn from jurisdictions that have already traversed this path, and modestly take from their emerging lessons.

Conclusion

Allow me to conclude.

The South African regulators recognise the role they can play in addressing these access challenges. The IFWG aims to demystify the regulatory landscape, provide space for safe experimentation, and actively advance innovation. We do this through the Innovation Hub, launched earlier this year, and its three facilitators: the Regulatory Guidance Unit, the Regulatory Sandbox and the Innovation Accelerator.

Since launching the Innovation Hub, we have received nearly 100 queries in the Regulatory Guidance Unit and over 50 applications to the Regulatory Sandbox. These numbers show just how vibrant and dynamic the South African fintech ecosystem is. Most importantly, though, they are a positive sign of increasing access to regulators and rule-making for fintechs, which enables us to hear more of those divergent and new voices.

In addition, the Innovation Accelerator is a space for us to drive both internally oriented and market-facing innovation initiatives. We focus particularly on those initiatives that address the challenges faced, and have the potential to deliver benefits across the regulatory and broader financial services landscape. We currently have eight initiatives under the Accelerator, looking at important topics such as digital platforms, crypto-assets, financial markets innovation, Open Banking, non-traditional data and big tech in fintech. What makes this unique is that regulators are journeying along to co-create an understanding of the major issues facing fintechs, including co-developing policy stances.

The fintech phenomenon is here to stay, and will continue to grow. In the end, however, it is not about fintech but about creating vehicles to support innovation in the economy and the financial sector. It turns out that fintech firms just happen to be the key agent through which we are moving towards a more dynamic financial sector.

I trust you will enjoy the deliberations today, and would like to end by congratulating the IFWG and the Monetary Authority of Singapore for arranging this event.

Thank you.