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President and CEO

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INSTITUTE OF INTERNATIONAL FINANCE

The Honourable Charles Abel, MP
Chair, APEC Finance Ministers Meeting
Deputy Prime Minister and Minister for Treasury, Papua New Guinea

RE: Asia-Pacific Economic Cooperation and Digital Finance Policy

Dear Mr Abel:

The Institute of International Finance ("IIF")[1] welcomes the continued efforts of the organization for Asia-Pacific Economic Cooperation ("APEC") in promoting economic growth and cooperation throughout the region. This is an important function, and one that increasingly has the emerging digital economy at its center.

To this end, the IIF wishes to highlight the criticality of regulatory and policy considerations for digital finance. Indeed, policy-makers, regulators and supervisors have a difficult but critical task in ensuring a resilient and stable financial system, providing a level playing field for all participants, and fostering an innovative, secure and competitive financial market and investment climate that fully supports capital formation, economic growth, and job creation.

Our comments relate to informed consumer and investor choice, financial stability, and the need for an efficient regulatory structure for cross-sectoral and cross-border competition in the FinTech ecosystem.[2] We have focused on four aspects:

1. **Consistency of regulatory and supervisory frameworks across the new competitive environment**

The principle of **"same activity, same risk, same rules, same supervision"** should be the foundation of any framework in this rapidly evolving digital marketplace. In the digital space, where boundaries across sectors are fading, the regulatory and supervisory frameworks should focus on the activity undertaken and the risk it brings for customers and financial stability, and not exclusively on the nature of the entity.

[1] The IIF is a global association of the financial services industry representing over five hundred commercial and investment banks, asset managers, insurance companies, sovereign wealth funds, hedge funds, central banks and development banks in 70 countries: www.iif.com

[2] The FinTech ecosystem referred to in this letter encompasses all technology-driven innovation in the provision of financial services, inclusive of small new entrants, "BigTech" companies, incumbent financial institutions and the regulators and supervisors

This approach merits looking beyond the traditional "silos" of regulation – both within the traditional financial sector (e.g. bank regulation distinct from insurers, distinct from securities companies), and between those and broader topics such as competition policy, data protection and cyber-security. A consistent **cross-sectoral** approach is needed, where the prevailing lens is that of providing protections and safeguards for those participating in the economy, whether as investors or borrowers, rather than on the entity-type of the provider.

Furthermore, the nature of digital competition is inherently global by nature. New and emerging technological players in financial services, particularly the so-called "BigTechs", each already have or will soon have a reach beyond local and even regional borders. This underscores the criticality of **cross-border regulatory coordination**. Just as a more cross-sectoral and activities-based approach is taken with respect to regulation, this approach needs to be complemented by international coordination and mutual feedback, helping to ensure fair international competition and consistent regulatory approaches.

If new entrants (whether "BigTech" firms or others) can offer comparable financial services from outside of the regulatory perimeter, using their platforms to reach large customer bases, then there exists a risk that they could reach a position of systemic importance without being subject to the same safeguards that have been applied to regulated institutions.

Such a regulatory gap could negatively impact both the consistent protections afforded to customers and the integrity of markets. Were such a new firm to reach a position of dominance in the provision of a particular service or transacting and holding funds for a significant cohort of the economy, this could ultimately threaten the gains in financial stability that have been achieved post-crisis.

2. Equality in data access and usage

Data is an area of great opportunity for better information and knowledge, has often been a catalyst for constructive new investments and innovations, and by itself is a valuable resource that warrants critical protection. Data-driven innovations will be at the heart of the digital transformation for all industries. For the data economy to become a reality, the first condition is to ensure the right incentives are in place to generate high quality data, and to reward proprietary investment and innovation. All market participants should be encouraged to invest in systems, models, and teams that produce and utilize high-quality data, which in turn enable them to provide customers with products and services more effectively and economically.

Where some jurisdictions have started to require banks to share specific data with new entrants, any such approach should be reciprocal and applied equally across sectors and to all players performing similar activities, including "BigTech" firms. By the very nature of their business models, BigTech firms often have a significantly higher degree of personal information, upon which to build their products and services. "Open banking" data-sharing initiatives are intended to promote financial inclusion and enable greater customer choice, but should not play a role in deciding market winners.

While data sharing is at the heart of the open banking concept, and this may help to provide customers with more personalized products and services, there are several additional considerations in how such data is shared and used. **Protection of customers' data** should be a top priority, with a framework defined to ensure that all the players in the ecosystem put in place the necessary measures to comply with this. While customers are generally aware of the personal information that their bank or insurer holds, it is apparent that users of services from "Big Tech" firms do not always have this insight.

Creating a FinTech ecosystem in which the sharing of data is secure (in all bonds of the chain), and where there is a certainty on who owns what and how data is stored and used, should be a key priority. All companies wanting to provide financial services to a customer should be bound by the same rules and have the same high standard to ensure that the data is secure, for instance by extending requirements beyond just financial institutions, to the whole ecosystem. If this is ensured, then customers will be able to select, on a transparent and informed basis, from a range of trusted providers, underpinning a strong and uniformly regulated market in digital financial services.

In pursuing a common minimum level of security for all participants, we encourage APEC and its members to consider examples of efforts currently underway in other jurisdictions, such as the relevant data protection provisions contained in Europe's General Data Protection Regulation (GDPR). Similarly, the Monetary Authority of Singapore (MAS) is developing a set of "Guidance on responsible use of data analytics" for all participants.[3]

The availability of increasing amounts of valuable structured and unstructured data, including customer-specific information (acquired through telematics, sensors, wearables, etc) also requires a sound public policy discussion on responsible considerations for the use of that data, weighing both privacy impacts and benefits for the availability of financial products, such as affordable protection for higher risk (and potentially lower income) individuals.

Any potential initiatives for data access and sharing within the FinTech ecosystem should require (i) a consistent minimum level of data protection amongst all participants, and (ii) reciprocity amongst all participants.

3. Regulatory cohesion, especially for cyber-security

Notably, regulations affecting players in financial services extend beyond those issued by the sector's regulators and agencies – with other regulations governing topical areas such as data protection and cyber resilience. Greater consistency and interaction

[3] Monetary Authority of Singapore (MAS), *MAS and financial industry to develop guidance on responsible use of data analytics*, April 2, 2018, http://www.mas.gov.sg/News-and-Publications/Media-Releases/2018/MAS-and-financial-industry-to-develop-guidance-on-responsible-use-of-data-analytics.aspx

between financial and non-financial regulations would help promote efficiency, in addition to promoting a competitive environment for all participants.

This is particularly pertinent in the case of cyber-security. The highly dynamic nature of the threat makes it critical that cyber-security regulation is efficient, and that firms are provided with the necessary flexibility to be able to adjust their responses to the threats posed in an agile manner, in order to protect their customers, companies, and investors, rather than be mired in unnecessary or duplicative regulatory reporting and compliance. Unnecessary duplication can add a substantial compliance burdens for firms, and divert valuable resources and expertise from activities that can help improve resilience.

Better coordination on cyber-security regulation is needed to enhance the resiliency of the sector, including greater harmonization across regulatory agencies, adoption of a common lexicon, and harmonized interpretations and implementation of specific rules and guidance.

An agile coordination among the different agencies is necessary not just for cyber-security, but across the FinTech space. Several other jurisdictions are more readily able to embrace innovation, where they are supported by more streamlined regulatory structures.

4. **Ability of incumbent firms to adopt new technologies, to compete and serve their customers**

In this dynamic and evolving environment, it is important that incumbent firms are able to continue innovating, in order to keep pace with customer preferences and alternate offerings in the market, and to improve their operational effectiveness. Where banks and insurers adopt new technologies, this is for the betterment of their customers through promoting customer choice, as well as enhancing firms' own risk management capabilities. As observed in the IIF-McKinsey 2017 report *The Future of Risk Management in the Digital Era*, digital innovations are increasingly being deployed within banks' risk functions, both to enhance risk management and gain improved insights, and in other cases to keep pace with the digitalization of the front-line, in support of customer fulfilment.[4] Similarly, insurers are constantly enhancing their abilities to identify, analyze and manage risk, including by applying new technologies (including customer-facing tools as well as tools for better risk and market data analytics).

Regulators and supervisors should encourage incumbent firms to pursue an agenda of increased digitalization to better meet the needs of their customers. Faced with such a dynamic competitive landscape, firms **must be able to adapt** and transform themselves to ensure their ongoing viability and profitability without fear of subsequent supervisory or enforcement actions, such as via No-Action Relief described by US Commodity

[4] IIF-McKinsey, *The Future of Risk Management in the Digital Era*, October 2017, iif.com/publication/regulatory-report/future-risk-management-digital-era

Futures Trading Commission Chairman Christopher Giancarlo.[5]

Where the traditional paradigm of stability was a static one, there increasingly needs a more dynamic view – that **financial stability is about evolution and moving forward**, rather than standing still or looking backward. Restrictions on the ability of incumbent institutions to transform themselves and adapt to the new environment might ultimately prove the largest threat to the system as a whole.

In this context, it is significant that banks and insurers move forward and innovate in a controlled and considered manner, cautious in their experimentation and implementation of new solutions. Regulated financial institutions of all kinds recognize that their top asset is the trust they have with their customers, and, therefore, they maintain robust change management controls to ensure this trust isn't jeopardized.

In many instances, the benefits of adopting new technologies at incumbent institutions outweigh the associated risks – for example, the Financial Stability Board has recognized that cloud computing can be safer, more robust, and better protected than legacy infrastructure.[6] Similarly, the IIF's recent study on machine learning in credit risk modeling and management highlighted that the adoption of these techniques is delivering greater accuracy in modeling, better use of existing data and additional insights from new data sources, as well as an enhanced ability to overcome biases inherent in traditional modeling approaches.[7] Such initiatives are agents for transformation and data-driven decision-making, ultimately making banks and insurers stronger, more stable and secure.

Moreover, the regulatory structure should allow that **all participants can innovate under similar conditions**. It is critical that banks and insurers are provided a framework that allows them to onboard and develop innovative ideas, both in-house and through different methods of collaboration. Examples of asymmetries or barriers to banks and insurers innovating include:

- the banking prudential framework's requirements for consolidation of activities under a banking group, which places an extra layer of regulatory burden and lowers their capacity to innovate whether in-house, via acquisition or through a dedicated FinTech entity;
- legacy requirements on banks for third party management, which are designed for traditional vendors rather than FinTech innovators with whom banks might seek to partner;
- flexibility in the use of third party cloud services; and

[5] Christopher Giancarlo, remarks at IIF Washington Policy Summit, April 19, 2018.
[6] Financial Stability Board, Financial Stability Implications from FinTech: Supervisory and Regulatory Issues that merit authorities' attention, June 2017, http://www.fsb.org/2017/06/financial-stability-implications-from-fintech/
[7] IIF, *Machine Learning in Credit Risk*, March 2018: the IIF interviewed 58 banks and 2 mortgage insurers on their adoption and exploration of machine learning techniques in credit risk modeling and management.

- accessibility of 'sandboxes'[8] for incumbent firms as well as new entrants, with the same level of flexibility.

Accordingly, we encourage greater agility by regulatory agencies, along with collaboration with industry and other participants to develop the appropriate regulatory and oversight mechanisms (eg. sandboxes, hackathons, co-operation agreements) to enable safe and effective innovation, accessible equally to all participants. Third party management requirements should be reviewed for their applicability to FinTech innovators.

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We hope you find our comments helpful, and as always, the IIF stands ready to provide further input and any necessary expansions or clarifications on our comments. To this end, we would welcome the opportunities to discuss these issues further with APEC members.

We look forward to our continuing engagement with officials and the regulatory community throughout the Asia-Pacific region. If you have any questions on the issues raised in this letter, please do not hesitate to contact me or Brad Carr, the IIF's Senior Director of Digital Finance Regulation and Policy (bcarr@iif.com).

Sincerely,

[8] Regulatory "sandboxes" provide financial institutions and non-financial firms with a controlled space in which they can test innovative FinTech solutions with the support of an authority for a limited period of time, allowing them to validate and test their business model in a safe environment.