Keynote Speech

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The Revolution and Evolution of Digital Assets

Thank you for the kind introduction! It is great to be here with you today. I would like to extend my thanks to the IMF and Georgetown University for inviting me to take part in this FinTech Week and to share perspectives on the topics of FinTech and crypto assets. I know many of you might feel less than comfortable with a regulator as your lunchtime speaker, but you can relax, as I do not plan to upset your meal today. I have to say that the most frustrating part of giving a FinTech speech is that much of what I say will be outdated before you get home this evening. With that in mind, I will try to be quick.

I am an American, but I believe my precise role here today is to be the “foreigner”. I have now been working and living overseas for 22 years, all of this time dealing, in some way, with financial services regulation in emerging markets. In researching this event, I am also proud to say that I began my career with the Office of the Comptroller of the Currency, and I see you have the Comptroller, Mr Otting, on the agenda for tomorrow. I also note that words of a former Comptroller, Thomas Curry, might have been a genesis of this event.

Finance, more than any other industry in the world, is global, and must not retreat in that view. The application of technology to financial services is nothing new – it has been the norm since the creation of the ATM card in the 1970s. The difference at this juncture is the speed of change. FinTech started as a buzzword several years ago, but is now here to stay. FinTech firms are no longer just start-ups looking for a billion-dollar buyout. Saying that, FinTech firms are, in my opinion, no longer "disruptive" in nature, but are now turning a corner to be a truly "transformative" power. Long-time entrants to the market, and their regulators, must adapt to new technological advances or face the risk of extinction.

I continuously reflect on a quote by Bill Gates, many years ago, that banking is a necessary part of every economy, but banks do not necessarily need to be part of it. This quote brought laughter 10 years ago, brought nervous laughter five years ago, and brings general nods of agreement today amongst the global titans of finance.

We are seeing that many parts of traditional financial services business models can be adapted for the better using the greater computing capacity and newer technologies now available. At their best, FinTechs have the potential to improve the efficiency of markets; provide cheaper and quicker services; improve financial inclusion; enhance customer experience; and, enhance security and compliance.

In the disruptive sense, we must consider that the best poker players are often the newest players, who do not follow convention or rules, but simply play the game differently. Globally, we are seeing large, already established financial institutions looking to "up their game", finally with the mindset of offering a better customer experience, and big tech companies such as Apple, Google, Alibaba and Tencent that are now becoming active in financial services, in no small part because of consumer trust in their brands.

Regionally, in the Middle East, FinTech is still in its infancy. Some government agencies still want to know my fax number. I don’t know why this is still on my business card, because I don’t know where the fax machine is! That means that we are only beginning to see this potential play out in practice, but we are ready to take a giant leap. Dubai’s “Smart City” initiative is just one example of the rapid transformation that is taking place right now.

The recently published Bali FinTech agenda has done a fantastic job of setting out a roadmap for how regulators (large and small) should be thinking about FinTech. This is a credit to our hosts here today.

Like many regulators, the DFSA is excited about the potential benefits of FinTech. Also, like many regulators, we are wary. While regulation can be seen to be impinging on development and innovation, it shouldn’t be forgotten that it is our responsibility, amongst other things, to make sure consumers are appropriately protected and treated fairly, and that markets have integrity and stability. These principles apply to FinTech too! The same people asking me to stay away from innovation and leave these firms alone will be exactly the same people who will be asking where I was when something goes wrong! I have seen this movie many times! We believe that in order to tip the balance in favour of successes, governments need to create a collaborative ecosystem that incorporates so much more than just a proper regulatory framework to really make it work.

This means balancing caution with excitement. More broadly, it also means looking at the benefits that technology brings alongside the risks to society. Where we recognise those benefits are real and the risks are understood, we should seek to facilitate and encourage that innovation.

In my view, regulating <u>institutions</u> should begin to give way to regulating <u>products and services</u>. Regulators will need to stop thinking about what a bank does or what an insurance company does, and instead turn their attention to who provides credit, who takes deposits and has digital wallets, who offers life insurance, who provides investment advice and who makes payments, just to name a few. These activities might be in a traditional market participant, and might not be.

The Middle East is increasingly embracing FinTech. The MENA region's financial technology market is predicted to grow rapidly in the coming years. According to recent industry forecasts, increased annual investment will boost the number of FinTech start-ups from only a few in 2005 to around 250 by 2020.

Four countries account for almost 75 per cent of start-ups in the MENA region – the UAE, Lebanon, Jordan and Egypt. The UAE remains the centre of the new frontier with a combination of initiatives, accelerators, rising investments and cross-industry partnerships. High smartphone penetration, tech-savvy, young people and the government's support are all turning the region into an attractive hub for FinTech.

Alongside that, initiatives like Dubai International Financial Centre's (DIFC) FinTech Hive, whose start-ups raised over $10 million in funding in 2017, are significantly growing the FinTech ecosystem in the region. We see major banks and financial institutions placing huge strategic focus on blockchain, robotics, AI and predictive analytics to unleash the potential of FinTech across the banking and financial services industry.

On that note, I will move to crypto-assets, including a focus on ICOs, an area of FinTech and a universe of its own, which is growing exponentially, has piqued great interest of many, and is why you are here today. However, before I go into this, what do we mean by crypto-assets?

There is no universal classification of "crypto assets." Terms used include: digital assets, virtual currencies, crypto-currencies and so on. Recent work undertaken by the Financial Stability Board (FSB), the Basel Committee and the Financial Stability Institute (and by many other standard-setters and international bodies) illustrates the differences in terminology used across different jurisdictions. Interestingly, I noted that FinTech, RegTech and SupTech appear on almost all of the FSB's regional agendas these days, in addition to the global agenda. No place is immune to this discussion.

We need to think about the ecosystem of an ICO and what the various participants in an ICO want, so we can determine what regulations are important. Many small businesses want cheaper, faster and more efficient access to debt and capital markets. I am all for that! However, there are those who want to abuse the market. Many regulators are signalling their concern about the potential for fraud, a logical conclusion given the immense growth of ICOs over the past few years. On the investor side, many people want a new asset class with a potentially attractive yield. That is great! However, there are more than just a few who want to get rich quick by buying the next Bitcoin, those who want to create a new currency or payment mechanism, and those who want to use the new asset class in illicit finance.

I would like to put a bit of water onto the fire of the “get-rich-quick” crowd. I would like to add words of caution to those who want to use these assets as a payment mechanism, and stronger words of caution to those who wish to use this as a currency. I would like to crush those who want to use these assets for illicit finance. Anti-Money Laundering and Counter-Terrorism Financing risks are probably top of my list of concerns in this field.

So given all of this, why are investors so keen to get their hands on digital assets? Amongst the many reasons, novelty is a major draw, linked in part to fear of missing out.

Digitised assets have the capacity to:

- Increase financial inclusion for the under-banked or un-banked
- Create investments that may be more liquid and fungible
- Reduce costs
- Increase the investor base available to start-ups or SMEs
- Increase payment efficiencies
- Facilitate international remittances

However, these benefits are not without risks. Regulators remain particularly concerned about consumer protection risks, as consumers may not understand what they are buying and in most cases protection mechanisms haven't been created or adapted to protecting them yet.

Furthermore, security remains a massive concern – both cyber and real-world. Reviews of cyber incidents have since shown that much of the blame can be attributed to weak cyber security measures. There has also been an increase in physical attacks on crypto assets and related infrastructure (including thefts of Bitcoin ATMs). How digital assets can be protected will greatly impact on their uptake in the future. Cyber security can only be solved with a public private partnership effort, and, we must remember that cyber defences are equally as much human resource management issues as they are IT issues.

However, there is more light than dark here, in my view.

Here I go back to what I said earlier: We need to create a collaborative ecosystem that incorporates so much more than just the right regulatory framework to really make it work. What do I mean by that? Well, digital assets do not exist in a vacuum. Given their links to the real world and real-world assets, the inefficiencies we find in real world assets will continue to affect the efficiency of digital ones. That means that the development of digital assets cannot be in isolation and needs to be part of a much wider and wide-ranging transformation.

Such a transformation will enable digital assets to move to a real change in the quality of the product. However, it will require growth in infrastructure, as well as increasing interconnectedness between multiple systems. And continued improvements in the technological capabilities of digital assets and how secure they are in practice.

Specifically, we consider that the following elements will be required:

- Reliable custodian measures
- Relevant laws and regulations
- Sufficient cyber security standards
- Consumer protection requirements
- Financial literacy and market education
- Linking to relevant government services or registries, for example, for intellectual property
- Real-world settlement mechanisms, where relevant
- Real-world enforceability of rights

And this is what could be revolutionary in the future yet we are not there yet. Going forward, I think that the crypto-assets market, as a whole, will be increasingly subject to regulation. This is a very good thing. Regulating crypto-assets should mean that the volatility affecting the market would decrease even as the investment in cryptocurrencies continues to expand.

Whilst the adoption of cryptocurrency adoption is most advanced in developed countries, all indicators show us a relatively quick growth in activity and interest in emerging markets within MENA. Given the promises and enhancements technology could provide, governments across the region are now implementing various services to support the region’s thriving crypto products and FinTech ecosystem. Governments cannot simply say, “not here”, because “here” is also hard to define with web based products and services.

For the DFSA, working with FinTech firms is not just about letting them into a market and putting in sufficient controls. Many of the risks are still not fully clear, so we cannot be sure that the conventional controls, on which regulators have traditionally relied, will even work. Instead, we think it is important to think broader than that and to plan our approach more holistically. And this is applicable to many types of FinTechs and not just digital assets.

And like many regulators across the world, we are looking at our role within this development. For us, this currently includes the following:

a) creating of our regulatory sandbox (our Innovation Testing Licence programme)
b) creating of fit-for-purpose regulatory regimes (including crowdfunding)
c) working closely with the financial services industry and being open to dialogue; and
d) working closely with the other UAE regulatory authorities to develop a more unified approach.

In a world where technologies and markets are fusing, there is a case that regulators need to work together far more closely. In August 2018, the DFSA, in collaboration with 11 other financial regulators from around the world, issued a discussion paper announcing the establishment of a Global Financial Innovation Network (GFIN) and consulting on its proposed functions. GFIN is a network of leading global regulators, which will seek to conduct joint work and share experiences of financial innovation, to improve financial stability, integrity, customer outcomes and inclusion, through the responsible adoption of emerging technologies and business models. By joining the GFIN, we intend to ensure that the development of innovative financial services takes place sustainably and effectively, across borders.

It will be through the coordinated government investment and the continued development and refinement of various types of financial technology that digital assets can start to deliver on some of the potential they have.

Until that point, we may continue to see scepticism from regulators. Contrary to what the market would have everyone believe, we can get excited about innovation. But even though we are acutely aware of what is at risk when it's wrong, we are really excited for it to go right.

As the world of finance and money keeps transforming before our eyes, crypto assets and innovative financial channels, instruments and systems are creating new paradigms for our industry. These advancements are not only set just to transform markets, but also to affect the assumptions which lie behind their regulation.

Regulators ought to be responsive and adopt a pro-innovation culture. We should "adapt" to these new changes, but we probably should not "lead" this change. On a more philosophical note, this leaves us to constantly ponder one question: What is our purpose as a regulator, and the value our intervention brings to society? A deep question but one, which we must all now, consider. Our mission statements do not end with a comma, except for FinTech. Our mission includes FinTech.

Those mission and vision statements on the wall of every regulator are not just artworks; they have real meaning. Our mission as a regulator is not to test compliance with a rulebook. Our mission is also not to be popular or necessarily liked. Our mission is much deeper than that as regulators, which forces us to look at those statements when we decide the path forward for all new products and services. Dust those statements off, or change them if you want, but follow them.

Thank you!