

Governments' role in the evolution of fintech

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Governments globally are recognizing the emergence of financial technology (fintech) as a means to deliver social and economic outcomes more effectively and efficiently.

To some, governments seem to be allowing fintech startups free rein while saddling traditional financial services with ever-increasing regulatory burdens. To others, government support is necessary for the healthy development of the fintech sector, which can potentially revolutionize financial services products, services and delivery mechanisms worldwide, as well as deliver social and economic outcomes more effectively and efficiently.

How can governments strike the right balance — and how can fintech and financial services industry players alike shape this ongoing conversation?

Divergent approaches with a common goal

Looking at developments worldwide, it is clear that there is no consensus on how or where government support should play into the evolution of the fintech sector and, in turn, its role more broadly within the financial services industry and national economy. For example, the UK government has focused on supporting the fintech sector through financial incentives such as grants and tax incentives, including a recently announced £2 billion government investment in businesses conducting technology research and development. In Singapore, the Monetary Authority of Singapore (MAS) established a dedicated fintech office with funding from across government entities to drive the

development and promotion of Singapore as a fintech hub, and has recently announced the easing of regulations surrounding venture capital investment in early-stage startups.

Not only do different governments have divergent views on the proper role of legislation and regulation with regard to fintech innovation, but considerable points of divergence can even be seen between some countries' federal regulations and those applied at the state, province or territory level. This is particularly evident in the US, where the complexity, lack of regulatory uniformity across states and varying state legislation can pose significant roadblocks for fintech companies. States like California and New York are strong fintech hubs due to loan programs, tax credits, grants and more, while many other states lag behind.

Variations in countries' approaches to policy and regulation will always exist; however, the current diversity in approach may speak more to uncertainty surrounding the impacts and implications of new technologies than it does to differences in political ideology. Regardless, it is clear that governments internationally believe that fintech is key to the future of the financial services industry, and that their support is necessary to guide the sector's development for the good of consumers, businesses and the global economy.

Government motivations in supporting fintech

At its most basic level, the role of the industry remains the same, regardless of the presence of new technologies: to provide access to necessary financial services to individuals, businesses and other organizations. Yet, while the core goals remain the same, the mechanisms by which these goals may be achieved are undergoing significant transformation. Governments are now asking the same questions that are on the minds of many financial services executives: What are the risks and benefits of these technologies, and how can we embrace and encourage change without courting disaster?

By supporting and promoting fintech, governments are broadly looking to achieve four core goals:

1. Increase financial inclusion and access.

Fintech provides new opportunities to expand the reach of financial services to the un/under-banked and the un/under-insured, with potentially substantially positive impacts for the public good. In developing markets, fintech can provide the mechanism by which millions or even billions of people can gain safe access to basic financial services, especially in remote areas. In developed markets where access is less of an issue, fintech solutions can provide financial services institutions with a greater wealth of data that can, for example, allow a bank to underwrite credit to an individual who lacks a sufficient traditional credit profile.

2. Improve efficiency.

Governments must ensure that the country's financial system is efficient and sufficiently robust, which makes enabling technologies and solutions such as real-time payments, open application programming interfaces and blockchain especially appealing.

In addition, efficiency gains will increasingly require greater levels of public and private sector collaboration. For example, regulators working with industry participants and fintech companies to pilot KYC (know your customer) utilities in their effort to remove a major inefficiency in current practices.

3. Stimulate competition.

Healthy competition is always a motivating factor, and it is clear that new fintech players in the market are already a driving force for competitive change. One area where governments' impacts can be seen is through the authorization and bank licensing processes for new entities. For example, regulators and policy makers in the UK and Germany have been assisting fintech startups to obtain banking licenses, supporting the rise of a number of so-called 'challenger'



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banks, many of which are mobile-only entities. Other directives, such as the EU's second payment services directive (PSD2), also fit under this broad umbrella.

4. **Ensure stability.** Finally, governments wish to ensure the stability of the financial services system as a whole by managing any emerging bubbles and potential systems risk areas. In relation to fintech and the disruption it poses to the industry, this goal can initially seem counterintuitive; however, fintech's potential to foresee larger, systemic risk areas through cognitive systems and artificial intelligence (AI) outweighs the effect of short-term industry disruption. Core areas of government interest in this regard include using technology to gain a clearer line of sight on emerging risk areas surrounding conduct, credit, residential mortgages, and more, as well as providing access to tools and techniques that will allow better management of that risk or more efficient means to comply with regulatory obligations (a subset of fintech referred to as regtech).

Turning goals into action

In working to achieve these goals, much of government activity worldwide is understandably focused on modifying existing regulatory frameworks and enacting new legislation where there are acknowledged gaps or shortcomings. This can range from providing class exemptions and introducing new regulations such as PSD2, to providing guidance around areas such as data management, blockchain and robo-advice.

Yet changes to policy and regulation only come following periods of learning and consultation. To support this activity, government actions can be broadly described by the 'three Es':

1. **Engage.** Engagement with both the fintech startup community and the broader financial services community is essential to develop an understanding of current trends, use and risks of emerging technologies, and other

developments. Core government engagement activities include setting up digital innovation hubs and forming advisory committees. Some government representatives are also taking less formal approaches, including attending meet-ups and visiting fintech accelerators to expose themselves first-hand to these industry developments.

2. **Educate.** Understanding the complex issues surrounding the fintech sector and the technologies that drive it is critical to being able to create effective regulations and good fiscal policy. Building on the 'engagement' activities above, governments are also actively working to better educate themselves on the complexities of this rapidly changing industry. Such actions can include talking to other government entities within the country, as well as internationally; conducting research; and speaking to industry experts.
3. **Experiment.** Given the potential impacts and consequences of certain changes, safe experimentation is important to maintaining stability during a period of rapid change. This is why governments are frequently seen doing things like setting up sandboxes and running hackathons. In some places, like Australia, sandboxes are only made available to startups, whereas in countries like Canada and Singapore, sandboxes are open to all industry players. Such actions can thus also work as a litmus test for the government's perceived role in the development of the fintech sector in the local market.

Governments may also consider how they can experiment and affect changes to policy in a more accelerated time frame than traditionally the case, helping to test and learn themselves.

Outside of regulation, government actions designed to attract capital — such as attractive taxation policies and providing access to government grants — can also have a significant

impact on fintech's development. For example, Singapore recently announced a number of new incentives specifically designed to attract venture capital (VC) investment into their local technology ecosystem, including fintech VC support.

In addition, policies surrounding the mobility of talent and attracting skills through work visas can also help or hinder local entrepreneurial activity. As an example, passporting, visas and the availability of talent to support technology and financial services companies in the UK and the US have been areas of growing concern since Brexit in the UK and the new Trump administration came into office in the US.

Finally, governments themselves are large procurers of technology capabilities and there are opportunities for them to engage with fintech companies to help government in areas such as data and analytics, digital identity, payments and transactional banking. More progressive governments will be opening up data, in a safe and controlled manner, for startups to innovate and create new forms of value.

Shaping the conversation

Government influence is an important factor in the financial services industry. However, while legislative and regulatory change is needed not only to support and promote fintech but for the health

of the industry as a whole, some would argue that this support can go too far, providing fintech startups with an unfair competitive advantage.

A careful balance must be struck, with regulations providing necessary protections and encouraging startup innovation without hindering the development of traditional institutions' products, services and platforms. This is why the input and feedback of all industry players is critical during this time of change. Active engagement with government, whether through formal feedback mechanisms such as advisory committees or more ad hoc opportunities and conversations, can help shape the future of the industry for the benefit of all stakeholders.

Unlike VC investors, government's involvement in fintech or any industry shouldn't be in 'picking winners' or backing particular ideas. Rather, government should work to promote both startups and established entities within the sector, help to invest in education and research, enable appropriate infrastructure and explore opportunities for engaging fintech companies themselves. The insight, guidance and feedback of industry specialists is key to achieving these goals. ■

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