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FinTech Offers Multinational Innovation

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International Finance Centres are now more in the centre of FinTech innovation than ever before. They have the ability to craft innovation sandboxes, if you will, where FinTech firms can start without all of the heavy burdens of legacy regulations. Regulations that handicap innovation with burdensome and irrelevant rules. [1]

FinTech, simply defined, involves the design and delivery of financial products and services through new technology. FinTech impacts financial institutions, regulators, customers, and merchants across a wide range of industries. These global digital technologies are challenging the fundamentals of the highly regulated, centralised financial sectors, leading to the emergence of non-traditional payment systems, peer-to-peer money exchanges, and increased turbulence in currency markets.

FinTech comes in two strains. Those two strains are automation and innovation. Automation is the automation of some processes that were already in place but less efficient. The technology is aimed at creating a tool that can fill a need, automating a process that used to be very manually intensive. Also to bring better service to a greater breadth of a population such as the unbanked or smaller customers that are not economical for traditional institutions to service. Innovation is the creation of something new and utterly compelling for a market niche.

The two most remarkable FinTech solutions occurred in the United States and Kenya. In the United States, after 9/11, when all of the aircraft were grounded, the Federal Reserve could no longer clear cheques. It was a little known fact that the physical cheques crisscrossed the United States every day and every night via aircraft. When you mailed a cheque from Florida to

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Texas to pay your credit card bill, that cheque has to come back to your bank to clear. Once a cheque was deposited into a Texas bank, it made its way into the Federal Reserve clearing systems and was brought back to Florida and presented to the maker's bank for payment. After 9/11, the Federal Reserve, seeing the fragility of its physical cheque clearing procedures, began a process called 'Check 21', bringing the system into the 21st century. The new process led to the use of a captured image of a cheque to substitute for the physical cheque, so the clearing between banks was accomplished electronically. Eventually, the technology came to the retail sector for instant cheque depositing at stores, then onto Automated Clearing House (ACH) payments. ACH payments are electronic payments that pull funds directly from your bank account by initiating a debit transaction in your account and a credit transaction in your merchant's account. It is also referred to as Direct Deposit for payroll or credits or automatic bill payments for debits. These are all types of ACH payments.

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Kenya hosted the creation of M-Pesa. M-Pesa is a mobile banking and payment system operating in Kenya and a few other countries. The total number of M-Pesa accounts in Kenya has long since eclipsed the number of traditional bank accounts. Its ease of use and reliability are a huge feature. On a trip to Kenya, we had to buy 10 litres of petrol in the bush. Seeing "Petrol" very neatly painted on a tin shed, we knew this was where we could buy the petrol. In 30 seconds, the driver and the petrol man exchanged price and account information, and, with their phones, they made and accepted the payment in seconds.

Disintermediation of traditional models

FinTech is also about the disintermediation of the traditional financial business models across six financial industry segments: Payments, Financial Research, Insurance, Deposit and Lending, Investment Management, and Crowdfunding. The innovations have been nothing if not breathtaking. Around the globe, the payment, deposit, and lending technology have brought in many of the unbanked, facilitating payments at a fraction of the cost of traditional methods. Financial Research is using AI to sources opportunities that may have gone unseen and tokenisation to fractionalise and track ownership in non-traditional investments or transactions. Insurance providers are now able to sell insurance over your mobile device, bill insurance by the mile, and rate different drivers by their driving habits. Investment management has seen the rise of the Robo advisors and credit coaching applications to millions at very affordable pricing or nearly free. Crowdfunding has matched the entrepreneur with venture capital from the public without the filtering of a VC, securities broker-dealers, or your uncle's keen insight – for better or for worse.

FinTech is bringing services to those who need the services but were previously not an economically viable group for the traditional models. In the US, there are 30 million businesses, and 24 million are sole proprietorships. Think of landscapers, the food truck you love, auto repair shops, the corner pub. FinTech is bringing services to this very population. Larger banks, advisors, insurance companies, etc. were just too expensive. The traditional institutions did not make it easy as this market segment was not profitable for them. FinTech facilitates the inclusion of these people and businesses into the financial ecosystem.

Data Gaps

Where is the push back coming from? Yes, it's the regulators and central banks.

FinTech has created data gaps that the regulators and central banks find unsettling.

Many FinTech companies are classified outside the financial sector, as many were set up initially as IT companies. Underpinning the knowledge gap is the fact that these firms are small, diverse, often multinational, and not easy to identify. The lack of granular information on the transaction flows is problematic. For example, the FinTech services and accounts include intermediaries providing financial services that bleed over into the traditional financial institution's sector. Traditional financial institutions have been embracing innovation by sponsoring wholly-owned technological start-ups. However, their FinTech activities and results are buried in the financial institutions' reports – these results are not disambiguated.

What central banks and regulators see are new assets, services, and firms outside of the regulatory framework. Further, many firms are small, diverse, and are not recognised as FinTechs.

In short, the diaspora of multinational innovation and money flows are depriving the regulators of oversight and control. Some of this concern is tied to new opportunities for money laundering. This is a legitimate concern. Other fears revolve around unfettered or even unknown growth in the money supply, which could lead to inflation. This, too, is a legitimate concern

The recommendation for FinTech regulation from the Bank for International Settlements was;

"There is also a demand for stronger international coordination, not least to enhance classification standards and develop harmonized cross-country statistics, a precondition for any meaningful analysis of fintechs' impact on the global financial system".

This is hardly surprising.

IFCs Offer Flexibility And Stability

So, where do the IFCs fit? IFCs provide the opportunity for FinTech firms to spread and test their innovative and commercial wings. A platform hosted in an IFC has the benefit of flexibility, stability, and competent courts, tied with fit regulators and lower costs of operation. An IFC is an added advantage when looking to do business with the unbanked, smaller frequent transactions, and a population that cannot access independent and competent advisory services. Trust is placed as much in the company as in the jurisdiction from which it operates.

This is not to say that the regulators should take a *laissez-faire* approach. The regulators should keep in mind the expectations of international regulators, law enforcement, FinTech investors, and customers. The expectations are the same for all - a straight deal with no surprises.

Research on successful FinTech companies has indicated that FinTechs are most successful at the disruption of the financial sector if the applications are: clean and easy to understand; address and occupy a specific and strategic market niche; enable non-traditional methods of credit rating; and improve the inclusion of previously excluded market segments.

Footnote:

[1] *I am reminded of a custodial bank which issued several letters of concern by regulators for their cash handling and lack of any meaningful policy, the acceptance of cash, proper ID when accepting cash, money logs, and accounting for cash on hand. Their defence was 'We don't need this because we do not accept cash". Undeterred, the regulators said that the regulations require the bank to have those policies and procedures in place. They had to relent. The first draft of their Cash policy began, "We do not take cash. Anyone found handling cash other than their own, will have the cash removed by their direct supervisor and sent to the board where the money can be split amongst the members". I am sure something else made it to manuals. A shame, actually.*

ABOUT THE
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Mr. Files is an international financial investigator and due diligence expert who has run cases in over 130 countries and has visited over 100 countries. Mr. Files has tackled investigations running from a few hundred thousands dollars to over 20 billion. Along the way he became familiar with the knowledge of what people need to do, for due diligence, preventing corruption, and to avoid helping criminals launder money. He brings this experience of hands on investigating and

problem solving experience to his lectures on Due Diligence, AML, and Anti-Corruption. Prior to founding FE&E, Inc. he served as the Director of Corporate Finance for American National an investment bank focused on development stage venture capital. He was also employed by Oppenheimer/Rouse as a commodities specialist trading customer accounts in Agri-Business and 24-hour gold, silver, and foreign currency trading. Mr. Files has authored six books, and many white papers and articles. He has been quoted in major publications including The Guardian, The Financial Times, Forbes, US Newsweek and more. He is the author of the award wining book Due Diligence For The Financial Professional 2nd Edition. Mr. Files serves on the board of directors for several private companies, funds, and non-profits. Mr. Files active in several civic organizations. In the past Mr. Files has served as a member of the Arizona Governor's Board on Solid Waste Management, as an advisor to the Governor's Board on Economic Planning and Development. Mr. Files has also received a Commission and a Medal of Merit from the President of the United States.


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