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New Fintech Regulatory Framework in the Making

The financial-technology industry's rapid growth is posing new regulatory challenges for the integrity, safety and soundness of the financial system. In this light, on 2nd June 2016 announced the establishment of a Financial Technology Enabler Group (FTEG), which will be responsible for formulating and enhancing regulatory policies to facilitate the adoption of technological innovations in the Malaysian financial services industry.

The FTEG is part of the BNM's commitment to support innovations that will improve the quality, efficiency and accessibility of financial services in Malaysia.
Earlier on 26 May 2016, Governor Muhammad Ibrahim in his Keynote Address at the ASLI 20th Malaysian Banking Summit announced that BNM will be introducing a framework to regulate the financial technology (fintech) industry by July 2016. BNM is expected to craft a new framework to deliver a number of benefits and which is expected to provide regulatory clarity for fintech start-ups, and for financial institutions and consumers that use their services.

Fintech, by definition "is a line of business on using software to provide faster and cheaper financial services, and fintech companies are generally start-ups founded with the purpose of disrupting incumbent financial systems and corporations". According to a recent McKinsey report cited by Governor Muhammad Ibrahim in his speech, the number of fintech start-ups globally has now exceeded 2,000, more than twice the number than in the year 2015, and the growth is expected to escalate.

Fintech developments such as blockchain, artificial intelligence and biometric applications are now expanding the frontiers of banking and financial solutions. In the area of payment services, e-payment has revolutionized payment mechanisms through convenient and accessible channels. The launching of the Investment Account Platform (IAP) in February 2016 by a local bank was the most recent initiative in Malaysian Islamic finance industry and is an important example of a collaborative strategy by the industry to bring game-changing innovations to the market. The IAP is the first Islamic bank-intermediated internet-based platform that combines the expertise of Islamic banks with the efficiency of technology to channel funds from investors to viable economic ventures. As such, IAP promotes risk-sharing financial transactions by providing the platform for musharakah and mudharabah-based bank financing.

Due to the profound implications of new technology, BNM has to ensure the regulatory framework remains appropriate to identify and manage the risks in a timely manner while encouraging productive innovations that would drive costs down and improve the quality and range of services to consumers. Therefore, BNM is looking at this from several prospective –

(1) the impact of fintech strategies on the management of risks by financial institutions;

(2) the potential for fintech start-ups to introduce new risks to the broader financial system as a result of regulatory arbitrage; and

(3) the impact to customers including protection on customer data.

However, the potential impact of technological disruptions to the financial sector is estimated by BNM to be about 10% to 40% of overall banking revenue which will disappear by 2025 as fintech challenges the status quo in the financial industry. New business models will emerge while delivery channels will challenge existing norms and with the overall effect of reducing transaction costs. Fintech is transforming the financial landscape as the smartphone is fast becoming our "bank", computer programmes are offering investment advice and we are now can lend directly to one another online. On the other hand, although technology will replace many jobs in finance, fintech will also create new jobs.

Fintech is clearly not without risks, and the risks are very different given the different nature of technologies. For instance, there would be issues on the authentication and identity in digital payments and use of digital currencies which have implications for consumer protection and greater possibilities for fraud especially when it comes to P2P lending platforms or crowdfunding. Additionally, for cloud computing there is a potential risk of cyber security.

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