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FINTECH IN 2019: FIVE TRENDS TO WATCH

— THOUGHT LEADERSHIP

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Technology continues to have an enormous impact on financial services and the pace of change shows no signs of abating. Following the bold predictions we made last year, we highlight the five stand-out trends for fintech in 2019.

1

Crypto crackdown

There has been massive growth in the market for cryptoassets such as Bitcoin and tokens issued in initial coin offerings (ICOs), but market participants have faced uncertainty as to whether cryptoassets may be regulated financial products (and subject to scrutiny by regulatory authorities). Enforcement investigations globally have largely focused on issues of fraud, but now, there's a renewed focus on guarding the regulatory perimeter (i.e. ensuring businesses carrying on regulated activities have the appropriate authorisation). Disputes and enforcement cases are arriving in courts across the globe.

What's next?

- Enforcement activity focussing on the perimeter issue of necessary authorisations will increase.
- As changes in law and regulation take effect, authorities will expand enforcement activities to other issues including market manipulation compliance, anti-money laundering and investor protection, and there will be an increase in private civil litigation.
- Given the decentralised, international nature of cryptoassets and related activities, we expect to see international collaboration around enforcement activity. Questions of jurisdiction and applicable law will feature prominently as courts struggle to apply existing precedent to public and private blockchains and their international participants.

2

The Middle East: the fintech centre for the future

The Middle East will emerge as a highly-competitive, vibrant and successful fintech region. As part of the Emirates blockchain Strategy 2021, the UAE government has announced its intention to use blockchain for 50% of federal government transactions by 2021. The Abu Dhabi Global Market's (ADGM) and Dubai International Financial Centre (DIFC) have implemented crowdfunding regulations and, along with Bahrain, have developed international regulatory sandboxes with licensed fintechs emerging. In 2018, the ADGM introduced a licensing regime for crypto-asset business, Fintech Saudi was launched and further sandboxes were introduced in the UAE and Kuwait.

What's next?

- A number of world-leading projects are expected from the region. Digital assets and Islamic finance projects are high on the agenda, with a number of fintechs creating pioneering concepts. This includes a project to create a market leading blockchain platform for Islamic capital markets with a DIFC "innovative testing license" from the regulator, and tokenisation projects under discussion by major institutions.
- Market-transforming legislation is on the agenda in Bahrain and the DIFC, and the UAE Securities and Commodities Authority has announced plans to regulate ICOs and has prepared crowdfunding rules.
- We can also expect to see significant tech investment activity continue from the region's sovereign wealth funds and other investors, following Saudi Arabia's Public Investment Fund (PIF) and the UAE's Mubadala positioning themselves as world-leading tech investors.
- Dozens of global financial institutions have established fintech accelerators and incubators in Israel. Whilst this gives those institutions a first look at acquisition opportunities, the volume and scale of Israeli fintech companies means that many look to international markets to fuel their growth. We expect to see an increasing number do so in the year ahead.

After the data deluge, what next?

2018 saw businesses and consumers overloaded with data and grappling with GDPR. How data is used, stored, transferred, processed, protected and valued is high on the political agenda and will be central to how financial institutions remain competitive in 2019.

3

What's next?

- Businesses need to deal with data ethics. Consideration has to be given to the monetisation, use and trade of data as well as issues relating to transparency, bias and customer control. Those "doing the right thing" will set themselves apart as leaders.
- The risks of data loss and misuse are significant – trust and shareholder value can disappear overnight. We predict 2019 will bring large fines and reputational damage to big-name financial businesses.
- Data will be an international trade issue: on the one hand, countries such as Japan are aligning data privacy standards with GDPR to secure access to the EU "data market" whereas in others, data protectionism will emerge under the guise of data privacy, cyber security and national security.

Digital capital markets?

In 2018, we saw a number of virtual prototype bond issuances including the World Bank's "Bondi" bond, issued and managed using only blockchain technology, and the first issuance of digital tokens representing common stock by a US Real Estate Investment Trust (REIT). Regulatory-compliant "Security Token Offerings" (STOs), have become a focus for businesses raising capital.

4

What's next?

- In 2019, traditional market participants will build a reliable track record of blockchain-based bonds and capital markets products using permissioned platforms run by industry consortia, with the legal and regulatory considerations being ironed out.
- There will be a focus on digitalising the initial stages of transactions including market soundings, book building and allocations; settlement and ongoing maintenance will continue to pose the greatest challenges for digitalisation.
- STOs will increase, drawing more first-time issuers from established industries looking for an alternative to legacy models of raising capital. Underlying market infrastructure will continue to evolve to meet the demand for STOs at scale and historical constraints on market growth will recede as regulated service providers enter the market.

Tech reg (not reg tech)

Regulators recognise that new technologies bring new risks requiring bespoke regulation. Charles Randell, chair of the UK's Financial Conduct Authority, warned in 2018 that the financial services sector risks a "Cambridge Analytica moment". AI tools have made unpredictable decisions and engaged in anti-competitive, unethical and potentially market abusive behaviours. Blockchain offers new technology interconnections between financial institutions.

5

What's next?

- Existing technology regulation (e.g. of crypto wallet providers/exchanges, algo-trading controls and conduct rules for robo advisors) will extend in scope and geography. With the EU and Japan leading on algo-trading rules, other global regulators are under pressure to respond.
- New technology regulations for financial institutions will be passed addressing potential conduct and financial crime risks but also tackling the systemic issues technology can pose to financial markets, something the Financial Stability Board is already wary of.
- In this new technology environment, regulators will hone their own tools to help with supervision so expect "Sup Tech" to be big in 2019.
- Distinctions between unregulated "software development" and regulated activity will continue to blur and use of shadow infrastructure will continue to grow.

C L I F F O R D

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