

World Federation of Exchanges: FinTech in the Market Infrastructure Space

INTRODUCTION

The World Federation of Exchanges (WFE) is the global industry association for exchanges and clearing houses. We represent more than 200 market infrastructure providers, of which more than 100 are Central Counterparties (CCPs) and Securities Depositories (CSDs). Our members include exchange groups and standalone CCPs.¹

Our members are both local and global, operating the full continuum of financial market infrastructure in both developed and emerging markets. Of our members, 41 percent are in the Asia-Pacific region, 40 percent in EMEA and 19 percent in the Americas. WFE exchanges are home to nearly 45,000 listed companies, and the market capitalisation of these entities is over \$67.9 trillion; furthermore, around \$84.18 trillion in trading annually passes through the infrastructures our members safeguard.²

The WFE works with global standard setters, policy makers, regulators and government organizations to support and promote the development of fair, transparent, stable and efficient markets. We share their goals of ensuring the safety and soundness of the global financial system.

Furthermore, we believe there are significant benefits to the wider population of integrated financial markets, and we think it important to have strong common principles, approaches and supervisory coordination to promote financial integration and market integrity, whilst safeguarding supervisory coordination. This is fundamental to well-functioning and safe markets in which investors can have confidence.

BACKGROUND

New technologies have the potential to change the financial industry and the way firms and markets operate.

Whilst technological innovation in markets is not new, investment in technology and the pace of innovation have increased significantly in recent years across all parts of the industry, and across all parts of the supply chain. This is giving rise to new services and business models by established financial institutions and technology companies, and new market entrants. Among the technological innovations driving this change are artificial intelligence (including machine learning and big data analytics, etc.), machine learning, mobile applications, cloud computing, distributed ledger technologies (DLT) and big data analytics – many of which are relevant to the exchanges and post-trade infrastructure providers that sit within the WFE's membership.

New technologies can benefit both individual consumers and firms by enabling greater access to financial services, choice, efficiency, and a more competitive landscape. However, they can also introduce risks, including operational, data privacy, and cyber-related. Exchanges and post-trade infrastructure providers are considering how to use these technologies to offer new services, improve operational efficiency and cut costs whilst ensuring the markets remain safe and resilient.

FinTech has been and remains one of the WFE's key priority areas. This has led to many initiatives over 2016 and 2017, including research and work on behalf of IOSCO³, and input to regulatory consultations⁴ as global, regional and national authorities consider their approach to the regulation of FinTech.

¹ The WFE membership list [can be found here](#)

² As at end 2016

³ WFE/IOSCO Survey: [Financial Market Infrastructure and Distributed Ledger Technology](#) – August 2016

⁴ WFE Response to ESMA Discussion Paper: [Distributed Ledger Technology Applied to Securities Markets](#) – September 2016

WFE Response to European Commission Consultation: [FinTech – A More Competitive and Innovative European Financial Sector](#) – June 2017

WFE Response to UK FCA Discussion Paper: [Distributed Ledger Technology](#) – July 2017

Given the continued, growing interest in, and importance of, FinTech to the wider WFE membership, in 2017 the WFE established a formal FinTech Working Group (FTWG), comprising senior technology and innovation representatives from nearly 20 exchanges and CCPs globally. The purpose of the Group is to enable members to develop comprehensive and coherent industry policy positions to help shape regulatory thinking in this space, whilst also sharing information about new developments.

WFE VIEWS ON FINTECH AND THE REGULATORY ENVIRONMENT

This section seeks to summarise WFE's current views on FinTech and the regulatory environment in which our members operate. These high-level considerations are intended to support ongoing compliance efforts, to ensure that markets are not only resilient, stable and robust, but are also able to operate on a fair and level playing field with regards to FinTech. In addition – and importantly – they are intended as a prompt for further regulatory and industry discussion to ensure – as and when they are developed – rules, standards, guidelines and expectations are designed that appropriately fit the nuances of global markets operating in local jurisdictions.

Market driven innovation

In general, innovation should be market driven. This could not only improve the efficiency and functioning of the market, but also potentially benefit regulation as well⁵. Nevertheless, it is clear that authorities have a role to play in ensuring the system remains stable in the face of changing technology, and indeed that some innovation may in fact be prompted by regulatory initiatives (RegTech, for example). In any event, global authorities should be proactive in engaging with the market to identify the nature of the application, to understand the technology which underpins it, and to work with the market to ensure the existence of an appropriate regulatory framework.

The scope of existing regulations should be broadly sufficient

We believe the scope of existing regulations should generally be sufficient to extend to many or most potential FinTech initiatives; this is because initiatives tend typically to be based around new *technologies* as opposed to new *activities*. Nevertheless, it is important regulators consider initiatives on a case-by-case basis to determine legal or regulatory impact. Legislation, rules and practices should only be adapted if strictly required, and be technology neutral, i.e. avoid conferring undue advantage to one technology over another (or inadvertently limiting competition by unnecessarily increasing barriers to entry).

Any regulatory approach should encourage innovation whilst ensuring investor protection and system stability

The development of regulatory and/or legal standards should not prevent market and technological innovation. It is important that the authorities remain focused on ensuring investor protection and the safety of markets whilst at the same time encouraging an environment that enables financial technology which improves efficiency and stability of the capital markets. In order to do this, it will be important that legislators maintain an ongoing dialogue with market participants and keep track of evolution in this space to ensure the necessary investor protection measures remain adequate to the business conducted.

⁵ For example, possibly encouraging a gradual shift of reporting from an ex-post to an ex-ante activity, enabling more proactive policy-making

The implications of outsourcing

Due to the systemic importance of exchanges and CCPs, regulation and supervision must consider the implications of outsourcing of key market functions to a third party. It is a well-established supervisory principle that the responsibility for the outsourced functions should remain with the regulated entity. Whilst the technology inherent in FinTech applications itself may present unique risks (for example, operational, cyber, etc), the underlying principles of outsourcing remain sound and appropriate. As such – and in the absence of any other effect on regulatory roles and responsibilities - we see no reason why regulated entities' use of new FinTech applications and solutions in and of itself should be any different in principle to the outsourcing of any other function⁶.

It is important there is regular and open dialogue between regulators and the market

As described above, whilst we consider that existing regulations should in most cases be sufficient to broadly extend to potential FinTech initiatives, it is nevertheless important that authorities are proactively engaging with the industry to identify the nature of FinTech application, to understand the technology which underpins it, and to work with the market to ensure the existence of an appropriate regulatory framework (if existing frameworks are not deemed appropriate). In this regard, regulatory sandboxes and innovation hubs have proven to be a useful tool for the FinTech industry and these should be extended - where relevant - to ensure that appropriate collaboration and exchange of information occurs between industry (whether regulated, or not) and regulator. This will also enable regulatory applications to be tested and examined before they go to market ensuring minimal disruption and a shared understanding of regulatory expectations.

It is also important – where possible – to coordinate regulatory thinking in this space at the global level

Markets are increasingly international, and FinTech innovation is likely to have global applications and uses. As such it is desirable to have global consistency based on international guidelines and principles. We therefore believe – as far as possible – there should be collaboration at the international regulatory organisation level (e.g. within IOSCO in this regard) to develop a common approach and understanding. To ensure regulatory coherence amongst the wide range of current and potential FinTech providers and participants, a multi-layered approach to regulation should be avoided. Notwithstanding the proactive nature of regulatory scrutiny from national as well as regional authorities, we believe it highly desirable for a globally harmonised approach in a topic as internationally relevant as FinTech. FinTech is innately international with global applications and uses and therefore we believe any regulatory principles and/or guidelines should be developed at that global level.

There should be consistency in the application of rules to both incumbents and new FinTech entrants

The nature of FinTech innovation is such that non-financial companies may enter this market seeking to perform core market functions, some of whom may not have any experience of regulated environments. As such, it will be important that any regulatory framework ensures appropriate consistency between such firms and traditional regulated entities such as exchanges and CCPs. This is a precondition for maintaining the integrity, stability and fairness of the financial system. Services and activities based on new technology need to abide to the same rules as for incumbents. The risk is that a lack of awareness of the regulatory environment by previously unregulated entities may result in negative consequences for investor protection, and secure and orderly markets.

⁶ We acknowledge that aspects of outsourcing rules are currently under discussion in some jurisdictions – in particular relating to the cloud and the appropriateness of rights to physical access to relevant business premises of the service provider – the challenge being in practice this might result in a disproportionate burden for cloud service providers, introducing operational risk.

CONCLUSION

The WFE and its members are focused on ensuring transparent and orderly public markets; as such, we applaud the willingness of regulators to evaluate the benefits as well as the risks FinTech can bring in order to ensure this. We encourage regulatory authorities to remain focused on ensuring investor protection and the integrity and safety of markets whilst at the same time enabling financial technology which improves capital markets to advance unimpeded.

Given the universality of the issue and its systemic significance, global organisations and regulators must continue to play a key role in developing, fostering and promoting consistent industry-wide standards. Industry groups should also work together to ensure the common standards are the highest possible and consistently applied to ensure strength in the system. In that light, the WFE encourages standard setters and implementing authorities to engage closely with the industry, and to use the following high-level principles when developing and implementing requirements to ensure they are sufficiently flexible and workable.

Finally, notwithstanding the proactive nature of regulatory scrutiny from national as well as regional authorities, we consider it is highly desirable for a globally coherent approach in a topic as internationally relevant as FinTech. FinTech is innately international with global applications and uses and therefore any regulatory principles and/or guidelines should be developed at that global level. As such, we encourage regulators to continue to work alongside global authorities to ensure a common approach that enables innovation yet maintains the safety and resilience of the system whilst ensuring a level playing field amongst the wide range of incumbents and new providers.

ANNEX

Principles to consider when designing rules, standards and guidelines for Financial Technology in the Market Infrastructure space

- i. In general, innovation should be market driven and not be constrained unnecessarily by regulation;
- ii. Legislation, rules and practices should only be adapted if strictly required; the scope of existing regulations should be broadly sufficient to extend to many or most potential FinTech initiatives;
- iii. Any regulatory approach should encourage innovation whilst ensuring investor protection and system stability;
- iv. Whilst the technology itself may present unique risks, the underlying principles of outsourcing remain sound and appropriate and so regulated entities' use of new FinTech applications and solutions should be treated consistently with the outsourcing of any other function in the absence of other regulatory impact;
- v. There should be open, regular and proactive dialogue between regulators and the market in order for authorities to understand the technology which underpins FinTech applications, and ensure the existence of an appropriate regulatory framework;
- vi. FinTech is innately international with global applications and uses; regulatory principles and/or guidelines should therefore be developed at the global level to reflect the increasingly global nature of markets; and
- vii. There should be consistency in the application of rules to both incumbents and new FinTech entrants in the interests of maintaining the integrity, stability and fairness of the system.