Keynote Address at The Finance Today Summit

The Digital Path for Financial Industry – Innovation for Sustainable Growth

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INTRODUCTION

Thank you for the invitation to speak today. It is a pleasure to be here with you all in person and not worrying about who hasn't pushed mute, whether someone's camera is off, and whose dog is barking.[1]

The organisers of the Finance Today Summit have assembled an impressive set of conversations on how innovation and technology are driving change in financial services. Today I'd like to reflect on how these trends are reshaping the future of finance – and regulation. We regulators must keep our rules up to date. We must moreover encourage the adoption of better technology and responsible business practices so that we can work together toward "net zero" and a more sustainable future for all.

This adoption is what we commonly refer to as "digital transformation": while this transformation brings benefits for firms and customers, new technology may bring risks to operations. Today I'm going to talk about how financial regulators, such as the Dubai Financial Services Authority, are adapting in this fast-paced world.

Digital transformations

[1] The speaker thanks Elisabeth Wallace, Peter Smith, and Mary Keenan for their advice and input for these remarks.

It is easy to forget how much the adoption of new technology has changed the provision of financial services. After the 2008 financial crisis, Paul Volcker, the late former Chair of the Federal Reserve, famously said that the only useful thing banks had invented in 20 years was the automated teller machine, or ATM. In the 13 years since that quotation, we have seen a tidal wave of innovation. We need to be aware that although innovation can bring considerable benefits, not all of it would pass Mr Volcker's "usefulness" test. We see - far too often - solutions looking for problems. Perhaps this is inevitable given the range and pace of innovation?

Initially after the financial crisis, financial institutions have engaged in digital transformation mostly because they want to. This choice was generally about increasing operational and market efficiency and enhancing the customer experience. Firms that adopted new technology often did so to sharpen their "edge" against traditional competitors, but also to face off against non-traditional (and often technologically savvy) competitors in the "new" world of FinTech.

In 2022, and over the last couple of years, more financial institutions are engaging in digital transformations because they have to, and not solely because they want to. Operational resilience has become a new competitive landscape. Institutions that don't keep up with technology today will find themselves left behind tomorrow. The pandemic has driven this further, requiring financial institutions to accelerate their digital transformation as more and more activities move from offline to online.

THE BALANCE

We regulators must likewise transform ourselves and our rules to remain relevant. In the past, some of our regulations may have assumed that transactions would always encounter natural limits on their speed or value imposed by barriers such as distance, national borders, and even time. Yet these and many other sources of friction fade away when money moves at the speed of light and at nearly zero cost. Many of these innovations make our lives easier. We save time, money, and energy when we don't need to drive to a store to purchase a good or stand in line at a bank branch – or even at one of Paul Volcker's favoured ATMs – to deposit or receive funds.

As guardians of the safety and soundness of the financial system, we regulators face a dilemma: we want consumers and businesses to enjoy the fruits of useful and better technology and business models today. Yet we don't know whether these innovations may introduce bitter risks into the system tomorrow. So we encourage innovators and providers to build safeguards into their businesses that will protect customers but not increase costs associated with regulation so much that innovation becomes pointless.

When regulators grapple with this dilemma, market participants often accuse us of being resistant to change. I have a different perspective. We are in some ways custodians for the market: we always seek to take a responsible and objective view of new technology and new business practices.

Regulators are not here to eliminate all risk. That cannot be our job amongst firms that essentially price and then buy or sell risk. We fully support and encourage the use of technology in the delivery of financial services and in complying with regulation. Nonetheless, we do not encourage or support any innovation that comes at the expense of client protection, market integrity, or financial stability – all of which are core objectives for a regulator. Today we likewise take a dim view of “greenwashed” products and services that may undermine policy objectives related to sustainability.

Managing these objectives takes discipline. When a financial institution offers an exciting new product or service, we have to stop ourselves from saying, “How cool is that!” Instead, we train ourselves to ask, “What could go wrong?” or, “What could be the harm to customers, the market, the reputation of the Dubai International Financial Centre, and financial stability?” It is through this lens that regulators approach all new financial services and technologies.

Our hosts today have set out a broad agenda on so many interesting – and dare I say “cool” – innovations and topics. I’d like to share several personal reflections on one of the hottest topics in finance today, virtual assets. I’ll begin with an overview on the existing and proposed rules that the DFSA has issued for virtual assets. Then, as any good regulator should, I will ask, “What could go wrong?” and share some thinking on four key challenges that we see in this area. I’ll conclude with some of the initiatives we are involved in to help ensure that innovation does flourish in the Dubai International Financial Centre (DIFC) and across the UAE in a responsible and prudent manner.

NEW RULES

I’ll begin with some of the newest rules we’ve issued or proposed related to our virtual assets or “Token” ecosystem, as virtual assets are trending as a topic across markets and at this conference, too.

You simply cannot scroll through Instagram, read the paper online or drive down Sheikh Zayed Road without being reminded about crypto. Maybe you’re reading about the boom in the sale of non-fungible tokens, which are a kind of digital art.

Or perhaps you've wondered about developments in the online "metaverse" or anywhere that crypto assets are currently being mined – which is everywhere.

Investment Tokens

Last year, the DFSA issued CP138 on Investment Tokens. Investment Tokens are existing financial instruments, such as shares, bonds, or derivatives, that have been "tokenised," or rendered into a secure digital form.

The regime, much like our traditional regime for Investments, set out definitions of these Tokens, how to treat their issuance, how to treat those carrying out related activities, such as trading, and how these Tokens should be marketed, and to whom they may be marketed and sold.

We adopted our final rules in October 2021, and firms can now be licensed to deal with Investment Tokens in the DIFC.

Crypto Tokens

Investment tokens represented our first step into the virtual asset space. Earlier this month, we took a second step and issued CP143 on the Regulation of Crypto Tokens. We have called them Crypto Tokens, but others may refer to them as Cryptocurrencies, Crypto Assets, Digital Assets or Virtual Assets.

Crypto Tokens are typically not backed by any tangible asset and as a result their price can be unpredictable. This volatility doesn't seem to have dampened investors' interest. We even see large-scale marketing campaigns to legitimise and boost confidence in them among the public. Unfortunately, much of this advertising misuses statistics to suggest that historical appreciation in the value of these assets will continue indefinitely. These ads play upon "FOMO" – the fear of missing out.

Our proposals in CP143 were prompted by the need to introduce appropriate levels of investor protection. Some of the risks that we have seen, and are seeking to mitigate through these proposed rules, and existing rules, include (1) market abuse; (2) energy usage; (3) anti-money laundering and combatting the financing of terrorism; and (4) cybersecurity. I'd like to share brief thoughts on each of these four risks.

ISSUES NEW AND OLD

1. Market Abuse through "Finfluencers"

First, we're concerned about market abuse that may reflect the outsized impact that noteworthy individuals can have on this young market. A "finfluencer" is a new term to describe financial influencers and celebrities who leverage social media platforms to promote, advertise or recommend certain cryptocurrencies or NFTs. Platforms like Instagram, YouTube and TikTok provide the perfect storm – access to a large young audience, who can then seamlessly, in real time, access and buy those products or services at the touch of a button.

Some of you may know that Kim Kardashian promoted a crypto token called Ethereum Max to her 228 million followers. What was not disclosed was that Ethereum Max is not the same as the existing Ethereum virtual asset. Instead, Ethereum Max had been created a month before her Instagram post by unknown developers. The boxer and boxing promoter Floyd Mayweather likewise endorsed Ethereum Max.

We view finfluencers as “risky business” and remain concerned about misinformation, unchecked rumours and bad advice that can undermine investor confidence, and ultimately, orderly markets.

In CP143, we have proposed that firms we licence exercise care when they present any marketing or education materials via social media, and we want to see risk warnings put in place. We will monitor developments and consider any further guidance or direction for marketing as crypto activities grow in the DIFC.

2. Concerns about Energy Use through consensus mechanisms

Second, some have concerns about how much energy some crypto token schemes require. Many tokens are currently created or “mined” by a large number of computers working to solve complex equations and “voting” on the best solution. Regulators, politicians, and others have raised concerns about how much electricity all of those computers require to create crypto tokens as part of the process known as “proof of work”.

The European Parliament, for example, recently put forward an amendment to the “Markets in Crypto Assets Regulation” (MiCA) text that could have, in effect, banned Bitcoin. The provision had sought to limit the use of Proof of Work due to its energy intensive computing process, though it was not adopted.

Similarly, the Executive Order issued by U.S. President Joe Biden earlier this month calls for a report to address the effect of cryptocurrencies’ consensus mechanisms on energy usage, including research into potential mitigating measures and alternative mechanisms of consensus and the design trade-offs those may entail.

Some in the crypto community will argue that the energy use of proof of work is necessary and worth the cost for the level of security that it delivers. We know as well that some are working to reduce the energy requirements associated with the mining of crypto tokens. Still, this concern highlights a broader social debate on the tradeoffs involved: might society accept slightly less security for crypto tokens if it means more energy is saved? And while we could seek to power consensus mechanisms with renewable energy sources, we know that electricity markets in countries where miners are active are highly sensitive to crytpo mining activities. Should hospitals and schools pay more for electricity supply simply because of crypto mining? We are following this debate closely as we progress with our proposals.

3. AML/CFT

A more familiar challenge can be found in efforts to prevent the abuse of the financial system through money laundering or the financing of terrorism, which brings me to the third risk we seek to mitigate in crypto assets, this time through existing regulation.

As I'm sure you're all aware, the Financial Action Task Force (FATF), the global standards-setting body for anti-money laundering, updated its assessments of the relevant risk frameworks in a number of countries in March, which resulted in the UAE being placed under increased monitoring. The DFSA has long been and remains fully committed to this key regulatory priority. We are resolute in having zero tolerance for money laundering, terrorism financing and proliferation financing activities, nor for deliberate breaches of United Nations and UAE sanctions. We will continue to work closely with the Dubai International Financial Centre Authority (DIFCA) and alongside our fellow regulators and relevant government authorities to secure the stability and integrity of the financial system.

In that vein, in early February we issued our second Financial Crime Prevention Programme (FCPP) Report for 2019-2021, which was prepared and published in collaboration with DIFCA. The Report provides insight into the DFSA's supervisory and enforcement efforts on financial crime within the DIFC. The Report outlines the additional steps taken to align DIFC regulatory, supervisory and enforcement frameworks further with the FATF Recommendations by conducting monitoring programmes, thematic reviews, compliance assessments and notifications, which underpin an intensive and sustained cycle of supervision to reduce and mitigate the risks of financial crime.

We await with interest the FATF's next guidance on the regulation of Virtual Assets and Virtual Asset Service Providers, which will help shape our regulation of crypto tokens.

4. Cyber

Finally, as more of our assets and transactions move online from offline, cybersecurity becomes an even more significant policy objective. In this regard, in January 2020, the DFSA launched our Cyber Threat Intelligence Platform (DFSA TIP). It is the first regulator-led platform of its kind in the region and has created an information sharing system for firms in the DIFC through a public-private partnership.

Since its launch, over 150 organisations have registered to use the platform and 1.6 million attributes for 56,806 cyber threats are now posted to it. We continue to grow the platform and are looking to extend it to the wider financial services community in the region.

For today's event, the key point is that with business online, data in the cloud, information and funds speeding around the world, the need for robust cyber security resilience is greater than ever. We will expect firms licensed by the DFSA to focus on cyber security as a key priority.

Technology Guidelines

So, I've just covered four of the risks related to virtual assets and crypto tokens that we're trying to mitigate through regulation. Beyond that, we've been involved in some UAE-wide initiatives to foster greater confidence in the market and help ensure that firms are applying technology in a safe and secure manner.

We worked closely with the UAE Central Bank, supported by the Financial Services Regulatory Authority at Abu Dhabi Global Markets, and the Securities Commodities Authority, in 2021, to publish Guidelines for Financial Institutions on the use of Enabling Technologies.

The technologies covered include Application Programming Interfaces, Cloud Computing, Biometrics, Big Data, artificial intelligence and distributed ledger technology. In the guidelines, we've set out principles that financial institution should adhere to when using these types of technologies.

To cite one example, when firms use Big Data and artificial intelligence, we require them to promote fair treatment of customers and ethical outcomes that are aligned with the providers' standards and values. Similarly, when firms use biometrics, they must have the means to ensure the confidentiality, authenticity

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and integrity of the data provided throughout all phases of the authentication process.

Conclusion

This brings me to a final thought.

The acceleration of digitalisation in financial services has led to important benefits for consumers and providers.

Consumers can now receive 24/7 access to financial products and services and compare products at the touch of a button. In some countries, innovations such as mobile money have introduced unbanked individuals to formal financial services for the first time.

Firms can now distribute their products and services to a wider consumer base, reducing barriers to entry and time to market for new products. They can also use data in more sophisticated ways to help understand consumer demand and personalise financial products and services.

We see more opportunities for partnerships between financial institutions and innovative firms, which allow financial institutions to be agile and adjust to customer demands.

The pandemic accelerated in so many ways the digitalisation of not just our economic activities, but even our lives. While we had long been shopping and conducting some of our banking online, we learned to converse and even socialise using video conferencing and instant messaging. While we couldn't always travel to where we wanted to be, the Internet helped us to maintain connections and contact with friends, family, and colleagues near and far.

Yet after almost two years of working and socialising remotely, many of us learned from these amazing modern technologies the wisdom of the ancient Greeks: all things in moderation. As I mentioned, it's a pleasure to participate again in face-to-face meetings and in-person events like the Finance Today Summit. I suspect, nonetheless, that we'll continue to draw on innovations like videoconferencing and remote working where it makes sense to do so.

So, innovation will continue to be an important driver of change in financial services. As we explore and adopt new technology and new business practices, let me encourage everyone to tap their inner regulator and consider both the opportunities and the risks. Let's work together to build a more resilient, inclusive, and sustainable digital financial system that serves the needs of all.

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