



---

**PUBLIC LECTURE BY UNATHI KAMLANA, COMMISSIONER OF THE FINANCIAL SECTOR  
CONDUCT AUTHORITY (FSCA), AT THE NORTH-WEST UNIVERSITY**

***“BALANCING INNOVATION IN THE FINANCIAL SECTOR WITH THE NEED FOR EFFECTIVE  
REGULATION”***

**26 JUNE 2024**

---

## **Introduction**

The academic staff and management of the North-West University;

Students;

Distinguished guests;

Ladies and gentlemen;

Good morning!

It's a real honour for me to address you this morning. Let me thank Professor Chitimira and the University's Law Faculty for inviting me. At the Financial Sector Conduct Authority (FSCA), we always look forward to engaging and sharing insights on what we see in the evolution of the financial sector, how we think about the challenges and opportunities in the sector, and certainly how we understand our role as a regulator in navigating and responding to those dynamics.

## **The backdrop of the global financial crisis**

As a point of departure, after the 2008 global financial crisis, regulators and policymakers around the world focused on strengthening regulatory frameworks as a response to the crisis. I think we can all agree that, given the catastrophic impact of the crisis, such a focus was warranted, as global regulatory standards were found wanting somewhat. Here in South Africa, we also initiated a comprehensive financial sector policy and regulatory reform in 2011, which was the most significant reform in 30 years, aimed at strengthening our regulatory frameworks and enhancing the effectiveness, governance, and coordination of financial sector regulators. This initiative led to the adoption of the Twin Peaks model of regulation, which established the Prudential Authority and the Financial Sector Conduct Authority as the two primary regulators of the financial sector in South Africa.

As these reforms were being implemented, the financial sector continued to evolve, with technological advancements fundamentally altering the financial sector landscape, diversifying products and service offerings, and transforming how they are provided. This evolution was further accelerated by the COVID-19 pandemic, which increased the pace of digitalization of financial services. As we witnessed unprecedented advances in technology in the financial sector, we also encountered new risks and observed new vulnerabilities. The key challenge for us as regulators lies in fostering an environment that promotes financial innovation and growth, while simultaneously safeguarding the integrity of the financial system and protecting financial customers. Today, I want to talk about how we balance these two objectives - innovation on the one hand and the need for effective regulation on the other.

### **The imperative for financial innovation**

Now coming to the imperatives and drivers of financial innovation. The financial sector has always evolved in response to changing economic conditions, technological advancements, and consumer needs, demonstrating a continuous trend of innovation to drive and/or respond to economic outcomes.

During periods of economic growth, there is often increased demand for new financial products and services, encouraging institutions to innovate to meet consumer and business needs. However, economic downturns can also spur innovation as financial institutions seek to reduce costs and improve efficiencies. For example, during the COVID-19 pandemic, financial institutions rapidly adopted digital solutions to ensure continuity in the provision of financial services while adhering to the then necessary social distancing measures. As indicated earlier, this period saw a significant acceleration in the adoption of digital financial services, transforming how products and services are delivered and driving the need for further innovation to enhance resilience and efficiency in the financial sector.

Technological advancements have been a primary catalyst for innovation in the financial sector. Historically, the financial sector has seen several periods of significant innovation. The introduction of ATMs, credit cards, and online banking marked important milestones in the evolution of financial services. More recently, technologies such as blockchain, artificial intelligence, and machine learning have streamlined processes, reducing transaction times and operational costs for financial institutions. Today, the sector is able to execute a variety of financial transactions—from making payments to investing—with unprecedented speed and efficiency. These technologies not only improve agility and operational efficiency but also enhance the accuracy and security of

transactions. In the result, financial institutions can offer more reliable and cost-effective services to their customers.

Consumer needs and expectations also play a crucial role, as consumers demand convenience, speed, and personalisation in their interaction with financial services. This demand drives the development of seamless, user-friendly financial products and services. Additionally, competition from fintech startups and non-traditional financial service providers challenges established institutions, pushing them to innovate in order to stay competitive. Regulatory changes also drive and accommodate innovation by creating new opportunities and frameworks for development.

### **Impact of financial innovation**

So what do we observe as the key impacts of financial innovation? Innovation in the financial sector has far-reaching and transformative impacts that extend beyond mere enhancements in technology and processes.

One of the most significant impacts of innovation is the efficiency gains in the provision of financial services. Innovative technologies streamline processes, reduce operational costs, and improve service delivery. For example, automation and artificial intelligence can handle routine tasks such as data entry and customer inquiries, freeing up human resources for more complex and strategic roles. This not only reduces the risk of human error but also speeds up transaction processing times, thereby improving overall customer satisfaction. Additionally, blockchain technology offers a transparent and secure way to record transactions, reducing the need for intermediaries and thus lowering transaction costs.

Innovation can also improve the accessibility of financial services. In many parts of the world, traditional banking infrastructure is limited, leaving vast populations unbanked or underbanked. Mobile banking and digital payment systems have bridged this gap by providing financial services through mobile phones and other digital platforms. For instance, M-Pesa in Kenya has enabled millions of people to perform financial transactions, save money, and access credit, all through their mobile phones.

The creation of new financial products and services is another critical impact of innovation. Fintech companies and innovative financial institutions are developing products that cater to the diverse needs of consumers. These include microloans for small businesses, peer-to-peer lending platforms, digital wallets, and robo-advisors for personalised investment advice. Such innovations provide consumers with a broader range of options, making financial services more tailored and responsive to individual needs.

It would be remiss of the economist in me not to talk about the economic impact of financial innovation. Through creating new sub-sectors and industries, innovation can generate employment opportunities, attract investment, and promote diversification in the economy. A compelling case study illustrating this benefit is the rise of crypto assets. Crypto and blockchain technology have not only created a new asset class but have also driven significant investments in new sectors such as decentralised finance (DeFi) and blockchain infrastructure.

For example, countries which have embraced blockchain technology, such as Switzerland with its own "Crypto Valley," a blockchain and crypto hub equivalent to Silicon Valley in the US, have seen a rise in startup activity and investment, positioning themselves as global leaders in financial innovation. Here at home, since we declared crypto assets as financial products under the Financial Advisory and Intermediary Services Act, we have received over 300 applications from potential crypto asset service providers. Out of these applications, we have approved over 100. I share these figures with you because I want to demonstrate that crypto has created a dynamic and rapidly growing sector that is reshaping our financial sector landscape, with the potential to contribute to the economy through investment in crypto technology and blockchain. However, the jury is still out on the real value creation of these innovations compared to more traditional forms of finance.

### **Factors which militate against innovation**

Despite the myriad benefits of innovation in the financial sector, several significant barriers can hinder its development and implementation. One potential obstacle to innovation in the financial sector is regulatory constraints. The financial sector is heavily regulated to ensure stability, protect consumers, and prevent financial crimes. While these regulations are crucial, they can also be burdensome for innovation. Compliance with stringent regulatory requirements often demands significant resources and time, which can stifle the agility needed for innovation. For example, obtaining necessary licenses, ensuring data protection, and meeting anti-money laundering (AML) and know-your-customer (KYC) requirements can be complex and costly, particularly for smaller fintech startups. Additionally, regulatory uncertainty or constantly evolving regulations can create an environment of risk-aversion, where financial institutions may hesitate to invest in innovative solutions.

Market resistance is another critical factor that can impede innovation. Incumbent financial institutions, such as established banks and insurance companies, often dominate the market and may be resistant to change. These institutions have established business models, customer bases, and infrastructure that may not be easily adaptable to new technologies. They may perceive innovative startups as threats to their market share and prefer to maintain the status quo rather than

disrupt their existing operations. This resistance can manifest in various ways, such as slow adoption of new technologies, and reluctance to partner with or invest in innovative firms.

### **The case for regulation**

This brings us to the question of the necessity of regulation. Regulation in the financial sector is a necessary mechanism to ensure stability, protect consumers, and maintain the integrity of the financial system. While innovation drives progress and offers numerous benefits, it also brings new risks and challenges that need to be managed effectively. This is where the case for regulation becomes compelling.

Regulation plays a critical role in safeguarding consumers. In a rapidly evolving landscape, consumers are often exposed to new and complex financial products and services. Without adequate regulatory oversight, these innovations can lead to exploitation, fraud, and financial loss for unsuspecting customers. For example, the South African Banking Risk Information Centre (SABRIC) reported a 24% increase in digital banking fraud incidents in 2022 compared to the previous year, with gross losses escalating from R440 million in 2021 to R740 million in 2022<sup>1</sup>. These statistics highlight the ongoing vulnerability of digital financial services to cyber threats and fraud, emphasizing the need for robust regulatory measures to safeguard consumers and maintain the integrity of the financial system.

The lack of transparency in complex financial products and services is another significant risk that underscores the need for regulation. Without adequate regulatory oversight, these products could pose substantial risks to consumers who may not fully understand the implications of their financial decisions. This issue is particularly concerning in the crypto assets market, where the rapid rise of new and often poorly understood financial products can expose investors to high risks.

A pertinent example is the Mirror Trading International (MTI) scandal. MTI operated as a Ponzi scheme under the guise of a substantial return crypto trading platform and defrauded investors of billions of rands before its downfall in late 2020. The FSCA's intervention, in collaboration with other regulatory bodies, to dismantle this scheme and pursue legal action against the perpetrators underscores the critical role regulation plays in maintaining market integrity and protecting consumers.

Regulations are also essential for maintaining the stability of the financial system as highlighted by the global financial crisis. In the absence of robust regulations, financial institutions engaged in risky behaviors that may ultimately lead to widespread financial instability and economic losses.

---

<sup>1</sup> <https://www.sabric.co.za/media/gq4hmbjw/sabric-annual-crime-stats-2022.pdf>

Trust is the cornerstone of the financial sector. It is the foundation on which the sector is built. Without trust, the entire system can break down, leading to a loss of confidence among consumers and investors. Effective regulation help maintain and enhance this trust by ensuring transparency, accountability, and ethical behavior within the industry by requiring financial institutions to adhere to high standards of ethics and conduct.

### **The cost of regulation**

While regulation in the financial sector is essential for ensuring stability, protecting consumers, and preventing financial crimes, we acknowledge that it comes with significant costs. One of the most direct costs of regulation is the financial burden associated with compliance and implementation. Financial institutions are required to invest substantial resources to meet regulatory requirements. This includes costs related to implementing new systems, training staff, conducting audits, and ensuring ongoing compliance with regulatory changes. For smaller fintech startups, these costs can be particularly prohibitive, as they may lack the financial and human resources of larger, established institutions. The high cost of compliance can stifle innovation by diverting funds away from research and development into regulatory compliance.

It can be argued that regulation can also lead to slower market entry and reduced competitiveness, particularly for new and innovative players in the financial sector. The complex and lengthy process of obtaining regulatory approvals and licenses can delay the launch of new products and services. This can be especially challenging for fintech startups that rely on speed and agility to disrupt traditional financial markets. Furthermore, an excessive regulatory burden can itself become a barrier to entry, protecting established incumbents and reducing competition in the market. This can ultimately lead to higher costs and fewer choices for consumers.

### **The need to balance the costs and benefits**

#### **Current landscape and approach**

To effectively manage the dynamic and rapidly evolving financial sector and strike the balance between costs and benefits of innovation, we have been enhancing our regulatory frameworks to ensure they are principle-based, risk-focused, and proportional. This adaptive approach allows for the targeted application of regulations that foster innovation while mitigating potential risks. This adaptable approach is properly anchored in the regulatory framework encapsulated in the Financial Sector Regulation (FSR) Act which enables us to respond swiftly to emerging risks and regulatory gaps, by empowering financial sector regulators to issue standards which apply to specific sector or risk areas, protecting consumers from potential harm.

In addition, we are also shifting towards an outcomes-focused and principles-based regulatory approach, focusing on ensuring fair treatment of customers rather than prescribing detailed rules. This transition is supported by the development of the Conduct of Financial Institutions (CoFI) Bill by the National Treasury, which aims to consolidate various conduct-related financial laws into a unified legislative framework. This Bill enables us to be agile in responding to cross-sector risks through issuing of conduct standards.

Furthermore, recognising the importance of nurturing innovation while controlling risks, the Intergovernmental Fintech Working Group (IFWG) was established to foster collaboration among South Africa's primary financial sector regulators including the South African Reserve Bank, FSCA, the PA, National Treasury, the Competition Commission, the NCR, and other regulatory bodies. This group's efforts led to the creation of the country's first Innovation Hub, which includes a Regulatory Guidance Unit, a Regulatory Sandbox, and an Innovation Accelerator. These facilities collectively support the safe testing and scaling of fintech innovations, ensuring they align with regulatory standards while fostering industry growth. The Regulatory Sandbox, for example, received 52 applications in its first cohort in 2020, with 9 progressing to the testing phase<sup>2</sup>, illustrating the effectiveness of these collaborative frameworks.

The FSCA has also established a dedicated Fintech Department in order to continuously monitor and respond to technological trends, producing several insightful publications on topics like open finance and understanding the crypto asset market. These resources are intended to deepen our understanding of the fintech landscape and guide the sector's evolution. These papers are available on our website, and I encourage you to read them to gain a deeper understanding of our work and the evolving fintech landscape.

## **Conclusion**

In closing, it is clear that the future of the financial sector hinges on the ability of regulators like the FSCA and policymakers to strike a delicate balance between fostering innovation and maintaining robust regulatory oversight. The future demands that as regulators we should be both proactive and adaptive, continuously evolving our approaches to keep pace with technological advancements. This will involve embracing new regulatory frameworks, leveraging advanced technologies for oversight, and maintaining a flexible mindset to accommodate the rapid changes in the sector.

To the students who are here, as technology continues to change the way we live and work, your role in shaping the future becomes increasingly important. Embrace the challenges and opportunities that come with technological advancements and equip yourselves with the knowledge and skills needed to navigate this dynamic landscape. Make sure to stay informed about the latest

---

<sup>2</sup> [https://www.ifwg.co.za/IFWG%20Documents/FirstSandboxReport\\_20221012.pdf](https://www.ifwg.co.za/IFWG%20Documents/FirstSandboxReport_20221012.pdf)

developments, think critically about the implications of new technologies, and actively participate in discussions about the future of regulation and innovation. Thank you.