

SECURITIES AND EXCHANGE COMMISSION, NIGERIA



THE ROLE OF FINTECH IN DEBT CAPITAL MARKET

MARY UDUK, FCIB
Ag. Director General

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PROTOCOL

Good morning, distinguished guests, ladies and gentlemen.

It is a great pleasure to be here with you at the 2018 Bonds, Loans & Sukuk Nigeria Conference. I would like to thank and warmly congratulate the organizers of this programme, GFC Media Group for inviting me and on successfully hosting the market to this year's event.

I am delighted to be in the midst of distinguished guests, participants, stakeholders, and market players to discuss what I have titled, **“The Role of FinTech in Debt Capital Market”**.

Last month, I spoke at a gathering of market stakeholders and FinTech enthusiasts on the starring role of digital finance as an essential powerful tool for enhancing Financial Inclusion. The use of digital tools creates the potential to make financial services available to a wider range of consumers and enterprises, promoting financial inclusion and affordable financial services. A financially included society will provide increased access to finance, especially for women, help support sustainable growth-and will create millions more jobs.

At that meeting, I highlighted the gains of having a more inclusive financial system, which helps broaden financial markets and make policies more effective. We were in Bali, Indonesia last month for the IMF/World Bank Annual Meeting, where the need to foster FinTech for the promotion of financial inclusion and development of financial markets was outlined as one of the 12 considerations of the Bali FinTech Agenda. By bringing more sections of the population into the formal sector, the effects of market-deepening initiatives are better expanded. The gains are less elusive when our economy is more inclusive, the market is deeper, vibrant, and more effective.

So let's take a closer look at what we have before us today, and in doing this, I'll like to you to bear in mind, the following posers:

- (i) How is FinTech changing the debt capital raising process?
- (ii) Is FinTech a competitor or a prospective partner of DCM/Investment bankers?
- (iii) How is FinTech bringing costs down and improving efficiency in the DCM process?
- (iv) What mechanisms/products of accessing capital are available in FinTech?

I am heartened that this discussion will help bring greater focus to the important issues that cryptocurrencies, initial coin offerings (ICOs), related products and activities present for Nigerian investors and Our Market as a whole.

The mission of the Commission is to Develop and Regulate a Capital Market that is Dynamic, Fair, Transparent and Efficient, to Contribute to the Nation's Economic Development. An efficient market is one that, amongst other things, facilitates capital formation for governments and corporate entities. Cryptocurrencies, ICOs, and related subjects are the latest in a host of market issues which we, at the Commission and other market stakeholders have been closely conversing and engaging on to strengthen our Capital Market for investors and market participants.

In 2016, at a time when over 400,000 small- and medium-sized Australian companies said lack of finance prevented them from innovating, and 1 in 6 could not grow (*Australian Bureau of Statistics, ABS and NSW Business Chambers*), Neu.Capital, a FinTech firm, launched a solution to tackle that lucrative gap in the Australian Capital Market. At the time, Banks had rejected capital applications from many of those SMEs. Neu.Capital therefore sought to provide SMEs access to the capital they require; thereby plugging the niche banks were unable to service. It created the online marketplace that allowed hardworking Australian companies to get the funds they needed to grow and innovate, by allowing them to securely reveal key metrics to investors on a desktop, tablet, and mobile phones, without revealing their private company's identity.

Technology has long been the engine driving capital markets efficiency—for investors in the markets, CMOs, Securities Exchanges, and central counterparties. It is an entire value chain effect. In recent times, FinTechs are bringing new technologies to market even faster and with a greater impact. Hundreds of FinTechs are focusing their development on capital markets infrastructures, and while providers recognize that FinTech will have a significant influence on the industry, many remain unsure of which technologies to adopt and to what degree, and how best to engage and interact with FinTech companies.

While retail banking innovations and payments players are hogging the FinTech limelight, it is widely acclaimed that financial technology specialists have increasingly expanded their role in capital markets.

A recent McKinsey report, entitled FinTech Decoded: “Capturing the opportunity in capital markets infrastructure” concludes that FinTech activity in capital market infrastructure has outpaced other areas in financial services, growing 277%, compared with corporate banking (186%) and payments (184%).

The McKinsey Panorama Fintech database is so robust, as it covers over 6,000 of the more than 12,000 FinTech innovations in the global marketplace. Based on their activities and technologies, about 700 FinTechs are relevant to the CMI industry. Through steady growth, this number has almost quadrupled since 2010, and has outpaced other areas of FinTech within financial services, such as corporate banking, and payments.

1. HOW FINTECH IS INFLUENCING THE CAPITAL MARKET VALUE CHAIN

Four FinTech themes have been identified to be shaping the capital market value chain. Some of these themes increase productivity and lower costs, while others generate new sources of revenue. These are stated below:

- **The use of advanced analytics and artificial intelligence (AI)** is set for rapid growth, as the amount of available data circulating through capital markets grows, and amid increasing interest in the application of advanced analytics to market, financial, and economic data.
- **Distributed ledger technology (DLT)** is applied to a range of CMI operations. Use cases include clearing and settlement, alternatives to the traditional markets for access to capital (initial coin offerings [ICOs]), and new digital markets.
- **FinTechs will bring greater efficiency through innovative technologies such as cloud and quantum computing**—for example, in the sphere of matching technologies—while driving depth in traded markets and expansion towards new asset classes.
- **Post-trade services will gain in productivity through the application of automation and robotics.** A separate branch of regulatory tech firms (RegTechs) will bring efficiency and uniformity to risk management and regulatory reporting.

For those who seek to raise capital to fund an enterprise, as many in the ICO space have sought to do, a primary entry into the SEC's jurisdiction is offer and sale of securities, with provisions as set forth in Part IX of the ISA 2007. Determining what falls within the ambit of a securities offer and sale then becomes paramount. The cryptocurrency and ICO markets, while new, have grown rapidly, gained greater prominence in the public conscience and attracted significant capital from retail investors. But when the provisions of our extant laws and regulatory guidelines are not followed, the risks to all investors are high and numerous – including risks caused by or related to poor, incorrect or non-existent disclosure, volatility, manipulation, fraud and theft.

I am very optimistic that developments in financial technology will help facilitate capital formation and provide promising investment opportunities for institutional and retail investors alike. From a financial regulatory perspective, these developments may enable us to better monitor CMOs, transactions, and other activities and characteristics of our market, thereby facilitating our regulatory mission, including, very essentially, investor protection.

There are various ways FinTech resides in the capital market value chain, but of particular focus, I will be delving into Access to Capital, with specific attention to debt capital market issuance – which FinTechs influence by creating innovative ways to reach and serve issuers and investors, and broaden the range of asset classes offered. This is achieved through the following mechanisms;

- Crowdfunding platforms
- Start-up exchange venues
- Bond issuance platforms
- Peer-To-Peer Lending (P2P)
- Private listing platforms for SMEs
- Initial Coin Offering platforms

Because of time, we shall look at a few of these.

1.0.1 CROWDFUNDING

Crowdfunding is a relatively new and evolving method of using the internet to raise capital to support a wide range of ideas and ventures. An entity or individual raising funds through crowdfunding typically seeks small individual contributions from a large number of people. Individuals interested in the crowdfunding campaign – members of the “crowd” – may share information about the project, cause, idea or business with each other and use the information to decide whether to fund the campaign based on the collective “wisdom of the crowd.” The Jumpstart Our Business Startups Act (the “JOBS Act”), enacted in April 2012 under former US President Barack Obama’s administration, establishes a regulatory structure for startups and small businesses to raise capital through securities offerings using the Internet through crowdfunding. The crowdfunding provisions of the JOBS Act were intended to help provide startups and small businesses with capital by making relatively low dollar offerings of securities, featuring relatively low dollar investments by the “crowd,” less costly.

1.0.2 ICOS AND RELATED TRADING

Coinciding with the substantial growth in cryptocurrencies, companies and individuals increasingly are beginning to use ICOs to raise capital for businesses and projects. Typically, these offerings involve the opportunity for individual investors to exchange currency, such as U.S. dollars or cryptocurrencies, in return for a digital asset labeled as a coin or token. In the US for instance, the size of the ICO market has grown exponentially in the last year, and it is estimated that almost \$4 billion (*US SEC, February 2018*) was raised through ICOs in 2017.

These offerings can take different forms, and the rights and interests a coin is purported to provide the holder can vary widely. According to an analysis by CB Insights, ICOs have surpassed venture capital as the biggest source of funding for companies developing blockchain technology. While ICOs can have great potential, regulators around the world are mostly skeptical, and have warned investors of their short track record and high risk, as evident in the IOSCO Board Communication of January 18, 2018 on *Concerns Related to Initial Coin Offerings (ICOs)* and contained in *The Economist* of November 11, 2017 – “*Regulators begin to tackle the craze for ICOs*”.

1.0.3 BOND ISSUANCE PLATFORMS

All over the world, FinTechs are beginning to threaten big investment banks' grip on the primary markets. With regulators insisting on greater transparency and audit trails for investor allocations, the control of information that made the banks' masters of these deals is already slipping. Barely a day passes without some new FinTech start-up announcing its latest idea to take retail customers away from the established banks by offering them a better, faster, cheaper way to hold, manage and transfer their money.

In April 2016, a Canadian startup, Overbond was introduced as the first end-to-end, two-way pricing communication tool for bond issuers and dealers. The company looked to transform how global investment banks, institutional investors, corporations, and governments connect by digitizing and streamlining all aspects of primary bond origination workflow. By digitizing the entire deal execution process, issuers can get to market faster to take advantage of favorable market timing and access a broader investor base.

Likewise, in August 2018, the World Bank launched bond-i (blockchain operated new debt instrument), the world's first bond to be created, allocated, transferred and managed through its life cycle using distributed ledger technology (DLT). The two-year bond raised \$110million, marking the first time that investors have supported the World Bank's development activities in a transaction that is fully managed using the blockchain technology.

1.0.4 PEER-TO-PEER (P2P) LENDING

Peer-To-Peer (P2P) Lending is a method of debt financing that enables individuals to borrow and lend money to individuals or businesses through online services, without the use of an official financial institution as an intermediary. Lenders can earn higher returns compared to savings and investment products offered by banks, while borrowers can borrow money at lower interest rates, even after the P2P lending company has taken a fee for providing the matchmaking platform and credit checking the borrower. There is the risk of the borrower defaulting on the loans taken out from peer-lending websites. Peer-to-peer lending removes the intermediary from the process, but it also involves more time, effort and risk than the general orthodox lending scenarios. It is also known as social lending or crowdlending.

2.0. SO HOW IS TECHNOLOGY BEING USED TO ENHANCE ACCESS TO CAPITAL?

Either through new assets, markets and connections or a potential entry point for DLT, FinTechs are altering traditional access to capital models in several ways:

- Providing crowdfunding offerings that raise equity and debt for smaller firms, and are open to both retail and institutional investors
- Developing platforms that create new connections among issuers and investors, focusing on nontraditional asset classes such as real estate, cloud capacity, venture capital, and private equity, as well as cryptocurrencies
- Deploying new technologies for the direct issuance of equity and bonds through distributed ledgers, reducing costs, frictions, and settlement times in new issues. This challenge is likely to have the biggest impact on the industry and incumbents. In particular, DLT networks are facilitating ICOs, which issue digital tokens to investors that can be traded online.

Equity crowdfunding portals are disrupting the venture capital (VC) market by enabling investments directly into private company start-ups, and peer-to-peer (P2P) lending platforms are disrupting the banking market by facilitating lending to small and medium-sized enterprises (SMEs). The growth potential is tremendous. Goldman Sachs' 2015 report entitled 'Socialization of Finance' called crowdfunding **“potentially the most disruption of all the new models of finance”**. The World Bank estimates that crowdfunding investments in developing countries alone could reach \$96billion a year by 2025. According to the World Bank, the market potential in Africa for crowdfunding would reach \$2.5billion by 2025.

As conditions for accessing finance are deemed too stringent for many start-ups, the necessity for **equity-based crowdfunding in Nigeria is growing immensely**. It provides a cheaper alternative source of financing which obviates the need to provide collateral security.

3.0 A SELECTION OF BLOCKCHAIN USE CASES – focus on Access to Capital

Let us see a selection of blockchain use cases; I'll focus more on the applicability to Accessing Capital:

- London Stock Exchange - Cooperation with IBM to digitally issue private shares of Italian SMEs and digitize shareholding structures
- NASDAQ - LINQ—a platform that allows private companies to simplify share management and powers capitalization tables
- Stock Exchange of Hong Kong - Plans to launch a blockchain-powered private market in 2018, aimed at helping early-stage and smaller firms obtain financing
- Korea Exchange - Launched Korea Startup Market in November 2016 with blockchain technology to enable equity shares of start-up companies to be traded in the open market

4.0 SO, IS FINTECH A COMPETITOR OR PROSPECTIVE PARTNER OF DCM BANKERS?

Perhaps the most striking difference in capital markets infrastructure is that the incumbents mostly welcome FinTechs as potential partners rather than disrupters. Curiously, for an industry where IT expenditures are enormous, Market Infrastructure providers look to FinTechs for their technological capabilities and innovation firepower.

There is, of course, a certain proportion of more aggressive FinTech firms interested in disruption — in blockchain particularly — but most want to work with incumbents, and incumbents need them.

While one market commentator said FinTechs can learn banking faster than banks can learn FinTech, that position is probably not the same in the Capital Market. In much of the capital market world, FinTechs and firms are looking for cooperation in B2B (Business to Business) as well as B2B2C (Business to Business to Customers). Firms are looking to FinTechs for faster speed to market, better service levels to clients, sophisticated analytics and artificial intelligence solutions, and blockchain, or Distributed Ledger Technology (DLT).

According to a survey of the membership of the World Federation of Exchanges (WFE) published in the McKinsey report, "FinTech Decoded: Capturing the opportunity in capital markets infrastructure", no respondents saw FinTechs as a threat, but instead viewed them as potential partners to incumbents and enablers of growth, rather than competitors. They acknowledged, though, that the extent of the impact is difficult to ascertain.

5.0 TRENDS IN THE REGULATORY REGIME

Regulatory compliance solutions, have evolved, with RegTechs bringing big data, machine learning, and AI to increasingly demanding regulatory and compliance regimes. These technologies enable the implementation of automated, standardized approaches for more complex tasks such as customer onboarding and KYC requirements, AML compliance, trade surveillance, fraud and cyberattack detection through forensic analytics, and the preparation of compliance and regulatory reporting.

RegTechs also offer technology for managing collateral and counterparty risk for more efficient use of institutions' capital. In some ways, this concept can be tailored with a view to adopting something similar for debt post-issuance processing.

CONCLUSION

Over the years, technological innovations will improve our markets, including through increased competition, lower barriers to entry and decreased costs for market operators. Distributed ledger and other emerging technologies have the potential to further influence and improve the capital markets and the financial services industry. Businesses, especially smaller businesses without effective access to traditional capital markets, can be aided by financial technology in raising capital to establish and finance their operations, thereby allowing them to be more competitive both domestically and globally. In addition, Governments can leverage technology in their debt capital raising issuances, and these technological innovations can provide investors with new opportunities to offer support and capital to novel concepts and ideas.

These opportunities will thrive best when pursued in harmony with provisions of the law and regulatory guidelines. These laws reflect our tripartite mandate to protect investors, maintain fair and efficient markets and facilitate capital formation to contribute to the nation's economy. Being faithful to each part of this mandate not in isolation, but collectively, will serve us optimally. Simply put, we should embrace the pursuit of technological advancement, as well as new and innovative techniques for capital raising, but not at the expense of the principles undermining our well-founded and proven approach to protecting investors and making our market competitive.

Thank you for listening.

Mary Uduk, FCIB

Ag. Director General

Securities and Exchange Commission, Nigeria