

Session 3: Market Surveillance in the Era of Technology Development - Towards Establishing a RegTech Ecosystem

Introduction

The moderator introduced the discussion topic of the session by describing that the impact of technology development on securities markets was huge; and that most people regard the securities industry as having well adapted to technology development until now, but a new wave, one quite unlike any seen in the past, was now crashing onto the shores: FinTech.

In this session the panelists, who had been taking on the challenge of tackling new risks in this new era, gave presentations and then took part in a discussion.

The outline of opinions expressed during the session was as follows.

Current initiatives

- Business platforms based on blockchain technology (permission-type) are offered, and the scheme could have more effective governance by involving a third party into the network. The authorities will be able to use this network effectively by getting involved properly, which should be a form of RegTech needed.
- For market surveillance, a correct understanding of actual conditions in the market is a prerequisite. In addition, if incidents such as unfair transactions occur, they should be quickly discovered, remedied, and penalized/prosecuted. For that reason, it will be important to analyze current market conditions with a forward-looking approach that anticipates developments five or ten years ahead.
- Although technology development is recognized as a positive thing on the whole, it also brings risks and challenges with it, and the following points in particular will need to be kept in mind: (1) divergence of laws and actual conditions, (2) larger volume and more complex data requiring surveillance, (3) effective use of technology (e.g. analysis of big data).
- Technological development will provide both opportunities and challenges. The LEI (Legal Entity Identifier) system that was adopted internationally in the wake of the last global financial crisis would have been unimaginable in an era in which technology was not advanced. On the other hand, there are challenges

such as how regulators should utilize the information obtained, and how the appropriateness and accountability of robo-advisors should be regarded. Regulators need to look at both the bright and dark sides of the development. As FinTech advances, regulators have been taking actions to promote the innovation and simultaneously to protect users and ensure fairness.

- Advances in technology such as blockchain and cloud computing are already affecting the current surveillance activities in some areas. In order to properly respond to such technology development, an ecosystem for RegTech needs to be established.
- RegTech, the theme of this session, the following three elements can be raised as the component: (1) automation of regulatory reporting, (2) adoption of digital IDs for KYC (Know Your Customer), and (3) real-time analysis of market trends (e.g. use of algorithms). With regard to (1) in particular, financial institutions currently incur huge costs in complying with regulations, and it seems that the success of RegTech will hinge on the extent to which it allows such costs to be reduced.

Solutions to challenges

- Responding to open innovation
 - When various technologies are being used (AI, blockchain, etc.), it is important to adopt an issue-driven approach, not a technology-driven one. In the case of blockchain, for example, it will be important to make an approach with the idea that improvements can be made by sharing data.
 - Budgets should be requested with having short-, medium-, and long-term visions for a system gathering digitized data and analyzing and examining it in real time.
- Actions toward surveillance responding to technology development
 - Recently we got a prospect of practical application of AI to surveillance for detecting market manipulation and are developing market surveillance system utilizing AI. We have researched a variety of technologies until now. Some of them did not go so well, but it is important to keep taking on challenges.
 - Unfair transactions involving the use of multiple names (e.g. borrowed names) are currently aggregated by carefully examining each transaction to

infer that they were all made by the same party. There is a potential to employ technology here.

- Regulation of new financial products and transaction formats as well as development of human resources required for that
- Since regulatory authorities around the world have engaged in discussions through a trial-and-error approach, they have a shared view to some extent on how each case should be handled. However, the current trend may completely overturn that. Taking ICOs as an example, with the stances of each country differing considerably, what should be done about that? I believe that this is a point that needs to be addressed through deeper international discussions.
- Regarding the human resource development, it will be necessary to develop experts needed or to hire them from outside after considering and defining what is going to be needed five or ten years from now. Nevertheless this will not be achieved by regulators on their own, so both the public and private sectors will need to work hard together within the ecosystem.

Expectations for the SESC

- Blockchain is a revolutionary technology that is capable of building such trust in the Internet as it cannot be tampered with. I would therefore like the SESC to make effective use of that technology in order to build up the trust further.
- As the actions and behaviors of the SESC may directly determine the quality of regulation in some ways, I would like the SESC to engage in surveillance activities that appropriately reflect conditions and changes in the markets.
- Policy determination should become more empirically-based through, for example, the use of regulatory sandboxes. If the SESC wants to advance innovation, they will need to foster a relationship of trust with the SESC and the market participants that provides supports in the case of failure.

The above comments were responded as follows:

- With international cooperation becoming increasingly important, the SESC would like to take solid actions including enhancement of international cooperation while tapping the capabilities and knowledge of the private sector.

Conclusion

The following was recognized through this session.

It has been three years since the term FinTech became widely known in Japan, and it appears that the view of it in the securities sector has changed considerably.

Up until now, the buds of innovation have sometimes not been nurtured due to a focus on conducting business with caution. As the view that FinTech is essential has come to prevail, new challenges are taken on more aggressively than in the past, which will be essential for the industry in the future.

This session reaffirmed that the securities sector needs to develop in a sound manner by employing new technology to appropriately adapt to new risks that are being faced as a consequence of innovation.