Ideas and Observations re Fintech/Third Party Risk Management

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Agenda

- “Fintech” generally
- IHS Markit, a fintech firm
- Ideas for third party/fintech oversight and regulation

What is a "fintech?"

- FSB (2017) definition of "fintech" as "technologically enabled financial innovation that could result in new business models, applications, processes, or products with an associated material effect on financial markets and institutions and the provision of financial services."
- Scope of OCC third-party risk management guidelines explicitly covers relationships with fintech service providers (among others)

IHS Markit fintech services (incl. “regtech”)

1. **Post-trade** (loan processing and clearance and settlement*, derivatives processing (MarkitSERV*))
2. **Pricing and valuation** (parsing, fair valuation, TOTEM, liquidity, FRTB)
3. **Reference data** (credit default swap [CDS] RED codes, bond and loan reference data)
4. **Indices*** (proprietary, third-party administrator, calculation agent)
5. **Managed services** (know-your-customer [KYC], counterparty, and trading algorithm due diligence, ISDA Amend, third party risk management [KY3P], and tax)
6. **Market Digital** (website hosting, admin, and content, including robo-advisory tools)

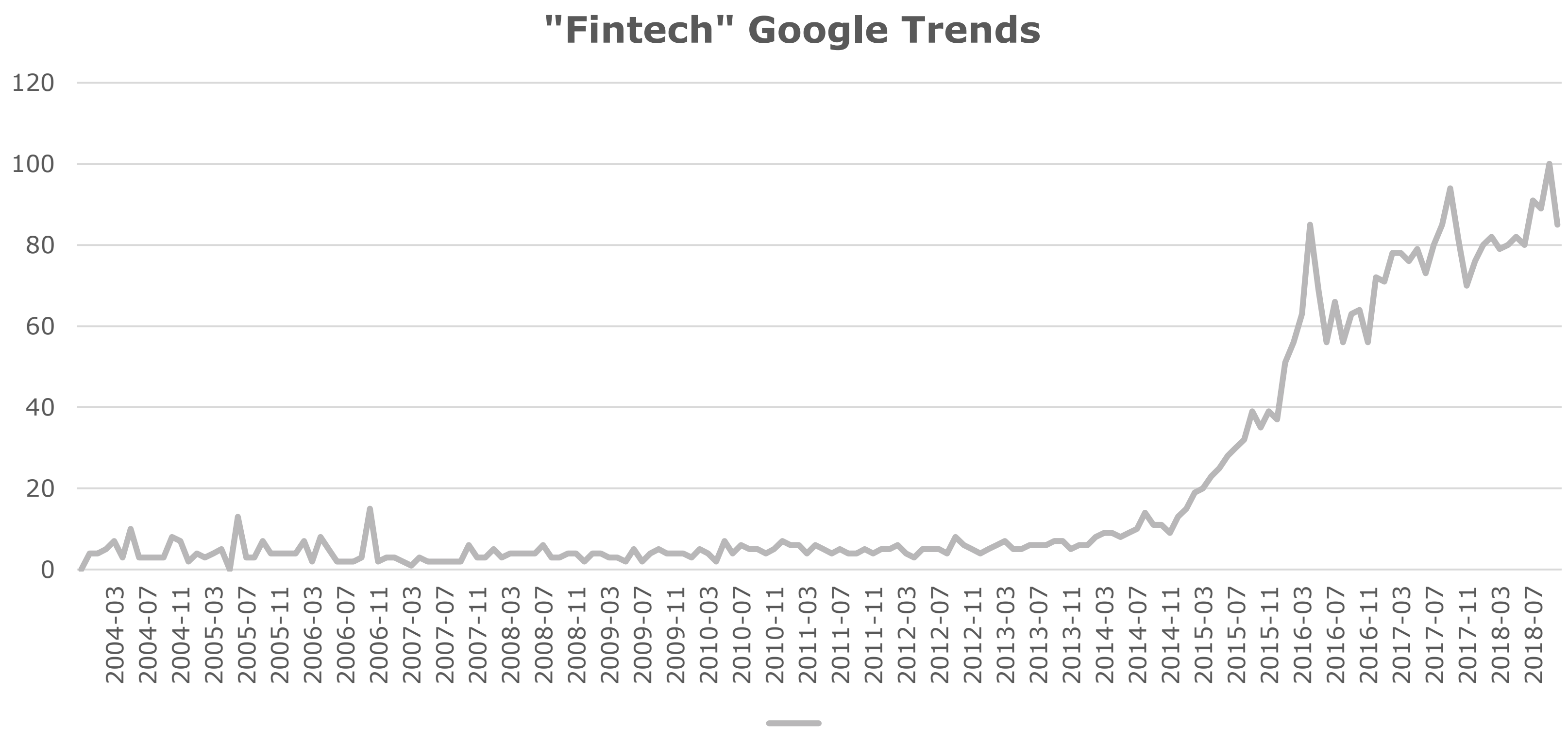
** - currently or in process of being directly regulated*

What drives customer demand for 3P/fintech service?

1. **Lower cost** (scale and network benefits)
2. **Better performance/greater efficiency** (specialization to perform a particular function and perform it well)
3. **Focus on core value proposition** (opportunity cost of in-house solution)

IHS Markit: a fintech before “fintech”

- “Fintech” search term peaks in May 2016 and October 2017 (and remains high)
- Before August 2014 search term never more than 1/10th of peak index value



Five core principles for fintech/third party risk management oversight (and regulation)

1. **Documentation**
2. **Non-discrimination**
3. **Open dialogue**
4. **Responsiveness**
5. **Proportionality**

When does it make sense to directly regulate a 3P/fintech?

What is the rationale to regulate financial institutions/infrastructures? (selection)

- Ensure appropriate conduct for a significant **fiduciary or customer relationship** (banks, trusts, dealers, advisors, transfer/clearing agents, credit rating agency)
- Ensure integrity in operation of execution or **price discovery** venues and products (exchanges, trading facilities, benchmark/index administrators)
- Ensure appropriate risk management for central **risk nodes** (financial market infrastructures [FMIs], banks, and dealers)
- Mitigate substantial **operational risk** (e.g., SEC Regulation SCI)
- Facilitate **commerce** (e.g., provide legal certainty)

What is the rationale *not to regulate*? (selection)

- Avoid barriers to entry
- Encourage innovation/competition by avoiding imposing large fixed cost
- Regulation of service would be disproportionately costly vs. risk/benefit profile
- Market discipline

Choices before CFTC

- Continue current approach
- Written policy guidance for registrants’ management of third party risk
- Certifications
- External validation
- Direct regulation through existing authority
- Direct regulation through new authority (needs legislation)

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