

The rise of regulatory retrofitting

By [Christiaan Harmse](#)

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Regulatory sandboxes offer businesses the opportunity to push the legislated boundaries of their sector. While South Africa has launched such a sandbox for local use and encourages a dialogue between regulators and regulated entities to facilitate product sandboxing, you may find yourself feeling somewhat... sceptical.



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If the intended product is truly such a trailblazer that the regulators have not foreseen its creation (and therefore its regulation), would ensuing discussions ensure that the parties are on the same page with what is intended? Considering its intrinsic novelty to the field, it is not an unwarranted concern that the importance of specific technological innovations may become lost in translation. The innovator may be in a position that allowed their years of cross-sector knowledge to culminate into their unprecedented creation but their regulatory audience might not be.

And what if, even where the parties are on the same page, the intended product is fundamentally incapable of being regulated due to a lack of regulatory infrastructure and by not just a lack of written regulations, but by the regulator's technological capabilities as well?

We'll get to all this soon, but first – let's talk cars.

Road trip, anyone?

Since the 1960s, cars were scolded for following the laws of thermodynamics. Too many cars creating too much smog made policymakers see that something needed to be done about address the issue of exhaust emissions. A flurry of regulations and a couple of decades caused the populous to abandon environmentally unfriendly vehicles for newer cars produced in compliance with tightening emission standards. But what about the environmentally conscious individual stumbling upon an immaculate 1950's barn find? With 2021 automotive tech on their side, retrofitting the exhaust system with much more efficient filtering methods should be a cruise.

The result: An impressive system representing the peak of industry expectations, capable of implementing new technological advancements to keep pace with a changing environment - all done without compromising its core mechanics. I think you can see where this analogy might be heading...



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28 Feb 2018



The powers that be

Although one's typical conceptualisation of bureaucracy perhaps includes waiting in a slow-moving queue with "innovation" perhaps only found in the dictionary propping open the door, it's perhaps time to modernise this portrayal.

Someone waiting in this conceptual line to submit a sandboxing application may be second-guessing the capabilities of this institution that seemingly can't maintain air-conditioning, let alone theorise system architecture to manage the blockchain tech underpinning the product on the now-slightly-clammy application form. Imagine their surprise when, upon reaching the front of the queue, the attending clerk pulls out schematics for cloud computing and machine learning to be used as regulatory tools for crypto assets while enthusiastically enquiring about the uses and market benefits.

"It's called supervisory technologies," they may laughingly answer the perplexed face still holding the soggy application form. Suptech for short, it is the regulators' answer to keeping pace with industry innovators.

What goes around

It isn't that difficult to argue in favour of retrofitting regulators with the tools to deal with novel concepts. With systems and procedures only designed to mitigate conceivable risks, there's a clear benefit in implementing new technology into an existing regulatory structure if it serves to solve the previously inconceivable. The alternative would be to implement a raze-and-raise approach, cycling regulatory successors rather than implementing system updates.

And it isn't all just a matter of playing catch-up with the industry. Although suptech as a field takes from what market participants are currently working towards in terms of innovative products in order to devise technology that can manage such regulation, it shouldn't be considered as being solely reactive in its workings. There are predictive aspects to suptech as well, capable of utilising behavioural analysis to allow regulators to take [pre-emptive actions](#). If such behavioural data indicate the potential bedrock for new products, "playing catch-up" would be an inappropriate analogy to use.



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Not a regulator? Not a problem

What does all this mean for you? If you find yourself in the financial services industry, whether it be as a service provider or product developer, having an appreciation of the governing structure is embracing, adopting and moving towards, may greatly influence the way in which how you do business. Suptech can also provide frameworks to streamline existing compliance obligations for all involved.

And it's not just the fintech start-up transposing their machine learning knowledge into the financial sector that should take note of these behind-the-scenes developments. Even if you're not directly involved in the financial services sector, but rather find yourself in, say, the information technology industry, you may be tempted to partner with some financial sector stakeholders to showcase the potential application of your work on suptech by either assisting the regulator in data processing with your new compression algorithm, or helping FSPs with their compliance obligations by introducing them to the wonders of AI that can compile and submit reports all on its own.

Businesses still in their structuring phase of operations could consider and incorporate this information into their vision and well-established entities could utilise this information to prepare for a profitable opportunity.

South Africa's recent financial sector regulatory restructuring in accordance with the Twin Peaks model shouldn't be seen as a commitment to an inflexible means of governance. Suptech is, and will continue to be, an invaluable tool to allow regulators to adhere to global best practice in terms of structuring while simultaneously leaving enough room for innovation to identify, adapt, and yes, even lead, changes in the financial sector. Perhaps something to think about while out on your next Sunday drive?

ABOUT THE AUTHOR

Christiaan Harmse is an Associate at Dommisse Attorneys. Christiaan holds a BComm(Law), LLB and LLM, all of which were obtained at the University of Stellenbosch. He is also a registered compliance officer with the FSCA and approved for Financial Services Providers in Categories I, II, IIA and IV. Christiaan started working as a candidate attorney at Dommisse Attorneys in February 2019. Having had prior exposure to compliance in the financial services industry, he joined the Regulatory Team with the ambition to further his knowledge in commercial compliance and develop his skillset across their various areas of operation. He is interested in the developments in the financial services industry under a new regulatory structure and the interactions thereof with technological innovations.

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