

Barefoot Innovation Podcast with Nikhil Rathi

Chief Executive of the Financial Conduct Authority

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Jo Ann: I could not be more excited than I am to say that my guest today is Nikhil Rathi, who is the leader of the Financial Conduct Authority, the CEO of the Financial Conduct Authority in the UK. Nikhil, thank you for joining me.

Nikhil Rathi: Thanks for having me Jo Ann. It's wonderful to be here.

Jo Ann: We are on the sidelines now of the Singapore FinTech Festival in Singapore, which is enormous. And we just came off the plenary stage where we were talking about ESG, and we're going to cover that and some more subjects. I'm just thrilled to have you join us. Our listeners know I'm second to none in admiring the FCA and the really innovative leadership that you've brought to the whole world, and so we're just thrilled to have you with us today.

Nikhil Rathi: Well, great to be here. And it is great to be here at the Singapore FinTech Festival. It's quite an occasion here. It must be one of the largest gatherings in the world of FinTech leaders and a lot of creativity, innovation going on in the halls here at the expo.

Jo Ann: Yes. I think I heard there's 60,000 people here. I think that might make it the largest financial conference in the world and back in person this year, which has just been thrilling. So we did just come off the stage and our topic was how to get it right in terms of the G in ESG, the governance component of it. And I thought to start, I'd just ask you to share with this audience what your main advice is and main insights on that.

Nikhil Rathi: Governance has been a key component of how the FCA supervises our 60,000 firm regulated population. We focus on four things, purpose, leadership, reward, remuneration and governance. And in our experience, firms that have got strong governance where there's a framework that holds management to account, where there is a strong culture and tone set from the top of the organization, clarity around how strategy is formulated, in our view, those firms perform in a regulatory sense better, and we would say most likely in a business sense better as well.

And on the flip side, and as we saw in the global financial crisis but also since then, where things have gone badly wrong in regulated firms there may well be some specific risk failures or other things, but you very often will find that there have been governance problems as well.

So it's a big focus for us and it's at the heart of all of our major initiatives. A few years ago in the UK we introduced a senior manager and certification regime to

provide clarity of accountability for key regulatory functions within firms. We believe that has been very supportive of our broad agenda here and also helpful for firms as well.

Jo Ann: Before you leave that, I'm very interested in that. What does it take to become certified as a senior manager in a firm in the UK?

Nikhil Rathi: Well, there are different functions which qualify for the senior manager function, and we will be expecting individuals and we would need to approve very often the senior managers, not all the certified individuals, those are left for firms to decide. But the senior managers are typically interviewed by us and our fellow regulators at the Bank of England where it's a dual regulated firm. We'll be looking at the competence, the qualities of leadership, the understanding of financial regulation and the ability to confidently discharge duties. So very often in those functions, the requirement is for individuals who can challenge surface issues and surface risks and ventilate them and have a proper conversation about them.

We also want to support growing firms, and you talked kindly about the work the FCA does on innovation. We have sought to pioneer the sandbox concept, whether that's our regulatory sandbox, our digital sandbox, and other mechanisms for firms to pilot new ideas and see what works in a safe environment from a regulatory perspective.

We have also more recently introduced an early and high growth oversight function within our organization. And we are currently supporting around 300 firms who are looking to grow and scale very quickly. And we want to support them in making sure they do so in a way which is consistent with our regulatory expectations. And a key part of the engagement we have with those firms is on their systems and controls, but also making sure that as they have these very ambitious growth plans, that their governance is consistent with those plans as well. And we find that having those conversations earlier, providing that steer and engagement early, actually leads to more success for those firms as they're looking to grow and provide competition in new markets.

Jo Ann: Absolutely. That's absolutely fascinating. I want to turn a little bit to the international framework. As you mentioned, the FCA pioneered the regulatory sandbox concept, which is now emulated all over the world. Also, tech sprints were invented at the FCA and have been picked up all around the world. And you also were the leading organizer or instigator of GFIN, the Global Financial Innovation Network. Talk about where you are and where we are in creating a global infrastructure for learning from each other, doing things together, accelerating progress.

Nikhil Rathi: Well, we're really pleased with the work that GFIN does. I think there are now over 80 international partners that we work with through the Global Financial Innovation Network we chair. And we've piloted a few ideas to support innovators in financial services. So for example, cross-border testing. Very often

a firm that is looking to bring a new product to market isn't just thinking about how they do that in one jurisdiction. They want to think about how that could be rolled out across multiple jurisdictions, particularly in the area of ESG. You'll find a lot of cross-border activity there.

So we've done some work to support firms think about how they can test in a regulatory environment across more than one jurisdiction. In other areas there's been very important cooperation, for example, in how we can use technology to tackle financial crime and tackle money laundering. That's been really important.

Jo Ann: Which is inherently a cross border challenge.

Nikhil Rathi: Very often a cross border challenge. We're also excited by the work that IOSCO is undertaking here. Led indeed by our colleagues at the MAS who chair the FinTech task force. And we actively participate in that. And you are increasingly seeing work being done globally on issues such as how should we construct a regulatory framework for use of artificial intelligence or machine learning in regulated financial services. Obviously very deep and detailed discussions going on around crypto assets and what the appropriate global regulatory framework should be.

Jo Ann: Fascinating. So the FCA, and I think frankly the other country that stands out is Singapore and MAS really frankly have been several years ahead of most of your peers. I'll say that you don't have to answer it, but I'm confident in saying that's the case. And I think it's happening again as you are sort building on what you've done and really turning to the question of how to become a data led regulator now that we have the explosion of digital data and new kinds of tools to analyze it. Talk about what you're doing in that space and what the challenges are and what can you envision coming out when you've got the architecture built the way you want it to be built?

Nikhil Rathi: Well, increasingly, we are seeing financial services companies focus very heavily on the data components of their businesses. You see it in wholesale financial services, the very sharp growth in share of wallet that's accruing to companies with data businesses, be that index providers, benchmark providers or other data providers. In the consumer space a very significant uptick in the use of big data and other techniques to develop consumer financial services, target consumers in a particular way.

So we as regulators have to make sure we are ready for that to support the right approaches but also make sure that there are checks and balances in place. So we are investing very heavily in our own skills and capabilities in that area. We are bringing on board many more data scientists and many more data analysts. We're investing in our own technology as well. And we're also looking at how we can use data analytics and data tools to do our core supervisory function.

So to give you a recent example, we've had to mobilize in support of the multilateral sanctions effort as a consequence of the Russian invasion of Ukraine. And one of the things we've done is built a database of a hundred thousand sanctioned entities, which we can use to test, using big data techniques, test firms systems and controls. Previously checking sanctions in compliance was a relatively manual process. We're now able to use data in a different way. When it comes to tackling fraud and scams we now have a web scraping tool that trawls hundreds of thousands of websites every week, triages them and helps us identify those websites where we think there is the biggest risk. And then we can work out how we intervene, whether we need to take them down, whether we need to work with a partner authority, whether we need to take any other action.

In our most recent tech sprint for authorized push payment fraud, a really significantly increasing problem affecting all kinds of consumers, particularly vulnerable consumers. We started testing synthetic data sets that were compiled from not just data that was held by banks, but also telecoms providers. Because sometimes actually you can start to detect markers of fraud risk by combining data that's available from multiple different sources and different sectors to work out where the risks are. And that's looking to provide some very promising avenues for us to cooperate with the industry going forward to tackle some of this authorized push payment fraud.

So those are all some of the specific things we are doing. We've also signaled that we want to make sure that competition is effective in these markets. So in the area of wholesale data, we are looking to study that market to make sure that the market is working as effectively as it should. And in the area of ESG data specifically, we do believe that that should now come into regulation and that's broadly supported by the industry in the UK at least. So that in the area of ESG where everybody is reliant on taxonomies, on data provision, on metrics, that there are some common baseline standards that people can work off.

Jo Ann:

The FCA is one of the youngest financial regulatory agencies in the world. And I think in some ways you've had an advantage in that you haven't been quite as caught up in legacy tech infrastructure as some of the venerable agencies that we see. Do you have thoughts for regulators who may be listening on how to tackle this challenge of becoming a data led regulator, including to have your own technology that can do what's needed? Has that been difficult or easy? What words of advice do you have?

Nikhil Rathi:

Yeah, funnily enough, I was on a panel which you were just moderating with a younger regulator, which is the National Financial Services Center Authority in India. So they're starting very much from scratch. I think a regulator like ours, like many of our fellow regulators around the world is a large organization and we are collecting all kinds of data from firms and from market.

We have regulatory reporting, we have transaction reporting, we have other public databases which we interrogate and use as well. And what we are doing is

investing in moving to the cloud, which we have now largely done. We have a data lake there, and now we are looking to make sure we have tools which are able to use that data platform as effectively as possible. So one innovation which we've rolled out to nearly half our portfolios at supervised firms is our single viewer firm, which allows frontline supervisors to see through one portal structured and unstructured data about firms. We can then overlay on top of that analytics and risk metrics, which will help a supervisor look at a portfolio of firms to think about, okay, which are the outliers and which may need some more specific attention.

And in terms of how we may want to start thinking about these issues in the future, when I think about the senior leaders in the FCA and those of our colleagues who run the departments, traditionally a senior leader will be thinking very hard and very thoughtfully about how they lead and manage their people, how they manage their budgets, because we always have to use our resources economically and efficiently. But increasingly, the third dimension is how do they use data as effectively as possible? I think about that as an absolutely core and fundamental resource that has to be managed and targeted and directed in the right way.

Jo Ann: You mentioned that you're hiring even more data scientists than you've already hired, frankly a much higher proportion of data scientists, I think, than most regulators do. Do you have insights on how to attract these tech folks into a regulatory environment? I know a lot of people struggle with that.

Nikhil Rathi: Absolutely, and I think that that is always going to be a work in progress. What I would say is we have a very powerful public service mission, particularly at this moment in time, coming out of the pandemic and dealing with all the scarring that's happened in the consumer landscape during the pandemic, dealing with these extraordinary external environment and market conditions. Then specifically in the UK, we are in a process of reviewing just about every part of our regulatory framework following our departure from the European Union and think about what the right framework is for us for the future, aligned to international standards. We have, from our perspective, some of the largest wholesale markets in the world as well on which we collect data. So for anybody looking to learn the trade, to learn about finance, to learn about big tech, to test new techniques in data science, to test them with international partners as well.

There is a canvas here, which I believe is incredibly interesting and exciting. And I think that's certainly one of the reasons why a lot of our data science teams work with us. We are also expanding our geographical footprint within the United Kingdom, so we're not just London based. We also have a significant presence in Edinburgh, and we've also opened an office in Leeds in the north of England. And particularly we chose Leeds because of a very strong university presence in data science and technology in that region. And that's something we're also hoping to harness as well in the coming years.

Jo Ann: Very interesting. I think the regulators have a little bit of a reputation, and I say this is a former regulator myself, we're seeming boring and bureaucratic, but an agency like yours is doing interesting work, world changing work, and I do think that tech people are attracted to solving interesting problems.

Nikhil Rathi: Well, I look at all of the problems that we are seeking to deal with right now. They're complex public policy problems, which require us to work in partnership. They require us to work in partnership with our fellow regulators, whether they are regulators in the United Kingdom or internationally, and also increasingly collaboratively with industry as well.

So whether it's seeking to tackle financial crime and fraud, which has ballooned on an exceptional scale in recent years. Thinking about what we do when it comes to pensions regulation, and some of the issues arising from demographic change and the shift in long term savings rates. How do we also approach the question of vulnerable consumers? So as you see financial markets digitizing, there can be implications for financial inclusion for those segments of population that may not be as familiar with or have as much access to new forms of technology. All of these are questions, which I think are incredibly interesting, and there's a particular moment in time right now where we are grappling with them.

Jo Ann: Absolutely. We've talked a couple of times, we've touched on ESG here, environments, social and governance, and I'd like to ask you to talk a little bit more about these issues of fairness and responsibility and including the DEI, the diversity, equity and inclusion dimension. How are you thinking about that? And again, what advice might you have to our listeners on getting it right?

Nikhil Rathi: We've, been working very collaboratively at the FCA with our colleagues at the Bank of England and also with the industry to really place diversity, equity, inclusion at the heart of regulatory thinking.

What's the justification for doing that? Well, firstly, I think we would argue that organizations both at senior levels, but all the way through the organizations that are diverse, that bring diversity of thought, perspective, background into their organization are likely to support better conduct and risk management. We want environments in our regulated firms where there is an ability to speak up and challenge and test matters when significant risks are being taken. And more inclusive environments, we would hope would tend to encourage those kinds of behaviors.

We generally see, I think, a fair amount of support from the industry for this, not least because financial services firms are always competing for talent and we certainly believe it's good for financial firms' competitiveness to be able to attract the most diverse talent of any background and allow that talent to rise to the top of their organizations.

Jo Ann: We recently held a tech sprint again, learned to do tech sprints from the example that you all have set. We did one with the Reserve Bank of India's innovation hub on women's economic empowerment. And something that came out of it that has really stayed in my mind was the experts saying that if you design a financial product for women, it will work for everyone, but if you design for men, it may not work for women. And I think that's an insight into the superior results that we can get if we really are consciously more diverse. I know our time is limited. Is there anything I haven't asked you that you'd like to share with our listeners?

Nikhil Rathi: Well, I think we've had a really interesting set of conversation. The other area where I'm seeing a huge amount of innovation. And you're actually seeing a lot of this innovation happen in developing economies like India and Brazil is the area of payments which offers considerable potential in this area of financial inclusion because you're starting to see millions of people who perhaps were unbanked outside the realm of financial services through some of the innovations on digital identity, as you've seen in the [inaudible 00:22:17] system in India, the UPI system there, and then similar systems in Brazil come into the financial system and access financial products in a way that wasn't possible before.

So it's no surprise when you walk around the FinTech festival here, just how present a lot of the payments firms that are innovating are. And it certainly seems to me that's one area which will be very, very exciting for us to focus on in the future.

Jo Ann: Absolutely. We will put in the show notes much more information on all of this, and the website for the FCA is-

Nikhil Rathi: www.fca.org.uk.

Jo Ann: That's what I thought. Nikhil Rathi, thank you so much for joining me today. I think we've, we've had a conversation we're going to have a lot of people re-listening to over and over. It was just wonderful to hear your insights, so thank you.

Nikhil Rathi: Thank you, Jo Ann.