Fintech Policy in Europe: Making Regulation Fit for the Digital Age

Dr Sergey Filippov
President and Co-Founder, Fintech Policy ASBL

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Fintech: Old Wine in New Bottle?

• Fintech as **technology-enabled financial innovation**
  • by banks, startups, technology companies, or in collaboration

• **Three stages** (by Arner et al, 2015)
  • FinTech 1.0 (1866-1967): From Analogue to Digital
  • FinTech 2.0 (1967-2008): Development of Traditional Digital Financial Services
  • **FinTech 3.0** (2008 – present): Democratising Digital Financial Services

• **What is new?**
  • Consumer expectations: 24/7, digital, user-friendly, customisation, omni-channel
  • Emergence of a new class of non-licensed newcomers, non-banks
    • not constrained by legacy mainframe systems
    • and often lack a financial compliance culture
  • “Banking is necessary, banks are not” (Bill Gates, 2015)
Industry Digitisation Index

Financial services and insurance is the most digitised...

...and the most dynamically innovating industry!

Source: Strategy& (Booz&Company)
Fintech Investment by Region, $bn

Source: Autonomous Research

Economist, 06 May 2017
Do We Need New Rules for Fintech?

- Considering the **multifaceted nature of fintech**, there can’t be “a fintech law”
  - rather, amendment of sectoral rules, to make them “digitally-friendly”
- Technology powers financial activities, but the functions (payments, deposits) have not fundamentally changed, hence, normally, **the same rules apply**
  - **New rules for new business models** powered by technologies?
- Quite often, the problem for fintech startups is not regulation as such but **a lack of knowledge** of it
- Biggest disruption will be in payments – PSD2 directive
  - Requires banks to open up their payment infrastructure to third parties. Towards “open banking”?
Technology-Neutral Regulation


  - (20) **Durable mediums include in particular** floppy discs, CD-ROMs, DVDs **and the hard drive of the consumer's computer on which the electronic mail is stored, but they do not include Internet websites unless they fulfil the criteria contained in the definition of a durable medium.**

- On 20 November 2009 the Commission adopted a Communication on the review of the Directive. “**There is no evidence that consumers face problems arising from incorrect implementation of the Directive.**”

Source: http://ec.europa.eu/consumers/financial_services/distance_marketing/index_en.htm
## Sectoral Financial Regulation

<table>
<thead>
<tr>
<th>Area</th>
<th>Respective Regulation</th>
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| Capital markets and exchanges | Directive on markets in financial instruments (MiFID II)  
                          | Regulation on markets in financial instruments (MiFIR)                               |
| Insurance                 | The Solvency II Directive                                                                |
|                           | The Regulation on key information documents for packaged retail and insurance-based investment products (PRIIPs) |
| Investment products       | The Regulation on key information documents for packaged retail and insurance-based investment products (PRIIPs)  
                          | Regulation on Key Information Documents for packaged retail and insurance-based investment products (KID) |
| Payments and transfers    | The revised Directive on Payment Services (PSD2)                                      |
|                           | Payment Accounts Directive (PAD)                                                       |
|                           | Multilateral Interchange Fees (MIF)                                                    |
Developments in Member States

- **Belgium**: Webpage for fintech firms on the regulator’s website
- **Denmark**: FinTech Lab at the Danish FSA (Apr 2017)
- **France**: Regulatory “soundbox” – guidance for all; AGILITY programme designed to attract UK fintech firms to France
- **Germany**: An internal Federal Financial Supervisory Authority project group; webpage with an overview of business models and the corresponding regulation on BaFin website
- **Lithuania**: “Newcomer” programme, for companies that are already licensed in another EU country and would like to move their place of residence to Lithuania
- **Luxembourg**: Digital Lëtzebuerg initiative
- **Netherlands**: Public consultations, Innovation Hub, Regulatory Sandbox
- **United Kingdom**: FCA public consultations, UK Envoy for Fintech, Innovation Hub, Regulatory Sandbox
Company start-ups and fintech companies

There is still no clear definition of the concept of a fintech company. Combining the words “financial services” and “technology”, fintech companies are commonly understood to be young undertakings that provide specialised and in particular customer-oriented financial services using technology-based systems.

Business models

Fintech business models are diverse and may – depending on their structure – require authorisation by the Federal Financial Supervisory Authority (Bundesanamt für Finanzdienstleistungsaufsicht – BaFin). You can find an overview of the business models that are currently the most common, as well as regulatory information, on the following subpages:

- Alternative payment methods
- Automated portfolio management
- Crowdfunding
  - Crowdfunding
  - Crowdlending
- Platform for automated investment advice
- Platform for signal trading and automated order execution
- In certain cases, fintech companies, just like other providers have to draw up a capital investments information sheet.
- Virtual Currency (VC)

Authorisation requirement

The description of the different business models is merely indicative in nature and does not constitute a final legal assessment by BaFin. Authoritative evaluations can only be made based on the individual circumstances pertaining to a specific case. To find out if the authorisation requirement applies to you, please fill out our contact form (only available in german).
UK Treasury's “special envoy” for fintech is well-known London seed investor Eileen Burbidge MBE

Press release

PM leads the charge to make the UK a global financial technology hub

From: Department for Business, Innovation & Skills, UK Trade & Investment, Prime Minister's Office, 10 Downing Street, and The Rt Hon David Cameron
Part of: Exports and inward investment, Business enterprise, Indonesia, Malaysia, Singapore, and Vietnam
Published: 30 July 2015

On a trade mission to south-east Asia, David Cameron is promoting the UK's quest to become the leading FinTech centre in the world.
EU Market Fragmentation

- **EU Single Market** remains fragmented, esp in financial services
  - EU Directives and goldplating
  - Divergent interpretation and enforcement of the same rules
- **E.g.: Opening a bank account** in a different EU country
  - Very complicated, normally requires physical presence in a branch for KYC-checks
  - Is Skype / video call equivalent to “face-to-face” checks?
- Fintech firms are creating a truly single EU market in financial services; **fragmentation as a business model**
  - **Raisin**: retail investors unable to benefit directly from the most interesting financial offerings from all over Europe, can do it through this leading marketplace for investments
  - **Funderbeam**: the first and only platform in the world where growth companies are funded and traded across borders.
Financial Market Place Providers

License patchwork for providers offering cross-border services

- **Germany**: No license required
- **Spain**: No license required, after discussion with the regulator
- **Italy**: License as an intermediary of financial services
- **France**: License as an intermediary in banking and financial services (with substance requirements)
- **Belgium**: License as an intermediary in banking services
- **Ireland**: Authorisation as a (Irish) deposit broker with substance requirements; two managers have to reside in Ireland, and further requirements

Source: Raisin. Presentation at CEPS Taskforce on Future of Retail Financial Services, 08 December 2016
Policy Intervention at EU Level

• What is the **rationale** of policy intervention at EU level?
• **Technology-neutral** regulation
  • Not to regulate technology as such, but the use of technology and new business models made possible by this technology
• **Too small** to care VS **too large** to ignore
  • Early intervention risks to stifle innovation
  • Late intervention may be damaging for consumer protection and financial stability
  • Technology develops fast, when is the right moment?
• **Policy response** options
  • Restrictive
  • Watchful
  • Facilitative
"We need to have a cautious regulatory approach – not to regulate this industry to the death before it even picks up. So we need to assess what kind of regulation would be needed at European level, what works in terms of regulation at different member states – also having a possibility to test certain concepts in so-called “regulatory sandboxes.”"
• 03 May 2016: European Commission Staff Working Document “Crowdfunding in the EU Capital Markets Union”
• 30 Sep 2015: Action Plan on Building a Capital Markets Union
• 14 September 2016: Communication “Capital Markets Union - Accelerating Reform”
• 20 January 2017: Public Consultation on the Capital Markets Union Mid-Term Review 2017
• 10 Dec 2015: Green Paper on Retail Financial Services
• 23 March 2017: Consumer Financial Services Action Plan
• 14 Nov 2016: Launch of Task Force on Financial Technology
Mid-Term Review

• New approaches in the financial sector made possible by digital technologies (‘FinTech’) can improve businesses’ access to finance, reinforce competitiveness, produce consumer benefits and stimulate the growth of startups. A public consultation has been launched to help prepare actions at EU level as part of the Capital Markets Union.

• Blockchain is also one of the breakthrough technologies which can have a huge potential impact in the financial sector, but also far beyond. A European observatory on Blockchain technologies is planned, to map and monitor developments, build expertise and promote use cases.
European Parliament

• 19 Jan 2016: Resolution on **Stocktaking and Challenges of the EU Financial Services Regulation**
  • “the Commission should take account of the latest technological developments”

• 26 May 2016: Resolution on **Virtual Currencies**
  • Calls for a proportionate regulatory approach at EU level
  • Calls for the establishment of a taskforce led by the Commission

• 15 Jun 2016: **Report on Fintech** initiated

• 22 Nov 2016: Resolution on the **Green Paper on Retail Financial Services**
  • Called for the Commission to remain ambitious in breaking down barriers and protectionist tendencies that block innovation in retail financial services.

• 17 May 2017: **Report on Fintech: Adopted in plenary**
Report on Fintech (1)

• Rapporteur: Cora van Nieuwenhuizen MEP, ALDE-NL

• With a view to ensuring a level playing field while facilitating ease of access for new market entrants and preventing regulatory arbitrage across Member States and legal statuses, legislation and supervision in the area of FinTech should be based on the following principles:
  • Same services and same risks: the same rules should apply, regardless of the type of legal entity concerned or its location in the Union;
  • Technology neutrality;
  • A risk-based approach, taking into account the proportionality of legislative and supervisory actions to risks and materiality of risks
54 policy actions and recommendations clustered in seven categories:

1) defining an EU framework for fintech
2) data
3) cybersecurity and ICT risks
4) blockchains
5) interoperability
6) financial stability and consumer and investor protection
7) financial education and IT skills

Calls on the Commission to draw up a comprehensive FinTech Action Plan in the framework of its Capital Markets Union (CMU) and Digital Single Market (DSM) strategies
EP Plenary on 16-17 May

Vice-President Valdis Dombrovskis:
“Our approach is guided by 3 overarching principles:

- **Technological neutrality**: the same activity should be subject to the same regulation, irrespective of the technology used. Regulation should not give preference for one technology over another;

- **Proportionality**: regulation should reflect the business model, size, significance, complexity and ultimately the risk;

- **Integrity**: in terms of transparency, security or the use of data.”
Horizontal Policy Areas

• **Cloud and data analytics**
  - General Data Protection Regulation
    • Adopted 27 Apr 2016, applies from 25 May 2018
  - EC Communication Building a European Data Economy
    • Published 10 Jan 2017 (and public consultation till 26 Apr 2017)

• **Cybersecurity**
  - The Directive on Security of Network and Information Systems
    • Adopted 06 Jul 2016, applies from 10 May 2018

• **Electronic identification and electronic authentication, identity management**
  - Regulation on electronic identification and trust services for electronic transactions in the internal market (eIDAS)
    • Adopted 23 Jul 2014, applies from 01 Jul 2016 (trust services), and as of 29 Sept 2018 (recognition of notified eID)
Regulatory Sandbox

• A regulatory approach allowing to innovate in controlled (but live) environments, “a safe space”, where innovators can test different financial innovations with consumer protection in place
  • Managing regulatory risks during the testing stage
  • Not "de-regulation", but a two-way regulatory dialogue between innovator and regulator – in fact, more regulatory scrutiny
• Worldwide, available in Australia, Abu Dhabi, Australia, Hong Kong, Indonesia, Malaysia, Singapore, Thailand
  • Brand new sandbox programme in Abu Dhabi – open for all fintech firms across the globe; first intake on 16 May 2017
• In Europe, UK’s FCA leads the way
  • In Q4 2017, FCA is expected to publish a “lessons learned” report
• A common EU-approach?
  • National implementation, but common EU guidelines and standards
The Financial Conduct Authority (FCA) today entered into a co-operation agreement with the Securities and Futures Commission (SFC) in Hong Kong to foster collaboration in support of financial technology (Fintech) innovation.

Under the agreement, the FCA and SFC will co-operate on information sharing and referrals of innovative firms seeking to enter one another’s markets.

Christopher Woolard, Executive Director of Strategy and Competition at the FCA, said: “Co-operation agreements are absolutely vital in fostering an environment of Fintech innovation on a global scale. In the last few months alone we’ve signed agreements with colleagues in China, Japan, Canada and the Hong Kong Monetary Authority. Working with other regulators internationally, we want to build a common understanding of the principles of good innovation and we look forward to working closely with the SFC.”

Having signed a similar agreement with the Hong Kong Monetary Authority in December 2016, today’s announcement means that the FCA now has agreements with a number of key regulators in Hong Kong, which will be important given the breadth and speed in development of the Fintech sector.
Blockchain (1)

• Industry-led initiatives:
  • U.S.-based **R3CEV** consortium
  • Jan 2017: MoU to develop a blockchain-powered cross-border trade finance platform for SMEs in Europe, by HSBC, Rabobank, Société Générale, Natixis, UniCredit and KBC
  • Oct 2016: Blockchain Insurance Industry Initiative, or **B3i**, by Allianz, Aegon, Munich Re, Swiss Re and Zurich

• The JRC’s EU Policy Lab in cooperation with European Commission’s DG GROW began **Blockchain4EU: Blockchain for Industrial Transformations** in March 2017
  • to explore the possible uses and impacts of these technologies across a number of areas
• Risk is a fragmentation: divergent blockchain applications
• A European Blockchain Initiative?
  • Similar to the EC-led European Cloud Initiative
Blockchain (2)

- **The Blockchain Observatory**
  - EU Tender launched in Spring 2017
  - provide an up-to-date overview of relevant initiatives relying on Blockchain around the world
  - follow-up closely the developments of this technology
  - develop expertise on transversal topics
  - build and animate a platform for the European blockchain community
  - explore possible use cases with a value added at EU level

- **Regulation:**
  - Generally, technology-neutral
  - The legislation in place is designed for centralised solutions, with central data sources held at the central securities depository – opposite to the decentralised nature of blockchain.
  - Settlement finality. It is imperative to clarify (or modify) the legal definition of settlement on blockchain.
EU Fintech Consultation

Public consultation on FinTech: a more competitive and innovative European financial sector

Details
23 March 2017 - 15 June 2017
Policy areas: Financial services, Banking and financial services
Departments: Financial Stability, Financial Services and Capital Markets Union

Target group
All citizens and organisations are welcome to contribute to this

Fintech Policy is preparing a response. We welcome your contribution!
Key Policy Issues and Principles

- **Activity-based regulation** (not entity-based): financial services providers are governed by the same rules
- **Digital first**, digital fitness check in all EU regulation!
- **Technological neutrality** at all levels of legislation
- **Data access**, portability and reciprocity
- Digital disruption in **payments** (forthcoming PSD2)
- Common EU approach to **Regulatory Sandbox**
  - “interoperability between regulators”
- Common EU approach to **Blockchain** development?
- Clarification and simplification of the outsourcing rules for compliance (**RegTech**)
- Comprehensive framework for **cybersecurity**
Fintech Policy: EU Dimension

• Much **better political understanding** of the importance and relevance of fintech at EU level:
  - From individual policy initiatives (crowdfunding, virtual currencies) to a more coherent and comprehensive view on fintech
• No “silos” but **collaborative work**
  - **within** the European Commission: DG CNECT (technology) and DG FISMA (finance)
  - **between** the European Commission and the European Parliament
• European Commission in a **data-gathering mode**, closely monitoring developments, **“a wait-and-see”** approach
• Overall, EU Fintech Policy is **on the right track**
  - But, no reason for complacency
  - Global regulatory competition: South-East Asia, Middle East, ... and non-EU United Kingdom
Thank you

• Dr Sergey Filippov
• sergey.filippov@fintechpolicy.eu

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