European Financial Services Round Table

July 2018

EFR PAPER ON THE EUROPEAN COMMISSION'S FINTECH ACTION PLAN

EFR major concerns

Concerning every digital issue and proposed legislation/regulation the following most pressing topics need to be taken into account:

- **Cyber crime is a top tier global risk** and therefore it is key to assess the potential cyber security risk of each proposal before coming up with legislation/regulation. Furthermore, the global context should be taken into account, which requires a consistent and **coordinated approach at international level**.
- **Fair competition and fair choice:** small start-ups – FinTechs, digital platforms etc –might eventually become very large players. Therefore, the **regulatory framework must be able to adapt swiftly to emerging risks and should provide appropriate governance, transparency, data accessibility, interoperability and liability, to ensure fair competition and fair choice** both for customers and service providers.
- **Regulatory sandboxes** should be standardised (e.g. have a common definition) and, given the (potential) cross-border implications, **supervision should take place within an EU level framework.** A coordinated European approach ensures that the benefits of innovation apply cross-border and that a level playing field is maintained. Once a product leaves the controlled sandbox environment it should fully comply with existing regulations, and therefore regulatory sandboxes should not create breaches in this regard.
- **Competition policy and law enforcement** should be focusing on innovation barriers, technological lock-in or lock-out effects and considering the implications of multi-sided markets.

Executive summary

Against the backdrop of these general concerns about the current regulatory approach, the European Financial Services Round Table (EFR) welcomes the Action Plan on FinTech from the European Commission, but is concerned that the European Commission's rather cautious approach might delay concrete measures that could speed up beneficial innovation in the European financial sector or prevent cyber risks and unlevel playing field issues. Hence, the EFR has the following recommendations to reinforce or complement the initiatives of the FinTech Action Plan, strengthening the Digital Single Market:

- **Scaling innovation:**

  In order to harness the digital transformation of financial services and the emergence of many new players, **a regulatory framework should be considered that provides for the governance, transparency, data accessibility, interoperability and liability, to ensure fair competition and fair choice** both for customers and service providers.

  The efforts to identity national best practices in the field of **licensing and sandboxing** are a step in the right direction, but the EFR believes that the European authorities should take bolder steps towards the establishment of a European regulatory sandbox framework with an EU level supervisory framework. Such a framework should enable cross-border innovations and scale, and alignment with similar regimes in key global financial centres, while ensuring a level playing field.

  Activity specific FinTech licenses would allow to foster and to harness currently promising - but grey - zones.

  The work on standardised APIs (Application Programming Interfaces) for GDPR compliant **data portability** has to be on a cross-sector basis, in order not to further unbalance the level playing field with players from other industries.

  Competition issues in vertically integrated platforms should be addressed in the case they put service providers on a given platform in disadvantage with the platform's own downstream services.

- **Adoption of innovation:** The EFR welcomes the measures outlined in the Action Plan aimed at a new regulatory and supervisory approach to technological innovation, eliminating regulatory obstacles and facilitating for instance the use of cloud, AI and DLT.

  The review of the existing financial regulatory framework in a public-private dialogue should ensure also the fitness of the prudential regulation (e.g. targeted deconsolidation) and supervision (e.g. organisational structures) in the digital context.

- The EFR welcomes that **cyber security, being a top tier global risk**, is prioritised in the Action Plan, and believes that the proposals to enhance information sharing, promote supervisory convergence and develop a coherent testing framework will contribute to enhance the resilience of the financial sector.

  The EFR would welcome the creation of a "one-stop-shop" mechanism and a harmonised incident taxonomy and reporting scheme.

  The global context of cyber threats should be taken into account, which requires a consistent and **coordinated approach at international level**.

In conclusion, Europe urgently needs a globally-aligned, cross-sectorial and forward-looking response to the digitalisation challenge, if the EU is to realise its aspiration of becoming a global hub for innovation in financial services. On the contrary, hampering the financial industry to transform itself might become a threat to the system as a whole.

FinTech Action Plan – seen from the financial services industry's perspective

The EFR welcomes the publication by the European Commission of a FinTech Action Plan and praises the European Commission's efforts to foster and to harness the opportunities presented by technology enabled innovation in financial services.

However, developments in technology and new market dynamics might also create challenges and new risks for consumer protection, financial stability and integrity. The traditional financial regulatory and supervisory framework is not adapted and lacks flexibility to address challenges that often go beyond the financial sector. Europe needs a regulatory framework that enables firms to adopt innovations quickly yet safely, for the benefit of consumers and businesses.

In this effort, the European Commission has opted for a rather cautious approach focused on deepening the understanding of the new technological developments. While this approach seems reasonable to avoid over-regulation, it might delay concrete measures that could speed up the process of successfully integrating technological innovation.

The Action Plan includes important steps aimed at **making it possible for new business models to achieve scale** in the single market and for the financial sector to **make use of the rapid advances in new technologies.** Furthermore, the European Commission's Action Plan also focuses on **making the EU financial sector more cyber resilient.** However, it misses addressing for instance important level playing field issues that should be addressed in further regulation and by competition law.

Therefore, the EFR would like to take this opportunity to comment on each of the three building blocks in the European Commission's Action Plan:

1. Enable innovative business models to reach EU scale

The European Commission is of the view that the majority of innovative business models fits within the existing European financial services regulatory framework, while EBA concludes that a significant number of unregulated or only nationally-regulated FinTech initiatives exist[1]. The EFR welcomes the European Commission's proposal to further analyse national regimes and identify best practices. The EFR is of the view that the introduction of **specific FinTech licenses by activity is necessary**, ideally benefitting from mutual recognition across the EU under a common framework, and therefore removing national barriers (e.g. prudential, technological). This could facilitate a more rapid development of new business models across Europe whilst introducing more security in areas that remain unregulated. In that vein, the proposal harmonising requirements on crowdfunding services across the EU is welcomed.

These FinTech licenses should be clear on what specific purpose/activity is covered and would help to remedy existing gaps in regulation and not be understood as a shortcut to provide additional activities to the one that is authorised. We are not calling for a "generic FinTech license". We advocate fair competition between all market participants and these activity-based licenses should also be available to "traditional" players. This is particularly useful in nascent areas, which do not fit entirely into the existing financial license frameworks, such as crowdlending, financial services marketplaces and virtual currencies.

Also, we believe that authorities must strengthen their supervisory function on the new services that arise, taking a proactive role when the service provider does not meet legal requirements or exceeds its license.

The introduction of **regulatory sandboxes** can become an additional avenue by which regulators and supervisors might gain an accelerated learning in a low-risk environment. We welcome the efforts by the European Commission to identify best practices in national approaches to regulatory sandboxes as a first step. However, the EFR is of the view that the

[1] Commission FinTech Action Plan, chapter 1.1 and Discussion Paper on the EBA's approach to financial technology (EBA/DP/2017/02)

European Commission should establish an EU wide regulatory sandbox under an EU level supervisory framework that seeks to make national approaches to regulatory sandboxes interoperable across the EU. Furthermore, EU regulators should seek alignment and mutual recognition with sandbox regimes in other key financial centres. This should be principles-based and could include a set of minimum standards, such as entry requirements, regulatory safeguards and operational procedures. A level playing field is needed when exiting the sandbox and regulators should have views at the end of the sandbox pipeline. An information sharing framework could also be created in order to enable better monitoring of trends and conduct more informed risks assessments.

Finally, the European Commission's Action Plan encourages joint efforts by market players to develop **standardised APIs compliant with GDPR**. As GDPR is a cross-sectoral regulation, the initiative to foster GDPR APIs should be extended without delay to all other sectors. Personal data portability that is not supported by universal standards will be leading to fragmentation across industries.

PSD2 has created an asymmetry with respect to how customers can access their data at banks in comparison to other non-financial services institutions. Under PSD2 banks are required to provide, with the appropriate consent of the customer, instant and ongoing access to payments data of individuals or firms to regulated third party payment providers (TPPs), using standardised access protocols via open APIs.

These TPPs include technology firms and other non-bank players that may also have valuable data as a result of the digital services they provide. Yet while TPPs can access customer data at banks, there is no reciprocal regulatory obligation or mechanism to enable banks to access customer data held by non-banks on similar terms to PSD2 (instant and secure access, including commercial clients' data). This creates a competitive imbalance. We believe that some kind of "PSD2-like" access to data in platforms and ecosystems across a variety of sectors that generate market access issues would help to restore the level playing field between banks and non-banks and help banks to better meet the expectations of customers, policymakers and supervisors.

Competition issues in vertically integrated platforms should be addressed in the case they put service providers on a given platform in disadvantage with the platform's own downstream services. A typical example is the access to NFC chips for mobile payments, which is not open in all mobile platforms.

Indeed, there are difficulties in assessing abusive practices in a market were data plays a key role in establishing significant market power and where some players might be abusing vertical integration, gatekeeper roles and economies of scale. More specialised resources might be needed to enforce competition policy in this space. Moreover, the lack of transparency and clear incentives is a structural problem that is rightly addressed by the European Commission proposal for a business to online intermediaries regulation.

The overarching objective of all initiatives should be to contribute to a fair and single market in financial services.

2. Support the adoption of technological innovation in the financial sector

In order to fully unlock the opportunities of the digitalisation of finance in the EU Single Market, it is critical that currently licensed financial entities - banks and insurance companies - are able to speed up their own transformation journeys. Regulators and supervisors should adopt a dynamic view in that wherever possible a risk-based approach should be applied in order to accelerate innovation in financial services. We encourage the EU authorities to review the current legislation to ensure that the **regulatory and supervisory approach is digital-friendly.** This would enable safe and effective innovation, taking account of regulatory requirements alongside safe harbor protections.

The EFR also attaches great importance to measures aimed at **eliminating regulatory obstacles** that might restrict the uptake of technological innovation in the financial sector, and are supportive of the work that will be undertaken by the European Commission's High Level Expert Group (ROFIEG). Without prejudging the outcome of this analysis, some initial negative examples include:

- Data localisation rules that impact the uptake of cloud and the deployment of global cloud solutions;
- Rules on AML that impact entities' ability to deploy end-to-end digital financial products.
- Sector-specific barriers that do not exist for other sectors when providing the same services.
- Prudential rules that apply on a consolidated basis and have impacts on investments in software and remuneration policies that limit financial institutions' ability to retain digital talent (Not to be taken to imply opposition to rules that apply at a group/consolidated level more generally).

Especially welcomed are efforts to facilitate the adoption of cloud computing. The industry views **cloud computing** as an enabling technology, core to the transformation of IT estates, the development of new innovative technologies and essential for partnerships with FinTech companies. Although cloud computing does bring potential risks, as recognised by the Financial Stability Board, it is often safer, more robust and better protected than legacy infrastructure[2]. Given the financial stability and system integrity imperative for banks and insurers to modernise their IT architectures, restrictions on the ability of financial entities to use cloud to transform themselves may ultimately prove to be a risk to financial stability and the system as a whole. It is thus essential to empower financial entities in their efforts to migrate to the cloud, provided that security and data protection are guaranteed.

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[2] Financial Stability Board, Financial Stability Implications from FinTech: Supervisory and Regulatory Issues that merit authorities' attention, June 2017, http://www.fsb.org/2017/06/financial-stability-implications-from-fintech/

The industry wants to engage early with regulators in order to improve mutual understanding of the concept of cloud computing in financial services, discussing important concerns such as the concentration risk in a small number of providers, the aspirations of financial services firms and the expectations of regulators and supervisors. There is also a need to strengthen existing guidelines on the use of public cloud and harmonise the requirements of financial supervisors. Our aspirations would be to have pre-approved contracts with the main providers for specific types of initiatives.

Advanced data processing, analytical techniques and artificial intelligence are technologies with a great potential to further democratise access to financial services by lowering the complexity and the costs associated with certain advisory and scoring services; or they enable to better understand the individual's level of risk, to better serve that individual and to detect fraud more easily.

Distributed ledger technologies (DLT) have the potential to address cost inefficiencies at the core of the financial infrastructure.

The EFR welcomes the efforts by the European Commission to leverage the industry's knowledge and experience with all these technologies in order to gain a deeper understanding of them.

Steps to **promote public-private dialogue** - such as through the establishment of the EU FinTech Lab - should be accompanied by other actions from regulators and supervisors to update the knowledge, skills and tools of their staff, through training, industry secondments or targeted recruitment policies.

The **organisational structures of regulatory and supervisory bodies** should be adapted to the digital regulatory needs, by using centralised pools of experts for specific digital projects, until the other existing departments have acquired enough digital knowledge.

3. Strengthen cyber security in the EU financial sector

The EFR agrees with the European Commission that cyber security should be at the top of the agenda going forward. **Cyber crime is a top tier global risk** and therefore it is key to assess the potential cyber security risk of each proposal before coming up with legislation/regulation. The initiatives brought forward by the Action Plan to enhance **information sharing** on cyber threats, promote **convergence in supervisory practices** and develop a **coherent cyber resilience testing framework** will undoubtedly contribute to achieve a more resilient financial sector. The EFR would also welcome the creation of a "one-stop-shop" mechanism for incident notification and a **globally aligned taxonomy of incidents and reporting scheme**. Improvements in incident notification would also improve cyber insurability. Examples of these are the CRO Forum taxonomy and pilot exercise for classifying and reporting cyber incidents, as well as the ECB cyber incident reporting framework. The EFR invites the European Commission to continue engaging with other national and international institutions and actively participate in the **G20/G7 work on developing a principles-based global cyber security framework.**

All in all, Europe needs a decisive response to the digitalisation challenge. This response should acknowledge that in the current environment, the boundaries between sectors tend to disappear and therefore, the response should be cross-sectorial and forward-looking. In light of the fast pace of change in the new digital economy and the traditional rigidity of the European regulatory reform process, authorities must embark in this process with urgency.

The EFR will continue to constructively engage in the debate and would welcome the opportunity to discuss with the authorities any of the topics raised.

The European Financial Services Round Table (EFR) was formed in 2001. The Members of EFR are Chairmen and Chief Executive Officers of international banks or insurers with headquarters in Europe. EFR Members believe that a fully integrated EU financial market, a Single Market with consistent rules and requirements, combined with a strong, stable and competitive European financial services industry will lead to increased choice and better value for all users of financial services across the Member States of the European Union. An open and integrated market reflecting the diversity of banking and insurance business models will support investment and growth, expanding the overall soundness and competitiveness of the European economy.

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