

FINANCIAL INNOVATION: Proposals for European action by Fintech Associations and Stakeholders

October 2019

*Financial technologies not only **improve the quality** of services, but they also make financial products **available to a wider spectrum** of consumers and companies. Entrepreneurs around the world use digital technologies to make financial services quicker, safer, and more affordable, transforming old and creating new business models and products. In Europe, financial innovations can help modernize economy, accomplish the Digital Single Market and include the hitherto underbanked and financially underserved.*

*At the same time, financial technologies can open new sources of financing that companies and self-employed need to embrace the challenges and opportunities of digital transformation. Technology-enabled instruments can become an **important tool for co-financing the EU objectives** of the new multiannual financial framework, such as the Digital Europe or Horizon Europe programmes.*

*To create a truly **open finance** environment, where European companies and startups can grow to compete with American or Chinese corporations and the European consumers get better services and protection, the European Union needs to build up on the initiatives set by the FinTech Action plan in 2018. The undersigned fintech associations from across the Union have formulated several proposals for action to be implemented on the EU level:*

Open finance

PSD2 introduced the principle of opening the banking infrastructure and enabling third party access to data stored on accounts. However, due to the lack of a single open banking standard, lack of obligation to provide API and other provisions that leave the interpretation to the discretion of banks, the scope of account data available and the modalities of access by third parties are not harmonized across Europe. Diverging interpretation as to which accounts can be accessed, for how long, and in what format the information is provided all lead to unsatisfactory customer experience and lower quality of services.

- ◊ What is required is a **revised and harmonized regulatory technical standard** that would allow third parties to access all accounts (consumer, corporate, state-provided) and data (from debit and credit transaction, pension scheme data, standing orders etc.). To harmonize the application of PSD2 the European Commission should also issue **implementation guidelines**.
- ◊ To create a truly open finance environment, the idea of open banking as enclosed in the PSD2 should be **extended** to other financial services, such as **insurance and investment services**.

Online identification

The newest directive on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing puts remote and electronic identification on par with physical identification. At the same time, it gives member states the discretion to recognise and approve only specific types of remote and electronic identification, which again leads to uneven customer experience and discriminatory environment, where companies in some member states can identify their customers electronically, while others are de facto prevented from using advanced technologies to do so.

- ◊ To make sure that companies and customer across the EU can use the same, technologically advanced tools, the EU should issue **Guidelines for electronic and remote identification** for the purpose of preventing money laundering or terrorist financing issue, harmonizing the provisions of the

new AML Directive. In connection with the increasing use of biometric solutions, these guidelines should also indicate the security level of specific biometric technologies, including a GDPR **legal basis for biometric identification** of the clients of financial institutions.

- ◊ European authorities should establish legal framework for **inclusion of Self Sovereign Identity systems** into the national and transboundary electronic identification schemes.

Securities on blockchain

When applied to securities, distributed ledger technologies (DLT) can release **new sources of financing**, especially for SMEs, which need funds for modernization, R&D activities or are underbanked. Therefore, they could become a powerful tool of co-financing national and European programmes that support innovation and digitisation. DLT can lower securities issuance and trading costs, help better allocate capital across regions and borders thanks to their increased liquidity, and enhance transparency and auditability of the market. Owing to these features, securities on DLT can also reduce the cost of **international trade and trade financing** as they ensure the credibility of electronic documents and allow for self-execution of contracts given the fulfilment of conditions included therein.

- ◊ The EU should therefore **harmonize the definition of securities and provide legal clarity for issuing, storing and trading securities on DLT**. To account for future advancements such harmonization should be technologically neutral. As such it could eg. incorporate the provisions of Model Law on Electronic Transferable Records developed by UNCITRAL, which enables the legal use of electronic transferable records both domestically and across borders.
- ◊ At the same time, DLT and blockchain should be **recognized as a tool** that will help **accomplish EU goals**, such as Digital Single Market or Capital Markets Union, and support the objectives of the new financial framework, set in **Digital Europe, Horizon Europe** and other EU programmes.

Crypto-assets

The recent publication of the Libra White Paper and its announced roll-out for 2020 are only the most recent reminder that a common approach to crypto-assets (digital assets) is necessary on the EU level. In the surveys conducted lately by ESMA national authorities identified crypto-assets as one of the areas where gaps and issues exist in the current EU regulatory framework. Distributed ledgers, decentralized financial platforms and smart contracts create new business models and products that require amended or new legal definitions.

- ◊ The EU should create a **bespoke regime for crypto-assets with harmonized definitions** of various types of digital assets as well a clear distinction between situations where blockchain and DLT only provide technology for electronic money or other (traditional) financial instruments and where DLT implementation creates new types of assets and instruments. The regime should be based on a thorough analysis of the underlying objectives of protecting (i) customers, (ii) financial stability, and (iii) creating such a level-playing field that when a monopoly in one sector (eg. a social platform) enters a new market (eg. payment services) it cannot leverage its monopolistic power and has to open its infrastructure to third parties (eg. in compliance with the PSD2).
- ◊ European authorities should also consider strict **legal framework for activity of cryptocurrency exchange platforms (marketplaces)**, foremost the regulations in scope of **protection of the customers crypto-assets** held by such entities.

Crowd-financing

At present, the European Union is working on the Regulation of the European Parliament and the Council on the European Crowdfunding Service Providers (ECSP) for Business. The activities should be continued to unify the legal framework of crowdfunding platforms (crowdfunding and p2p lending platform) by issuing appropriate guidelines.

- ◊ A legal framework for **p2p lending activity should be established**, unifying the authorities' approach in regards to p2p platform operators and the status of users providing funds for lending and foremost to protect the consumer and lender.

Enabling innovative business models

National financial supervisors have different authorization processes and take different approaches to applying proportionality and flexibility when licensing new business models. Some of them have special programmes (sandboxes, innovation hubs) for facilitation of innovation in finance, while others have more conservative views on a supervisor's role in enabling technology-based innovation. This undermines a fintech startup's chance to establish and scale up their business in a heavily regulated sector. While it is of utmost importance to ensure financial stability and customer protection, licensing requirements cannot hinder small innovative companies from entering the market and compete with traditional service providers.

- ◊ Following recent ESMA Report on Licensing of FinTech business models, which only surveyed National Competent Authorities, and the evidence that can be provided by special national programs for financial innovation, **EU-wide licensing and reporting rules should be adopted to enable financial innovation**. They should consider e.g. (i) De Minimis threshold under which no authorisation or lighter authorisation conditions are required, (ii) calculation of the licence applicant's own funds, where activated (development) costs and subordinated loans could be taken into account, (iii) reporting requirements that reflect the structure (eg. platform-type), size and potential risk for the customer and sector of the service provider.
- ◊ Additionally, other **legal acts with relevance to financial technologies should be considered for revision**. One of such examples is the IDD2 so as to allow for cross-selling of banking and insurance products up to a certain threshold (e.g 50 EUR /year).
- ◊ Investments in innovation is crucial not only from the perspective of fintech companies, but for the entire financial sector, which has been the largest user of digital technologies. Banks are investigating into different forms of financing for innovation, one of them being via their Corporate Venture Capital (CVC) funds. However, they face certain obstacles such as the capital treatment of their CVCs, which at the moment is similar to the treatment of the VC exposure. It means that the current capital requirements (exposure) to such investments are still a very costly for the banks. Therefore, **levering obstacles to corporate venture capital (ie. innovation financing) by banks** (regulatory treatment of exposure to equity funds vs. booking of corporate VC funds) would foster the goals of Capital Markets Union, improve innovation in the banking sector and boost banks' cooperation with the ecosystem, especially with startups and fintech companies.

Facilitating and recognising innovation in finance

Official debate about financial technologies has often been led on the EU level without a proper representation of those who provide them. EU FinTech Labs as introduced by the FinTech Action Plan remains only a discussion platform, EU working groups often lack representatives of fintech companies, while the European Forum for Innovation Facilitators (EFIF) established in April this year has as members only the European Supervisory Authorities and the National Competent Authorities. Such a situation, where exclusively well-established financial service providers and public institutions take part in dialogue may not only (i) result in an unlevel playing field but it also (ii) prevents traditional and public actors from having access to first-hand information about the newest technological trends and rightly assessing risks and profits.

- ◊ Formal **professional channel on the future of finance in the EU** should be established between the representatives of fintech companies, the EU (European Supervisory Authorities), the National Competent Authorities and other relevant actors. It can either be part of the EFIG, a standing body of

the EU FinTech Lab or a new EU-wide working group. Additionally, representatives of other relevant DGs, in specific of DG CONNECT, should be invited.

◊ As ESAs highlighted in their report at the beginning of 2019, fintech sandboxes and fintech hubs are two regulatory tools that help companies in complying with the existing regulation, and address the needs of authorities to better understand the risks and mitigations of innovative business models in financial technology. Several member states have already implemented regulatory sandbox programs and most of them have opened innovation hubs. To avoid further fragmentation of regulatory environment in finance the European companies, especially startups and scaleups, would benefit from a coordination initiative. Therefore, we propose to establish a **European Fintech Sandbox Coordination Program**. This initiative should take into consideration global developments, in specific the Global Sandbox Program as initiated by the Financial Conduct Authority in the UK.

◊ To recognize financial innovation “made in EU” an **Excellence Award Programme in Financial Innovation** should be established. This would not only help promote EU success stories but first and foremost could motivate companies and public sector in other member states to adopt the awarded financial innovation. This program could be aided by channeling more research funds and grants to support innovation in finance from calls under the Digital Europe, Horizon Europe and Creative Europe programmes. Additionally, member states should be encouraged to **positively discriminated financial technologies in projects financed from EU funds**. These activities should be coordinated the above mentioned formal professional channel on the future of finance in the EU.