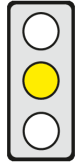


KEY ISSUES

Objective of the Communication: The Commission sets out initiatives on new financial technologies to make the European financial sector more competitive and innovative.

Affected parties: Financial market players, customers, supervisory authorities.



Pro: (1) Greater convergence between national regulatory systems regarding licensing requirements facilitates transnational platform activities.

(2) Guidelines by the ESAs on outsourcing to cloud service providers may contribute to harmonised supervisory practice concerning the duties of financial institutions when outsourcing.

Contra: (1) The Commission should not influence the market-driven development of API-standards because this may affect or even distort competition.

(2) The EU should refrain from striving at EU-regulatory sandboxes, and concentrate on innovation hubs. They offer a neutral, innovation-friendly solution on how to apply regulatory requirements to new technologies.

The most important passages in the text are indicated by a line in the margin.

CONTENT

Title

Communication COM(2018) 109 of March 8 2018: **FinTech Action plan: For a more competitive and innovative European financial sector**

Brief Summary

► Context and objectives

- According to the Commission, the financial sector is the largest user of digital technologies and is therefore identified as “a major driver in the digital transformation of the economy and society” (p. 2).
- FinTech, i.e. technology-enabled innovation in financial services, has significantly gained relevance in recent years and presents opportunities to provide better access to financial services for consumers and to improve the efficiency of the financial system. FinTech can also help to deepen the Capital Markets Union. (p. 2)
- Although FinTech offers opportunities for the European financial sector, it also includes risks and challenges, such as cyber-related risks, consumer and investor protection issues and supervisory framework uncertainties, which need to be addressed (p. 2 and 3).
- In this Action Plan, the Commission sets out various initiatives to make the European financial sector more competitive and innovative, which aim to (p. 4, 10 and 15)
 - enable innovative business models to be rolled out across the EU in order to benefit from economies of scale,
 - support “the uptake of technological innovation in the financial sector” and
 - enhance the “security and integrity of the financial sector”, in response to cyber-related risks.

► Enabling innovative business models to reach EU scale

Licensing requirements

- Diverging licensing requirements for FinTech firms across Member States hinder the efficient supervision of financial services firms and effective protection of consumers and investors (p. 5).
- In order to determine clear and consistent licensing requirements and thus to enable innovative business models to scale-up across the EU, the Commission wants (p. 5 and 7)
 - the European Supervisory Authorities (ESAs), by the first quarter of 2019, to
 - identify existing authorising and licensing regimes for FinTech business models within Member States,
 - assess the need for an EU framework, and
 - provide guidance for a greater convergence between national regulatory systems;
 - to assess, in the course of 2018, the risks, opportunities and suitability of the current EU regulatory framework, and to evaluate whether EU regulatory action is necessary regarding
 - “initial coin offerings” – i.e. a new, digital way of raising money by issuing “coins” or “tokens” which are partly comparable to conventional initial public offerings – and
 - crypto-assets in general – i.e. digital assets recorded on a so-called distributed ledger, a decentral database held and updated by the members of a large network –;

- to establish a European “passport regime” for crowdfunding activities, enabling crowdfunding platforms to operate across the EU – as proposed by the EU Regulation on European Crowdfunding Service Providers (ECSP) for Business [COM(2018) 113, [cepPolicyBrief](#) to follow].

Common standards and interoperable solutions

- Through common standards and interoperability, the Commission wants to increase competition and simplify “the exchange of and access to data between market players”, so that the FinTech market reaches its full potential on an EU scale. The standard-setting process should be open and transparent; and effective access to standards should be provided on fair, reasonable and non-discriminatory terms (FRAND). (p. 7)
- The FinTech Action Plan includes two initiatives concerning standardisation (p. 8): the Commission will
 - work with major European and international standard-setting bodies to develop “more coordinated approaches” on FinTech standards, and
 - support the market-driven development of a standard for application programming interfaces (APIs) – i.e. protocols to facilitate the interaction of two software programs – enabling FinTechs to gain standardised access to their users’ payment accounts at banks, which is part of the Payment Services Directive [PSD2, Directive (EU) 2015/2366, see [cepPolicyBrief](#)].

Innovation facilitators

- Innovative approaches and technologies do not always fit well with existing regulatory requirements and supervision practices. This makes it difficult for market players to offer innovative services on a European scale, e.g. by using a “European passport”. (p. 8)
- The Commission advocates (p. 8 and 9)
 - “innovation hubs” – industry and supervisors discuss regulatory issues related to new business models – and
 - “regulatory sandboxes” – a framework whereby innovators are given a controlled space in which to test new products with the support of a supervisory authority.
- The Commission urges the ESAs to (p. 9)
 - identify best practices on innovation hubs and regulatory sandboxes by the end of 2018 and
 - issue non-binding guidelines on these topics “where appropriate”.
- By the beginning of 2019, the Commission will present a report with best practices for regulatory sandboxes (p. 9).

► **Supporting the uptake of technological innovation in the financial sector**

Technology-neutrality

- According to the Commission, innovation may be hindered by previously adopted regulation which in practice is not technology neutral, e.g. when it requires paper-based documentation or physical presence (p. 10).
- By the second quarter of 2019, a Commission expert group will assess whether “unjustified regulatory obstacles to financial innovation” exist in the current financial services regulatory framework (p. 11).

Removing obstacles to the use of cloud services

- The Commission underlines the benefits of outsourcing data processing and storage capacity by using cloud service providers. However, the legal requirements for financial institutions to outsource these tasks are often unclear and differ across Member States. (p. 11)
- In order to ease the use of cloud services, the Commission proposes that (p. 12):
 - the ESAs issue guidelines on outsourcing to cloud service providers, building on respective European Banking Authority’s recommendations [[EBA/REC/2017/03](#)],
 - stakeholders develop “cross-sectoral self-regulatory codes of conduct” aiming at facilitating the change of cloud service providers, as already mentioned in the Commission’s proposal for a Regulation on the free flow of non-personal data [COM(2017) 495, see [cepPolicyBrief](#)] and
 - “standard contractual clauses for cloud outsourcing by financial institutions” be developed.

EU blockchain initiative

- Blockchain and distributed ledger technologies have great potential to make processes simpler and more efficient. They may become “central to future financial services infrastructure”. (p. 12)
- Regarding blockchain and distributed ledger technologies, the Commission (p. 13 and 14):
 - conducted a [public consultation on the EU framework for public reporting by companies](#), investigating amongst others the role that distributed ledger technology can play in the European Financial Transparency Gateway, a pilot project which connects national databases,
 - launched an EU Blockchain Observatory and Forum to foster cross-border cooperation concerning the use of blockchain, and
 - conducted a study to assess the opportunity and feasibility of an “EU public blockchain infrastructure to develop cross-border services”.

Building capacity and knowledge among regulators and supervisors

- Major obstacles hindering the development of FinTech include a “lack of certainty and guidance” on the use of new technology, and differences in the approaches taken by national regulators and supervisors (p. 14).

- The Commission established an “EU FinTech Lab” with European and national authorities and technology solution providers to “raise the level of regulatory and supervisory capacity and knowledge” concerning new technologies. The first meeting took place on 20 June 2018; its focus was on cloud outsourcing. (p. 14)

► **Enhancing security and integrity of the financial sector**

- As the financial sector is increasingly dependent upon digital technology and at risk of cyberattacks, the EU financial sector must be safe and cyber-resilient to maintain its stability (p. 15 and 16).
- In order to enhance cybersecurity and the integrity of the EU financial system, the Commission stresses the need for a closer cooperation between financial market players regarding threat intelligence – i.e. the identification and analysis of cyber threats – and between national supervisory authorities regarding resilience testing (p. 16).
- The Commission wants the ESAs, by the beginning of 2019, to (p. 17)
 - identify the “existing supervisory practices across financial sectors around ICT security”,
 - issue guidelines and suggest legislative improvements to the Commission, and
 - investigate the costs and benefits of an EU-wide cyber-resilience testing framework.

Policy Context

In March 2017, the Commission carried out a public consultation on FinTech. The present FinTech Action Plan draws its conclusions from this consultation. It is part of the Commission’s efforts to create a Capital Markets Union [COM(2015) 468, see [cepPolicyBrief](#)].

Options for Influencing the Political Process

Directorates General:	DG Financial Stability, Financial Services and Capital Markets Union
Committees of the European Parliament:	Economic and Monetary Affairs
Federal Germany Ministries:	Federal Ministry of Finance
Committees of the German Bundestag:	Finance Committee (leading)

ASSESSMENT

Economic Impact Assessment

In all economic sectors, technological innovations may create a need for regulation to be adapted. This is especially true in the financial services sector, which is highly regulated for reasons of consumer protection and financial stability. FinTech innovations as well make it necessary to duly examine the need for regulatory changes in order to continue to reach these regulatory aims. At the same time, legislators should ensure that regulation does not hinder innovative business models but is technologically neutral, so that consumers’ preferences and behaviour determine the success of FinTech-based business models.

Whether or not licensing requirements currently hinder FinTech companies in scaling up and marketing services in all EU-Member States depends on companies’ business models. For a number of activities, regulation has already been harmonised and the EU-Passport applies. In such cases – e.g. for residential credit or insurance intermediation – the license granted in any Member State allows market players to operate across the EU.

For a number of other activities, such as the increasingly important platform activities of FinTech companies, this is not necessarily the case. Given that such platforms profit from network economics, i.e. their added-value increases with the number of users, an “EU framework”, or “greater convergence between national regulatory systems” regarding licensing requirements, will facilitate transnational platform activities. As FinTech business models highly diverge and are still developing in different directions, a harmonised “EU Framework” might however be challenging. For the time being, the convergence of national regulatory measures could be a more realistic route.

Initial coin offerings (ICOs) operate in a regulatory grey area and are not always subject to existing prospectus requirements (see [cepPolicyBrief](#)). In cases where the requirements do not apply, ICOs can be a cost-effective way of raising funds for projects but do not necessarily offer the same degree of information and protection to investors. Given that ICOs are often very risky, a number of financial supervisory authorities have issued warnings for ICOs. In order to avoid a distortion of competition and to uphold consumer protection, the level of protection applicable to traditional initial public offerings should in principle also apply to initial coin offerings. However, as in the case of crowdfunding platforms (see [cepPolicyBrief](#)), lower regulatory requirements may be permitted as long as a specified investment sum and a specified degree of complexity have not been reached. Thus, an efficient and innovative way to raise funds may be safeguarded without endangering investor protection to an unacceptable extent.

For many FinTech firms, access to users' bank accounts is essential for their business. The second Payment Services Directive [PSD2, Directive (EU) 2015/2366, see [cepPolicyBrief](#)], in combination with a technical standard [Delegated Regulation (EU) 2018/389; Art. 30 para. 3], provides for such access. It prescribes an interface which follows standards issued by international or European standardisation organisations.

As a political actor, **the Commission should not** "support", i.e. **influence the market-driven development of API-standards because this may**, depending on their design, limit the flexibility of banks to develop services which are different from those of their competitors and may thus **affect or even distort competition**.

The United Kingdom's intensive use of regulatory sandboxes has attracted a considerable number of FinTech firms. Depending on the scope of the future, still to-be-negotiated access of British financial firms to European markets, an EU sandbox approach might make the EU more attractive as a FinTech-hub. However, regulatory sandboxes cause a number of problems. First, the supervisory authority may deny access to some enterprises. Hence, its decision may distort competition, because some firms profit from special regulatory treatment and others do not. Also, sandboxes are, per definition, a regulatory work-in-progress. Therefore, they may lead to higher risks for consumers and for financial stability. **The EU should refrain from striving at EU-regulatory sandboxes and concentrate on innovation hubs** instead: **they** are open to all relevant stakeholders and **offer a neutral, innovation-friendly solution on how to apply regulatory requirements to new technologies**.

Cloud services are increasingly used by both FinTech firms and traditional financial service providers. However, cloud services may suffer from technical failure or be subject to cyberattacks. All this presents risks to the ability of financial service providers to offer services in an undisturbed manner. Such lack of business continuity can cause dangers both for the affected institute – e.g. customers may lose trust and withdraw funds – and for financial stability as a whole. Thus, **guidelines by the ESAs on outsourcing to cloud service providers may contribute to harmonised supervisory practice concerning the duties of financial institutions when outsourcing**. Moreover, as an alternative to regulation and supervision of the outsourcing financial institutions, direct regulation and supervision of cloud service providers operating in the financial sector would be justifiable if cloud services were to achieve the status of critical infrastructure to the financial sector.

Legal Assessment

Legislative Competence of the EU

The legal basis for harmonising financial markets regulation is provided by the internal market competence (art. 114 TFEU). The legal basis for the coordination of national provisions concerning the taking-up and the pursuit of self-employed activities is provided by the competence implementing the right of establishment (art. 53 (1) TFEU).

Subsidiarity

Dependent on the actual design of the follow-up measures. Unlikely to be problematic however, due to the cross-border nature of financial markets.

Proportionality with respect to Member States

Dependent on the actual design of the follow-up measures.

Compatibility with EU Law in other Respects

Dependent on the actual design of the follow-up measures.

Impact on and compatibility with German Law

Dependent on the actual design of the follow-up measures.

Conclusion

For the increasingly important platform activities of FinTech companies, greater convergence between national regulatory systems, regarding licensing requirements, will facilitate transnational platform activities. The Commission should not influence the market-driven development of API-standards because this may affect or even distort competition. The EU should refrain from striving at EU-regulatory sandboxes, and concentrate on innovation hubs. They offer a neutral, innovation-friendly solution on how to apply regulatory requirements to new technologies. Guidelines by the ESAs on outsourcing to cloud service providers may contribute to harmonised supervisory practice concerning the duties of financial institutions when outsourcing.