European Commission public consultation on FinTech: a more competitive and innovative European financial sector. June 2017.

The European Commission (the "Commission") has issued a document for consultation, running from 23 March to 15 June, on FinTech and achieving a more innovative and competitive European financial sector. The connected Digital Single Market is one of the priorities of the current Commission presidency, as stated in its 2015 communication "A Digital Single Market Strategy for Europe". The policy objectives set out in the strategy are to support the development of digital infrastructures, improve access to digital goods and services and design rules that foster technological development.

New technologies are changing the financial industry and the way investors and firms access financial services. Non-disruptive FinTech business models trigger incremental innovations and increase efficiency while disruptive models can create completely new markets. Both enhance the competitiveness of the economy.

The Commission's stance on FinTech is based on three core principles: a) technological neutrality, which means the same activity is always subject to the same legislation, b) proportionality, which takes account of entities' business model, size, systemic importance, complexity and cross-border activity, and c) market integrity, whereby the application of technologies to financial services should promote greater market transparency to the benefit of consumers and companies but without creating unwarranted risks, such as market abuse, cyber security issues or systemic risk.

The consultation invites input from stakeholders (regulators, the financial industry and consumers) on the impact of new technologies in the financial services industry and asks whether the regulatory and supervisory framework fosters technological innovation in line with the three abovementioned core principles. The goal is to create an enabling environment where innovative FinTech products and solutions take off rapidly throughout the European Union ("EU"), while assuring financial stability, financial integrity and safety for all participants in securities markets.

The Commission has set up a Task Force on Financial Technology to coordinate all financial regulation work on technology, data, access to finance, entrepreneurship, consumer protection and competition. The consultation document is split into four sections covering four general policy objectives which reflect the main opportunities and challenges associated with FinTech. These are:

1. Fostering access to financial services for consumers and businesses

FinTech can bring consumers and firms benefits in terms of access to financial services in the form of wider investment options, more user-friendly services at lower prices and strengthened financial inclusion.

Regarding automated financial advice and execution, artificial intelligence and big data analytics have the potential to significantly lower the price of financial advice so investors can access products better tailored to their individual needs and more efficient risk management. It could also reduce the need for geographical proximity and promote access to cross-border services. Automated advice may also, however, pose challenges and risks. It could encourage pro-cyclical investment behaviour – herding as a consequence of standardised risk profiling – require measures to maintain investor protection, generate new possible errors that will require similarly automated systems to control and make it hard to assign liability in the event of economic loss to the customer.

Regarding social media and automated matching platforms for crowdfunding, the consultation document recognises these new channels for accessing finance as alternatives to bank finance for individuals and SMEs. The Commission wants to know if stakeholders see a need for European-scale regulation of non-bank financing.

2. Bringing down operational costs and increasing efficiency for the industry

The document recognises FinTech's potential to cut operating costs and improve the efficiency and speed of financial service delivery while also acknowledging the challenge these changes pose to financial stability, including possible cyber risks and the fragmentation of industry processes. Also, streamlining functions could destroy jobs in the financial industry, although it would also create new jobs to implement FinTech solutions. These last would, however, require different technological skills and training in hard sciences.

RegTech – the application FinTech to comply with regulatory requirements – will allow firms to cut compliance costs and regulators to access data more easily and tailor compliance requirements to individual cases.

When it comes to matters of recording, storing and securing data, the consultation asks whether cloud computing, an already available technology, faces regulatory or supervisory obstacles in the EU and if it warrants further measures at European level.

Regarding disintermediation of financial services, the document discusses whether distributed ledger technology (DLT) is the best way to go. It describes disruptive and less disruptive DLT applications in areas such as international payments, syndicated loans, post-trade applications, securities issuance, re-hypothecation of assets, financial reporting and compliance. However, it also points out that this technology remains unproven and raises technological, operational and regulatory problems regarding scalability, interoperability, standards and governance, protection of personal data and digital identity management to ensure fair and secure access to data. The document also highlights significant legal risks: which law is applicable to DLTs? Who has ultimate liability? Which authority can recognise or license them and provide legal recognition that data stored using DLT is true? ESMA takes the position, following last year's published consultation, that regulatory action is premature as the technology is still in an early stage of development.

3. Making the single market more competitive by lowering barriers to entry

The document identifies a number of ways in which FinTech reduces entry barriers to financial services markets: a) disrupting traditional distribution channels, such as digital payment platforms, peer-to-peer lending solutions and mobile applications, b) lowering production costs, c) more advanced data analytics (use of alternative data sources) to develop their own credit-scoring and customer preference systems, and d) mobility of customers through online platforms. However, the document also indicates that further barriers remain to be eliminated. The Commission commits to ensuring that unjustified legal or practical barriers that prevent setting up and scaling up FinTech solutions across the Single Market will be removed, while preserving investor protections and monitoring potential impacts on financial stability.

The consultation also proposes that regulation should consider FinTechs in licensing, proportionality and outsourcing. The Commission is aware that there are different approaches to licensing in member states, which is costly and could reduce incentives to innovation in the EU. It is considering publishing guidelines on how certain business models fit with the current regulatory regime. The Commission also stresses that regulation must be applied proportionately to promote competition. Finally, some FinTech firms do not provide financial services directly but offer tools to regulated firms on an outsourcing basis.

The document also recommends that supervisors should see their role as enabling innovation. Supervisors need to build up their experience and knowledge to deal with the new developments. It identifies a number of options for action by supervisors: a) maintaining regular contacts with the industry and other national and international supervisors, b) laying down core principles for supporting firms across Europe, and c) setting up regulatory sand boxes. Some national authorities are already up and running with this last option and the Commission asks for stakeholders' opinion on a possible European-scale initiative.

Delivering financial services using FinTech solutions depends on standardisation of data and the interoperability of systems and applications. In the area of payments, the revised Payments Systems Directive already allows access to data for payment initiation and account information services. FinTech raises challenges to financial stability as technological development poses threats to incumbents. This has consequences for systemic risk and supervisors need to be alert to this issue.

4. Balancing greater data sharing and transparency with data security and protection needs

FinTech relies on more data sharing and greater transparency. This raises questions about personal data processing, data management policies, data standardisation, data sharing, security and access to data by providers of financial services. There is an apparent need to regulate access to data in a competitive commercial environment. Financial information should be stored and shared using a reliable tool. The use of cryptography to sign messages and store and transmit data is basic, as is reliable technology for digital ID.

Big data analytics can help lower information barriers for SMEs and other users if non-bank funding providers could access financial information via matching platforms and credit information sharing.

Security and operational integrity and resilience are essential preconditions for the confidence of market participants. To provide this, there is a need to set requirements on cyber security and eliminate any regulatory barriers that prevent or restrict the sharing of information between financial service providers and public authorities on cyber attacks.

Link: European Commission public consultation on FinTech: a more competitive and innovative european financial sector.