

Fintech and the Capital Markets Union

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Fintech & CMU

- Fintech: “technologically enabled financial innovation that could result in new business models, applications, processes or products with an associated material effect on financial markets and institutions and the provision of financial services” (FSB)
- Its essence? Faster data processing and information sharing technology to lower the costs of payment and to disrupt the incumbent investment and credit supply paradigm.
- Is Fintech contributing to market integration and risk-sharing?
- Can the Fintech Action Plan act as a catalyst for the widespread adoption of technological innovation by the financial sector?
- Are new regulatory initiatives warranted? I.e., is Fintech **hype or revolution in the world’s most overbanked continent?**

The Promise of Fintech (i) – Broadening Access

- Fintech promises to broaden access to finance, promote financial inclusion, increase operational efficiency, deepen EU capital markets and improve regulatory compliance and reporting.
- Broadening access
 - Digital ID
 - More accurate credit records
 - Credit scoring
- Broadening financial inclusion and offering focused products: Chetwood's Financial dynamic loan.
 - Chetwood has launched the first dynamic loan, where borrower's interest rate falls as their credit score improves.
 - The firm uses technology to monitor a customer's credit score and reduce the interest rate as the risk of the loan decreases.
 - It seeks to fill the gap left by payday lenders and end the exploitation perpetrated by payday lenders such as Wonga, by offering customers affordable financing.

The Promise of Fintech (ii) – Regtech-based compliance & reporting

- New technologies can be used to facilitate and streamline regulatory compliance and reporting and improve supervision
 - It can facilitate and simplify post-trade recording alleviating the burden imposed on firms by MIFID II.
 - Financial supervision increasingly driven by data with regulators requiring data of a greater granularity and at greater frequency.

EMIR requires the reporting of derivatives contracts to trade repositories.

- A number of new technologies, such as distributed ledger technology, can improve data aggregation, management and sharing.
- Embracing new technologies could result in information streamlining, lower the costs of trading
 - It can encourage more trading (liquidity) in less liquid assets improving market efficiency,
 - allow a near-real time view of transactions, where this is desirable.

Fintech, Market Integration and Risk-Sharing: Evidence

- According to the EBA's mapping exercise, over 1500 Fintech firms are established in the EU.
- 31% are not subject to any regulatory regime under EU or national law, 9% are subject to a national registration regime and 5% subject to a national authorisation regime.
- Total volume of alternative finance remains low, especially in comparison to the size of capital markets.
- Bulk of activity is concentrated in the UK.
- Fintech activity is domestic.
- Fintech is not scaling at the European level.

Fintech, Market Integration and Risk-Sharing

- The operation of many Fintech firms under national authorisation or registration regimes leaves room for divergence in their treatment across the EU.
- High percentage of firms not subject to any regulatory regime suggests potential regulatory arbitrage.
- As more European countries join the trend toward establishing regulatory sandboxes the risk of creating a fragmented ecosystem becomes greater undermining the common market
- The Commission tries to address the challenges through the Fintech Action Plan
- BUT
- The Commission has decided against broad legislative or regulatory action.

A Pan-European Sandbox?

- “Regulatory sandboxes are controlled ‘safe spaces’ in which innovative products, services, business models and delivery mechanisms can be tested without immediately being subject to all of the regulatory requirements” EBA Banking Stakeholder Group (2017, 2018).
- Sandboxes foster innovation by strengthening communication and empathy among the different stakeholders.
- UK’s FCA was the first regulator to set up a sandbox in May 2016.
- Other European countries are joining the trend.
- Divergent regulatory practices and supervisory criteria give rise to the risk of regulatory arbitrage and creation of a fragmented ecosystem with different regimes.
- They merely promote innovation at the local level.
- EBA is currently seeking to identify best practices in the design and operation of sandboxes and draw up recommendations for the core design of a sandbox.

A Pan-European Sandbox?

- EBA's Banking Stakeholder Group (2017, 2018) called for exploring the possibility of "cross-border sandboxes" in the EU.
- A Pan-European sandbox would be a sandbox designed and implemented at the EU level. It would:
 - foster Pan-European financial innovation
 - minimize the risk of regulatory arbitrage and fragmentation.
- Which EU institution would be responsible for the sandbox?
 - ESMA, European Commission, EBA?
 - EBA's Fintech Knowledge Hub brings together competent authorities and promotes engagement with Fintech firms and other stakeholders.

A Pan-European Sandbox? (i)

- Can EBA's Fintech Knowledge Hub become responsible for overseeing an EU-wide sandbox?
- Meroni doctrine?
 - Are national authorities better equipped to deal with local markets?
- Different national rules in the field of, for instance, consumer protection.
- Other private law issues
- Would a *lex specialis* be desirable/feasible?

A Pan-European Sandbox (Regime)? (ii)

- Level playing field issues?
 - *Same business, same risks, same rules*
- Greater integration potential – possibility for the passport
- The “good” the “bad” and the “ugly”:
- AI and deep learning can be the key to overcoming the linguistic barriers the industry currently faces across the Eu-27
- but they also raise massive ethical considerations –
 - Whose ethical standards?
 - Who should deal with them?