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European Banking Authority

## **Discussion Paper on the EBA's approach to financial technology (FinTech)**

The Swedish Bankers' Association (SBA) appreciates the opportunity to comment on the Discussion Paper on the EBA's approach to financial technology (FinTech). Our reply is divided into two parts: first, we present our main topics and general comments we believe EBA should consider and secondly, answers and comments to the individual questions.

### **General comments**

1. A broad definition of Fintech is required – Fintechs are companies that provide financial services and have offerings in the financial segment. Therefore, the definition of Fintech cannot and should not be limited to certain players within the industry. There are already many incumbent financial players, including credit institutions, providing Fintech solutions to their customers. Fintech should therefore be considered as an activity of providing services and not limited to a legal subject or class of companies. Therefore, we advocate for that the same regulatory and supervisory obligations must apply to the provision of the same services, across the single market and regardless of the type of the entity providing such services.
2. Ensure a balanced level playing field and equal terms – it is difficult to identify the difference between innovation as an activity, incremental innovation i.e. within an organization and the innovation that smaller non-bank actors apply. If the European Union wishes to have a regulatory environment that deviate from the rest of the world, we believe it to be important to define Fintech appropriately to ensure that European institutions can compete globally.
3. Today, incumbent banks provide access to infrastructure and back-end systems for non-bank Fintech companies; where risks such as legal responsibilities, reputational risks and compliance risks lie with the incumbents. However, with the entry of non-bank Fintech companies there is no "accountability-chain" or burden sharing agreements for many of these requirements and burdens, for example Anti-Money Laundering (AML).

Hence, there is an inherent risk that the role of the incumbent credit institutions over time is transformed to one where they become the involuntary distributor of back-end infrastructure to parties with which they have no contractual nor commercial agreements with. It is therefore important that these actors act within the roles and responsibilities provided, for example those defined in PSD2.

4. Apply a risk-based approach – legislation and supervision should take a technologically neutral approach. Hence regulators need to identify and measure all activities that involve risk regardless where these occur, especially as many Fintechs offer services and activities that are neither supervised nor have the same regulatory requirements. Consumer protection and financial stability for the European Union should never be jeopardized by Fintech-activities.
5. Review current and future infrastructural components that are – or may be – shared by Fintech companies as well as incumbent banks. Examples are SWIFT on global level that may – or may not – partly be replaced by Distributed Ledger Technologies (DLT). It should be in the interest of society to safe guard and promote use of a shared financial infrastructure. It is the service provided that should be regulated and supervised and not the back-end infrastructure. Regulators should take a key role in supporting the effective development and implementation of new incremental technologies.
6. Allow sandboxes, but – Sandboxing should be an exception rather than the norm and should always be limited in time. However, the purpose with a sandbox should be to provide for a dialogue and communication with the supervisor without circumventing existing regulatory framework.
7. Sharing fraud and threat intelligence cross-border is a regulatory obstacle from several risk perspectives that prevents institutions from fully protecting their customers.

## Replies to the EBA questions

### **1. Are the issues identified by the EBA and the way forward proposed in section 4.1 relevant and complete? If not, please explain why.**

Considering the emphasis European supervisors and regulators place on the necessity for high levels of consumer protection, the presence of so many unregulated entities (53% non-supervised) suggests that further investigation is required to ensure that a high level of consumer protection is withheld across the Union. Such an inventory, would most likely also find Fintechs who neither need to be supervised nor regulated.

Like concluded in the Commission's Fintech consultation, we instead believe that communication between innovators, regulators and supervisors is central to maintain a level playing field. Thus, to green the innovation a progressive and risk-based approach to regulation would be preferred. Moreover, once experience is obtained, we support an assessment to convert the EBA Guidelines on authorisations under PSD2 into an RTS. Such an assessment also needs to take national regulation into consideration. Concerning sandboxes, we believe that participation in potential sandboxes should not discriminate based on the entity size, but rather let all types of entities participate on equal terms. Sandboxing should not be used for the circumvention of the existing procedures in financial services but should only be applied for a limited time and in a limited scope, so to evaluate new processes under close supervision and communication between the engaged parties and competent authorities.

We support the effort to further assess the features of sandboxing regimes, innovation hubs and similar regimes to avoid regulatory arbitrage between different Sandbox-regimes in Member States and maintain a level-playing field within the European Union. We also support the additional activities proposed by the EBA for 2017/18 and encourage the EBA to move forward with guidelines in this area.

Therefore, we advocate that the same regulatory and supervisory obligations must apply to the provision of the same services, across the single market and regardless of the type of the entity providing such services.

**2. Are the issues identified by the EBA and the way forward proposed in subsection 4.2.1 relevant and complete? If not, please explain why.**

Developing our reasoning from the previous question, as innovative services are not only provided by new or smaller entities, the definition of Fintech cannot and should not be limited to certain industry players. Especially as there are already many incumbent financial players, including credit entities, providing Fintech solutions to their customers. Therefore, the definition needs to be linked to the services provided regardless of the size of the innovative entities.

Maintaining a level playing field is important for several reasons but especially when it comes to regulatory arbitrage. Smaller non-regulated and non-supervised entities can potentially circumvent capital and/or liquidity requirements of and even AML/CFT controls when executing traditional bank services such as lending or payments through the application of new technologies. If these requirements are reduced or if they are possible to circumvent it could limit society's capacity to withstand financial turbulence and identify unlawful activity.

The need for focus on culture, education, training and awareness will, as the number of players providing fintech services and activities grows, also need to expand as the financial ecosystem is growing in both size and complexity. Banks and regulators have a long history of focussing on these matters. Going forward it should be discussed how to broaden this discussion across the whole ecosystem.

Regulators should therefore consider Fintech as an activity and not a legal subject or class of companies; where it is the activity that should be regulated and not the company. Therefore, to provide guidance to supervisors on how to act on, understand and evaluate these new risks, it is essential to continuously observe trends and communication with the industry. Not only to identify and evaluate the growth of new prudential risks stemming from new technologies, but also to prevent regulatory arbitrage.

Management of new risks such as cybersecurity and data management is central to maintain high levels of consumer protection for all European citizens. As incumbents already possess large legal and compliance units, and established communication with supervisors, cooperation grows in importance going forward as the incumbents can assist smaller players to scrutinise and strengthen their business to better manage operational risks and ensure customer protection.

We also believe that, given arguments mentioned above, the global digitisation landscape should be taken into consideration by European regulators and supervisors - both with respect to market drivers and market developments as well as the implications global digital entities have with respect to the formulation, entry into force and enforceability of legislation by European authorities.

Therefore, we support EBAs strive to understand and follow digitalisation as it is changing society, a change that will transcends into many sectors.

**3. What opportunities and threats arising from FinTech do you foresee for credit institutions?**

As mentioned in the previous question we believe that regulators and supervisors need to take the global digitisation landscape into consideration with respect to the formulation, entry into force and enforceability of EU regulation. This since regulatory gaps, both at a global and European level, can be used to circumvent regulation, allowing for a lean regulation sector if non-banks are allowed to provide bank services.

Value does not always have to be measured in monetary terms. Both perceived and actual trust, confidence and security go hand-in-hand and take time to build, but can disappear instantly. Fintechs aim to disrupt the value chain to a larger extent while incumbent banks aim to maintain the infrastructure and back-end processes behind the value chain.

Such Fintech-activities can result in unwanted consequences such as an increase of the volatility on the credit market. Hence, it would be valuable if EBA could study how digital internet giants and large global corporates should be treated with regards to their Fintech-activities. The sharing economy activities, such as crowdfunding and lending must be included and understood by regulators.

A threat that has not been identified by the EBA is the key challenge from platform such as distribution platforms include crowdfunding, segment platforms and/or data. Here the unclear regulatory environment increases uncertainty in the system through by encouraging excessive leverage in a shadow banking type of manner. Therefore, we believe that this should be added to the agenda.

Moreover, both Fintechs and incumbent banks are exploring smart contracts, being a part of Blockchain and distributed ledger technologies (DLT). Smart contracts could enable automation and improvements in process execution. Being a contract, they must also be legally binding. An important issue for both governments and banks within the EU is KYC and assurance in digital identities.

**4. Are the issues identified by the EBA and the way forward proposed in subsection 4.2.2 relevant and complete? If not, please explain why.**

Although we believe that it is important to evaluate the potential risks with new technologies; we also believe that it is important for regulators and supervisors to

focus the service and/or product and not the technology behind the service. Therefore, it is important to maintain an understanding of different back-end technologies operate; whilst simultaneously have a horizontal communication between different supervisors to better understand and identify potential risks.

For instance, in the areas of payments, we support that the EBA continues its assessment of security-related products required under PSD2. However, the Commission's ambition to appear innovative may raise concerns over consumer protection, legal certainty and other risks as these risks seem secondary in relationship to the finalisation of the Regulatory Technical Standards. Therefore, we support the proposed way forward and look forward to a continued dialogue, including public consultations, with the EBA.

**5. What opportunities and threats arising from FinTech do you foresee for payment institutions and electronic money institutions?**

There are many opportunities and threats arising from Fintech, for example:

1. Liability for transactions and fraud when several parties are involved and unclear contractual agreements.
2. Responsibility and accountability in AML/KYC/CTF-monitoring.
3. Secure digital identities, secure authentication and legal binding digital signatures.
4. Security of digital wallets, crypto keys and consensus mechanisms.

**6. Are the issues identified by the EBA and the way forward proposed in subsection 4.3.1 relevant and complete? If not, please explain why.**

As concluded by EBA, less constrained new market entrants can be more agile where the application of new technology can radically change how their products or services are defined, produced and/or distributed. But these might not possess the infrastructure and/or know-how to assess the risks connected to the development of their new products or services.

As initially stated, a level playing field is essential when discussing the future of financial innovation; but we also need to take incremental innovation into account i.e. innovation that enhances existing products and services without changing the business model. Here it is also important to remember that a large driver to this incremental innovation is regulation and that in incumbent institutions such developments are normally scrutinized by different compliance, risk and legal departments.

Moreover, it is important to evaluate the attitude supervisors have to a progressive regulatory approach to innovation, no matter the size of the innovator. That is why we believe that communication with innovators, no matter their size, is key to understand the impact of the innovative products and services on consumer protection and whether the product or service actually needs to be regulated (as stated in question 3). Increased communication is also something that several regulators have expressed that the main conclusion from regulatory Sandboxes.

We welcome that the EBA is planning to conduct interviews with representatives from credit institutions to develop a thematic report on changes to the business models of incumbent credit institutions and we look forward to having such a dialogue.

**7. What are your views on the impact that the use of technology-enabled financial innovation and/or the growth in the number of FinTech providers and the volume of their business may have on the business model of incumbent credit institutions?**

Against the background of customer behavioural, technological and regulatory change, incumbent credit institutions are focused on finding the best solutions, including the best partners, to solving challenges, new customer needs and implementing these solutions as quickly and safely as possible. Thus, incumbent credit institutions generally both buy technology and build solutions, and partner with other Fintech entities.

To enable this process regulators and supervisors hold a key responsibility to ensure that new technology-based products and services can be deployed without any undue encumbrance. Fintech activities should therefore be subject to the same obligations as the credit institutions are in this respect, to establish a safe foundation for partnerships, and ultimately to ensure a level playing field.

**8. Are the issues identified by the EBA and the way forward proposed in subsection 4.3.2 relevant and complete? If not, please explain why.**

We support the EBAs ambitions to conduct interviews with a representative sample of payment institutions and electronic money institutions and develop a thematic report on changes to the business models of incumbent payment institutions and electronic money institutions.

**9. What are your views on the impact that the use of technology-enabled financial innovation and/or the growth in the number of FinTech providers and the volume of their business may have on the business models of incumbent payment or electronic money institutions?**

Innovation, free competition and a level playing field have traditionally been the main drivers of gaining a strategic advantage in the industry. Hence, one player's innovation has forced the other players to re-evaluate their strategic positions i.e. that innovation changes the playing field is nothing new. However, as technology has become cheaper and more accessible competition has intensified and has forced players of all sizes to cooperate, invest in innovation and/or acquire other entities.

**10. Are the issues identified by the EBA and the way forward proposed in subsection 4.4.1 relevant and complete? If not, please explain why.**

It is essential that consumers obtain full transparency on the services, terms and risks regardless of which company provides the service, especially given that consumer protection has been the focus of regulators for decades. Moreover, given both the digital dimension of the services and global dimension of several service providers it is also important that the EBA takes a global perspective when evaluating product and service liabilities in this value chain.

Further, it is advised to look into how technology is used in creating digital identities for consumers as well as companies, for example based on distributed ledger technologies. It is also advised to the process of authentication, as used by Fintechs as well as incumbent banks. Digital identities and authentication are used to identify users and owners of so called digital wallets, but have recently been the subject of fraud and loss of assets relating to blockchains and cryptocurrencies. These are all factors we believe that the EBA need to take into consideration going forward.

**11. Are the issues identified by the EBA and the way forward proposed in subsection 4.4.2 relevant and complete? If not, please explain why.**

Concerning these issues the EBA needs to for instance keep in mind that the digital dimension creates challenges for supervisors as both large and small innovative entities might not aim to set up branches or apply for licences in all member states where the services are provided. Hence, the cross-border provisioning of financial services adds complexity to the consumer protection legislation difference between the EU member states and to home/host supervision.

The issues expressed in this question directly tie into the previous sub-section where it is evident that borders tend to fade in the provision of digital services, especially if

the service provider is domiciled in a third country. This is why the same regulation should be extended to non-regulated and non-supervised Fintech entities, large and small, that provide same services. When developing such EU financial services regulation and supervisory frameworks, aspects such as fostering innovation, developing the single market and global players need to be taken into consideration.

Under these considerations, the way forward proposed in sub-section 4.4.2 is supported.

**12. As a FinTech firm, have you experienced any regulatory obstacles from a consumer protection perspective that might prevent you from providing or enabling the provision of financial services cross-border?**

Yes. It is advised to further investigate this.

**13. Do you consider that further action is required on the part of the EBA to ensure that EU financial services legislation within the EBA's scope of action is implemented consistently across the EU?**

Notable throughout the Commission's Digital Single Market initiative the requirement for harmonised legislation applied throughout the EU, especially for all matters pertaining to and affected by digitisation. These goals may not be attained through any silver bullet; a useful starting contribution for the EBA could be to compile an overview of waivers, gold-plating and other national dispositions implemented by Member States from both regulatory and supervisory perspective. This should serve as the basis for an assessment of the impact that these differences in transposition have for consumer protection and for the level playing field.

**14. Are the issues identified by the EBA and the way forward proposed in subsection 4.4.3 relevant and complete? If not, please explain why.**

In most European regulation, such as PSD2, it is already stipulated how consumer's complaints with regards to payments are to be handled. The requirements on complaints handling procedures should be based on the services provided and not upon the circumstance whether the Fintech service is delivered from a company which is un-regulated or regulated from a financial services perspective. All participants in the value chain need to respect and adhere to all national customer

complaints requirements and should therefore all be under supervision by national competent authorities.

However, it is still a major concern that legislation closely related to PSD2 such as other consumer protection regulations differ between countries, which is an additional obstacle for a consumer friendly and otherwise consistent single market as such. Thus, a pan-European guideline for consumer complaints could be a positive contribution to the non-regulated part of the industry and especially for entities acting from outside the EU.

With regards to 3 c it should be noted that the relevant issues raised will continue to be a problem if there are no requirement on any kind of Fintech service provider to identify their part in a factual value chain. Each acting party must understand and act upon their part in the value chain with regards to if they are providing Fintech services direct to consumers.

This view must also be adopted even if more actors providing parts of the service in a value chain as it always has been handled in practice. The disruption of traditional business models shall not be allowed to disrupt the consumer experience. In addition, with regard to the AI reflection – all solutions should be technological neutral – there should be no difference between man and machine provided Fintech services.

**15. Are the issues identified by the EBA and the way forward proposed in subsection 4.4.4 relevant and complete? If not, please explain why.**

The issues identified are in line with our concerns raised earlier in this response; therefore, the proposed way forward is supported.

**16. Are there any specific disclosure or transparency of information requirements in your national legislation that you consider to be an obstacle to digitalisation and/or that you believe may prevent FinTech firms from entering the market?**

There are several consumer protection legislations requiring institutions to provide great amounts of information to the consumer ex-ante. Here additional national requirements, such as the requirement that certain contracts need to be physically signed in a bank branch, make it even more difficult to digitalise the value chain.

Furthermore, some member states have been or are gold plating the EU consumer protection and financial market regulations. This makes it difficult for providers from

other member states to offer their products and service. Hence, hindering the entrance of new players'; reserving the market for the domestic providers.

**17. Are the issues identified by the EBA and the way forward proposed in subsection 4.4.5 relevant and complete? If not, please explain why.**

Enhancing financial literacy is a general concept wherein further work to coordinate and foster national initiatives is supported. Member States' citizens have various degree of digital maturity. However, against the background of an increasingly digital world, the key recommendation would be to design legislation having consumers' financial and digital literacy in mind. This should be achieved notably by legislators avoiding unnecessary fragmentation and complexity - ensuring that harmonized conditions apply across the single market.

An illustrative example is PSD2 and GDPR where consumers have difficulties to understand what they agree to when third parties are allowed access to their data. To provide simple and clear information of what the customer signs is well-known challenge. Regulation should to the furthest extent possible, remain fully relevant as the key way to ease understanding by consumers and prevent complaints and claims.

**18. Would you see the merit in having specific financial literacy programmes targeting consumers to enhance trust in digital services?**

Financial literacy should be promoted from a channel and technology-neutral angle, whilst digital literacy, with a particular emphasis on cybersecurity aspects, is a field of its own and should be promoted by governments.

**19. Are the issues identified by the EBA and the way forward proposed in subsection 4.4.6 relevant and complete? If not, please explain why.**

Due to both reduce costs and the reachability to new customer segments, automated financial advice is expected to lead to a growth in the number of customers who receive financial advice. Regarding possible malfunctioning of the tools due to errors, hacking or manipulation of the algorithm, it is important to emphasize the stringent cybersecurity regimes that banks follow, which protects the customer from this kind of manipulation and hacking.



However, hacking or manipulation can occur in all type of entities. Therefore, it is important to monitor cybersecurity functions for all market participants in the same way, i.e. to maintain a level playing-field. Currently, several robo-advisory solutions base their profiling decisions on a limited set of variables, and few suitability tests are undertaken. Making it difficult for customers to understand which measures the robo-adviser is actually taking. Therefore, to further enhance consumer protection, ensure advice neutrality and to provide a minimum set of standards to the robo-advice sector, a supervision of these services is required.

As we believe that regulation should remain technology-neutral in all instances it is proposed that robo-adviser activities should be supervised to ensure compliance with MiFID II. In addition, it is important for regulators and policy makers to also consult with academics and other industries who have already gained experience in the area of automatization and machine learning. Here the German "Industrie 4.0" project, which promotes the computerization of manufacturing, should be seen as a good example.

Moreover, when deploying artificial intelligence, financial service providers should ensure that both the systems and the ways in which they are used integrate the values for which they stand. A continued dialogue should be instigated between financial service providers and regulators and supervisors, for the former to contribute their ever-growing experience with technology, ethical management, and legal implications and potential requirements not only to sectoral but also to public debate and further research.

**20. Are the issues identified by the EBA and the way forward proposed in section 4.5 relevant and complete? If not, please explain why.**

The generalisation of instant payments will require an amendment to current resolution procedures, especially concerning weekends. Simultaneously, instant payment systems need to come with all the required audit trails which allow for the establishment of when an instruction has been accepted and when it was, or should have been executed, thus easing the sequencing required in a resolution process.

This question is not entirely Fintech-related if the new roles and services stipulated in PSD2 are respected and used. Instant payments require an understanding of the potential consequences for the parties who are financially responsible for the services provided. Since, for instance, instant payment schemes can speed up the movement of deposits this can change conditions for bank runs, particularly in a time of crisis.

The use of credit transfer based instant payments in the retail payments area with the legal finality of payments concept also creates challenges. This is specially the case when transactions like return of goods, transaction errors correction, fraud

claims etc. need to be managed. European and national authorities' resolution powers need to continuously adjust to changes in payment solutions with regard to financial stability.

Moreover, other new digitization based payment solutions can also speed up the movement of deposits in a time of crisis, changing the conditions for bank runs. Authorities' resolution powers need to continuously be aware and able to adjust to changes in payment solutions with regard to financial stability.

**21. Do you agree with the issues identified by the EBA and the way forward proposed in section 4.6? Are there any other issues you think the EBA should consider?**

New market entries must be subject to the same obligations as incumbent credit institutions where they provide or support the same services. This is also necessary to identify and report suspicious transactions for AML/CTF and regarding sanctions on non-compliance. There is a need for increased collaboration within the industry and with supervisors. As mentioned before, new technologies will not only come with new risks but also with new opportunities for both the industry and consumers and for supervisors to develop new tools especially in the area of AML/CTF. With these considerations, the proposed way forward is supported.

**22. What do you think are the biggest money laundering and terrorist financing risks associated with FinTech firms? Please explain why.**

New technology and new market entries are appealing potential targets for criminal activities, for example within activities such as crowdfunding, peer-to-peer lending, virtual currencies and prepaid cards. Anonymous crypto currencies, real-time payments, global payments and the sharing economy make it easier for money laundering. This is mainly due to the lax regulatory and supervisory environment of these activities applicable to new market entrants, combined with the possibility in some activities, of maintaining a certain level of anonymity combined with lacking KYC capability for non-bank institutions.

**23. Are there any obstacles present in your national AML/CFT legislation which would prevent (a) FinTech firms from entering the market, and (b) FinTech solutions to be used by obliged entities in their customer due diligence process? Please explain.**

What difficulties a FinTech would find with the Swedish AML/CTF-regulation depends on the kind of financial services the company would provide and in what capacity. If it is an Obligated Entity under the AML/CTF-Act, it would face the same difficulties and obstacles as other Obligated Entities. As a customer to an Obligated Entity, a FinTech will be subject to the Obligated Entity's risk based KYC-measures. Depending on the risk the FinTech entails, the KYC-measures could be quite enhanced.

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