

WHITE PAPER



ESBG's white paper on innovation facilitators

ESBG (European Savings and Retail Banking Group)

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I. Regulatory sandboxes¹

I.a. General remark

Due to its very nature of rapid innovation, FinTech² involves a large amount of testing financial solutions and products, and might need a dedicated regulatory perimeter to avoid its growth to stop. Several jurisdictions around the world have already set up regulatory sandboxes to allow FinTech firms to develop new products without having to provide some of the safeguards related to financial stability or consumer protection and to test processes by providing a dedicated environment under the monitoring of competent authorities.

As a guiding principle for FinTech supervision inside and outside of regulatory sandboxes, similar risks should always attract similar regulatory treatment. In this sense, there must not be a separate regulatory regime for firms that deal with FinTech only, but instead a broadening of the existing regime.

In addition, regulatory sandboxes usually allow supervisors to exercise existing national stability or supervisory mechanisms provided by EU and national law and, in ESBG's view, the competent authority must will keep on requiring to everyone the same relevant regulatory requirements.

The ESAs' Report on Regulatory Sandboxes and Innovation Hubs confirmed this trend, stating that sandboxes currently observed in EU Member States "*do not allow [...] the carrying out of regulated financial services without a licence*" nor "*involve the disapplication of regulatory obligations [...] as a result of EU and/or national law*".

I.b. Selection criteria

As a prerequisite, regulatory sandboxes should be open to every kind of FinTech firms, including not only newly founded financial institutions, but also incumbent institutions and technology providers, given the importance of cooperation among established firms and financial start-ups.

However, access to sandboxes provide participating firms with a potential advantage compared to those that develop the same innovation outside the sandbox. These advantages can be of both an operational nature (e.g. less time required from innovation to market, lower costs, accelerated authorization processes, etc.), as well as of regulatory nature (e.g., a more proportionate treatment by supervisors, deposit insurance, consumer protection measures). The sandbox approach therefore carries a potential risk to undermine the level playing field.

In the light of the above, the selection criteria for sandboxes are a topic that needs to undergo a thorough discussion involving firms and authorities at EU level.

ESBG's suggestions for the sandbox selection process:

- Supervisors should be entitled to identify and select innovative projects;

¹ESAs BoS Report '*FinTech: Regulatory sandboxes and innovation hubs*' (<https://eba.europa.eu/documents/10180/2545547/JC+2018+74+Joint+Report+on+Regulatory+Sandboxes+and+Innovation+Hubs.pdf>), defines (p.16) regulatory sandboxes as '*a scheme set up by a competent authority that provides regulated and unregulated entities with the opportunity to test, pursuant to a testing plan agreed and monitored by a dedicated function of the relevant authority, innovative products or services, business models, or delivery mechanisms, related to the carrying out of financial services*'.

² Fintech to be interpreted as "*technology enabled innovation in financial services*". Please see previous ESBG's reflections on the Commission FinTech Action Plan, p. 2 (https://www.wsbi-esbg.org/SiteCollectionDocuments/0184_final.pdf).



- Selection process should have as an object the type of innovation to be tested, and not the type of innovator; for instance, a call for tender on a specific innovation could be organized to allow several actors to take part on a voluntary basis.
- As the regulator could use the result of a sandbox test as inspiration for new regulatory rules, it would be important to have many actors involved in a test order to grant market representativeness and not to ground regulatory reforms on outcomes given by only one type of actor.
- Sandboxes should involve European regulators, as there is a risk that regulatory reforms based mainly on inputs coming from markets outside the EU (as in the case of the so-called 'global sandbox') will not take into account the specific issues of the Single Market. The 'global sandbox' proposal came during early 2018 from the UK Financial Conduct Authority – FCA – and the Global Financial Innovators Network – known as 'GFIN'³, a network of currently 29 organisations supporting financial innovation, was built on it.
- An innovator using the sandbox space test should bear in full the financial risk of the test, in order to ensure consumer protection.

I.c. Framework for participants

Once the selection process is completed, a protocol has to be signed by the firm. The protocol will be flexible in determining an *ad hoc* instrument, the scope of the project, the planning, guarantees, responsibilities and other specific conditions of each test or set of tests.

I.d. Transparency and confidentiality of the results

Innovation is a major tool of competition and innovations are usually kept confidential before market launches. Nevertheless, as there are several advantages to be part of a test within a sandbox and to ensure a level playing field with those outside the sandbox, transparency on the results of the test should be ensured.

I.e. Coordination at EU level

Considering the aim of reaching an EU single financial market, competition between national authorities based on regulatory arbitrage must be strictly avoided; therefore, sandboxes should not become an economic tool for individual Member States to attract new entrants on their market only.

³ The GFIN has the tasks of 'act(ing) as a network of regulators to collaborate and shar(ing) experience of innovation in respective markets, including emerging technologies and business models; provid(ing) a forum for joint policy work and discussions; and provid(ing) firms with an environment in which to trial cross-border solutions (<https://www.fca.org.uk/publications/consultation-papers/global-financial-innovation-network>). It was formally launched in January 2019 by an international group of financial regulators and related organisations, including the Dubai Financial Services Authority (DFSA). A documents outlining the cooperation model was published beginning of February 2019 ('Terms of Reference for Membership and Governance of the Global Financial Innovation Network', please see <https://www.fca.org.uk/publication/mou/gfin-terms-of-reference.pdf>.) Currently, the GFIN has announced the start of a pilot phase for cross-border trials (for an example, please see the DFSA's website: <http://dfsa.ae/Documents/Fintech/GFIN---Webpage-content---28012019-FINAL.pdf>). Also, more regulators joined the network, even though not all agencies participate in cross-border trials. Together with the South African Reserve Bank (SARB), and some securities regulators from Canadian provinces (i.e. ASC, BCSC, OSC) and Hong Kong (HKSF), also the Central Bank of Hungary and the Bank of Lithuania joined, being the first EU Member States authorities to join after the FCA.



In addition, proposals to enhance supervisory consistency and foster coordination in the operation of regulatory sandboxes including, where appropriate, EBA Guidelines, could contribute to a convergence in domestic innovation policies across the EU, thereby facilitating the emergence of a single market for financial services (E.g. through the approval of a European sandbox).

Even in case sandboxes' practices and regulatory coordination will be harmonized at EU level, it would still be important to define the role of European regulators on the global market.

As in the case of the FCA – run global sandbox, where all collaborating financial regulators were from third countries outside the EU, and considering that it is not possible to ensure participation of all European regulators, ESGG suggests that EBA should represent European regulators in international networks.

For instance, concerning the GFIN, EBA should ensure that the aims of the EU Single Market are supported. When it comes to GFIN's actions to support companies in conducting trials across multiple jurisdictions, EBA should be aware that a competitive disadvantage for the EU market would result if this occurs outside the EU.

In the light of the above, ESGG concludes that there is a need for rules and standards at EU level and welcomes the initiative of the European Commission to launch an European Forum for Innovation Facilitators ('EFIF').

However, even though remarkable, ESGG considers such an initiative insufficient to harmonize regulation at EU level, as the EFIF consists merely of a forum to exchange best practices, while no further steps have been made to ensure convergence in the applicable rules, which would enable EU operators to act consistently on the international scenario and to ensure a level playing field and prevent regulatory arbitrage. On the same note, ESGG believes that the approach adopted so far by the Commission favours a fragmentation of the regulatory framework, as it takes into account only regulators and supervisors belonging to the financial services regulatory framework, without considering the need to involve also supervisors and regulators which usually act in different frameworks, such as those dealing with cybersecurity or data protection (e.g. at European level: ENISA, EDPB, EDPS, etc.).

In short, it would be of great importance to have a more holistic approach, also from the European Commission, on innovation facilitators.

II. Innovation hubs⁴

II.a. General remarks

As both regulatory sandboxes and innovation hubs (and similar regimes too) are innovation facilitation mechanisms, and given the need of harmonization of these mechanisms at EU level, in order to facilitate the creation of an EU single financial services market, ESGG suggests that these mechanisms should not be treated separately. In the light of the above, ESGG also encourages common approaches and responses to questions of regulatory and supervisory issues relating to sandboxes, innovation hubs and similar regimes, and suggests that there is a clear EU framework and mechanisms established with clearly defined rules – a framework that should be promoted within the EU to prevent discrepancies and an uneven level playing field. Sharing of regulatory best practices and learning between regulators, various jurisdictions and industry should be encouraged, too.

⁴ The aforementioned ESAs Report (p.7) defines innovation hubs *'as a scheme whereby regulated or unregulated entities can engage with competent authorities on FinTech-related issues and seek non-binding guidance on the conformity of innovative financial products, services, business models or delivery mechanisms with licensing, registration and/or regulatory requirements'*.



II.b. Selection criteria

As mentioned above, innovation hubs should be treated according to the same guiding principles as regulatory sandboxes. Therefore, as a prerequisite, innovation hubs should not be treated differently depending on the type of FinTech firm.

III. FinTech developments

III.a. Cross-border application

Differences in national regulations and supervisory systems have an impact on the EU market and affect cross-border application of FinTech, regardless of any development in the regulatory sandboxes and innovation hubs fields.

These are some examples of fields that suffer from a lack of harmonization that adversely affects technological innovation in the financial industry:

- Consumer protection law, which is inherent to the provision of cross border retail banking products and services, affects both consumers and banks, as, for instance, banks must adapt their contracts to the national law applicable in the specific case, in order to comply with Regulation EC/593/2008 – Rome I⁵.
- Digital Identity: the related frameworks are currently not sufficiently developed, and, in any case, regulations across Europe is still fragmented in a way to hinder a harmonized European digital identity framework.
- European Passport: the system might suffer from potential divergences in national supervisors' approaches.

⁵ Please see Articles 3, 4 and 6 of the abovementioned Regulation; for instance, according to Article 6(1), the applicable law is the one of the consumer's habitual country of residence in case the professional directs his activities to a consumer in a Member State different from the one where he pursues his commercial or professional activities.



About ESBG (European Savings and Retail Banking Group)



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