

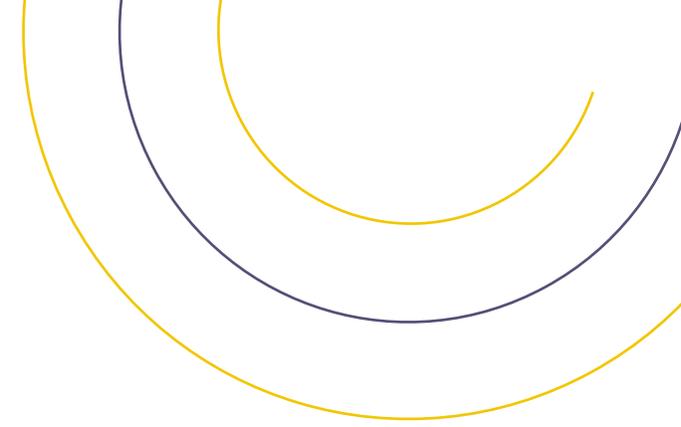
3RD Annual Fintech Conference
Fintech and Regulation:

Taking innovation to **the Next Level**

Conference Summary

Senior policy makers and industry came together to discuss key aspects of FinTech regulation at the 3rd Annual Conference on 'FinTech and Digital Innovation: Regulation at the European Level and Beyond

Discover the conference



“The speed of change, triggered by innovation, is accelerating”

On 26 February 2019, Afore Consulting organised its 3rd Annual FinTech & Regulation Conference: Taking innovation to the next level. The event again brought together more than 450 participants from the European regulatory and supervisory community, industry, academia and civil society. We would like to take this opportunity to thank once more the speakers, sponsors and participants who helped Afore Consulting make this conference the success it has become.

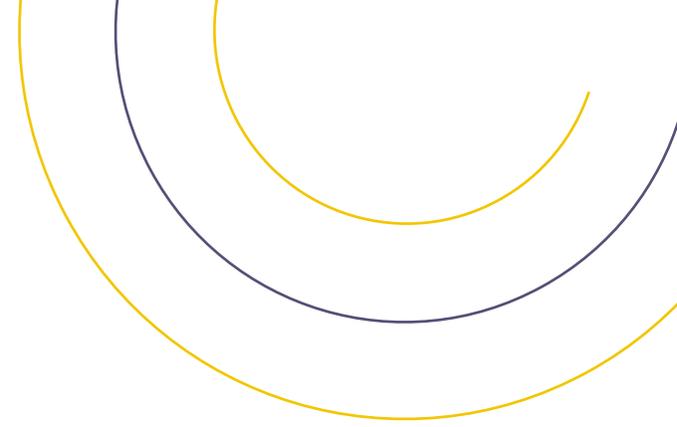
The conference came at an important juncture in the European political cycle. One year after the formal launch of the European Commission's Action Plan on FinTech the keynotes and panels took stock how technology and the financial services industry has evolved, what progress the EU has made on its policy objectives and, importantly, helped set out some of the policy and regulatory priorities for the incoming European Parliament and European Commission later this year.

Speakers agreed that the speed of change, triggered by innovation, is accelerating. FinTech is not only about new entrants in the market challenging and disrupting existing market operators and regulatory concepts. Technological change impacts all parts of the value chain from customer facing, to process improvement, transaction speed, better risk management and the development of new financial products, such as crypto assets or cyber insurance.

It is also not sector specific. The results can equally be seen in banking, insurance, asset management, securities markets and payment services. New technologies also bring new risks. Examples of this are systemic or market integrity concerns, cyber security, adequate consumer protection, the clear allocation and enforceability of liability but also, and that was a new dimension at this year's conference, the ethical considerations that result from more targeted risk management or optimised AI solutions.

While the conference highlighted areas where additional regulation might be beneficial to avoid regulatory arbitrage, facilitate cross-border service provision and thereby scalability of innovative solutions across the EU, and manage new potential risks, speakers generally cautioned against acting too fast and before either the technology or the newly developed financial services have had a chance to mature. Speakers therefore advocated overall for 'supple regulation'. Areas where regulation might make sense is in retail payments, markets for crypto assets or around the use of data by third parties. Generally speakers, including those from the US, Japan, Switzerland and Australia, highlighted the value of complementary policy tools, such as standard setting, self-regulatory codes, effective enforcement of competition policy, supervisory cooperation and best practice exchange, or through close supervisory cooperation through innovation hubs and sandboxes. Everyone agreed that technological advancement will require not just the industry but also regulators and supervisors to adapt the way they operate.

Key Outcomes



Key Outcomes

The conference consisted of five panel discussions and fireside chats covering crypto assets, crowdfunding, AI, data, cyber security and resilience, international cooperation and Europe's ability to innovate. This led to a number of interesting observations:

- At a strategic level Brian Hayes, MEP, asked whether the EU has the **appropriate institutional arrangements to promote innovation in the EU**. The response by his panellists was encouraging. Nonetheless, Europe could do better. Access to venture capital remains limited. Once a European company is successful, it seeks to attract US funding. Regulators and supervisors are faced with new products, services and companies. This creates challenges as to whether and how to regulate. The Irish Minister Michael D'Arcy welcomed competition between Member States to attract talent. All of this needs to build on an open and effective EU's Single Market that allows innovators to scale up their ideas. The digital economy democratises economic participation. Smaller companies have a chance to compete. Creating the right environment for start-ups might be more important than large-scale public policy initiatives. Examples include innovation hubs or sandbox approaches. Policy makers should be careful not to regulate too early. In many cases it is better to let competition run its course. At the same time, the drive for innovation should not put incumbents at a disadvantage if offering comparable services. As one speaker suggested the principle should be 'same activity, same regulation'. Companies will only be successful in the new environment if they find ways to cooperate.

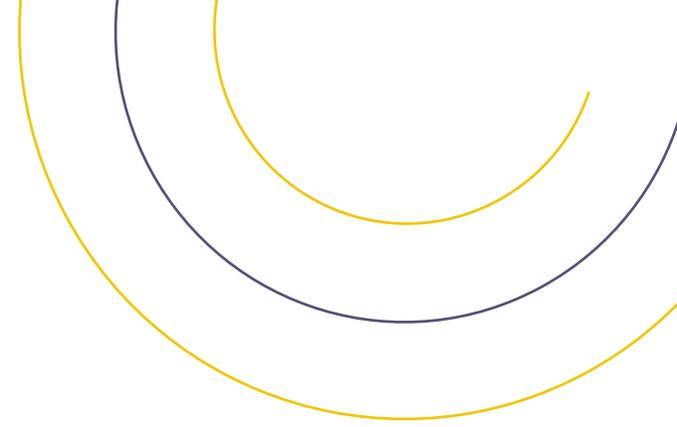
- The panel disagreed on the need for regulation of **crypto assets**. Levin Holle of the German Finance Ministry called on the Commission to present a legislative proposal on crypto assets early in the new term. Regulators and supervisors are still mapping the market. Early regulation could destroy a nascent market. It is also not clear whether these assets should be treated as securities, payments, commodities or a totally new asset class. Where a crypto asset clearly displays the characteristics of one of these features they should be subject to the appropriate regulation. The problem is that EU regulation does not rely on common definitions. Japan and Switzerland have opted for regulation covering AML and anti-terrorism financing (as has the EU). Switzerland has gone further establishing a framework for crypto assets, while Malta regulates the underlying technology. All the speakers agreed that there is a need for clear consumer protection rules.
- **Crowdfunding** is a very different test case. The market remains small but is growing. The European Commission has issued a proposal that would give platforms a European passport. The current European regulatory framework is based on national regimes and is very fragmented. 'A precondition for the success of crowdfunding is that you have a crowd'. Scalability remains an issue in Europe. The legislative discussions on the proposal are overshadowed by two questions: whether crypto assets, if used for funding purposes should be in scope and what should be the appropriate level of consumer protection.

- The **debate on data** has moved on from data protection to the appropriate use of data; taking of course into account the GDPR where this concerns personal data. How do we balance privacy of information vs. better product and service delivery to the customer; security of data vs access and convenience of customers; and the benefits of sharing data vs. monetisation of data? Ultimately, it will be about striking the right balance. Often the level of acceptance of these trade-offs will depend on external events, such as data breaches. The thresholds of acceptability will also differ within the respective cultural context and from one person to another. Another important consideration is the treatment of personal data vs non-personal data, the level of sensitivity of the data and the rise of inferred data (where data only becomes sensitive by aggregating different data sources). Finally, the panel discussed data security. New technologies, such as tokenisation can help mitigate these concerns.

- **AI** is seen as an important innovator in the financial services sector that challenges how existing regulatory responsibilities, such as the fiduciary duty in the asset management sector, can be safeguarded. There was broad agreement that AI is a new tool through which financial companies can interact with their clients more efficiently but that it does not alter the regulatory framework of the duty of care. AI allows companies to do new things and to replace the more repetitive tasks. The result is better customer services, more effective risk management and a better customer experience. Ultimately though it is better to speak of AI assisted services as AI will not fully replace human judgement. Regulators and supervisors need to be equipped to understand what is happening in the market, such as the development of algorithms. In this context, the role of ethics will become increasingly important. The panel agreed that AI relies on the use of data and the ability of financial institutions to buy in specialised services from third party providers. Therefore, the policy response to AI is closely linked to that on data and outsourcing.

- One panel discussed how the financial services industry is adapting to **cyber security** risks. What role can technology play in making the industry more cyber resilient? How should the operational risk framework, the governance and oversight be re-designed? Can individual countries handle these risks individually? All agreed that cyber-attacks pose systemic risk to the sector. At the same time it will be impossible to avoid all attacks. There needs to be a degree of prioritisation. The EBA Guidelines on cyber security and separately on outsourcing provide a baseline of cyber resilience banks and financial institutions should meet. The panel focussed a lot on the relationships with suppliers as risks could be transmitted through the value chain but also on the role third parties can play in strengthening cyber resilience. In the latter case supervisors are struggling when these might become critical functions (such as in the area of cloud computing) and additional requirements or limits should be imposed on financial institutions to outsource these activities. Speakers were in favour of effective information sharing and cooperation throughout the financial services eco system. They also called for more international cooperation.

Keynote Speeches





Europe needs
to embrace
FinTech if it
wants to remain
internationally
competitive.

Valdis Dombrovskis

Vice President of the European Commission

Focussed his remarks on three main themes. Europe needs to embrace FinTech if it wants to remain internationally competitive. This in turn requires closer cooperation between EU supervisors. He announced the launch of a European Network of Innovation Facilitators. Secondly, he signalled that the Commission will conduct a cost-benefit analysis whether specific EU regulation of crypto-assets would be desirable. Thirdly, he stressed the importance of innovation in the payments market. He signalled that this Commission is reflecting on whether a strong regulatory push is needed to speed up instant payments and the review of the Payment Account Directive this year could be an opportunity to pursue concrete actions. The aim would be to extend the scope of basic payment account services that banks need to offer at cost to other basic banking services. Combined with ECB efforts to develop a common EU API open banking scheme this would introduce, so the Commissioner claims, innovation in the EU's retail banking sector.

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Said that there are three reasons why policy makers and supervisors are paying attention to FinTech

Christopher Giancarlo Chairman of the CFTC

Said that there are three reasons why policy makers and supervisors are paying attention to FinTech: a) the exponential acceleration of technological change, b) the disintermediation of traditional services and actors, and c) the scarcity of programming resources and technological knowledge not only but also within the supervisory community. Mr Giancarlo set out four ingredients for regulators and supervisors to deal with FinTech: (1) adopting an exponential mind-set to maximise the regulatory capability across the board, (2) mobilising internal stakeholder through initiatives such as Lab CFTC FinTech, (3) transitioning to becoming quantitative regulators, and (4) embracing market-based solutions.

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Highlighted that FinTech not only brings challenges to supervisors but also opportunities

Joseph Cuschieri

Chief Executive Officer of the Malta Financial Services Authority

Highlighted that FinTech not only brings challenges to supervisors but also opportunities, especially to smaller markets such as Malta. He listed six strategic pillars: [i] regulation; [ii] the wider ecosystem; [iii] the market architecture; [iv] international links; [v] supervisory knowledge; and [vi] a focus on system security. Malta has already developed a framework for the regulation of crypto assets and related services.

Mr Cuschieri took the opportunity of the conference announce an Academy of Excellence for Financial Supervisors with a two-fold objective: [i] that of training young and upcoming financial supervisors; and [ii] giving the opportunity to experienced supervisors to grow further and update their knowledge.

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Set out
the current
market trends in
crypto assets

Robert Ophèle

President of the French Financial Markets Authority (AMF)

Set out the current market trends in crypto assets. The market cap has declined and is now closer to its fundamentals. Crypto assets bring important innovation: global and 24/7 accessibility, automatization of processes and a downward pressure on transaction costs. He suggested that Member States should develop their own optional regimes for crypto assets where these or their activities are not already covered by EU regulation, especially by MiFID.

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Contributed to the ethics in AI debate by outlining criteria that could enhance the added value of principles in AI

Hanzo Van Beusekom

Member of the Executive Board of the Netherlands Authority for the Financial Markets (AFM)

Contributed to the ethics in AI debate by outlining criteria that could enhance the added value of principles in AI. One of his key messages was that for principles to be effective they should have a clear link to existing rules in our current regulatory framework. He was optimistic that we can use current regulatory building blocks in GDPR and financial regulation to curb the dark side in AI. In order to illustrate this message, he was inspired by developments at the AFM.

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Explained
ESMA's policy
advice regarding
crypto assets

Steven Maijoor Chair of ESMA

Explained ESMA's policy advice regarding crypto assets. ESMA has identified a number of concerns in the current financial regulatory framework regarding crypto-assets. For crypto-assets that qualify as financial instruments, there are areas that require potential interpretation or re-consideration of specific requirements (relating to keys, forks and coding errors). Where crypto-assets do not qualify as financial instruments, the absence of applicable financial rules leaves investors exposed to substantial risks. At a minimum, ESMA believes that Anti Money Laundering (AML) requirements should apply and there should also be appropriate risk disclosure in place.

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Gabriel Bernardino Chair of EIOPA

Turned the discussion to cyber security. The rise of cyber risk brings both new risks to the insurance industry and opportunities. The insurance sector is a key target for cyber-attacks given the level of sensitive data these companies access. This means that EIOPA and EU supervisors are increasingly assessing the resilience of the industry. EIOPA plans to issue guidelines later this year. Cyber risks are nonetheless a wider economic and societal challenge. The insurance sector should develop a sophisticated market for cyber insurance. Ideally, the EU should move to compulsory cyber insurance, similar to car or civil liability insurance.

Turned the
discussion to
cyber security

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Stressed
the benefits of
innovation within
a free market
economy

Yves Mersch

Member of the Executive Board of the ECB

Stressed the benefits of innovation within a free market economy. The combination of new telecommunications, big data analytics, cryptography and machine learning technologies has the potential to change the whole banking industry in faster and more disruptive ways than ever before. Fintechs could make the financial system more diverse and competitive, offering customers better-targeted, faster and cheaper but it is important that they track FinTech developments. FinTech could also lead to the emergence of new risks and greater concentration.

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Demonstrated
live examples
of how AI and
data analytics
is used in the
payment sector

Liz Oakes

Executive Vice President at Vocalink

Demonstrated live examples of how AI and data analytics is used in the payment sector to identify, understand, track and trace money-laundering and financial crime activities. While technological innovation has made big strides in helping companies, payment operators and supervisors to protect users of payment services, organised crime groups are also utilising technology to manipulate payment systems to hide their illicit money, not least because of today's speed of payment transactions. A centralised view of the transaction flows provides a complete view of a complex data model to detect patterns of unusual behaviour and to enable tracing of funds.

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Reflected on
the increasing
automation and
digitalisation of
all aspects of
the economy
and society

Thomas Lillelund CEO for Europe at AIG

Reflected on the increasing automation and digitalisation of all aspects of the economy and society. Thomas set out that the Internet of Things and increased digitalisation is increasing the danger of cyber-attacks multi-fold. This raises the demand for cyber insurance in all economic sectors and it will be important for the insurance industry to effectively understand the cyber insurance risk it is writing. AIG is therefore moving towards transitioning to 'affirmative' cyber insurance where cyber cover is explicitly ruled in or ruled out.

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Taking innovation to the Next Level



Afore Consulting is an independent, premium European public affairs consultancy with a core area of expertise in financial services, regulation and policy.

