FinTech in International Capital Markets

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FinTech regulatory developments

**European Commission:** consultation on EU framework for markets in crypto-assets

On 19 December 2019, the European Commission launched a Consultation on EU Framework for Markets in Crypto-Assets. Building on the advice from the EBA and ESMA, this consultation should inform the Commission services’ ongoing work on crypto-assets: (i) for crypto-assets that are covered by EU rules by virtue of qualifying as financial instruments under MiFID II or (ii) as electronic money/e-money under the Electronic Money Directive (EMD II), the Commission services have screened EU legislation to assess whether it can be effectively applied. For crypto-assets that are currently not covered by the EU legislation, the Commission services are considering a possible proportionate common regulatory approach at EU level to address, inter alia, potential consumer/investor protection and market integrity concerns. The consultation is open until 19 March 2020.

**European Commission:** consultation on a digital operational resilience framework for financial services

On 19 December 2019, the European Commission also launched a Consultation on a Digital Operational Resilience Framework for Financial Services: Making the EU Financial Sector More Resilient and Secure. The EU has taken steps towards a horizontal cyber security framework that provides a baseline across sectors. The ICT and security risks faced by the financial sector and its level of preparedness and integration at EU level warrant specific and more advanced coordinated actions that build on, but go substantially beyond, the horizontal EU cyber security framework and that are commensurate with a higher degree of digital operational resilience and cyber security maturity expected from the financial sector. The focus of this public consultation is to inform the Commission on the development of a potential EU cross-sectoral digital operational resilience framework in the area of financial services. This consultation aims at gathering all stakeholders’ views in particular on: strengthening the digital operational resilience of the financial sector, in particular as regards the aspects related to ICT and security risk; the main features of an enhanced legal framework built on several pillars; the impacts of the potential policy options. The consultation is open until 16 March 2020.

**ECB:** exploring anonymity in central bank digital currencies

On 17 December 2019, the ECB released its “In Focus” paper (issue no. 4), Exploring Anonymity in Central Bank Digital Currencies. Against the background of the ongoing digitalisation of the economy, the payments ecosystem needs to find an answer to an issue that concerns all citizens: the question of how to allow some degree of privacy in electronic payments, while still ensuring compliance with AML/CFT regulations. The proof of concept that has been developed by the ESCB’s EUROchain research
network proposes an answer to that question for CBDC. The EUROchain research network seeks to foster a common understanding of DLT and gain practical experience of such technology. The main thing that this prototype shows is that, in a simplified environment typical of a proof of concept, DLT can be used to balance an individual’s right to privacy with the public’s interest in the enforcement of AML/CFT regulations.

European Commission Expert Group: report on regulatory obstacles to financial innovation

On 13 December 2019, the European Commission’s Expert Group on Regulatory Obstacles to Financial Innovation (ROFIEG) published its recommendations on creating an accommodative framework for FinTech in the EU. Although the ROFIEG does not identify many obstacles in existing EU law, the group highlights that the absence of EU law, the inconsistent application of EU law, and the gap in supervisory knowledge in various areas is hampering the scaling up of FinTech in the EU. The ROFIEG also recommends action to further empower data subjects as regards access to and sharing of data. The ROFIEG has used as guiding principles the need for “technological neutrality” in regulatory and supervisory approaches (same activity, same risk, same rule). The ROFIEG also urges a cross-sectoral and, where relevant, internationally coordinated approach in view of the potential application of FinTech across the financial sector.

CPMI: considerations for developers of wholesale digital tokens

On 12 December 2019, the CPMI issued a report setting out a list of criteria for developers and market participants to consider when designing digital tokens for use in wholesale transactions. The Wholesale Digital Tokens report describes the potential innovations and design questions associated with digital tokens that could be used to settle wholesale, or large-value, payments, made possible by new technologies such as blockchain, or distributed ledger technology. Private developers are exploring several applications for wholesale digital tokens. While these could be developed simply to make payments, many initiatives also seek to provide the payment leg of tokenised securities and FX transactions, where a token represents a share, bond or other financial asset. The report only covers variants of digital tokens issued by identifiable issuers and denominated in sovereign currency. It is not directed at so-called “stablecoins” for retail payments.

BCBS: designing a prudential treatment for crypto-assets

On 12 December 2019, the BCBS published a discussion paper to seek the views of stakeholders on a range of issues related to the prudential regulatory treatment of crypto-assets, including: (i) the features and risk characteristics of crypto-assets that should inform the design of a prudential treatment for banks’ crypto-asset exposures; and (ii) general principles and considerations to guide the design of a prudential treatment of banks’ exposures to crypto-assets, including an illustrative example of potential capital and liquidity requirements for exposures to high-risk crypto-assets. The Committee welcomes comments on the analyses and ideas set out in this paper from all stakeholders, including academics, banks, central banks, finance ministries, market participants, payment system operators and providers, supervisory authorities, technology companies and the general public. Comments on any element of this discussion paper should be submitted by 13 March 2020.

DLT can be used to balance an individual’s right to privacy with the public’s interest in the enforcement of AML/CFT regulations.
**FSB: financial stability implications of BigTech in finance**

On 9 December 2019, the FSB published the report *BigTech in Finance: Market Developments and Potential Financial Stability Implications*. The entry of BigTech firms into finance has numerous benefits. They can also contribute to financial inclusion, particularly in emerging markets and developing economies, and may facilitate access to financial markets for small and medium-sized enterprises. However, BigTech firms may also pose risks to financial stability. Some risks are similar to those from financial firms more broadly, stemming from leveraging, maturity transformation and liquidity mismatches, as well as operational risks. The financial services offerings of BigTech firms could grow quickly given their significant resources and widespread access to customer data, which could be self-reinforcing via network effects. An overarching consideration is that a small number of BigTech firms may in the future come to dominate, rather than diversify, the provision of certain financial services in some jurisdictions.

**FSB: third party dependencies in cloud services**

On 9 December 2019, the FSB also released the publication *Third-Party Dependencies in Cloud Services: Considerations on Financial Stability Implications*. The adoption of cloud computing and data services across a range of functions at financial institutions raises new financial stability implications. By creating geographically dispersed infrastructure and investing heavily in security, cloud service providers may offer significant improvements in resilience for individual institutions and allow them to scale more quickly and to operate more flexibly. However, there could be issues for financial institutions that use third-party service providers due to operational, governance and oversight considerations, particularly in a cross-border context and linked to the potential concentration of those providers. The report concludes that there do not appear to be immediate financial stability risks stemming from the use of cloud services by financial institutions. However, there may be merit in further discussion among authorities.

**IMF: designing central bank digital currencies**

On 18 November 2019, the IMF issued the Working Paper (WP/19/252), *Designing Central Bank Digital Currencies*. The paper studies the optimal design of a central bank digital currency (CBDC) in an environment where agents sort into cash, CBDC and bank deposits according to their preferences over anonymity and security; and where network effects make the convenience of payment instruments dependent on the number of their users. CBDC can be designed with attributes similar to cash or deposits and can be interest-bearing; a CBDC that closely competes with deposits depresses bank credit and output, while a cash-like CBDC may lead to the disappearance of cash. Then, the optimal CBDC design trades off bank intermediation against the social value of maintaining diverse payment instruments. When network effects matter, an interest-bearing CBDC alleviates the central bank’s trade-off.

**BIS: innovation hub centre in Singapore**

On 13 November 2019, the MAS and the BIS launched the BIS Innovation Hub Centre in Singapore. This is the BIS’s first expansion of its global footprint in 17 years. The Hub Centre in Singapore will initially focus on two projects. The first project is to establish a framework for public digital infrastructures on identity, consent and data sharing. Trusted digital identities for individuals and corporates is a foundational public good that supports the development of inclusive digital financial services including payments as well as other transactions in the broader digital economy. The second project is to create a digital platform connecting regulators and supervisors with digital and technology solution providers. Through the platform, central banks can put up regulatory problems and challenges to source solutions from the FinTech community. This will help central banks develop innovative solutions and policies for cost-effective regulation and supervision.

**IOSCO: statement on IOSCO study of emerging global stablecoin proposals**

On 4 November 2019, IOSCO issued a statement on its study of emerging global stablecoin proposals. In 2019, IOSCO examined a number of (“stablecoin”) initiatives. The IOSCO Board acknowledged that stablecoins can potentially offer benefits to market participants, consumers and investors. However, the IOSCO Board is also aware of potential risks in a number of areas, including consumer protection, market integrity, transparency, conflicts of interest and financial crime, as well as potential systemic risks. To support its discussions, the IOSCO FinTech Network produced an assessment for the Board of how IOSCO Principles and Standards could apply to global stablecoin initiatives. The detailed assessment concluded that a case-by-case approach is needed to establish which IOSCO Principles and Standards, and national regulatory regimes, would apply. A detailed understanding of how the particular proposed stablecoin is expected to operate is therefore needed, including the rights and obligations it confers on participants and the continuing obligations of the sponsor.
EBA: potential impediments to the cross-border provision of banking and payment services

On 29 October 2019, the EBA published a report identifying potential impediments to the cross-border provision of banking and payment services in the EU. The first important challenge is the identification of when a digital activity is to be regarded as a cross-border provision of services. Although this is a crucial element in determining which regulatory and supervisory frameworks apply, currently, competent authorities and firms lack clear guidance on how to classify cross-border activity under the freedom to provide services or right of establishment. The second challenge stems from areas of EU law that are not fully harmonised or are not yet covered by EU law. In particular, the EBA identifies issues related to authorisations and licensing, consumer protection, conduct of business requirements and anti-money laundering (AML) and countering the financing of terrorism (CFT).

G7 Working Group on Stablecoins: investigating the impact of global stablecoins

On 18 October 2019, the G7 Working Group on Stablecoins released a report on Investigating the Impact of Global Stablecoins. Payments are in a state of flux, and innovation is extensive. Domestic payments, in most instances, are increasingly convenient, instantaneous and available 24/7. Yet, despite significant improvements in recent years, current payment systems still have two major failings: lack of universal access to financial services for a large share of the world’s population and inefficient cross-border retail payments. Stablecoins, which have many of the features of earlier cryptocurrencies but seek to stabilise the price of the “coin” by linking its value to that of a pool of assets, have the potential to contribute to the development of more efficient global payment arrangements. This report lays out initial recommendations for both private sector stablecoin developers and public sector authorities to address the challenges and risks.

FSB: note on regulatory issues of stablecoins

On 18 October 2019, the FSB published an Issues Note on Regulatory Issues of Stablecoins. The paper responds to the G20 Leaders' Osaka Declaration, which noted the importance of monitoring developments in crypto-assets and remaining vigilant to existing and emerging risks, and asked the FSB and other standard-setting bodies to advise on additional multilateral responses as needed. The launch of stablecoin-type arrangements for domestic and cross-border retail payments with the potential to reach global scale could alter the current assessment that crypto-assets do not pose a material risk to financial stability. At the same time, the emergence of global stablecoins that could be used for cross-border payments and remittances by a large number of users in different countries could provide benefits to the financial system and the broader economy. In order to implement the G20 mandate and, building on earlier work by the G7, the FSB will submit a consultative report to G20 Finance Ministers and Central Bank Governors in April 2020, and a final report in July 2020.

BIS: the suptech generations

On 17 October 2019, the BIS’ Financial Stability Institute published a report on The Suptech Generations. Financial authorities’ use of technology has evolved over the years, leading to different generations of technology that culminate in what the paper considers as suptech. Suptech refers to the application of big data or artificial intelligence (AI) to tools used by financial authorities. There are many ways of exploring suptech tools and these are not mutually exclusive. They range from developing explicit suptech roadmaps, incorporating suptech into institution-wide digital transformation or data-driven innovation programmes, to establishing innovation labs or one-off programmes such as accelerators or tech sprints. While suptech is still in its infancy, it is gaining traction, with a significant number of suptech use cases found in the areas of misconduct analysis, reporting and data management. But most of these use cases are still experimental in nature.

BIS: innovation hub centre in Switzerland

On 8 October 2019, the SNB and the BIS signed an operational agreement on the BIS Innovation Hub Centre in Switzerland. [...] The Swiss Centre will initially conduct research on two projects. The first of these will examine the integration of digital central bank money into a distributed ledger technology infrastructure. This new form of digital central bank money would be aimed at facilitating the settlement of tokenised assets between financial institutions. Tokens are digital assets that can be transferred from one party to another. The project will be carried out as part of a collaboration between the SNB and the SIX Group in the form of a proof of concept. The second project will address the rise in requirements placed on central banks to be able to effectively track and monitor fast-paced electronic markets.

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