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FinTech regulatory developments

ESMA: final report on its guidelines on outsourcing to cloud service providers (CSPs)

On 18 December 2020, ESMA published the final report on its *Guidelines on Outsourcing to Cloud Service Providers* (CSPs). The Guidelines are intended to help firms identify, address and monitor the risks arising from cloud outsourcing arrangements. They provide guidance to firms on: the risk assessment and due diligence that they should undertake on their CSPs; the governance, organisational and control frameworks that they should put in place to monitor the performance of their CSPs and how to exit their cloud outsourcing arrangements without undue disruption to their business; the contractual elements that their cloud outsourcing agreement should include; and the information to be notified to competent authorities. In addition, the Guidelines provide guidance to competent authorities on the supervision of cloud outsourcing arrangements, with a view to fostering a convergent approach in the EU.

BIS: SupTech and other innovations challenging the status quo of regulatory reporting

On 16 December 2020, the Bank for International Settlements' Financial Stability Institute (FSI) published its report, *From Data Reporting to Data-Sharing: How far can SupTech and Other Innovations Challenge the Status Quo of Regulatory Reporting?*. The paper covers regulatory reporting initiatives at 10 financial authorities that are implementing or have implemented SupTech innovations. Most authorities are standardising data needed to populate reports and/or requiring more granular data; half are modernising the means of data transmission; and a few are improving reporting formats or actively accessing data from financial institutions. These innovations are enhancing the quality of regulatory data and setting the basis for achieving the ultimate objective of moving towards the concept of "data-sharing" (ie on-demand monitoring of financial institutions). Although authorities' implementation of their regulatory reporting initiatives face a number of challenges and hence a widespread shift to regulatory data-sharing may take time, the trend towards more granular reporting is very likely to continue.

BIS, Swiss National Bank and SIX: successful wholesale CBDC experiment

On 3 December 2020, the Bank for International Settlements' Innovation Hub (BISIH) Swiss Centre, the Swiss National Bank (SNB) and the financial infrastructure operator SIX announced the successful completion of a joint proof-of-concept experiment "Project Helvetia" that integrates tokenised digital assets and central bank money. Project Helvetia explored the technological and legal feasibility of transferring digital assets through (i) issuing a wholesale CBDC onto a distributed digital asset platform; and (ii) linking the digital asset platform to the existing wholesale payment system. A wholesale CBDC has potential advantages when settling digital assets. Yet it would raise major policy and governance hurdles. Linking existing systems to new DLT platforms would avoid many of these problems but would forgo the potential benefits of full integration. Project Helvetia explored a wholesale CBDC, restricted to banks and other financial institutions.

"A wholesale CBDC has potential advantages when settling digital assets. Yet it would raise major policy and governance hurdles."

BIS: working paper on stablecoins: potential, risks and regulation

On 24 November 2020, the BIS published its working paper on *Stablecoins: Risks, Potential and Regulation*. Both the emergence of distributed ledger technology (DLT) and rapid advances in traditional centralised systems are moving the technological horizon of money and payments. These trends are embodied in private "stablecoins": cryptocurrencies with values tied to fiat currencies or other assets. The paper looks at market developments, how they might be monitored, the potential role of stablecoins and what this implies for their regulation.

IMF: working paper on legal aspects of Central Bank Digital Currency

On 20 November 2020, the IMF published its working paper on *Legal Aspects of Central Bank Digital Currency: Central Bank and Monetary Law Considerations.* The paper analyses the legal foundations of CBDC under central bank and monetary law. Absent strong legal foundations, the issuance of CBDC poses legal, financial, and reputational risks for central banks. While the appropriate design of the legal framework will up to a degree depend on the design features of the CBDC, some general conclusions can be made. First, most central bank laws do not currently authorize the issuance of CBDC to the public. Second, from a monetary law perspective, it is not evident that "currency" status can be attributed to CBDC. While the central bank law issue can be solved through rather straightforward law reform, the monetary law issue poses fundamental legal policy challenges.

ECB: working paper on central bank digital currency in an open economy

On 19 November 2020, the ECB published its working paper on *Central Bank Digital Currency in an Open Economy*. The paper examines the open-economy implications of the introduction of a central bank digital currency (CBDC). The paper (i) adds a CBDC to the menu of monetary assets available in a standard two-country DSGE model with financial frictions and consider a broad set of alternative technical features in CBDC design; (ii) analyses the international transmission of standard monetary policy and technology shocks in the presence and absence of a CDBC and the implications for optimal monetary policy and welfare; and (iii) notes that the presence of a CBDC amplifies the international spill overs of shocks to a significant extent, thereby increasing international linkages; but (iv) the magnitude of these effects depends crucially on CBDC design and can be significantly dampened if the CBDC possesses specific technical features. The paper also shows that domestic issuance of a CBDC increases asymmetries in the international monetary system by reducing monetary policy autonomy in foreign economies.

FSB: discussion paper on regulatory and supervisory issues relating to outsourcing and third-party relationships

On 9 November 2020, the FSB published a discussion paper for public consultation on *Regulatory and Supervisory Issues Relating to Outsourcing and Third-Party Relationships.* Financial institutions have relied on outsourcing and other third-party relationships for decades. However, in recent years, the extent and nature of interactions with a broad and diverse ecosystem of third parties has evolved, particularly in the area of technology. The financial sector's recent response to COVID-19 highlights the benefits as well as the challenges of managing the risks of financial institutions' interactions with third parties. The pandemic may have also accelerated the trend towards greater reliance on certain third-party technologies. There is a common concern about the possibility of systemic risk arising from concentration in the provision of some outsourced and third-party services to financial institutions. The deadline for responses was 8 January 2021.

BIS: working paper on regulatory sandbox effects on FinTech funding

On 9 November 2020, the BIS published its working paper, *Inside the Regulatory Sandbox: Effects on FinTech Funding*. Policy makers around the world are adopting regulatory sandboxes as a tool for spurring innovation in the financial sector while keeping alert to emerging risks. Using unique data for the UK, the paper provides first evidence on the effectiveness of the world's first sandbox in improving FinTechs' access to finance. Firms entering the sandbox see a significant increase of 15% in capital raised post-entry, relative to firms that did not enter; and their probability of raising capital increases by 50%. The results suggest that the sandbox facilitates access to capital through two channels: reduced asymmetric information and reduced regulatory costs or uncertainty. The results are similar when exploiting the staggered introduction of the sandbox and compare firms in earlier to those in later sandbox cohorts, and when comparing participating firms to a matched set of comparable firms that never enter the sandbox.

World Bank and CCAF: impact of COVID-19 on FinTech regulation and supervision

On 29 October 2020, the World Bank, in collaboration with Cambridge Centre for Alternative Finance (CCAF), published its *Global COVID-19 FinTech Regulatory Rapid Assessment Study*. Between June and August 2020, the joint World Bank and CCAF research team surveyed 118 central banks and other financial regulatory authorities from 114 jurisdictions. 66% of surveyed regulators are from emerging market and developing economies. This represents one of the largest empirical studies to date on the impact of COVID-19 regarding the regulation and supervision of FinTech, as well as related regulatory innovation initiatives. The study finds that regulators are responding to the challenges of COVID-19 and increasing digitalisation of financial services by taking both sector-wide and, to a lesser extent, FinTech-specific regulatory measures, as well as accelerating the pace of regulatory innovation initiatives.

IMF: staff paper on macro-financial implications of digital money across borders

On 19 October 2020, the IMF published its staff paper, *Digital Money Across Borders: Macro-Financial Implications*. Rapid ongoing progress with digital technologies has increased the prospects for adoption of new forms of digital money for both domestic and international transactions. These include CBDCs and the so-called global stable coins (GSCs) proposed by large technological companies or platforms. The paper explores the complex interactions between the incentives to adopt and use CBDCs and GSCs across borders and discusses the potential macro-financial effects.

FSB: recommendations for regulation, supervision and oversight of "global stablecoin" arrangements

On 13 October 2020, the FSB published its final report and high-level recommendations on *Regulation, Supervision and Oversight of "Global Stablecoin" Arrangements*. The paper sets out ten high-level recommendations that seek to promote coordinated and effective regulation, supervision and oversight of GSC arrangements to address the financial stability risks posed by GSCs, both at the domestic and international level, while supporting responsible innovation and providing sufficient flexibility for jurisdictions to implement domestic approaches.

The recommendations call for regulation, supervision and oversight that is proportionate to the risks, and stress the value of flexible, efficient, inclusive, and multi-sectoral cross-border cooperation, coordination, and information-sharing arrangements among authorities that take into account the evolving nature of GSC arrangements and the risks they may pose over time.

ECB: report and consultation on a digital euro

On 12 October 2020, the ECB launched a consultation following publication of its *Report on a Digital Euro*. The report examines the issuance of a central bank digital currency (CBDC) – the digital euro – from the perspective of the Eurosystem. Such a digital euro would be a central bank liability offered in digital form for use by citizens and businesses for their retail payments. It would complement the current offering of cash and wholesale central bank deposits. To ensure that meaningful answers are obtained to the open questions raised in the report, towards mid-2021 the Eurosystem will decide whether to launch a digital euro project, which would start with an investigation phase. Consultation questions can be found here. The deadline for responses is 12 January 2021.

BIS: central banks and BIS publish central bank digital currency (CBDC) report laying out key requirements

On 9 October 2020, a group of seven central banks together with the Bank for International Settlements (BIS) published *Central Bank Digital Currencies: Foundational Principles and Core Features* to identify foundational principles necessary for any publicly available CBDCs to help central banks meet their public policy objectives. The report was compiled by the Bank of Canada, the Bank of England, the Bank of Japan, the European Central Bank, the Federal Reserve, the Sveriges Riksbank, the Swiss National Bank and the BIS, and highlights three key principles for a CBDC: (i) coexistence with cash and other types of money in a flexible and innovative payment system, (ii) any introduction should support wider policy objectives and do no harm to monetary and financial stability, and (iii) features should promote innovation and efficiency. The group of central banks will continue to work together on CBDCs, without prejudging any decision on whether to introduce CBDCs in their jurisdictions.

FSB: report on the use of supervisory (SupTech) and regulatory (RegTech) technology

On 9 October 2020, the FSB published its report on *The Use of Supervisory and Regulatory Technology by Authorities and Regulated Institutions: Market Developments and Financial Stability Implications*. The report finds that technology and innovation are transforming the global financial landscape, presenting opportunities, risks and challenges for regulated institutions and authorities alike. The opportunities offered by SupTech and RegTech have been created by the substantial increase in availability and granularity of data, and new infrastructure such as cloud computing and application programming interfaces. These allow large data sets to be collected, stored and analysed more efficiently. Authorities and regulated institutions have both turned to these technologies to help them manage the increased regulatory requirements that were put in place after the 2008 financial crisis.

EU Parliament: provisional adoption of resolution with recommendations on crypto-assets

On 8 October 2020, the EU Parliament provisionally adopted a resolution with recommendations to the Commission on *Digital Finance: Emerging Risks in Crypto-Assets – Regulatory and Supervisory Challenges in the Area of Financial Services, Institutions and Markets.* The resolution welcomed the adoption by the Commission of the Digital Finance Package including two legislative proposals on crypto-assets and operational resilience; considered that the Commission proposal on crypto-assets, as well as on operational and cyber resilience, are timely, useful and necessary due to recent developments in Union and global markets and represent a crucial step towards bringing legal clarity and developing a new regulatory regime; but noted that the Commission did not properly address the problems related to money laundering, terrorism financing and criminal activity associated with crypto-assets and requested the Commission take urgent actions in these areas.

EU Parliament: report on regulatory sandboxes and innovation hubs for FinTech

On 29 September 2020, the EU Parliament published its report on *Regulatory Sandboxes and Innovation Hubs for FinTech: Impact on Innovation, Financial Stability and Supervisory Convergence*. The study aims to provide an overview of the level of dissemination and the key features of innovation facilitators, mainly focusing on the models adopted in the EU and the EFTA countries. The objective is to identify certain key elements of the design and operational parameters of innovation facilitators, which impact on the potential benefits and risks linked to their operation. Looking ahead, the study discusses certain proposals for strengthened coordination at EU level to mitigate the risk of diverging supervisory practices and market fragmentation and to contribute to the formulation of an EU-wide policy response to FinTech.

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