

European Association for Banking and
Financial Law (AEDBF)
What to regulate? How to regulate? Who
should regulate?

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The regulatory perimeter: A multi-layered approach

Check Against Delivery
Seul le texte prononcé fait foi
Es gilt das gesprochene Wort

Good morning. I am very pleased to be able to join you for this timely event on the ambit of EU financial services regulation.

In this panel we are tasked with the question of *what* to regulate, a question which I will seek to answer by reference to the EBA's work on financial innovation.

In describing our approach, I will not reflect on the subsidiarity and proportionality principles with which you will all be familiar, although I believe they are particularly relevant for our approach to technology, which should be proportionate and allow technology to flourish cognisant of, and quick to act on, risks as they emerge.

However, I would like to recall the EBA's objectives which are to:

- improve the functioning of the internal market, in particular by ensuring a sound, effective and consistent level of regulation and supervision;
 - prevent regulatory arbitrage and promote equal conditions of competition;
 - ensure that the taking of credit and other risks are appropriately regulated and supervised;
 - enhance consumer protection;
 - prevent the use of the financial system for the purposes of money laundering and financial crime; and
 - promote financial stability.
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Clearly these objectives frame any question of *why* we regulate and therefore *what* to regulate. They also underpin our approach towards innovative applications of technology in the financial sector in accordance with the principle of technological neutrality.

What does this mean?

It means that our regulatory and supervisory approach should not prefer or prejudice the use of a specific technology nor should it inadvertently prevent the use of a specific technology, for instance by being unsuited or out-of-date. It also means that when it comes to factors such as operational resilience, including the management of ICT risk, consumer protection, strong customer authentication and AML/CFT requirements, activities should be subject to similar regulation and supervision notwithstanding the technology leveraged to carry out those activities. Equally, and I am always keen to underscore this point, technological neutrality does not mean weakening prudential standards that are specifically designed to ensure that combinations of activities and aggregate risks are appropriately regulated taking account of the impact of businesses failing. Finally it means that we are also neutral with regards to incumbents and new entrants and ensure that our regulatory and supervisory approach doesn't favour one or the other.

So technological neutrality is very much an expression of our risk-based approach: it is about achieving the right balance between facilitating innovation, scalability and competition across the internal market whilst continuing to achieve the central regulatory objectives of consumer protection, prudential resilience, market integrity and ultimately financial stability.

So how do we put this all into action?

1. Monitoring the perimeter and acting where needed

The EBA has a centrally important statutory task of monitoring and assessing market developments, for instance in relation to technological innovation and, another topic close to my heart, the integration of environmental, social and governance (ESG) factors.

This means the EBA is continuously monitoring the regulatory perimeter and the appropriateness of EU regulatory and supervisory approaches in light of market developments, primarily from three angles.

The first is using our radar of technological developments to identify how a new technology or related product relates to a regulated activity and transforms the way in which (existing) regulated services may be delivered or compliance processes fulfilled. Here we reflect on whether we need to adapt our regulatory and supervisory approach to avoid inadvertently blocking a new technology and to address any new risks. Examples include our work in relation to technologies used to facilitate remote customer onboarding, cloud outsourcing, DLT, RegTech, and advanced analytics. Recognising the general trend towards increased dependency on digital technologies, another example can be seen in our work to strengthen information and communication technology (ICT) and security risk management across the EU banking and payments sectors.

The second angle is to identify where innovative technologies may be leveraged to provide new services and whether and how the EU regulatory and supervisory framework should be adapted to accommodate these new services. Examples include the work on crowdfunding and (new) crypto-asset services, such as wallet provision and the issuance of tokens that do not qualify as MiFID financial instruments nor e-money.

The third angle is to identify where technology is being leveraged to bring about structural changes within the EU financial sector. And we can see this where players leveraging innovative technology may be creeping (inadvertently or deliberately) into the regulated space, or becoming increasingly important within that space, without the appropriate regulatory framework or oversight, which may also require us to identify any regulatory gaps and adapt accordingly. Examples include critical third party providers (e.g. of cloud services), the use of APIs pursuant to PSD2, and the use of digital platforms to provide new bundles of services.

Because we have a risk-based approach you can see that we are not limiting our work to entities or even activities. Instead we are adopting a multi-layered approach taking into account horizontal elements such as opportunities to improve the functioning of the EU financial sector and new or enhanced risks, for example from activity bundles and market concentrations and interconnections.

Let me elaborate a few examples I have just mentioned to illustrate evolutions in our approach towards innovative technologies.

1. Technologies applied to transform the way in which (existing) regulated services are delivered or compliance processes fulfilled

The EBA's early monitoring of financial institutions' reliance on cloud services identified not only a trend toward greater reliance on third party providers but also divergences between the Member States in terms of the acceptability and supervision of these services which were impacting firms' capacity to integrate these technological solutions into their businesses and across group structures.

For these reasons in 2017 we issued guidance on the use of cloud services which was further updated and integrated into the EBA's Guidelines on outsourcing with a view to promoting consistency in the management and oversight of operational risks arising from these solutions and facilitating the use of cloud services. As a further measure to enhance operational resilience, we published new Guidelines on ICT and security risk management which are intended to ensure a consistent and robust approach to the management of ICT and security risks in the EU banking and payments sectors. Something that is absolutely crucial, for instance in the context of the increased acceleration toward digital solutions for retail financial services in the context of the COVID-19 crisis.

But our monitoring did not end with the adoption of the guidelines. Instead, we have continued to monitor the increasing reliance on third parties for critical services and here we identified in our most recent advice a need for micro and macro changes to the EU regulatory framework. At the micro level, we identified a need to strengthen the toolkit to enable more effective supervision of

the activities which are provided by third parties, including conferring on supervisors direct access rights, audits rights and sanctioning rights rather than relying only on contractual provisions in outsourcing contracts. At the macro level, for critical third party providers, we identified a need a new oversight framework that sets higher standards related to security and data protection (e.g. obligatory cybersecurity certification) and helps facilitate the monitoring of concentration risks, financial stability risks, and ensures effective cooperation between all relevant authorities. I pleased to say that these micro and macro elements are reflected in the European Commission's legislative proposals on digital operational resilience (DORA) – on the one hand strengthening the existing regime and on the other extending the perimeter of direct supervisory oversight.

So this example actually illustrates not only how the use of technology has evolve to transform processes (category 1) but has also created players increasingly relevant and significant to the functioning of the EU financial services sector (category 3) highlighting very well the importance of the continuous monitoring of developments.

Technologies used to deliver new services that should be regulated

Turning to crypto-assets, whilst these have a lineage dated back to 1983 when “ecash” was conceived by David Chaum, it was the development of the decentralised Bitcoin in 2008 that really started to generate attention in this area. Of course the initial public interest focused largely on the potentially speculative value and use as a means of (sometimes illicit) payment. This led the EBA to issue a public warning in December 2013 to emphasise to consumers the risks of what we described at that time as ‘virtual currencies’, pointing out their value volatility and absence of consumer protection measures due to their unregulated status. Risks we reiterated publically in 2014. But, as a result of our further monitoring of market developments, we also issued in 2014 an opinion recognising some theoretical benefits from the application of the technologies, such as lower transaction costs, faster speed and possible financial inclusion, and highlighting the need for some regulatory changes (focusing at that time on AML/CFT) in keeping with the desire to ensure the regulatory framework remains fit-for-purpose.

Again, our monitoring work did not stop there – indeed we stepped it up in line with the increasing piloting of the underlying encryption and ledger technologies, including in the context of capital raising, trade finance, and green bond issuance, culminating in the 2019 EBA and ESMA advice to the European Commission. That advice identified that the use of crypto-assets and associated technology was still insufficiently widespread to raise financial stability concerns but highlighted that evolving uses of the technologies presented opportunities and that the ambit of the EU regulatory framework merited further consideration to secure consistency in the acceptability of the use of technologies and their regulation and supervision. In particular, we highlighted that the majority of crypto-assets in circulation at that time were not within the ambit of EU financial services law (MiFID and the EMD) and therefore activities involving those assets were not subject to common EU standards, exposing consumers to substantial risk.

The advice was significant in informing the European Commission's legislative proposal for a regulation on markets in crypto-assets (MiCA), which sets out measures to extend the EU regulatory

perimeter to cover issuers of crypto-assets, such as asset-referenced and e-money tokens including so-called stablecoins, and crypto-asset service providers, such as exchanges and custodian wallet providers.

The Commission has also brought forward in parallel a pilot regime for DLT experimentation in a securities and markets context. In that case the tokens in question fall already in scope of EU law (MiFID) but there are some interesting questions to be explored about whether any legislative adaptations are needed, which I would group under category 1 of my analysis.

Technologies bringing about structural changes in the financial sector

For me, I think one of the most interesting trends going forward relates to the way in which technology is being leveraged to bring about structural transformations in the EU financial sector.

If we take the example of the changes brought about by PSD2, in particular the framework for data sharing through application programming interfaces (APIs), these have facilitated a disintermediation of payment services thereby promoting competition in the sector. And the European Commission is now looking toward an 'open finance' framework to further promote business-to-business data sharing leveraging APIs.

But we have other examples where I think we are only at the start of what will be a long term trend toward the (re)aggregation of financial services, and non-financial services on digital platforms. This can offer many opportunities, for instance, greater access or choice for consumers, including through the cross-border provision of services, but some risks may also arise. For these reasons the EBA launched last month industry and competent authority surveys on digital platform use in order to promote common understanding of how platforms are currently being leveraged in the EU banking and payments sectors and how they may be leveraged in future. We also looking to identify opportunities and challenges, for instance in relation to consumer protection, interconnectedness, the suitability of the EU regulatory and supervisory framework, including the role and coordination between different supervisors. We expect to report our findings, with any recommendations as appropriate, mid-2021.

2. Tech readiness – supervisory knowledge

But very often our monitoring work exposes that the perimeter of EU financial services regulation remains fit-for-purpose. Instead, action is needed to facilitate a consistent supervisory approach.

Indeed, our FinTech work to-date has identified that supervisors quite often adopt different policies or stances towards applications of technology in the financial sector that show an inadvertent bias towards the status quo, quite often stemming from a lack of familiarity with newer technologies and the opportunities and risks involved.

Differing approaches, and sometimes just a lack of knowledge, can pose a very significant barrier for the scaling up of new technologies across the European Union. For instance, taking the case of

a banking group with a presence in multiple jurisdictions, they may receive different answers when asking each local supervisor whether blockchain could be piloted for intra-group transactions.

Promoting supervisory knowledge sharing is therefore a key priority for us and is why we established the EBA's 'FinTech Knowledge Hub' accessible via our website to help bridge supervisors on technology-related developments, publishing, for instance, thematic reports on advanced analytics and big data. Indeed we are doubling our efforts to gather the latest trends in technology developments and supervision and share them widely to enable supervisors to ask the right questions in a constructive way. We have done so, for example, with our reports on the use of technology in customer due diligence and are in the course of doing so in relation to RegTech applications.

Additionally, the European Forum for Innovation Facilitators (EFIF) has been established on a joint basis by the ESAs to enable supervisors to share experiences, technological expertise, and their reactions to the latest technology and innovations. The EFIF also enables supervisors to leverage knowledge gained from innovation facilitator initiatives, to discuss specific technology applications and use cases. This closer engagement enables us to fine-tune our regulatory and supervisory expectations at a pace that is in close alignment with market developments, thereby supporting the scaling up of innovation across the EU financial sector.

So with these examples I really wish to underscore the point that delivering technological neutrality in practice rests not only on the ambit of regulation but also a common understandings of the risks and opportunities presented by innovative technologies and consistent supervisory approaches.

The work ahead

I'll end by highlighting our FinTech work for the year ahead.

In addition to the continuation of our work on issues such as crypto-assets, AI, Big Data and machine learning, and wider innovation monitoring, we will be focussing our attention on RegTech and SupTech, platformisation and the delivery of new mandates pursuant to the European Commission's September 2020 Digital Finance Strategy.

Specifically, we are taking forward work to assess how banking regulators and supervisors can leverage technology in our own processes. In particular, we are stepping up our monitoring of RegTech solutions in the market to analyse how new technologies could be used by market participants to address regulatory and compliance requirements more effectively and efficiently, to identify any potential obstacles for the use of RegTech and to propose possible solutions/recommendations if needed.

In case of SupTech, we are also be working to enhance the sharing of use cases between competent authorities across the EU to facilitate a common approach to the utilisation of technologies, for instance in the context of suspicious transactions monitoring and regulatory reporting.

I mentioned already our major thematic piece focussing on s the trend towards the reaggregation of products and services on platforms and the surveys currently underway.

Finally, in accordance with the mandates set out for us in the Digital Finance Strategy, working in close cooperation with the other ESAs, we will be taking forward work to:

- develop regulatory and supervisory guidance on the use of AI applications in finance, following the publication of the upcoming EU-wide framework on AI;
- prepare guidelines to promote greater convergence on the elements related to identification and verification needed for on-boarding purposes (so-called e-ID), and on the manner and extent to which financial service providers are allowed to rely on customer due diligence (CDD) processes carried out by third parties, including other financial service providers;
- further monitor the EU regulatory perimeter, and support the European Commission in its analysis of potential future actions to strengthen cross-border lending.

And of course we will be continuing to support the European Commission in the context of the legislative proposals for DORA and MiCA which also foresee significant new supervision and oversight tasks for the EBA.

In all this work continuous monitoring and dialogue between industry and supervisors, and among supervisors, is essential in order to secure technological neutrality in our regulatory and supervisory approaches and ensure our frameworks are fit for purpose in the digital age. This is as much about addressing risk as it is leveraging opportunities for EU customers and business that come from the ability to scale innovative technologies across the EU as part of the digital transformation of our economy and society.

So I hope that helps explain how we choose *what* to regulate. And very interested in your thoughts on future evolutions of the EU regulatory framework. Thank you very much for your attention.