



## **Session 2 - Regulatory and Supervisory approaches to FinTech** *EBA's approach to FinTech*

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*Andreas Papaetis*

Policy Expert - Banking Markets, Innovation and Products Unit

# THE EUROPEAN BANKING AUTHORITY AT A GLANCE 1/2

## Profile

- The European Banking Authority (EBA) is a **specialised agency of the European Union** set up to achieve a more integrated approach to banking supervision across the EU.
- The EBA was **established on 1 January 2011** as part of the European System of Financial Supervision (ESFS). The ESFS is comprised of the three European supervisory authorities (ESAs): the EBA, the ESMA, the EIOPA, as well as the ESRB, the Joint Committee of the ESAs, the ECB and the Member States' competent supervisory authorities.

## Role

- to contribute to the creation of a single market for the EU banking sector. The EBA is in charge of developing the **EU single rulebook** on banking
- to promote pan-EU convergence of banking supervisory practices
- to assess risks and vulnerabilities in the EU banking sector which includes the initiation and coordination of the EU-wide stress test exercise
- to promote a transparent, simple and fair internal market for consumers in financial products and services

# THE EUROPEAN BANKING AUTHORITY AT A GLANCE 2/2



## Regulatory tools

### *Guidelines and Recommendations*

- Provide guidance to institutions and competent supervisory authorities on the application of EU regulations and directives. They are required **to make every effort to comply**.

### *Technical standards*

- Mandated by EU legislative texts (such as the CRD IV package and the BRRD) to produce TSs.
- The EBA drafts TSs are submitted to the European Commission for final endorsement. Once published in the Official Journal, TSs become **legally binding and apply directly in all MSs**.

### *Opinions*

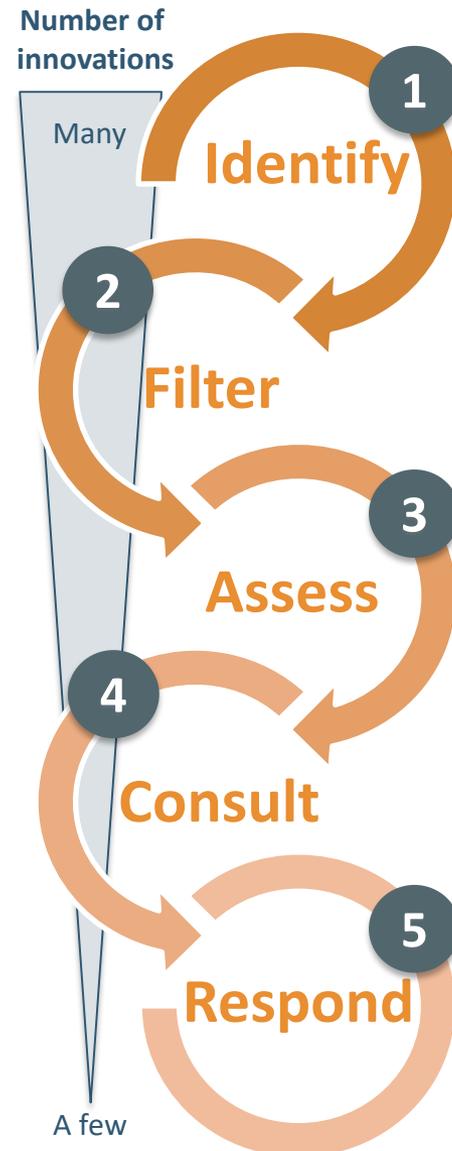
- Provide EBA's views on supervisory and regulatory matters to EU institutions and national authorities. These also include technical advice which the EBA provides to the EC.

### *Reports*

- A wide range of reports are published for identifying and analysing trends in the banking sector (e.g. potential risks and vulnerabilities stemming from the micro-prudential level).

# EBA mandate and mission on *financial innovation*

- **Monitor new and existing financial activities** with a view to promoting the safety and soundness of markets and convergence of regulatory practice
- Achieve a **coordinated approach to the regulatory and supervisory treatment** of new or innovative financial activities



# EBA FinTech Roadmap and FinTech Knowledge Hub



Impact on business models, prudential risks and opportunities

Authorisation and regulatory perimeter issues

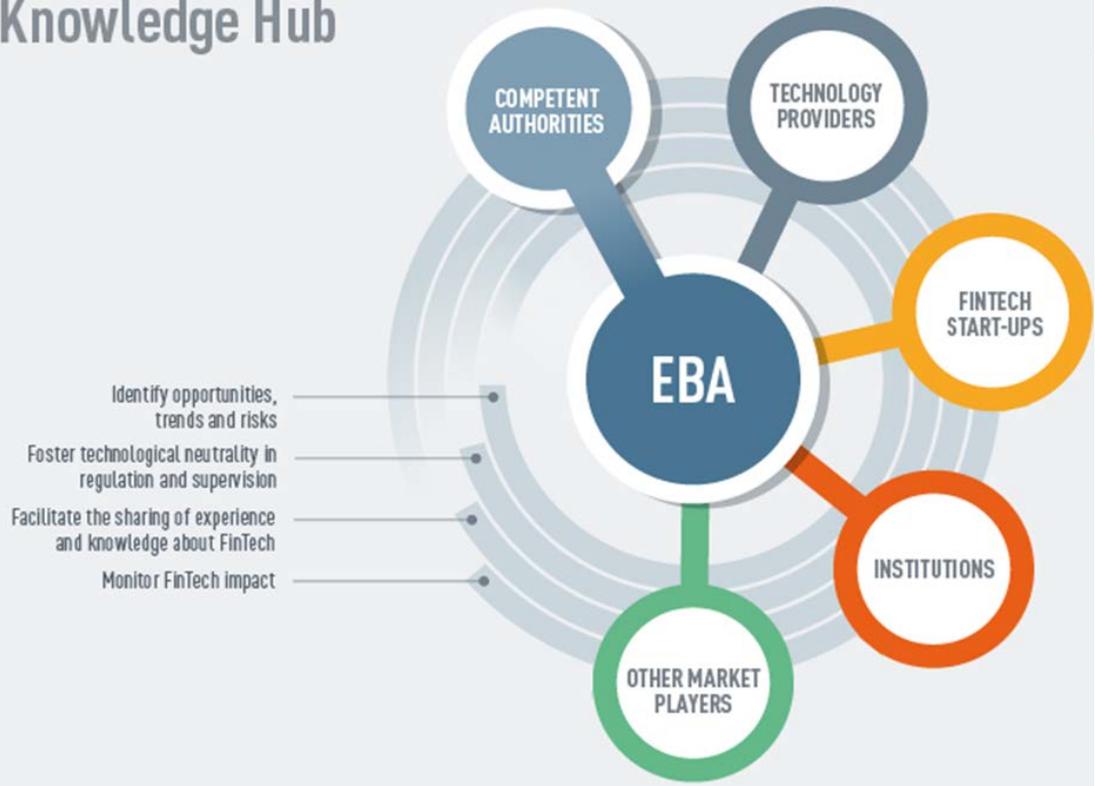
Regulatory sandboxes and innovation hubs

Consumer and Conduct Issues

Cyber security

AML/CFT

## EBA FinTech Knowledge Hub



You are invited to **register** to the **EBA FinTech Knowledge Hub**:  
Link: <https://www.eba.europa.eu/financial-innovation-and-fintech/fintech-knowledge-hub/stakeholder-register/registration-form>

## 2019

- ESAs Joint Advice on (i) legislative improvements relating to ICT risk and (ii) on the need for a cyber resilience testing framework
- ESAs Report on **regulatory sandboxes and innovation hubs**
- Report on **crypto assets**
- **Guidelines on outsourcing arrangements (includes outsourcing to cloud)**

## 2018

- Consultation on Guidelines on **ICT and security risk management**
- Report on the **impact of FinTech** on incumbent credit institutions' **business models**
- Report on the **prudential risks and opportunities arising for institutions from FinTech**
- Opinion on the implementation of the RTS on **strong customer authentication** and common and secure communication
- ESAs report on **Big Data**
- ESAs Warning on **Virtual Currencies**
- ESAs Opinion on the use of innovative solutions in the **customer due diligence processes**

## 2017

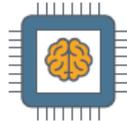
- Report on **Innovative uses of data**
- Recommendations on **outsourcing to cloud service providers**

# EBA work programme 2019-2020

## TECHNOLOGY-ENABLED INNOVATIONS



Cloud



AI and Big Data analytics



RegTech / SupTech



Open Banking / APIs



DLT

## AREAS OF REGULATORY FOCUS



Innovation facilitators



Regulatory obstacles to innovation



Licensing and perimeter



Crypto-assets



Operational resilience and cyber security

## ONGOING ACTIVITY



# Innovation facilitators

The European Commission's March 2018 FinTech Action Plan mandates the ESAs to carry out an analysis of innovation facilitators and to identify best practices.

ESA joint report in January 2019 on:

## *Regulatory sandboxes*

- schemes to enable firms to test innovative financial products, services or business models. May imply the use of legally provided discretions (depending on the relevant applicable EU and national law), but do not entail the disapplication of regulatory requirements;
- operated by competent authorities in **5 EU Member States**. Preparations are underway to establish sandboxes in 3 other EU MSs and 1 EEA state.

## *Innovation hubs*

- dedicated points of contact for firms to raise enquiries with competent authorities on FinTech-related issues and to seek non-binding guidance on regulatory and supervisory expectations and conformity of innovations with licensing requirements;
- operated by competent authorities in **21 EU MSs** and **3 EEA states**, and preparations underway in 1 Member State.

The report sets out **comparative analysis**, **best practices**, and **options to enhance coordination**.

# European Forum for Innovation Facilitators

**On 2 April 2019 the European Forum for Innovation Facilitators was launched.**

- The EFIF will provide a **platform for supervisors** to **share expertise on innovations** and to **reach common views** on the regulatory and supervisory treatment of innovative products, services and business models.
- The EFIF is also expected to provide a platform for **supervisors to collaborate** in:
  - ✓ **responding to firm/group-specific questions** about innovations; and
  - ✓ for those with regulatory sandboxes, to consider where appropriate **joint testing arrangements**.
- Knowledge sharing within the EFIF is also expected to **inform future EC/ESA work**.
- The EFIF will meet on a regular basis and the next event will be **hosted by the EBA**.

# Advice on Crypto-assets

In January 2019 the EBA published its assessment of **the applicability and suitability of current EU banking, payment, e-money and AML/CFT law to crypto-assets.**

The *EBA report with advice for the European Commission on crypto-assets* complements the *ESMA advice* (published the same month): *Initial Coin Offerings and crypto-assets*.

## Main findings

- Crypto-asset activities in the EU are relatively limited and **do not appear to give rise to implications for financial stability.**
- Scope to **improve monitoring** and **consumer-facing disclosure practices.**
- **Typically** crypto-asset activities **do not constitute regulated services within the scope of EU banking, payments and e-money law. Some** crypto-assets qualify as **financial instruments within the scope of the MiFID**, but clarifications are required to ensure the effective application of the existing regulation.
- Clarifications to **accounting and prudential treatment** are needed.
- **AML/CFT** improvements are required.

## Next steps

- **European Commission** urged to consider appropriate EU-level response further to the findings of the EBA and ESMA and will take forward further analytical work in 2019.
- Further actions for the **ESAs** (e.g. for EBA: monitoring, prudential treatment, AML/CFT).

# EBA Guidance for outsourcing to the Cloud

## Objectives

- To provide common EU-wide guidance for the use of outsourcing (including cloud services) by institutions.
- This allows institutions to **leverage the benefits** of using cloud services, while ensuring that any **related risks are adequately identified and managed**
- To harmonise supervisory **expectations** across the EU for institutions adopting cloud computing.

**EBA Recommendations on outsourcing to the cloud –  
(EBA/REC/2017/03) December 2017 REPEALED BY:**



**EBA Guidelines on outsourcing arrangements –  
(EBA/GL/2019/02) February 2019**

# EBA Guidelines on Outsourcing arrangements

## EBA/GL/2019/02

Key components of the Guidelines that are particularly relevant for Cloud Outsourcing:

### 1. Critical or Important outsourcing (replacing material outsourcing)

more stringent requirements when designated as critical or important

### 2. Location of services

(i) The outsourcing Register should include where the service is to be performed, including the data location and (ii) the outsourcing agreement should include data storage and processing locations.

### 3. Sub - outsourcing

Service providers should execute appropriate oversight over the sub-service providers. (still the institution need to maintain also its own control)

### 4. Security of data and systems

service providers should comply with appropriate IT security standards

### 5. Access information and audit rights

service provider grants (a) full access to all relevant business premises and (b) unrestricted rights of inspection and auditing related to the outsourcing arrangement

### 6. Exit strategies

institutions should have an exit strategy for critical or important functions for a number of adverse scenarios including failure of the service provider or deterioration of the quality of the function provided

# Draft Guidelines on ICT and security risk management

- **Scope:** payment service providers for their payment services; credit institutions for all activities beyond their payment services; investment firms for all activities.
- These Guidelines integrate the ‘Guidelines on security measures for operational and security risks of payment services’ under Article 95 PSD2 (December 2017, EBA GL 2017/17), and elaborate further on certain topics that contribute to mitigating ICT risks in financial institutions. EBA GL 2017/17 will be repealed from the date of application of these Guidelines.
- **Timeline:** Public consultation was until **March 2018**. Finalisation in Q4 2019.

## CONTENT

ICT governance and strategy

ICT risk management framework

Information security

ICT Operations management

ICT Project and Change management

Business continuity management

# ESA Joint advice to the European Commission

on the need for **legislative improvements** for **ICT risk management requirements** in the EU financial sector

→ Overall **operational resilience** including ICT governance and security

- Proposal that every entity should be subject to general and fundamental **requirements** on governance and security of ICT (including cybersecurity) to ensure the safe provision of regulated services (proposal for legislative amendments)

→ Flagging concerns on **incident reporting**

- Proposal that **inconsistent** terminology, templates, reporting timeframes used for a variety of different incident reporting frameworks are harmonised

→ Potential impact of concentrations of **third party providers**

- Proposal that concentration risk associated with third parties in the finance sector is addressed and to consider the establishment of an **appropriate oversight framework** for monitoring critical service providers to the extent that their activities may impact relevant entities

# ESA Joint advice to the European Commission

on the costs and benefits of a **coherent cyber resilience testing framework** for significant market participants and infrastructures within the whole EU financial sector

## → In the short term

- Proposal that the ESAs, CAs and regulated entities focus on **achieving a cyber-resilience baseline** across the sectors in proportion to the needs and characteristics of relevant entities.
- Proposal that the European Commission considers facilitating the establishment by the ESAs and other relevant authorities and experts (e.g. CAs, Financial Stability Authorities, ENISA, ECB, ESRB or others) of **an EU wide coherent cyber-resilience testing framework**, on a voluntary basis, focusing on TLPT by taking into account existing initiatives.
  - Acknowledgement of the TIBER-EU framework
  - An explicit legal basis to be set out for a coherent cyber resilience testing framework

## → In the long term

- Proposal that when the necessary coherent cyber resilience testing framework is agreed, specific practical and policy implementation questions are addressed, and a sufficient cyber ‘maturity level’ is developed across identified relevant entities, the Commission to consider the possibility for **cyber resilience testing exercises** to be coordinated by the ESAs and / or other relevant authorities and managed by involved authorities for the identified most systemic, critical and significant relevant entities.

# Report on impact of FinTech on banks' business models



In line with its **FinTech Roadmap**, the EBA has conducted an analysis of the current impact of FinTech on incumbent banks' business models aiming to enhance knowledge sharing among regulators and supervisors. The thematic report was published in July 2018 with the following **key observations**:

- ➔ Key drivers for the use of technology-enabled innovation: **improve customer experience** and **operational efficiency**. Digitalisation/Innovation strategies have a twofold trend: (i) digital transformation, and (ii) digital disruption. Banks are moving towards an agile approach for the implementation of their innovation projects and planning to increase their IT-related investments.
 

**Payment and settlement** business line as well as retail banking appear to be mostly affected by new entrants with a negative impact in incumbents' revenues.
- ➔ The predominant type of relationship between incumbents and FinTech is **partnership with FinTech firms**, which is considered a "win-win" situation. A more active involvement of **BigTech** firms could alter the existing financial intermediation ecosystem.
- ➔ Incumbents are categorised into **(i) proactive/front-runners**, **(ii) reactive** and **(iii) passive** in terms of the level of adoption of innovative technologies and overall engagement with FinTech. Potential risks may arise both for incumbents not able to react adequately and timely, remaining passive observers, but also for aggressive front-runners.
- ➔ Five factors that might significantly affect incumbents' business models from a sustainability perspective: **(i) digitalisation/innovation strategies**, **(ii) challenges arising from legacy ICT systems**, **(iii) operational capacity**, **(iv) retain and attract talent** and **(v) heightened competition** from peers and other entities.

# Report on prudential risks and opportunities of FinTech



One of the priorities set out in the EBA **FinTech Roadmap** is the analysis of the prudential risks and opportunities for institutions arising from FinTech and to this end, the EBA assessed **seven use cases**, where new technologies are applied or considered to be applied to existing financial processes, procedures and services. The report was published in July 2018 and aimed to raise awareness, setting out potential prudential risks and opportunities from each use case:

## Use Case

- 1 *Biometric authentication using fingerprint recognition*
- 2 *Use of robo-advisors for investment advice*
- 3 *Use of big data and machine learning for credit scoring*
- 4 *Use of DLT and smart contracts for trade finance*
- 5 *Use of DLT to streamline customer due diligence processes*
- 6 *Mobile wallet with the use of near-field communication;*
- 7 *Outsourcing core banking/payment system to the public cloud;*

➡ No significant implementation of sophisticated technologies has been noted yet by institutions, possibly because of security concerns and filtering the hype around FinTech. There is a **growing shift towards operational risk**, arising mainly from the **accentuation of ICT risks** as institutions move towards more technology-based solutions.

➡ **Dependencies on third-party providers, heightened legal and compliance risks** and **negative impact on conduct risk** add to the overall increased operational risk. The potential efficiency gains and improved customer experience are currently the predominant potential opportunities while the changing customer behaviour is an important factor triggering institutions' interest towards FinTech.



## **EUROPEAN BANKING AUTHORITY**

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Floor 46, One Canada Square, London E14 5AA

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Tel: +44 207 382 1776

Fax: +44 207 382 1771

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E-mail: [info@eba.europa.eu](mailto:info@eba.europa.eu)

<http://www.eba.europa.eu>