

DIGITAL FINANCIAL SERVICES

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Taking the EU forward:

The Commission's pledge to promote cloud uptake

Joyce Kolman, Executive Associate at Kreab, looks at the road ahead

The emergence of BigTech is disrupting the traditional financial services industry. BigTech participation in finance offers numerous benefits to incumbent financial institutions (FIs); however, it also poses risks to financial stability, including cyber vulnerabilities, poor governance and process controls, and unfair competition. Furthermore, greater dependencies on a small number of globally dominant third-party providers, such as cloud service providers (CSPs), have increased the operational links between BigTech and incumbent FIs, potentially giving rise to new financial stability implications.

The European Supervisory Authorities (ESAs) – EBA, ESMA and EIOPA – have warned that the interconnectedness of dominant CSPs in the financial system could be a single point of failure if one were to experience a serious data breach. This is a main reason why FIs have been slow to adopt cloud services in comparison. A strict regulatory environment also presents a further main obstacle for adoption. Additionally, the large number of financial regulators involved in the authorisation of cloud use can lead to inconsistent requirements and additional burdens.

As part of the Digital Single Market Strategy, the Commission (EC) has attempted to address cloud services obstacles. It put forward the Free Flow of non-personal Data (FFoD) Regulation in 2017 to remove data localisation restrictions. This Regulation allows companies and public administrations to store and process non-personal data anywhere in the EU.

In its 2018 FinTech Action Plan, the EC committed itself to developing standard contractual clauses for cloud outsourcing by FIs, building on the SWIPO Codes of Conduct. The EC also invited the ESAs to consider issuing guidelines for the risks of increasing use of cloud computing and data services. In response, the EBA prepared revised Guidelines on Outsourcing Arrangements, which have been in force since September 2019. The Guidelines address FIs' governance frameworks and the related supervisory expectations for outsourcing. The Guidelines also introduce stricter requirements for outsourcing arrangements which concern critical functions. For its part, EIOPA is finalising its guidelines on cloud outsourcing, which are expected shortly.

The work undertaken by the ESAs will lead to the adoption of Guidelines, which some think may be insufficient. The new Commission will, therefore, include in its upcoming Digital Finance Strategy specific policy proposals related to operational resilience of the cloud as regards the financial services industry.

Firstly, the EC is expected to put forward an oversight framework of third-party providers as part of its planned Digital Operational Resilience Framework for Financial Services. In their Joint Advice from April 2019, the ESAs suggested that an oversight framework could provide a useful template to monitor the risks stemming from third-party providers when they are considered critical service providers to financial entities (i.e. CSPs). The Commission has taken this advice seriously, although it will still need to decide on the appropriate level of oversight. Three possibilities are currently on the table: i) direct supervision with rigid rules; ii) a certification model based on standards; iii) a model of lighter oversight based on expectations. With a view to launching the proposal in Q3 2020, the EC has opened a feedback period until 19 March 2020 to collect stakeholder input.

Secondly, and more generally, the EC is working on plans to mitigate concentration risk in the European cloud market and reduce its reliance on U.S.-based cloud services. As part of its bigger push to claim 'digital sovereignty', the EU is looking into the creation of a European Cloud Federation for the storage of (high-value) datasets from the public and private sectors. This European Cloud Federation will be funded through the Digital Europe Programme and could be developed on the basis of Germany's Gaia-X project, which aims to ensure EU data sovereignty and enable the sharing of data on a broader, more secure basis. This initiative will be part of the Commission's Data Strategy for Europe, which is expected on 19 February.

To avoid overregulating the cloud and financial services space, it will be crucial to strike the right balance between innovation, on the one hand, and (cyber)security and data protection, on the other hand. A model of light oversight to monitor systemic risks, combined with common security and data portability standards, may therefore be the most likely way forward.

CYBERSECURITY

Commission seeks to update cyber resilience in the financial sector

The financial sector is the largest user of Information and Communication Technology (ICT) infrastructure in the world. The increasing level of digitalisation makes the financial sector more vulnerable to cyberthreats and operational incidents. The Commission is determined to strengthen the digital operational resilience of the EU financial sector by upgrading existing rules and introducing new requirements where needed. To that end, it published a roadmap and a public consultation on a digital operational resilience framework for financial services on 19 December 2019. The consultation is intended to help the Commission with the development of a possible EU cross-sectoral cyber resilience framework in financial services.

Next steps:

EC expected to present a legislative proposal by Q3 2020.

CROWDFUNDING

New rules to boost cross-border funding activity whilst also safeguarding investors

In December, the co-legislators reached a preliminary interinstitutional agreement on the European Crowdfunding Service Providers (ECSP) Regulation. The new framework, which was proposed by the European Commission in March 2018 as part of the Fintech Action Plan, intends to remove barriers for crowdfunding platforms to operate cross-border by harmonising the minimum requirements when operating in their home market and other EU countries. The agreed rules also aim to increase legal certainty through common investor protection rules. They will cover equity-based and lending-based crowdfunding campaigns of up to EUR 5 million over a 12-month period.

Next steps:

COREPER and EP to endorse the text after technical revision.

FINTECH

ROFIEG presents 30 recommendations to bolster FinTech in the EU

Fintech has gained a prominent role in the EU's agenda for financial services. To boost the FinTech market, the Commission Expert Group on Regulatory Obstacles to Financial Innovation (ROFIEG) published a report proposing 30 Recommendations on Regulation, Innovation, and Finance on 13 December 2019. ROFIEG puts emphasis on reducing fragmentation and ensuring greater coordination and consistency in regulatory approaches at the EU-level. To ensure level-playing field, the report endorses a 'same activity, same risks, same regulation' approach for all market participants. Furthermore, ROFIEG explicitly endorses technological neutrality in financial supervision and regulation as a means to encourage the adoption of new technologies.

Next steps:

A new Action Plan on FinTech is expected in Q3 2020.

CRYPTOCURRENCIES

Digital currencies continue to draw international attention

On January 23, the Bank for International Settlements (BIS) published its report analysing the adoption of Central Bank Digital Currencies (CBDCs) across the world. The report follows a 2018 survey in which 66 central banks across the globe weighed in on their strategy and approach to the adoption of CBDCs. Overall the BIS report concludes that while many central banks are not currently preparing to issue CBDC in the immediate future, they are increasingly becoming engaged with research and proof of concept projects to understand potential benefits, risks, and systemic implications. The report also noted the difference in opinion from developing economies, who were much more proactive in preparation for CBDC issuance in order to address reliance on cash use, improve payment infrastructure and address safety concerns.

In addition to the BIS report, the World Economic Forum has also announced it will establish a Consortium for digital currency governance. The group of central banks plans to examine possible solutions to designing a governance framework and address fragmentation.

KREAB FINANCIAL SERVICES AND TECHNOLOGY FORUM

Kreab's Financial Services and Technology Forum (FSTF) allows stakeholders to engage in high-level discussions on the most pertinent technological and regulatory topics. Launched in 2014, the Forum has addressed a broad spectrum of topics, such as security tokens, crowdfunding, blockchain, payments, data protection, and Artificial Intelligence. This year the FSTF will host quarterly events on issues likely to take centre-stage in 2020, including crypto-assets, Artificial Intelligence in FS, Instant payments, and cybersecurity in FS.

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