INNOVATION IN FINANCIAL SERVICES AND THE DEVELOPMENT OF FINTECH OFFERS MAJOR BENEFITS FOR CONSUMERS AND BUSINESSES

- Improved functionality of existing financial services to consumers – e.g. reminders to save, better access to advice, monitoring spending.
- Increased accessibility to financial services through new channels – e.g. use of mobile phones to manage accounts.
- Increased competition from new and innovative business models – e.g. P2P lending, robo-advisor investing, cloud computing enabling more rapid innovation.
- Reducing economic informality – e.g. digital payments offer greater transparency for governments.
- New methods of assessing credit quality – e.g. data mining social media to augment traditional credit information.
- Greater accuracy and efficiency in compliance through regulatory technology ‘RegTech’ – e.g. using electronic identities and biometric authentication for ‘know your customer’ (KYC) and other purposes.
- Improved efficiency through the digitization of paper work – e.g. using blockchain technology to support the certification of trade finance transactions, use of cloud for business processes.

AS WELL AS POSEING RISKS THAT MUST BE MANAGED APPROPRIATELY

- Increased focus on managing cyber risks – e.g. greater international cooperation on tackling cyber-crime.
- Greater focus on financial inclusion – e.g. helping develop digital skills and competencies.
BUSINESS PRIORITIES FOR THE OECD TO CONSIDER

1) Businesses want regulatory frameworks that empower them to research, invest and innovate

- Businesses and governments want customers to benefit from cutting-edge products and services which meet both convenience and cost requirements while maintaining appropriate levels of customer protection, privacy and security.

- However, the regulatory and supervisory frameworks currently in force in some OECD countries can sometimes act as a disincentive to innovation and experimentation, preventing new products and services coming to market.

- We call on the OECD to promote principles-based regulation, combined with a risk-based supervisory approach, which can provide flexibility and adaptability to new solutions and business models.

- Future-proofing regulation in today’s fast-paced environment means avoiding prescriptive or technology-specific regulation. Rather governments should aim for a platform neutral, business-model neutral, approach which meets policy goals in the least burdensome way. One way of achieving this could be moving away from regulation that is ‘legal entity’ based towards ‘activity’ based. The general approach should be same risks, same rules and same supervision.

- Engaging the financial services sector at the outset of regulatory change also enhances the design of regulation and we encourage OECD governments to take a collaborative approach with the private sector.

- Regulatory coordination, both domestically and internationally, between different government departments and regulators also helps to avoid regulatory overlap or contradiction.

- Technological innovation also implies that the focus of regulatory needs may shift. Data issues are a good example - as new technologies for automation and analytics require the availability of high-quality data, there is an increased need for improved data sharing policies, data standards and other policies for data improvement and protection both nationally and internationally.

2) Poorly designed, or badly implemented, regulation has significant opportunity and societal costs

- Appropriate regulation is essential to sound financial markets and to building public confidence in financial services. However the burden of regulation needs to be taken into account. For all businesses the resources spent complying with new regulation diverts resource from investment, recruitment and business planning. Business at OECD is aware of cases where the development of new financial products and services has been side-lined as a result of significant resources being drawn towards compliance.

- Lack of regulatory clarity and predictability also contribute to the regulatory burden, especially in financial services where 86% of CEOs recently surveyed by PwC reported concern about the impact of over-regulation on their firms’ growth prospects.\(^1\)

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\(^1\) PwC (2017), Setting the bar higher: 20\(^{th}\) CEO Survey ‘Key findings in the banking and capital markets industry’
• Getting the regulatory approach right matters not just for the success of both FinTech firms and incumbents but also to foster digitalization across the wider economy. Traditional financing tools can sometimes fail to keep pace with the digital transformation and “Industry 4.0” projects which typically involve new forms of collaboration between companies and a greater emphasis on intangible assets. By using innovative new approaches firms can complement and improve existing financing tools to support digitalization.

3) **Good supervision is just as important as developing innovation friendly regulation**

• We call on regulators to equip their supervisory teams with the right knowledge and resources to allow the appropriate taking of risk by regulated firms pursuing financial or technological innovation, whilst protecting consumers and ensuring financial stability.

• The ability of supervisors to quickly understand, and accept, new technology and unfamiliar business models is key to enabling the engagement of innovative firms with regulators. This can be facilitated by better engagement with innovative business through sector secondments, joint working groups with practitioners and firm open days. Regulatory sandboxes or testing labs can also be a helpful tool for supervisors to experience firsthand how innovation happens on the ground and give firms a safe space to ensure new ideas are appropriate for customer use.

• Supervisors should also be encouraged to formulate and communicate the principles and criteria that they will apply to assessing new business models and their related risks. The development of these principles and criteria should be pursued through wide consultation and interaction with stakeholders, both the demand and supply sides. Recommendations and conclusions pursuant to any consultation should be supported by independent impact assessments.

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**Case study 1: the UK Government and Financial Conduct Authority have taken positive steps to support FinTech innovation**

- **Regulatory space and proportionality**: The Financial Conduct Authority’s (FCA) Project Innovate and the “regulatory sandbox” allows businesses to test innovative products, services, business models and delivery mechanisms in a live environment, with controlled regulatory risk and has been widely supported by businesses.

- **Managing legal problems**: the Joint Money Laundering Task Force has allowed London banks to work directly with regulators and law enforcement on ways to deal with money laundering problems that might otherwise be impeded by data-sharing restrictions, while reducing their enforcement risk. This type of joint effort could be broadened to include relevant FinTech firms as well. A similar group has been organized to deal with Cybersecurity issues.

- **Targeted trade support**: The FCA’s FinTech Bridges program with other countries is aimed at reducing barriers to entry in the bridged jurisdictions and encouraging innovation in both countries’ financial services sectors, making it easier for FinTech firms to scale up internationally.

- **Targeted business support**: Tech City UK, a business organization, working with the UK Government, is trialing a FinTech Professional Services Hub to connect promising FinTech companies with the right professional services providers.

- **Business and government collaboration**: The FinTech Delivery Panel brings together industry leaders with the UK government to develop and drive FinTech specific policy recommendations in close collaboration with the government.
**Case study 2: The French government and financial regulatory bodies are supporting innovation**

- **Innovation Hubs**: Joint FinTech Innovation Hubs created by the Autorité de Contrôle Prudentiel et de Résolution, and Autorité des Marchés Financiers target one of the most important barriers to entry, knowledge about financial regulation, by assisting firms to navigate the regulatory landscape. Crucially, they are open to all, recognizing that innovation can be driven by all types of businesses.

- **Open and innovative industry-government dialogue**: The “FinTech Forum,” is a consultative body with representatives from FinTech firms, incumbents, lawyers and consultancy firms. By helping to identify the challenges and issues associated with financial innovation it supports the constructive development of regulation and supervisory practices. It helpfully brings a wide range of government bodies together including the French Data protection authority (CNIL) and French Financial Intelligence Unit (TRACFIN) as well as the French Ministry of Finance, recognizing that ‘FinTech issues’ cover a wide range of government areas.

- **Targeted business and financial support**: the Public Bank of Investment (BPI France) has launched a funding and support program to connect promising startups with the right business actors. The French Tech initiative, run by a group of public actors, including the French government, was created in 2013 to coordinate public action in favor of startups, including FinTechs.

- **Tailored and responsive regulation**: France’s 2014 crowdfunding regulation is a good example of regulatory agility where rules can be adjusted appropriately, new statuses introduced and which are focused on the main risks raised by the activity. The fact that French law now acknowledges blockchain technology for the registration of non-listed equities is also a good example of ‘test and learn’ initiatives which will be needed to develop regulation effectively.
SUGGESTED FURTHER READING:


- Institute of International Finance (2017), ‘Deploying RegTech against financial crime: a report of the IIF RegTech Working Group’ 

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