The uneasy road toward a single EU market for fintech

Current rules fall short of providing a clear framework for a single European market for fintech companies, as **Jonathan Rogers**, **Angelo Messore** and **Paula Melendez** explain.

The development of a single market for fintech has recently been placed at the center of the EU financial services agenda. In its 2018 "Fintech Action Plan", the European Commission identified a number of supervisory initiatives to help fintech companies reach scale across the EU through a more consistent supervisory framework and bespoke legislative proposals. Additional work has been done by European Supervisory Authorities to provide guidelines on certain key aspects of fintech business models and licensing procedures, as well as on other policy areas that are relevant to the development of fintech in the EU.

Based on the Commission's 2018 Action Plan, the European Banking Authority (EBA) presented its own "Roadmap to Fintech", identifying the regulatory priorities for 2018 – 2019. On the basis of the Roadmap, the EBA published a report on October 29, 2019 on potential impediments to the cross-border provision of banking and payment services.

The EBA report on cross-border banking and payment services

The EBA report identifies a number of important challenges for fintech firms seeking to expand their footprint in the EU and highlights the existence of national divergences across EU Member States that could hinder the ability of firms to operate on a cross-border basis.

This is a pressing issue. In 2016, only 7 percent of consumers used financial services from another EU Member State. While differences in language, degree of financial awareness or consumer preferences have been suggested as barriers, the EBA report focuses on divergences in national legislation.

EBA published a report on potential impediments to the cross-border provision of banking and payment services

Although the EBA report is specifically focused on the provision of banking and payment services by credit institutions and payment service providers, the issues it raises apply to fintech firms and have wider implications for the entire industry.

Cross-border performance of digital activities

An important question faced by fintech entrants when seeking to provide cross-border financial services in the EU is whether a digital activity can be considered to be a cross-border provision of services and, if it is, whether it is carried out under the freedom to provide services or the right of establishment. The distinction is important to determine passporting requirements, rules of conduct and relevant supervisory authorities.

The EBA report says that there are currently no common EU rules in this area. Competent authorities follow a case-by-case approach by relying on the case law of the Court of Justice of the EU and a 22-year-old communication on the performance of cross-border banking services issued by the Commission.

It is also unclear whether the use of local agents or distributors by payment services providers or e-money institutions could amount to an establishment in the host Member States. Further, the EBA report highlights the lack of visibility on cross-border activities by competent authorities of the home and host Member States.

The EBA report accordingly advises the Commission to issue clearer guidelines on the cross-border performance of digital activities and to strengthen the applicable reporting requirements.

Consumer protection and conduct of business

Consumer protection and conduct of business requirements are critical areas of compliance for new fintech market entrants. They may be susceptible to enhanced scrutiny from local supervisory authorities and could be required to make significant investments in regulatory compliance before crossing the borders of a new EU jurisdiction.

The EBA report found that, despite the common framework applying under relevant EU Directives, the

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level of protection of consumers and the rules of conduct applicable to service providers tend to differ depending on national regulatory regimes, as well as on whether the services are performed under the freedom to provide services or right of establishment.

For instance, despite the fact that EU product-specific legislation usually contains disclosure requirements, there is a lack of harmonization in advertising and adequate explanations to consumers. This means that service providers may need to adjust disclosures—in terms of content or format—depending on the jurisdiction where consumers are located.

The EBA report suggests that further harmonization should be considered in consumer-facing disclosure requirements, allocation of home-host Member State responsibilities for supervisory practices and handling complaints and powers regarding the right of establishment and the freedom to provide services. Additional guidance on the means to comply with disclosure requirements through a "durable medium" is also recommended to promote convergence and adaptability to evolving technology.

Anti-money laundering

The fourth Anti-Money Laundering Directive sets out the anti-money laundering obligations that apply to financial services providers operating in the EU. However, the Directive provides for a minimum harmonization of national anti-money laundering regimes, meaning that EU Member States can go beyond the standards set at the EU level and include additional measures where this is necessary to mitigate money-laundering risks.

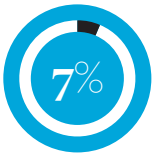
As noted in the EBA report, differences in supervisory practices are creating complexity and possibly hindering the provision of services. These difficulties are amplified when firms operate on a cross-border basis in different Member States, as they need to adjust their policies and compliance procedures in each jurisdiction where they operate.

According to the EBA report, the key areas where supervisory convergence is desirable are customer due diligence measures, digital identification, third-party reliance and the application of local regimes to service providers operating under the freedom to provide services.

Additional impediments to the cross-border provision of fintech services

The EBA report provides useful insights into the obstacles that limit the growth potential of EU fintech firms. Yet the list of legal barriers to the cross-border performance of services provided by the EBA is not exhaustive, and there are several additional hurdles that EU fintech companies should consider when performing services in the EU territory.

Notwithstanding the technological neutrality promoted by EU institutions and EU rules on digital signature, some national competent authorities are still reluctant to accept the use of paperless signature or pre-contractual disclosure processes. Similarly, there are no harmonized processes in the EU for electronic identification and remote know-your-customer activities. The need to adjust the client on-boarding procedures and signature or pre-contractual disclosure processes to national regimes can be a relevant obstacle to the performance of cross-border fintech services, considering that the offer of an intuitive and seamless customer digital experience is a key value proposition of fintech companies.



Only 7 percent of consumers used financial services from another EU Member State in 2016

The lack of common licensing regimes for certain fintech services is also among the obvious areas for improvement of EU legislation. Besides crowdfunding platforms—which the Commission is already in the process of regulating—the absence of a common framework for consumer credit and direct lending by non-bank institutions restricts the possibility for certain fintech lenders to operate on a cross-border basis without being subject to the burdensome requirements applying to banks under EU law.

Looking at the broader regulatory landscape, European authorities have already tried to adapt certain regulatory requirements to fintech firms in light of the proportionality principle, particularly regarding the suitability of shareholders and members of the management body. However, additional flexibility should be sought in other areas that typically affect venture capital-sponsored fintech companies, such as variable remuneration schemes for fintech firms providing banking, investment or asset management services.

Falling short

Fintech firms largely rely on the offer of long-distance services through the internet or mobile applications. The use of technology could be a powerful tool to scale up the EU internal market with limited investments and no local presence or personnel.

However, the current rules fall short of providing a clear framework for the cross-border performance of fintech business. In several cases, EU fintech firms perform services only domestically, or restrict the access to their digital platforms to customers located in a limited list of EU jurisdictions. This is also due to fear of navigating a shattered

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legal ecosystem when providing cross-border services across the EU, as well as to the costs of compliance, which are proportionate to the level of fragmentation of the EU legal framework.

In addition to reducing the appetite of fintech firms to expand their EU operations, the existing legal barriers also hamper the ability of consumers to benefit from the wider offering available and limit market efficiency and competitiveness of the EU single market for financial services.

Further regulatory initiatives are desirable in this area, especially in the use of digital technologies in customer on-boarding and the compliance with applicable rules of conduct and disclosure requirements. It is clear that these initiatives will not eliminate some natural barriers to cross-border services deriving, for instance, from the lack of harmonization in national tax regimes, labor and contract law. Nonetheless, an enhanced level of harmonization of the regulatory framework could significantly help EU fintech companies fully exploit their growth potential and profit from the opportunities offered by the single market.

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