Committee on Economic and Monetary Affairs

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DRAFT REPORT

with recommendations to the Commission on Digital Finance: emerging risks in crypto-assets - regulatory and supervisory challenges in the area of financial services, institutions and markets
(2020/2034(INL))

Committee on Economic and Monetary Affairs

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MOTION FOR A EUROPEAN PARLIAMENT RESOLUTION

with recommendations to the Commission on Digital Finance: emerging risks in crypto-assets - regulatory and supervisory challenges in the area of financial services, institutions and markets
(2020/2034(INL))

The European Parliament,

– having regard to Article 225 of the Treaty on the Functioning of the European Union,

– having regard to the Communication from the Commission of 8 March 2018 entitled 'FinTech Action plan: For a more competitive and innovative European financial sector'[1],

– having regard to the Final report of the Commission's Expert Group on Regulatory Obstacles to Financial Innovation: 30 recommendations on regulation, innovation and finance of 13 December 2019,

– having regard to the Joint Advice of the European Supervisory Authorities To the European Commission on the need for legislative improvements relating to ICT risk management requirements in the EU financial sector of 10 April 2019,

– having regard to the Joint Advice of the European Supervisory Authorities To the European Commission on the costs and benefits of developing a coherent cyber resilience testing framework for significant market participants and infrastructures within the whole EU financial sector of 10 April 2019,

– having regard to the European Banking Authorities' Guidelines on ICT and security risk management of 29 November 2019,

– having regard to the European Banking Authority Report with advice for the European Commission on crypto-assets of 9 January 2019,

– having regard to the advice of the European Securities and Markets Authority to the Commission on Initial Coin Offerings and Crypto-Assets of 9 January 2019,

– having regard to the European Commission's Consultation Paper on an EU framework for markets in crypto-assets of December 2019,

– having regard to the report of the European Central Bank on implications of digitalization in retail payments for the Eurosystem's catalyst role of July 2019,

– having regard to Benoît Coeure's keynote speech 'FinTech for the People' of 31 January 2019,

– having regard to Yves Mersch's keynote speech 'Lending and payment systems in upheaval: the FinTech challenge' of 26 February 2019, at the 3rd Annual Conference on

[1] COM/2018/0109 final

FinTech and Digital Innovation,

– having regard to the report by the Financial Stability Board on Financial Stability Implications from FinTech, Supervisory and Regulatory Issues that Merit Authorities' Attention of 27 June 2017,

– having regard to the report by the Financial Stability Board 'Decentralized financial technologies. Report on financial stability, regulatory and governance implications' of 6 June 2019,

– having regard to the report by the Financial Stability Board 'Crypto-assets: Report to the G20 on work by the FSB and standard-setting bodies' of 16 July 2018,

– having regard to the report by the Financial Stability Board on FinTech and market structure in financial services, Market developments and potential financial stability implications of 14 February 2019,

– having regard to the investigation of the G7 Working Group on Stablecoins on the impact of global stablecoins of October 2019,

– having regard to the analysis of the Bank for International Settlements 'Policy responses to FinTech: a cross-country overview' of January 2020,

– having regard to Fernando Restoy's intervention 'Regulating FinTech: what is going on, and where are the challenges?' of 16 October 2019, at the ASBA-BID-FELABAN XVI Banking public-private sector regional policy dialogue,

– having regard to Rules 47 and 54 of its Rules of Procedure,

– having regard to the report of the Committee on Economic and Monetary Affairs (A9-0000/2020),

A. whereas digital finance is a consistently evolving area of the financial sector which deserves ongoing monitoring and consideration both on an industry and regulatory level;

B. whereas the term 'crypto-assets' is used to refer to a wide variety of digital assets, including but not limited to virtual currencies and tokens;

C. whereas the two most common components of crypto-assets adopted are (i) the private nature of the asset, and (ii) the use of cryptography and distributed ledger technology (DLT) or similar technology to underpin exchanges of the asset;

D. whereas stablecoins exhibit similar features to crypto-assets and do not take the form of any specific currency, but rely on a set of tools which aim to minimise fluctuations of their price as denominated in a currency;

E. whereas a Central Bank Digital Currency (CBDC) is based on the concept of a stable asset, is sovereign in nature and therefore distinct to crypto-assets;

F. whereas possible initiatives for implementing CBDCs are under consideration, both within the Union and on a global level;

G. whereas digital finance has a strong cross-border element, which goes beyond the Union level and therefore international cooperation in this field is essential;

H. whereas, according to market data, at the beginning of 2020, over 5,100 crypto-assets exist globally, with a total market capitalisation exceeding USD 250 billion[2];

I. whereas experts of the European Central Bank (ECB) noted in their publication of 2019[3], that even though crypto-assets are highly speculative, they do not represent an immediate threat to financial stability;

J. whereas digital finance can contribute in a number of ways to tackling the economic effects of the COVID-19 outbreak as regards consequences for citizens, SMEs and other businesses and financial services;

K. whereas the financial sector is the largest user of information and communications technology (ICT) in the world, accounting for about a fifth of all ICT expenditure;

L. whereas the increased use of artificial intelligence in financial services will lead to a need for stronger operational resilience and the appropriate corresponding supervision;

M. whereas operational problems, particularly ICT and security risks, can generate systemic risks for the financial sector;

N. whereas the current EU rulebook for financial services takes a piecemeal approach to the issue of operational risk provisions;

O. whereas the ICT and security risks faced by the financial sector, and its level of integration at EU level, warrant specific and more advanced actions that build on but go beyond the NIS Directive;

P. whereas cyber resilience is an integral part of the work on the operational resilience of financial institutions carried out by authorities on a global level;

Recommendations:

General Considerations

1. Welcomes the commitment of the Commission to finalising an Action Plan on FinTech by Q3 of 2020; considers that a Commission proposal on crypto-assets, as well as a cross-sectoral financial services act on operational and cyber resilience, are timely and necessary due to recent developments in the markets; requests that the Commission submit on the basis of Article 114 respective proposal following the recommendations set out in the Annex hereto;

2. Considers that FinTech will be integral to the success of the Capital Markets Union

[2] https://www.europarl.europa.eu/RegData/etudes/STUD/2020/648779/IPOL_STU(2020)648779_EN.pdf
[3] https://www.ecb.europa.eu/pub/economic-bulletin/articles/2019/html/ecb.ebart201905_03~c83aeaa44c.en.html#toc4

(CMU) and encourages the Commission to consider how to harness the benefits of FinTech in driving forward capital market integration in the Union;

3. Highlights the importance for the Commission to closely align its work with international fora and regulatory bodies in developing international standards given the cross-jurisdictional nature of digital finance;

4. Calls on the Commission to deploy a proportionate, cross-sectorial and holistic approach to its work on FinTech;

5. Calls on the Commission to act as first mover in order to create a favourable environment for European FinTech hubs and firms to scale up;

6. Stresses that law and supervision in the area of FinTech should be based on the following principles:

   a. the same services and their associated similar risks should be subject to the same rules;

   b. technology neutrality;

   c. a risk-based approach;

7. Points out that Union level measures should not stifle opportunities for businesses to grow and develop within the Union;

8. Highlights the importance of the triangle of trust, identity and data in order to ensure that operators, consumers and supervisors are able to have confidence in digital finance;

Defining a Framework for Crypto-Assets

9. Considers that developing a pan-European taxonomy for crypto-assets is desirable as a step towards fostering a common understanding, facilitating collaboration across jurisdictions and providing greater regulatory certainty for market participants engaged in cross border activity; recommends taking into account the importance of international cooperation and global initiatives as regards frameworks for crypto-assets, bearing in mind in particular their borderless nature; cautions, however, that developing an open-ended taxonomy template may be more appropriate for this evolving market segment;

10. Believes, therefore, that any further categorisation should be balanced and flexible in order to give space for innovation in the sector while ensuring that risks can be identified at an early stage;

11. Further stresses that clear guidance on the applicable regulatory and prudential processes is needed in order to provide regulatory certainty regarding crypto-assets;

12. Points out that applying existing regulations to previously unregulated crypto-assets will be necessary, as will creating bespoke regulatory regimes for evolving crypto-asset activities, such as initial coin offerings;

13. Highlights that a common Union framework on crypto-assets should help increase

consumer and investor protection, enhance know your customer (KYC) obligations and oversight of the underlying technology;

A common approach to cyber resilience of the financial sector

14. Points out that with the increasing digitalisation of financial services, as well as outsourcing to external IT solution or maintenance providers, such as cloud providers, the exposure of financial institutions and markets to disruption caused by internal failures or external attacks is becoming more pronounced;

15. Calls on the Commission to propose legislative changes in the area of ICT and cyber security requirements for the Union financial sector in order to address any inconsistencies, gaps and loopholes that are found to exist in relevant law;

16. Considers that these changes should focus on four key areas:

    a. modernisation;

    b. alignment of reporting rules as regards ICT incidents;

    c. a common framework for penetration and operational resilience testing across all financial sectors;

    d. oversight of critical ICT third-party providers;

17. Stresses the need for further information sharing, in particular on incidents, and enhanced coordination between relevant regulatory and supervisory authorities;

Data

18. Recalls that the collection and analysis of data play a central role for FinTech, and therefore highlights the need for consistent, technology-neutral application of existing data laws;

19. Points out that the Union is the global standard setter as regards personal data protection; highlights that the transfer and use of personal and non-personal data in the financial services sector should meet all relevant standards while allowing for the flow of data needed to scale up innovative finance initiatives;

20. Requests, in this regard, that the Commission examines how to ensure that digital finance entities can access on an equitable basis relevant and useful data to help ensure that innovative FinTech businesses can grow within the Union and beyond;

21. Requests that the Commission consider a framework for digital onboarding and the use of digital financial identities, which would aim to harmonise these measures across the Union insofar as necessary;

22. Points out that customer data or "big data" is being increasingly used by financial institutions; recalls the provisions of Article 71 of the GDPR and calls on all stakeholders to increase efforts to guarantee the enforcement of the rights therein;

23. Believes that the lack of accessible data and information regarding FinTech activities can be a detriment to growth; advocates for increased transparency and enhanced reporting of FinTech activity so as to reduce asymmetries and risks;

24. Calls for effective oversight of 'big data' analytics in a way that addresses the opacity of models while ensuring that there is sufficient access to relevant and quality data;

25. Instructs its President to forward this resolution and the accompanying recommendations to the Commission and the Council, and to the parliaments and governments of the Member States.

ANNEX TO THE MOTION FOR A RESOLUTION: RECOMMENDATIONS AS TO THE CONTENT OF THE PROPOSAL REQUESTED

A. PRINCIPLES AND AIMS OF THE PROPOSAL

1. To set the groundwork for a future-oriented approach to rules concerning digital finance in the Union;

2. To ensure that digital finance can continue to be an innovative driver of growth and jobs across the single market;

3. To foster a common understanding of the key issues concerning digital finance and encourage the harmonisation of relevant provisions, which will lead to enhanced cross border activity;

4. To increase data sharing in accordance with Union principles in order to stimulate innovation. The aim should be to facilitate access to public data across the Union. This would not only benefit digital finance companies, but would also be to the benefit of a number of other Union policy areas and increase market transparency;

5. To consider three areas for initial action of the Union, specifically developing a framework for crypto-assets, developing a framework for cyber and operational resilience, and also to work to harmonise the concept of digital onboarding within the single market.

B. ACTION TO PROPOSE

1. To put forward a legislative proposal for Crypto-Assets, which provides legal certainty for the treatment of Crypto-Assets while ensuring consumer and investor protection. Such a framework should consider an open taxonomy and aim to legislate according to the principle of the same rules applying according to the same activity and risks;

2. To make a legislative proposal on cyber resilience, which ensures consistent standards of ICT security across the Union financial sector. Such a framework should be future-oriented and focus on modernising the current rules applicable concerning cyber resilience, while also closing any regulatory loopholes and gaps, which may put businesses, investors and consumers at risk;

3. To propose a framework for digital onboarding. Such a framework should comply with relevant Union legislation such as Anti-Money Laundering provisions and aim to ensure a common understanding of digital financial identities across the single market.

EXPLANATORY STATEMENT

Introduction

Digital finance, also known as FinTech, consists of the use of new technologies to enable and enhance the activities of the financial sector. Digital finance thus plays a key role in developing financial activities and increasing their prevalence, as its application has significant benefits, such as a general gain in efficiency, cost reductions, improved protections for consumers, data management and transparency. The potential innovations introduced by it can contribute to the automatisation of several processes, as well as many investment and administrative decisions, and have contributed to more efficient decision-making and traceability of operations, by improving the quality of the data available to market operators. The introduction of new technological instruments to the financial sector can also lead to more financial inclusion and to stronger cross-border financial flows through alternative lending and investment channels, if properly managed. Furthermore, in order to facilitate the Capital Markets Union (CMU) in Europe, digital finance will have a key role to play in terms of innovation and breaking down cross-border barriers so long as it remains an integral part of the broader CMU objectives. Bearing in mind particularly the current COVID outbreak and the associated growth of the use of digital means for consumers, investors and financial institutions to deal with finance, FinTech will continue to grow in both size and importance to the EU economy.

However, at the same time, the ongoing evolution of technology and the enlargement of its potential applications in other sectors is one of the biggest challenges both from an economic and regulatory perspective. The expansion of FinTech entails risks in fields like financial stability, financial crime and consumer protection.

Besides those regulatory challenges, the global market for FinTech will continue to expand, bringing the importance of international co-operation in this area to the forefront. The European Union will need to be able to respond in an agile manner to global developments in the marketplace. Furthermore, and even though the application of new technologies to financial activities presents massive opportunities for European financial actors, the European Union is at risk of lagging behind its global counterparts. There is fragmentation of regulatory regimes concerning digital finance, as well as a lack of venture capital and budgetary instruments for boosting growth of existing FinTech companies in Europe. This calls for the adoption of a number of legislative and non-legislative measures at European Level, aiming both to address the aforementioned challenges and to consolidate and expand the digital finance sector across the Union.

European financial entities and in particular FinTech require a comprehensive and stable regulatory framework to expand their activities and operate with legal certainty. Consequently, any proposal aiming to efficiently regulate the impact of technology on finance and its potential risks should primarily aim to develop a level playing field (combining appropriate oversight and equal treatment), while targeting its most significant financial stability risks. The Commission's proposals should be technology-neutral and apply the principle of legislating equally for similar activities, which present the same risk. Any legislative proposal should also take a risk-based approach and should lay the groundwork for financial entities and consumers to increasingly benefit from digital innovation, while providing for a level playing field.

Furthermore, the actions undertaken by regulators worldwide could be a good example for European legislators, as they show the different ways in which the authorities have aimed to address the risks emerging from the expansion of FinTech and the growing use of crypto-assets. Besides the measures adopted by third countries, international institutions like the Financial Stability Board, the Bank for International Settlements and the G7 Working Group on Stablecoins (among many others) have led efforts to build a smart regulatory approach to FinTech.

The core priorities of this report are to target the main areas that demand a pan-European regulatory response to digital finance. The report addresses 3 issues for consideration for legislative action: Crypto-assets, cyber resilience and Data. These areas are central to the future development of digital finance in Europe.

Defining a framework for crypto-assets

The appearance of different crypto-assets and the expansion of transactions involving them has raised debates on their potential impact for financial stability. Therefore, as the crypto-asset market, which currently constitutes 5100 crypto-assets with a market capitalisation of over $250bn globally[1], continues to grow, it is important that within Europe we are ready to seize the opportunities presented by them while ensuring that we do not risk financial stability. Furthermore, the potential risks for financial stability are increased by the lack of a comprehensive and coherent regulatory framework. This is the case in the European Union, where regulatory regimes are fragmented and generally outdated, and they thus do not efficiently assess the implications of the extension of the use of crypto-assets. Consequently, the Commission should put forward a proposal aiming to form a framework for crypto-assets that addresses their potential impact for financial markets, classifying them accordingly.

This draft report calls for the Commission to begin considering how to develop a taxonomy concerning crypto-assets, with a common definition the most appropriate starting point. Such a pan-European taxonomy for crypto-assets would enhance collaboration across different jurisdictions and provide market operators with legal certainty. Any taxonomy template should be open-ended, given that crypto-assets are likely to experience a significant period of evolution in the coming years. Besides defining crypto-assets, any regulatory initiative should primarily aim to target the most pressing risks emerging from the expansion in the use of crypto-assets, as well as ensuring that new risks can be identified at an early stage. The risks that emerge from increased exposure of the banking sector to crypto-asset holdings should also be appropriately addressed.

A level playing field is a pre-requisite to ensure that operations get the same regulatory treatment irrespective of the member state in which those operations take place. In addition, it is important to consider how to adapt current legislation to ensure that there are no gaps or loopholes concerning the use of crypto-assets.

In any case, in developing a definition and considering a future taxonomy for crypto-assets, we, as legislators, should acknowledge that crypto-assets are likely to evolve in the short run. Future innovation in the financial sector could enlarge the scope of this kind of asset, or even modify

[1] https://www.europarl.europa.eu/RegData/etudes/STUD/2020/648779/IPOL_STU(2020)648779_EN.pdf

their nature and possible uses, so it would be necessary for the regulators to develop a flexible regulatory approach to crypto-assets. Their evolution should not make the whole regulatory framework obsolete. It is thus necessary to ensure that there is regulatory certainty for crypto-assets from their moment of issuance.

It would be necessary to ensure, within the legislative framework, that investors and consumers are adequately protected when operating with or holding crypto-assets. In order to ensure adequate investor and consumer protection, KYC obligations and the oversight of the underlying technology should be adapted.

A common approach to cyber-resilience of the financial sector

As we come to rely more on technology in the financial sector, it is also important for businesses to strengthen cyber-resilience in order to safeguard against potential disruption caused by internal failures or external factors.

The Commission should therefore propose targeted measures to increase cyber security through addressing inconsistencies and shortcomings in existing legislation, which apply to the financial sector. It may be appropriate, therefore, to propose a framework that applies primarily to the financial sector. This framework should aim to modernise and harmonise current rules while focusing on concerns related to the financial sector.

In addition, the rapid evolution of information and communications technology (ICT) has made it necessary to address the inconsistencies and shortcomings in the existing regulatory framework revealed by its application. Consequently, any legislative change in the field of ICT should be focused on modernising it; aligning reporting rules in the light of previous incidents; strengthening the oversight of critical ICT third party providers; and developing a common framework for penetration and operational resilience testing across all financial sectors.

This report calls on the Commission to address these concerns, while encouraging additional coordination between national and European regulatory and supervisory authorities.

Data

Data driven innovation is a key driver of growth and jobs in Europe and across the world. In order for the EU to benefit from this growth, it is important that the right data policies are in place for each sector, enabling trust from the consumer side through current frameworks such as GDPR while at the same time allowing for businesses in the financial sector to benefit from data-sharing across the single market.

Therefore, within the digital finance sector it is important that we put in place the right measures, which can help drive growth and ensure access to finance for a broad range of entities, from micro-enterprises and SMEs through to large businesses. Data sharing, in this context, would help to ensure that European businesses are able to innovate and expand both within the Union and beyond. The right policies will ensure that asymmetries and risks are reduced in parallel, while the lack of good quality and accessible data could hinder the expansion of European companies.

Consequently, data treatment is a key part of FinTech, making it necessary to include consistent, technology-neutral measures aiming to ensure an adequate treatment of data in the financial sector.

Furthermore, the EU's traditional role as a global standard setter regarding data calls for an ambitious regulatory approach to data management by financial entities, where consumer protection is a priority for legislators, given that consumer data that is now particularly useful given incipient technological instruments that allow for its analysis (the so-called "big data") is already being used by financial institutions. An enhanced oversight of such usage is necessary, particularly if it is framed in a way that targets the opacity of models while guaranteeing fair access to relevant data by financial actors.

Lastly, the reports calls on the Commission to study the possibility of introducing a framework for digital on-boarding, as well as for the use of digital financial identities which takes account also of current national measures, as such a framework would facilitate financial inclusion and cross-border supply of financial services within the single market.