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Fintech: trends of development and regulatory policy

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The paper analyses the development and present state of FinTech in Ukraine and in the European Union (the EU), its trends and prospective. It was studied the legal regulation of FinTech in Ukraine, defined the latest regulatory initiatives and made a comparison of such initiatives with the regulation of the EU. During the performance of the research, it was evidenced that due to the novelty of the topic there are not many scientific works on this matter. Moreover, practical development of the FinTech industry to some extent outruns its regulation in Ukraine and even in the EU. Therefore, FinTech service providers must fit within the regulation developed before the rise of the industry. It should be mentioned, that the core EU's FinTech regulatory acts such as Payment Services Directive 2, General Data Protection Regulation, Regulation on

Electronic Identification and Trust Services for Electronic Transactions in the Internal Market are capable to regulate and sustain proper functioning of the FinTech market within the EU. Ukrainian legislation, regulating the FinTech is not well developed compared to the EU. Since the beginning of the European integration process, the Ukrainian authorities are trying to implement the main regulatory concepts of EU to the national legislation and the FinTech area is not an exception. For instance, in 2017 the Ukrainian Parliament adopted the law “On Electronic Trust Services”, this law basically corresponds with the EU Regulation on electronic identification and trust services for electronic transactions in the internal market. Another good example is a registration in the Parliament of the draft law “On Amendments to the Regulation of Transfer of Funds”, which is based on the EU Directive on Payment Services in the Internal Market 2.

It was established that the EU’s and Ukraine’s regulatory authorities and other participants of the market facilitate the development of FinTech by means of regulatory and advisory initiatives. In addition, considerable input is made by NGOs working in the area of technology and FinTech. It was concluded that Ukraine has partially implemented the European regulatory standards into the national legislation and continues harmonisation of the respective national law.

It was recognized that a subsequent harmonisation of the laws and implementation of the valuable European practical experience would play a significant role in the formation and the rapid development of FinTech in Ukraine.

Фінтех: тренди розвитку та регуляторна політика

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Ключові слова:

фінтех, ЄС, фінансові послуги, гармонізація законодавства, електронні фінансові послуги, захист персональних даних.

У статті досліджено процес розвитку й сучасний стан фінтех індустрії в Україні та Європейському Союзі (далі – ЄС), окреслено основні тенденції й перспективи розвитку. Досліджено відповідні законодавчі акти України та ЄС, виявлено низку особливостей законопроектів та ініціатив у сфері цифровізації й фінтех. Зокрема, проаналізовано такі законодавчі ініціативи в сфері фінтех, як Закон України «Про електронні довірчі послуги», Проект Закону України про внесення змін до деяких законодавчих актів України щодо регулювання переказу коштів тощо. Представлено характеристику діяльності державних органів влади, які беруть активну участь у регулюванні сфери фінтех шляхом як законотворчої діяльності, так і запровадження ініціатив щодо програм розвитку фінансового сектору, зокрема Комплексної програми розвитку фінансового сектору України до 2020 року від Національного банку України, Концепції розвитку цифрової економіки та суспільства України на 2018–2020 роки та плану її реалізації, затверджену Кабінетом Міністрів України.

Виконано порівняння з основними законодавчими актами ЄС у сфері фінтех та ініціативами розвитку за цим напрямом. Серед законодавчих актів можна виокремити Регламент ЄС про

електрону ідентифікацію та довірчі послуги для електронних транзакцій у межах внутрішнього ринку (eIDAS), Директиву ЄС про платіжні системи (PSD2), Регламент ЄС про захист персональних даних (GDPR). Також варто зазначити План дій, представлений Єврокомісією на початку 2018 року, і деякі передбачені ним ініціативи.

На основі аналізу виявлено потенційно прийнятні для України ініціативи, які можуть бути впроваджені вже в найближчий термін. Зростання регулювання поряд зі стрімким упровадженням інноваційних технологій є важливим підґрунтям для ефективного функціонування ринку фінансових послуг, використовуючи можливості фінтех. Доведено, що державні органи й інші учасники ринку сприяють активному розвитку фінтех індустрії законодавчими та іншими ініціативами рекомендаційного характеру.

Зроблено висновок, що нині основні підходи до регулювання електронних фінансових послуг у ЄС є частково імплементованими в національне законодавство, а запропоновані державними установами програми розвитку перебувають у процесі виконання.

Установлено доцільність подальшої поступової гармонізації законодавства України із законодавством ЄС, що створить базис для здійснення якісних змін у сфері фінтех.

In the beginning, it is necessary to determine a definition of the FinTech. As of the date, there is no consensus about what the term FinTech means. Basically, the term FinTech is a short form of financial technology. This phrase could be used to describe many concepts. Some of the authors use the definition of the FinTech to describe an industry, for example, Wharton Fintech Club provides suggest the following: “FinTech is an economic industry composed by the companies that use technology to make financial services more efficient” [13]. The Oxford English Dictionary provides with the product-based definition: “Computer programs and other technology used to support or enable banking and financial services” [14]. Patrick Schueffel, in his research dedicated to the definition of the FinTech concluded that the most commonly used definition of the Fintech is as follows: “Fintech is a new financial industry that applies technology to improve financial activities” [15]. The author of this article agrees with the “industry approach” in defining the FinTech, however, proposes a slightly amended version: “FinTech is a financial industry, which applies technology-

based products to improve quality of the financial services”.

Digital technology-based innovations in financial services (the FinTech) is developing in at a fast cruising pace. This emerging market provides customers with a wide range of innovative solutions and traditional financial services with increased usability. At the same time FinTech contains numerous risks and challenges financial stability. Therefore, policymakers, regulators, supervisors should consider an adequate regulatory response to the disruptive technologies [1, p. 58]. As at the date, the Ukrainian FinTech regulation requires more liberal and agile approach, therefore, performance of a deregulation and implementation of the new concepts is an essential measure. The prospective transformation raises a problem of the proper implementation of such new concepts. On the one side the most efficient approach is to implement legislation of the EU, on the other side, the regulators should take into account peculiarities of the existing legal system in Ukraine and consider appropriate harmonization.

There are not many scientific works dedicated to the topic, due to its novelty, the main sources of information are: the primary legislation, FinTech articles and guides, researches of non-governmental organisations and of regulatory authorities. Among other works, the author would like to mention the catalogue FinTech in Ukraine prepared by the USAID together with the innovative park UNITCity and the FinTech Guide 2018 prepared by the non-governmental organization Toplead.

FinTech services providers to a certain extent must fit within the regulation existed before acceleration of the industry. The regulatory approach depends upon the FinTech company organisation structure, the nature of its product and service. For example, the FinTech company and its activity could be subject to EU regulations or a member state's national law, or to be subject to any financial services' specific regulation.

The potential of the FinTech is not underestimated by regulatory authorities of the EU. Since early beginning policymakers began to analyse FinTech, its impact on the EU's economy, traditional financial markets and consumers of financial services. As a result of such examination, regulatory authorities started to amend already existing and implement new regulations and guidance for FinTech providers [2].

Influenced by the development of the FinTech, Europe's core financial regulatory and supervisory frameworks such as the Payment Services Directive and the Regulation on Markets in Financial Instruments were revised [3].

The General Data Protection Regulation (the GDPR), which has entered into force in May 2018, require from providers of services (including financial) to remodel their current approach to the privacy of data while processing, storing and using the client's information [4].

Recent initiatives provided to the EU regulators, emphasized on consideration of FinTech while amending old and adopting new regulations. At some point a complexity

of the regulation or its absence, a lack of supporting environment and infrastructure have a negative impact on the existing demand of the FinTech market.

As a response to these calls, the European Commission launched a future-oriented regulatory framework development program, which embracing trends of digitalisation and provides conditions for FinTech companies to scale-up its products from national to the EU level without damaging the EU's financial stability, consumer and investor protection.

In March 2018, the European Commission adopted the FinTech action plan aiming to make the European financial sector more innovative and competitive (the "Action Plan"). The Action Plan sets out 19 steps [5], namely:

- to increase the uptake of blockchain, artificial intelligence, cloud services and other innovative technologies in the financial sector;
- to enable Fintech business models to scale-up at the EU level;
- to increase security, cybersecurity and the integrity of the financial system;
- to set up the EU FinTech Laboratory (the non-commercial platform for cooperation between the EU, the EU member-states authorities and Fintech companies);
- to promote the EU Blockchain Observatory and Forum, which is already working on a strategy on distributed ledger technology and blockchain addressing all sectors of the economy and on analysis of the crypto industry;
- to consult the companies listed in Europe on the matter of digitisation of published information in order to interconnect national databases;
- to set up the workshops on cybersecurity;
- to present a blueprint with best practices for regulatory sandboxes (framework that allows innovators to conduct live experiments in a controlled environment, under a regulator's supervision) [6].

The mentioned above initiatives are focused on the increase of regulation toward technological innovations and prepare financial market of the EU to grasp the opportunities brought by new technologies.

To our view, some of the listed initiatives are very promising. Particularly, the author would like to admit the following:

- the EU Blockchain Observatory and Forum (the “Observatory”). This newly established organisation will help the EU to rescue new opportunities offered by blockchain, build expertise and facilitate leadership in this area. Among others, the Observatory will analyse actual trends, monitor and gather information, which explores the potential of blockchain technology. In addition, the Observatory will serve as a hub for regulators, public authorities, blockchain specialists and FinTech business representatives [7];

- the EU FinTech Laboratory. Development of the EU FinTech laboratory was one of the key objectives of the Action Plan. This institution is aimed at increase of the level of regulatory and supervisory capacity and knowledge about new technologies. The EU FinTech laboratory is a great training opportunity for representatives of the FinTech industry and regulators to address regulatory and supervisory concerns and to explain the technologies. It should be noted, that the European Commission, the European Supervisory Authorities and the European Central Bank will participate in the meetings. The first meeting focused on outsourcing to cloud in the banking and insurance sectors was held on 20 June 2018. [8] The second meeting of the EU FinTech Laboratory dated 19 November 2018 was dedicated to artificial intelligence [16];

- best practices for regulatory sandboxes. Within the framework of the Action Plan, 13 EU member states established “FinTech facilitators” (regulatory sandboxes) to provide general guidance to firms which are at initial stages of their existence. The “FinTech facilitators” create advantageous conditions for such firms, allowing them to access the market and

understand the rules quicker. From the regulator’s perspective, such initiative is an important source of information, helping the market players to have a better understanding of the FinTech business and the respective regulation. According to the European Commission, best practices will be implemented to the “best practice guide on regulatory sandboxes”.

The recent steps made by the EU show its intent to become a global FinTech hub, enabling the EU business and investors to use the opportunities granted by the “single market” of the European Union [9; 8].

Generally, Ukraine shows a positive trend, the government actively participate in the formation of the FinTech industry in Ukraine, gradually amending the national legislation based on the EU experience.

After execution of the Ukraine-EU Association Agreement (the “Association Agreement”) in September 2017 [9], Ukraine experienced significant transformation. The concept of the economic and legislative reforms, among others, included revision of the financial services regulation approach.

In 2017, the Ukrainian Parliament adopted the law “On Electronic Trust Services” [11], which mainly corresponds with the EU Regulation on electronic identification and trust services for electronic transactions in the internal market, also known as the eIDAS. Also, later this year, the Parliament registered the draft law “On Amendments to the Regulation of Transfer of Funds”, which is written on the basis of the EU Directive on Payment Services in the Internal Market (also known as PSD 2).

The Ukrainian government is trying to facilitate the evolution of FinTech by means of creation of concepts and development programs. Namely, in June 2017, the National Bank of Ukraine (the “NBU”) approved “The Complex Programme for Development of the Financial Sector of Ukraine until 2020” (the “Development Programme”), which envisages:

- introduction of amendments to the legislation regulating financial services;
- increase in the share of international financial service providers operating in the local market;
- improvement of the regulation of non-banking financial services providers' activity;
- implementation of the bank ID system for remote identification of clients;
- introduction of the new licensing policy;
- introduction of the e-documents and digital storage of documents;
- increase in the share of online financial services;
- introduction of the non-cash economy;
- implementation of the ISO20022 standard;
- increase of security of financial services;
- increase of financial awareness of Ukrainian population; and
- protection of the customers [11].

In 2018, the Cabinet of Ministers of Ukraine approved the “Concept for the Development of the Digital Economy and Society of Ukraine for 2018–2020” (the “Concept”). The Concept stipulates digitalization in Ukraine, an introduction of the digital economy and further harmonisation of the national legislation with the respective EU regulations.

One of the most recent achievements is an introduction by the NBU of the mentioned above bank ID. In early October, the NBU issued Regulation No. 105, which amends certain NBU's regulations in the way, allowing to use the bank ID system as an instrument of identification for the provision of banking, financial and other administrative services to individuals. It should be mentioned, that the bank ID system can be applied not only by banks but also by non-banking institutions connected to the system. According to the NBU, the new

instrument should significantly increase usage of the banking and other services requiring identification of the individuals [12].

It seems that the latest FinTech regulatory initiatives will set up a basis for future developments. As compared Ukrainian, the EU initiatives have a more practical approach and concentrate on solving business issues.

Progressive European FinTech market and its regulation are evolving rapidly and providing Ukraine with an opportunity to learn. The gradual implementation of the EU legal framework has had a positive effect on the Ukrainian FinTech market.

Considering the novelty of innovative technologies, decisions and regulation adopted at early stages may set important precedents and consequences. Ukrainian government should continue to assess the adequacy of legislative regulation of FinTech, with the objective of embracing the benefits while mitigating risks.

To our view, among other factors, enhancement of the regulation in the EU is stimulated by pressure made by representatives of the FinTech business. The EU market has a strong demand and proposal for innovative solutions, which driving the government to be more agile in its activity. Meanwhile, the participants of less wealth and mature Ukrainian market are unable to create such pressure. Nevertheless, considering the growing interest and initiatives in FinTech area the situation may change in a short period of time.

As at the date, Ukraine has identified achievable goals and priorities of development for the next two years. The author believes, that implementation of the FinTech labs, tight coordination of the government with the representatives of the business, and the establishment of regulatory sandboxes in Ukraine will be the next step after adoption the EU framework regulation into the national legislation.

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