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DANMARK

Response to the Basel Committees Sound Practices: Implication of fintech developments for banks and bank su- pervisors

We hereby submit our response to your "Sound Practices: Implication of fintech developments for banks and bank supervisors"

The Basel Committee's consultation consists of 10 observations with 10 corresponding recommendations. This document presents the 10 observations and recommendations, as well as Finance Denmark's response to the 10 recommendations.

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General remarks

In the consultation, the Basel Committee mentions the need for a common definition of the fintech concept and states that such a definition of fintech can affect the regulatory approach. This view is fully supported by Finance Denmark.

We support the fintech definition that the Basel Committee has chosen to use: *"technologically enabled financial innovation that could result in new business models, applications, processes, or products with an associated material effect on financial markets and institutions and the provision of financial services"*

All banks and mortgage banks are in our view to be classified as fintech companies. Today they base their business on digital technologies and systems which are one of the fundamental building blocks of fintech. The difference between established fintech companies (banks and mortgage banks) and fintech start-ups are their approach to innovation and business development. This difference is among others shaped by cultural differences and the amount of legacy in their digital system setup. In order to gain access to the new opportunities provided by new technology and innovation, many established fintech companies (banks and mortgage banks) have started to collaborate with fintech start-ups or disrupt themselves from within by establishing start-ups hub or garage projects. To succeed in the future established fintech companies as well as fintech start-ups must be able to change and adapt their business model in order to handle the "material effect" that "technologically enabled financial innovations" is expected to have.

We suggest that the Basel Committee sees it as one of its goals to ensure, that both financial and non-financial regulators adapt a similar fintech definition.

Based on this definition of fintech, there is no substantial difference between small fintech start-ups and established banks or mortgages banks. When addressing fintech or any other tech ex. regtech or insurtech it is important to focus on the actual activities. Therefore it is our opinion that, the regulation regardless of size or age should be centred around on the following 4 guiding principles, which in our view will constitute a level playing field:

- Regulate the activity not the company (with particular focus on consumer protection)
- Technology neutral regulation
- Risk-based approach
- No special national rules (avoid regulatory arbitrage)

In order to achieve a level playing field it is important, that all regulators; financial and non-financial; are focused on the potential regulatory gap, that may occur with regard to non-bank fintechs. Cooperation between financial and non-financial regulators is an important issue that must be addressed.

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Observation 1

The nature and the scope of banking risks as traditionally understood may significantly change over time with the growing adoption of fintech, in the form of both new technologies and business models. While these changes may result in new risks, they can also open up new opportunities for consumers, banks, the banking system and bank supervisors.

Recommendation 1

Banks and bank supervisors should consider how they balance ensuring the safety and soundness of the banking system with minimising the risk of inadvertently inhibiting beneficial innovation in the financial sector. Such a balanced approach would promote the safety and soundness of banks, financial stability, consumer protection and compliance with applicable laws and regulations, including anti-money laundering and countering financing of terrorism (AML/CFT) regulations, without unnecessarily hampering beneficial innovations in financial services, including those aimed at financial inclusion.

Finance Denmark's comment on observation and recommendation 1

We agree with observation 1 and the corresponding recommendation. It is however crucial that the supervisory authorities ensure the right balance = a level playing field. If supervisors are to ensure this balance and level playing field we recommend that this is done on the basis of our 4 guiding principle, which we have mentioned in our general remarks above.

It is possible that some of these new entrants with a specialised focus will experience high growth rates and fast becomes systemically important within their specialised area of business. It is important that such companies are being subjected to the same kind of regulation and supervision with respect to both capital requirements and consumer protection as any other systemically important financial company.



Observation 2

For banks, the key risks associated with the emergence of fintech include strategic risk, operational risk, cyber-risk and compliance risk. These risks were identified for both incumbent banks and new fintech entrants into the financial industry.

Recommendation 2

Banks should ensure that they have effective governance structures and risk management processes in order to identify, manage and monitor risks associated with the use of enabling technologies and the emergence of new business models and entrants into the banking system brought about by fintech developments. These structures and processes should include:

- Robust strategic and business planning processes that allow banks to adapt revenue and profitability plans in view of the potential impact of new technologies and market entrants;
- Sound new product approval and change management processes to appropriately address changes not only in technology, but also in business processes;
- Implementation of the Basel Committee's Principles for sound management of operational risk (PSMOR) with due consideration to fintech developments; and
- Monitoring and reviewing of compliance with applicable regulatory requirements, including those related to consumer protection, data protection and AML/CFT when introducing new products, services or channels.

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Finance Denmark's comment on observation and recommendation 2

We agree with the observation 2 and the corresponding recommendation.

However, we do not consider recommendation 2 specifically aimed at the emergence of new innovative fintech start-ups or the implementation of new technology or business models with established players. These requirements are universal requirements that all professional companies who deliver financial products and services must adhere to. It is essential that the supervisory authorities have this understanding in order to ensure the right balance = level playing field and to ensure that the application of new innovation and new technology within the financial sector is not unnecessarily hindered.

Observation 3

Banks, service providers and fintech firms are increasingly adopting and leveraging advanced technologies to deliver innovative financial products and services. These enabling technologies, such as artificial intelligence (AI)/machine learning (ML)/advanced data analytics, distributed ledger technology (DLT), cloud computing and application programming interfaces (APIs), present opportunities, but also pose their own inherent risks.

Recommendation 3

Banks should ensure they have effective IT and other risk management processes that address the risks of the new technologies and implement the effective control environments needed to properly support key innovations.

Finance Denmark's comment on observation and recommendation 3

We agree with the observation 3 and the corresponding recommendation. We refer to our response to recommendation 2.

Observation 4



Banks are increasingly partnering with and/or outsourcing operational support for technology-based financial services to third-party service providers, including fintech firms, causing the delivery of financial services to become more modular and commoditised. While these partnerships can arise for a multitude of reasons, outsourcing typically occurs for reasons of cost-reduction, operational flexibility and/or increased security and operational resilience. While operations can be outsourced, the associated risks and liabilities for those operations and delivery of the financial services remain with the banks.

Recommendation 4

Banks should ensure they have appropriate processes for due diligence, risk management and ongoing monitoring of any operation outsourced to a third party, including fintech firms. Contracts should outline the responsibilities of each party, agreed service levels and audit rights. Banks should maintain controls for outsourced services to the same standard as the operations conducted within the bank itself.

Finance Denmark's comment on observation and recommendation 4

We agree with the observation 4 and the corresponding recommendation. We refer to our response to recommendation 2.

Observation 5

Fintech developments are expected to raise issues that go beyond the scope of prudential supervision, as other public policy objectives may also be at stake, such as safeguarding data privacy, data and IT security, consumer protection, fostering competition and compliance with AML/CFT.

Recommendation 5

Bank supervisors should cooperate with other public authorities responsible for oversight of regulatory functions related to fintech, such as conduct authorities, data protection authorities, competition authorities and financial intelligence units, with the objective of, where appropriate, developing standards and regulatory oversight of the provision of banking services, whether or not the service is provided by a bank or fintech firms.

Finance Denmark's comment on observation and recommendation 5

We agree with the observation 5 and the corresponding recommendation. It is crucial that the various regulators have an interdisciplinary understanding of the market and providers of financial services. It is essential that there is established cooperation across the different regulatory authorities. This will require the authorities to have a common understanding of the fintech concepts and a common understanding of the technologies that are instrumental in the production and provision of financial services. Here we refer to our general comment in the introduction on a common definition of the fintech concept and our 4 guiding principle.

There is a potential blind spot, with respect to legally non-regulated fintech companies, that we believe needs to be addressed. We encourage the Basel Committee to promote cooperation between relevant supervisors in order to handle this issue.

Observation 6



While many fintech firms and their products – in particular, businesses focused on lending and investing activities – are currently focused at the national or regional level, some fintech firms already operate in multiple jurisdictions, especially in the payments and cross-border remittance businesses. The potential for these firms to expand their cross-border operations is high, especially in the area of wholesale payments.

Recommendation 6

Given the current and potential global growth of fintech companies, international cooperation between supervisors is essential. Supervisors should coordinate supervisory activities for cross-border fintech operations, where appropriate.

Finance Denmark's comment on observation and recommendation 6

We agree with the observation 6 and the corresponding recommendation. It is crucial not to create opportunity for regulatory arbitrage and to avoid special national regulations, including that supervisors and regulators across different jurisdictions have the same understanding of the fintech concept. Please see our remarks under general remarks at above regarding our proposed definition of fintech and our 4 guiding principles.

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Observation 7

Fintech has the potential to change traditional banking business models, structures and operations. As the delivery of financial services becomes increasingly technology-driven, reassessment of current supervision models in response to these changes could help bank supervisors adapt to fintech-related developments and ensure continued effective oversight and supervision of the banking system.

Recommendation 7

Bank supervisors should assess their current staffing and training models to ensure that the knowledge, skills and tools of their staff remain relevant and effective in supervising new technologies and innovative business models. Supervisors should also consider whether additional specialised skills are needed to complement existing expertise.

Finance Denmark's comment on observation and recommendation 7

We generally agree with observation 7 and the corresponding recommendation. Fintech has set in motion new and powerful dynamics, which will change the financial sector as a whole and bank supervisors must react and changes themselves according to the new powerful dynamics of fintech. In addition, we believe that this recommendation is not only appropriate with regard to banking-supervisors, but to all supervisory authorities that come into contact with fintech companies.

Observation 8

The same technologies that offer efficiencies and opportunities for fintech firms and banks, such as AI/ML/advanced data analytics, DLT, cloud computing and APIs, may also improve supervisory efficiency and effectiveness.

Recommendation 8

Supervisors should consider investigating and exploring the potential of new technologies to improve their methods and processes. Information on policies and practices should be shared among supervisors.

Finance Denmark's comment on observation and recommendation 8



We agree with the observation 8 and the corresponding recommendation.

Today banks and mortgage institution devote large amount of time and resources to understand and apply regulation. Today compliance has become a strong cost driver. Sharing policy implementation and practices, among supervisors and with the industry as a whole will help reduce and limit the upward trend in compliances costs. Sharing policy implementation and practices will also and equally important prevent gaps, uncertainty and risks regarding customer protection and mitigate regulatory arbitrage.

Observation 9

Current bank regulatory, supervisory and licensing frameworks generally predate the technologies and new business models of fintech firms. This may create the risk of unintended regulatory gaps when new business models move critical banking activities outside regulated environments or, conversely, result in unintended barriers to entry for new business models and entrants.

Recommendation 9

Supervisors should review their current regulatory, supervisory and licensing frameworks in light of new and evolving risks arising from innovative products and business models. Within applicable statutory authorities and jurisdictions, supervisors should consider whether these frameworks are sufficiently proportionate and adaptive to appropriately balance ensuring safety and soundness and consumer protection expectations with mitigating the risk of inadvertently raising barriers to entry for new firms or new business models.

Finance Denmark's comment on observation and recommendation 9

We agree with observation 9 and the corresponding recommendation. It is essential that regulators also focus on gaps in regulation in relation to companies in other industries, including fintech companies who legally operate without supervision. It is likely that gaps between different regulatory regimes either across national borders or between different national supervisors may create unintended differences (easing or tightening) that will ultimately reduce competition and consumer protection.

At present special Danish financial regulation makes the use and implementation of cloud based solution difficult.

It is our belief that a licensing framework for cloud services would be of substantial benefit, as a means for securing compliance and reducing costs.

Observation 10

The common aim of jurisdictions is to strike the right balance between safeguarding financial stability and consumer protection while leaving room for innovation. Some agencies have put in place approaches to improve interaction with innovative financial players and to facilitate innovative technologies and business models in financial services (eg innovation hubs, accelerators, regulatory sandboxes and other forms of interaction) with distinct differences.

Recommendation 10

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Supervisors should learn from each other's approaches and practices, and consider whether it would be appropriate to implement similar approaches or practices.

Finance Denmark's comment on observation and recommendation 10

We agree with the observation 10 and the corresponding recommendation.

However, we believe that recommendation should be further strengthened so that supervisors are obliged to learn from each other and obliged to ensure coordinated practice. This is crucial in order to avoid the possibility of regulatory arbitrage across Europe.

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