Regulating fintech financing: digital banks and fintech platforms[1]

Executive summary

This paper explores how fintech financing is regulated. New technology-enabled business models related to deposit-taking, credit intermediation and capital-raising have emerged. These are digital banking, fintech balance sheet lending and crowdfunding platforms (the latter two are referred to as fintech platform financing). In this paper, we provide a cross-country overview of the regulatory requirements for these fintech activities in 30 jurisdictions. The paper is based on an extensive desktop review of regulations and related documents, complemented by responses to an FSI survey conducted in early 2019.[2]

The proliferation of new technology-enabled business models has raised questions about the regulatory perimeter. Authorities are assessing whether their existing regulatory framework needs to be adjusted. Their response will likely depend on (i) how they see potential risks to consumers and investors, financial stability and market integrity; (ii) their assessment of how these new activities might benefit society in terms of strengthening financial development, inclusion and efficiency; and (iii) how risks are dealt with under the existing framework and whether opportunities for regulatory arbitrage have emerged. The overall challenge for authorities is to maximise the benefits of fintech innovations while mitigating potential risks for the financial system.

For digital banking, most jurisdictions apply existing banking laws and regulations to banks within their remit, regardless of the technology they apply. From these jurisdictions, a few have put in place initiatives that are intended to ensure that new banks find it easier to enter the market by allowing them time to complete their build-out or to meet the requirements of the prudential framework in full.

In the few jurisdictions that have set specific regulatory frameworks for digital banks, the main licencing and ongoing requirements are similar to those for traditional banks. Applicants for a digital bank licence face requirements on the place of incorporation and legal form, sustainability of business plan, minimum paid-up capital, fitness and propriety of management, risk governance frameworks and documentation of the exit strategy. They also face requirements on ownership and control, although these may be different to those applicable to other banks. After obtaining a digital bank licence, licence holders are subject to the same ongoing requirements as traditional banks on capital, leverage, liquidity, anti-money laundering/combating the financing of terrorism (AML/CFT), market conduct, data protection and cyber security.

The main difference between licensing requirements for traditional and digital banks is in technology-related elements and the aims of the business plan. Digital banks face restrictions on their physical presence and, in some cases, the market segments they are allowed to serve. Their fit and proper

[1] By Johannes Ehrentraud (Johannes.Ehrentraud@bis.org) and Denise Garcia Ocampo (Denise.GarciaOcampo@bis.org), Bank for International Settlements and Camila Quevedo Vega (caquevedo@superfinanciera.gov.co), Financial Superintendence of Colombia.

The authors are grateful to the contacts at the central banks and financial authorities from the jurisdictions covered in this paper; to Sharmista Appaya, Juan Carlos Crisanto, John Cunningham, Jon Frost, Kinga Huzarski, Fabiana Melo, Jermy Prenio, Nobu Sugimoto and Greg Sutton for their helpful comments; to Mathilde Janfils for valuable research assistance, and to Martin Hood, Esther Künzi and Christina Paavola for their helpful support with this paper. The views expressed in this paper are those of the authors and not necessarily those of the BIS, the Basel-based standard setters or the covered jurisdictions listed in Annex Table 1.

[2] The survey covered most of the jurisdictions covered in this paper, except Chinese Taipei, Finland, India, Korea, Malaysia and Portugal.

requirements tend to be more prescriptive in relation to board members' expertise in technology; a satisfactory track record in operating a technology business; and assessments of technical infrastructure by independent third-party technical experts. In addition, some jurisdictions require digital banks to demonstrate a commitment in driving financial inclusion, particularly for underserved and hard-to-reach market segments.

Most surveyed jurisdictions have no specific regulatory framework for fintech balance sheet (FBS) lending. In these jurisdictions, FBS lending is subject to regulations for non-bank lending. Requirements on the extension of credit, however, vary considerably across countries and the responsibility for supervising this activity does not necessarily lie with the financial authority. Brazil is the only surveyed jurisdiction that has introduced a specific licensing framework for FBS lending.

Many surveyed jurisdictions have introduced crowdfunding (CF) regulations. The regulatory setup, however, varies across jurisdictions and is influenced by a jurisdiction's overall supervisory architecture, as well as the differences in risks that loan and equity CF entail. Separate frameworks were most often implemented for equity CF. In these cases, a third of surveyed jurisdictions have a specific framework exclusively for equity CF. This is twice the number of jurisdictions that have frameworks for loan CF. For multi-type frameworks, about half of surveyed jurisdictions have an exclusive regulatory framework for loan and equity CF. In jurisdictions without a dedicated regulatory framework for crowdfunding, it is subject to existing banking, securities and payments regulations.

Dedicated regulatory CF frameworks typically have two broad sets of requirements, where the first set is intended to regulate how platforms may operate, which activities they can perform and what they must do to mitigate the risks they incur. In most surveyed jurisdictions, equity or loan CF platforms must be authorised before they can offer services. In terms of requirements, most surveyed jurisdictions require CF providers to operate under a specific legal form and have a minimum amount of paid-in capital. Even though they are allowed to broker multiple financial instruments, in most jurisdictions restrictions limit the ability of crowdfunding providers to invest in the financial instruments they intermediate. In most jurisdictions, crowdfunding platforms are subject to capital, business continuity and operational resilience and AML/CFT requirements.

The second set of requirements is intended to protect investors and make them aware of potential risks by disclosing relevant information. Most loan and equity CF frameworks have requirements as to how information should be provided; on conducting due diligence checks on borrowers and/or issuers; and on procedures for selecting potential borrowers or projects and publishing related information. Apart from requirements related to disclosure and due diligence, there may be several other restrictions to protect investors. Commonly used investor protection tools include restrictions on the holding of clients' funds, operating secondary markets or caps on investments or funds raised.