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The International FinTech Review 2023/24

Contents

Foreword:
Dr. Marc Roberts - General Counsel at Raisen and Co-President of the EFA
Intro to the International FinTech Review 3-4

Mr Matthias Bauer-Langgartner - Senior Financial Services Expert at European Central Bank (ECB)
Regulation will further boost Fintech in 2024 5-6

China – Fangda Partners:
Mr Zhiyi Ren & Mr Blake Wang
FinTech Regulation in China........ 7-14

Ireland – A&L Goodbody:
Mr Patrick Brandt & Ms Louise Hogan & Ms Sinéad Gleeson
Key developments and latest trends in fintech – an Irish legal perspective 15-24

Ireland – KPMG:
Mr Ian Nelson & Ms Noleen Scullion & Mr Tony Smith
Why the incoming PSD3 / PSR and SEPA Instant legislation levels the playing field for Irish and European Payments and improves Open Banking and Consumer Protection........ 25-34

Italy – KPMG:
Mr Silvano Lenoci
Current State and Outlook of the Italian Fintech Landscape 35-43

Italy – Paradigma – Law & Strategy:
Mr Massimo Donna & Ms Chiara Bianchi & Ms Giorgia Bevilacqua
Italian FinTech Evolution: Investments, Regulations, and Future Trends 44-51

Japan – EY:
Mr Tomotaka Hirabayashi
Emerging Trends in the Japanese FinTech Market 52-58

Mexico – Instrag:
Ms Lizette Neme & Mr Eduardo Valdez
Financial Innovation Group: A multidisciplinary approach to advance FinTech in Mexico 59-65

Philippines – Divina Law:
Mr Enrique Dela Cruz Jr & Mr Jay-r C. Ipac & Mr Terence Mark Arthur S. Ferrer
Navigating Fintech Regulations in the Philippines:
A Comprehensive Overview of Frameworks and Licenses 66-74

South Africa – Mazars:
Mr Wiehann Olivier & Ms Mia Pieterse
Africa: A Hub of Fintech Innovation........ 75-84

Switzerland – Prager Dreifuss:
Dr Christian Schönfeld
Fintech Developments in Switzerland........ 85-90

UAE – Karm:
Ms Akshata Namjoshi & Mr Ratul Roshan & Mr Kabir Hastir Kumar
International FinTech Review- UAE 91-99

UK – Moore Kingston Smith:
Mr Tom Moore
Navigating the Winds of Change: The UK Fintech Market in 2024........ 100-104

FOREWORD
Intro to the International FinTech Review

DR. MARC ROBERTS

General Counsel – Raisin & President - Co-President of the EFA - European FinTech Association (EFA)

BIO

Dr. Marc Roberts has been General Counsel since 2017 of one of the biggest German FinTechs Raisin that aims to revolutionise the savings and investment market. He is Co-President of the European FinTech Association (EFA) that gives innovative businesses in finance a voice in the European space. Prior to joining the deposits specialist Raisin he was Senior Associate at the German law firm Hengeler Mueller where he specialised in compliance and corporate law as well as Cravath Swaine & Moore (New York).

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Dr. Marc Roberts, General Counsel at Raisin and Co-President of the European FinTech Association.

The last year was quite turbulent for FinTechs. War in Ukraine and the middle-east caused uncertainty, economic distress and decade high inflation causing a turnaround in key interest rates. For FinTechs, these shifts in the economic environment led to a change in not only fundraising conditions, but also in the entire market environment and expectations of investors. Today, after years of hypergrowth, FinTechs adapt and change their focus from maximised to sustainable and profitable growth.

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> Digital Payments are the key to ensure the completion of a EU wide digital single payments market.

Although conditions clearly got more challenging in recent times, FinTech remains one of the most prominent industries in our world. There are lots of reasons to be optimistic for the future. Independent research shows that revenues in the fintech industry are expected to grow almost three times faster than those in the traditional banking sector between 2023 and 2028. Looking ahead, the fintech industry will not only face challenges but also several opportunities yet to be unlocked. No matter whether it is the use of artificial intelligence or the slowly but surely adapting regulatory environment.

Together with all members of the European FinTech Association, we are specifically looking forward to the implementation of three policy fields. With initiatives in the **Digital Finance** space we are hoping for a move from open banking to open finance with clear rules on the sharing of data, increasing participation of retail investors with more accessible and inclusive investing services and digital identification solutions. However, they should also take into account current set-ups such as platforms offered by FinTechs.

Digital Payments are the key to ensure the completion of a EU wide digital single payments market. Participation of FinTechs in policy making here is crucial for an innovative and open, interoperable payment infrastructure that promotes competition for the benefit of all European consumers and SMEs.

Another key policy field is **Anti-Money-Laundering**. We are very happy that multiple initiatives are currently being discussed and implemented since there is a huge need for harmonisation of AML rules across Europe. The unification will strengthen the Single Market by making it more straightforward for innovative European companies to scale their products and services across jurisdictions. To further foster accessibility, companies should be able to leverage innovative technologies, such as remote onboarding and machine learning, allowing them to make customer due diligence more effective and more efficient.

With sensible regulation, ambitious goals, and a competitive industry, I am convinced that FinTech will thrive further and will remain one of the fastest growing industries.

FOREWORD

Regulation will further boost fintech in 2024

MATTHIAS BAUER-LANGGARTNER

European Central Bank - SSM Governance & Operations / Authorisation

Matthias Bauer-Langgartner
Senior Financial Services Expert

BIO

Matthias is a Senior Financial Services Expert at the European Central Bank (ECB) focusing on financial and emerging technologies, particularly distributed ledger technologies. As part of the ECB's Authorisation Department, he is leading on the assessment of crypto-asset and fintech-related banking applications and policy discussions, including the EU's Markets in Crypto-assets Regulation (MiCAR).

Prior to the ECB, Matthias served as Managing Director at a European Digital Assets Investment platform, leading its UK and Irish expansions.

In the decade prior to joining the private sector, Matthias gained invaluable expertise in UK and EU regulations and policymaking at three European regulators (UK FCA, German BaFin, and Austrian FMA). In his last role at the FCA, Matthias was a Technical Specialist at the Innovate Department, where he set up and continuously improved the FCA's regulatory sandbox, and led the FCA's approach to distributed ledger technology, including as part of the UK Cryptoassets Task Force.

Regulation will further boost fintech in 2024[1]

In a world of increased geopolitical and macroeconomic uncertainty, technology driven innovation in financial services (fintech) continues to revolutionise the financial services landscape one step at the time. 2024 promises to be an(other) exciting year for fintech, as it will see new regulatory frameworks being designed or implemented, spanning from Open Banking to crypto-assets and artificial intelligence (AI) – to name just a few.

> "Well-calibrated regulatory frameworks are pivotal for the safe and enduring growth of fintech.

Cloud-based infrastructure and improved interoperability using APIs, empower businesses to cater to specialised customer segments with intuitive solutions. The global surge in digital payments, including advancements in central bank digital currencies, and Open Banking exemplify this trend. A new distribution model – Banking-as-a-Service – has taken up in multiple geographies, in partnership between banks and non-banks. These partnerships may be beneficial to both banks and non-banks as they often combine banks' strengths in infrastructure, experience, risk management, and regulatory relationships, with the strengths of non-bank partners in customer acquisition, product development, and user experience. Within the EU, the Payment Service Directive (PSD) is paramount to Open Banking's success. The forthcoming revision, PSD 3, targets improved competitiveness, laying the groundwork for its further – even global – adoption. In 2024, we can expect to see more widespread distribution of APIs, fostering unparalleled interconnectedness among financial stakeholders, creating new opportunities (and risks) for firms and customers.

Secondly, recently implemented and prospective regulatory frameworks for crypto-assets, including in South Korea, the UK and the EU, emphasise conduct and prudential rules, signifying a pivotal shift. The EU's Markets in Crypto-Assets Regulation (MiCAR) sets standards in terms of authorisation and supervision of crypto-asset service providers and issuers of crypto-assets, including so-called stablecoins. Its upcoming implementation should be closely observed: Already in 2024, we can expect to observe direct and indirect effects on markets, including whether MiCAR can restore investors' shaken confidence marred by recent scandals. MiCAR imposes obligations and capital requirements on previously unregulated players, potentially prompting structural changes and market consolidation. Simultaneously, regulatory clarity might entice a wave of new market entrants, stimulating innovation in products like e-money and asset-referenced tokens. This dynamic landscape could create fresh prospects for both fintech startups and established players, fostering wider crypto-asset adoption. A fine line between collaboration and competition is likely to define interactions between market players in this evolving space.

Thirdly, discussions globally revolve around regulatory and ethical frameworks governing AI usage. The EU's proposed AI Act, characterised by its risk-based approach, is well positioned to set new standards for the development and use of AI systems. The AI Act aims to introduce enhanced disclosure and data management obligations for both AI providers and users, notably also financial services firms, and seeks to ban applications considered as 'unacceptable risk'. While AI adoption, including applications like chatbots, credit scoring, and algorithmic trading, is expected to increase in 2024, a new regulatory framework could bring greater clarity and legitimacy, further encouraging the utilisation of AI, especially in consumer-oriented applications.

As regulators and supervisors prepare for their evolving tasks, they will continue to enhance technological capabilities to harness the benefits of emerging tools and more expansive data resources, working towards more pro-active, technology-supported and effective supervision.

Concluding, well-calibrated regulatory frameworks, striking a balance between fostering innovation and ensuring effective oversight, customer protection, and market stability, are pivotal for the safe and enduring growth of fintech. The year 2024 emerges as a pivotal juncture, witnessing the introduction or design of numerous technology-related regulatory frameworks that lay the groundwork for sustainable innovation within financial markets for the years to come.

Expect regulation to further boost fintech in 2024.

1. Views expressed are personal views only and cannot be attributed to the ECB.

CHINA
FinTech Regulation in China

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BIO

Zhiyi Ren is a leading regulatory lawyer in China, specializing in regulatory, financial markets, fund products, and M&A transactions in the financial sector. Since 2003, he has provided legal services to multinational financial/asset management companies in China, covering entity establishment, products, compliance, regulatory investigations, crisis management, and cross-border transactions. Prior to joining Fangda Partners, he worked as Head of Compliance in an internationally renowned investment bank's domestic subsidiary on all its China investments, covering securities, futures, funds, commodities, trusts, guarantees, special opportunity group, and quant research. He gained abundant experience handling several financial enterprises' legal and compliance affairs. He also worked in an international law firm for many years and is a member of the PRC Bar and the New York State Bar.

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BIO

Blake Wang specialises in financial regulation, asset management, and M&A. Blake advises renowned international financial institutions, asset managers and proprietary trading firms on establishing or investing in PRC entities, and investing in PRC financial markets. Blake has a rich experience in assisting foreign investors (e.g. QFIIs, PFMs) on product issuing and marketing, account opening, custody and advisory services, covering contract review and legal advice. Prior to joining Fangda, Blake worked for another leading PRC firm focusing on asset management and M&A practices. Blake also worked at the head office of Bank of China from 2010 to 2011. Blake holds degrees from Peking University and Zhejiang University.

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I. Overview

From the perspective of financial licensing/regulatory rules, in the PRC the major types of FinTech businesses and their primary regulators include, among others:

FinTech Businesses	Regulators
Online payments, e.g., WeChat Pay and Alipay	PBOC
Online lending, e.g., the online microloan or consumer financing platforms of Ant Group	NFRA (previously CBIRC)
FinTech for asset management: e.g., the use of artificial intelligence (AI) and big data in securities investments	CSRC
FinTech for fundraising/distribution, e.g., internet fund sales	CSRC, NFRA
FinTech for other financial services: e.g., the use of new technology in KYC, trade execution and risk control by banks, securities companies and insurance companies	PBOC, NFRA, CSRC

Abbreviations:
CBIRC - China Banking and Insurance Regulatory Commission
CSRC - China Securities Regulatory Commission
NFRA - National Financial Regulatory Administration
PBOC - People's Bank of China

From a historical perspective, during the earlier days of China's FinTech industry, the concept "internet finance" emerged and was often mentioned by PRC financial regulators in relevant official documents issued in years such as around 2014 and 2015. As indicated by its name, internet finance refers to primarily the use of internet in financial activities, and used to be primarily associated with online financing platforms such as peer-to-peer (P2P) lending and crowdfunding. Since around 2016, as far as we are aware, major FinTech servicers gradually began to play a significant or even overwhelming role in many financial services. These years also have witnessed a massive jump in the AUM of China's asset management industry, the growing power of large internet companies and their expansion to the financial sectors, and increased concerns over financial stability and data security. In recent years, the development of China's FinTech regulation has been highlighted by key regulations and regulatory actions with respect to particularly the asset management industry (*see Section II below*), financial services of internet companies (*see Section III below*), and cyber security and data protection (*see Section IV below*).

II. FinTech for Asset Management

Generally there are no separate licenses for carrying out asset management via FinTech. Rather, asset managers, after obtaining the appropriate asset management license, may carry out their asset management via FinTech to the extent compliant with applicable regulatory rules. For the asset management industry broadly, related financial licenses may include mainly the investment management license, the investment advisory license, and the investment product sales license.

With respect to the investment management/advisory licenses, the Guiding Opinions on Regulating Asset Management Business of Financial Institutions (《关于规范金融机构资产管理业务的指导意见》, commonly referred to as the "**New Asset Management Rules**") promulgated in April 2018 requires that, among others:

- providing investment advisory services by making use of AI shall be subject to investment advisory licensing requirements;

- non-financial institutions may not engage in asset management businesses in a disguised form by making use of AI;

- when carrying out asset management by making use of AI, financial institutions still need to meet general regulatory requirements in respect of investor suitability, investment scope, information disclosure, and risk segregation; and

- to facilitate regulation over investment activities driven by AI, financial institutions shall report trading parameters and investment portfolio logic of AI model to financial regulators for record, and financial institutions shall also fully disclose to investors of the inherent defects and relevant risks of AI algorithms.

Meanwhile, PRC regulators have been watching over the application of AI and algorithmic trading in the asset management industry. For mutual funds investments, on 25 October 2019, the CSRC issued the Circular on Carrying Out the Pilot Work of Investment Advisory Business for Publicly Offered Securities Investment Funds (《关于做好公开募集证券投资基金投资顾问业务试点工作的通知》，the "**Fund Investment Advisory Circular**"), launching the pilot program of fund investment advisory business. Entities that have been approved to provide fund investment advisory services under the Fund Investment Advisory Circular include traditional fund management companies, securities companies, commercial banks, and also large internet companies. Among such entities, a mostly reported one is Vanguard Investment Advisors (Shanghai) Investment Consultancy Co., Ltd. (先锋领航投顾（上海）投资咨询有限公司, the "**Ant-Vanguard JV**"), a joint venture established by Ant Group and Vanguard. The Ant-Vanguard JV has launched its "Helping You to Invest" (帮你投) investment advisory service, which profiles and advises users by making use of AI, big data and cloud calculation.

A most recent development, which has been hotly discussed among China's securities market participants in 2023, is the use of program trading/algorithm by asset managers. On 1 September 2023, each of the three major PRC stock exchanges issued notices to tighten oversight over program trading. Also on 1 September 2023, the CSRC disclosed on its website that it will further enhance relevant regulatory arrangements, and strengthen differentiated regulation over high-frequency trading.

III. Financial Services of Internet Companies

Internet companies in China overall have quickly caught up with or even overpassed their foreign peers in the aspect of leveraging FinTech to provide financial services, such as online payments, online lending and online distribution of asset management products. In the past around three years, PRC regulators appear to be concerned over the power of large internet companies and taking particular efforts to strengthen regulation over their financial services.

Among such efforts, the most well-known event might be the suspension of Ant Group's IPO in November 2020. Meanwhile the market discussed whether to view and evaluate Ant Group as a technology company or as a financial institution[1]. From the PRC regulators' perspective, the answer appears to be that regulation over financial activities of FinTech companies shall be strengthened. For example, also in November 2020, the CBIRC and the PBOC issued the Interim Measures on Internet Microloan Business Administration (Draft for Consultation) (《网络小额贷款业务管理暂行办法(征求意见稿)》, the "**Microloan Measures**"). The Microloan Measures set out restrictions on microloan companies, such as:

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> PRC regulators have been watching over the application of AI and algorithmic trading in the asset management industry.

- for a joint loan (which in practice may refer to a loan jointly extended by a FinTech company through its microloan company and a commercial bank), the fund contributed by the microloan company may not be less than 30%;

- the outstanding amount of funds obtained via issuing bonds or ABS may not be over 4 times of its net assets.

Such rules, once implemented, might substantially restrict the financial business scale of certain large internet companies which is achieved through the so-called "originate-to-distribute" business model.

1. See, e.g., The Ant Group (Part 4): FinTech Or Bank? Why It Matters (November 27, 2020, Forbes), available at https://www.forbes.com/sites/georgecalhoun/2020/11/27/the-ant-group-part-4-fintech-or-bank-why-it-matters/.

A most recent example is the Regulation on Supervision and Administration of Non-Bank Payment Institutions (《非银行支付机构监督管理条例》, the "**Non-Bank Payment Regulation**"), which was issued on 9 December 2023 and will take effect on 1 May 2024. The Non-Bank Payment Regulation will strengthen regulation over the non-bank payment market as a whole, including payment services of internet companies such as WeChat Pay and Alipay.

More broadly, Chinese authorities appear to be concerned about the overall business risks of large internet companies and their strong presence in various business sectors. Such concern of Chinese authorities might be more serious than regulators in many other jurisdictions, since large Chinese internet companies are equipped with both big data and various financial licenses (lending, payments, credit rating, asset management, etc.). They are active across various types of financial services and have dominant market shares in areas such as online payments, making them more powerful than their foreign counterparties[2].

> China has been strengthening regulation over cyber security and data protection in the recent years, with a particular attention to the financial sectors.

Notably, the business form of large internet companies has been recognized by authorities as "platform economy" (平台经济), which requires coordinated regulation by various authorities. In December 2021, the Several Opinions on Promoting Compliant and Healthy Sustained Development of Platform Economy (《关于推动平台经济规范健康持续发展的若干意见》, the "**Platform Economy Opinions**") was issued by nine authorities jointly, including among others the PBOC, the National Development and Reform Commission and the Cyberspace Administration of China. The Platform Economy Opinions provide that all financial activities must be subject to financial regulation and be carried out by licensed entities. The Platform Economy Opinions also require regulating platform economy from such perspectives as data security, credit information and anti-monopoly. As such, the powerful internet platforms in China might face more stringent regulations in various aspects such as data security, anti-monopoly and anti-unfair-competition.

IV. Cyber Security Law and Data Protection

China has been strengthening regulation over cyber security and data protection in the recent years, with a particular attention to the financial sectors.

In June 2017, the PRC Cyber Security Law (《中华人民共和国网络安全法》, the "**CSL**") came into effect. Under the CSL, a critical information infrastructure operator (关键信息基础设施的运营者, "**CIIO**") is subject to stringent obligations such as setting up and deploying specialised security management departments and security management responsible persons. Critical information infrastructure ("**CII**") is defined under Article 31 of the CSL as information infrastructure in important industries/sectors including, among others, the financial industry, which, if damaged, disrupted or impacted by data breach, may materially impact national interest or public interest.

2. See Page 7, FinTech and market structure in financial services: Market developments and potential financial stability implications (FSB, 14 February 2019), according to which "single platforms in China integrate online shopping, mobile phone wallet capability, and activities including money transfer" whilst in other jurisdictions "the mobile payments market is more disaggregated".

In particular, the CSL imposes stringent requirements on collection and use of personal information by network operators. When collecting and using personal information, network operators must comply with the principles of legality, justification and necessity, disclose rules for such collection and use, clearly indicate the purposes, methods and scope of information collection and use, and obtain the consent of those from whom the information is collected. Network operators are further subject to specific obligations such as:

- shall not collect personal information that is not related to the services they provide;

- shall not collect or use personal information in violation of applicable laws and regulations and the agreed methods;

- shall not disclose, falsify, or damage collected personal information, shall not disclose personal information to third parties without the consent of the person from whom the information is collected, unless after processing the information the specific person cannot be identified and the information cannot be recovered;

- shall take technical and other necessary measures to ensure the security of personal information and prevent leakage, damage or loss of such information. In the event that personal information has been or may be leaked, damaged or lost, remedial actions shall be taken immediately.

With respect to financial institutions specifically, on 13 February 2020, the PBOC released the Personal Financial Information Protection Technical Specification (《个人金融信息保护技术规范》, the "**PBOC PFI Specification**", JR/T 0171—2020), which sets out detailed technical requirements on protection of personal financial information by financial industry institutions (金融业机构) through the process of providing financial products and services within the PRC. Financial industry institutions under the PBOC PFI Specification include, apart from licensed financial institutions, also relevant institutions that are involved in processing personal financial information.

V. RegTech

Regulatory technology ("**RegTech**") is sometimes considered a subdivision of FinTech and refers to the use of technologies by financial institutions to more efficiently comply with regulatory compliance requirements. In China, RegTech does not have an official definition, and it appears to also refer to using technology by regulators to enhance regulatory efficiency.

Whilst public information on RegTech developments in China might not be very transparent and detailed, relevant media reports suggest that RegTech has been developing robustly and involves two major types of entities:

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> With respect to financial institutions specifically, on 13 February 2020, the PBOC released the Personal Financial Information Protection Technical Specification

- Regulatory authorities: Each of the CSRC and the NFRA has established a Scientific and Technological Regulation Division (科技监管司). Particularly, for the Scientific and Technological Regulation Division under CSRC, its functions as officially announced include, among others, carrying out RegTech research;

- RegTech service providers: According to media reports, there are three types of RegTech service providers, including (1) large internet/FinTech companies, such as Alibaba and Tencent; (2) traditional FinTech companies which expands its business to RegTech, such as Hundsun; (3) specialised RegTech developers.

The advancement of technology enables PRC regulators to enhance their regulatory rules to supervise the market. For example, under the *Measures for the Supervision and Administration of Anti-money Laundering and Counter-terrorism Financing of Financial Institutions* (《金融机构反洗钱和反恐怖融资监督管理办法》) issued by the PBOC in April 2021, the PBOC expanded the applicable scope of AML and CFT obligations to entities such as internet micro lending companies and consumption finance companies. Other examples include the CBIRC's regulation on IT outsourcing risks of banking and insurance institutions, and the CSRC's regulation on IT management of securities and fund institutions.[4]

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> The FinTech industry in China has been facing a more stringent regulatory environment compared with the earlier stage of their development.

VI. Regulatory Trend

The FinTech industry in China has been facing a more stringent regulatory environment compared with the earlier stage of their development. Various regulators have strengthened regulation in aspects such as:

- prohibiting unlicensed FinTech businesses: In the end of 2022, the CSRC announced that it contemplates requiring Futu and Tiger to cease illegally providing outbound securities investment brokerage services to PRC domestic investors;
- strengthening cyber security and data protection regulation: PRC regulators issued various new regulations in this field, such as the Measures for Assessment of Data Offshoring Security Assessment (《数据出境安全评估办法》) and the *Administrative Rules on Internet User Account Information* (《互联网用户账号信息管理规定》);
- enhancing financial consumer protection: New rules issued in this area include, e.g., the Administrative Measures for Protecting Rights and Interests of Consumers of Banking and Insurance Institutions (《银行保险机构消费者权益保护管理办法》).

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ACHIEVING EXCELLENCE

We have more than 20 years' experience of advising traditional fund management and alternative asset management companies on legal and compliance issues for all their complex asset management requirements.

Fangda offers fully fledged services relating to financial institutions and asset management and the Chinese financial and asset management markets, ranging from regulatory and transactional work to contentious matters. We bring a practical and business-oriented approach to offering a full-range of commercial legal services and balancing client business needs with regulatory compliance.

Our clients include all key participants in financial and asset management services, including investment banks, asset managers, commercial banks, financial sponsors, alternative fund managers, insurers and fintech companies.

Our team comprises leading lawyers with extensive experience as outside counsel advising financial institutions and asset managers on regulatory and M&A matters and as in-house counsel advising securities firms, PFMs and mutual fund managers on legal and compliance matters.

We have developed close working relationships with the financial regulatory bodies in China through working with them on many matters over many years. This practical experience enables us to provide clients with advice that is not only strategically tailored but also tactically well-informed.

We offer a unique combination of international and domestic capabilities through our in-depth understanding of both international and domestic markets and regulations to ensure that matters are handled efficiently and effectively to best safeguard and accomplish client interests.

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A&L GOODBODY

BIO

Patrick Brandt is a partner and head of A&L Goodbody's Financial Regulation team. Before joining ALG, Patrick led Skadden Arps London office's financial regulatory group.

Patrick has extensive experience advising a wide variety of banks, payment institutions, asset managers, brokers and intermediaries on non-contentious and contentious regulatory issues. Patrick also spent time as a regulator, having worked in the UK Financial Services Authority's enforcement division.

A&L Goodbody

A&L GOODBODY

BIO

Louise Hogan is an associate in A&L Goodbody's Financial Regulation group. Louise has experience advising a wide variety of banks, payment institutions, electronic money institutions, asset managers, brokers and intermediaries on regulatory and compliance issues.

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BIO

Sinéad Gleeson is an associate in A&L Goodbody's Financial Regulation Advisory group. Sinéad advises a range of domestic and international clients across the financial services sector.

Clients include credit institutions, investment firms, payment institutions and electronic money institutions, as well as other regulated and unregulated entities. Sinéad advises on a variety of regulatory and compliance issues, for example conduct of business and prudential requirements, authorisation and passporting requirements, acquisitions and disposals, corporate governance, fitness and probity, along with AML/CFT.

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Brief overview of fintech in Ireland

Home to a vibrant and dynamic technology sector as well as an established financial services landscape, Ireland continues to be a hub for fintech.

Fintech is a strong driver of growth and employment in the Irish economy, with the sector being supported by financial and non-financial government initiatives and strategies. The Irish fintech ecosystem has developed in the context of a favourable business environment, which includes an attractive corporate tax regime, a credible financial regulator, a skilled and relatively young English-speaking workforce and EU membership.

" Key supervisory priorities for the Central Bank of Ireland (CBI) that are particularly relevant for the fintech sector include safeguarding of client funds, outsourcing, and operational and financial resilience.

The pace and scale of developments in fintech create significant opportunities as well as challenges for both market participants and regulators. A balance must be struck between innovation and regulation, ensuring that firms are able to innovate and harness opportunities while ensuring that this does not come at the cost of customers or financial stability.

In this article we consider some current trends and key developments in fintech, informed by our Irish market experience.

Regulatory focus

Supervisory priorities

Key supervisory priorities for the Central Bank of Ireland (**CBI**) that are particularly relevant for the fintech sector include safeguarding of client funds, outsourcing, and operational and financial resilience.

Safeguarding

Safeguarding rules require regulated fintechs to segregate and protect customer funds. In a January 2023 industry communication, the CBI noted that one in four Payment Institutions (**PIs**) and E-money Institutions (**EMIs**) had self-identified deficiencies in their safeguarding risk management frameworks during 2022. Accordingly, all PIs and EMIs were required to conduct a specific safeguarding audit, with the results to be provided to the CBI, reflecting intensified CBI scrutiny in this area. In our view, additional feedback and/or action by the CBI is likely to follow the submission of the safeguarding audits during the course of next year.

Outsourcing

The use of outsourcing arrangements has become the norm in the fintech industry. Outsourcing risk management continues to be a supervisory priority for the CBI. The CBI has highlighted the risks of sub-outsourcing, off-shoring and concentration risk. The CBI has also made clear that intragroup outsourcing carries the same risks as third-party outsourcing and expects such arrangements to be managed accordingly, with appropriate outsourcing agreements in place to manage risk.

An area of concern for firms has been the CBI's view that branch service provision should also be regarded as a form of intra-group service provision, as the risks are indistinguishable from those related to outsourcing. Whilst a formal legal agreement between a branch and its head office is obviously not possible, in order to meet CBI guidance, firms should nevertheless seek to have in place appropriate internal policies, procedures and controls providing for equivalent measures to ensure the effective oversight and supervision of any branch services.

Operational resilience

The need for fintechs, both regulated firms and their technical services providers, to guard against operational outages and cybercrime is obvious. The CBI has been increasingly focused on operational resilience and the need for firms to demonstrate readiness for, and resilience to, operational disruptions. The CBI has observed an increase in the number of major incidents/outages being reported by PIs and EMIs, with many of those having been as a result of issues with critical outsourced service providers (**OSPs**), both group and third-party. Firms are therefore expected to review and adopt appropriate measures to strengthen and improve their operational resilience frameworks in line with the CBI cross-industry guidance on operational resilience (published 2021) and cybersecurity (published 2016). These domestic requirements will be supplemented by the Digital Operational Resilience Act (**DORA**) when it comes into full force in January 2025.

In this regard, we have seen a specific regulatory focus on firms' ability to ensure continuation of services following unforeseen disruptions/outages, with low regulatory tolerance for such incidents. It is therefore important for firms to ensure adequate resources and focus on these risks. Accordingly, regardless of the technology used, firms should seek to follow the pillars of operational resilience, namely:

- **Identification:** identifying and preparing critical impact areas in advance
- **Mapping:** mapping operational interdependencies between systems and service providers
- **Testing:** ensure that there is regular and rigorous testing of systems and dependencies
- **Look-back:** where operational incidents occur, a formal look-back review should be undertaken to understand where issues arose, as well as what operational risk management measures performed well

Financial resilience

It is important that fintech firms are financially resilient so that business failures in the regulated area are kept to the bare minimum. The CBI completed a thematic review of business model and strategic risk across a number of PIs and EMIs during 2022. It found that certain firms did not have defined or embedded Board-approved business strategies in place.

The CBI noted that, while firms may operate within and be reliant on group strategic decisions to inform local strategy, it is critical that firms ensure there is sufficient financial (capital and liquidity) and operational (including resources, IT etc.) capacity and capability to execute that strategy. It further noted weaknesses in firms' financial projections and reiterated its expectations that firms have robust strategic and capital planning frameworks.

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We have seen a specific regulatory focus on firms' ability to ensure continuation of services following unforeseen disruptions/outage.

Market trends

Use of contactless payments

The latest figures from the Banking & Payments Federation Ireland's Payments Monitor (published 13 October 2023) show a strong move towards use of contactless payments in Ireland. Almost 85% of credit and debit card transactions in H2 2023 were contactless payments, with 41% of those being made with mobile wallets instead of physical cards. The Payments Monitor also shows that the number of online and mobile banking payments grew by 4% year on year in H1 2023. Since H1 2018, these forms of payment have risen by 60%.

Increased fintech offerings

A number of Irish fintechs are seeking to expand their product and service offering, with a lot of activity around digital wallets and embedded payments, potentially requiring an expansion of their authorisation/permissions. This includes a number of UK fintech firms who chose Ireland as their European base post-Brexit, who have matured and settled into the European market and are now looking to expand. The withdrawal of two retail banks from the Irish market (Ulster Bank and KBC) also means that the Irish retail banking and payments market is now smaller, potentially prompting further offerings from non-bank service providers.

The CBI has highlighted the importance of early regulatory engagement, and ensuring that appropriate governance and risk management frameworks are put in place with sufficient financial and operational capacity to deliver on the proposed business strategy. In our experience, there is also a related general European trend, with a shift in regulatory expectations for firms seeking authorisation as EMIs or PIs in terms of the level of local substance a firm is required to have irrespective of Member State.

> “We continue to see an increase in firms using regtech solutions to assist with compliance and risk management and monitoring.

The blurring of lines between more traditional finance models and fintech also continues, with more software providers diversifying into finance or finance adjacent sectors, and seeking regulatory licences to provide new regulated services themselves.

Financial institutions are also seeking to broaden their product offering by embracing fintech, often through partnering with fintech companies (e.g. in the area of strong customer authentication). Conversely, there is also an observable trend of fintechs moving into the provision of more traditional financial services (e.g. mortgages). On the crypto-asset side, we are continuing to see strong interest from issuers and exchanges in establishing in Ireland.

Use of regtech solutions

We continue to see an increase in firms using regtech solutions to assist with compliance and risk management and monitoring. While this helps drive efficiencies and deliver other benefits for both firms and customers, it also involves increased reliance on OSPs. This in turn has created increased risks from cyber threats, as well as increasing firms' operational risk profiles from the CBI's perspective. Firms should therefore have a clear understanding of the benefits, risks, and operational interdependencies and vulnerabilities of any new systems or software solutions being deployed.

Key developments

Regulatory approach to technology

The CBI takes a 'technology-neutral' approach to regulation, focusing on the risks associated with the use of technology solutions. Firms are expected to do sufficient due diligence on systems to understand how those systems work and their potential risks, including customer impact and ability to comply with regulatory requirements.

In particular, the CBI is focused on the risks that can arise for consumers, potential risks to personal data, and the increased exposure of firms and consumers to operational issues such as system weaknesses, outages, and cyber vulnerability.

In the context of AI, as the first sector to be reviewed, the CBI has expressed concern about the ethical use of data in relation to the insurance sector. It identified the risk of financial exclusion of consumers, data protection and cybersecurity issues, complex outsourcing risks and the importance of informed consent from consumers.

The use of AI in the EU will soon be regulated by the AI Act, the world's first comprehensive AI law. The AI Act will adopt a risk-based approach, categorising AI systems into four risk categories from 'minimal' to 'unacceptable', with corresponding compliance requirements attached to each category (and systems categorised as 'unacceptable' being prohibited). The majority of obligations will attach to high-risk systems. In terms of AI systems likely to be used in the fintech space, from the current text it seems likely that systems used to evaluate credit scores or determine creditworthiness of an induvial would fall into the high-risk categorisation, while chatbots that use generative AI or systems that flag fraudulent transactions would not. The AI Act also proposes requirements around the design and development of AI technology such as transparency, human oversight, risk management, technical documentation demonstrating compliance, and security.

The AI Act is expected to pass before the end of 2023 and will likely enter into force towards the end of 2025 or early 2026.

Digital Operational Resilience

DORA is a key current area of focus in the fintech sector. It aims to harmonise rules across the EU to address Information and Communications Technology (**ICT**) risk in the financial sector, and create a regulatory framework for firms to ensure that they can withstand, respond to, and recover from, ICT-related disruptions and threats, including cyber-attacks.

DORA aims to mitigate ICT risk by setting targeted rules relating to:

- ICT risk management
- ICT third-party risk management
- incident reporting
- digital operational resilience testing
- information and intelligence sharing

It applies to a wide range of financial services entities, including PIs, investment firms, and crypto-asset service providers, as well as to critical ICT third-party service providers.

Given the CBI's existing guidance on operational resilience, Irish firms should be ahead of the curve when it comes to DORA implementation. Nevertheless, we have seen some concern from firms around how CBI expectations will square with the upcoming European requirements. Although the CBI has stated that its expectations should not be inconsistent with DORA, the prescriptive obligations are not identical. Firms will therefore need to review their existing ICT governance and risk management frameworks to ensure DORA compliance.

> "
> DORA is a key current area of focus in the fintech sector.

Firms might also note the revised Network Information Security Directive which introduces stricter procedures around incident reporting, expands the scope of security measures firms must have in place, as well as requirements around supply chain security, cyber security training for staff, encryption and penetration testing.

Markets in Crypto-Assets Regulation (MiCA)

MiCA forms part of the EU's Digital Finance Package and aims to create a comprehensive regulatory regime for cryptocurrencies across the EU, implementing a regulatory framework for crypto-assets not already covered by existing legislation. MiCA primarily focuses on the issuance of crypto-assets and the provision of crypto-asset services, by requiring providers to meet consumer protection, transparency, conflict of interest and governance standards. Many of the measures set out in MiCA will be familiar to those working in currently regulated sectors, as it seeks to introduce similar protections for consumers and the market more generally.

MiCA introduces requirements including:

- offerings and marketing to the public of crypto-assets, including an obligation to publish an information document called a "white paper"
- asset-reference tokens and e-money tokens (e.g. stablecoins), including an obligation for issuers to be authorised in the EEA and the publication of a white paper in respect of the relevant offering
- crypto-asset service providers, including regulatory licensing requirements, and in respect of specific services such as custody of crypto-assets, trading platforms for crypto-assets, exchange of crypto-assets for fiat currency or for other crypto-assets, and order execution

> "
>
> The upcoming implementation of the SEPA Instant Payment Regulation will also be a significant development in rolling out instant payments across the EEA.

MiCA also introduces a market abuse regime, based on prohibitions of unlawful disclosure of inside information, insider dealing, and market manipulation.

Revised Payment Services Directive (PSD3)

In June 2023, the European Commission put forward a proposal to amend and modernise payments through PSD3. Specific proposals include:

- allowing payment service providers (**PSPs**) to share fraud-related information between themselves, increasing consumers' awareness
- levelling the playing field between banks and non-banks, in particular by allowing non-bank PSPs access to all EU payment systems, with appropriate safeguards, and securing those providers' rights to a bank account
- combating and mitigating fraud by making a system for checking alignment of payees' IBAN numbers with their account names mandatory for all credit transfers

These clarifications will be welcomed by industry. It is also hoped that PSD3 will cut down on regulatory divergence between Member States, including greater consistency in the application of exemptions. However, certain changes could have the potential to result in some firms currently operating in Ireland under exemptions needing to become licensed as an EMI or PI going forward, or otherwise to cease providing payment services themselves (likely partnering with existing regulated PSPs to facilitate transactions in the future).

The upcoming implementation of the SEPA Instant Payment Regulation will also be a significant development in rolling out instant payments across the EEA.

Individual accountability

The Individual Accountability Framework (**IAF**) is one of the most important Irish regulatory developments in recent years. It became law in 2023, and seeks to make fundamental changes to the existing individual liability and enforcement regimes for members of senior management in regulated entities.

The IAF contains the following key elements:

- The Senior Executive Accountability Regime (**SEAR**)
- common conduct standards (applying to individuals in all regulated firms) and additional conduct standards (applicable to senior executives)
- enhancements to the existing Fitness & Probity regime
- amendments to the CBI's Administrative Sanctions Procedure

The IAF is being introduced in light of regulatory focus on individual accountability, good governance, risk management, and firms' culture and conduct over the last number of years. Although it provides for significant legal changes, the CBI's message has been consistent in that it does not mean a change in regulatory approach overall. Instead the IAF signifies a move away from more rules-based prescribed contraventions towards a focus on conducts standards more akin to general principles.

Conclusion

There are significant regulatory and supervisory changes due to come into effect in the Irish fintech market over the next year or so. These changes reflect both new ways in which firms are doing business, as well as reflecting insights gained by the CBI and other regulators as part of their supervisory and regulatory engagements.

The ever-increasing use of technology, both for delivery of services and to support compliance by regulated entities, poses opportunities for fintechs. However, firms will need to be conscious of the additional risks, interdependencies, and reliance on third parties that this creates. Firms will need to manage these challenges proactively to ensure appropriate and robust oversight and management of their systems and services providers.

Ireland nevertheless remains an attractive jurisdiction in which to base new fintechs, developing and offering new and novel products and services to customers both in Ireland and across the EU.

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There are significant regulatory and supervisory changes due to come into effect in the Irish fintech market over the next year or so.

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IRELAND

Why the incoming PSD3 / PSR and SEPA Instant legislation levels the playing field for Irish and European Payments and improves Open Banking and Consumer Protection

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BIO

Ian has been with KPMG for over 20 years and is Head of Financial Services for KPMG Ireland, which includes the Banking, Aviation Finance, Asset Management, Insurance and Private Equity sectors. In total c.2,500-3,000 people in KPMG Ireland work in Financial Services. Ian is also Head of Regulatory Consulting for KPMG Ireland and works with all domestic and international banks and a number of asset managers, payment firms and fintechs in Ireland.

Ian is a regulatory / risk specialist and has overseen many regulatory and risk engagements with domestic and multinational companies. His banking experience includes a secondment with the Irish Central Bank where he was the Head of Financial Measures Programme working closely with the Irish authorities and international partners in the ECB, IMF and European Commission. Ian also works directly with a number of the new entrants into the Irish Financial Services sector such as fintechs and is a Fintech and Payments Association of Ireland Council Member.

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BIO

Noleen is a Director in KPMG's Risk and Regulatory Consulting team with 10 years' experience in the financial services industry. Noleen specialises in banking, payments and fintech regulation and provides risk and regulatory related advice to clients on all stages of the regulatory lifecycle including authorisation, supervision and enforcement. Her experience includes supporting firms with engaging with the Regulator, offering insights and industry standards and helping clients to operationalise regulatory requirements with regards to, inter alia, risk management frameworks and associated policies, governance and organisational structures, outsourcing and AML requirements.

Noleen has recently advised a number of clients on applications for authorisation, including electronic money institutions, payment institutions, account information service providers, payment initiation service providers and retail credit firms. She is also working with a number of of payment and e-money firms in providing advice and strategic direction in relation to risk management practices, compliance and outsourcing requirements as well providing support in relation to existing and upcoming regulation.

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BIO

Tony joined KPMG Ireland as an Associate Director in Management Consulting, with a focus on the banking and payments sectors. Tony brings to the firm 13 years' industry experience, during which time he held a variety of technology and business roles within the banking and fintech space.

His experience includes heading up the Irish Correspondent Banking business for a European Bank, supporting a fast growth fintech on International Payments and FX strategy, and developing a SEPA Credit and Debits payments systems using SQL and .NET for an Irish based direct participant bank, which grew to process €60bn+ annually.

Tony is passionate about payments and holds expertise across ISO 20022, SEPA and SWIFT. He has most recently started exploring Blockchain based payments solutions such as Ripple On Demand Liquidity (ODL), Stablecoin and CBDCs.

Executive Summary

The European payments landscape has changed considerably since the introduction of Payment Services Directive 2 (PSD2) in 2015. Demand for cashless payments has increased greatly over the past number of years, further accelerated by the Covid 19 pandemic, while the launch of new payments rails such as SEPA Instant Payments in 2017 have shifted the European payments landscape considerably.

In parallel, there has been significant technological advancements with institutions delivering more sophisticated customer journeys and full-featured digital wallets, while providing customers with more choice around payments to reflect the ubiquity and popularity of contactless payments.

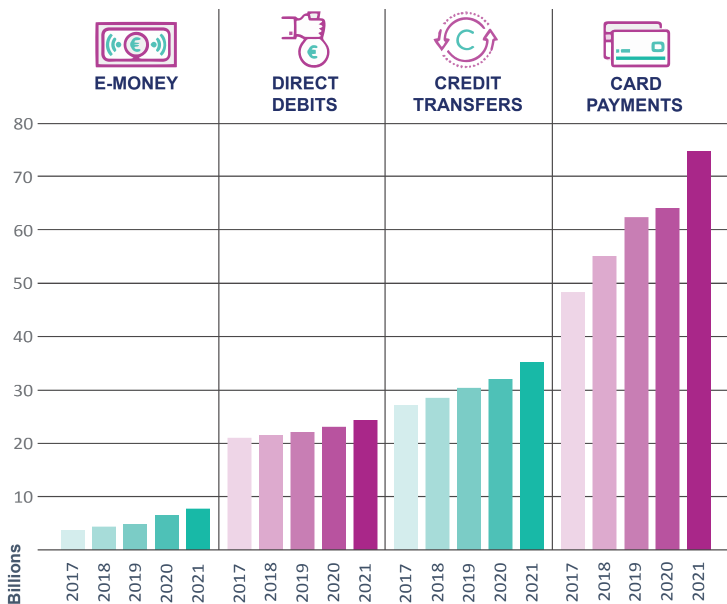

Figure 1No. of cashless payments in the EU 2017 - 2021. European Commission June 2023

The growth has created lots of opportunities for new players but obstacles still remain for Payment Service Providers (PSPs). For example, the introduction of Open Banking has allowed consumers to access financial data efficiently and securely, but Account Information Service Providers (AISPs) and Payment Initiation Service Providers (PISPS) still have trouble accessing data.

To address some of the challenges in the payments market and to keep pace with consumer and business requirements a new legislative framework has been proposed by the European Commission; Payment Services Directive 3 (PSD3) and the Payment Services Regulation (PSR).[1] The proposed requirements aim to strengthen customer protection and define parameters within which Open Banking should operate, enhancing opportunities in this space. They will also help level the playing field for all participants across the payments industry by allowing, for the first time, non-banks to participate directly in the SEPA payment schemes.

In addition to PSD3 / PSR, new SEPA Instant Payments legislation has been provisionally agreed and is expected to enter into force in Q1 2024. This will most notably make participation in the instant payment scheme mandatory for all PSPs who currently offer SEPA Credit Transfer to their customers. This is a welcome move which reflects the relative lack of uptake for this scheme thus far and supports the vision that instant payments in euro will be affordable, secure, readily available and processed without hindrance across the EU.

1. The proposals will be reviewed by the European Parliament and Council. The exact timelines for entry into force are not yet known. Based on the usual legislative process, the final versions may become available by the end of 2024. Since Member States are usually granted an 18-month transition period, the Directive and Regulation will likely start to apply somewhere in 2026.

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In Ireland, we have seen the Central Bank of Ireland's (CBI's) supervisory approach to payments and e-money institutions intensify over the past 24 months with the publication of two industry Dear CEO letters and the focus will continue to grow through the shift to instant payments, growth in open banking and broader regulatory landscape.

In this article, we provide an overview of some of the key regulatory changes including the impacts of PSD3/PSR and the evolution of instant payments. The pace of change is challenging leaders like never before and Fintechs should not only be aware of these upcoming changes but should be preparing for them in the short, medium and long term.

PSD3 / PSR

Macro drivers of change since PSD2

The highly anticipated proposals for the PSD3 and PSR were published by the European Commission on 28 June 2023. To understand the impact PSD3/PSR will have on European Payments and Open Banking, it is perhaps useful to reflect on what has brought us to this point.

During a European Commission evaluation[2] of the PSD2 implementation, the European Commission found that while PSD2 positively impacted fraud prevention through SCA (70-80% lower for remote card payments)[4] and brought increased efficiency, transparency and choice of payment instruments, some improvements were still required. They found that AISPs and PISPs experienced issues accessing data as the APIs varied in quality and performance. In some member states, including Ireland, there is no publicly available data showing API volumes, efficiency, uptime etc, as distinct from other jurisdictions which do publish regularly.[3]

An evolution, not a revolution

The findings from the European research formed the basis of the EU proposals for PSD3/PSR. The proposals aim to achieve four key objectives and introduce a number of revisions and improvements to PSD2:[4]

1. Strengthening user protection and confidence in payments

Proposed fraud and liability improvements:

- Extended IBAN/name matching verification to all credit transfers
- Strengthening of transaction monitoring, most notably the introduction of a legal basis for sharing fraud-related information between PSPs.
- Obligation to provide education to increase awareness of payments fraud among customers and staff
- Extension of refund rights: in case of failure of IBAN/name verification or for victims of 'spoofing' fraud, victims can be entitled to claim damages from their PSP.
- Improvements to strong customer authentication. For example, requiring PSPs to ensure that SCA methods do not depend on one single technology, device or mechanism, such as the possession of a smartphone.

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> The highly anticipated proposals for the PSD3 and PSR were published by the European Commission on 28 June 2023.

Proposed consumer rights and information improvements:

- Obligation to inform payment service users on estimated charges for currency conversion for credit transfers and money remittances from the EU to third countries.
- PSPs must provide information on payment account statements to unambiguously identify the payee.

1. The proposals will be reviewed by the European Parliament, Council and Commission. The exact timelines for entry into force are not yet known. Based on the usual legislative process, the final versions may become available by the end of 2024. Since Member States are usually granted an 18-month transition period, the Directive and Regulation will likely start to apply somewhere in 2026.
2. https://ec.europa.eu/commission/presscorner/detail/en/qanda_23_3544
3. E.g. UK, API performance stats – Open Banking
4. KPMG Netherlands, PSD3 & PSR: New EU proposals game-changing for payments?, https://kpmg.com/nl/en/home/insights/2023/06/psd3---psr-.html

2. **Improving the competitiveness of open banking services**

- New requirements for dedicated data access interfaces with prohibited obstacles. For example, requiring additional checks of the permission given by the payment service users to a PISP or AISP or restricting payments initiation via a PISP only to those payees that are on the payer's beneficiaries list.
- No permanent "fall-back" interface for banks required anymore.
- Banks and PSPs are required to set up a dashboard for consumers of open banking to provide insight in data access rights they have granted and to whom, with a withdrawal functionality.
- To ensure the continuity of open banking, PSPs can request the national authority to be allowed to use an effective alternative interface, such as using the interface banks use for their customers, if the dedicated interface is down and the bank cannot rapidly offer effective alternative solutions.

A key proposed change in PSD3 is the merger of the licencing and authorisation frameworks applicable to Payment and E-money Institutions.

3. **Improving the enforcement and implementation in Member States**

- Shifting elements from PSD2 into the new PSR, which applies directly and consistently across the EU.
- Integration of the Electronic Money Directive (EMD) with PSD3 and PSR. The EMD will cease to exist. E-money institutions will disappear. Payment Institutions can be authorised to offer e-money services.
- Enhancing enforcement of the rules, including a list of breaches (infringements) and administrative sanctions and measures. For these breaches, such as on the rules on access to accounts maintained by banks, secure data rules by ASPSPs, AISPs, PISPs and fraud prevention mechanisms, the nature of sanctions and measures will therefore be known upfront.

4. **Improving (direct or indirect) access to payment systems and bank accounts for non-bank PSPs**

- Toughened requirements for banks to provide bank account services to non-bank PSPs. For example, banks need to explain and justify access refusal based on the specific situation including serious grounds to suspect illegal activities by or via the PSP.
- PSPs may be offered an additional possibility to safeguard users' funds, namely to hold those funds at a central bank.
- Possibility of direct participation to payment systems for non-bank PSPs.

While these proposals have been put forward as evolutionary rather than revolutionary, they do represent a welcome move to strengthen Open Banking and level the playing field for participating Fintechs across the European payments landscape.

The proposals for PSD3 / PSR will undoubtedly evolve but firms should not delay in considering the likely impacts the regulatory requirements will have on their business models. Firms will need to prepare by undertaking a gap analysis against the PSD3/PSR requirements to identify a remediation plan. Firms should identify the impacts of regulatory change on their business and strategy to determine the necessary changes in process, capability, technology etc. and undertake implementation of the necessary requirements to meet the enhanced regulatory regime.

Re-Authorisation under PSD3 / PSR

Merging the E-money and Payment firm regimes

A key proposed change in PSD3 is the merger of the licencing and authorisation frameworks applicable to Payment and E-money Institutions to increase harmonisation of the regulation and supervision process across Europe with the removal of the Electronic Money Directive. With the consolidation of their legislative basis, E-money firms will become a subset of Payment Institutions and all existing PSPs will have to reapply for authorisation under PSD3.

What that re-authorisation will look like for firms, depends on a number of factors, including:

- Where competent authorities have evidence that a currently authorised Firm meets the requirements of PSD3 they can automatically authorise these firms as PSPs.
- Firms will need to seek re-authorisation from national authorities within 24 months of the new rules coming into force, with existing licences grandfathered for 30 months after PSD3 enters into force.
- Where a Firm does not meet the authorisation requirements of PSD3, the competent authorities will decide what measures are necessary to ensure such compliance.
- If a Firm ultimately does not meet the requirements of PSD3 it will no longer be authorised as an E-money firm or Payment Institution once the grandfathering period ends.

The authorisation requirements should not change significantly from previous requirements, however some of the key changes are outlined below:

- **Winding-up plan:** A "winding-up" plan will be required for all firms under PSD3.

- **Notification procedures for limited network activities or exclusion based on payment volumes:** Self-assessments will no longer be effective and firms will be obliged to notify their competent authority when seeking to benefit from the limited network or exclusion based on payment volume thresholds. This notification process will allow authorities to assess whether the relevant requirements are fulfilled.

- **Professional indemnity insurance:** PISPs and AISPs will be able to hold initial capital of €50,000 instead of obtaining professional indemnity insurance. This will apply at the licensing or registration stage only.

- **Initial capital requirements adjusted for inflation:** Initial capital requirements have been increased to reflect the impact of inflation since the adoption of PSD2, with the exception of PISPs.

Payment and E-money Institutions will need to prepare for re-application for authorisation. This may include preparation of re-authorisation material, discussion with the CBI and remediation of any areas of deficiency identified as part of the re-authorisation process or the regulatory regime more broadly.

SEPA Instant

Instant payments; the new normal?

In parallel to the PSD3/PSR draft legislation, work to finalise the SEPA Instant Payments legislation has been provisionally agreed on 7 November 2023 by European Parliament and Council allowing up to €100k to be transferred within 10 seconds, anywhere in the SEPA zone 24 hours a day, 7 days a week and every calendar day of the year.

The legislative intervention was brought about as the current non-mandatory SEPA instant payments scheme, which was launched in 2017, has not seen the impacts and uptake initially envisaged. Today 61% of PSPs operating in the SEPA Credit Transfer scheme (SCT) in Europe also operate in Instant.[5] That number is significantly less in Ireland, with only 11 of 195 SCT participants operating in the SEPA Instant scheme.[6]

Spotlight: country ana

Participation in SCT and Inst today

	SCT	Inst	Covera
	3,684	2,274	61%
	195	11	6%
	107	34	32%
	1,274	1,127	88%
	259	136	52%
	387	294	76%
	119	93	78%

5. As at 15 October 2023
6. Registers of Participants in SEPA payment and payment related schemes | European Payments Council
7. https://ec.europa.eu/commission/presscorner/api/files/attachment/873809/2022-10-instant-payments_en-.pdf.pdf

Research conducted by the European Commission indicates lack of uptake was largely down to four reasons:

1. **Reluctance to Invest:** As the PSP of both the sender and receiver must use instant payments technology for the instant transaction to be successful, many PSPs are reluctant to invest without having the guarantee that other providers will be able to support these transactions.

2. **High cost to the consumer:** Consumers and businesses are put off by the high price of instant payments.

3. **Perceived Concerns about the risk of Fraud and Errors:** Consumers and businesses do not have sufficient assurances to address concerns with instant payments.

4. **High failure rates:** A high number (9.4%) of cross border instant payments fail due to slow, inefficient sanctions screening methods used by the industry which are not fit for fast payments.[7]

As such, the new SEPA Instant Payments mandate, which is intended to co-exist alongside the mandatory SEPA Credit Transfer scheme, needs to be seen as affordable, secure and the 'new normal'.

> "For consumers, online and mobile banking payments have jumped 60% in Ireland in the last 5 years.

The incoming legislation is expected to enter force in Q1 2024 and sets out:

1. Mandatory participation: All PSPs currently offering SEPA credit transfers must offer instant payments to all customers

2. Restrictions on cost to the consumer: Charges for instant payments must be equal to or lower than charges for non-instant euro credit transfers

3. Verification Process: All providers must offer a service to check the match between IBAN and beneficiary name, warning about any detected discrepancy as it could suggest fraud

4. Harmonisation of sanctions screening processes: All PSPs must follow a harmonised procedure for sanctions screening based on daily checks of their own clients against EU sanctions lists.

The legislation's final implementation timeline for the receiving and sending of SEPA Instant Payments is nine and 18 months, respectively. Separately, the name and IBAN matching requirement will be applicable at 18 months, while the new sanctions screening requirements will be applicable at nine months.

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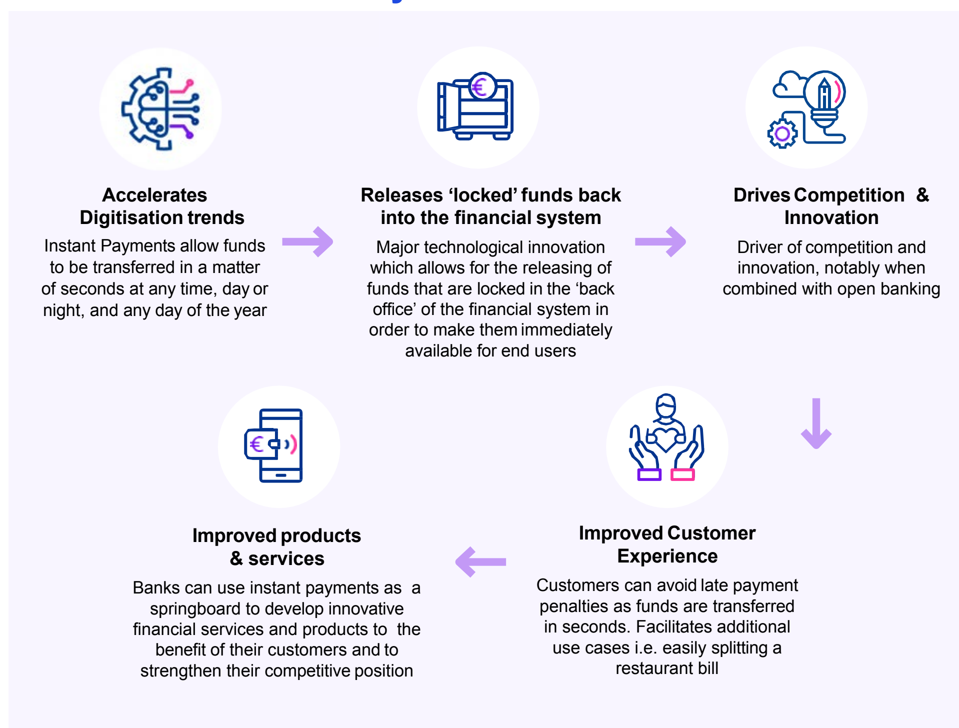
Benefits of Instant Payments



The real value of Instant Payments

For consumers, online and mobile banking payments have jumped 60% in Ireland in the last 5 years.[8] Consumers are tapping for 85% of their in-store transactions, showing the customer preference for digital and quick, frictionless payments – which Instant Payments will support. Migrating payment flows from same day to instant will allow the releasing of funds that are locked in the financial system (currently €200bn in Europe at any given time)[9], making them immediately available to end users for consumption and investment.

For businesses, instant payments mean better real-time visibility of cash and an improved cash flow. For e-commerce retailers particularly, it means less risk, since they can fulfil orders immediately (for comparison, online card payments take up to three days to settle).
In order to be ready for ready for SEPA Instant Payments, Firms should prioritise the performance of a gap analysis to understand the areas of work that must be completed to bring your current environment to the desired end state.

This should include, for example,:

- Current state diagnostics and development of overall Payments and Product Strategies, Revenue, cost and competition analysis;
- Alignment and implementation of ISO strategy;
- Design of programme and governance structures;
- Implementation and migration plans based on use cases;
- Design of the payments system architecture;
- Platform build, development and testing;
- Business and change readiness; and,
- Review of existing sanction screening approach, systems and methodologies, including establishing an appropriate and robust risk-based approach.

The movement from a bulk processing environment Mon – Fri (as is the case with SCT), to having all channels, across all accounts, operating in real time (less than 10 seconds) 24 x 7 x 365 means significant change. Firms that embrace these opportunities with their customers will be the long-term winners.

8. BPFI Payments Monitor - Q2 - Banking & Payments Federation Ireland
9. https://ec.europa.eu/commission/presscorner/api/files/attachment/873809/2022-10-instant-payments_en-.pdf.pdf

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ITALY
Current state and outlook of the Italian Fintech landscape

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BIO

Silvano specializes in M&As both for domestic and cross-border transactions, particularly focused on CEE Countries; public tender offers on listed companies; valuation of Insurance Companies and Banking Institutions; financial planning models for Bank, Insurance and Asset Gathering Corporations; and valuation of Leasing and Factoring Companies.

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1. Bio and track record: Silvano Lenoci, Partner at KPMG

Silvano Lenoci, who joined KPMG in 2000s, is currently Partner, Head of Corporate Finance Italy, Head of Start-up/Tech for the Italian network, Co-Head of Global M&A Banking and Insurance and Head of EMA Insurance Deal Advisory.

Silvano has extensive experience in M&A transactions, both at national, European and global level having successfully directed several transactions, working for important Financial Institutions and Tech companies, ensuring his experience also in public offerings and preparation of industrial plans, strategic analysis and reorganisation projects.

During the recent period, the range of activities undertaken as a financial advisor in the Fintech sector encompasses numerous initiatives, including but not limited to:

- Digital Payments:
    i. the ongoing acquisition by FSI of Banco BPM Payments Business Unit and the set-up of a strategic partnership;
- Cyber Security:
    ii. the acquisition by BV TECH of the 80% stake in Arturai Group in 2023;
- Insurtech:
    iii. the acquisition by TDH Holding of the co-founder's stake of Prima.it in 2022;
- Lending:
    iv. the acquisition by Willoughby Capital of the 49% in Scalapay in 2022.

2. Current State of the Italian Fintech Market

2.1. Overview of the Current Market Size

The Italian Fintech market stands as a dynamic and ever-expanding ecosystem. The sector has experienced significant growth, both in terms of market size and the variety of services offered. Italy's Fintech market size is €1,879 million, with an estimated 2023-2027 compound annual growth rate of 11.7%[1] that underscores the industry's resilience and adaptability.

> "The Italian Fintech market stands as a dynamic and ever-expanding ecosystem.

The Fintech in Italy covers several business segments along the entire business value chain. Digital payments continue to be a vibrant segment, with mobile payment solutions gaining traction among consumers (from Buy Now, Pay Later ("BNPL"), both private and retail, to Peer-to-Peer ("P2P")). In the contemporary Italian Fintech landscape, strategic collaborations and partnerships have become integral to the growth strategies of both startups and incumbents.

Strategic alliances are not only prevalent within the Fintech sector but also extend to collaborations between Fintech companies and traditional financial institutions. These collaborations aim to leverage the strengths of both parties, combining innovation with the established infrastructure and customer base of traditional players.

1. Source: Statista Market Insights, Revenue of the Fintech sector in Italy

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2.2. Main Italian Fintech subsectors

2.2.1. Digital payments

The Digital payments industry comprises various electronic transaction methods, encompassing everything from online and mobile payments to the use of digital wallets and contactless technologies.

During 2023, there has been a notable shift in investing trends, as numerous investors redirected their focus towards Fintech companies possessing strong core payment processing capabilities and resilient business models. The prevailing concerns about a potential worldwide economic downturn, elevated inflation, and swift interest rate hikes in various regions probably played a role in the substantial deceleration, alongside the persistent downward pressure on valuations.

Simultaneously, there is a growing trend towards innovative payment solutions like mobile and wearable technologies. The market for digital wallets and shared savings platforms is expanding significantly, with a projected cumulative annual growth rate of 16.4% until 2027.[2]

2.2.2. Insurtech

The Insurtech industry leverages on technology to innovate various aspects of the insurance sector, including policy development, risk evaluation, and the processing of claims.

During 2023, there has been a continuous and strong focus on the risk prevention side of insurance, particularly from general insurance carriers. This focus spanned quite a spectrum, from the use of sensors to detect and prevent leaks and fires before a major issue occurs to mechanisms to prevent and mitigate the impact of Cyber-attacks. Given the difficulty of pricing emerging risks, insurers have also shown interest in solutions able to help them understand and quantify specific risks in order to better develop related insurance offerings.

The industry is also increasingly leaning towards Insurtechs that act as 'enablers' within the existing insurance value chain, enhancing risk assessment and prevention capabilities. In addition, there is an increasing emphasis towards the customer experience, which is further increased by the implementation of data analytics.

2.2.3. Wealthtech

The Wealthtech sector involves the integration of technology into the asset gathering/private banking industry, focusing on investment management, personal finance, and wealth optimisation solutions.
Even though it still accounts for a relatively small percentage of the market in Italy, interest in Wealthtech offerings is growing. The growing middle class has begun generating a demand for innovative banking products beyond basic cash accounts, encompassing solutions that include funding capabilities.
This shift reflects a broader trend towards democratising investment opportunities, traditionally reserved for high-net-worth individuals, through innovative approaches like fractionalised fundings. Alongside this development, robo-advisors are gaining prominence, catering to this growing customer base by providing straightforward access to trading and a variety of funding.

> "
> The growing middle class has begun generating a demand for innovative banking products.

2. Source: Statista Market Insights, Transaction value of the Digital Payments sector in Italy

2.2.4. Cyber Security

The Cyber Security sector encompasses the development and application of technologies focused on digital security, network protection, data integrity, and defence against online threats.

In the Italian landscape, Cyber Security companies have continued to focus significantly on responding to the demands of their customers, including the demand for real-time monitoring. In particular, Cyber Security companies have embraced the use of AI and automation to develop more robust real-time platforms; they are now looking at generative AI as a mechanism to further improve their real-time compliance monitoring, assessment, and decision response solutions.

> "Cyber Security companies have embraced the use of AI and automation to develop more robust real-time platforms.

Over the last years, Cyber Security attacks have continued to grow in complexity, becoming increasingly challenging and time consuming for organisations to manage.

2.2.5. Lending

The lending sector includes, among the others, financial services focused on providing loans and credit facilities to businesses and individuals, often incorporating innovative technologies and models like Buy Now, Pay Later, which is steadily gaining popularity.
Italian lending Fintechs are demonstrating notable development dynamics, particularly in the area of digital platforms facilitating business financing, especially for small and medium-sized enterprises. 2022 was characterised by mega rounds and registered a substantial increase in the volume of funds provided, compared to the previous year, though this growth was more pronounced in business lending than in direct loans to private individuals.

Currently, a significant trend in this sector is the growing adoption of blockchain technology and the development of innovative products aimed at addressing new financial needs such as BNPL models, and products focused on environmental and social sustainability.

3. M&A and Venture Capital activity in the Italian Fintech Market

In an era marked by rapid technological innovation and evolving financial landscapes, the Italian Fintech sector has emerged as a hub of innovation and growth. This chapter aims to provide a detailed overview of the market, offering valuable insights into the dynamics shaping mergers and acquisitions ("M&A") in this vibrant sector.

3.1. Overview of the M&A Fintech Landscape in Italy

The Italian Fintech market is a complex and diverse ecosystem comprising various segments like Payments, Lending, and Wealthtech among others. This diversity is underpinned by a collaborative spirit between traditional financial institutions and Fintech firms, fostering an environment ripe for strategic M&A activities.

Mergers and acquisitions have emerged as strategic tools that not only reflect the maturity of the Fintech market but also underscore the competitive forces driving companies to collaborate, consolidate, or reinvent themselves. M&A activities in the Italian Fintech sector have far-reaching implications, influencing market structures, fostering synergies, and propelling the industry into new frontiers.

Moreover, the Cyber Security sector is taking the lead as the most prioritised by investors and bigger players focused on amping up Fintech platforms to incorporate AI-based Cyber Security tools and technologies.

3.2. A selection of recent M&A deals in the Italian landscape

3.2.1. Digital payments

3.2.1.1. FSI and Iccrea partner with Banco BPM

On July 14, 2023, Banco BPM, Gruppo BCC Iccrea, and FSI have entered into a binding agreement to create a strategic partnership, giving rise to a prominent player in Italy's digital payments sector. This collaboration, supported by KPMG Italy as financial advisor to FSI, is marked by an innovative and growth-oriented approach and aims to set new standards in the country's Fintech landscape.

The joint venture will leverage on Banco BPM's extensive network of over #1,300 branches and BCC Iccrea Group's #117 cooperative banks with almost #2,500 branches, collectively representing nearly 20% of the bank branches in Italy.[3]

This initiative is underpinned by a commitment to digital and Fintech innovation, with plans to expand the customer base to other banks and financial operators in the domestic market, also following FSI and ICCREA partnership launched in 2022.

3.2.1.2. Nexi signs a strategic agreement with Banco de Sabadell to acquire Paycomet

On February 27, 2023, Banco de Sabadell and Nexi entered into a strategic partnership in the digital payments sector across Europe.

As part of this agreement, Nexi will acquire an 80% stake of Banco de Sabadell's merchant acquiring business for €280 million, after its carve-out into Paycomet. With an enterprise value of €350 million for 100%, this transaction will involve #380 thousand merchants and approximately €48 billion of transaction volumes.[4]

3.2.2. Insurtech

3.2.2.1. Groupama Assicurazioni sells G-Evolution to FairConnect

Groupama Assicurazioni, a leading international insurance and banking group, has successfully signed an agreement to sell 100% of the share capital of G-Evolution, a leading provider of telematics services and specialised in the use of advanced AI algorithms for data analysis for support in the insurance sector, to FairConnect, a prominent provider of connected insurance solutions in Europe.[5]

> “Groupama Assicurazioni, a leading international insurance and banking group, has successfully signed an agreement to sell 100% of the share capital of G-Evolution

3.2.3. Wealthtech

3.2.3.1. M&G partners with Moneyfarm

Moneyfarm, the leading Wealthtech company that enables users to create and manage investment portfolios based on investment targets and their risk appetite, announced on January 26, 2022, the partnership with M&G, with the intention of providing direct investment services to UK consumers.

M&G Wealth, the UK-based wealth management division of the company, invested €53 million in Moneyfarm and plans to leverage on its current technology, digital capabilities, and investment guidance paths to support its own uniquely branded offering. Additionally, M&G and Moneyfarm will jointly investigate various opportunities to collaborate in additional European wealth markets.[6]

3. Source: FSI and Banco BPM's press releases
4. Source: Nexi and Banco de Sabadell's press releases
5. Source: Groupama Assicutazioni and FairConnect's press releases
6. Source: M&G and Moneyfarm's press releases

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3.2.4. Cyber Security

3.2.4.1. BV Tech acquires a majority stake of Arturai Group

On February 9th, 2023, BV Tech, a prominent Italian entity in the fields of information and communication technology as well as management consulting, strategically enhanced its market footprint by acquiring a majority stake in Arturai Group with the support of KPMG Italy. Arturai, recognised as a leading provider of multi-cloud security and web performance solutions, operates across several European countries. This acquisition cements BV Tech's position in the Cyber Security and digital transformation arenas.[7]

> "Arturai, recognised as a leading provider of multi-cloud security and web performance solutions, operates across several European countries.

3.2.5. Lending

3.2.5.1. Scalapay's Series B financing round

Scalapay, a leading payment solution in Southern Europe specialising in BNPL services without interest, secured $497 million in a 2022's Series B investment funding.[8] The funding round, led by Willoughby Capital, that was supported by KPMG Italy, featured participation from players such as Tencent, Tiger Global, Gangwal, Moore Capital, Deimos, and Fasanara Capital. This achievement has elevated Scalapay to unicorn status.

Scalapay's BNPL offerings, including Pay in 3, Pay in 4, and Pay Later, enable customers to defer payments and choose between three instalment options. The company aims to enhance the customer purchasing experience by reducing the financial burden.

3.2.5.2. Aidexa's financing rounds

Aidexa is the first digital financial institution in Italy with an open banking system dedicated to SMEs, with top customer experience, fastest time to credit answer and best NPS score. In 2022 it raised €12 million from investors to improve bank's solidity and there are market rumours that Aidexa will launch a new round in 2024.

Aidexa's potential customer base is around #800k in the small business segment, one of the most attractive niche markets in terms of risk-adjusted profitability in Italy.

On 24 February 2020, PBI S.r.l., major shareholder of Aixeda, entered into a co-investment agreement with #30 investors for a total capital raised higher than €40 million. More than #300 potential investors were contacted, including: #4 institutional investors, #6 family offices and #20 angel investors.[9]

3.3. Venture Capital at a glance

The Italian Fintech ecosystem experienced significant growth in the second half of 2022, marked by large-scale deals such as Satispay's €320 million funding, Scalapay's €441 million round in February 2022, and Moneyfarm's €53 million financing.[10] However, the trend shifted in 2023, witnessing a slowdown in M&A transactions and a pivot towards a stronger focus on the Venture Capital ("VC") ecosystem. In fact, based on BeBeez Private Data's elaborations, the fundraising activity of Italian fintech startups and scaleups has seen a quiet year, with €200 million raised in #32 rounds. This contrasts with the notable success of 2022, which concluded with a total fundraising of €1.05 billion spread across #28 rounds from #26 companies. This shift was accompanied by a notable downturn in the Fintech market, characterised by reduced valuations and investor risk appetite, leading to an increased emphasis on developing new technologies and business models, supported by incubators, events, and organisations.

7. Source: BV Tech and Arturai's press releases
8. Source: Scalapay's press releases
9. Source: Aidexa's press releases
10. Source: Satispay, Scalapay and Moneyfarm's press releases

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Venture capital investment in financial technology companies saw a significant decrease in the third quarter of 2023, continuing the pattern of reduced funding deal volumes. Despite this general downturn, there was a notable resurgence in mature startups, which contrasted with their performance in previous quarters. This resurgence, particularly in late stage investing, appears to be a market correction following the previous year's funding challenges. However, the lasting effect of this improvement on early-stage investments is still uncertain.

During this period, the sector observed a few digital banks re-entering the VC market and a sustained interest in AI-based Fintech models. In addition, there has been a strong trend related to launching digital banks to compete with foreign institutions.

More specifically, Intesa Sanpaolo launched Isybank in June 2023, while Unicredit revamped Buddybank in October 2023, updating the homebanking app to keep up with competitors. Yet, these positive trends were insufficient to counteract the overall downward trend in funding across different sectors and regions. Late-stage startups fared relatively better than other stages, but valuations across the Fintech sector continued to face challenges. The future recovery in Fintech venture funding may hinge on creating more exit opportunities through IPOs and M&A activities, which could potentially kickstart a new growth cycle in the sector.

4. Future outlook: envisioning the trajectory of the Italian Fintech market

Throughout 2023, Fintech funding experienced significant restraint as numerous investors refrained from undertaking substantial funding commitments amid a multitude of market challenges. These challenges included notably elevated interest rates, which fundamentally posed a challenge to existing business models.

The following key trends will be defining the Fintech industry's future:

1) Fintech investors are progressively placing higher importance on companies that can showcase substantial top-line revenue growth and quicker routes to profitability.

2) The payments sector will remain active, with a strong focus on consolidating the existing businesses and launching new in-house solutions to achieve greater scale and reach and take advantage of significant scheme changes across all markets.

3) Corporate Ventures will embrace start-ups able to help them operate more seamlessly and efficiently: corporate fundings will likely focus on solutions able to help their corporate customers operate more effectively and transform digitally — from Cyber Security platforms to solutions that help financial processes.

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> The payments sector will remain active, with a strong focus on consolidating the existing businesses and launching new in-house solutions

4) The role of accelerators and incubators in fostering innovation cannot be overstated. In Italy, numerous entities are nurturing startups, particularly in their early stages. This nurturing is creating a pipeline of innovative companies, making them attractive targets for M&A.

5) The enthusiasm for AI is poised to grow further: scaleups will highlight their established AI capabilities as they seek funding and establish business partnerships, while new startups will be nurtured and expanded to harness AI as a transformative factor in operational efficiency and services. The involvement of major tech giants will be pivotal in advancing generative AI Fintech solutions.

2. Source: Statista Market Insights, Transaction value of the Digital Payments sector in Italy

6) ESG considerations are becoming increasingly prominent in the Fintech sector. This will further increase its impact in a period that requires sustainability and solidity.

7) The concentration of Fintech startups in Northern Italy, especially Milan and Turin, is a significant factor in the M&A landscape. However, the potential for growth in Southern Italy, supported by training programs and fiscal incentives, represents untapped opportunities for strategic M&A, also thanks to the increasing hubs launched through universities.

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> The concentration of Fintech startups in Northern Italy, especially Milan and Turin, is a significant factor in the M&A landscape.

4.1. Conclusion

In conclusion, the Italian Fintech market presents a landscape with several opportunities and challenges. Predictions indicate continues growth in digital payments, the influence of emerging technologies, and the impact of global trends such as ESG considerations. Furthermore, the heightened significance of startups and technology enablers in the Fintech environment is expected to increase in the upcoming years, even though 2023 registered an 81% decrease in investments compared to 2022, with only €200 million raised.[11] The role of M&A will persist as a strategic lever, enabling companies to capitalise on these opportunities while addressing regulatory complexities and market dynamics.

11. Bebeez Private Data

Transformation never stops. Neither do we.

Our people can work with you to make transformation part of your every day.

KPMG in Italy

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ITALY

Italian FinTech Evolution: Investments, Regulations, and Future Trends

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Massimo Donna has been a lawyer focusing on technology and finance for over 20 years. After graduating from the University of Rome - La Sapienza, and completing a Masters Degree in European Union Law at Universidad Autonoma, Madrid, Massimo worked in New York and London at a number of international law firms. A 6-year stint as a senior counsel in charge of South EMEA and Spanish LATAM at a multinational software company allowed Massimo to gain an unparalleled understanding of the workings of digital enterprises. Massimo regularly advises clients on tech-driven M&A, FinTech, AI and, in general, contentious and non-contentious IT and commercial matters. Massimo regularly contributes to international legal publications and lectures on the intersections of technology, finance and the law.

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Chiara Bianchi specialises in contentious IT and commercial matters, as well as in regulatory matters. Chiara is an ITechLaw member, and a regular contributor to international publications in the FinTech and Cybersecurity sectors. She has been a partner at Paradigma - Law & Strategy since 2020.

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1. Background

In 2022 FinTech investment in Italy increased by 240% vis-a-vis the previous year. Such outstanding figures were achieved on the back of certain VC-funded "mega-rounds", each of them worth in excess of 50 million Euros, but also as a result of a number of smaller investments across the Financial Technology board. Within the FinTech sector, most investments have focused on digital payments, InsurTech, RegTech and Open Banking.

> "In 2022 FinTech investment in Italy increased by 240% vis-a-vis the previous year.

Whilst final data are not available for 2023 yet, the general sentiment is that higher interest rates have triggered a not insignificant drop in Venture Capital activity, both by number of deals and size. As for crypto, investments have followed the general trend, dropping as a result of the FTX debacle. On the bright side, the coming into force of the EU DLT Pilot Regime and of the Italian FinTech Decree prompted a renewed enthusiasm for tokenisation with financial and banking regulators, as well as in the private sector. Also, the government Sandbox Programme has yielded some excellent results, with its second application window due to close in early December 2023.

2. The FinTech Landscape

A broad range of Fintech offerings are now available in Italy, with Payment Systems, Crypto Assets and Crowdfunding certainly counting on the broader user base and being on the regulators' and supervisors' radars.

Payment Systems. With the transposition into the Italian legal system of EU Directive 2015/2366 (the second Payment Service Directive, or "**PSD2**"), banking intermediaries (or **ASPSPs**, Account Servicing Payment Service Providers) must allow access to third party providers ("**TTPs**") in order for them to provide certain payment services, even in the absence of an agreement between ASPSPs and TTPs. In particular, TTPs include Payment Initiation Service Providers ("**PISPs**"), Account Information Service Providers ("**AISPs**") and card-based payment instrument issuers ("**CBPIIs**"). ASPSPs must ensure the identification of and secure communication with TTPs for the purposes of the provision of payment services either by way of adapting their customer interface or by setting up a dedicated interface for TTPs. ASPSPs must also set up a fall-back interface, unless they are exempted from doing so based on the verified robustness of their TTP interface. In Italy, most ASPSPs have opted to adopt the interfaces (also dubbed Open Banking Platforms) developed by four platform service providers. Only a few ASPSPs elected to develop their own proprietary interfaces, typically adapting their customer interfaces. The Bank of Italy, as the authority responsible for overseeing payment systems, is in charge of supervising ASPSPs to make sure that they allow TTPs the required level of access, but also of supervising Open Banking Platform providers and infrastructure service providers. By the end of 2022 more than eighty TTPs operated in Italy, most of them authorised both as AISPs and PISPs, but the industry consensus is that the number of active TTPs in Italy is bound to dramatically increase in the next few years.

Crowdfunding. The EU crowdfunding regulation (EU Regulation no. 2020/1503) came into force on 10 November 2023, replacing the previous national regime. In fact, Legislative Decree no. 30 of 30 March 2023, amended the Italian legal system in order to ensure the regulation's full application. On 5 June 2023 the financial markets regulator and supervisor (**CONSOB**, Commissione Nazionale per le Società e la Borsa) adopted a new crowdfunding regulation in line with EU law. For its part, on 17 May 2023 the Bank of Italy launched a consultation on the supervising guidelines on crowdfunding service providers, the outcome of which was published on 2 August 2023. The EU Regulation covers the service of facilitating the granting of loans (**lending-based crowdfunding**), and that of placing without a firm commitment basis, as well as the reception and transmission of clients' orders of, transferable securities and crowdfunding instruments (**investment-based crowdfunding**) via online platforms. The Regulation also covers the individual management of portfolio loans, i.e. the case in which clients entrust the crowdfunding service provider with capital, and the service provider allocates such capital on different lending projects available on its online platform. Regardless of any additional authorisation held, the crowdfunding service provider must obtain an ad-hoc authorisation to provide crowdfunding services, whilst holding additional authorisations (for example for the provision of investment services or activities, or for payment services) may allow the provision of further services along with the crowdfunding services. Crowdfunding services authorisations are granted by CONSOB further to consulting with the Bank of Italy, unless the applicant already holds a banking, payment or e-money institution, or financial intermediary authorisation, in which case the crowdfunding authorisation is granted by the Bank of Italy upon consultation with CONSOB. Noticeably, the Legislative Decree stipulates that, as an exception to the general rule that quotas of Limited Liability Companies (Società a Responsabilità Limitata) cannot be offered to the public, such quotas can be placed via crowdfunding platforms.

Robo-advice. Under the EU MIFID II Directive – principally transposed in Italy by way of amending the TUF (Testo Unico della Finanza) – financial advice is a regulated activity, which can only be carried out by entities authorised to provide investment services and activities in Italy. In simple terms, Robo-advice can be described as the activity carried out by Artificial Intelligence agents by collecting and processing a great amount of investors' data in order to recommend the most appropriate investment service. Whilst Robo-advice has been heralded by some as the potential solution to prevent agency and conflicts of interest, it can also pose significant threats to investors. In fact, algorithms can be faulty, due both to their design, bugs or hacking, and algorithmic appropriateness does not necessarily coincide with regulatory appropriateness. Concerns have been raised in relation to the suitability of the advice rendered by robo-advisors, which ESMA tried to tackle by way of its 2018 Guidelines on certain aspects of the MIFID II suitability requirements. In particular, the ESMA report included some noticeable algorithmic transparency obligations on robo-advisory service providers. From a financial stability standpoint, it has been noted that robo-advisors tend to route customers' investments towards Exchange Traded Funds (ETFs), which could lead to herding behaviours that could eventually dent market stability. The above concerns notwithstanding, robo-advisors are steadily increasing their market share in Italy.

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The EU crowdfunding regulation (EU Regulation no. 2020/1503) came into force on 10 November 2023, replacing the previous national regime.

Buy Now Pay Later (Consumer). The typical BNPL structure involves a vendor allowing its customers to pay only a portion of a service's or a product's price, and settle the balance in monthly payments. At the same time the vendor would assign the relevant account receivable to a bank or an intermediary. Since no direct contractual relationship is established between the bank/intermediary and the consumer, the consumer credit legislation does not apply. This is going to change with the coming into force of Directive (EU) 2023/2225, which will also apply to consumer BNPL -with a few specific exceptions- and may also require BNPL service providers to be granted ad-hoc authorisations.

Algorithmic Credit Scoring utilises big data and next generation AI-based business analytics to provide swifter and customised credit scoring services. Algorithmic Credit Scoring is also increasingly used in the insurance sector, as there appears to be a correlation between credit scoring and risk profile. Relinquishing personal data is still regarded with some degree of suspicion in Italy, even if people are realising that only with better profiling can customised services be enjoyed.

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> Algorithmic Credit Scoring utilises big data and next generation AI-based business analytics to provide swifter and customised credit s coring services.

AI-based alternative lenders aims at simplifying and expediting the traditional bureaucratic borrowing experience. Some of these new breeds of lenders grant loans and financing in a matter of minutes leveraging artificial intelligence. Other Fintech startups are focusing on revenue-sharing lending, allowing borrowers to repay their loan periodically through their business proceeds.

3. Crypto Assets and Tokenisation

Crypto Services (Exchanges and Wallets). Operating a crypto exchange in Italy (i.e., the businesses of converting cryptocurrencies into different cryptocurrencies, fiat money into cryptocurrencies, or the other way around) is not regarded, per se, as an investment service, hence is not subject to authorisation by CONSOB. Crypto exchanges and wallet service providers, however, must meet rigorous anti-money laundering ("**AML**") requirements pursuant to the AML5 EU Directive, as implemented in Italy by way of amendment to Legislative Decree no. 231 of 2007. In addition, as from 16 May 2022, all Crypto Services providers operating in Italy are required to enrol with an ad hoc register (the "**OAM Register**") held by the public body governing financial agents and mediators. Applicants can be either individuals or legal persons, in the latter case incorporated in Italy or – if incorporated in another EU Member State – having set up a permanent establishment in Italy.

Micar. With the coming into force of Micar (Regulation (EU) 2023/1114 on Markets in Crypto Assets), the regulation of offering/issuance of Asset Referenced Tokens ("**ARTs**"), E-Money Tokens ("**EMTs**") and of other tokens not belonging to the aforementioned categories ("**Utility Tokens**") shall be unified at EU level. Micar will also regulate the provision of crypto-asset services. However, although Micar has been widely welcomed as a measure providing certainty to the regulatory environment of the crypto sector, certain open issues are still outstanding. For example, Micar shall not apply to crypto assets that fall within the application of MIFID II, however, such a directive leaves some room to Member States as to the definition of financial instruments. Also, certain crypto assets may not fall within the definition of financial instruments, but may be regarded as financial products and be subject to certain national prospectus requirements.

Tokenisation. Under Regulation (EU) 858/2022 (the so called "**DLT Pilot Regime**") certain financial instruments can be issued and negotiated on distributed ledgers. In particular, such digital financial instruments can be negotiated on DLT multilateral trading facilities ("**DLT MTF**"), settled on DLT securities settlement systems ("**DLT SSS**"), as well as both traded and settled on a DLT trading and settlement system ("DLT TSS") which combines activities of both a DLT MTF and a DLT SSS. At a national level, Italy adopted Law Decree no. 25 of 17 March 2023 -which was dubbed the "**Fintech Decree**"- not only to introduce all the necessary changes for the full application of the DLT Pilot Regime, but also to allow the tokenisation of financial instruments even if they are not negotiated on trading venues.

Regulators and Supervisors

CONSOB is the financial market watchdog in charge of supervising entities carrying out investment services and activities (intermediaries) or offering financial products, as well as regulated markets and other trading venues and issuers of financial instruments. CONSOB's responsibilities are extremely broad as they span from: granting (or denying) authorisations to carry out investment services in Italy; ensuring that investment services providers established in other EU countries meet the requirements to carry out their activity in Italy; ensuring that entities offering financial products draw up an appropriate prospectus describing the products that they intend to offer and obtain CONSOB's approval on the prospectus; and supervising the functioning of regulated markets, trading venues and issuers, including their reporting and governance obligations and IPOs duties. Over the past few years, as an increasing number of players in the crypto domain entered the Italian market, CONSOB has found itself facing several challenges, such as determining whether the new crop of crypto offerings fall within the definition of financial products or financial instruments.

The **Bank of Italy** is part of the European System of Central Banks (ESCB). In this context, the Bank of Italy works along with and supports the European Central Bank in granting banking authorisations, supervising banks and, when required, sanctioning them. In particular, banking authorisations are granted by the European Central Bank upon the proposal of the Bank of Italy. The Bank of Italy, along with the European Central Bank and in the framework of the Single Supervisory Mechanism, is also responsible for carrying out prudential supervision over Italian banks. Typically, significant banks are under the responsibility of the European Central Bank and less significant lenders are looked after by the Bank of Italy. However a bank's significance may vary over time or there may be other specific reasons why a lender should be supervised directly by the ECB. Most significantly for fintechs, the Bank of Italy's financial intelligence unit (Unità di Informazione Finanziaria) is in charge of enforcing AML legislation, which is of particular relevance for crypto service providers and, in general, all fintechs.

Fintech Sandbox Programme.

A long-awaited piece of legislation introducing regulatory sandboxes for Fintech businesses was recently passed. In fact, on 17 July 2021, the Decree of the Ministry of Economy and Finance no. 100 of 30 April 2021 entered into force (the "**Sandbox Decree**"). The idea behind the Sandbox Decree is to set up a FinTech Committee composed of representatives of all the authorities potentially involved in the authorisation or supervision of Fintech businesses, i.e. CONSOB, the Bank of Italy, the communications authority (AGCOM), the competition authority (AGCM), the data protection authority, the governmental body in charge of digitalisation, the tax agency and the insurance industry supervisor. The FinTech Decree has so far benefited dozens of startups, also facilitating the cooperation between fintechs and established players in the financial and banking sector.

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JAPAN
Emerging Trends in the Japanese FinTech Market

EY

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Committee Member of the Japan Tourism Agency (Promotion of tourism DX)
Committee Member of the Japan Tourism Agency (Functional enhancement for JNTO certified Foreign Tourist Information Centres)

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Landscape of the Japanese FinTech market

While the global impacts of the COVID-19 pandemic gave rise to temporary stagnation in the FinTech market, the preventative measures undertaken in response accelerated the adoption of contactless and unattended services and paved the way for continued growth.

Current projections call for the global market to reach an astonishing USD1.5 trillion in magnitude by 2030, a six-fold increase from 2021 levels[1]. A notable driver of this growth is the APAC region, which is projected to surpass the North American market by 2030 and become host to the world's largest FinTech market (at sizes of USD6 trillion and USD5.2 trillion, respectively).

> "Current projections call for the global market to reach an astonishing USD1.5 trillion in magnitude by 2030

While the Japanese FinTech market was no exception to the global and domestic impacts of COVID-19, a market recovery is underway with projections calling for continued market expansion; banking and investment services boast the highest growth rates forecast in a measure of total Japanese enterprise IT spending, standing at 6.8% in 2023 (c.f. the average of 4.7%) and 6.6% in 2024 (c.f. the average of 4.9%).[2]

A brief history of FinTech in Japan

The Global Financial Crisis of 2008 — commonly known in Japan as the eponymous "Lehman Shock" — is recognised as the catalyst for global recognition of FinTech, as the former employees of affected financial institutions (primarily in the US and the UK) began to push the limits of technology to gain mainstream status by unbundling offered services into standalone functions capable of providing enhanced convenience and versatility. The rapid gains in service quality brought about by this flurry of activity seemed at one time poised to disrupt the established system of financial institutions.

The global shockwaves generated by the birth of FinTech abroad fell flat in Japan, however, producing only lukewarm reactions in a market saturated with and insulated by forerunner products generated through the domestic industry's unique and successful focus on the sophistication of such individualised services. At that time, Japan was already enjoying a suite of services at the intersection of finance and technology: the capability for same-day deposit of interbank fund transfers, for instance, was already online at the majority of Japanese financial institutions; and the NTT Docomo mobile phone service Osaifu-Keitai enjoyed a dominant position in Japanese society and served as a precedent for later mobile payment services such as Apple Pay and Google Pay. This social climate effectively laid the foundations for the concurrent adoption of personal finance management, asset management, insurance and cloud-based accounting services.

The development pathways taken by the domestic industry contributed to the birth of a large number of startups in the years since interest in FinTech began to deepen in Japan circa 2015, although the impact of this interest in the financial markets was limited in comparison to the shockwaves that traversed other world markets.

1. QED Investors, "Global FinTech 2023 Reimagining the Future of Finance", Boston Consulting Group website,www.bcg.com/ja-jp/publications/2023/future-of-fintech-and-banking, accessed 31 October 2023
2. Gartner, 日本における2023年のエンタプライズIT支出の成長率を4.7%と予測 [Gartner Forecasts Japanese Enterprise IT Spending To Grow 4.7% in 2023], www.gartner.co.jp/ja/newsroom/press-releases/pr-20230227, accessed 31 October 2023

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Alignment in the space between financial institutions and FinTech companies

While some expected FinTech to disrupt the established network of financial institutions, very few ventures have actually effected disruptions; in fact, the current state of the market serves only to highlight the possibilities made feasible by collaboration and alignment between financial institutions and FinTech companies. FinTech ventures' initial struggles to acquire large market shares and win over new clients in Japan can largely be attributed to the high degree of trust placed in traditional financial institutions by the local populace. The difficulties faced by FinTech ventures generated room for successful collaborations aimed at providing the clientèle of traditional financial institutions with more convenient services, as the traditional financial institutions such ventures chose as collaboration partners had themselves long lacked the capacity to speedily develop and commercialise a versatile suite of financial services.

Categorisation of the impact FinTech has had within the context of the industry's development in Japan gives rise to two major but inexhaustive groupings:

1 Increasing the importance of data utilisation
- Data collection and analysis techniques continue to advance with the passage of time, enabling the architecture and offering of data-driven services.
- With the practice of data collection shifting from analog to fully digital methods comes better infrastructure for data utilisation.

2 Increased vectors for customer reach
- Mobile and other types of newly offered customer experiences provide additional pathways for developing new customers in existing business domains and for reaching customer groupings that were heretofore cost-prohibitive.
- Reductions in the cost of business generated by technological advances provide additional pathways for offering new services in new business domains.

These two categories of impact continue to be of great importance in the present day, as they are at the essence of FinTech services and digital transformation (DX). When Japanese interest in FinTech first began to grow circa 2015, FinTech services were most frequently part of the service lineup offered by financial institutions, and were included under the premise that the benefits obtained therefrom would include the two categories of impact described above. Long-sustained low interest rates and the COVID-19 pandemic spurred financial institutions into rebooting their store location strategies,[3] and such activities helped facilitate the burgeoning transition of analog channels for customer interaction into their digital equivalents, and the major challenges this transition posed for financial institutions attempting to design the optimal customer experience.

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> The difficulties faced by FinTech ventures generated room for successful collaborations aimed at providing the clientèle of traditional financial institutions with more convenient services

Financial services offered by non-financial corporations

The emergence of FinTech provided an overnight reduction in the barriers to entry in the financial services industry, and corporations with core non-financial businesses — including the likes of Apple, Google, Tencent and Alibaba — expanded into financial services offerings, with the majority of such initial forays into payments. These corporations leveraged the data they obtained from such services to launch financing and other services, ultimately developing into platform operators that host a seamless suite of financial and non-financial services.

3. 世界の銀行店舗、10年で1割減　DX·低金利で削減加速 [Global bank locations decrease 10% in 10 years, DX and low interest rates spur closures], The Nikkei, 4 August 2021, www.nikkei.com/article/DGXZQOGD19BJO0Z10C21A7000000/ (accessed 31 October 2023)

A great number of non-financial corporations in Japan also began their forays into the financial services through payment services, but Japan's already-saturated mobile payment landscape made success a difficult prospect for any of those ventures. In part due to this business environment, the growing global popularity of embedded finance, wherein businesses refrain from building their own payment service offerings and instead partner with financial institutions to provide financial services, is readying to take root in Japan as well.

SBI Sumishin NetBank is a ready supporter backing the ventures of non-financial corporations with Banking as a Service (BaaS). Current SBI Sumishin NetBank clients for BaaS services include JAL, Yamada Holdings and Culture Convenience Club, and this trend is likely to grow further in popularity, in part due to similar offerings in development at other financial institutions.[4]

The most alluring benefits financial institutions obtain through collaborations with non-financial corporations are the ability to reach the customers of their collaboration partners, as well as the ability to use the front-facing structuring of the offering, which conceals the brand of the financial institution under the covering of the non-financial corporation's brand, as a pathway to developing new customers. Such arrangements have the potential to outcompete previous ways of doing business, as they enable financial institutions to act on strategies which fully leverage the front-facing brand of a chosen non-financial corporation to their advantage, without the constraints of the brand established by the financial institution itself.

> “The Japanese FinTech industry is similar to its global counterpart in that embedded finance is the dominant industry trend.

Non-financial corporations stand to benefit from increased customer retention through higher usage of their apps and services (e.g., point programs) and the ability to increase the value of their brand by building longer-lasting customer relationships tied to their provision of financial services such as home loan financing or asset management.

Rising demand for embedded financial services

As described above, the Japanese FinTech industry is similar to its global counterpart in that embedded finance (the incorporation of financial services into the service offerings of non-financial corporations) is the dominant industry trend.

In the US and other countries, interest is growing in a category of post-payment services known as "buy now, pay later" (BNPL) aimed at customers who avoid or do not have credit cards. Similar services offerings were once commonplace, with examples including those made available by Japan's major household appliance retailers, and the transition into the digital realm has conferred an additional factor of convenience onto such services. Projections are for the domestic market to grow in a similar manner as that seen in international markets, i.e., primarily driven by younger sectors of the population.[5]

Services for corporate clients are garnering attention in much the same manner as customer-focused services. Topics trending in Japan, such as operational efficiency and digitalisation, have boosted the adoption of cloud-based solutions for invoicing, accounting and other services. Some providers of such services even undertake the pseudo-securitisation of such invoices as accounts receivable and provide financing, factoring and loan services. A notable feature of such arrangements is that financial institutions are not providing financial service functions per se, but rather aligning to the provision of actual services, including via the acquisition of other corporations.

The majority of Japanese small and medium enterprises (SMEs) are in need of flexible, timely financing, and as services such as those described above provide methods for obtaining such financing, there is a strong likelihood of continued growth in the market for such services.

4. 銀行の広告参入相次ぐ　住信SBI、CCCと組みポイントも [Banks flood into advertising: SBI Sumishin and CCC collaboration includes point programs], The Nikkei, 20 December 2022
5. E-commerce Payment Service Market in Japan: Key Research Findings 2023, Yano Research Institute Ltd., https://www.yanoresearch.com/en/press-release/show/press_id/3217 (accessed 31 October 2023)

Further growth is also predicted in the market for initiatives aimed at supporting SMEs, including schemes in which the provision of BaaS functions to non-financial corporations is used in indirect support of the clients of the corporation purchasing such functions. While an increase in online tourism reservations is expected to occur in response to the global expansion of the tourism industry, the online travel agents who provide bookings of hotels and other services currently go no further than providing the platforms through which said bookings are made. This transaction data, however, could easily be leveraged to, for example, provide support directly to the hotels and other businesses registered on the platform in the form of loans and other financial services. The alleviation of the historical difficulties constraining financial services providers from easily supporting SMEs, namely the difficulty of obtaining information concerning their ordinary transactions, will likely be realised through the usage of services provided by non-financial corporations.

The outlook for financial institutions under threat of dumb piping

In April 2023, the Japanese government permitted the payment of wages to digital wallets, smartphone payment apps and other services (below, "digital salary payments").[6] Underlying this development promoting cashless payments is a commitment made to reaching the cashless payment prevalence targets set forth by the Japanese government in its Cashless Vision (i.e., 40% of payments in 2025, with an ultimate target of 80% of payments).

Widespread adoption of this policy will effectively mandate an overhaul of financial institutions' tried and true strategy of utilising direct deposit accounts to entice clients into utilising other financial services. The loss of direct deposit account dominance will erase that category of customer touchpoints and deepen the business challenges facing such enterprises.

FinTech businesses have succeeded in expanding thus far by approaching customer acquisition and development through their collaborations with financial institutions. Increased digitalisation is engendering an outflow of customers from conventional financial institutions, and as a result collaborations with the subset of non-financial corporations who remain within constant reach of their customers is on the rise. Such collaborations are prime examples of embedded finance at its essence.

In the sense that embedded finance is a trend unique to FinTech, FinTech companies specialising in payments, insurance or other fields will enjoy a relatively stronger ability to remain the corporate face of the services they offer. Conventional financial institutions, however, may find service offerings that highlight their own brand are incompatible with the brands of non-financial corporations. Potential avenues for such companies include either rebranding the services they offer or dedicating themselves to providing functionality in the role of a behind-the-scenes financial services platform operator (i.e., the dumb piping of financial institution services).

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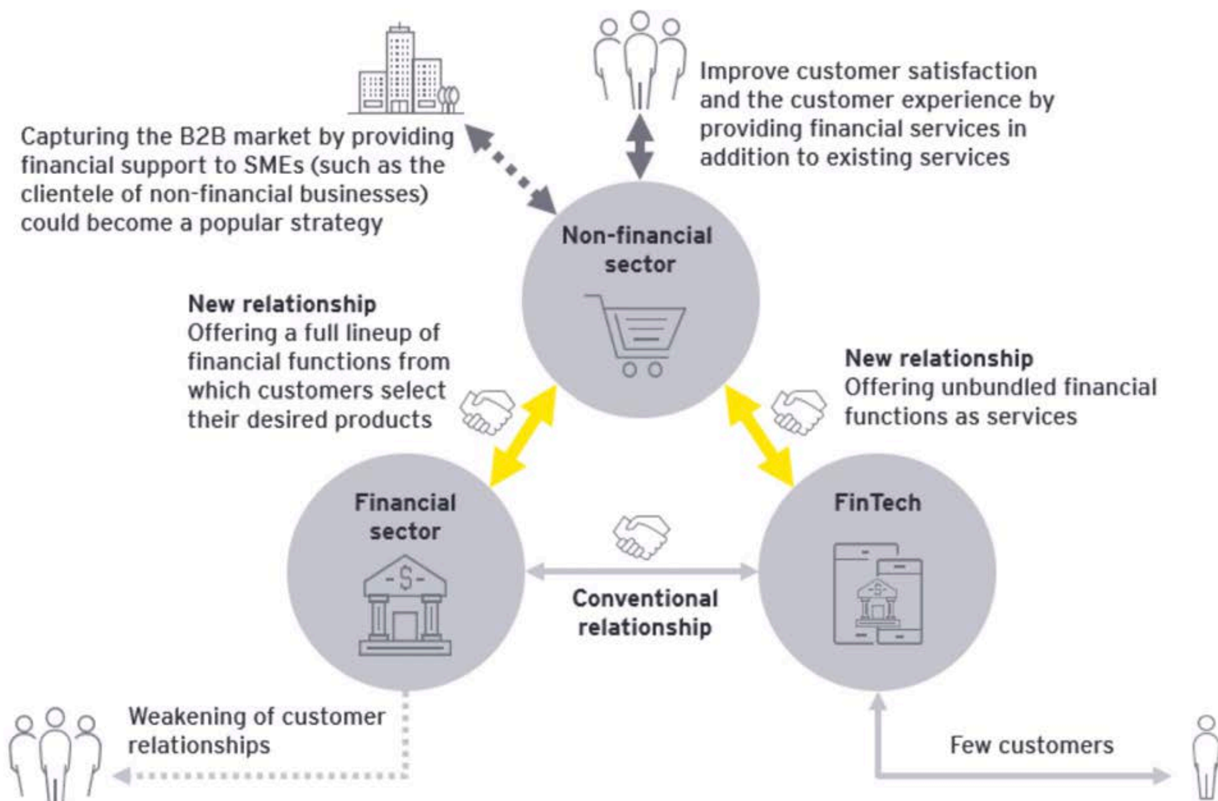
> In April 2023, the Japanese government permitted the payment of wages to digital wallets, smartphone payment apps and other services.

In the US, Goldman Sachs has committed to transitioning into a technology company and entered the BaaS market. As similar actions are being taken in Japan, largely by online banks operating within its borders, the number of corporations aiming to expand their financial services offerings by providing BaaS functions is increasing.

6. Digital salary payments can be received only via the accounts of fund transfer service providers (i.e., operators of cashless payment services) designated by the Minister of Health, Labour and Welfare; and as such digital salary payments are unavailable as at the time of writing (October 2023).

As trust has been an essential component of finance since its inception, the path to growth was in increasing brand awareness and thereby gaining new customers and service users. These rules are no longer absolute in the current era, as non-financial corporations are increasingly enjoying more prevalence in front-facing roles than financial service providers and are thus becoming the primary touchpoint for customers. While it goes without saying that financial institutions must continue to provide trustworthy services, a key component of business strategy for any such institution is now the twin choices of which corporations to partner with and which services to offer.

The relationship between FinTech companies and financial institutions, who once enjoyed a plethora of possibilities for collaboration and alignment, is starting to be laid bare to competition through the vector of their interactions with non-financial corporations. Financial institutions who find themselves at such junctions will likely be forced to revisit their strategies and choose whether to leverage their established brands for continued customer service offerings or to shift to a role behind the scenes providing a varied and highly trustworthy lineup of services with the high versatility of said services as their primary value proposition.



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MEXICO

Financial Innovation Group: A multidisciplinary approach to advance FinTech in Mexico

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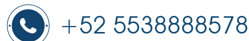
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Financial Innovation Group:
A multidisciplinary approach to advance FinTech in Mexico

1. The Financial Innovation Group: Context

Mexican FinTech Law, enacted in March 2018, includes a section mostly forgotten until recently. Articles 93 to 95 create the Financial Innovation Group, a consulting, advisory and coordination instance integrated by up to 12 proprietary members from the public and private sectors. The public sector members include representatives from the Ministry of Finance, the Central Bank and all supervisory financial agencies -(i) the Banking and Security Commission, (ii) the Insurance and Bonds Commission, (iii) the Pension Saving System Commission and (iv) the Financial Consumers' Protection Agency-. The rest of the members should represent FinTech and other financial entities invited by the Ministry of Finance. Third parties may be invited without voting rights when the nature of the session requires it.

According to the Law, the Group is intended to encourage the exchange of opinions, ideas and knowledge between government and industry and, most importantly, for the authority to learn about and understand new developments around financial technology and plan in an orderly manner its development and regulation.

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> The Ministry of Finance inaugurated the three-day event, recognising that the FinTech sector has had a non-stop escalation with 20% of annual growth.

We can personally attest why the writers of the law wanted this body to exist. They fully understood that what was being regulated was in constant change and that regulators will never match the speed and progress of technology. By periodically meeting with the people on the ground, they would understand, try to adapt and, most importantly, not hinder innovation and the growth of the sector.

By legal mandate the Group has to convene at least once a year. Sadly, this has not happened.

Up to December 2023, the only public evidence that the Group gathered was on August 2018, complying with one of the commands in the Law stating that the first meeting had to be held at the latest in September 2018. What is interesting is that the private members being invited to this first meeting were "*innovation specialists for banking, securities, insurance, e-payments, cryptocurrencies and crowdfunding sectors*". As to the agenda, a special guest was invited, the Head of the Global Macro-Financial Monitoring and Lead Financial Sector Economist in the World Bank, to talk about the FinTech landscape and vision worldwide, as well as his view on the development through technology of the Mexican financial system in Mexico.

No other evidence of further meetings were found, in spite of the legal mandate mentioned above, until a big event shifted the attention back: the First FinTech Week organised by the Ministry of Finance along with the other financial authorities, held in August 2023.

2. The First FinTech Week: Kick-off to pending agenda

The Ministry of Finance inaugurated the three-day event, recognising that the FinTech sector has had a non-stop escalation with 20% of annual growth and increase in the user base 7 times higher than traditional banks. The number of granted authorisation reached 65.

So their intent is to consolidate the ecosystem to become a benchmark in innovation, sustainability and collective well-being. For this, they recognised that a proper regulatory environment prone to protect the consumers and integrity of the financial system, without hindering innovation, competition and growth, is what had to be promoted and safeguarded.

The Underminister of Finance called upon authorities, regulators, and representatives from the sector to collaborate in creating an enabling and proportional environment for the sector allowing it to realise its potential and, therefore, benefiting the entire Mexican population, while ensuring a level playing field.

We consider this recognition a huge milestone achieved by the current administration in Mexico.

Further, a working agenda was shaped which, no doubt, fell short of all pending matters in the ecosystem but definitely served as a kick-off for all work to be done. The items mentioned by the Underminister were:

a. Urgent definition and implementation of the pending open finance regulation, which would help to offer new, better and personalised services, helping clients in better money management and informed decision-making.
b. Issuance of clear rules for the card payment system to foster competition and the establishment of new payment networks.
c. Produce specific regulation for "digital" brokers to provide legal certainty and create an ad-hoc framework.
d. Update and increase the investment limits in crowdfunding products to offer higher returns and more benefits for consumers.

Finally, they called to **activate** the Financial Innovation Group to work hand in hand, fostering innovation, sustainability, inclusion, and education within digital financial services. "*Maintaining constant dialogue, we aim to turn Mexico into one of the **leading financial hubs** in the region.*"

3. 2023 Meeting of the Group

The Financial Innovation Group finally gathered in December 2023. The FinTech regulatory agenda for the next year, in general terms, was discussed. The topics outlined were: incorporation of innovative models (regulatory sandbox), use of cryptocurrencies, digital financial education, open finance, cybersecurity and strengthening of existing models, including payment systems. The specific working agenda will be landed in weekly meetings to be held up until the end of February 2024, with the purpose of issuing policy recommendations in March.

> "
> A working agenda was shaped which, no doubt, fell short of all pending matters in the ecosystem but definitely served as a kick-off for all work to be done.

a. Payment systems

A zoom in to discussions around payment systems is interesting. Context is that in October 2018, Mexican competition authority ("COFECE") initiated an investigation into potential barriers to competition in the payment systems market involving a clearinghouse for card payments. In December 2020, the Investigation Department issued a preliminary report concluding that there were no conditions for effective competition due to the likely existence of four barriers hindering competition and free entry. These barriers not only impede market entry and raise costs for new participants but also inhibit innovation and new investment to address operational and security issues, and increase overall costs. The barriers are the following:

(i) The existence of a single card payment network.
(ii) Anticompetitive requirements limiting entry for new clearinghouses.
(iii) Co-ownership of Prosa and E-Global (incumbent clearinghouses).
(iv) The obligation of brand holders (Visa and Mastercard) to ensure daily liquidity for transactions processed by clearinghouses without timely and necessary information, hindering technological innovation in security and the entry of new brand holders.

The COFECE resolution confirmed the majority of the conclusions outlined in the preliminary report and was ultimately published in late September 2023. While this represents a significant step forward in recognising factors that limit the competitiveness of the system, two issues stand out: the lack of a stance on the vertical integration problem in clearinghouses and the risk associated with setting maximum prices for interchange fees.

In the case of market verticalisation in card payments, a few entities control multiple roles in the value chain, restricting market competition and overall efficiency. Initiating a process of de-verticalisation through regulatory changes enhances competition and allows both payment recipients and cardholders greater choice. In a similar case in Colombia, for instance, authorities' intervention to eliminate vertical integration allowed new entrants into different market segments, ultimately resulting in an increase in the supply of services with products more tailored to consumers' needs. In Mexico, allowing such modifications would genuinely enable the participation of other stakeholders.

> "Setting maximum prices for interchange fees between participants would lead to market inefficiency and consistently high costs.

On the other hand, setting maximum prices for interchange fees between participants would lead to market inefficiency and consistently high costs. In this case, it is more advisable to change the methodology for establishing these fees to encourage card payment networks to have more elements to differentiate themselves independently, thereby improving the innovation proposal that allows, among other things, ongoing efforts to reduce rejection rates.

In summary, the necessary modifications to the current regulation should include (i) rules to ensure interoperability when a transaction requires the involvement of two or more networks, (ii) making it the responsibility of the authorities to set the maximum limits for interchange fees for each business sector, rather than leaving it to the banks that own the current clearinghouses, allowing players to freely establish the fees they should apply, (iii) enforcing the establishment of interchange fees with objective criteria, (iv) regulating and authorising the connection to processing systems by the authority, not by those managing the systems, and (v) incorporating controls to mitigate collusion among players.

b. Open Finance

Open finance is still a pending matter. Last year's article mentioned that we were expecting rules to be issued in 2023. This has not happened yet. We urgently need APIs' standards to share transactional data to trigger more and better products and services for Mexican consumers and, no minor fact, to comply with the legal mandate established in the FinTech law to issue this secondary regulation.

4. Way forward

Topics mentioned in this article and many others require a deep dive and a longer discussion. However, it is crucial that, beyond technology, the role of regulators in ensuring a level playing field for all participants is acknowledged. For example, in the payment systems case, COFECE has taken positive steps, but the actual and effective implementation of its recommendations relies on closer collaboration between the government, regulators, and the financial industry.

Despite the obvious fact that any political change in politics demands consensus, all the projected financial reforms in Mexico will need a carefully crafted strategy and broad consensus between the public sector, including executive and legislative branches, and the private sector, including incumbents and new entrants. This will be particularly crucial in 2024, as Mexico is set to engage in a presidential election.

In June 2024, Mexico is set for a landmark general election. While the formal announcement of official candidates is not expected until February, the fact of the unprecedented scenario where two women are the leading presidential candidates is a notable development. Claudia Sheinbaum, a former Mexico City mayor and representative of the governing party, will contend against Xóchitl Gálvez, an opposition candidate. Although neither candidate has a background in finance or has held leadership roles in the industry, their financial strategies are expected to play a crucial role in the electoral process. While other candidates may emerge in the coming months, the real contest is likely to only involve Sheinbaum and Gálvez.

Regardless of the election outcome, the next administration is set to take office in October 2024 and will face the challenge of addressing unresolved issues from previous years. The role of Congress, in this context, is anticipated to gain greater significance, especially given the unlikelihood that the new president will achieve the consistently high approval ratings above 60% that current President López Obrador has comfortably enjoyed.

Despite President López Obrador's frequent declarations about retiring from politics, his influence is likely to continue shaping the political landscape. This, combined with the pressing need to address regulatory issues, calls for a Congress and private sector that is both proactive and decisive, potentially accompanying significant shifts in policy and governance strategies.

As technological advancements continue to transform the financial sector, the possibility of expanding inclusion and offering a wider range of financial services becomes more feasible. In this context, the role of entities like the Financial Innovation Group becomes crucial. Their collaboration with authorities, regulators, and industry representatives is key to achieving a healthy financial ecosystem.

The expectations set during the First FinTech Week, along with the collective efforts from the sector, emphasise the need to stimulate the industry and enhance competitiveness. Continuity in the authorisations of FinTechs and achieving regulatory certainty for all participants are essential in this regard. These steps will position Mexico as a leading figure in the region, especially in areas like Open Finance and Cryptocurrencies that have the potential to flourish.

Moving forward, the continuation of collaborative efforts will be crucial. It will be vital to encourage the financial sector to actively engage with the newly elected leaders of public administration and Congress, sharing best practices and insights. Such cooperation will be instrumental in achieving the policy reforms necessary to support the growth and innovation of the sector, thereby enhancing financial services in Mexico.

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PHILIPPINES

Navigating Fintech Regulations in the Philippines: A Comprehensive Overview of Frameworks and Licenses

DIVINALAW

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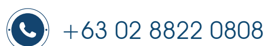
Jay-r C. Ipac
Partner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The regulation of fintech industry participants in the Philippines is based on the specific service or product offered by the participant, and closely follows the regulations applicable to non-fintech entities intending to engage in the same or similar service or products.

1. REGULATORY SANDBOX FRAMEWORK

A regulatory sandbox is defined under BSP Circular No. 1153 as "a controlled, time-bound, live testing environment, which may feature regulatory waivers xxx [that] involve limits or parameters within which participants must operate."

Under the Circular, the applicants should meet the following criteria to be able to participate in the regulatory sandbox:

"

A regulatory sandbox is defined under BSP Circular No. 1153 as "a controlled, time-bound, live testing environment, which may feature regulatory waivers xxx [that] involve limits or parameters within which participants must operate."

a. The financial solution:

1) uses new or emerging technology or utilises an existing technology in an innovative manner, or,
2) bridges a market gap in the delivery of financial products/ services. The financial solution must be supported by research that shall be part of the documents submitted to the BSP.

b. The applicant must demonstrate its capability to deploy the proposed solution through a roll-out plan or strategy.

c. The applicant shall provide an initial test plan, which includes test case scenarios and expected outcomes of the experiment.

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d. The applicant must be able to identify significant risks, including money laundering and terrorist financing risks, IT and cybersecurity, data integrity and data privacy, market acceptability, consumer protection, and project implementation/execution, relevant to the innovation and the corresponding proposed safeguards and risk mitigation strategies.

e. The applicant must be able to identify Key Performance Indicators or other metrics in monitoring the progress of the pilot implementation; and,

f. The applicant shall provide an acceptable exit and transition strategy once the experimentation is completed regardless of the outcome.

Those who are eligible will be allowed to test their proposed innovation in accordance with the BSP-approved test plan which shall be suited to the features of the proposed innovation/solution. Specific regulatory requirements may be relaxed during the testing period in accordance with the test plan. Once the test plan is approved, the BSP will issue a Letter to Proceed with the Test Implementation.

From there, the Testing Implementation Phase commences, with testing duration ranging from 3 to 12 months from the go-live date, depending on the complexity of the proposed solution. After the testing stage, a comprehensive evaluation of the whole experimentation shall take place as part of the exit procedures. The participants must comply with the reportorial requirements mandated by the BSP to establish the necessary information and results of the experimentation.

Participants whose sandbox activities are assessed as successful and whose products or services are deemed fit for public consumption may apply to operate and offer for public use and consumption the proposed product or service that was subjected to the sandbox activity. The Sandbox Oversight Team shall endorse for approval the product or service that resulted in a successful sandbox testing. The pertinent requirements and processing timelines for the issuance of an authority to offer electronic products and financial services shall apply for this purpose. However, the approving authorities in the BSP reserve the right to approve or disapprove the proposed product or service despite the successful sandbox testing.

2. FINTECH LICENSES

Although most businesses only require registration with SEC, the Philippines require fintech companies that engage in remittance, money-changing, foreign exchange, and virtual currency exchanges (later termed as virtual asset service provider or VASP) to also register with BSP.

To further supervise and regulate fintech companies in the Philippines, BSP initially created two special regulations: BSP Circular No. 942 and 944, including a specialised government unit the Financial Technology Sub-Sector (FTSS).

BSP Circular No. 942 monitors fintech companies engaged in remittance, money-changing, or foreign exchange dealing. BSP Circular No. 944, on the other hand, governs the operations and reporting obligations of fintech companies that offer virtual currency exchanges or engage in activities that provide facilities for the conversion or exchanges of virtual currencies. Fintech companies that provide alternative financing, however, may be regulated under the Lending Company Regulation Act.

A Fintech startup can apply for any of the following licenses from the BSP:

1. Electronic Money Issuer ("EMI");
2. Virtual Asset Service Provider ("VASP");
3. Operator of a Payment System("OPS");
4. Money Service Business ("MSB"); and
5. Digital Banks.

Electronic Money Issuer (EMI) License

Section 702 of the Manual of Regulations for Banks defines E-money and an EMI as follows:

"E-money shall mean monetary value as represented by a claim on its issuer,
that is –
a. electronically stored in an instrument or device;
b. issued against receipt of funds of an amount not lesser in value than the monetary value issued;
c. accepted as a means of payment by persons or entities other than the issuer;
d. withdrawable in cash or cash equivalent; and
e. issued in accordance with this Section."

> "
> A Certificate of Registration to Operate as an EMI will provide a licensee with the capability to convert cash into electronic money, issue stored value cards, transfer funds and provide payment solutions to its business clients subject to compliance with other BSP license requirements.

Electronic money issuer (EMI) shall be classified as follows:

a. Banks (EMI-Bank);
b. NBFI supervised by the Bangko Sentral (hereinafter called EMI-NBFI); and
c. Non-bank institutions registered with the Bangko Sentral as a monetary transfer agent under Sec. 4511N of the MORNBFI (hereinafter called EMI-Others).

A Certificate of Registration to Operate as an EMI will provide a licensee with the capability to convert cash into electronic money, issue stored value cards, transfer funds and provide payment solutions to its business clients subject to compliance with other BSP license requirements. In addition, an application to operate a Money Service Business (MSB) can be integrated with the EMI application since non-bank EMIs or EMI-others are usually previously registered as Remittance and Transfer Companies or MSB Type C.

However, BSP Memorandum No. M-2021-064 and Monetary Board Resolution No. 1549 dated 11 November 2019 suspended the regular application window for new Electronic Money Issuers – Others ("EMI Others") licenses for non-bank financial institutions until 16 December 2023 except for new non-bank EMI applicants with proposals involving (i) new business models, (ii) unserved, targeted niches, and/or (iii) new technologies may request for exception under the Test-and-Learn / Regulatory Sandbox Framework ("Sandbox").

Virtual Asset Service Provider

Under BSP Circular No. 1108, Virtual Assets ("VA") and VASP are defined as follows:

a. ***Virtual asset*** refers to any type of digital unit that can be digitally traded, or transferred, and can be used for payment or investment purposes. It can be defined as a "property", "proceeds", "funds", "funds or other assets", and other "corresponding value". It is used as a medium of exchange or a form of digitally stored value created by agreement within the community of VA users. VAs are broadly construed to include digital units of exchange that (i) have a centralised repository or administrator; (ii) are decentralised and have no centralised repository or administrator; or (iii) may be created or obtained by computing or manufacturing effort. VAs are not issued nor guaranteed by any jurisdiction and do not have legal tender status.

> "
> As a derivative of EMI licenses, a VASP license holder may also operate international and local remittance and payment functions subject to compliance with MSB and OPS requirements.

Digital units of exchange that is used for (i) the payment of goods and services solely provided by its issuer or a limited set of merchants specified by its issuer (e.g., gift checks); or (ii) the payment of virtual goods and services within an online game (e.g., gaming tokens) shall not be considered as VAs. Also, virtual currencies as previously defined in Bangko Sentral Circular No. 944 (Guidelines for Virtual Currency Exchanges) shall now be referred to as VAs.

b. ***Virtual Asset Service Provider (VASP)*** refers to any entity that offers services or engages in activities that provide facility for the transfer or exchange of VA, which involve the conduct of one or more of the following activities:

(1) exchange between VAs and fiat currencies;
(2) exchange between one or more forms of VAs;
(3) transfer of VAs; and
(4) safekeeping and/or administration of VAs or instruments enabling control over VAs.

As a derivative of EMI licenses, a VASP license holder may also operate international and local remittance and payment functions subject to compliance with MSB and OPS requirements.

However, in BSP Memorandum No. M-2022-035, BSP closed the regular application window for new VASP Licenses for three years from 1 September 2022, subject to reassessment. Nevertheless, existing BSP Supervised Financial Institutions who wish to expand operations by offering VASP services may still apply for a license.

Operator of a Payment System

Section 4 (1) of RA 11127 defines an operator of a payment system as "any person who provides clearing or settlement services in a payment system, or defines, prescribes, designs, controls or maintains the operational framework for the system." While Section 4(p) of the same law provides that a Payment System is "the set of payment instruments, processes, procedures and participants that ensures the circulation of money or movement of funds."

Subsequently, BSP issued Circular No. 1049 and defined an Operator of a Payment System as a person that performs any of the following functions:

(a) Maintains the platform that enables payments or fund transfers, regardless of whether the source and destination of accounts are maintained within the same or different institutions;
(b) Operates the systems or network that enables payments or fund transfers to be made through the use of payment instruments;
(c) Provides a system that processes payments on behalf of any person or the government; and
(d) Performs such other similar activities, as may be determined by the Monetary Board.

All operators of payment systems (OPS) are obliged to comply with the regulations and guidelines set out by the BSP. All OPS are required to register with the BSP. Registered OPS that intend to operate within a designated payment system must secure prior approval from the BSP, which shall designate any payment system that:

• poses, or may pose, systematic risk that threatens the stability of the national payment system; or
• could have a major economic impact or undermine the confidence of the public in the national payment system.

Money Service Business

Under Section 4511N.1 of the Manual of Regulations for Non-Bank Financial Institutions ("MORNBFI"), Remittance business may be performed by the following:

(a) Remittance and Transfer Company (RTC) - refers to any entity that provides Money or Value Transfer Service (MVTS). MVTS refers to financial services that involve the acceptance of cash, cheques, other monetary instruments or other stores of value and the payment of a corresponding sum in cash or other form to a beneficiary by means of a communication, message, transfer, or through a clearing network. This includes the following:

(1) Remittance Agent - refers to any entity that operates a remittance business network which includes any or combination of the following:

> (a) Remittance Direct Agent (RDA) - refers to any entity that is covered by a direct contracted remittance agreement or similar agreement to act in behalf of a third party engaged in remittance business.
> (b) Remittance Agent Network Provider (RANP) – refers to any entity that provides a network of Remittance SubAgents to perform remittance services to RTC.
> (c) Such other similar entities as may be determined by the Monetary Board. For the purpose of this Section, entities functioning as an RA as herein defined shall be registered as such, notwithstanding whether they are also acting as Remittance Sub-Agent (RSA).

(2) Remittance Platform Provider (RPP) – refers to any entity that provides a shared or common platform/IT infrastructure and maintains settlement accounts in order to provide funds for remittance transactions within its network.

Digital Banks

Under BSP Circular No. 1105, series of 2020, a digital bank is defined as one that offers financial products and services that are processed end-to-end through a digital platform and/or electronic channels with no physical branch/sub-branch or branch-lite unit offering financial products and services.

Under the Circular, a digital bank may perform any or all of the following services:
a. grant loans, whether secured or unsecured;
b. accept savings and time deposits, including basic deposit accounts as defined under Sec. 213;
c. accept foreign currency deposits, as defined under R.A. No. 6426, as amended;
d. invest in readily marketable bonds and other debt securities, commercial papers and accounts receivable, drafts, bills of exchange, acceptances or notes arising out of commercial transactions;
e. act as correspondent for other financial institutions;
f. act as collection agent for non-government entities;
g. issue electronic money products subject to the guidelines provided under Sec. 702;
h. issue credit cards;
i. buy and sell foreign exchange; and
j. present, market, sell and service microinsurance products subject to the guidelines provided under Sec. 113-B.

However, BSP imposed a three-year moratorium and closed the application for a new Digital Bank License until August 2024.

Related Regulations: (i) Regulation of Value-Added Services
The delivery of financial services through mobile applications or online platforms generally falls under the definition of value-added services that are subject to National Telecommunications Commission (NTC) regulation, pursuant to the Philippines' Public Telecommunications Policy Act.

Related Regulations: (ii) Crowdfunding
SEC Memorandum Circular No. 14 or the Rules and Regulations Governing Crowdfunding (Rules Governing Crowdfunding) shall primarily govern the operations and use of equity-based and lending-based Crowdfunding (CF) by registered persons who participate in CF through an online platform. Under said rules, crowdfunding platforms should be duly registered with the SEC. Section 2 (c) of said Rules defines crowdfunding platforms as "programs accessible via the Internet or other similar electronic communication medium through which a registered broker or a registered funding portal acts as an intermediary in a transaction involving the offer or sale of securities."

Related Regulations: (iii) Financing and Lending Companies
Under R.A. 8556 or the Financing Company Act, Financing Companies are defined as corporations, except banks, investments houses, savings and loan associations, insurance companies, cooperatives, and other financial institutions organised or operating under other special laws, which are primarily organised for the purpose of extending credit facilities to consumers and to industrial, commercial, or agricultural enterprises, by direct lending or by discounting or factoring commercial papers or accounts receivable, or by buying and selling contracts, leases, chattel mortgages, or other evidence of indebtedness, or by financial leasing of movable as well as immovable property. They are regulated by the BSP. While under R.A. 9474, or the Lending Company Regulation Act, Lending Companies are defined as a corporation engaged in granting loans from its own capital funds or from funds sourced from not more than nineteen (19) persons and shall not be deemed to include banking institutions, investment houses, savings and loan associations, financing companies, pawnshops, insurance companies, cooperatives and other credit institutions already regulated by law. Lending companies are regulated by the SEC.

Related Regulations: (iv) Artificial Intelligence Roadmap.
In May 2021, the Department of Trade and Industry launched the country's Artificial Intelligence (AI) Roadmap which contains four major dimensions for AI readiness, namely: (1) Digitisation and Infrastructure, (2) Research and Development, (3) Workforce Development, and (4) Regulation. These dimensions are then supported by seven (7) measurable strategic imperatives and forty-two (42) strategic tasks. In line with this, the country has recently enacted Republic Act No. 11927, the Philippine Digital Workforce Competitiveness Act and Republic Act 11899, the Second Congressional Commission on Education Act II to enhance the skills and competitiveness of the Philippine workforce in human, and digital technology and innovations.

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BIO

Wiehann joined Mazars in South Africa in 2010 and obtained international experience working for Mazars in New York. Wiehann services a variety of clients in various industries, with a focus on FinTech & Digital Assets. He has featured in various South African and International publications, television interviews and online webinars for his expertise and thought leadership in the FinTech & Digital Assets sectors.

In addition to being a Chartered Accountant (SA), Wiehann also holds a Master of Science degree in Blockchain and Digital Currencies and forms part of Mazars South Africa's Innovation Committee. He has successfully completed two executive programs: one on Blockchain Technologies at MIT and another on Artificial Intelligence at Oxford University. His experience in the FinTech & Digital Assets industry includes consulting and assurance engagement services for a variety of clients in South Africa, Singapore, Sweden, Switzerland, the UAE, US, and the UK.

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BIO

Mia started her journey with Mazars in South Africa in 2012, where she qualified as a Charted Accountant (SA) in 2015 and is currently specialising in the financial services industry. Mia's financial services experience include the audit of Exchange Traded Funds, Unit Trusts and stock exchange listed entities. She is also an accredited JSE Reporting Accounting Specialist and assists entities with listing particulars, products, and corporate actions.

Given her experience in a highly regulated environment, Mia understands the importance of regulation in the financial services industry, especially the FinTech market. Mia has completed executive FinTech courses at UCT and Harvard University, focusing on the Disruption of FinTech in the traditional financial services market. She has recently featured in various South African publications for her thought leadership around the importance of FinTech and Open Banking as well as the benefits it could have in a developing South African Market.

Africa has emerged as a hub for fintech innovation. Multiple factors have converged to catalyse transformative change within the financial services sector, with South Africa serving as an entry point into the continent for numerous providers.

The FinTech in Africa report[1] compiled by FT Partners highlights various factors supporting the robust fintech ecosystem on the continent, including:

- a massive, young, unbanked, and underbanked, tech-savvy population
- a population with traditionally heavy cash usage
- a rapid shift from informal to formal sectors
- a market increasing in mobile penetration
- a generally favourable regulatory environment
- governments lobbying for greater financial inclusion and digitisation.

In South Africa, additional factors at play include fintech disruption, supportive regulations, customer demands for convenience and personalised experiences, cost savings through automation, enhanced risk management and cross-border transaction facilitation. These are all aimed at making banking services more accessible and efficient for the broader population.

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> World Bank data shows that around 45% of people living in Sub-Saharan do not have a bank account.

"The absence of traditional banking infrastructure in many regions has paved the way for innovative fintech solutions to fill the gaps and meet the diverse financial needs of the population, with mobile penetration rates supporting a digital-first shift in how Africans transact and bank," says Mia Pieterse, Partner and fintech specialist at Mazars in South Africa.

As a result, Africa stands at the forefront of global fintech innovation, with five key themes playing out.

Mobile money

World Bank data shows that around 45% of people living in Sub-Saharan do not have a bank account. While South Africa compares favourably to other regional nations in terms of access to financial services, around 24% of the population remains underbanked, according to a 2022 analysis by the Oxford Business Group.[2]

According to World Economic Forum data[3], various factors exclude these individuals from the formal banking system. A lack of valid documentation is a major issue, with approximately 500 million people in Sub-Saharan Africa living without proof of legal identity. In addition, most people who live in rural areas or informal settlements in South Africa do not have an address or paperwork that serves as proof of residence.

As such, these individuals are unable to meet the Financial Intelligence Centre Act (FICA), Know Your Customer (KYC), and Anti-Money Laundering (AML) regulatory compliance requirements needed to open a bank account.

Other significant factors that sustain financial exclusion among the economically marginalised in South Africa include low education levels, age, home language, number of dependents and a lack of income due to the country's high unemployment rate.

"Broadening access to affordable, relevant and sustainable financial products and services that cater to the everyday transactional needs of the underbanked and traditionally marginalised groups in society (like women), is a critical step towards improving inclusivity to address the poverty and inequality that persists today," explains Pieterse.

1. https://www.ftpartners.com/fintech-research/fintech-africa-momentum
2. https://oxfordbusinessgroup.com/reports/south-africa/2016-report/economy/the-final-20-reaching-the-unbanked-population-is-a-complex-task
3. https://www.weforum.org/agenda/2017/05/making-everyone-count-the-case-for-national-identification-systems/

Mobile money solutions meet this need by offering a viable means for the underbanked to transact while also addressing other uniquely African financial requirements, like cost-effective and reliable cross-border remittance.

Despite the financial challenges faced by the majority of South Africans, the smartphone penetration rate surpassed 90% in 2019, according to the State of the ICT Sector[4] report compiled by the Independent Communications Authority of SA (Icasa).

Growth in the Vodafone-owned M-Pesa mobile payment platform offers greater insight into the relevance of mobile money services in Africa. Launched initially in Kenya in 2007, the platform now supports approximately 56 million[5] active customers across Kenya, Tanzania, Mozambique, the Democratic Republic of Congo, Lesotho, Ghana and Egypt.

M-Pesa helps many Africans access financial services for the first time and transact easily in the informal economy.

"The ubiquity of M-Pesa in these regions allows users to send and receive peer-to-peer (P2P) payments, while widespread merchant acceptance allows consumers to pay businesses (P2B) for goods and services via a mobile device," elaborates Wiehann Olivier, Partner and Fintech & Digital Assets Lead for Mazars in South Africa.

"In South Africa's more fragmented financial services ecosystem, M-Pesa never reached the critical mass needed for widespread merchant acceptance and consumer adoption" Olivier explains that when a single supplier such as M-Pesa fails to achieve mass adoption, it creates interoperability issues for merchants and users.

"Utilising distributed ledger technology and digital currencies could potentially address this interoperability issue due to the technology's unique characteristics, such as offering a trustless means of payment able to facilitate programable money."

According to Pieterse, other mobile payment and e-wallet services have also gained traction as mobile network penetration provides the infrastructure needed to facilitate payments in areas where banks have yet to invest to expand infrastructure and reach underserved communities.

"This is particularly prevalent in remote rural areas, where isolated communities lack access to basic banking services," she says.

Resistance to traditional banking services in informal townships in urban hubs also exists due to the perception that bank accounts are exclusively available to the middle and upper classes, despite significant growth in low-cost, low-barrier banking services from emerging challenger and digital-only neo banks.

> "
> Despite the financial challenges faced by the majority of South Africans, the smartphone penetration rate surpassed 90% in 2019.

"Available solutions also meet specific utilitarian needs, with applications in the informal economy, which is vital to determine buy-in. Without community buy-in, mass adoption cannot happen. " continues Pieterse.

Cross-border remittance

The ubiquity of platforms like payment apps or financial services enabled over platforms like WhatsApp also facilitates cross-border payments, which is an important feature for Sub-Saharan Africa's large migrant workforce.

4. https://www.icasa.org.za/legislation-and-regulations/state-of-ict-sector-in-south-africa-2019-report
5. https://www.vodafone.com/news/services/m-pesa-celebrates-reaching-50-million-customers

Market research firm Statista predicts that South Africa's digital remittance transaction volume will reach US$273.30m by the end of the 2023 year.

"These transactions are driven mainly by the many non-residents working in South Africa," says Olivier.

According to the latest census data from Stats SA[6], more than 2.4 million immigrants work and live in the country, which equates to around 3% of the total population.

> "Digital remittance services need to address numerous legacy issues to boost adoption and usage.

Popular digital platform remittance services include uKheshe, Mukuru and Mama Money. Mukuru is primarily a money transfer service that allows people in South Africa to send money at an affordable rate to 17 countries within Africa, the UK, China, India, Pakistan, and Bangladesh. Other services include mobile payments to other digital wallets and an enterprise payment platform.

Mama Money is an app-based platform that enables local or cross-border mobile remittance using a feature phone, smartphone, or computer.

Key drivers necessary for the adoption and usage of these digital cross-border remittance payments include ease of use, transaction costs and trust.

According to Olivier, "distributed ledger technology could significantly increase the execution speed of cross-border transactions, and at a fraction of the cost associated with legacy platforms. "These features make the technology fundamental to emerging markets such as South Africa and the rest of Africa".

Traditional remittance wire transfers in Africa are expensive, which erodes the money families receive, and disproportionately impacts low-income earners by making traditional services unaffordable for the vast majority."

In terms of trust, digital remittance services need to address numerous legacy issues to boost adoption and usage. For example, Mama Money built trust by establishing local agents who could assist individuals face-to-face, to expose consumers to more technology and assist them with their transactions.

As adoption has grown, financial sector regulators in countries like Tanzania and Ghana have bolstered the legitimacy of these services by allowing users to earn interest on mobile money, with more Southern African Development Community (SADC) countries set to adopt this approach.

As consumer trust in the service grows, clients become empowered to bank, transact and even save directly on their phones without ever opening a bank account, which will help to enrich customers with increased access to more financial services.

Digital financial services

As more people across Africa embrace mobile banking, transactions and cross-border remittance, opportunities for exponential growth in the broader digital financial services sector will continue to emerge. This includes everything from cashless transactions and access to credit and lending, to investment platforms and low-cost insurance products from insurtech providers.

Emerging markets like Africa offer higher growth rates, new users and an untapped market opportunity for global financial services companies to support their expansion plans. According to a McKinsey report[7], Africa is the world's second-fastest-growing and most profitable payments and banking market after Latin America.

6. https://www.statista.com/outlook/dmo/fintech/digital-payments/digital-remittances/south-africa#:~:text=Transaction%20value%20in%20the%20Digital,US$345.30m%20by%202027
7. https://www.mckinsey.com/~/media/mckinsey/industries/financial%20services/our%20insights/african%20retail%20bankings%20next%20growth%20frontier/roaring-to-life-growth-and-innovation-in-african-retail-banking-web-final.ashx

In this regard, South Africa boasts a thriving innovation pipeline as the country's vibrant fintech ecosystem develops services around banking and other financial products.

Non-traditional neo banks like Tyme and Bank Zero in South Africa are breaking down barriers to entry for banking and a broader set of financial services with no-fee products and digital-only accounts that consumers can open via a paperless process from any internet-enabled device without going into a branch.

The major area of innovation relates to instant cardless payments and an expansion in payment mechanisms as the sector moves to support a cashless society.

One example is the Rapid Payments Programme (RPP), which forms part of the South African Reserve Bank's (SARB) Vision 2025 plan. The industry-led payments modernisation initiative aims to revamp and renew the country's ageing payment rails for low-value transactions.

"In line with its strategy, the SARB announced the launch of PayShap in March 2023, a real-time fast payments platform designed to offer South Africans safer, faster and significantly more convenient payment options."

"All the major banks have adopted the PayShap service to combat the disruption and fragmentation caused by smaller mobile money and fintech providers entering the market, while also building out their digital payment solution ecosystem," explains Olivier.

The major banks in South Africa are also partnering with innovative fintechs to address the competitive market pressures and craft relevant digital financial services in a rapidly evolving industry.

"In terms of payment processing and digital transactions, bank account holders can integrate their accounts with services like Ozow to process secure, instant online payments," continues Olivier.

The 6 million plus registered Ozow users can use the service to make fast bank-to-bank payments with their smart devices for truly cashless, cardless and contactless digital payments. Businesses can also use the service to facilitate payment options like QR codes, eCommerce, e-billing, and payment links to offer customers greater convenience and a seamless payment experience.

"With regard to international payments, banks are leveraging BankservAfrica's comprehensive SWIFT solution and infrastructure to offer customers a high-quality, uninterrupted and secure international payments service," states Olivier.

"

In terms of payment processing and digital transactions, bank account holders can integrate their accounts with services like Ozow to process secure.

Moreover, digital currencies are playing a role in shaping the cashless society of the future, with the emergence of various Central Bank Digital Currencies (CBDC) an important development.

According to the IMF Virtual Handbook[8], CBDCs "offer a safe store of value and efficient means of payment, which can increase competition for deposit funding, raise banks' share of wholesale funding, and lower bank profits. A CBDC also could bolster financial inclusion."

Beyond payments, neo banks like Tyme and Bank Zero also offer attractive interest rates on deposits, helping to promote saving and wealth creation in a country where the gross savings rate is just 14.8% (June 2023, CEIC Data[9]).

"Furthermore, banks are also building out other capabilities that leverage their growing digital channels with partnerships in the insurtech space to provide more personalised insurance products that are easily accessible, relevant and cost-effective," says Olivier.

8. https://www.mckinsey.com/~/media/mckinsey/industries/financial%20services/our%20insights/african%20retail%20bankings%20next%20growth%20frontier/roaring-to-life-growth-and-innovation-in-african-retail-banking-web-final.ashx
9. https://www.ceicdata.com/en/indicator/south-africa/gross-savings-rate#:~:text=Key%20information%20about%20South%20Africa,an%20average%20rate%20of%2014.8%25.

Open banking

According to Olivier, open banking is an emerging trend that will play an increasingly vital role in the personalisation of financial services, with banks leveraging application programming interfaces (APIs) to grant secure third-party access to financial data.

"Clients want the ability to integrate their digital lives by connecting various applications with bank accounts and other financial institutions. This functionality enables them to get quotes on insurance or apply for loans, with the ability to pre-populate application forms to streamline the application process and reduce the friction inherent in traditional financial processes," explains Olivier.

"
AI-powered chatbots and virtual assistants give clients access to faster and more personalised services around the clock.

Integrating bank accounts with third-party services will also benefit related sectors, with auditors able to gain direct and secure access to client banking information.

"With the ability to access banking information via an API key, auditors would gain access to transactional data for an entire year to utilise as part of the audit process," continues Olivier.

Furthermore, open banking models enable programmable banking, which Pieterse says is a growing trend.

"Modern consumers and business clients want to take charge of their finances, with the ability to hyper-personalise their experience at the individual level," explains Pieterse.

"Programmable banking allows tech-savvy businesses and consumers to customise their banking interfaces using simple code to create bespoke rules, such as payment scheduling or card payment parameters, and craft individualised banking experiences."

In this regard, leading South African private bank Investec has partnered with OfferZen to deliver programmable banking. Through this innovative open banking initiative, Investec private and corporate clients can use programmable banking to programme their bank cards, setting limits or usage parameters. The private bank also has a partnership with OneCart, which allows cardholders to programme cards to only work with specific retailers and set limits on those cards for specific transactions.

Machine learning and AI

"While the application of artificial intelligence (AI) and machine learning (ML) is still nascent in the local financial services sector, these technologies are already revolutionising multiple aspects of the industry," explains Olivier.

Current applications include automated customer engagement and customer service, lending, fraud detection, insurance, investing and back-office process automation.

"AI-powered chatbots and virtual assistants give clients access to faster and more personalised services around the clock, while AI leverages data to help financial institutions make more informed decisions about lending or make personalised recommendations about investments," says Olivier.

"AI and ML also support risk management and fraud prevention at scale, with the ability to identify trends and patterns and respond to potential fraud attempts in real-time."

As ML algorithms become increasingly more sophisticated in detecting suspicious activity, this technology will reduce the risk of financial losses and improve customer security.

As adoption accelerates, Olivier says banks and financial services providers will need to invest in solutions that securely store larger data sets.

"AI tools require data cleanliness and ongoing hygiene to deliver valuable outcomes. Banks need to train AI models utilising years of historical transaction data to help the algorithms identify and generate patterns."

According to Olivier, as more applications for the technology emerge, access to additional data sets will require more resources to sift through the information and sanitise the data sets to train models for the relevant outputs.

"Ultimately, AI models are only as good as the data used to train them. In this regard, open banking can help to grant access to clean data sources," he concludes.

South Africa leads Africa's fintech revolution

In South Africa, the local fintech sector reflects a dynamic interplay of continued investment, a deep innovation pipeline, a favourable regulatory environment, and supportive digital infrastructure. This has firmly established the country as the major hub for fintech innovation within Africa.

With continued investment, the country is well positioned to maintain its leading role as the regional driver of fintech innovation, reshaping digital financial services across the continent while contributing positively to financial inclusion and economic growth in the country.

> "AI tools require data cleanliness and ongoing hygiene to deliver valuable outcomes.

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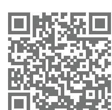

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Dr Christian Schönfeld is counsel at Prager Dreifuss and a member of the corporate and M&A practice group. He focuses on the law of banking and capital markets and the regulatory issues associated with financial market law. Within these areas he has particular experience in collective investment schemes law and in the areas of Fintech and crypto assets (ICOs, tokenization etc.). Furthermore, he works in the areas of corporate and commercial law including mergers and acquisitions. He also advises on data protection matters and is a member of Prager Dreifuss' Startup Desk.

Prior to joining Prager Dreifuss as a lawyer, he worked as a research assistant at the University of St. Gallen where he also earned his doctorate with a thesis on collective investment schemes in distress. He is a regular speaker at conferences and publishes on the topics he specialises in.

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1. Introduction

Switzerland encourages innovative business models and aims to keep regulatory requirements at a sensible level and to reduce unnecessary regulatory obstacles. However, the goal to encourage innovation may be at odds with the regulatory aims of protecting investors and ensuring transparency and the proper functioning of the financial markets. Therefore, the constant technological progress also requires the constant re-evaluation of existing regulatory answers to strike a balance between enabling innovation without jeopardising the other goals of financial market regulation.

> "So far, Switzerland has refrained from enacting a separate, comprehensive Fintech statute.

Following last year's overview of the general Swiss Fintech framework, this essay shall provide an overview of recent trends in the Fintech area and how Switzerland addresses the issues connected therewith.

2. Foundation: The Principle of Technology Neutrality and the Main Sources of Swiss Financial Market Law

Swiss financial market regulation adheres to the principle of technology neutrality, i.e. "same business, same risks, same rules". This means that the same rules shall apply to equivalent activities irrespective of the underlying technology unless such technology results in a different risk structure which, in turn, warrants a different regulatory treatment. In other words, Switzerland regulates business models instead of technologies.

So far, Switzerland has refrained from enacting a separate, comprehensive Fintech statute. Consequently, the statutes which regulate the financial industry apply also in the context of Fintech, namely the following:

The **Banking Act (BA)** provides the rules for the provision of banking services, i.e. in particular lending services and accepting deposits from the public on a professional basis.

The **Financial Institutions Act (FinIA)** regulates dealing in securities. Securities firms require a license by the Swiss Financial Market Supervisory Authority FINMA (**FINMA**) if they operate on a commercial basis. In addition, FinIA also contains rules pertaining to further financial market participants, e.g. asset managers.

The **Financial Services Act (FinSA)** regulates the provision of financial services to clients and includes various obligations to be complied with by financial service providers. Furthermore, it regulates the obligation to prepare and publish prospectuses in certain cases.

The **Collective Investment Schemes Act (CISA)** regulates the formation of collective investment schemes.

The **Financial Markets Infrastructure Act (FMIA)** regulates financial market infrastructures such as stock exchanges.

The **Anti-Money-Laundering Act (AMLA)** regulates the obligations of so-called financial intermediaries (including regulated entities such as banks as well as persons who on a professional basis accept or hold on deposit assets belonging to others or who assist in the investment or transfer of such assets) in combating money laundering. Namely, this includes the duty to perform KYC checks, to notify the competent authorities in case of suspected money laundering and to affiliate with a self-regulatory organisation.

The aforementioned statutes are supplemented by lower-level regulation as well as circulars and guidelines published by FINMA on its practice.

The legal basis for FINMA is provided by the **Financial Market Supervision Act (FINMASA)**.

3. Recent Developments in the Area of FinTech and Connected Legal Issues

3.1. From Open Banking and Open Finance to Decentralised Finance

3.1.1. Open Banking and Open Finance

Open Banking describes a business model which is based on the standardised and secure exchange of transaction data between banks and trusted third-party service providers, namely Fintech companies. Open Finance can be viewed as an extension of the concept of Open Banking in that it is not limited to the exchange of transactional data but also includes further information, e.g. on available assets.

Despite the growth in popularity of such business models, the Swiss legislator, so far, refrains from specifically regulating them. Notably, there is no obligation of banks to provide open interfaces to service providers. Instead, Open Finance models are governed by existing regulation. Particularly, FINMA has published a circular on outsourcing by banks and other financial institutions that regulates regulatory outsourcing, i.e. cases in which a company mandates service providers with performing all or part of functions that are significant to the company's business activities independently and on an ongoing basis. Significant functions are functions that have a material effect on compliance with the goals and regulations of financial market legislation. However, often Open Finance services will not qualify as such a regulatory outsourcing because they occur on the client's initiative instead of the bank's initiative.

Furthermore, the services provided by a service provider may qualify as financial services and trigger obligations under FinSA. The bank has to inform its client about the risks of providing information to the service provider. Compliance with anti-money laundering rules is a further topic: The outsourcing bank falls under the scope of AMLA due to it being a regulated entity. To what extent AMLA also applies to service providers depends on the circumstances, e.g. whether they may dispose of the client's assets.

3.1.2. Decentralised Finance

Decentralised Finance ("**DeFi**") refers to openly accessible financial services linked to open-access distributed ledger platforms. DeFi applications do not rely on traditional financial intermediaries like banks but function on a peer-to-peer basis with so-called smart contracts, i.e. programs that automatically execute the terms of a contract. Consequently, there are no longer individually identifiable or controlling operators.

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Despite the growth in popularity of such business models, the Swiss legislator, so far, refrains from specifically regulating them.

So far, Switzerland regulated the distributed ledger technology only to a limited extend. In 2021, the so-called DLT Act came into force. Among else, it opened certain regulatory concepts for business models based on crypto assets and it created a new category of licensed financial market infrastructures, the DLT trading facility which enjoys more freedom than traditional trading facilities like stock exchanges regarding who may be granted access and what services may be offered. Beyond that Switzerland has not enacted comprehensive legislation in this area. In line with the principle of technology neutrality, FINMA applies existing financial market regulation when assessing DeFi enquiries. If a DeFi project offers the same services and/or creates the same risks as a service provided by traditional financial intermediaries the same rules also apply including licensing requirements if a DeFi project – economically – pursues an activity which requires a license.

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> The automatic execution of smart contracts also raises civil law questions.

In principle, this approach is straightforward. Nonetheless, the peer-to-peer structure of DeFi projects raises new questions:

DeFi projects rely on a layered technical infrastructure, consisting, among else, of settlement, asset, protocol or application layers. On each layer different parties may participate which may remain unidentified. Furthermore, due to the peer-to-peer concept there is no party controlling the system. Rather, the system and the DeFi application on it run automatically. Meanwhile, financial market regulation relies on identifiable parties to attribute (licensing and other) obligations and responsibilities to. Additional complexity stems from the fact that independent parties may be active on different layers which only together trigger the regulatory consequences (traditionally, somewhat similar issues are addressed by considering parties acting in concert as a group and by applying regulation to the group). Mostly, the scope of financial market regulation follows the principle of territoriality. This makes it difficult to apply regulation to DeFi applications due to their international decentralisation. For these reasons, complying with regulation may often be difficult for DeFi initiatives. Also, it remains to be seen whether traditional enforcement mechanisms will prove to be sufficient, particularly in view of limiting the availability of unlicensed DeFi applications to protect investors.

The automatic execution of smart contracts also raises civil law questions. With the code being the law and due to the lack of a controlling operator it will be difficult, for instance, to enforce a court decision requiring a cancellation of a transaction. The pseudonymous nature of distributed ledger platforms further complicates enforcement of claims as a claimant may struggle to find out who his counterparty is.

Besides that, this pseudonymity also raises questions with respect to compliance with anti-money laundering rules, namely KYC obligations. While there are technological attempts to ensure compliance with KYC obligations (e.g. so-called zero-knowledge Know-your-customer technologies, zkKYC) they likely do not satisfy the requirements of AMLA.

3.2. Use of Artificial Intelligence in Financial Services

3.2.1. Background

Recently, artificial intelligence (“**AI**”) received substantial public attention (particularly, in connection with OpenAI’s ChatGPT platform).

However, this rise of AI has not only been met with enthusiasm but also with some scepticism as its use also raises various (legal and other) questions, not least whether new legislation is needed to address issues associated with the use of AI solutions.

These general remarks also apply in the context of financial markets and Fintech solutions. Here, AI has been used for a while already, for instance for AI assisted decision making, e.g. in assessing the risk of default when granting loans or choosing investment options when providing investment advice. Also, chatbots are used to interact with clients and AI solutions help monitoring and identifying suspicious transactions in view of AML obligations.

Switzerland has no dedicated AI legislation yet. However, this is likely to change as already members of the Swiss government have publicly stated that regulation is needed.

Due to this lack of specific legislation, Swiss law relies on existing law to deal with the legal challenges of AI.

3.2.2. Regulatory Issues

Generally speaking, AI solutions may be used in the financial sector provided they comply with the existing regulatory requirements. The principle of technology neutrality also applies here. FINMA will assess the use of AI solutions in view of the aims of financial market regulations, particularly the protection of customers/investors and financial market stability. For instance, when employing roboadvisors to provide financial services the requirements of FinSA must be complied with same way as when humans provide such services. Particularly, one must also consider the (likely) limited knowledge of clients regarding the general functioning of such roboadvisors. Beyond this general principle, the exact details remain open at this point.

3.2.3. Further issues

The use of AI solutions also raises further issues, not least data protection concerns. A fundamental requirement of data protection law is informing the data subject about the processing of his/her personal data. Adequate, clear and comprehensive information is particularly important considering the consequences the processing, e.g. in connection with investment advice or loan approvals, may have for the data subject (consequences may range from financial repercussions, e.g. when denying a loan, to potential criminal law proceedings, e.g. in the context of transaction monitoring). Furthermore, in such cases the processing of personal data in this context may qualify as so-called profiling. In addition, automated decision making by AI solutions triggers obligations in addition to enhanced information requirements, e.g. the duty to provide the data subject with the opportunity to request the decision made by the AI to be reassessed by a human. Also, prior to using such solutions a data protection impact assessment may need to be performed and additional measures to reduce the potential risks for the data subjects must be implemented.

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> Switzerland has no dedicated AI legislation yet.

The processing of personal data must be proportionate. Furthermore, personal data may only be collected for a specific purpose that the data subject can recognise and, subsequently, personal data may only be further processed in a manner that is compatible with this purpose. Besides the aforementioned requirement to inform the data subjects this may also limit the further use of existing collections of data. Whether the processing of already available personal data for a new purpose can be justified (e.g. based on an overriding interest) requires a careful assessment in each case.

> Swiss financial market regulation follows the principle of technology neutrality and, consequently, regulates specific technologies only to a limited extent.

Finally, AI solutions regularly rely on services by, and require the transfer of personal data to, third party providers. In this context it is necessary to ensure that no professional secrecy requirements, e.g. banking secrecy rules, are violated. Also, where such transfers occur across borders additional requirements for international transfers of personal data apply. This may cause challenges where service providers operate from jurisdictions which – from a Swiss viewpoint – do not offer a similar level of data protection, namely the US.

4. Conclusion

Swiss financial market regulation follows the principle of technology neutrality and, consequently, regulates specific technologies only to a limited extent. Therefore, Swiss law largely relies on the existing statutes and regulation also when dealing with new developments such as Open Banking, Open Finance, DeFi but also the use of AI solutions.

This allows Switzerland to foster innovative business models within the rapidly evolving area of Fintech. At the same time Switzerland ensures not jeopardising the protection of investors and the functioning of the market. In combination, this increases the attractiveness of Switzerland as a hub for Fintech businesses.

However, refraining from adapting existing law also leads to the challenge of dealing with new issues under statutes which were enacted without consideration for such new problems. It remains to be seen what solutions will be found to these now problems. In any case, the current lack of clear and tested solutions and the potential consequences of violations of applicable laws make it highly advisable to seek expert legal advice in advance.

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Under her supervision, KARM team regularly engages with central banks, securities regulators and monetary authorities in the region to find regulatory solutions for niche projects. Additionally, Akshata has been instrumental in drafting of various policies on digital ID and e-KYC in the Arab region through her engagement with the Arab Monetary Fund and MENA Fintech Association. Akshata has been recognised as one of the top 30 under 30 lawyers by Business World Legal in the past.

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I. Introduction

The FinTech industry within the United Arab Emirates (**UAE**) has experienced remarkable growth and transformation in recent years, positioning itself as a leading jurisdiction in the global financial landscape. Fuelled by a combination of government support, burgeoning tech-focused initiatives, and a robust financial sector, the UAE has emerged as a prominent FinTech hub in the Middle East and North Africa (**MENA**) and Gulf Cooperation Council (**GCC**) regions. Several matrices and statistics can testify to the UAE's success in FinTech, including the 2021 AMF Finxar index report, wherein the UAE outshone its regional counterparts, achieving a leading score of 75% against the general index score of 43% for all members.[1] Additionally, 60% of FinTech companies within the GCC region have a base within the UAE.[2] At this level of growth and progression, Mordor Intelligence predicts that the UAE FinTech market will grow at a 10%+ CAGR by 2028[3].

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> The UAE financial free zones provide an alternative regulatory regime to the federal jurisdiction.

The UAE is home to a myriad of payment service activities under the regulations mentioned in sections below. Recently, certain activities have experienced a great uptake within the region, standing out against other services, including SVFs, acquiring and aggregation, fund transfer, and remittances. Over and above these activities, open banking and BNPL have recently been experiencing the most popularity, driven by market demand, economic trends, and regulatory enablement.

I. Regulatory Regime

The UAE's regulatory regime is effectively diversified, resulting in multiple regulatory agencies contributing towards FinTech growth and development.

1. Federal

At the federal level, the primary banking regulator is the Central Bank of the United Arab Emirates (**CBUAE**). The CBUAE is constantly creating and improving its regulatory frameworks to maintain pace with industry developments. There are several regulations governing payment services including the Stored Value Facilities Regulation 2020 (**SVF Regulation**), Retail Payment Systems Regulation 2021 (**RPS**), Large Value Payment Systems Regulation 2021 (**LVPSR**), Retail Payment Services and Card Schemes Regulation 2021 (**RPSCS**) and the Finance Companies Regulation 2023 (**FCR**).

1. Free zones

Further, the UAE financial free zones provide an alternative regulatory regime to the federal jurisdiction. The two financial freezones, the Abu Dhabi Global Market (**ADGM**) and the Dubai International Financial Centre (**DIFC**) issued their separate regulations covering inter alia financial, commercial, and corporate areas of law.

The DIFC's financial regulator is the Dubai Financial Service Authority (**DFSA**). The DFSA's regulatory framework for '*Providing Money Services*' is provided under the Regulatory Law 2004, and the rulebooks issued thereunder. The rulebooks provide a single set of regulations for all financial services and activities, each covering a different regulatory aspect.

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The Financial Service Regulatory Authority (**FSRA**) is the financial regulator of ADGM. The FSRA's regulatory framework is provided under the Financial Services and Market Regulations, 2015, and the rulebooks issued thereunder. The rulebooks provide a single set of regulations for all financial services, with each rulebook covering a different regulatory aspect, quite similar to the DFSA's regulatory framework design. Specifically, 'Money Services Businesses' are governed by distinct set of rules and requirements.

III. Licensing Framework

As stated before, each jurisdictional regulator is responsible for creating its own licensing framework at its own pace and discretion.

1. Federal

The CBUAE regulates FinTech activities through the various aforementioned regulatory frameworks and licensing regimes. Licensable activities under the CBUAE include service providers or issuers of Stored Value Facilities (**SVF**) (i.e., electronic wallets and prepaid cards) and retail payment services, including payment account issuance, payment instrument issuance, merchant acquiring, payment aggregation, domestic or cross-border fund transfer, payment token services, and card schemes. The emerging FinTech sector of open banking is covered under an Account Information Service Provider (**AISP**) and Payment Initiation Service Provider (**PISP**) licensing regime. Moreover, licensing for pay-later services like Buy-Now Pay Later (**BNPL**) is now available under the recently introduced '*Restricted Licence Finance Company*' license. The CBUAE also regulates and licenses retail or large payment systems providers.

2. Financial Free Zones

The DIFC also licenses a broad range of payment services. These activities include money services covered under the '*Providing Money Services License*' category, such as money transmission, providing or operating payment accounts, executing payment transactions, arranging money transfers, issuing a payment instrument, and issuing stored value. Within the emerging FinTech fields, the DFSA also licenses BNPL service providers (although limited to B2B models) and open banking by permitting AISP and PISP under the '*Advising on or Arranging Money Services License*' category.

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>
> The FSRA's regulatory framework is provided under the Financial Services and Market Regulations, 2015, and the rulebooks issued thereunder.

The FSRA also offers multiple licenses for payment services under the '*Providing Money Services*' license such as providing or operating payment accounts, payment transaction execution, issuing payment instruments or stored value, money transmission or remittance, and currency exchange. Within the emerging FinTech fields, the FSRA provides licenses for BNPL service providers (although limited to B2B models) and open banking through a Third-Party Provider (**TPP**) licensing regime.

IV. FinTech Products

Various FinTech licenses are available with the CBUAE, FSRA, and DFSA. Many of these licenses are available across all three regulatory bodies, offering entrepreneurs and businesses a broad spectrum of choices and flexibility. Moreover, the free zones enhance their appeal by providing common law based legal system. The three regulators CBUAE, DFSA and FSRA have all issued regulations on the below mentioned products.

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1. Stored Value Facilities

The SVF market has experienced tremendous growth, reaching 14 licensed SVF providers across the three jurisdictions. The growth can be attributed to many factors, most importantly being the dynamic and active nature of the regulators. All the three regulators have licenses for issuance of SVFs and DFSA and FSRA further have provisions for 'issuance of payment instruments' which can be leveraged for the purpose.
Some recent entrants and key players within the market include Noon Digital Pay, Noqoodi, and Emirates Digital Wallet.

2. Merchant Acquirers and Payment Aggregators

Another growing area within the payments sector is the services of merchant acquirers and payment aggregators which have namesake licenses under CBUAE's RPSCS regime. Such products also have an option of getting recognised as payment account providers within the FSRA and DFSA regimes. New market entrants have been on a steep rise in 2023, many of which have been racing to obtain licenses from the CBUAE. The UAE now has 12 service providers within this sector, with several market players having obtained their CBUAE licenses just this year, including Checkout.com, Worldpay, and MyFatoorah.

> "The CBUAE managed to sign several collaborative initiatives with the central banks of India and Hong Kong.

3. Fund Transfers and Remittances

Fund transfers and remittances have also experienced great progress, mainly driven by governmental initiatives instituted by the CBUAE. The CBUAE has provisions for domestic and cross-border fund transfers along with stand-alone licenses for currency exchanges. The CBUAE managed to sign several collaborative initiatives with the central banks of India and Hong Kong. Under these partnerships, the CBUAE seeks to enhance the cross-border transfer networks by leveraging each other's unique expertise. Additionally, Al Etihad Payments, a subsidiary of the CBUAE, recently unveiled Aani, an instant payments platform intended to offer businesses and consumers real-time fund transfer and settlement. The DFSA further provides a license for money transmission services which can be used for fund transfer activities. FSRA has a separate activity for

V. Emerging FinTech Segments

While the abovementioned activities have become quite popular within the UAE, two key activities have been emerging in line with regional and global trends, namely open banking and BNPL.

1. Open Banking

Open banking is already well recognised within the UAE across the three jurisdictions. The CBUAE and DFSA developed an AISP and PISP licensing regime as early as 2021. Similarly, the FSRA in 2021 released its licensing regime for open banking service providers i.e. the TPPs. However, it would take some time for the regulators to issue their first open banking licenses. The DFSA and FSRA issued their first licenses in 2022 to Tarabut and Lean Technologies, respectively. On the other hand, the CBUAE is yet to issue a license in this regard.

Nonetheless, the open banking sector has experienced substantial growth from 2022 to 2023, now comprising six authorised service providers. Among these, two are granted licenses by the Financial Services Regulatory Authority (FSRA) as Third-Party Providers (TPPs), while the remaining four are licensed by the Dubai Financial Services Authority (DFSA). Moreover, while open banking is the initial step to a data-sharing regime, open finance is gaining popularity worldwide, with jurisdictions like Australia leading the way. The UAE's regulators have noted this development and expressed their interest in expanding to Open Finance. In 2021, the ADGM collaborated with the MENA FinTech Association to publish a report exploring the importance of open finance and the unique opportunity it offers to the Arab region. The DIFC took a further step in 2022 by launching the region's first open finance lab, which focused on educating market participants on the importance of open finance in a growing data-driven economy. Following this announcement, the CBUAE also added the expansion into open finance to the list of its initiatives under its FIT Programme. The enthusiasm for open finance from the regulators has evidently sparked the interest of open banking/finance service providers, becoming another catalyst in the exponential growth of licensed service providers across the UAE.

2. Buy Now Pay Later

BNPL is an emerging sector that has been influenced by global economic trends turning harsh and leading consumers in search of cheaper sources of credit. The BNPL model offers a convenient repayment solution and a cheap source of credit at zero interest and little to no fees. However, regulators across the world have noticed the potential for loan sharks to exploit this opportunity, especially for vulnerable and low-income persons. As such, BNPL has been regulated as a credit service in many jurisdictions to ensure that BNPL service providers are subject to the stringent consumer protection requirements, with the exception of some jurisdictions such as Kuwait, which has regulated BNPL as a deferred payment service.

The DFSA and FSRA had already taken the initiative to provide a licensing framework for BNPL service providers, limiting its availability only to professional clients.

However, the CBUAE made a significant regulatory development through the release of the amended Finance Companies Regulation in late September 2023, which introduced the concept of Short-Term Credit that may be offered under the *'Restricted License Finance Companies'* license. The license enables entities looking to offer only Short-Term credit to apply for the limited license, which has lower requirements than the full 'Finance Company' license.

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Following the issuance of the revised Finance Companies Regulations by the Central Bank of the UAE (CBUAE), there has been a noticeable increase in market enthusiasm, particularly among pay-later service providers.

CAPITAL REQUIREMENTS & FEES

Each jurisdiction provides its own capital requirements and fees guided by the licensing design, range of service providers, and market opportunity to provide fair and non-cost restrictive access to the market.

1. Federal

Under CBUAE, the various FinTech activities are covered under several licensing categories with varying capital requirements. The initial capital requirement for each FinTech activity is provided for under the respective regulatory framework, ranging from AED 100,000 (~$27,273) to AED 20,000,000 (~$5,454,546). Some activities, such as SVF issuers and restricted license finance companies (for BNPL), also have variable capital requirements as part of their ongoing capital requirement, typically around 5% of the capital held or loaned. The CBUAE currently does not publicly express any licensing fees for its licensable activities; applicants are directly advised upon expressing their intention to apply for a license.

The FinTech landscape in the UAE has witnessed substantial growth and strategically positioned itself as a leader in the global financial arena.

2. Free Zones

The capital requirements and fees within the DIFC for money services activities are covered under the DFSA's Fees Module. The DFSA has a more diverse structure for its capital requirement, commendably taking into consideration the various financial structures and sizes of different FinTechs. The capital requirements are guided by the Base Capital Requirement (**BCR**) ranging between $10,000-$2,000,000, an Expenditure Based Capital Minimum (**EBCM**), and varying capital requirements such as a Transaction Based Capital Requirement (**TBCR**), Special Capital Requirement (**SCR**) and a Stored Value Capital Requirement (**SVCR**), where the highest is applicable. The licensing fees typically range from $5,000-$100,000 for all payment services and BNPL.

The FSRA provides the requisite capital requirements and fees for all FinTech activities under the Fees rulebook. The FSRA, in a similar fashion to the DFSA, also provides a wide capital requirements structure, and depending on the activity, it may be lower or higher in comparison to the DFSA requirements. The capital requirements are generally guided by a BCR that ranges between $50,000 to $2,000,000, an EBCM, and the varying capital requirements including the TBCR, SCR and the SVCR, where the highest is applicable. The licensing fees typically range from $5,000-$25,000 for all payment services and BNPL.

VI. Conclusion

The FinTech landscape in the UAE has witnessed substantial growth and strategically positioned itself as a leader in the global financial arena. The remarkable progress is attributed to a harmonious blend of government support, a tech-savvy population, and a robust financial sector. As the FinTech market continues to evolve, the UAE is poised to maintain its growth trajectory. The solid regulatory foundation and a commitment to innovation and collaboration position the UAE as a beacon of excellence in the ever-expanding global FinTech landscape.

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BIO

Tom heads up Moore Kingston Smith's Financial Services and Fintech Sector Groups. The team helps fintechs, financial services business and their stakeholders on a wide range of strategic, accounting, tax, compliance, and advisory issues.

Tom has 20 years of experience in working with clients across the fintech sector, from entrepreneurs who are scaling up new ventures, to fast growth tech companies, through to established international groups. His experience and access enables him to add value, disseminate ideas and views, and ensure that clients remain ahead of the curve. Tom knows what works and what the pitfalls are likely to be, which means that his advice is concise, focused, and effective.

Tom is a key member of Moore Kingston Smith's International Group, he advises and assists many businesses on their international operations, delivering compliance services and advising on international business structures and taxation issues. He regularly travels overseas – primarily to North America – to speak at seminars on sector issues and on expanding to the UK. Tom is a practical strategist with broad experience of financial services and disruptive technologies.

Moore Kingston Smith is a leading UK professional services firm providing innovative, bespoke solutions to help clients achieve lasting success at local, national and international level. Moore Kingston Smith is the London firm of Top 10 accounting and advisory network, Moore UK.

The UK's fintech landscape stands at a pivotal crossroads, poised for remarkable transformation and growth. Characterised by innovation and adaptability, the sector continues to redefine financial services, and 2024 promises to be no different.

According to research by consultancy McKinsey, revenues in the fintech industry are expected to grow almost three times faster than those in the traditional banking sector between 2022 and 2028. Compared with the six per cent annual revenue growth for traditional banking, fintechs could post annual revenue growth of 15 per cent over the next five years.

> “As fintech evolves, its impact extends beyond traditional banking services.

Fintechs have profoundly reshaped certain areas within the financial services sector due to their innovative and differentiated business models. The growth has also been driven by emerging economies such as China, India and Indonesia, which have some of the largest fintechs.

The fintech market is growing due to a combination of factors; so let's take a look at the key trends and influential aspects we expect to see throughout 2024.

AI-powered data intelligence offerings

The application of artificial intelligence (AI) and data analytics will be one of the cornerstones of fintech growth throughout 2024. Fintech companies are harnessing the power of AI to offer data intelligence solutions that not only enhance decision-making but also mitigate risks. AI-driven predictive analytics will play a pivotal role in asset management, portfolio optimisation, and risk assessment.

Financial institutions are increasingly relying on AI to analyse vast datasets and gain valuable insights into customer behaviour, market trends, and investment opportunities. This data-driven approach empowers financial professionals to make informed decisions and drive efficiency in operations. In 2024, AI-powered data intelligence offerings are expected to shake-up the way financial services are delivered and consumed.

Financial inclusion, financial literacy and emerging markets

As fintech evolves, its impact extends beyond traditional banking services. Inclusivity and accessibility are becoming central themes in the industry. Fintech firms are dedicated to addressing financial inclusion and literacy by providing innovative solutions to underserved populations, both domestically and in emerging markets.

In 2024, there is anticipated growth in initiatives aimed at bridging the financial literacy gap and expanding access to essential financial services. We expect fintech companies to continue to develop user-friendly apps and digital platforms that empower individuals to manage their finances more effectively. Furthermore, the emergence of blockchain technology and decentralised finance (DeFi) may open up entirely new avenues for financial inclusion, potentially transforming the global financial landscape.

Trust and uncertainty

Trust remains a core foundation of the fintech industry, especially in a post-Brexit and post-pandemic world. However, 2024 brings a complex landscape marked by regulatory changes, fraud concerns, and pressure on banks. The global economy's resilience and the stability of sectors like cryptocurrencies are under great scrutiny.

Fintech firms must navigate this evolving regulatory landscape while addressing emerging challenges such as increased fraud and cyber risks. Regulatory bodies are grappling with the need to strike a balance between innovation and consumer protection, especially in a landscape shaped by Brexit.

As fintech continues to disrupt traditional financial models, regulatory bodies are grappling with the need to strike a balance between innovation and consumer protection. Stricter regulations are expected in various areas, including digital assets and online payments. Fintech firms will need to adapt to these dynamic compliance requirements while maintaining consumer trust.

In parallel, cybersecurity and fraud prevention will be paramount. Fintech companies must invest heavily in cutting-edge security measures - advanced fraud detection algorithms, biometric authentication and real-time transaction monitoring - to safeguard against cyber threats. The ability to inspire consumer and investor trust will be a differentiating factor for fintech success over the year.

The digital revolution

The digital revolution in fintech shows no signs of slowing down. Real-time payments, cross-border transactions and shifts in consumer behaviour continue to reshape the financial landscape. In 2024, there is expected to be further innovation in how consumers transact, how financial services firms market their offerings, and how payments are processed.

Real-time payments are becoming the norm, providing unparalleled convenience for consumers and businesses alike. Cross-border transactions are being streamlined through blockchain technology and cryptocurrencies, reducing friction and costs. Moreover, fintech firms are tapping into the power of data analytics to personalise marketing efforts, making them more effective and customer centric.

As the fintech industry hurtles forward in 2024, it is impossible to overlook the looming presence of groundbreaking technologies like quantum computing. Quantum computing has the potential to revolutionise the financial landscape by tackling complex calculations and data analysis at speeds that were once inconceivable.

In the realm of fintech, this could translate to real-time risk assessment, faster transaction processing, and the development of more sophisticated AI algorithms. While quantum computing is still in its nascent stages, its inclusion in the fintech arsenal promises to reshape the industry's capabilities and set the stage for unprecedented advancements in financial services.

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Customer interaction

There's also an ongoing evolution in customer engagement through the integration of immersive technologies such as augmented reality (AR) and virtual reality (VR). These innovations are reshaping the customer banking journey, making virtual transactions a tangible reality.

Many financial institutions are adopting gamification strategies to motivate clients by facilitating goal setting, progress tracking and rewards, ultimately boosting financial literacy and prudent financial management. Fintech startups are also making waves by introducing voice-enabled payment services, enhancing the overall customer experience. Additionally, banks are embracing voice-to-text features in chatbots, making conversational banking more accessible and convenient.

Sustainability and green fintech

In 2024, we can expect a significant focus on eco-friendly banking and sustainable investment options. Fintech companies are leading the charge in developing innovative solutions to combat climate change and promote responsible financial practices.

One of the notable trends in this space is the rise of carbon footprint tracking tools. Fintech apps and platforms are providing users with insights into their carbon emissions, allowing them to make informed decisions about their spending and investment choices. These tools enable individuals and businesses to reduce their environmental impact while managing their finances.

Moreover, green investment platforms are gaining traction. Fintech firms are facilitating investments in renewable energy projects, sustainable agriculture, and environmentally responsible businesses. Through these platforms, investors can align their portfolios with their sustainability goals, driving positive change in the global economy.

> "One prominent trend is the rise of banking-as-a-service platforms

Blockchain technology is also playing a pivotal role in green fintech. It offers transparent and secure solutions for tracking and verifying sustainable practices throughout supply chains, ensuring authenticity in green investments.

As consumers and investors become increasingly environmentally conscious, the synergy between fintech and sustainability will continue to grow, reshaping the financial industry and fostering a more sustainable future investments in renewable energy projects.

Partnerships and collaborations

Fintech firms are recognising the value of working together with traditional banks and financial institutions, leading to the creation of hybrid financial services that offer the best of both worlds.

One prominent trend is the rise of banking as a service (BaaS) platforms. Fintech companies are partnering with banks to offer white label banking services, enabling startups, tech companies and even non-financial entities to provide financial products without the need for a full banking licence. This approach democratises financial services, fosters innovation and accelerates time-to-market for new offerings.

Another noteworthy collaboration trend involves fintech firms joining forces to offer comprehensive solutions. For instance, a fintech specialising in payment processing might partner with a cybersecurity-focused fintech to provide a secure end-to-end payment ecosystem. Such collaborations enhance the customer experience by addressing multiple aspects of financial transactions within a single platform.

Traditional banks are increasingly forming alliances with fintech startups to enhance their digital capabilities too. These partnerships enable banks to tap into fintech innovations, streamline operations, and offer customers more innovative and user-friendly services. However, these collaborations come with challenges, especially in terms of regulatory compliance and data security. Striking the right balance between innovation and consumer protection remains a key focus for regulatory bodies.

Those who seize the opportunities and invest in the future will position themselves for competitive advantage in the years to come. The winds of change are blowing, and the UK fintech sector is ready to set sail into uncharted waters, embracing the challenges and opportunities that lie ahead.

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