

STRATEGY FOR MONITORING
FINANCIAL INNOVATIONS
(FINTECH) IN THE NON-BANKING
FINANCIAL SECTOR 2021-2024

Sustainability and perspective

CONTENTS

- INTRODUCTION..... 2**
- OVERVIEW OF THE EXTERNAL ENVIRONMENT 3**
 - Strategy, objectives and priorities for digitization of financial services..... 5
 - Digital single market..... 6
- EUROPEAN SECURITIES AND MARKETS AUTHORITY (ESMA) 3
- EUROPEAN INSURANCE AND OCCUPATIONAL PENSIONS AUTHORITY (EIOPA) 3
- Digital innovation centers 4
- Overview of the scope, importance and prospects for the digital assets market 4
- Regulation on digital operational resilience for the financial sector /DORA/ – Highlights..... 5
- Regulation on Markets in Crypto-assets, and amending Directive (EU) 2019/1937 /MiCA/ – Highlights 5
- Development of cybersecurity 6
- Artificial intelligence (AI) in action 7
- Digital finance – risks..... 7
- Data sharing and related rights..... 8
- OVERVIEW OF THE INTERNAL ENVIRONMENT 10**
 - Strategic objectives 11
- COMPLIANCE WITH EUROPEAN LEGISLATION IN THE FIELD OF FINANCIAL INNOVATION..... 13
- Regulation of crowdfunding services 13
- INTERACTION, MONITORING AND REPORTING OF THE STRATEGY 13**

INTRODUCTION



Given the evolving digital technology in all aspects of human activity, its presence in the field of financial services clearly stands out. The future of financial services is digital and consumers' and entrepreneurs' access to these services is increasingly electronic. Innovative market participants are introducing new technology and existing business models are changing. Digital financial services also facilitate individuals and businesses when dealing with the emergency caused by the COVID-19 pandemic. Digital technology will be key to restarting and modernizing all sectors of the European economy. Meanwhile, consumers of financial services must be protected from the risks associated with increased reliance on digital innovation.

Supporting the deployment of digital technology, the wider use of digital financial services in the EU, which will bring significant benefits to both consumers and businesses, and taking into account the risks associated with these services, is a strategic objective within the single market for financial services.

In line with the European strategic objectives, the Financial Supervision Commission (FSC) will focus its efforts on achieving the common European goals, taking into account the development of the local financial services market, as well as consumers' attitude.

In order to ensure the fulfilment of the objectives set by the European Commission (EC) for the Member States, in the Strategy for Monitoring Financial Innovations FSC envisages active consultation on the processes for providing electronic access to financial services for consumers and businesses, reducing operating costs and increasing the competitiveness of the non-banking financial sector by reducing barriers for entering the market and balancing the identified need for data security and protection, the opportunity to share data and the transparency thereof.

FSC's Strategy for Monitoring Financial Innovations outlines the main action approaches – monitoring FinTech's development, assessing potential risks to the market and consumers, and potential actions and measures to minimize them in order to maximize the benefits of the growing interest in financial innovation products and/or technology at the service of the consumer, in compliance with regulatory requirements.

A challenge for the FSC is the development of regulatory rules, policies and guidelines to regulate the regime of providing innovative products and services, monitoring of applied technological solutions in the non-banking financial sector, and taking measures to reduce the risks associated with their implementation.

OVERVIEW OF THE EXTERNAL ENVIRONMENT



The challenge for regulators will be the monitoring of crypto-assets which are spreading rapidly. Surveillance requires effective cross-border cooperation, coordination and exchange of information between the relevant authorities.

As noted by the Financial Stability Board in its 2019 Report to G20 Finance Ministers and Central Bank Governors, many additional initiatives are being taken at international level on regulatory and supervisory approaches to crypto-assets. The work of the Basel Committee on Banking Supervision, the Committee on Payments and Market Infrastructures, the International Organization of Securities Commissions (IOSCO), the Financial Action Task Force, the Organization for Economic Co-operation and Development and the Financial Stability Board covers important aspects of the risks of crypto-asset trading. In particular, it focuses on investor protection, market integrity, the fight against money laundering, bank exposures and the monitoring of financial stability. The International Monetary Fund (IMF) has also contributed to regulatory efforts in the field of innovation by drawing up and providing a list of principles that should highlight the development of regulatory frameworks.

The European initiative to create and implement a new strategy for the digitization of financial services confirms the great importance of digitization in the financial sector, which stood out clearly during the COVID-19 crisis. The European programme includes four priorities and covers essentially all important areas of activity in the digital transformation of the financial sector.

A well-functioning single market for digital financial services will help improve access to financial services for consumers and retail

investors. Reducing its fragmentation is essential to enable its development.

The European Economic and Social Committee recommends ensuring the legal interoperability of digital identities. It is therefore desirable to harmonize the identification rules.

EU's strategy for the digitization of financial services focuses on the safety of citizens. The recommendation to the Member States is to introduce, parallel to the implementation of the strategy, legal and organizational measures to counteract the phenomenon of identity theft. With the development of digital services and products, this problem is becoming more common and, if no action is taken, it can become a factor hindering the implementation of the strategy.

In addressing the challenges and risks associated with the digital transformation, the regulation of technology providers, consumer protection, access to financial services, operational sustainability and security of networks and information systems are crucial for the creation of a digital single market for financial services.

The strategic vision of the FSC involves the need to take into account the risks associated with innovation, without hindering the development thereof. Having a flexible approach is key to the ever-increasing pace of development of the digital world.

FSC, in its role as a regulator, must pay attention to financial service intermediaries, as their behaviour may have a direct impact on the protection of investors and consumers, respectively on the stability of the financial system.

STRATEGY, OBJECTIVES AND PRIORITIES FOR DIGITIZATION OF FINANCIAL SERVICES

FSC pays serious attention to the strategy for digitization of financial services adopted on 24.09.2020 by the EC. The purpose of the document is to expand the use of digital financial services in view of consumer needs. The EC-approved digital financial services package includes several areas, such as a strategy for digitization of financial services, a strategy for retail payments, legislative proposals for an EU regulatory framework on crypto-assets and related distributed ledger technology (DLT)¹, as well as proposals on an EU regulatory framework for the operational sustainability of digital technology. In the particularly dynamic context of digital innovation accelerated by the COVID-19 crisis, the strategy aims to encourage consumers to embrace the use of digital financial services.

The strategy sets out EU action on four priorities to promote the deployment of digital technology by 2024.

The first priority is to address the fragmentation of the digital single market for financial services, which will enable European consumers to access cross-border services and help companies expand the market for their digital services.

The second priority is to ensure that EU legislation facilitates digital innovation for the benefit of consumers and market efficiency. Innovations that are based on or use DLT or artificial intelligence (AI) have the potential to improve

financial services for consumers and businesses. The regulation of financial services should ensure that they are used responsibly.

The third priority is the creation of a European financial data space to promote data-based innovation, building a European data strategy, including enhanced data access and sharing in the financial services sector. The EU has created an obligation to publish comprehensive financial and non-financial information on companies' activities and products. Extended data sharing and openness to all sectors and within the sectors themselves, in line with data and competition protection rules, will enable the financial services sector to take full advantage of data-based innovation. This will encourage the creation of innovative products for consumers and businesses and support the policy's more general objectives, such as the creation of a single data market.

The fourth priority is to meet the new challenges and risks associated with the implementation of digital technology. Financial services are migrating to digital environments with fragmented ecosystems consisting of interconnected digital service providers that fall partially outside financial regulation and supervision. Therefore, digital financial services can pose more challenges to existing regulations and supervision in order to maintain financial stability, consumer protection, market integrity, fair competition and security.

DIGITAL SINGLE MARKET

The objective of the strategy for digitization of financial services is to use the opportunities offered by the digital single market to enable consumers and entrepreneurs to reap the benefits of digital financial services. A well-functioning single market for digital financial services will help improve access to financial services for consumers and non-professional investors in the EU through more innovative, diverse and affordable banking, investment and insurance services.

By 2024, the EU should put in place a sound regulatory framework enabling the use of

interoperable digital identity solutions for individuals, which will ensure fast and easy access for new customers to financial services.

Guidelines have already been developed at European level to ensure greater convergence of the identification and verification elements required for registration purposes and the way and extent to which financial service providers can rely on customer due diligence (CDD) performed by third parties, including financial service providers.

¹ The concept is considered for the first time in the FSC Monitoring Strategy 2018-2020

As part of the forthcoming legislative proposals for new regulation on the fight against money laundering and terrorist financing, there will be detailed and harmonized requirements for the CDD in order to facilitate the use of innovative technology and allow for unimpeded cross-border operations without the need to implement different processes or compliance with additional requirements in each Member State. This will facilitate the identification of customers and the verification of their representative authority, while ensuring full compliance with the risk-based approach to the fight against money laundering and terrorist financing.

Financial technology companies can often provide services only within their country or reduce access to their digital platforms for customers who are included in a restrictive list of EU jurisdictions.

The collective financing regulation will introduce common rules and the possibility to operate in the

European Economic Area (EEA) under a single license for different types of collective financing services, including credit intermediation, and the current EC proposals for crypto-assets will set new common rules and the possibility to operate in the EEA under a single license for issuers and suppliers of crypto-assets.

FSC encourages the supervised persons and the persons providing innovative products and technology to continue to work actively with the established innovation centre, with a view to its development and subsequent formation of a regulatory environment. In this regard, the supervision of digital financial services requires enhanced cooperation between the various regulatory authorities and institutions, participation of the FSC in the forums related to the development of financial innovation, as well as significant new technical skills from the experts performing the supervision.

EUROPEAN SECURITIES AND MARKETS AUTHORITY (ESMA)²

Cooperation on financial innovation at EU level is key to closing the fragmentation of the digital financial services market. The development of digital financial identities³ that are usable and recognized across the EU (the legal entity identifier – LEI code) will make a positive contribution in this direction.

The focus is both on the risks and benefits of digitization of the financial sector and on the benefits, which include increased speed, efficiency, convenience and greater economies of scale and automated tools that help companies and authorities detect misconduct. Risk areas

include data security, operational incidents, data confidentiality, pricing, and sales practices.

The challenge for both financial market participants and supervisors is to build the necessary knowledge and experience to take advantage of digital technology. The main requirements for efficient and easy use of data are standardization and harmonization of data, security of IT systems and legal certainty regarding the respective responsibilities and permits for use. For easy use of publicly available data, it must be subject to unrestricted access.

EUROPEAN INSURANCE AND OCCUPATIONAL PENSIONS AUTHORITY (EIOPA)

EIOPA and its members have focused their innovation attention mainly on SupTech⁴ in order to prepare the competent authorities for its implementation. Any new tools or processes can be used by supervisors to utilize their work, but not have it done instead of them.

In the field of supervision, the tools for analysing specific aspects of the framework of Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance, such as investments, technical

² ESMA responded to the consultation of the European Commission on the Digital Finance Strategy on 29 June 2020.

³ Based on the existing global standard ISO 17442

⁴ (Supervisory Technologies) Development and implementation of high-tech solutions for the needs of financial regulation and supervision.

provisions, and solvency capital requirements, are the clearest.⁵

FSC participates in improving the cooperation and exchange of information, as well as the existing processes through the participation of experts in the ESMA and EIOPA working groups.

DIGITAL INNOVATION HUBS⁶

In connection with the EU's Digital Europe programme, the EC has elaborated a project to develop a European Digital Innovation Hub. It is a single or coordinated group of entities that have additional experience and are non-profit, supporting the digital transformation of public sector companies/organizations on a large scale. This development includes access to services such as technology testing, financial advice and market information. It works in collaboration with partners whose experience lies in business development/innovation or public sector training, as well as with partners who can help build networks and participate in the regional innovation ecosystem.

The strategic objective at EU level is to expand the use and benefits of digital financial services for consumers and businesses.

Wider use of digital financial services would foster innovation and create opportunities to

Much of ESMA's work is supported by standing committees, working groups and task forces that bring together experts from national competent authorities (NCAs).

develop better financial products for consumers, including people who do not currently have access to financial services. It opens up new channels for channelling funding to EU businesses, in particular small and medium-sized enterprises (SMEs).

Following European trends, FSC will promote digital financial services and support Europe's economic recovery strategy and the more general economic transformation. The aim is to help create new funding channels in support of the European Green Deal and the New Industrial Strategy for Europe.

Given that digital financial services have no borders, they have the potential to strengthen the integration of financial markets in the Banking Union and the Capital Markets Union (CMU), which will strengthen the European Economic and Monetary Union.

OVERVIEW OF THE SCOPE, IMPORTANCE AND PROSPECTS FOR THE DIGITAL ASSETS MARKET

The development of digital assets is related to the rapid technological development of Fintech in the traditional areas of financial services.

At the beginning of 2021, there were over 4,000 types of crypto-assets, which is a significant increase from the digital coins created in 2013. In fact, it is estimated that the top 20 crypto-assets represent nearly 90 percent of the total market.⁷

Crypto-assets, especially Bitcoin and Ethereum, have undergone significant price volatility over the past year.

The advent of cryptocurrencies and blockchain technology is part of a wider wave of technologies that facilitate peer-to-peer interaction (P2P), product individualization and flexibility in production methods. For example: stable coins (cryptocurrencies where the price is intended to be linked to cryptocurrency, fiat money or exchange traded goods, such as precious metals or industrial metals), which have a stable price and are usually of fixed value, could be a useful tool for cheaper cross-border remittances and payments.

⁵ Solvency II is a directive in European Union law that codifies and harmonizes EU insurance rules. Above all, it concerns the amount of capital that EU insurance companies must have in order to reduce the risk of insolvency.

⁶ Digital Europe. Draft guidelines for the preparation of work programme(s) 2021-2022

⁷ Data extracted from <https://www.statista.com/statistics/863917/number-crypto-coins-tokens/>

The growth of crypto-asset trading platforms, the introduction of new financial products and the growing interest of investors raise questions about the future importance and consequences of crypto-assets for the financial sector, as the diffusion and adoption of this new exchange organization is potentially transformational in nature.

The EC's new digital finance package has been developed following extensive public consultation and coverage, including a digital finance and retail strategy, as well as legislative proposals on crypto-assets (MiCA) and digital resilience. FSC actively participates through its working groups in connection with the legislative proposals on the digital package.

REGULATION ON DIGITAL OPERATIONAL RESILIENCE FOR THE FINANCIAL SECTOR /DORA/ – HIGHLIGHTS

The published EC proposal for a regulation on digital operational resilience for the financial sector (DORA), which builds on existing information and communication technology (ICT) risk management requirements already developed by other EU institutions and links several recent EU initiatives in one regulation, aims to create a much clearer basis for EU regulators and supervisors so that they can broaden their focus.

The most important aspects of the DORA proposal and the practical implications include bringing "third party service providers", including cloud service providers, into the regulatory perimeter. They will be monitored by one of the European Supervisory Authorities (ESAs) which

will have the power to request information, carry out on-site inspections, issue recommendations and requests, and impose fines in certain circumstances. This will be done with a view to harmonizing rules across the EU and establishing pan-European standards for digital testing of operational resilience.

It is expected that DORA will first be agreed by the EU institutions, after which additional secondary legislation will be developed.

FSC welcomes the introduction of a supervisory framework, as this will provide greater legal certainty regarding the acceptable level of asset protection in the cloud.

REGULATION ON MARKETS IN CRYPTO-ASSETS, AND AMENDING DIRECTIVE (EU) 2019/1937 /MiCA/ – HIGHLIGHTS

The EC proposal to regulate crypto-asset markets (MiCA) is a regulatory framework developed in 2018 to help regulate crypto-assets that are currently out of range and their service providers in the EU, and to ensure a single licensing regime in all Member States by 2024. MiCA aims to "harmonize the European framework for issuing and trading in different types of crypto-assets as part of the European digital finance strategy".

FSC takes into account the dangers that unregulated virtual assets pose to investors and markets, including risks of money laundering and terrorist financing.

The European Commission envisages the creation of a comprehensive framework by 2024, allowing the introduction of DLT and crypto-assets in the financial sector. The regulatory framework should also reflect the risks associated with these technologies.

The MiCA proposal introduces several definitions related to crypto-assets. These definitions will lead to harmonization of the definitions used in the field of crypto-assets. The definitions listed below are not final until the regulation is adopted by the European Parliament and the Council.

Crypto-asset	A digital representation of value or rights which may be transferred and stored electronically, using distributed ledger technology or similar technology
Distributed ledger technology (DLT)	A class of technology which supports the distributed recording of encrypted data („crypto-asset“) – type „utility token“, which is intended to provide digital access to a good or service, available on DLT, and is only accepted by the issuer of that token.
Asset-referenced token	A type of crypto-asset that purports to maintain a stable value by referring to the value of several fiat currencies that are legal tender, one or several commodities or one or several crypto-assets, or a combination of such asset.
E-money token	A type of crypto-asset the main purpose of which is to be used as a means of exchange and that purports to maintain a stable value by referring to the value of a fiat currency that is legal tender.
Crypto-asset service	Means any of the services and activities listed below relating to any crypto-asset: ⁸ <ul style="list-style-type: none"> (a) the custody and administration of crypto-assets on behalf of third parties; (b) the operation of a trading platform for crypto-assets; (c) the exchange of crypto-assets for fiat currency that is legal tender; (d) the exchange of crypto-assets for other crypto-assets; (e) the execution of orders for crypto-assets on behalf of third parties; (f) placing of crypto-assets; (g) the reception and transmission of orders for crypto-assets on behalf of third parties; (h) providing advice on crypto-assets.
Crypto-asset service providers⁹ /CASP/	Defined by MiCA as “any person whose occupation or business is the provision of one or more crypto-

⁸ An extended interpretation of the concepts is provided in Article 3 paragraphs 10-17 of the Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on Markets in Crypto-assets, and amending Directive (EU) 2019/1937.

⁹ This definition is broader than the FATF Virtual Asset Service Provider (VASP) definition to ensure that MiCA applies to most crypto companies and to protect it in the future against niche markets that do not yet exist.

	asset services to third parties on a professional basis”
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DEVELOPMENT OF CYBERSECURITY

Today, finance is being transformed by mobile technology, database, DLT, cloud computing, artificial intelligence and machine learning. Advances and the spread of digital technologies could dramatically increase financial inclusion by expanding access to financial services – especially among the population that does not have access to digital services, among micro, small and medium-sized enterprises and in rural areas. The potential benefits of this transformation are enormous, but the risks must also be managed.

DLT and blockchain technology, especially its application in crypto-assets, have attracted tremendous global attention. However, from blockchain development to the issuance and use of crypto-assets, a number of issues have arisen that pose regulatory challenges in the areas of transparency, cybersecurity and risks to financial stability. As such, although the systemic risk posed by these technologies may still be limited, monitoring is still needed, especially given market integrity and consumer protection concerns.

Given that DLT platforms rely on the use of digital information and communication technology (ICT)

ARTIFICIAL INTELLIGENCE (AI) IN ACTION¹⁰

AI is a strategic technology that offers many benefits to citizens, companies and society at large, provided it is human, ethical, sustainable and respects fundamental rights and values. It proposes a significant increase in efficiency and productivity, which can strengthen the competitiveness of European industry and improve the well-being of citizens.

FSC adheres to and supports the European approach to AI, which aims to promote Europe's innovation capacity in the field.

The White Paper on AI and the accompanying report on the safety and responsibility framework are linked to the launch of a broad consultation with Member States' civil society, industry and academia on concrete proposals for a European

services and infrastructures, they can naturally be subject to cyberattacks, fraudulent cyber activities and technical glitches. However, DLT is organized differently, as it relies on a database shared and synchronized in a network of participants (nodes). Thus, transaction records are visible to all and are stored in a decentralized and distributed manner by all participants, and P2P transactions can be performed without intermediaries and checked by the so-called “irregularity validators”. To the extent that this innovation opens up room for great potential economic benefits, it also includes some cyber risks that need to be identified. In particular, the development of a strategy for Europe's operational cyber resilience to allow for the emergence of a useful regulatory framework is being considered.

In this regard, FSC pursues a policy for monitoring cyberspace in order to research the risk of cybersecurity breaches by intentional or unintentional actions that pose a significant threat to the functioning of market participants in the non-banking financial sector.

approach to AI. These include both policy tools to stimulate investment in research and innovation, improve skills development and support for the uptake of AI by SMEs, and proposals for key elements of the future regulatory framework.

Given the great impact that AI can have on our society and the need to build trust, it is vital that it be based on our values and fundamental rights, such as human dignity and the protection of privacy.

Implementing its AI strategy adopted in April 2018, on 16 December 2018, the EC presented a coordinated plan, prepared jointly with the Member States, to promote the development and use of AI in Europe.

¹⁰ Brussels, 19.2.2020 COM (2020) 65 final White Paper on Artificial Intelligence – A European approach to excellence and trust

FSC considers this to be a challenge in the near future and aims to ensure clarity on supervisory expectations about the way in which financial

services legislation should be applied in relation to AI.

DIGITAL FINANCE – RISKS

Cybersecurity must be guaranteed with the stability of IT systems and technologies when it comes to crypto-assets. Cybersecurity is widely used to cover the range of strategies used to protect institutions, governments and individuals from IT risks and threats. Cybersecurity, on the other hand, involves digital asset-specific technology, IT platforms, and information and communication technology security. Cybersecurity includes measures to dissuade potential perpetrators through robust systems, sanctions mechanisms and cyber-diplomacy. The

incidence of cyber incidents will indeed increase if a constantly updated regulatory framework for their reporting and resolution is not provided. According to the European Parliament (EP), the financial sector (which costs the EU economy several billion euro each year) is already three times more vulnerable to cyberattacks than any other sector. Therefore, in order to provide a sustainable digital environment which contributes to the development of crypto-assets, there is a need for legislative improvements in this area.

DATA SHARING AND RELATED RIGHTS

An important feature of crypto-assets is that blockchain technology allows the use of DLT to generate and maintain records without the need for a central regulator to administer the system. As such, DLT platforms allow direct collection and dissemination of data between participants. This raises some questions about access rights and privacy. In addition, as crypto-assets are traded P2P globally, this also raises the issue of recording these transactions and the jurisdiction that is ultimately responsible for reporting on the stock exchange and positions. International cooperation will be required to ensure that the countries where the suppliers are located collect information on the country of residence of the counterparties in the transactions and on the positions in the different types of crypto-assets (from portfolio providers), while complying with the law. Therefore, further progress is needed in this area to increase the credibility of crypto-assets and ensure an appropriate level of data protection and regulation that allows EU innovators to grow and develop while protecting the rights of investors and consumers.

In addition, access to data is crucial for the development of digital finance in Europe, as most financial services now rely heavily on advanced digital technology and large amounts of data.

Fintech's ability to use customer data through AI raises the question of how supervisors should

approach consumer rights, especially in the broader context of data protection provisions. This is related to the question of how supervisors should consider the potential to encourage data sharing between different actors in the provision of financial services.

Equal access to data for Fintech entrepreneurs needs to be ensured in order to achieve a healthy level of competition and innovation. However, regulatory obligations for the financial business to share data on new participants may also create new risks that need to be addressed. DLT introduces new challenges for operators and regulators in terms of data use, sharing, storage and access rights. Questions arise about the processing and analysis of individual data through analysis techniques, and procedures (existing legislation) for identifying potential sources of risk have not yet been synchronized.

Regarding the effective implementation of Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation) (GDPR), in practice GDPR is the EU framework for data ownership, which determines who retains control over data, their use and dissemination. Data retention should also be considered,

especially when stored through cloud computing services, which are often outsourced. Here, the risks are once again mainly related to cybersecurity and the possibility of breakthroughs, which, as mentioned, requires

enhanced operational cyber resilience. In addition, there is a need for more specific guidance on the application of GDPR to the financial sector and on the ethical use of data.

OVERVIEW OF THE INTERNAL ENVIRONMENT



STRATEGIC OBJECTIVES

DETERMINING/RESEARCHING THE POTENTIAL NEED FOR REGISTRATION AND/OR LICENSING REGIME FOR COMPANIES OFFERING FINANCIAL INNOVATIONS.

FSC takes seriously the challenge facing supervisors as a result of the dissemination of financial products and services through the use of financial innovations – it requires the analysis and assessment of potential risks to the financial services market for consumers with the emergence of innovative business models and possible measures to deal with the risks in the fast-growing FinTech industry.

FSC will concentrate on four areas of action in relation to the specific tasks that lie before the regulator, namely:

1. ANALYSIS OF THE NEED TO INTRODUCE REQUIREMENTS FOR LICENSING OR REGISTRATION REGIME OF PERSONS OFFERING INNOVATIVE FINANCIAL PRODUCTS AND/OR SERVICES AND THE TECHNOLOGY OF THE NON-BANKING FINANCIAL SECTOR, AS WELL AS DEVELOPMENT OF SPECIFIC REQUIREMENTS.

The White Paper standard will also take into account the developed content and form of the White Paper on crypto-assets provided in Article 5 of the Proposal for a REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on Markets in Crypto-assets, and amending Directive (EU) 2019/1937.

2. ANALYSIS OF THE NEED FOR A REGULATORY FRAMEWORK IN CONNECTION WITH OUTSOURCING SERVICES, INCLUDING CLOUD SERVICES, AND TAKING APPROPRIATE REGULATORY MEASURES TO ENSURE THE SECURITY AND STABILITY OF THE FINANCIAL SERVICES MARKET AND THE PROTECTION OF CONSUMERS OF FINANCIAL SERVICES.

Cloud space is radically changing the way databases were used so far, allowing remote storage and access to information without the need for significant hardware devices in place. This reduces the cost of storing data and processes, making it easier to store and process large databases.

The cloud services used can bring significant benefits, yet, some risks cannot be ruled out. The

The aim of this task is to achieve results through participation in the established channel of close cooperation at European level, through participation in working groups of ESMA and EIOPA (Task Force FISC and InsurTech) and in-depth understanding of the nature of the various FinTech companies. FSC will take steps to ensure a secure and measurable regulatory environment in which FinTech companies offering financial products and services or offering products to FSC supervised entities may operate.

In this regard, FSC envisages the issuance of a standard for the so-called White Paper, which is a document describing the manner of implementation of a particular financial innovation, the marketing method, legitimizes the persons implementing it to the public target group – potential investors, and indicates the legal requirements it complies with, if any.

security and integrity of information systems using cloud services depends on the proper identification and management of these risks and the implementation and maintenance of appropriate security measures.

FSC will adjust its regulatory and supervisory activities in view of the prevailing trends for widespread use of cloud services, taking into account the need for appropriate supervisory mechanisms to manage operational risks arising from the lack of regulatory framework for third-country service providers for non-banking financial institutions. For example, in cloud computing and high-volume data processing services, as well as the concentration of the service provided by a particular third-country provider. The need to improve the quality of the global coordination process between regulators and information systems security authorities will be taken into account.

The guidelines of the European financial markets authorities – EIOPA and ESMA regarding the requirements for outsourcing to cloud service providers will also be taken into account. In connection with ESMA's guidelines, a change in

the regulatory framework is forthcoming in the next year and a half by FSC.

Cloud services are a combination of business and delivery models that allow on-demand access to a shared pool of resources, such as data processing applications, servers, storage, and network security. The services are usually provided as Software as a Service (“SaaS”), Platform as a Service (“PaaS”) and Infrastructure as a Service (“IaaS”).

The challenge for supervisors is the use of cross-border cloud infrastructures by the next generation of supervised persons, as well as the creation of European cloud services markets, where consumers will have a single portal for

In this regard, and given that cloud services are seen as that digital technology that will contribute to achieving the sustainability goals of the Green Deal in various areas, FSC has initiated a short survey among supervisors.

The study found that cloud services are the innovation that most people, both in the insurance, social security and investment sectors, claim to have helped reduce their costs. The main advantages of cloud services are: the better stability of the systems, the easier recovery in case of accident, as well as reduced costs for administration. They have been tested and allow greater efficiency due to the possibility for use of elastic resources.

3. DEVELOPMENT OF THE EXISTING INNOVATION HUB

The establishment of the Innovation Hub, as part of FSC's initiative to develop a concept for a strategy for monitoring financial innovation in the non-banking financial sector, will allow providers cooperation, easy access to communication and a two-way information exchange with the regulator in the non-banking financial sector. FSC's Innovation Hub will reduce the response time for questions and cases, raised by the applicant company offering innovative products, regarding the regulatory and legal status and the possibility for easy and fast access to information, by reducing the regulatory uncertainty for the business.

The Innovation Hub provided a channel of interaction between the persons supervised by

cloud offerings that meet key EU standards and rules.

Ensuring the secure and reliable operation of digital infrastructures is becoming increasingly important as more people use the online financial services provided and employees in the financial services sector themselves work remotely.

In this regard, an important point and another challenge for supervisors, including FSC, is to ensure security in the provision of digital services when using cloud services.

The safe and secure use of cloud services is inextricably linked to the appropriate classification of information system data. It is imperative to ensure that information security rules apply to every use of cloud services.

FSC and the FSC bodies, as well as a wider range of users and persons offering innovative products and services, easy access to communication and exchange of information with the service regulator.

The standardized form for submitting an inquiry to the regulator, developed and implemented by FSC, facilitates communication and cooperation, which enables it to receive feedback from companies offering financial innovations, in order to ensure the right direction for the regulatory framework, minimizing possible risks, caused by the entry of financially innovative products and/or services, without unnecessarily aggravating the licensing and supervisory regime for FinTech enterprises.

In the future, FSC will continue to actively develop this form of communication and interaction with the business and consumers through the web-based communication form, as well as through direct meetings. The opportunities provided by the Innovation Hub for the business will be promoted at FinTech forums, conferences, and seminars by FSC participants, and a special section of the Commission's website will be provided with explanatory materials on the work of similar innovation centres in other Member States.

4. MONITORING THE DEVELOPMENT OF SANDBOX MODES AND OUTLINING FOLLOW-UP ACTIONS IN CONNECTION WITH ITS POSSIBLE IMPLEMENTATION BY THE REGULATOR¹¹

In connection with the rapid development observed in the last year in the online offering of products and services, an ever wider supply of digital financial services on the Bulgarian market can be envisaged. Currently, financial market regulations are predominantly technology-neutral. At the same time, there is a need for supervisors to assess business models in terms of the security of the provision of financial services

as well as the risks to consumers. Therefore, in some countries the Sandbox mode has been introduced – a working environment provided by the regulator for testing new financial products under supervision and providing financial services in a digital environment. This operation mode for financial innovation is becoming increasingly popular among European regulators. In this context, FSC considers it appropriate to develop measures to approximate the practices of the European supervisory authorities of the Member States with regard to building the next level of interaction with supervised entities and businesses.

COMPLIANCE WITH EUROPEAN LEGISLATION IN THE FIELD OF FINANCIAL INNOVATION

REGULATION OF CROWDFUNDING SERVICES

In order to promote cross-border crowdfunding services and to facilitate the providers of such services in exercising their right to freely provide and receive such services on the single market, on 20.10.2020, the EP and the European Council adopted Regulation (EU) 2020/1503 on European crowdfunding service providers for business, and amending Regulation (EU) 2017/1129 and Directive (EU) 2019/1937, which will enter into force on 20.11.2021, and which overcomes existing obstacles the proper functioning of the single market for crowdfunding services and ensures a high level of investor protection

through the establishment of a regulatory framework at Union level.

The implementation of the new regulatory crowdfunding framework by the FSC, which is considered as an established form of alternative financing for start-ups and SMEs, which usually rely on small investments, will be one of the forthcoming tasks for the Commission. This task will be related to the supervision of a digital platform set up to connect or facilitate the connection of potential investors or lenders with companies seeking funding.

INTERACTION, MONITORING AND REPORTING OF THE STRATEGY

In this strategy FSC has outlined its main objectives for the digitization of financial services, the widespread use of cloud services, the rapid development of crypto-assets and the challenge before supervisors to ensure the integrity of financial markets and protect consumers from emerging risks.

The FSC Strategy for Monitoring Financial Innovations for the period 2021-2024 continues, but also builds on the tradition of the previous strategy, outlining the directions in which FSC would commit to develop its

¹¹ See <https://www.fsc.bg/bg/finansovi-inovacii/strategiya-zanablyudenie-na-finansovite-inovatsii-fintech/>

supervisory activities in the long run and seek unification of national regulatory frameworks and practices in the field of financial innovation at European Union level.

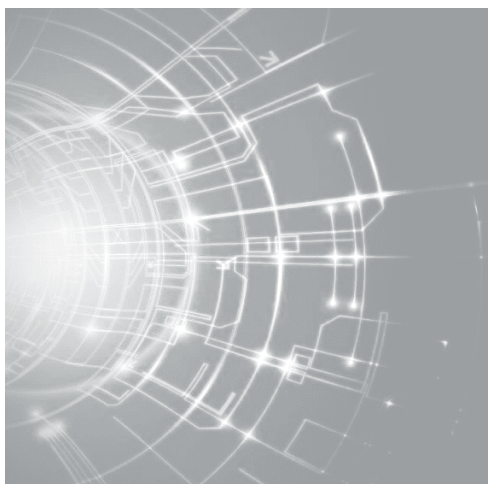
A systematic review of the performed activities and the progress in the implementation of the strategy will be carried out. The monitoring will identify emerging problems, the factors that determine them and possible solutions to these problems. This will allow problem areas and deviations from the plan to be identified early enough to allow for corrective action.

FSC encourages cooperation between consumers, businesses – supervised entities in the non-banking financial sector, companies offering products and services in the field of financial innovation, and will actively cooperate with the state administration, legislators and supervisors at European and national level for the development of financial innovation and improving the legislative framework and oversight.

FSC will actively work on the preparation of specific proposals at European level in connection with the development of applicable legislation aimed at establishing a unified methodology and policy for monitoring and promoting financial innovation in the future.

FSC will adhere to its leading priorities for monitoring and development of financial innovations, which aim to meet the emerging needs of consumers for new financial instruments, new and more modern ways to purchase and sell financial services and products, and thus generate value for the economy.

Full publicity will be ensured by publications on the FSC website in the section on financial innovations. The strategy is subject to an ex-post impact assessment following its completion.



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