



EUROPEAN CENTRAL BANK

BANKING SUPERVISION

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# **SSM approach to Fintech supervision**

Fintech-HO2020 Kick-Off

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- Financial technology (Fintech) is **transforming the business models** of financial service providers, creating a new landscape of **opportunities** and **risks**.

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- **New entities** with business models shaped by state-of-the-art technology provide innovative banking products and services.

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- **Incumbent banks** are led by market forces to increase IT investments and deploy new technology to **improve the quality, pricing, and convenience of products**, aiming to an enhanced customer experience.

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- Banks are also facing **challenges from non-bank fintech entities** offering innovative products and services.



- ❑ The ECB and the national competent authorities (NCAs) acknowledge the **benefits emerging from fintech**, which offers significant opportunities for both banks and consumers and can contribute to the stability of the financial system.
- ❑ Our philosophy is **technology-neutral** and seeks neither to support nor to discourage the use of any particular fintech solution.
- ❑ **All SSM banks**, both incumbents and market entrants, regardless of their business model, **are in charge** for putting in place adequate risk management processes to address the risks they face, **including emerging fintech related risks**.
- ❑ The ECB ensures that all SSM banks are **licensed in a consistent manner**, taking account of their specificities.
- ❑ **Supervisors need to understand** the impact of fintech on banks' business models, as well as on the risk management processes.
- ❑ Against this background, our objective is to promote a **common understanding of fintech related risks and to ensure a consistent supervisory approach** across the SSM, based on the current regulatory framework and fully aligned with the European Banking Authority (EBA).



## Licensing

Guide to assessments of  
Fintech credit institution  
licence applications

## Supervision

Assessing the impact of  
technologies on banks'  
business models and their  
application in various  
activities

## ECB initiatives



## SSM Fintech Hub

Improving the sharing of  
information and harmonising  
the best practices across the  
SSM

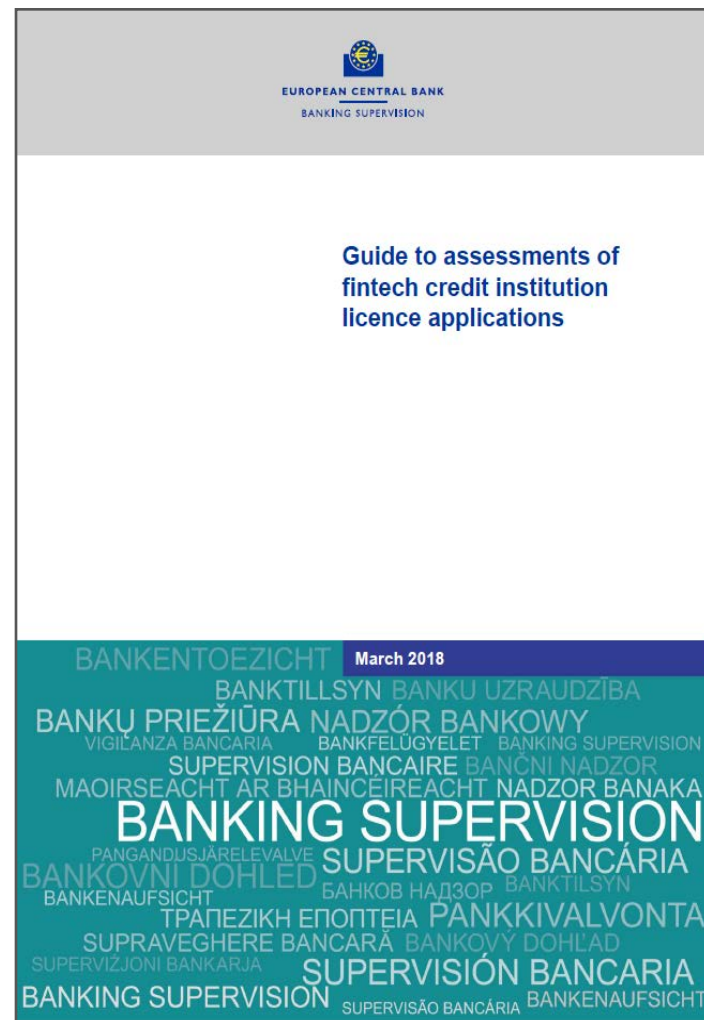
## Cooperation & Dialogue

Public consultations and  
industry dialogue

Exchanges with  
regulators (COM, EBA)  
and NCAs in and  
outside of the SSM

## The ECB has been looking at risks related to fintech banks, but also to traditional banks using fintech solutions

- ❑ Given the rising number of entities with fintech business models applying for banking licenses, the ECB and national supervisors have worked on a **joint policy approach**.
- ❑ In March 2018, the ECB published the **guide to assessments of fintech credit institution licence applications**.
- ❑ This will ensure that **applications are assessed in the same manner across the entire euro area**.
- ❑ **Specific risks** are being assessed **appropriately and proportionately**.



## The Guide addresses fintech specific risks at the licensing process

Chapter	Risk Area	Recommendations
<b>Members of the management body</b>	1. IT and competence of management	<ul style="list-style-type: none"> <li>Members of the management body should hold practical experience in <b>technology</b></li> </ul>
<b>Credit risk approval and governance</b>	2. Outsourcing of credit-scoring 3. Alternative data and credit-scoring methods	<ul style="list-style-type: none"> <li><b>Third-party credit –scoring</b> should follow a controlled process and be adequately documented and understood.</li> <li>Use of <b>alternative data and credit-scoring methods</b> should be supported by commensurate risk management and capital safeguards</li> </ul>
<b>Risk management (IT related risks)</b>	4. Safeguards against cyber risks 5. Outsourcing risk 6. Cloud outsourcing 7. Data governance and security risks	<ul style="list-style-type: none"> <li>An assessment of the safeguards against <b>cyber risks</b></li> <li>Appropriate due diligence of service providers and contractual <b>rights to audit / supervise outsourced activities</b> should be ensured</li> <li>Should be assessed in terms of <b>responsibilities of the provider, level of controls, aggregate exposure of the cloud provider risk and expertise of the provider</b></li> <li><b>Assessment of the adequacy of the framework</b></li> </ul>
<b>Programme of Operations</b>	8. Execution risks 9. Exit plan	<ul style="list-style-type: none"> <li>Applicant should demonstrate <b>ability to cover first three years of start -up losses</b> and costs associated with the possible execution of an exit plan;</li> <li>NCA can request the bank to prepare an <b>exit plan</b> identifying how to cease business operations in an orderly and solvent manner</li> </ul>



## Importance of Fintech to supervisors



### How to supervise new technologies and business models?

- *‘Moving target’*: technologies emerge (or not) and evolve (or not);
- Identify the **sufficiently mature technologies** and assess related risks.



There is a need for a **common understanding** of the implications fintech has for banks' business models and their risk management processes, in order to ensure **consistent** supervisory approach.

❑ The ECB's attention is on identifying the **impact of fintech on the banks' business models** and **risk management processes**, and on ensuring that banks have **adequate systems in place to mitigate such risks**.

❑ The ECB is looking into **relevant fintech technologies**, their **business model advantages**, as well as **the areas where supervisory attention could be warranted**.

- ❑ New technology has changed the foundations upon which the banking industry is built.
- ❑ Traditionally, banks have relied on their own self-sufficient IT hardware to run their systems. Similarly, in the past banks have required a physical branch structure to access clients.
- ❑ Fintech is making the **provisioning of cross-border services** easier, without geographical limits, **boosting cross-border consolidation opportunities**. Barriers to market entry are falling as the need for large free-standing IT investments are declining. Moreover, IT infrastructure can be drawn from remote external providers via the use of cloud computing, and branches are no longer required.
- ❑ Fintech is also contributing to the **cost optimization** of banks and improvement in **profitability**. However this may follow a **short term cost of shifting away from legacy IT systems**.
- ❑ **The ECB stays vigilant on the operational capacity of banks** (avoiding spillover effects from banks' cost reduction to their operational capacity).
- ❑ As banks are increasingly using regtech for regulatory compliance, **the ECB itself is also investigating the use of suptech**, aiming to become a smart adopter of new technology, to pursue its tasks more efficiently.



- The ECB together with the NCAs performs an assessment of how **fintech technologies** impact the bank's **business models**, creating a new landscape of **opportunities** and **risks**.
- Specific **technologies the ECB/NCAs are looking into** are the following:
  - Credit scoring methods based on artificial intelligence, big data and machine learning
  - Distributed ledger technology and smart contracts
  - Cloud computing
  - Regtech
  - Open banking
  - Robo-advisory services
  - Virtual asset
- These technologies entail common risk areas such as Internal Governance, outsourcing, operational risk which **the ECB is looking into**.
- Associated risks have to be fully covered in the banks internal **risk management procedures** and are to be considered for the ongoing supervision.

## SSM Fintech Hub

**Intensify the dialogue between the ECB and the NCAs in the pre-authorisation phase of an application**

**Provide guidance to the NCAs on fintech issues**

**Coordinate, promote and complement the NCAs practices**

**Establish a Forum to exchange knowledge and best practices**

- ❑ The ECB is fully engaged in the work of international regulators such as EBA / BCBS / EC to ensure alignment on fintech policy and supervision.
- ❑ The **ECB** in collaboration with the **NCAs** and the **EBA** is analysing technologies which are **impacting the business models** of incumbents and new banks entering the market.
- ❑ In addition, we **collaborate with with third country national supervisors** to get a further understanding of their approach towards fintech.
- ❑ The ECB in collaboration with the NCAs and EBA, will organise an **industry dialogue** to discuss areas of supervisory focus with the SSM banks.



# Questions?

