Who Should Regulate FinTech?

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Overview

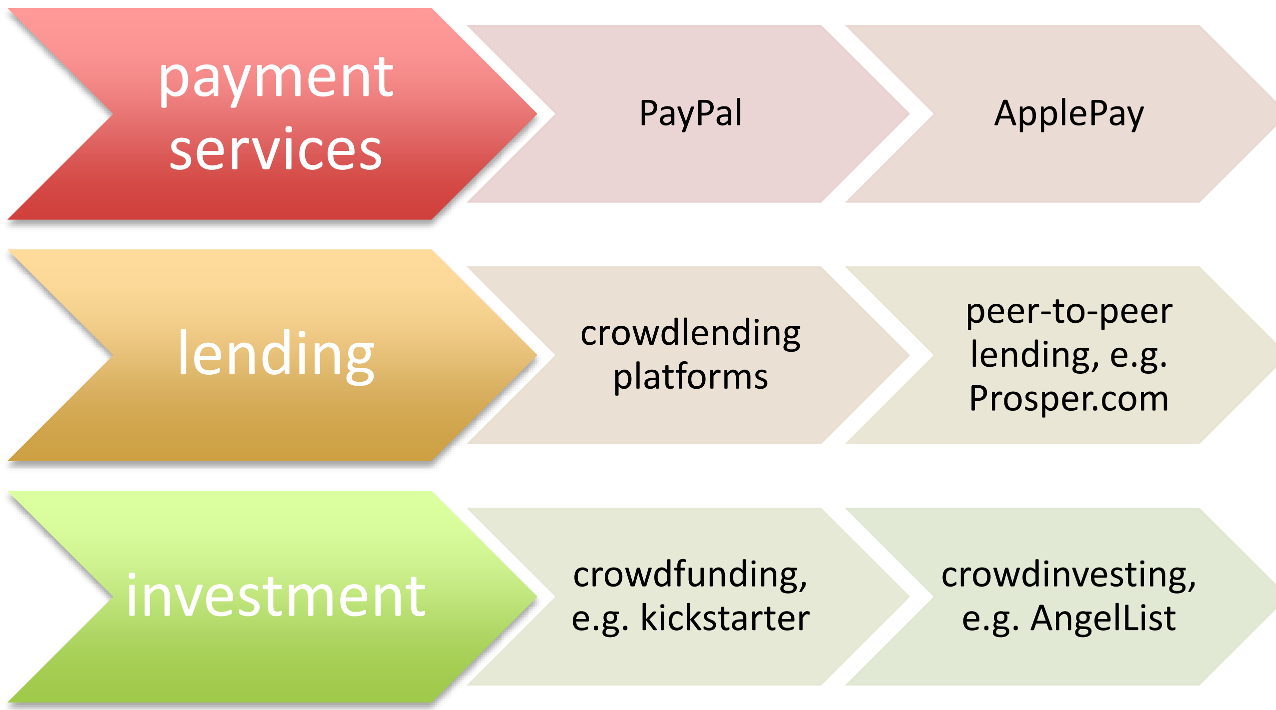
A. Why Regulate FinTech at all?
B. Analysis of Regulatory Jurisdiction
C. Distribution of Supervision

Part A

Why Regulate FinTech at all?

Why Regulate FinTech at all?

- how technological revolution transforms finance:



Why Regulate FinTech at all?

- What makes these services new and different?
  - ➢ dematerialization
  - ➢ disintermediation
  - ➢ delocalisation

→ also make regulation and supervision particularly problematic

Why Regulate FinTech at all?

regulatory interests touched upon by FintTech:

- private interests:
  - reducing informational asymmetry
  - protection against liquidity and insolvency risk
  - operational risk
  - possible conflicts of interests
- public interests:
  - reducing systemic risk
  - fighting money laundering
  - foreclose tax evasion
  - stopping terrorism finance

Why Regulate FinTech at all?

- the solution: leaving FinTech unregulated?
- CFTC (Giancarlo): regulatory “do no harm approach”
- the potential for market-based solutions:
  - ➢ possibility for consumer to get information
  - ➢ amount of data available over internet
  - ➢ rating mechanisms
  - ➢ Lior Strahilevitz: “Less regulation, more reputation!”

but:

- does not solve externalities
- being tech savvy does not mean being finance savvy
- bounded rationality
- different stakes in comparison to inception of internet

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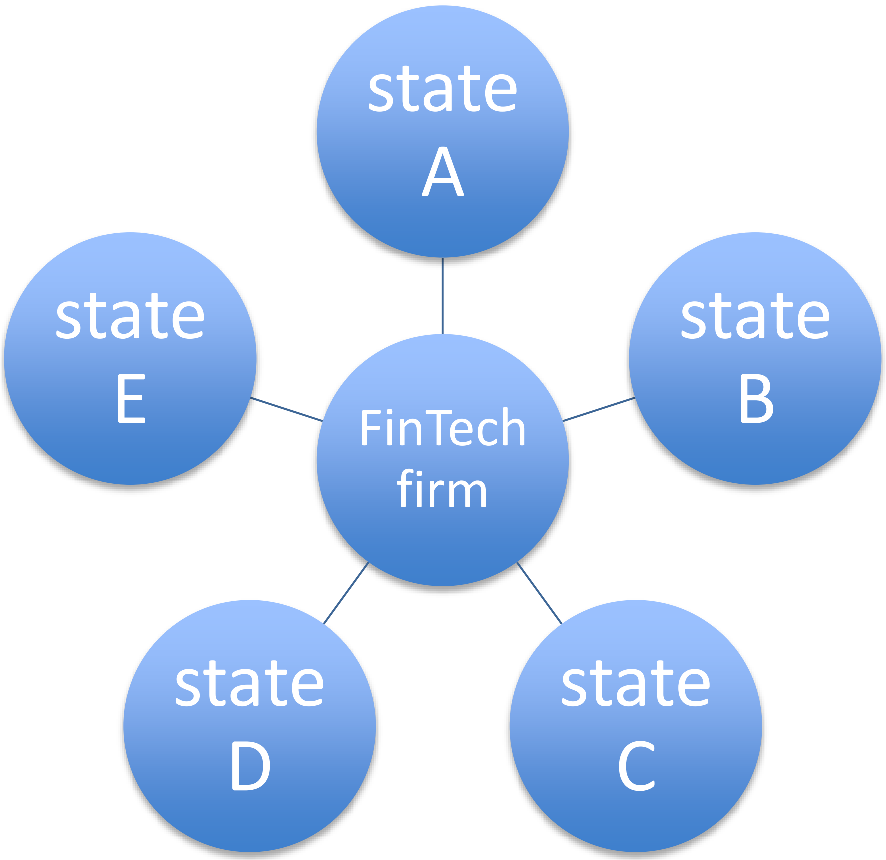
Part B

Analysis of Regulatory Jurisdiction

Analysis of Regulatory Jurisdiction



Analysis of Regulatory Jurisdiction

- variety of states are touched by same service
- degree of affectedness difficult to measure
- state of establishment of FinTech provider may have incentive to lower standards
- creates externalities for other states
- need for ‘extraterritorial application’ of law
- result: overlapping regulation
- leads to
    1. duplicative requirements
    2. legal fragmentation

Analysis of Regulatory Jurisdiction

$$B = E - C_R$$

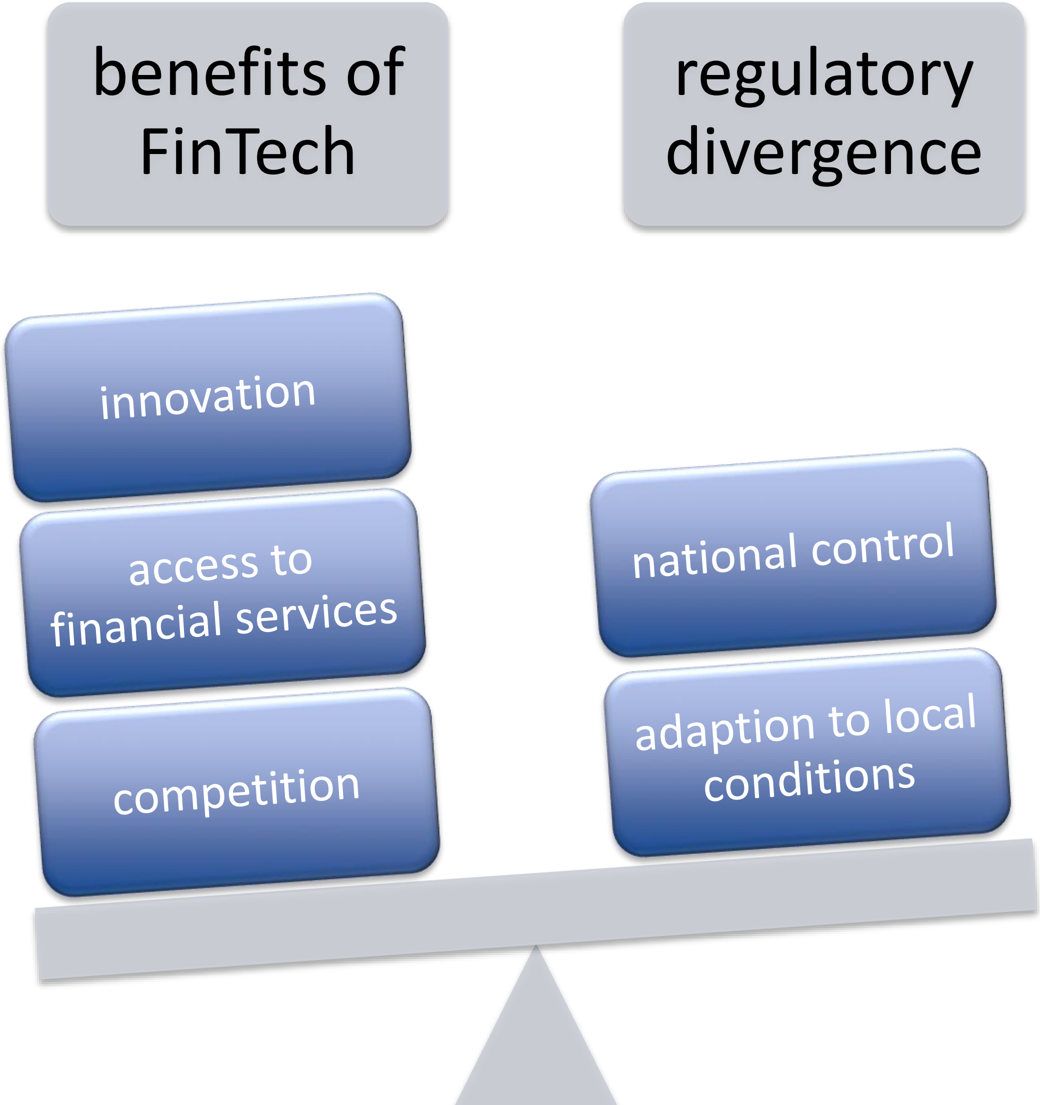
- B = net benefit of innovation for consumers
- E = economies of scale through use of technology
- C_R = cost of adapting to divergent regulatory environment

➢ consequence:

if $C_R > E$, no B

➢ **regulatory divergence may stifle innovation**

Analysis of Regulatory Jurisdiction



Analysis of Regulatory Jurisdiction

- the solution: self-regulation by the industry?
- advantages:
  - incorporates experience and expertise of industry
  - ensures high rate of compliance
  - lower cost of information and enforcement
  - world-wide scope
- disadvantages:
  - incentive of industry to favour its own interests
  - experience of global financial crisis
  - collective action problem

Analysis of Regulatory Jurisdiction

- two other solutions
  1. regulatory sandbox
  2. tech-neutrality of legislative rules
- but: also require identification of competent regulator

Analysis of Regulatory Jurisdiction

- therefore: necessity of globally uniform state-made rules
- advantages:
  - lower regulatory compliance and transaction costs
  - no need to determine the applicable law
  - development of a repository of precedents
  - protection against idiosyncratic changes in the law
  - preventing race to the bottom
  - excluding externalities

Analysis of Regulatory Jurisdiction

- forum:
- ISO (International Organization for Standardization)?
- **“Financial Stability and Innovation Board”**
- standard-setters: BCBS, IOSCO, IAIS
- access to FinTech services should be determined by local rules

Part C

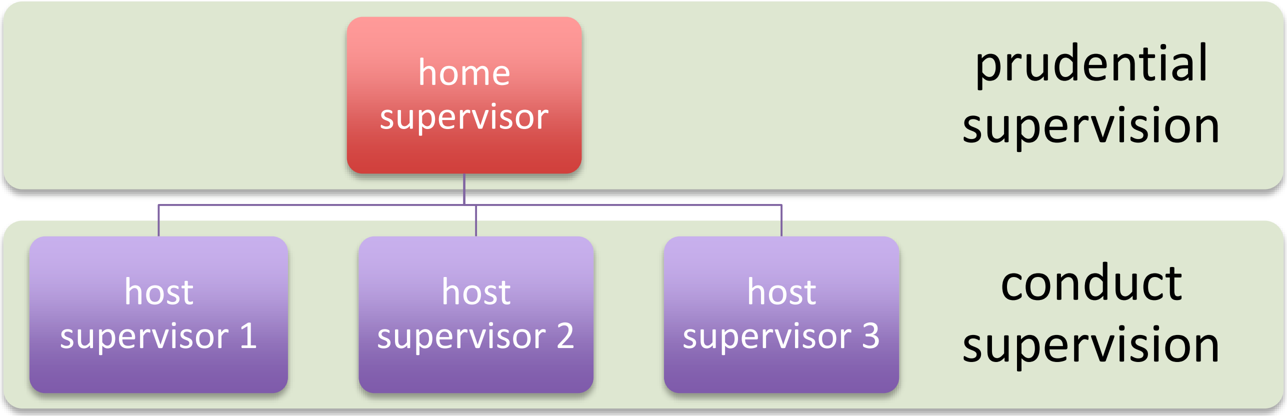
Distribution of Supervision

Distribution of Supervision

- global supervisor?
- supervision is likely to remain in hands of nation-States
- requires division of labour
- different models can be envisaged

Distribution of Supervision

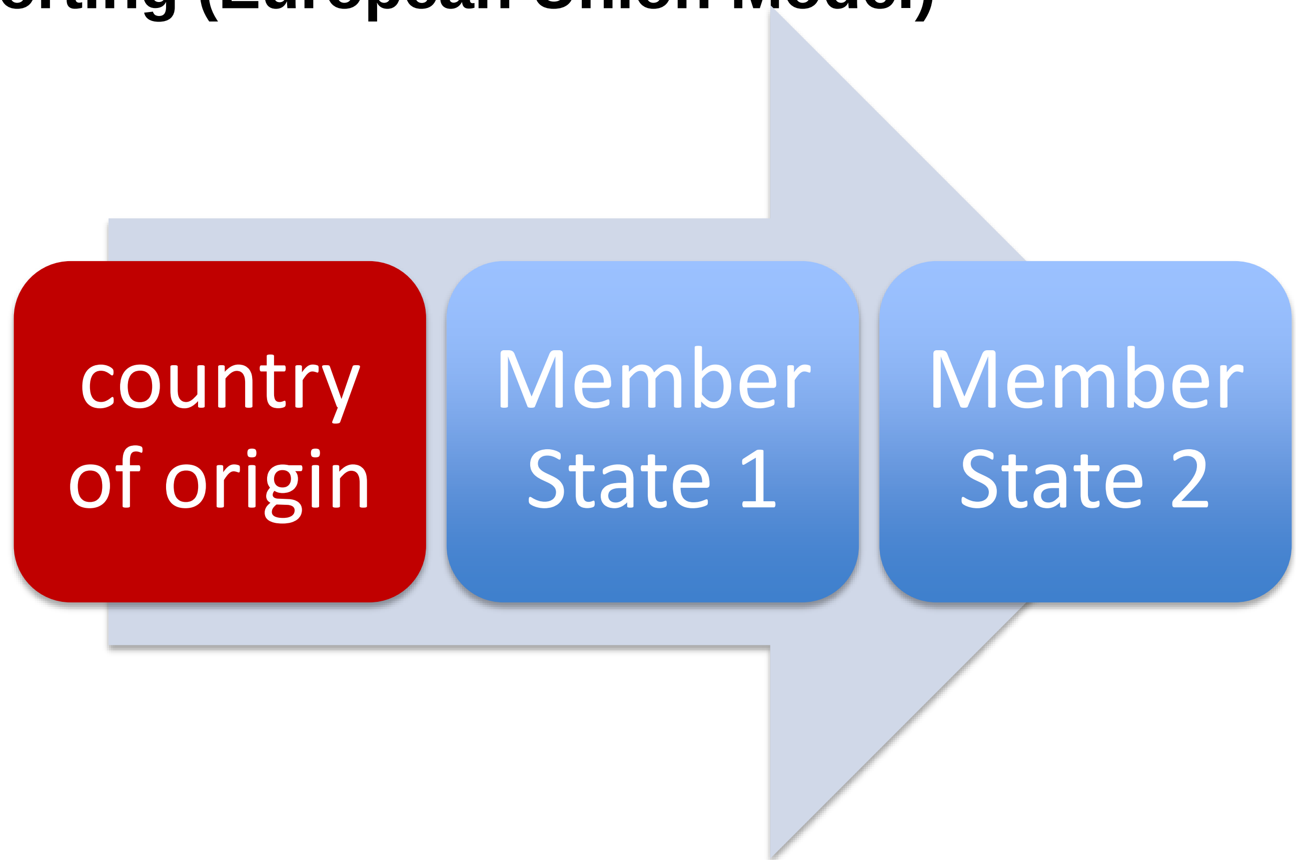
1. Home-Host Supervision (Basel Concordat Model)



- problem: no ‘conduct’ in other states

Distribution of Supervision

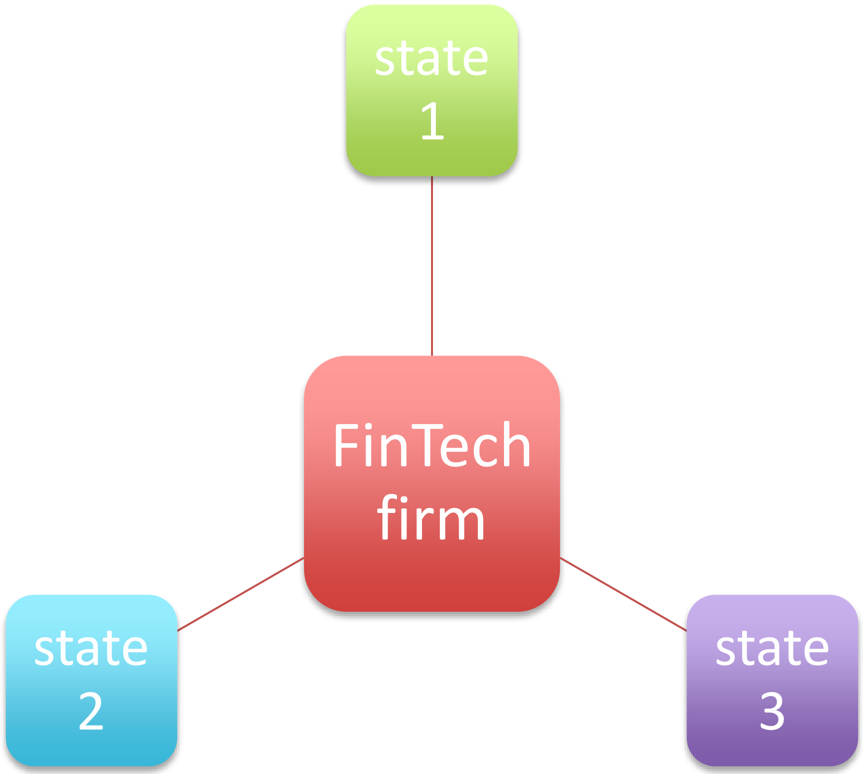
2. Passporting (European Union Model)



- ➢ problem: regulatory competition, ‘race to the bottom’

Distribution of Supervision

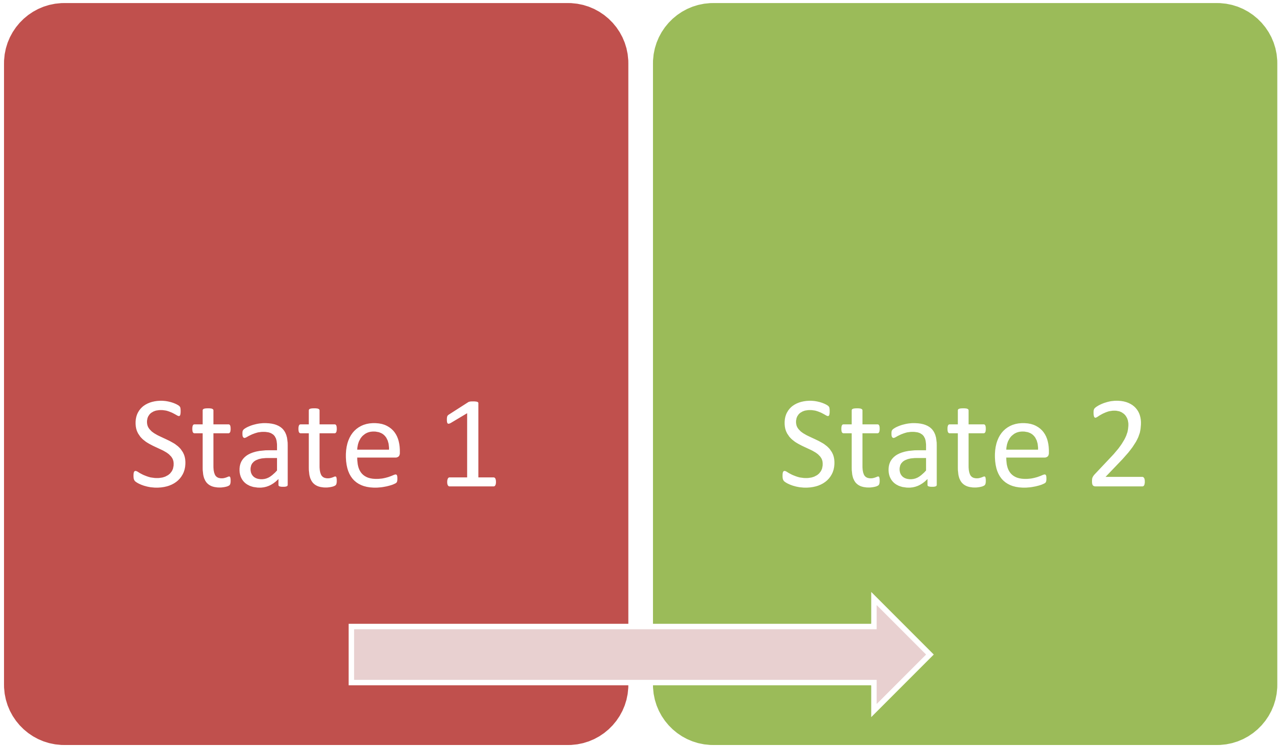
3. Multiple Registration (CCP Model)



➢ problems: costs, duplicative or contradictory standards

Distribution of Supervision

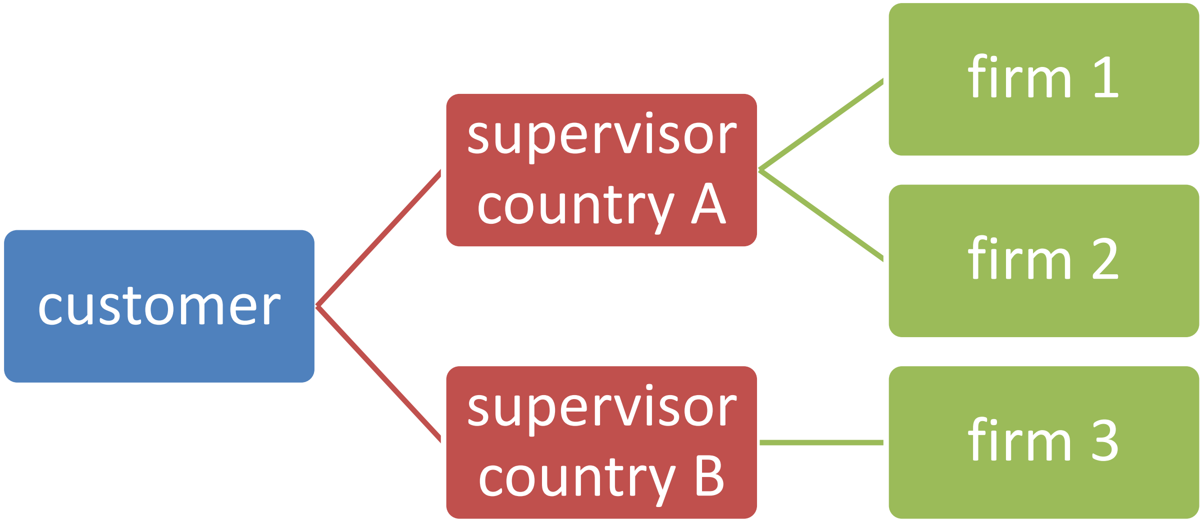
4. Mutual Recognition (Equivalence or Substituted Compliance Model)



➢ problems: time, cost, lack of reciprocity, no level playing field

Distribution of Supervision

4. Competition of Supervisors



- customer is informed about supervisor, choses firm partly depending on quality of supervisor

Conclusion

- need to regulate and supervise FinTech
- split regime:

1. globally uniform rules = economic sound way of regulation without stifling innovation
2. national supervision with competition between supervisors = may avoid supervisory arbitrage and trigger race to the top