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TAMING THE 'WILD WEST': FINTECH DEVELOPMENTS ACROSS EMEA

– THOUGHT LEADERSHIP

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Clifford Chance experts take a bird's eye view of fintech developments across EMEA and how regulators are responding.

What were the biggest fintech regulatory developments in 2018 across EMEA?

Anna Biala (EU): The European Commission published its Fintech Action Plan in March 2018, setting out 19 steps to enable innovative business models to scale up across the EU, support the uptake of new technologies in the financial sector, and improve cybersecurity and the integrity of the financial system. A draft Crowdfunding Regulation to introduce a harmonised licensing and passporting regime for both lending-based and investment-based crowdfunding platforms was also proposed. Meanwhile crypto has also been a hot topic.

Jack Hardman (Middle East): 2018 was a busy year across the Middle East. Activity in the fintech sandboxes and accelerators across the region has grown and change and innovation is taking place in financial services. On the regulatory side, highlights include crowdfunding platform regulations being developed across the UAE and its financial free zones, the Abu Dhabi Global Market (ADGM) creating a licensing regime for cryptocurrency business and the UAE announcing plans for initial coin offerings (ICO) and security token offerings (STO) regulations. Fintech Saudi was also launched and in Israel, we saw the introduction of cryptocurrency regulations.

Jennifer Mbaluto (Africa): 2018 witnessed increased interest in, and adoption of, regulatory sandboxes in Africa. Kenya, Mauritius, Mozambique, Rwanda, and Sierra Leone have launched sandboxes and Nigeria, South Africa, Tanzania and Uganda are at various stages of developing sandboxes.

Are blockchain-based platforms and cryptocurrencies becoming viable tools for mainstream corporate finance activities?

Peter Chapman (UK): There were exciting developments in 2018, including ground-breaking transactions such as Deutsche Börse Group's partnership with HQLAx to build a post-settlement solution for securities lending transactions using the R3 Corda blockchain platform. However, there is some way to go before the technology will replace existing platforms entirely. We've seen some successful prototype blockchain platforms in trade finance, securities lending and syndicated loans, for example. In 2019, we expect market participants will build a reliable track record of blockchain-based products using permissioned platforms run by industry consortia, with the legal and regulatory considerations being ironed out.

On crypto assets, there remain significant regulatory gaps. In the UK, the House of Commons Treasury Committee published a report on digital currencies in September 2018, concluding that regulation of the "Wild West" crypto asset market is needed. Following the establishment of a Crypto Assets Taskforce by HM Treasury, the UK's Financial Conduct Authority (FCA) and the Bank of England in 2018, the FCA has also recently issued a consultation paper to further assess the UK crypto asset market and provide regulatory clarity.

Anna Biala (EU): The European Securities and Markets Authority (ESMA) and the European Banking Authority (EBA) also published reports in January 2019, considering how crypto assets are treated under the current EU financial services law, identifying potential issues that arise when applying the existing regulatory framework to crypto assets and risks where crypto assets do not fall within the scope of the EU rules. Depending on a cost-benefit analysis, gaps and risks related to crypto assets may be addressed by specific regulation at an EU-level in the future. In the shorter term we're likely to see more bespoke local controls. For example, Italy is in the process of adding definitions of blockchain and smart contracts into national law and in Luxembourg, is amending the law on the circulation of securities such that it will give more legal certainty on the use of distributed ledger technology in holding securities.

Custody is another growing area, with investors looking to custodial wallet providers to safekeep their crypto assets. Start-ups have dominated this service, but we expect to see some bigger financial institutions enter the market in the coming months. This raises regulatory questions. around the types of services and activities that qualify as custody or safekeeping of crypto assets.

Jennifer Mbaluto (Africa): Despite the rising popularity of cryptocurrencies such as Bitcoin across key African countries, regulators have been slow to provide regulatory certainty. A few countries, such as Namibia, have banned cryptocurrencies, but in most cases we have just seen warnings to the public about the associated risks. However, there is significant interest by governments and regulators in exploring applications for blockchain use, particularly in financial and government services. In financial services, South Africa is leading the way with some interesting use cases, including the Khokha Project, which successfully tested a distributed ledger between several banks for an interbank payments system.

Are EMEA regulators staying ahead or falling behind other jurisdictions globally?

Peter Chapman (UK): The UK's FCA was an early advocate for the potential of fintech, being one of the first global regulators to roll out a fintech regulatory sandbox and enter into international cooperation agreements. And it remains very active. There has also been a significant focus on technology and its use in financial services by EU regulators. One trend that we're seeing from regulators globally is a move away from tech neutrality and towards tech regulation, as regulators recognise that new technologies bring specific new risks requiring bespoke regulation. New tech regulations for financial institutions will be passed to address potential conduct and financial crime risks but also to tackle the systemic issues technology can pose to financial markets. The first movers will be central in shaping global standards.

Jack Hardman (Middle East): Over the past 18 months there has also been a massive push from regulators across the Middle East. As part of the Emirates blockchain Strategy 2021, the UAE government has announced its intention to use blockchain for 50% of federal government transactions by 2021.
The ADGM has been a world leader in some respects in its approach to creating a bespoke licensing regime for crypto asset businesses. Following the ADGM's lead, crypto rules are on the agenda in Bahrain and the Dubai International Financial Centre (DIFC), and the UAE Securities and Commodities Authority has announced plans to regulate ICOs/STOs. In Israel, comprehensive anti-money laundering rules applying to peer-to-peer platforms and cryptocurrency service providers await finalisation.

Jennifer Mbaluto (Africa): As you would expect, the position is more diverse across Africa. Some countries (such as Kenya and South Africa) were some of the earliest adopters of fintech globally and their regulators have been working hard to keep pace with developments. The success of mobile phone money transfer service M-Pesa in Kenya has been a key example of the facilitative role regulation can play to foster innovation and deepen financial inclusion. The South African Reserve Bank's Khoka Project (see above) won Best Distributed Ledger Initiative at the Central Banking Fintech RegTech

Global Awards 2018 and South Africa's Intergovernmental FinTech Working Group has recently published cryptocurrency policy proposals.

What sort of competitive developments have you seen between regulators within EMEA to capture fintech?

Anna Biala (EU): Clearly the right regulatory environment is a hugely important factor in attracting fintech and innovation. Whilst the UK was quick off the block with fintech initiatives, others are now gaining ground – for example, Gibraltar, the Netherlands, Luxembourg, Israel and the Middle East are all becoming significant fintech hubs.

Peter Chapman (UK): In many respects we're seeing collaboration rather than competition. Many technology applications are inherently international. For example, the decentralised nature of blockchain and crypto assets means that cross-border issues are at the fore. Regulators have recognised this and there are over 75 fintech related cooperation agreements between regulatory and other bodies globally. In an extension of this, we've recently seen the launch of a Global Financial Innovation Network (GFIN) led by the UK's FCA which is intended to establish a global regulatory sandbox. Other EMEA participants include the central banks of Bahrain, Hungary, Lithuania and South Africa, the Israel Securities Authority, the Kenya Capital Markets Authority, the ADGM and Dubai Financial Services Authority. ESMA has also recognised that broader international cooperation is required.

Jack Hardman (Middle East) On the competitive side, the Middle East is seeing a real focus on sandboxes to draw fintech business. 2018 saw several new sandboxes being created, including in Saudi Arabia, UAE and Kuwait, and Bahrain issuing regulatory sandbox licences to several firms seeking to operate the first licensed cryptocurrency exchanges in the Middle East. We also expect that 2019 will see the highly anticipated fintech regulatory sandbox in Israel open its doors. However, we're also seeing collaboration. For example, the UAE and Saudi Arabia are piloting a project to develop and use a cryptocurrency in cross border financial transactions in 2019.

Jennifer Mbaluto (Africa): The approach we are seeing from African regulators appears to be one of collaboration rather than competition. Regulators are leveraging regional trading blocks to engage on fintech, a key example being the adoption by the East African Securities Regulatory Authorities of a sample regulatory sandbox application and evaluation criteria to guide member states' implementation of national sandbox initiatives. We are also seeing collaborations with non-African regulators. Kenya, for example, joined the GFIN and has signed MOUs on inter-regulatory engagement on emerging technologies with the Australian Securities and Investments Commission and the Financial Services Regulatory Authority of ADGM.

What should we be most excited about and worried about over the year ahead?

Peter Chapman (UK): As a regulatory lawyer, I'm excited to see how regulators globally will grapple with technology risk. What should worry all of us is tech going wrong and its potential to significantly impact the banking sector.

Jack Hardman (Middle East): We're going to see a number of world leading projects in the Middle East. Digital assets and Islamic finance projects are high on the agenda, with a number of fintechs creating pioneering concepts. One such project is to create a market leading blockchain platform for Islamic capital markets transactions with a DIFC "innovative testing licence."

Jennifer Mbaluto (Africa): The widespread but unregulated use of cryptocurrencies in large African markets concerns me. A 2018 study by Citi ranks three African countries among the top seven countries globally with the largest Bitcoin holdings; Nigeria's holdings as a percentage of its annual GDP was 4% and Kenya's 2.3%. Clearly, a Bitcoin crash could have a significant impact on these economies, and regulators need to do more than issuing risk warnings. I am excited by the increased level of investment in African fintechs, and the facilitative approach that many regulators are adopting, in recognition of the role innovation can play in achieving financial inclusion in Africa.

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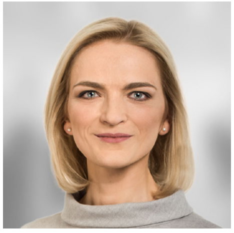

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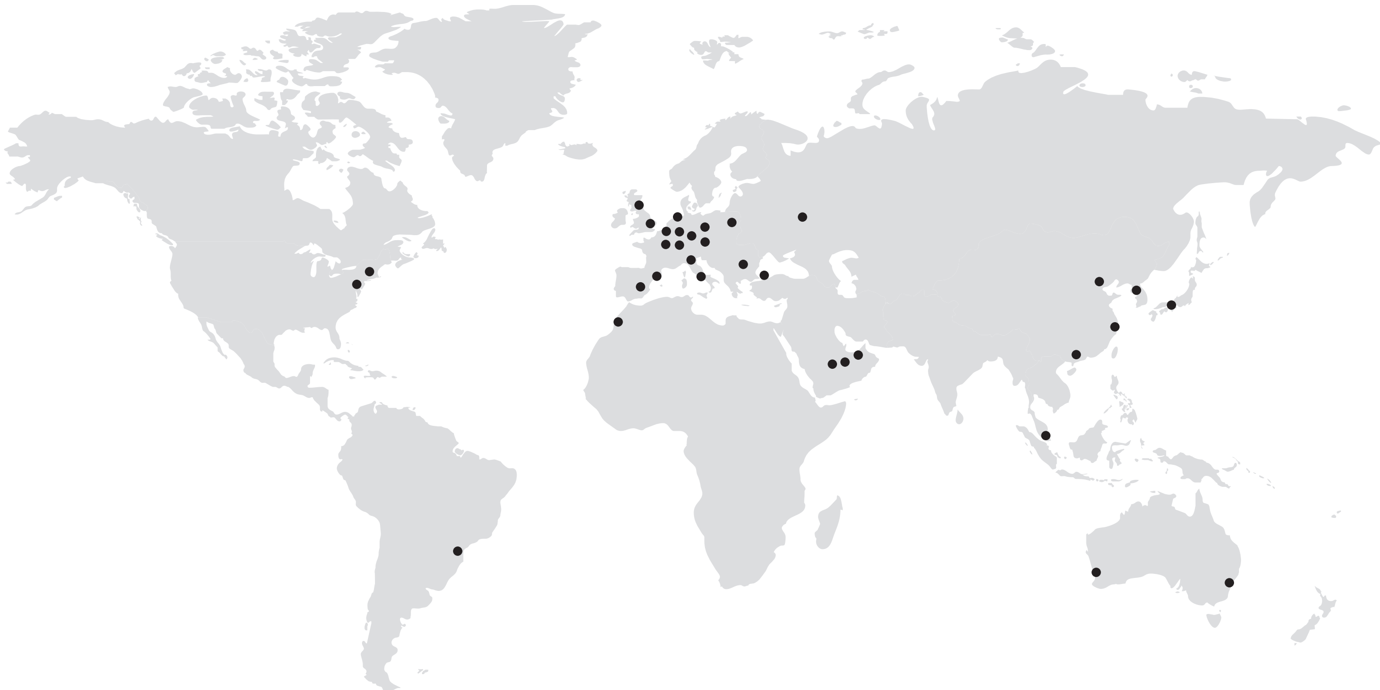

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