



MICROFINANCE CENTRE

INNOVATIONS IN EU POLICY AND LEGISLATION OPPORTUNITIES FOR MICROFINANCE

AN MFC HANDBOOK

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ABBREVIATIONS

AI	ARTIFICIAL INTELLIGENCE
AIFMD	ALTERNATIVE INVESTMENT FUND MANAGERS DIRECTIVE
AISP	ACCOUNT INFORMATION SERVICE PROVIDER
API	APPLICATION PROGRAM INTERFACE
ASPSP	ACCOUNT SERVICING PAYMENT SERVICE PROVIDER:
DLT	DISTRIBUTED LEDGER TECHNOLOGY
EBA	EUROPEAN BANKING AUTHORITY
ECSP	EUROPEAN CROWDFUNDING SERVICE PROVIDER
EESC	EUROPEAN ECONOMIC AND SOCIAL COMMITTEE
EFIF	EUROPEAN FORUM FOR INNOVATION FACILITATORS
ESA	EUROPEAN SUPERVISORY AUTHORITY
ESMA	EUROPEAN SECURITIES AND MARKETS AUTHORITY
GDPR	THE EU GENERAL DATA PROTECTION REGULATION
KIIS	KEY INVESTMENT INFORMATION SHEET
MIFID II	MARKETS IN FINANCIAL INSTRUMENTS DIRECTIVE AS AMENDED
MFI	MICROFINANCE INSTITUTION
PISP	PAYMENT INITIATION SERVICE PROVIDER
PSD1	THE FIRST EU PAYMENTS SERVICES DIRECTIVE
PSD2	THE EU SECOND PAYMENTS SERVICES DIRECTIVE
PSP	PAYMENT SERVICE PROVIDER
RTS	REGULATORY TECHNICAL STANDARDS
TPP	THIRD-PARTY PROVIDER
X2A	ALSO KNOWN AS "ACCESS TO ACCOUNT", ANOTHER TERM FOR THE DATA-SHARING COMPONENT OF THE PSD2

NOTES ON THIS HANDBOOK

INTRODUCTION TO THIS HANDBOOK

This Handbook was prepared by Ariadne Plaitakis for the Microfinance Centre (MFC). This Handbook is meant to be a brief guide for microfinance institutions (MFIs) in the Europe Union (EU). The main objective of this Handbook is to inform MFC members of the implications of recent EU legislation and policies in financial services, and to assist them in identifying potential market opportunities.

This Handbook is based on the EU's Revised Payments Services Directive, the European Commission's Fintech Action Plan and the draft text of the Crowdfunding Regulation as published by the European Commission on 8 March 2018. On 26 June 2019, the Council for the European Union published a compromise proposal in relation to the proposed Crowdfunding Regulation. Where this compromise proposal is substantially different from the Commission's proposal, this has been indicated in the text below. Note this Handbook does not take into consideration any subsequent versions of the draft Crowdfunding Regulation that may be issued since the Council's compromise proposal.

ABOUT THE MICROFINANCE CENTRE

The MFC is a regional microfinance resource centre and network that unites 110 organizations (including 77 microfinance institutions (MFIs) across 36 countries. Together, these 110 organizations service more than one million low-income consumers across Europe and Central Asia.

The MFC's mission is to empower people and communities through alternative social finance, including microfinance. While the MFC seeks to make financial services work for all people and all communities, it gives a particular focus to underserved and excluded people and communities. It accomplishes this by building on the potential and achievements of the social finance sector (microfinance, financial cooperative systems, etc.). It also works to develop partnerships between its network members and technology providers in order to improve products, outreach and scale as well as to charter innovative ways of accessing and using finance.

SUMMARY OF KEY OPPORTUNITIES FOR MFIS

BELOW ARE THE MAIN OPPORTUNITIES FOR MFIS PROVIDED BY PSD2 AND THE PROPOSED EU CROWDFUNDING REGULATION:

PSD2	EU CROWDFUNDING REGULATION
EU passporting for TPPs	EU passporting for ECSPs
Reach new client segments (millennials and digital natives)	Reach new client segments (millennials and digital natives as well as new types of clients/investors)
New business models: Advice based on data analytics, Referral based commissions, Smart repayment plans	New business model Intermediary platform
Better understanding of customers through analytics	Better understanding of customers through analytics
Add more value to existing products through data	New role as broker

A: THE REVISED PAYMENT SERVICES DIRECTIVE

A1. BACKGROUND AND TIMETABLE

The EU Revised Payment Services Directive (PSD2) provides the current regulatory framework for payments in the 28 Member States of the European Union. In force since 13 January 2018, it updates the first Payment Services Directive (PSD1). The PSD2 fixes some of the shortcomings of the PSD1, including the lack of technological neutrality and the inconsistency in Member State application and interpretation of the Directive. Further, the PSD2 increases competition in the EU payments market with the introduction of (i) new regulated entities: payment initiation service providers (PISPs)¹ and account information service providers (AISPs),² together known as “Third Party Providers” (TPPs) - to cover previous unregulated activities; and (ii) a new data sharing regime (“access to account” or X2A) that provides these new entities access to data held by banks, e-money issuers and other payment service providers (PSPs). Further, consumer protection is enhanced to instil consumer confidence in the EU payments market, and in these new services in particular.

Enacted in 2016 as an EU Directive, the PSD2 was to be transposed into national regulation by 13 January 2018. However, to date, Romania has not provided the EU Commission a copy of its implementing legislation, and Malta and Spain have only communicated partial measures.³ Further, even though the remaining 25 Member States have communicated full transposition measures, 16 of these Member States are still facing infringement proceedings due to lack or delay in notification as per the January 2018 deadline. Until national transposition, PSD1 rules stay in force in each relevant Member State. It should be noted that PSD2 is a “maximum harmonising directive”, which means that Member States are not able to require any higher or lower standard/ obligations of the payment institutions in their jurisdictions than PSD2 itself requires.

Although the PSD2 came into force in 27 of the EU countries as of 13 January 2018, a different deadline was foreseen for the new security measures introduced in the PSD2. (i.e. strong customer authentication and the standards for

1. PISPS ARE THIRD-PARTY SERVICE PROVIDERS THAT PROVIDE CUSTOMERS WITH ONLINE CONSOLIDATED INFORMATION ABOUT THEIR FINANCIAL ACCOUNTS WITH OTHER PAYMENT SERVICE PROVIDERS. E.G. YOLT, MONEYHUB.

2. AISPS ARE THIRD-PARTY SERVICE PROVIDERS THAT ALLOW CONSUMERS TO MAKE PAYMENTS FROM THEIR BANK ACCOUNTS DIRECTLY TO THE MERCHANT, TYPICALLY BY ESTABLISHING AN ELECTRONIC PAYMENT LINK BETWEEN THE PAYER AND THE ONLINE MERCHANT VIA THE PAYER'S ONLINE BANKING MODULE. E.G. CASHFLOWS, TRUSTLY, ADYEN, TRANSFERWISE.

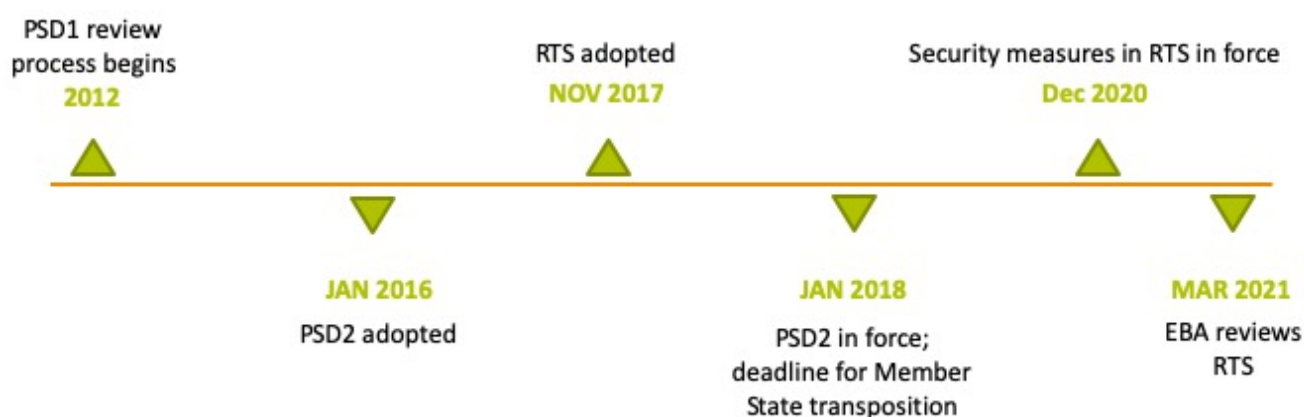
3. SEE EU COMMISSION'S WEBSITE: [HTTPS://EC.EUROPA.EU/INFO/PUBLICATIONS/PAYMENT-SERVICES-DIRECTIVE-TRANSPPOSITION-STATUS_EN](https://ec.europa.eu/info/publications/payment-services-directive-transposition-status_en)

secure communication between PSPs). Their entry into force were subject to the adoption of regulatory technical standards (RTS), which were developed by the European Banking Authority (EBA), adopted by the Commission in November 2017, and initially expected to enter into force in September 2019. Due to technical implementation difficulties, the implementation of these RTS has been suspended until December 2020.⁴

In countries where the PSD2 has been transposed, all PSPs that were previously authorized under PSD1 (as well as those commencing an authorised activity under PSD1 up until 18 January 2020) remain authorized as PSPs until 18 July 2020. If they wish to continue their activity thereafter, they are required to submit all relevant information to the competent regulators in order to allow the latter to

assess their compliance with PSD2 and if not, to identify the measures needed to be taken to ensure compliance.⁵ Those PSPs that wish to undertake the new TPP activities, however, are required to apply for authorisation/ registration under the PSD2 for these activities from the date of the effective national transposition in their particular Member States. As the new security measures of PSD2 will become applicable later than other provisions, TPPs that seek authorisation under PSD2 are not required to submit proof of compliance with these security requirements until that later date (even if they apply earlier).

FIGURE 1: PSD2 IMPLEMENTATION PROCESS



4. SEE EBA'S OPINION ON THIS: [HTTPS://EBA.EUROPA.EU/ EBA-PUBLISHES-OPINION-ON-THE-DEADLINE-AND-PROCESS-FOR-COMPLETING-THE-MIGRATION-TO-STRONG-CUSTOMER-AUTHENTICATION-SCA-FOR-E-COMMERCE-CARD-BASED-PAYMENT](https://eba.europa.eu/eba-publishes-opinion-on-the-deadline-and-process-for-completing-the-migration-to-strong-customer-authentication-sca-for-e-commerce-card-based-payment)

5. SIMILAR TRANSITION PROVISIONS EXIST FOR THOSE ENTITIES THAT BENEFIT FROM A SMALL BUSINESS WAIVER/ EXEMPTION UNDER THE PSD1.

A2. MAIN PROVISIONS AND INNOVATIONS

The PSD2 has three main pillars: (i) a section dealing with the authorisation of PSPs and the regulation of TPPs; (ii) a section setting out the rights and obligations of PSPs and their users (including rules on surcharging, security, liability and dispute settlement); and (iii) a section on transparency concerning information provided to users. The scope of the PSD2 covers PSPs and TPPs who provide electronic payment services within the EU (even if only one leg of the transaction is in the EU), provided the entity's revenue is above a certain threshold (as defined by each Member State, but which cannot exceed €3 million).

The main innovations introduced by PSD2 focus on (i) proportionate regulation of TPPs; (ii) a data sharing regime (X2A) for the benefit of TPPs; (iii) the introduction of push payments for payment initiation; and (iv) a liability shift for e-commerce and other digital payments.

TPPs, which previously were unregulated under PSD1, are now proportionately regulated: AISPs must only register, with no capital requirements,⁶ while PISPs have a reduced initial capital requirement of €50,000 in order to be authorized (versus €125,000 for PSPs).⁷

In consideration for being regulated and in order to allow TPPs to offer their

services in an effective way, these TPPs have the “right of access” on an objective, non-discriminatory and proportionate basis to information held by account servicing payment service providers (ASPSPs) (i.e. EU banks, payment institutions and e-money institutions), if the customer explicitly authorises them, without the requirement of a contractual relationship between the ASPSP and the TPP.⁸ This X2A regime is mandatory, and all EU banks, e-money institutions and payment institutions must provide this data if requested by a TPP.⁹ In particular, TPPs can:

- Check the availability of funds
- Initiate a credit transfer or direct debt from the current account
- Provide aggregated account information services.

These information exchanges relate solely to basic customer account data, transactional data and payment data. TPPs must only request, use, access and store data necessary for the provision of the service and are not permitted to store sensitive data. The data sharing is at no cost to the consumer, and ASPSPs cannot charge for provision of this data to TPPs.

By authorizing PISPs, the PSD2 also moves e-commerce and other digital

6. SEE ARTICLE 33 OF THE PSD2.

7. SEE ARTICLE 7 OF THE PSD2.

8. ART OF 67 (2)(1) OF THE PSD2 STATES THAT AN AISP SHALL “PROVIDE SERVICES ONLY WHERE BASED ON THE PAYMENT SERVICE USER'S EXPLICIT CONSENT” BUT THERE IS NO DEFINITION OF WHAT FORM “EXPLICIT CONSENT” SHOULD TAKE IN THE PSD2.

9. SEE ARTICLES 66 AND 67 OF THE PSD2.

payments to a “push” payment model, in contrast with the current “pull” model of credit card systems, where merchants “call” for payments via a card scheme. PISPs, through payment initiation, can take money from a customer bank account and transfer it directly to a merchant bank account, thereby circumventing the usage of credit cards altogether. (See Box 1 for a further explanation on the distinction of “push” and “pull” payments.)

Lastly, with the introduction of strong customer authentication, there is also a concurrent liability shift for e-commerce and other digital payments. In card scheme rules liability is usually on the e-merchant (in card scheme rules) for failing to authenticate card-not-present transactions. The PSD2 shifts this liability to the responsible PSP for failing to authenticate.

BOX 1: PUSH AND PULL PAYMENTS

Both credit/debit card payments and direct debit payments are a form of pull payment. Pull payments are where a merchant or service provider (the “payee”), through its bank or authorized entity, requests payment from a customer (the “payer”) via a card scheme or directly from the customer’s bank or stored value account holder; it is the payee who initiates the transaction, once given a mandate by the payer. Push payments, on the other hand, are both initiated and authorized by the payer. As foreseen under the payment initiation provisions of PSD2, a customer authorises a PISP to take money from his/her bank account on his/her behalf and transfers it directly to a merchant or service provider’s bank account. Push payments are often considered faster – and less risky for the payee – since the initiation and authorisation is undertaken by the same entity (the payer).

A3. KEY OPPORTUNITIES FOR MFIS

MFIs can take advantage of these innovations in a variety of ways. First, they can register as an AISP, which would allow them to offer account aggregation services. This type of service would give an MFI an automatic overview of a customer's finances and allow it to identify spending decisions and other patterns that customers might otherwise have missed to help these customers with debt rehabilitation. For example, an MFI that is registered as an AISP, after obtaining access to data in a customer's bank account(s), could show its client an aggregated picture of his/her accounts, and help identify where a microloan may be a better alternative than other current debt products.¹⁰ This could then lead to a recommendation to the MFI's own products, or products of partner MFIs; in this latter case the MFI could charge commission for the referral to the other MFI. (See Box 2 overleaf for the example of Tully in the UK.)

If the MFI is also authorised also a PISP, then it can execute a "smart" repayment schedule, allowing for a much more comprehensive offering and a seamless customer experience (see further information on "smart repayment" below). Acting as an AISP would allow an MFI both to funnel current customers to its offerings as well as to charge other MFIs (and other PSPs) commission for customer referrals.

If registering as an AISP and its compliance regime seems too daunting, MFIs could decide to connect to other AISPs through a partnership in order allow the AISPs to propose the MFI's products to their customers. In such a scenario the

AISPs would undertake the initial creditworthiness and affordability analysis on the MFI's behalf. Such a partnership would increase a MFI's exposure to new customers, without requiring any marketing budget or expenditure.

MFIs who are interested in providing "smart repayment plans"¹¹ and/ or who are interested in crowdfunding should consider becoming authorised as an PISP. PISPs can execute payments digitally on behalf of a customer, allowing for a direct push of funds from customer's bank account to a MFI's bank account (if it is a loan repayment) or to another MFI (if the MFI is also acting as an AISP and is making referrals to other MFIs). Such an authorisation is required for crowdfunding service providers if these providers decide to undertake the digital payment piece. Becoming an PISP is also a separate business model if the entity uses this authorisation in order to offer other industry stakeholders white label solutions ("payment-initiation-as-a-service").

In all cases, once an MFI is registered as an AISP and/ or authorised as an PISP in its home jurisdiction, it can use this authorisation to passport to other EU Member States. This passporting allows MFIs access to cross-border customers and markets for account information services and payment initiation services. The MFI, however, will be required to comply to national regulatory requirements for the provision of microfinance in each of the EU Member States where it wishes to offer microfinance loans through its account aggregation service offering.

10. NOTE THAT CASH SAVINGS, MORTGAGES AND PENSIONS ARE NOT COVERED BY THE PSD2 SO THESE SERVICES CAN ONLY GIVE A PARTIAL PICTURE OF A CUSTOMER'S FINANCES IF THEY RELY ONLY ON THE DATA THAT FALLS IN SCOPE UNDER THE PSD2.

11. THESE ARE DEBT REPAYMENT PLANS THAT CAN ACCOUNT FOR FLUCTUATIONS IN INCOME OF THE CUSTOMER DURING REPAYMENT PERIODS TO THE BENEFIT OF BOTH THE CUSTOMER AND THE MFI.

BOX 2: SPOTLIGHT ON PROVIDING DEBT ADVICE

Tully provides UK consumers a debt and budgeting advice service that uses X2A APIs to get a full picture of their customers' finances to help them with debt rehabilitation. Tully follows the following process:

- It first builds a free, accurate budget for the consumer.
- From this budget, Tully gives the consumer free debt advice and work out a personalized plan.
- With the customer's consent, Tully then contacts the customer's lenders, sets up affordable repayments for debts as well as provides support and coaching to the customer to stay on track.

This service is entirely free for the customer; Tully charges the lenders a small percentage of the money (called "fair share") that they help their customers payback. Tully, which is currently in pilot stage, is authorised by the UK Financial Conduct Authority (FCA).

A4. BECOMING A TPP

The PSD2 sets out the main requirements for becoming either an AISP or PISP, although specific details are found in the national transposition legislation¹² and the national authority responsible for payments in each Member State is the final arbiter of which entities can register as AISPs and/ or be authorised as PISPs.¹³

Under the PSD2, PISPs are required to be authorised, but are subject to a reduced minimum own funds requirement of €50,000. AISPs are expressly exempt from authorisation but are subject to a registration requirement. Both types of entities have to hold professional indemnity insurance or a comparable guarantee, in addition to providing a business plan, a description of safeguarding funds measures (for PISPs), a description of governance arrangements and internal control mechanisms, a description of customer complaint procedures, business continuity arrangements, security policy document, etc.¹⁴

Member States may exempt small PSPs and TPPs from the authorisation

requirements if: (i) the monthly average of the preceding 12 months' total value of payment transactions executed by the PSP/TPP, including any agent, does not exceed a limit set by the Member State but that, in any event, amounts to no more than €3 million; and (ii) none of the natural persons responsible for the management or operation of the business has been convicted of offences relating to money laundering/terrorist financing or other financial crimes.¹⁵

Member States are free to set stricter threshold limits for this exemption. Countries whose national transposition legislation include this "small business" exemption include Poland, Netherlands, the UK, Sweden, Czech Republic, Lithuania, Denmark and Finland. Entities who take advantage of this exemption must still register in their home Member State and will be part of the EBA register. Further, entities who claim this exemption cannot use it to passport to another EU Member State.

12. WHICH CAN BE FOUND HERE FOR THE 27 COUNTRIES THAT HAVE COMMUNICATED THEIR NATIONAL TRANSPOSITION LEGISLATION TO THE EU COMMISSION: [HTTPS://EUR-LEX.EUROPA.EU/LEGAL-CONTENT/EN/NIM/?URI=CELEX:32015L2366](https://eur-lex.europa.eu/legal-content/en/nim/?uri=CELEX:32015L2366)

13. AS PSD2 IS A "MAXIMUM HARMONISING DIRECTIVE", MEMBER STATES ARE NOT ABLE TO REQUIRE ANY HIGHER OR LOWER STANDARD/ OBLIGATIONS OF THE PAYMENT INSTITUTIONS IN THEIR JURISDICTIONS IN THEIR NATIONAL LEGISLATION THAN PSD2 ITSELF REQUIRES.

14. A FULL LIST OF REQUIREMENTS CAN BE FOUND IN ARTICLE 5 OF THE PSD2.

15. ARTICLE 32 OF THE PSD2.

B: FINTECH ACTION PLAN

B1. BACKGROUND

The EU Commission communicated the Fintech Action Plan on 8 March 2018. The plan comprises a list of targeted initiatives in 12 areas designed to help the EU embrace the digitalisation of the financial sector. The plan's main objective is the creation of a more competitive and innovative financial market in the EU. To this end, it aims to set out a future-oriented regulatory framework that embraces

digitalisation and creates an environment where innovative fintech¹⁶ products and solutions can be rapidly rolled out across the EU to benefit from the economies of scale of the single market, without compromising financial stability or consumer and investor protection.¹⁷

B2. MAIN PROVISIONS OF INTEREST TO MFIS

The plan's initiatives are placed in three separate categories: (i) innovative business models; (ii) supporting new technologies; and (iii) stronger cyber resilience. Of these initiatives, five areas may be of interest to MFIs:

INNOVATIVE BUSINESS MODELS

DEVELOPING STANDARDIZED APIS FOR FINANCIAL SERVICES

The Commission is supporting joint efforts by market players to develop, by mid-2019, standardised application programming interfaces (APIs) that are compliant with both the PSD2 and the General Data Protection Regulation (GDPR) as a basis for a European open banking eco-system covering payment and other accounts.¹⁸

This is of interest for MFIs that are interested in becoming TPPs under the PSD2, as such standardization will facilitate a TPP's interconnection with multiple ASPSPs.

CROWDFUNDING PROPOSAL

The EU Regulation proposal aims to ensure an appropriate and proportionate regulatory framework that allows crowdfunding platforms that want to operate cross-border to do so with a comprehensive passporting regime under unified EU supervision.¹⁹

MFIs may wish to consider becoming a European crowdfunding service provider (ECSP) to access new types of customers and new markets. Please see Part C for more details.

SUPPORT NEW TECHNOLOGIES

ASSESSING UNJUSTIFIED REGULATORY OBSTACLES

The Commission set up an expert group in the second quarter of 2019 to assess whether there are unjustified regulatory obstacles to financial innovation in the financial services regulatory framework.²¹ In particular, this group is looking at distributed ledger technologies (DLT) and artificial intelligence (AI), as well as

16. ALTHOUGH THERE IS NO EU LEGAL DEFINITION OF FINTECH, IN THE FINTECH ACTION PLAN IT IS DEFINED IT AS "A TERM USED TO DESCRIBE TECHNOLOGY-ENABLED INNOVATION IN FINANCIAL SERVICES THAT COULD RESULT IN NEW BUSINESS MODELS, APPLICATIONS, PROCESSES OR PRODUCTS AND COULD HAVE AN ASSOCIATED MATERIAL EFFECT ON FINANCIAL MARKETS AND INSTITUTIONS AND HOW FINANCIAL SERVICES ARE PROVIDED." SEE THE INTRODUCTION OF THE FINTECH ACTION PLAN: [HTTPS://EUR-LEX.EUROPA.EU/LEGAL-CONTENT/EN/TXT/?URI=CELEX:52018DC0109](https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52018DC0109)

17. EU COMMISSION, 8 MARCH 2018, FINTECH ACTION PLAN FOR A MORE COMPETITIVE AND INNOVATIVE EUROPEAN FINANCIAL SECTOR.

18. SECTION 1.2 OF THE FINTECH ACTION PLAN.

19. SECTION 1.1 OF THE FINTECH ACTION PLAN.

requirements for paper-based disclosure and the fact that software investment is less attractive under current prudential rules for banks.²²

This initiative is of general interest to MFIs as the recommendations should render the regulatory framework for financial services more enabling.

REMOVING OBSTACLES TO CLOUD COMPUTING

The Commission envisages three main initiatives to further this goal:

- The Commission invited the European Supervisory Authorities (ESAs) to explore the need for guidelines on outsourcing to cloud service providers by first quarter 2019.
- Further, it invited cloud stakeholders to develop cross-sectoral self-regulatory codes of conduct to facilitate switching between cloud service providers.
- Lastly, it encourages and is facilitating the development of standard contractual clauses for cloud outsourcing by financial institutions.

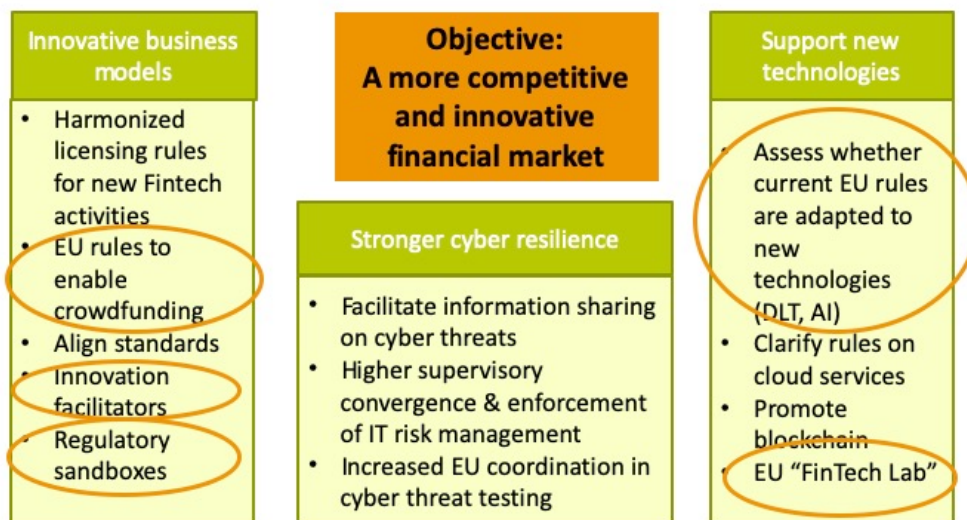
MFIs that are considering using cloud services to lower their IT costs should benefit from these measures, which facilitate switching between providers as well as ensure a minimum level of quality of service and contractual protection.

COMPREHENSIVE STRATEGY ON DLT AND BLOCKCHAIN²³

The Commission is continuing work on a comprehensive strategy on DLT and blockchain, addressing all sectors of the economy, including enabling FinTech and RegTech applications in the EU. This strategy will address all relevant legal implications. The Commission already launched an EU Blockchain Observatory and Forum in February 2018 and is undertaking a study on the feasibility of an EU public blockchain infrastructure to develop cross-border services.²⁴

Although MFIs may not currently be using DLT and blockchain enabled solutions, many of the future technological advances will be based on these technologies, so MFIs should be aware of the Commission’s strategy and its stance on legal implications of these technologies.

FIGURE 2: FINTECH ACTION PLAN IMPLEMENTATION AS OF APRIL 2019



20. SECTION 2.1 OF THE FINTECH ACTION PLAN.
 21. INVESTMENTS IN SOFTWARE MADE BY EU BANKS MUST BE DEDUCTED FROM THEIR REGULATORY CAPITAL, IN CONTRAST TO MORE FAVORABLE TREATMENT ENJOYED BY BANKS IN THE UNITED STATES.
 22. SECTION 2.2 OF THE FINTECH ACTION PLAN.
 23. BLOCKCHAIN IS A PARTICULAR TYPE OR SUBSET OF SO-CALLED DISTRIBUTED LEDGER TECHNOLOGY (DLT). DLT IS A WAY OF RECORDING AND SHARING DATA ACROSS MULTIPLE DATA STORES (ALSO KNOWN AS LEDGERS), WHICH EACH HAVE THE EXACT SAME DATA RECORDS AND ARE COLLECTIVELY MAINTAINED AND CONTROLLED BY A DISTRIBUTED NETWORK OF COMPUTER SERVERS, WHICH ARE CALLED NODES. BLOCKCHAIN IS A MECHANISM THAT EMPLOYS AN ENCRYPTION METHOD KNOWN AS CRYPTOGRAPHY AND USES (A SET OF) SPECIFIC MATHEMATICAL ALGORITHMS TO CREATE AND VERIFY A CONTINUOUSLY GROWING DATA STRUCTURE – TO WHICH DATA CAN ONLY BE ADDED AND FROM WHICH EXISTING DATA CANNOT BE REMOVED – THAT TAKES THE FORM OF A CHAIN OF “TRANSACTION BLOCKS”, WHICH FUNCTIONS AS A DISTRIBUTED LEDGER. SEE EUROPEAN PARLIAMENT STUDY ON CRYPTOCURRENCIES AND BLOCKCHAIN, JULY 2018.
 24. SECTION 2.3 OF THE FINTECH ACTION PLAN

B3. IMPLEMENTATION SO FAR

The latest update on the implementation of this Plan was provided by Vice-President Valdis Dombrovski in a speech at 3rd Annual Fintech Conference in Brussels on 26 February 2019. In conjunction with a review of the Commission's website, the state of play as of April 2019 is as follows:

INNOVATIVE BUSINESS MODELS

- On 8 March 2018, in conjunction with its communication of the Fintech Action Plan, the Commission issued its proposal for crowdfunding regulation.
- Together with the ESAs, the Commission launched on 2 April 2019 a European Forum for Innovation Facilitators (EFIF).²⁵ This network allows supervisors to learn from each other through continuous information sharing and enables companies to reach EU scale more easily, by creating referral mechanism when firms need to go beyond their national markets.
- The ESAs released on report on regulatory sandboxes²⁶ and innovation hubs in Member States on 7 January 2019, and the results are positive. As of the report's date, European countries have opened 21 innovation hubs²⁷ and 5 regulatory sandboxes²⁸ to help companies roll out innovative services in the financial sector.

SUPPORT NEW TECHNOLOGIES

- In regard to crypto assets and initial coin offerings, advice prepared by ESMA and EBA in January 2019 resulted in conclusion that, under certain circumstances, EU financial rules may apply to some crypto assets, although this raises complex questions. Further crypto-assets that do not meet the definition of a financial instrument still present many of the same issues regarding consumer protection, market integrity and a level playing-field. Thus, ESMA and EBA support that the Commission undertake a cost-benefit analysis to assess if EU level regulatory action is needed.²⁹
- In 2018 Commission set up an EU Fintech Lab,³⁰ which brings together supervisors, technology providers and financial institutions to deep dive into specific technologies. The lab has focused on cloud outsourcing and AI to date.

25. FOR AN OVERVIEW, SEE EFIF WEBSITE: [HTTPS://ESAS-JOINT-COMMITTEE.EUROPA.EU/PAGES/ACTIVITIES/EFIF/EUROPEAN-FORUM-FOR-INNOVATION-FACILITATORS.ASPX](https://esas-joint-committee.europa.eu/pages/activities/efif/european-forum-for-innovation-facilitators.aspx)

26. REGULATORY SANDBOXES ARE CONTROLLED 'SAFE SPACES' IN WHICH INNOVATIVE PRODUCTS, SERVICES, BUSINESS MODELS AND DELIVERY MECHANISMS CAN BE TESTED WITHOUT IMMEDIATELY BEING SUBJECT TO ALL OF THE REGULATORY REQUIREMENTS. SEE BANKING STAKEHOLDERS GROUP PROPOSAL TO THE EBA ON REGULATORY SANDBOXES, 20 JULY 2017.

27. SEE ANNEX A OF REPORT FOR LIST OF COUNTRIES WITH INNOVATION HUBS: [HTTPS://EBA.EUROPA.EU/ESAS-PUBLISH-JOINT-REPORT-ON-REGULATORY-SANDBOXES-AND-INNOVATION-HUBS](https://eba.europa.eu/esas-publish-joint-report-on-regulatory-sandboxes-and-innovation-hubs)

28. AS OF DATE OF THE REPORT, THESE WERE DENMARK, LITHUANIA, NETHERLANDS, POLAND AND UK.

29. VICE-PRESIDENT VALDIS DOMBROVSKI'S SPEECH AT 3RD ANNUAL FINTECH CONFERENCE IN BRUSSELS ON 26 FEBRUARY 2019.

30. FURTHER INFORMATION ON THE LAB CAN BE FOUND HERE: [HTTPS://EC.EUROPA.EU/INFO/PUBLICATIONS/180620-EU-FINTECH-LAB-MEETING_EN](https://ec.europa.eu/info/publications/180620-eu-fintech-lab-meeting_en)

C: CROWDFUNDING PROPOSAL

C1. BACKGROUND AND TIMETABLE

Crowdfunding matches up business projects in need of funding with investors through an online platform. Investors in exchange receive returns on their investment.

Crowdfunding is often the main funding tool for early stage companies, when venture capital or private equity funds are not interested.³¹ Crowdfunding provides an alternative to unsecured bank lending, such as bank overdrafts or credit card loans, which are often the main sources of external finance for SMEs.³² It offers new opportunities in particular for young, innovative companies who do not have extensive collateral, fixed assets or a strong financial track record.³³

In the EU, some Member States have already introduced national regimes on crowdfunding.³⁴ These states have adapted their regulatory frameworks to the characteristics and needs of local markets and investors, resulting in diverging domestic rules concerning the conditions of operation of crowdfunding platforms, the scope of permitted activities and the licensing requirements.³⁵ As a result of these different regulatory approaches, crowdfunding platforms are not easily able to expand into other EU Member States, especially given the uncertainty of divergent requirements

and the resulting high compliance costs. Thus, crowdfunding service providers face difficulties in scaling their operations, and cross-border EU flows remain limited. As a result, start-ups and SMEs are not able to benefit from the greater pool of potential EU investors, and investment opportunities for individuals are restricted.³⁶

Due to these issues, the Commission has proposed a draft EU Regulation that would create a comprehensive European passporting regime for those market players who decide to operate as European crowdfunding service providers (ECSP), under the unique supervision of the European Securities Markets Authority (ESMA). In particular, the draft Regulation attempts to solve three different, but related, issues:

1. Diverging national rules that hinder cross-border crowdfunding services;
2. Lack of information leading to low investor trust; and
3. Lack of transparency on projects and financial products sold (e.g. loans, shares) leading to uninformed decisions.³⁷

31. EU COMMISSION, 8 MARCH 2018, EXECUTIVE SUMMARY OF IMPACT ASSESSMENT ACCOMPANYING THE PROPOSAL FOR A REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL: [HTTPS://EC.EUROPA.EU/EN/PUBLICATION-DETAIL/-/PUBLICATION/EFF455F8-BE71-11E9-9D01-01AA75ED71A1/LANGUAGE-EN/FORMAT-PDF/SOURCE-106396260](https://ec.europa.eu/en/publication-detail/-/publication/eff455f8-be71-11e9-9d01-01aa75ed71a1/language-en/format-pdf/source-106396260)

32. *IBID.*

33. *IBID.*

34. THESE COUNTRIES INCLUDE UK, FRANCE, ITALY, GREECE, NETHERLANDS AND SPAIN.

35. SEE REGITALS OF DRAFT THE PROPOSAL FOR A REGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL: [HTTPS://EC.EUROPA.EU/INFO/LAW/BETTER-REGULATION/INITIATIVES/ARES-2017-5288649_EN](https://ec.europa.eu/info/law/better-regulation/initiatives/ares-2017-5288649_en)

36. *IBID.*

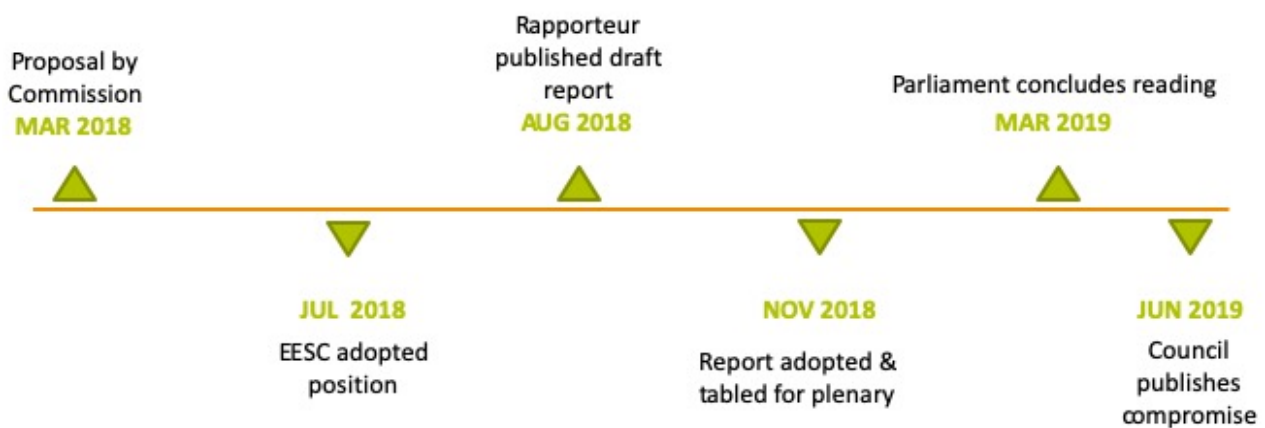
37. EU COMMISSION, 8 MARCH 2018, CREATING A MORE COMPETITIVE AND INNOVATIVE FINANCIAL MARKET: [HTTPS://EC.EUROPA.EU/INFO/SITES/INFO/FILES/180308-ACTION-PLAN-FINTECH-FACTSHEET_EN.PDF](https://ec.europa.eu/info/sites/info/files/180308-action-plan-fintech-factsheet_en.pdf)

The draft Regulation thus proposes:

1. An EU-wide passport that enables ECSPs to operate under same rules
2. The development of a common investor protection regime
3. The elaboration of a simple template for the disclosure of key characteristics of the projects and financial products sold (Key Investment Information Sheet or KIIS).

Since the Commission proposed the draft, the European Economic and Social Committee (EESC) has adopted its position, the Rapporteur has published its draft report, the Parliament concluded its reading and the Council published a compromise. (See Figure 3 for the timeline). The next step is for the Council and the Parliament to negotiate to agree a draft text. Although at this stage the date of implementation is not yet known, in all cases the Regulations will apply one year after they enter into force.

FIGURE 3. IMPLEMENTATION PROCESS FOR DRAFT CROWDFUNDING REGULATION



C2. MAIN PROVISIONS

In addition to setting out the authorisation process for ECSPs, the proposed Regulation sets out specific ECSP requirements, including (a) management policies and procedures, (b) rules on conflicts of interest, (c) safeguarding client assets requirements, (d) complaints handling obligations, and (e) rules on outsourcing. In addition, investor protection is reinforced through (a) client information requirements, (b) an entry knowledge test (repeated every 2 years thereafter) and a simulation of the ability of a client to bear losses, (c) risk warnings, (d) the prescribed key information document (KIIS); and (e) marketing communications.

The draft Regulation will apply to platforms intermediating projects of up to €8 million over 12 months.³⁸ The EU regime is optional, and co-exists with national regimes (or existing licenses, including those under the MiFID II, the PSD or the AIFMD) up until this threshold; the national regimes have exclusive

jurisdiction above this threshold. The proposed Regulation covers investment-based and lending-based crowdfunding service providers only.

The draft Regulation, as it currently stands, does not capture platforms directly providing loans to private consumers or individuals through the pooling of investors' assets, nor donation or reward-based crowdfunding.

As an EU Regulation, the legal text will have “direct effect” in all Member States and does not require transposition through national legislation. There will be one central European authority – the ESMA - so there will be limited opportunities for jurisdictional arbitrage and/or loose interpretation of the Regulation. It should, however, be noted that an ECSP authorisation does not remove the obligation for entities to be authorised for other activities that are outside the scope of this Regulation, such as TPPs or PSPs under the PSD2.

38. THE €8 MILLION THRESHOLD IS CURRENTLY PROPOSED BY THE COUNCIL; THE COMMISSION'S PROPOSAL HAD A €1 MILLION THRESHOLD.

C3. KEY OPPORTUNITIES FOR MFIS

MFIs can best take advantage of this Regulation, once it is passed, by applying for authorisation as an ECSP. Although this does entail embracing a new business model of acting as a platform intermediary, this diversification offers several opportunities. As an ECSP, MFIs can easily expand cross-border through the European passporting regime. Further, this new business model allows MFIs to both diversify and augment their current client base with new customer segments, such as millennials and “digital natives”,

in contrast to their traditional MFI clientele. In addition, current MFI clients can be targeted as a potential pipeline for projects, although due to conflict of interest rules in such a case the MFI/ECSP cannot have a financial participation in these projects on the platform. Lastly, by acting as a platform intermediary, this allows MFIs to tap in and leverage their current connections with the investor community.

C4. BECOMING AN ECSP

In contrast with many domestic crowdfunding regulatory regimes, the draft Regulation does not foresee capital requirements for the ECSP authorisation. The Commission believes that the platforms that operate such services do not warrant prudential treatment for minimal operational and continuity risk.³⁹ Further, this is also in line with the objective to create a regime that enables cross-border business activity. The Commission believes this removal of minimum capital requirements will result in a reduction of €50,000–125,000 in costs per MiFID licensed firm (depending on the type of MiFID license).⁴⁰

The main requirements for an authorisation application are set out in Article 10 of the draft Regulation, and include fit and properness requirements, and descriptions of (i) governance arrangements and internal control mechanisms, (ii) data processing systems, resources and procedures, (iii) business continuity arrangements, (iv) conflict of interest policy, (v) outsourcing arrangements and (vi) customer complaint procedures.

MFIs should note the existence of conflict of interest rules in particular. ECSPs are required to operate as neutral

intermediaries between the clients on their crowdfunding platform. ECSPs shall thus maintain internal rules to prevent conflicts of interest, ensuring that any conflict is disclosed to the platform's clients. Thus, ECSPs may not have any financial participation in the crowdfunding offers on their crowdfunding platforms.⁴¹ Therefore, if an MFI acting as an ECSP contracts with one of its microfinance clients to become a project owner on MFI's platform, the MFI cannot financially participate in that project (in contrast with its prior lender relationship with the same client).

In regard to continuing compliance measures, these are often significantly simplified in contrast with the regime MiFID (though the ECSP framework may be more restrictive and demanding than the domestic regulatory frameworks for crowdfunding). In addition to light record keeping, there is KYC due diligence for investors and project owners, responsibility for completeness of the KIIS⁴² and on-going information disclosure. The Commission estimates that MiFID licensed platform operators who become ECSPs could save €2,500–€5,500 on recurring compliance costs per year.⁴³

39. SEE THE COMMISSION'S IMPACT ASSESSMENT ON THE CROWDFUNDING PROPOSAL HERE: [HTTPS://EUR-LEX.EUROPA.EU/LEGAL-CONTENT/EN/TXT/?URI=CELEX%3A52018SC0057](https://eur-lex.europa.eu/legal-content/en/txt/?uri=CELEX%3A52018SC0057)

40. IBID. ON THE BASIS THAT THEY WILL APPLY FOR THE ECSP LICENSE AND DROP OUT OF MiFID.

41. OTHER PROVISIONS INCLUDE THAT SHAREHOLDERS HOLDING 20 PER CENT OR MORE OF SHARE CAPITAL OR VOTING RIGHTS, MANAGERS AND EMPLOYEES, SHOULD NOT ACT AS CLIENTS, IN RELATION TO THE CROWDFUNDING SERVICES OFFERED ON THAT CROWDFUNDING PLATFORM. SEE ARTICLE 7 OF THE DRAFT REGULATION.

42. THE KEY INVESTMENT INFORMATION SHEET (KIIS) OFFERS A STANDARDISED TEMPLATE WITH THE MINIMUM INFORMATION NECESSARY ABOUT RISK AND CHARACTERISTIC OF THE INSTRUMENTS SOLD TO INVESTORS. ALTHOUGH THE KIIS SHOULD BE DRAWN UP BY THE PROJECT OWNER, AS THE ECSP IS RESPONSIBLE FOR INFORMING THEIR PROSPECTIVE INVESTORS, THEY SHOULD ENSURE THAT THE KEY INVESTMENT INFORMATION SHEET IS COMPLETE. SEE ARTICLE 16 OF THE DRAFT REGULATION.

43. SEE THE COMMISSION'S IMPACT ASSESSMENT ON THE CROWDFUNDING PROPOSAL HERE: [HTTPS://EUR-LEX.EUROPA.EU/LEGAL-CONTENT/EN/TXT/?URI=CELEX%3A52018SC0057](https://eur-lex.europa.eu/legal-content/en/txt/?uri=CELEX%3A52018SC0057)



MICROFINANCE CENTRE

THE MICROFINANCE CENTRE IS A SOCIAL FINANCE NETWORK THAT PROMOTES FAIRNESS, INCLUSION, EQUALITY AND RESPONSIBLE SERVICE.

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