

Feedback Statement

FS16/2

Feedback Statement on Call for Input: Regulatory barriers to innovation in digital and mobile solutions



March 2016

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In this Feedback Statement we report on the main issues arising from Call for Input: Regulatory barriers to innovation in digital and mobile solutions.

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Abbreviations used in this paper

| | |
|--------------|---------------------------------------|
| AML | Anti-Money Laundering |
| API | Application Programme Interface |
| CDD | Customer Due Diligence |
| CMA | Competition and Markets Authority |
| DLT | Distributed Ledger Technology |
| DP | Discussion Paper |
| EU | European Union |
| FAMR | Financial Advice Market Review |
| FCA | Financial Conduct Authority |
| GDPR | General Data Protection Regulation |
| GDS | Government Digital Service |
| ICO | Information Commissioner's Office |
| JMLSG | Joint Money Laundering Steering Group |
| MLD4 | Fourth Money Laundering Directive |
| PSD2 | Payments Services Directive II |
| PSR | Payment Systems Regulator |

1. Overview

Introduction

- 1.1** In this paper we:
- summarise the feedback we received on our Call for Input: Regulatory barriers to innovation in digital and mobile solutions¹
 - set out our response to this feedback
 - explain the next steps for this work in the context of the wider Project Innovate agenda²

Context

- 1.2** In June 2015 we published our Call for Input: Regulatory barriers to innovation in digital and mobile solutions. We noted that:
- Digital and mobile solutions can be more convenient for many consumers and offer efficiency and cost benefits to providers. As a result, digital technology is becoming integrated in all sectors of the economy.
 - Applying digital solutions has become a top priority in the public sector in the UK and in the EU.
 - We would like to understand better the strategic regulatory barriers and enablers, either in the UK or at EU level, that prevent development of digital and mobile solutions.
- 1.3** We received 45 responses from a wide range of firms (large and small, established and start-ups) across the financial services sector as well as trade bodies and other interested parties.
- 1.4** In July and August 2015 we hosted six roundtable events through which we received further feedback. Some of the attendees also sent written responses to our *Call for Input*.
- 1.5** We would like to thank all those who responded with written feedback and/or participated in one of our roundtables. The views expressed have played a vital role in shaping our decisions on the next steps for this work.

¹ Call for Input: Regulatory barriers to innovation in digital and mobile solutions (June 2015) www.fca.org.uk/static/fca/documents/call-for-input-regulatory-barriers-to-innovation.pdf

² www.innovate.fca.org.uk/innovation-hub/project-innovate-next-steps

Key points

- 1.6** The *Call for Input* was positively received. The majority of respondents recognised that this work was part of our longer-term commitment to foster innovation and welcomed our engagement on these issues.
- 1.7** In their responses, most stakeholders sought clarity over regulatory definitions. It was also clear from the responses to the *Call for Input* that, while many innovative digital and mobile solutions already exist with stakeholders eager to use them and provide them to consumers, there are a number of perceived barriers that are preventing greater use of all the available technology.

2. Summary of feedback and our response

We will:

- Address the issues raised around communications through a Feedback Statement to our Discussion Paper (DP) on smarter consumer communications (DP15/5).³
- Continue to engage with Her Majesty's Treasury and the Joint Money Laundering Steering Group (JMLSG) to help them implement the Fourth Money Laundering Directive (MLD4) in a way that maximises its potential for digital solutions.
- Seek views of stakeholders on the implementation of Payments Services Directive II (PSD2) through industry engagement and a consultation on our current PSD Approach Document.⁴
- Host an event on payments in spring 2016 to further engage with stakeholders on key issues.
- Explore the issues raised in the financial advice market through the Financial Advice Market Review (FAMR).⁵
- Address the issues raised on the use of third-party cloud providers through our guidance consultation.⁶

2.1 In our *Call for Input* we asked for feedback on any specific rules and policies that restrict innovation. We also asked if any further regulation should be introduced to facilitate greater innovation in digital and mobile solutions.

2.2 Most stakeholders stressed the potential consumer benefits brought about by the greater use of technology within the sector, including increased product variety, speed, convenience and even cost savings. Some respondents also said it was incumbent on the industry to ensure they keep pace with consumer expectations, offering the services that consumers want to engage with.

³ www.fca.org.uk/static/channel-page/dp-smarter-comms/dp-smarter-comms.html

⁴ www.fca.org.uk/your-fca/documents/-psd-approach-document-

⁵ www.the-fca.org.uk/financial-advice-market-review-famr

⁶ www.fca.org.uk/your-fca/documents/guidance-consultations/gc15-06

- 2.3** Stakeholders have demonstrated broad support for the work of Project Innovate since its inception in October 2014. Many welcomed this *Call for Input* on regulatory barriers and recognised it as part of our wider work to foster greater innovation in the interests of consumers. Accordingly, many respondents expressed their eagerness to engage more with us as Project Innovate develops.
- 2.4** While the comments we received on our questions came from a broad spectrum of the sector their content was centred on the following six themes:
- Communications
 - *how our rules on consumer communications apply to digital and mobile solutions*
 - Customer due diligence (CDD) for the purposes of anti-money laundering (AML) checks
 - *how regulation interacts with digital identity and verification*
 - Payments systems and services
 - Data storage, privacy and data protection
 - Financial advice
 - *how the definitions of services may impact innovation*
 - Regulation and its relationship with technology
 - *the FCA's approach to technology and innovation*

Communications

We will:

- Address the issues raised through a Feedback Statement to our DP on smarter consumer communications this spring. We see this as an opportunity to clarify and reduce regulation and promote competition in the interests of consumers

Feedback

- 2.5** Among respondents there was significant agreement that regulatory requirements can inhibit firms from using a more innovative approach in how they communicate information to consumers. Stakeholders, regardless of their marketplace, argued that many consumers prefer to engage with services through digital and mobile platforms and therefore expect the industry to be able to offer products through these mediums.
- 2.6** The amount of feedback we received on issues related to communications is indicative of how fundamental this area is to the industry's attempts to innovate.

- 2.7** Detailed comments were made on aspects of the regulatory regime, including:
- specific rules on what constitutes a ‘durable medium’ for providing information to consumers
 - risk warning prominence for financial promotions, and
 - our recent guidance on the use of social media and how this applies to the ‘click-through approach’⁷
- 2.8** Most feedback urged a review of our rules and guidance on these matters.

Our response

In June 2015 we published a DP on smarter consumer communications (DP15/5) to seek stakeholder views on how firms’ communications can engage and empower consumers. Similar issues were raised by responses to DP15/5 to those raised by responses to our *Call for Input* on regulatory barriers. A number of respondents also noted that their comments on our *Call for Input* replicated those provided in response to this DP.

In light of the overlap between the two, we will address the issues raised in this *Call for Input* through the Feedback Statement on smarter consumer communications which will be published in spring 2016.

Customer Due Diligence (CDD) for the purposes of Anti-Money Laundering (AML) checks

We will:

- Continue to work closely with HM Treasury and the JMLSG to assist them in their implementation of MLD4 to ensure it maximises its potential for the use of digital solutions to meet AML requirements.

Feedback

- 2.9** A number of stakeholders argued that requirements in the Money Laundering Regulations 2007 create barriers to the use of digital and mobile solutions for the purposes of Customer Due Diligence (CDD).
- 2.10** Respondents also contended that the guidance for the financial services industry provided by the JMLSG, while seen as a safe harbour for the industry, is not compatible with modern means of digital verification and may be inherently biased against digital solutions in general. The definitions of CDD in part 1, chapter 5 of the JMLSG guidance were highlighted as a specific example.⁸

⁷ www.fca.org.uk/static/documents/finalised-guidance/fg15-04.pdf, Annex 1, Section 2

⁸ The Joint Money Laundering Steering Group, Guidance for the UK Financial Sector, Part 1, Chapter 5 (2014)

- 2.11** Respondents also said the perceived lack of clarity over the use of digital verification within the JMLSG's guidance was one of the main reasons firms are reluctant to utilise the many digital CDD solutions available.
- 2.12** Respondents were concerned that these perceived barriers to the use of digital solutions for CDD mean the industry is failing to meet growing consumer demand for an end-to-end digital service. Some firms argued that this is also adding unnecessary inefficiency to the process of CDD for the purposes of AML.

Our response

While current CDD practice focuses primarily on physical documentation, firms are able to take a risk-based approach to meeting their obligations, as these regulations do not explicitly prohibit the use of digital solutions. We therefore encourage the industry to take advantage of the many digital CDD solutions that exist and work collaboratively with us and the JMLSG to explore these alternatives.

We will continue to work with HM Treasury and the JMLSG to assist them in the implementation of MLD4. We will seek to ensure the Directive is adopted in a way that is supportive of the use of digital solutions for CDD, while remaining consistent with EU standards. HM Treasury will consult on the UK approach to implementation of this Directive shortly. We encourage stakeholders to engage with this process.

We have also been working closely with the Government Digital Service (GDS) to understand how a digital identity that meets high government standards, such as that available through GOV.UK Verify, could be used within the financial sector.⁹ We see the creation of high assurance digital identity as a significant step towards more modern, secure methods of verification; we encourage industry to work with the GDS as this work develops.

As part of our commitment to help firms meet their regulatory requirements more efficiently and effectively we are also exploring what innovative solutions exist through the greater use of technology. To understand better how the development of Distributed Ledger Technology (DLT) could aid firms in meeting their AML requirements we are currently engaging in discussions with government and industry. We encourage firms to engage with us as this work develops.

⁹ www.gov.uk/verify

Payments systems and services

We will:

- Make better use of the PSD2 section of the FCA website to provide useful updates on how this work is developing.
- Seek the views of stakeholders through a Call for Input on our current PSD Approach Document.¹⁰ Interested parties should provide comments to this by 23 March 2016.
- Host a payments event to engage with stakeholders on key sector issues.
- Continue to work closely with the PSR on issues related to indirect payments systems access.

Feedback

- 2.13** We received a substantial number of comments on a broad range of issues related to payments systems and services. Most respondents sought some form of assurance or clarity on existing FCA, government and European initiatives.
- 2.14** The significant amount of feedback we received on issues related to the payments sector is indicative of the number of new firms entering and innovating in this sector.
- 2.15** Many stakeholders queried our approach to the transposition and implementation of PSD2. They argued that a lack of clarity on the UK's eventual interpretation of the Directive, and the uncertainty around its related costs and potential outcomes, is stalling their willingness to innovate.
- 2.16** Respondents also sought assurance that the FCA was appropriately coordinated on the various initiatives within the payments sector. The open banking and standard application programme interface (APIs) work, which involves stakeholders across the Government and industry, was highlighted as an area where coordination is particularly important.
- 2.17** A number of stakeholders, especially those with interests in the development of virtual currencies and e-money, also called on us to clarify our regulatory position on these areas.
- 2.18** Some smaller firms mentioned difficulties in accessing payment systems as a result of being only indirect participants. In particular, they highlighted their dependency for access on agency agreements with direct members who are mainly large banks. They considered this indirect access to constitute a barrier to innovation.

Our response

The payments sector is subject to a number of ongoing initiatives both nationally and internationally. We recognise that the uncertainty this creates could be a barrier in itself as firms may be reluctant to develop innovative solutions in a period of flux.

¹⁰ www.fca.org.uk/your-fca/documents/call-for-input-payment-services-regime

To help combat this we are working to ensure that each of these initiatives is as joined up as possible. This includes working alongside the PSR, and also closely with HM Treasury, the European Supervisory Agencies (in particular the European Banking Authority), the CMA and other relevant industry representatives.

We recognise it is important that stakeholders understand the approach we are taking to the implementation of PSD2. We plan to make better use of the PSD2 section of the FCA website to provide more useful updates on how this work is developing. HM Treasury will be responsible for transposing this Directive into national law by January 2018. We will work closely with them to ensure this is done in a proportionate way.

To help inform this process we launched a *Call for Input* on 10 February 2016 seeking views on whether the current Approach Document and related guidance for PSD1 have kept pace with market developments and growth in payment services. We hope the feedback we receive will help us to address any existing issues and incorporate necessary changes in our updates for PSD2.

With regard to payment systems and issues related to access, the PSR has objectives in relation to competition, innovation and service-users. The PSR is undertaking a market review on indirect payment systems access and in March 2016 they will publish an interim report of their findings.¹¹ The issues raised in this *Call for Input* were passed on to the PSR and we will continue to liaise with them.

When we established Project Innovate we said we would hold thematic workshops on issues important to the industry.¹² The thematic week we held in September 2015 focused on the emerging 'robo-advice' market and proved to be a useful forum for both us and those who attended.¹³ In spring 2016 we plan to hold a similar forum for the payments sector, which will include sessions on many of the issues outlined in our *Call for Input*.

Data storage, privacy and data protection

We will:

- Continue to liaise with the Information Commissioner's Office (ICO) on issues related to data privacy and protection, including the requirements of the new General Data Protection Regulation (GDPR).
- Respond to the feedback we received as part of our consultation with stakeholders on the use of the cloud. This consultation closed on 12 February.

¹¹ www.psr.org.uk/sites/default/files/media/PDF/Indirect-access-mkt-rev-terms-ref_0.pdf

¹² www.fca.org.uk/your-fca/documents/feedback-statements/fs14-2

¹³ <https://innovate.fca.org.uk/innovation-hub/project-innovate-themed-weeks>

Feedback

- 2.19** While acknowledging that the remit for data protection and privacy sits with the ICO, some respondents expressed concern over how some EU data protection rules are perceived to be developing. Requirements set out in the current GDPR on individual profiling in the consumer credit and advice market were highlighted as an example. Stakeholders were concerned that some of the proposed rules could prevent the development of emerging digital and mobile solutions.
- 2.20** A small group of respondents sought clarity on our interpretation of data storage within the cloud and the use of third-party providers. While not suggesting this as an immediate barrier to innovation, some stakeholders said this perceived lack of clarity could be a potential obstacle to future development. We are aware of this issue and have already consulted on it.¹⁴

Our response

Data privacy and protection

As more firms look to digitise their products and services it is vital to ensure that consumers are afforded sufficient data privacy and protection is vital. We already work closely with the ICO on the data issues experienced by firms approaching the FCA's Innovation Hub.

We have relayed the feedback we received on the EU data protection regulations to the ICO. The ICO want to ensure that data laws do not create a barrier to innovation and they stand ready to assist firms in interpreting these new requirements.

The cloud

As set out in our *Call for Input*, we recognise that the use of cloud data storage through third-party providers is a key factor in many firms' plans to develop and innovate.

Following the *Call for Input* we have published a guidance consultation on cloud data storage and the use of third-party providers (GC15/06). This consultation closed on 12 February. We will publish our finalised guidance in summer 2016.

¹⁴ www.fca.org.uk/your-fca/documents/guidance-consultations/gc15-06

Financial advice

Feedback

We will:

- Explore the issues raised through the Financial Advice Market Review (FAMR). An update on FAMR will be published in spring 2016.

- 2.22** Many stakeholders, particularly those involved in the advice and investment market, suggested that lack of clarity over regulatory definitions of advice, guidance and personal recommendations were a barrier to the use of digital and mobile solutions.
- 2.23** Some stakeholders went further and suggested that the treatment of liability (specifically how the Financial Ombudsman Service makes decisions on consumer redress) coupled with the absence of a liability longstop for advisors, is another barrier to innovation. Respondents on this point were concerned that these factors act as a disincentive in the development of digital and mobile solutions.

Our response

We recognise that there are a number of aspects within the financial advice market that are perceived as barriers to innovation. These perceived barriers are relevant to both digital and mobile solutions as well as wider development in the sector itself.

Following the Government's pension reforms it is more important than ever to ensure that the provision of advice functions in a way that benefits consumers. As many stakeholders said in their responses, a number of issues relating to this *Call for Input* cross over with those currently being considered by the FAMR.

We are working jointly with HM Treasury on this review and will be presenting a set of proposals to the government in spring 2016. Given the significance of this work and its relevance to the issues raised by respondents to our *Call for Input*, we will explore these issues through the FAMR.

Regulation and its relationship with technology

Feedback

- 2.24** A small number of stakeholders posed fundamental questions relating to our approach to technology. Their comments suggested that we should re-evaluate our established 'technology-neutral' stance to regulation and create a more 'digitally conducive' regulatory environment.
- 2.25** Respondents on this point argued that it is a challenge to interpret existing rules and policies for the use of new technologies or solutions. Some felt their interpretation of the regulatory regime would benefit from more specific guidelines for technology. It was felt such guidance could be used to supplement existing rules and policies.

Our response

We are currently considering our priorities for 2016/17 and will set these out in more detail, including for innovation, in our upcoming business plan. We welcome feedback on the perceived challenges the regulatory regime may present to the use of technology. We are keen to address, where possible, any areas of regulation that depend on the use of a particular technology and could therefore inhibit new innovation.

However, we believe that the use of principles and broad rules in our Handbook provides flexibility for the emergence of new technology. It also offers greater durability than technology-specific guidance, which risks becoming outdated as innovation continues.

3. Next steps

The key next steps for this Call for Input

We will:

- Address the issues raised around communications through a Feedback Statement to our DP on smarter consumer communications (DP15/5).
- Continue to engage with HM Treasury and the JMLSG to help them implement the MLD4 in a way that maximises its potential for digital solutions.
- Seek views of stakeholders on the implementation of PSD2 through industry engagement and a consultation on our current PSD Approach Document.
- Host an event on payments in spring 2016 to further engage with stakeholders on key issues.
- Explore the issues raised in the financial advice market through the Financial Advice Market Review (FAMR).
- Address the issues raised on the use of third-party cloud providers through our guidance consultation.

Project Innovate's programme of work for 2016

- **RegTech** – To enable effective competition and promote innovation, it is important that technologies that help firms better manage regulatory requirements and reduce compliance costs are supported. Following initial consultation with a range of stakeholders, we issued a Call for Input in November 2015.¹⁵ We will host further workshops throughout Q1 of 2016 to seek broader views on how to progress this work.
- **Themed weeks** – From September 2015, we have been facilitating a series of themed weeks, designed to stimulate engagement between the FCA and stakeholders with an interest in a particular area of innovation. We see the themed weeks as a valuable way of reaching large numbers of stakeholders at once, learning about their problems with the regulatory system, and perhaps dispelling regulatory uncertainties or myths. We will continue to host themed weeks throughout 2016.
- **Regulatory sandbox** – In November 2015 we published our plans to open a regulatory sandbox.¹⁶ Our plan is to create a safe space in which businesses, authorised and unauthorised, small and large, can experiment with innovative products, services, business models and delivery mechanisms without immediately incurring all the normal regulatory consequences of engaging in the activity in question. We intend to open the sandbox unit to proposals from firms for testing in spring 2016.
- **Engagement with large incumbent institutions** – Project Innovate was always aimed at businesses of all shapes and sizes. But we have had little engagement with large, incumbent businesses. In 2016 we will undertake a programme of proactive engagement with large incumbents to make sure their potential for consumer-friendly innovation is not being held back by regulatory considerations.
- **International engagement** – Many innovators hope the UK will be a springboard from which they can launch internationally. To help innovators achieve this international scale we will put them in touch with regulators when they seek to do business in other jurisdictions; establish memorandums of understanding with key international regulators; and give help to non-UK innovators interested in entering the UK market.
- **An end-to-end experience** – To deliver a seamless regulatory process for innovative businesses, and minimise the risk of unnecessary delay, businesses that have received initial support from the Innovation Hub will have their applications for authorisation handled by a specialised Project Innovate authorisation process. After authorisation dedicated supervisory support is then provided, normally for one year.

¹⁵ www.fca.org.uk/your-fca/documents/regtech-cfi

¹⁶ www.fca.org.uk/your-fca/documents/regulatory-sandbox

Annex 1

List of non-confidential responses

1. Association of British Insurers
2. Accenture
3. Aegon
4. Association of Professional Financial Advisors
5. British Bankers' Association
6. Brewin Dolphin
7. Callcredit
8. Citi
9. Consumer Finance Association
10. Douglas Baillie
11. Electronic Money Association
12. eToro
13. Experian
14. FCA Consumer Panel
15. FCA Practitioner Panel
16. Finance and Leasing Association
17. Innovate Finance
18. International Finance Data Services
19. Investment Association

20. Jazz Arts and Communications
21. MBNA Bank of America
22. Nationwide
23. Nutmeg
24. Payments UK
25. Seedrs
26. ShopDirect
27. Standard Life
28. Taylor Wessing LLP
29. Threesixty Services LLP
30. Transferwise
31. Transpact
32. UK Cards Association
33. Virgin Money
34. Vocalink
35. Vodafone
36. Wealth Management Association
37. Whitechapel Think Tank

Annex 2

List of roundtables

| | |
|-----------------------|------------------------------------|
| 3 August 2015 | Payments systems and services |
| 3 August 2015 | Anti-Money Laundering Requirements |
| 3 August 2015 | Banking sector |
| 11 August 2015 | Insurance sector |
| 11 August 2015 | Asset management and advice sector |

Financial Conduct Authority



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