Background documentation

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Reduction of barriers to market entry for fintech firms

1. Background

Everyone is talking about digitisation and it has been swirling around in the world of finance too for the past few years. Examples of digital financial technology (fintech) include:

- Mobile payment systems
- Virtual currencies
- Online lending between private individuals (peer-to-peer lending)

All of these developments have the potential to challenge existing business models in the financial sector and to accelerate structural change at least in the longer term. Consequently, the speedy creation of innovation-friendly framework conditions is crucial.

On 20 April 2016, the Federal Council gave the FDF until autumn 2016 to examine whether there was a need for regulatory action to reduce the barriers to market entry for providers of innovative financial technologies (fintech firms).

2. Barriers to market entry identified

At present, fintech firms are affected by financial market regulation primarily in the areas of banking law (BankA) and anti-money laundering law.

Under certain circumstances, even fintech firms that provide innovative payment services (e.g. mobile payment applications for peer-to-peer payments) require a banking licence. In addition, fintech firms that provide services in the area of blockchain technologies (particularly traders, ATM operators and depositories for virtual assets and currencies) can come under the scope of application of the BankA.

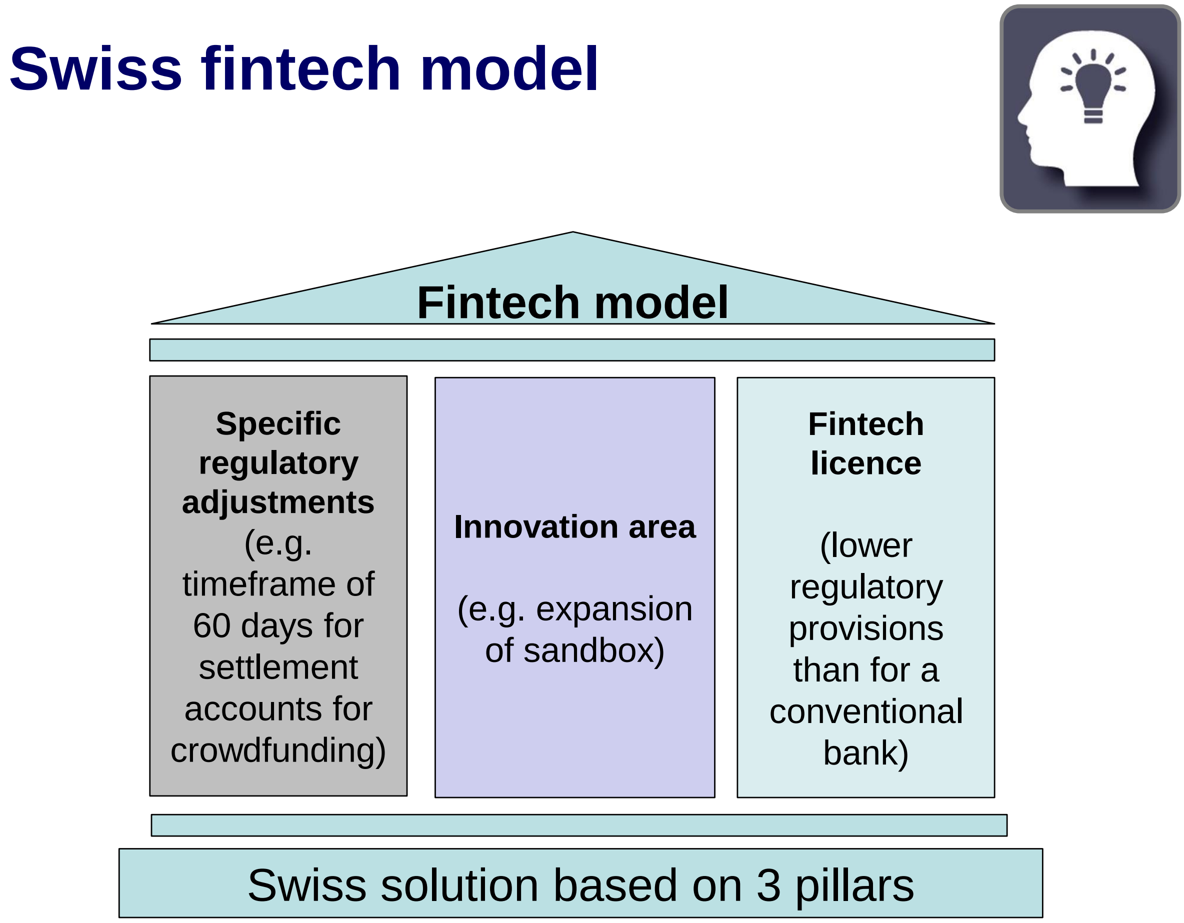
The BankA sets relatively high authorisation granting requirements, as such authorisation is generally aimed at banking activity (deposit-taking and lending business) with the corresponding risk exposure and need for regulation. Therefore, a banking licence in accordance with the BankA is a considerable barrier to market entry for innovative fintech firms that want to carry out only certain elements of banking.

Anti-money laundering and terrorist financing due diligence requirements are not fintech-specific barriers to market entry.

3. Key parameters for the new regulatory approach

An approach with three supplementary elements will be pursued, but no distinction will be made between the specific business models with regard to their regulatory treatment, thereby ensuring the approach is forward-looking.

The **parameters** set out below **for regulatory adjustments in three sub-sectors** form a holistic concept. The specific regulatory simplifications should reduce the identified barriers to market access for providers in the area of innovative financial technologies and increase legal certainty for the affected financial service providers overall.



3.1. Extension of the timeframe for settlement accounts

Under the Banking Ordinance (BankO), credit balances on client accounts of securities dealers, precious metal traders, asset managers or any similar firms that solely serve the purpose of the settlement of client transactions and on which no interest is paid are not considered to be deposits (Art. 5 para. 3 lit. c of the BankO). This exception can apply also for fintech firms, as determined by the Federal Council in its press release of 20 April 2016. In accordance with its mandate, FINMA set a timeframe of seven days for such settlement accounts. Because fundraising for a crowdfunding project usually last more than seven days, the timeframe is too short for business models that temporarily hold money on own accounts.

In order to create legal certainty in this area, a **timeframe of 60 days** should be set **for settlement accounts** at **ordinance level** (in Art. 5 para. 3 lit. c of the BankO). Because of the principle of equal treatment, such an amendment would not be restricted to fintech firms, and would instead be generally applicable for all players. Crowdfunding platforms that themselves accept funds could benefit from an extended timeframe for settlement accounts. If they accepted client funds only for the duration of that timeframe, they would not need a banking licence for this activity or the authorisation to be created for financial technology institutions (see section 4.3 below).

3.2. Expansion of authorisation-exempt activity

Under current law, funds can be accepted from a maximum of 20 depositors without authorisation being required. However, business models in the fintech area are generally aimed at more than 20 people. A moderate expansion of the existing authorisation-exempt activity would offer market entrants the possibility to check the conceptual and economic efficiency of their business model within a limited framework before having to decide on obtaining authorisation, for example.

In the future, a provider without a banking licence should be able to accept **public funds without restriction up to a total value of CHF 1 million**. More extensive fund acceptance or if more than 20 public depositors were involved would require a separate approval by Finma (see para. 3.3).

In order to ensure **transparency** also in the authorisation-exempt area, providers should have to inform their clients that their firm is not supervised by FINMA.

3.3. Authorisation for financial technology institutions

A new authorisation category should be created for institutions that do not carry out typical banking business but whose activity includes certain elements of banking. The business models of the holders of such an authorisation are beyond the core activities characteristic of the banking business and have a correspondingly lower risk profile.

The authorisation conditions and supervision can thus be less comprehensive than in the case of conventional banking activity. Consequently, a **new authorisation category** should be created for financial technology institutions that are restricted to the deposit-taking business (acceptance of public funds) and thus do not operate in the lending business with maturity transformation. This would have the following features: the **public deposits** accepted may not exceed a total value of **CHF 100 million**. So long as protection of the individual client is guaranteed by special conditions, FINMA can authorise a higher threshold. The deposits must be held on **one or more accounts** in the name of the authorisation holder and may **not be invested or interest-bearing**. For institutions in the new authorisation category, the **minimum capital is 5%** of the accepted public funds, but **no less than CHF 300,000**. The capital can be paid in cash or in kind. The 5% capital ratio not only includes a component for the authorisation holder's operational risks, but also ensures moderate capital backing for liabilities arising from the deposits accepted and allows this to grow alongside the authorisation holder's sound financial, personnel and organisational resources.

The new authorisation category significantly reduces the barriers to market entry for providers in the area of cashless payment transactions, blockchain applications and crowdfunding platforms.

4. International developments

Regulations have been created or amended abroad too in the wake of the digitalisation in the financial sector, whereby various objectives are pursued. Unlike the proposed Swiss approach, rather business-specific regulatory approaches have been chosen in other countries up to now.

Within the EU, for example, Germany, France and the UK have specific national regulations with regard to **crowdfunding**. Licensing and supervisory requirements particularly from an investor protection viewpoint have been defined for the specific area of crowdfunding in these countries.

Additionally, a regulatory sandbox was opened in the UK in May 2016, whereby firms can test innovative products and services with the guidance of the supervisory authority. Singapore has initiated a similar project and such a regulatory sandbox is being considered in the United States too. In all three countries, the supervisory authorities decide on the inclusion (of a limited number) of companies in the sandbox for a limited duration, and the companies are in close contact with the relevant supervisory authority. Therefore, these sandboxes likewise differ significantly from the Swiss approach of an authorisation-exempt area. The authorisation-exempt area is open to all companies – without supervisory authority guidance, authorisation or conditions – up to a maximum of CHF 1,000,000 in deposits.

5. Conclusion

The proposed authorisation category will give rise to new business opportunities for non-banks, together with lower compliance costs. Existing banks will have outsourcing opportunities and clients will benefit from a wider range of financial services. The expansion of authorisation-exempt activity will enable banks and non-banks alike to test innovative business ideas within a limited framework without having to comply with costly and time-consuming regulations. Thanks to the extension of the timeframe for settlement accounts, the legal situation will be clarified and better conditions will be created for crowdfunding investments.

In general, it can be said that a lowering of the barriers to market entry intensifies competition and is thus likely to increase the pressure on financial service prices and fees. The potential for the creation of additional value added and jobs will also be greater with a more competitive and appealing financial centre.

6. Next steps

A consultation draft with the legislative amendments in line with the proposed parameters will be prepared by January 2017. In this context, it is additionally necessary to examine the extent to whether additional adjustments to the Consumer Credit law must be examined.

The FDF is also planning to carry out further investigations on reducing other barriers to market entry for fintech firms. Clarification is needed with regard to the legal treatment of currencies such as bitcoin and assets based on blockchain technology, for example. The Federal Council is to receive a report on that by the end of 2017.

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