Summary of Conclusions

EFIF conference call, January 2022

1. Opening remarks by ESMA

ESMA as a Chair of the EFIF opened the 11th EFIF meeting (2nd chaired by ESMA) setting up the agenda for the day and thanking EFIF members for the input they provided for the meeting. She also thanked the EBA and EIOPA for effective cooperation since the establishment of the EFIF, welcomed the participants and let the new members to present themselves to the Forum.

2. Innovation facilitators: latest developments

Based on the input provided for the Newsletter, the EFIF Members informed on 1) the developments in the design and operation of their innovation facilitator(s); and on 2) the innovative products identified through hubs and sandboxes. During the "tour de table" EFIF members also informed about various research, events and publications conducted in their NCAs (e.g. a study on digital transformation in the banking and insurance sector; opening of a Sandbox; a Tech conference).

Main interventions: almost all EFIF members updated on their developments.

Discussion: Main topics mentioned were the review and improvements in the design of existing innovation facilitators; cross-border testing preparedness; supervision of virtual-assets, including surveys on digital currencies and regulatory/supervisory frameworks for investment funds investing in virtual assets; the growth of financial influencers (finfluencers) on social media; the risks of AI use in financial sector; relationship between innovation facilitators, sectoral regulators (e.g. data protection authorities) and engaging firms; increasing relevance of DeFi.

3. Follow up on the EFIF members' input on exemptions; NFTs; data protection issues; innovation mapping

Following the October meeting the members were asked to share with the EFIF their experiences, evidence and views on four topics: 1) legally provided discretions, exemptions, waivers, privileges that national sandboxes/hubs can grant to the firms testing or inquiring about their innovations; 2) the NFT-related queries received through national innovation facilitators; 3) data protection issues arising from the activities of national innovation facilitators; and 4) comments to the EFIF mapping of financial innovations. ESMA summarised and analysed the responses and presented results at this session.

1) The majority of the NCAs offered insights on the legal exemptions that their national sandboxes/hubs can provide to participants. Usually, hubs support firms in directing them to the relevant regulations they should consider, open up for communication and provide details on the authorisation processes and procedures. Firms entering sandboxes cannot be

exempted from requirements set by EU law, but some NCAs may grant certain exemptions within their national competences (or when those exemptions are already defined in the Law, e.g. the exemptions under art.32 of the PSD2 for authorization of payment institutions).

2) Most of the NCAs shared their experiences with NFT-related enquiries they received including proposals to tokenise some art works; legal qualification of activities consisting in creating NFTs or NFT trading platforms; fractionalised NFTs; questions on NFTs regulation and supervisory implications; relevance and applicability of MiCA.

3) The majority of NCAs sent their comments on data protection issues arising from the activities of national innovation facilitators. NCAs recognised the increased need for cross sectoral cooperation. They confirmed that the cooperation with national data authorities may often be tricky and time consuming. Indeed, the ESA's Advice on digital finance (to be published in February), highlighted the need for greater cooperation among sectoral authorities.

4) A few NCAs commented the EFIF mapping of financial innovations, and a revised version of classification expanded with glossary was presented. The presented mapping leveraged on the ESMA experience with the scoreboard for financial innovations. The mapping presented at the meeting is a live document meant to change as innovations evolve, therefore EFIF members were invited to continue to update the document and most importantly use it as a reference for experience sharing, categorisation, testing and for the digital platform.

Discussion: The EFIF members asked questions related to the next steps on the NFTs, their legal qualification (including under the MiCA proposal), the legal definition of fungibility, and the relevance to financial supervisors (bearing in mind the fact NFTs often typically relate to digital art, collectables etc). Since the role of innovation facilitators is to stimulate the dialogue between the supervisor and the FinTechs there is the need for a deeper knowledge on DeFi and its risks and there are benefits of continuing to monitor in the context of EFIF, along with NFT market developments. Members showed appreciation for the financial innovation mapping, asked about the possibility of changing the approach and mapping proposed by the ESMA, and stressed the need for a continuous update and supported a greater use of the document.

4. RegTech

— **Presentation by Elizabeth Cronan and Isabella Edmonds (GeoComply)**

GeoComply presented its anti-fraud, AML/CFT and KYC tools for government regulators and private enterprises. GeoComply's core industries include gaming and sports betting; banking, finance and crypto; and media. One critical area for GeoComply is fraud prevention and detection. GeoComply's tool can detect suspicious activity through analysing the use of VPNs or other IP 'masking' tech. Location data is key for financial institutions and law enforcement to mitigate cybercrime. In the sanctions area, one application of their tool is to ensure that products and services are not offered in prohibited jurisdictions or to prohibited individuals (by flagging and testing devices against historical data). Case studies included a visualisation of VPN usage, device interconnectivity, and how GeoComply flags suspicious devices engaging in money laundering and identity theft. Relevant to Europe, a recent GeoComply analysis found ransomware groups that have targeted European consumers and often used crypto to cash out. Hence crypto exchanges and wallets play a critical role in implementing controls to prevent illicit actors from exploiting the European financial system.

— **Presentation by Óli Páll Geirsson and Johann Haraldsson (Lucinity)**

Lucinity presented Lucinity's 'HumanAI' SaaS, which relies on a data-driven approach to AML that enhances human-made decisions. The tools Lucinity offers include transaction monitoring, customer insights (e.g., risk ratings), and performance management (e.g., 'gamified' compliance) - all aimed at helping people make faster decisions once a suspicious case is detected. Lucinity's data-driven approach relies on machine learning to create 'behaviour models' which identify patterns of transactional (financial) behaviours numerically. However, the predictive powers of these models are useless unless the end-user has all necessary data to explain or inform further decisions. In developing these models, Lucinity prepared a taxonomy of financial crimes (e.g., avoiding reporting requirements, concealing customer information, transacting in high-risk sectors) which helps analysts identify patterns and common violations.

Discussion: Questions related to 1) how GeoComply determines the legitimacy of VPNs (since they may be required as data protection measures for employees of public/private enterprises), 2) whether there has been growing demand for the RegTech both companies during the Covid-19 pandemic (the answer is yes, because of increased remote banking services and streaming services) and 3) whether GeoComply's tools are used in areas outside of financial crime—such as wider cyber threats (DDOS attacks). Other questions focused on how criminals may use crypto exchanges to avoid AML regulations and whether criminals or sanctioned individuals in a country (Russia) would be capable of dodging sanctions even in the scenario of SWIFT access being revoked. Other topics included the data formats (unstructured vs structured?) accepted through the APIs of various tools and the importance of ensuring RegTech tools evolve as criminal methods change. In response to a question from Francesca Medda (Consob) Lucinity said it does have experience tailoring generic products to the exact needs of a regulatory or supervisory authority. When Lucinity works with clients, they adopt a semi-supervised approach based on incorporating new data/observations into the model to limit 'false positives' of suspicious activity. They can also use historical data to start building insights - though relying too much on historical patterns comes with risks.

5. Update on the progress with the EU Digital Finance Platform

- **Presentation by FISMA (EC)**

FISMA presented key developments since June 2021 in building up the EU Digital Finance Platform that should among others enable Cross-Border Testing. Two stages are planned for the launch. Stage 1 is set for launch in March 2022 and phase 2 will follow later. The Platform will offer an interactive space for FinTech and Supervisors to cooperate, cocreate and promote events. At the centre of the platform, there is the EFIF Gateway showing: 1) the EFIF ongoing work; 2) a licensing section with links and a map to easily find all contact info on relevant authorities as well as national licensing requirements; 3) Cross-Border Testing framework, with the relevant documents. Phase 2 will incorporate updates and improvements, including based on user feedback, and probably additional functionalities. The EC also presented a 2-page factsheet (flyer) summarising the information on the Cross Border Testing and the Platform to support their promotion.

Discussion: The login to the platform will be granted to anyone that registers. Several members asked about the observer role in cross-border testing and what would be the implications in terms of

resources needed. The platform will also have a closed space for NCAs working on the same request launched by a firm and a separated space for them to communicate with firms. Some members provided suggestions to improve the factsheet (e.g. the cross-border testing framework should not be advertised as an EU-wide regulatory sandbox or give this impression).

- **Procedural framework for cross-border testing: candidates for testing (Lithuania)**

The Lithuanian Central Bank joined the GFIN network in 2019 and participated in 2020 in the insurance platform test. In 2021, it was part of the leading group on issuing guidelines for P2P insurance activities. They are using the sandbox to foster innovation including useful DLT applications. They have experimented on a first CBDC, called LBCOIN, and work on app development to use digital currency. They prioritise Insurtech and the Wealthtech sector, while looking into tokenised platforms and cryptocurrencies developments. The Bank will launch in February 2022 a new horizontal platform to foster market transparency and competition when entering the sandbox as well as to increase the possibility for Cross-Border Testing.

Discussion: There is a possibility for companies without a license to enter a sandbox and apply for it in parallel. The Cross-Border Testing model targets companies providing services all over EU. Financial services offered on the P2P platform at national level are regulated at Union level, therefore only national guidelines apply for now, depending on the innovation tested.

7. Global Financial Innovation Network (GFIN): Cross-border testing experience

Presentation by Steven McWhirter (FCA)

FCA's Steven McWhirter presented lessons learnt and best practices based on GFIN's experience with cross-border testing (CBT). He began with an overview of the mission and structure of the GFIN, including its mission which include three main workstreams: 1) serve as a network for regulators to collaborate on financial innovation issues, 2) share SupTech and RegTech best practices and 3) provide firms an environment to trial cross-border testing. GFIN launched its first cross-border testing cohort in 2020-21. Most of the applications came from the RegTech sector. Received a range of applications including complex technologies such as digital ID, tokenisation, machine learning, DLT, supply chain finance and others. Important features to streamline the process included a single application form (and other templates, e.g., a single FAQ) for participating firms/regulators, individual regulatory assessments and a regulatory compendium of accepted testing activities by all jurisdictions. Otherwise, areas for future improvement include determining a shared definition of what constitutes innovation, a focus on where regulators may want to see innovation happen (steer firms to a specific area—in fact industry wants direction from regulators), allow for flexible timing because not all regulators (and firms) move at the same pace. As next steps, GFIN will publish a CBT report in 2022 to be made public and decide on whether they will continue to progress with the effort.

Discussion: The discussion centred on how the GFIN member regulators shared the work and what those involved would change in the next iteration to better deal with cultural frictions or legal issues at the national level (including data confidentiality rules). On how to encourage applications from certain sectors or technology types, McWhirter (FCA) says GFIN conducted stakeholder engagement to ensure each market (globally) was aware of the initiative. To improve in the next iteration, GFIN would encourage larger more complex firms to apply (who may not have the

confidence to work with regulators) as opposed to just FinTech start-ups. Communication around applications desired by GFIN could help encourage those incumbents to apply. As to whether the GFIN CBT allowed simultaneous testing in different sandboxes or pursued a sequential ('one after the other') approach, McWhirter says GFIN did a geographic 'fencing' where necessary if a firm only wanted to operate in specific markets. McWhirter also noted that within the boundaries of the EU, this exercise should be easier, given the harmonisation level already in place.

8. AI Governance Principles

Presentation by Lutz Wilhelmy, Actuarial Association of Europe, EIOPA consultative expert group

AAE/EIOPA presented the report on AI governance principles for the insurance sector prepared in 2021 by EIOPA's consultative expert group on digital ethics in insurance[1]. The principles are a follow up to EIOPA's 2019 thematic review of AI and were published as part of the expert group's mandate to enhance trust in the European insurance market. The principles begin with an impact assessment by use case, which is based on risk proportionality. According to the principles, the two main ideas that insurers must consider in AI systems are fairness and non-discrimination (or inclusion). This means respect for human autonomy and no malicious manipulation of human decision-making (nudges). Discrimination risk correlates with tangible variables, such as race or gender, but also intangible variables, such as vulnerability and status. Indirect discrimination may arise from this dilemma. Hence transparency and explainability are at the core of the governance framework. In practical terms, the principles can be applied to data collection (to cover the gaps in GDPR and Solvency II) and record keeping (for reproducibility and arbitration).

Discussion: One EFIF member asked how EIOPA's governance principles will work with the Commission's latest proposal for an AI Act, including the amendment to include insurance-specific rules in the risk-based hierarchy and whether this is especially concerning for integrated regulators who have to manage different frameworks (for example derivatives trading risk vs. credit rating of individuals). Lutz Wilhelmy responded that integrating all insurance aspects into the horizontal legislation has been ruled out because it would hinder innovation that should otherwise be encouraged in the sector. His personal POV is that it is better to have insurance-specific regulation on the use of AI instead of having a one-size-fits-all approach. High-risk application for insurance currently found in the AI Act may unnecessarily limit innovation, Wilhelmy says, especially as the technology is still subject to human oversight. EIOPA noted that the report represents the views of the stakeholder group not necessarily EIOPA's institutional position. But given how intensive the use of AI is in the insurance sector, these non-binding principles should serve as strong guidance and a useful basis to be continued with the Commission's work on the AI Act.

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[1] https://www.eiopa.europa.eu/media/news/eiopa-publishes-report-artificial-intelligence-governance-principles_en