

Regulating FinTech and "FinTechifying" regulations

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Abstract:

The word "FinTech" conjures up a sort of hybrid monster. It resembles the Minotaur, a construction involving two protean elements that, taken separately, arouse hope and fear in equal measure. Regulating FinTech will require an ability to define unstable phenomena, to create policy networks and forms of innovative organisations between emerging stakeholders and, lastly, to factor in and address a form of anxiety on the part of regulators about their own utility. The FinTech movement is pushing regulators to question themselves and the need to "FinTechify" financial regulation.

"Year after year, I observe phenomena that were once confined to the realm of science fiction. [...] Finance will undergo overwhelming change because it will integrate the impact of innovations made possible by science and technology. [...] In my view, there is a monumental need for academic research."

Jean-Claude Trichet,
Former President of the European Central Bank
Labex ReFi luncheon, 15 June 2017

As the former ECB president notes, groups of technological innovations are transforming finance as we have known it up to now and opening up pathways that arouse both fascination and fear in keen observers. What are the challenges of regulating these innovations that have the potential to be highly disruptive? How do regulators and industry stakeholders interact? We will explore these issues in this paper.

We start by defining the elements of FinTech, before addressing the emergence of their policy networks: networks of stakeholders seeking to influence how these innovations are regulated. We then describe the structures proposed in response by the collective action of the economic community, and we conclude by looking at the fundamental issues that the emergence of FinTech poses for regulators themselves.

FinTech companies: a new Minotaur?

Let us first examine what defines the FinTech sector. The word "FinTech" conjures up a sort of hybrid monster. It resembles the Minotaur, a construction involving two protean elements that, taken separately, arouse hope and fear in equal measure. It is a mythical and anxiety-arousing merger, an ungainly and immoderate term that the academic community sometimes has difficulty approaching with distance and detachment. The regulation of FinTech is a dynamic, paced process, but its principles are easily grasped. This is the goal of this paper: to attempt to leave behind the mythical term and gradually return to the concrete simplicity of the regulatory process.

In "Taming the Beast: A Scientific Definition of Fintech", Patrick Schueffel (2016) describes the complexity, vagueness and ambiguity of this umbrella term, which covers various realities in multiple economic contexts. According to the author, FinTech is a financial industry that uses new technologies to optimise financial services. This rather broad framing thus allows us to include incremental innovations such as APIs and electronic signatures, but also potentially more disruptive innovations such as blockchain, AI and machine learning. These have already transformed, or have the potential to revolutionise, how financial systems work and how companies finance themselves, for example through crowdfunding or initial coin offerings (ICOs).

The emergence of FinTech policy networks

When a FinTech emerges, the first challenge is to understand the nature of the innovation. There is, first of all, a definitional issue, as Schueffel (2016) has shown. However, to define a phenomenon, it must be stabilised, and this stabilisation – of business models, for example – takes time. Early in the FinTech regulatory process there are entrepreneurs who take risks and use trial and error to slowly create a new regulatory object. In this phase in which a policy network emerges – i.e. a network of public and private stakeholders who attempt to influence the regulation of an activity – contacts between entrepreneurs and regulators are either non-existent or completely informal. In its early days, a FinTech innovation can be ignored, and then attract the bemused and intrigued attention of regulators. Within regulatory bodies, interest in these innovations gradually increases at the various hierarchical levels. It is often officials who are on the fringes of their institution, either because of their age or their position, who seize hold of a FinTech innovation that has hitherto flown under the radar, and promote it informally within their institution.

For a regulatory process to take shape, there must be an element that puts regulators and public officials under pressure. It can be an entrepreneur who promotes his company in the media. It can be a scandal that erupts and challenges the State's protective role. It may be a supranational or foreign regulator that publicly tackles a new subject. It may also be political will expressed by the regulatory authority's supervisory body that is committed to defining a specific framework for a new FinTech sector. In the case of crowdfunding, strong political will has supported from the outset this method of financing as an alternative to "faceless finance". In our opinion, this sanctioning by the political powers has helped concretise and accelerate the regulatory process in the FinTech sector (Berkowitz and Souchaud, 2017).

This activation of regulators then takes the form of formal consultations. A task force is set up that consults with all of the market players. It asks them to describe their business, to define how they plan to be regulated and to suggest literature to read or names of people to be interviewed. The challenge for the regulator is to fill the gap in its knowledge in relation to the entrepreneurs it intends to regulate – working with them but without being misled or becoming captive to them.

Here we have a better understanding of the issues raised by the constitution of the new FinTech policy networks. These networks remain incomplete, on the one hand because the public authorities have only limited technical expertise, and on the other hand because they have not fully mapped the sector's stakeholders, particularly due to the lack of an intermediary at collective level, which leaves a hole in the policy network (Berkowitz and Souchaud, 2017). The FinTech policy networks are also fragmented, since each sector and its regulation develop around particular technological innovations. These innovations require specific expertise, but also affect various economic stakeholders differently, which makes a holistic approach difficult.

Structuring a collective response by FinTech entrepreneurs

For their part, FinTech entrepreneurs must organise themselves. They have formed one or more sector-based associations: "meta-organisations" whose members are organisations. These meta-organisations may compete for the attention of the regulator and for representation of the sector. This may have been the case with crowdfunding, where several meta-organisations were created to represent the interests of the platforms to the regulatory authorities (*Financement participatif France*, *Association française de l'Investissement participatif*, *Association française du Crowdfunding immobilier*, etc.). FinTech entrepreneurs create pressure groups via formal partnerships (such as with law firms or other service providers) but also by forging informal ties (such as with officials or former officials who support their cause, sometimes in secret). They bombard regulators and public authorities with notes, e-mails, attention points and phone calls. They entrench themselves and seek to intellectually isolate other possible contenders. They constantly try to see things from the viewpoint of the regulator and the public authorities so that their documents can respond to these groups' concerns and be directly adopted by them.

We have observed these aggressive attempts to structure the field of action with *Financement participatif France* (FPF), the primary crowdfunding representative, but also more recently with the *Association Française des Gestionnaires de Cryptomonnaies* (AFGC), which is following a similar path. When FPF was set up in 2012, it brought together future competitors: stakeholders who had not yet even established a crowdfunding platform. The AFGC currently federates players who are themselves just beginning to think of ways to develop new business models. Indeed, we have shown (Berkowitz and Souchaud, 2017) that crowdfunding regulation is the result of successful co-construction efforts between regulators and platforms, thanks to the FPF meta-organisation, which has been able to embody varied goals and take into account the variety of interests that are represented in its board of directors –crowdlending, crowdequity and donation platforms, as well as civil society stakeholders.

Through constant dialogue with regulators, a policy of entrenchment and "coopetition" strategies (Berkowitz and Souchaud, 2018), meta-organisations have made a positive contribution to defining a new regulatory framework for crowdfunding and opening up new markets. This organisation of a collective response by new or even potential future entrants, and its role in defining both the regulatory framework and the sector, mitigates Philippon's (2017) observations concerning French regulators, whom he criticises for imposing changes on established players, in a top-down approach.

Existential challenges faced by FinTech regulators

When regulators begin to find their feet, their actions are always cautious and subjected to high tensions. An initial tension exists between the need to ensure that investors are protected and the need to not hobble the arrival of a national winner that might take the lead over foreign competitors. A second tension exists between the regulators themselves. First, between regulators in the same country, who jostle amongst themselves to be recognised as having a specific jurisdiction in an emerging FinTech area of activity. Second, between national regulators and foreign or supranational regulators: the first one out of the starting blocks will serve as a reference point for competitors/regulatory partners. Lastly, a third tension exists within each regulator: FinTech can call into question delicate balances within these organisations, they can serve as a support or pretext for powerful "side effects", personal ambitions and palace revolutions in internal struggles that are much more complex than those that pit the old guard against the vanguard.

There is another element that affects regulators. It may seem elusive and is rarely discussed publicly but in reality appears to be very much present in the field: a sort of anxiety that is not quite tantamount to fear. Regulators worry not only about being powerless in the face of the astounding evolutions of FinTech, but above all they worry about being disrupted, transformed or even – to put it bluntly – replaced by FinTech. New technologies are not only revolutionising traditional finance, they also pose a brutal challenge to traditional forms of regulation. For example, is there a need for a central bank when currency control can be delegated to a myriad of independent miners scattered around the world who ensure the proper functioning of a monetary regulation technology? How can regulators manage this existential dread of seeing their function reduced to next to nothing?

Theoretically, any institution is inclined to adopt its own survival as an implicit objective of its actions. Faced with a movement that challenges their own utility, regulators may seem divided between a traditional desire to control this disruption and a sort of reflexivity that compels them to support a movement whose logical outcome seems to be that of their own "fintechification". Thus, beyond the question of the regulation of FinTech, the question of the "fintechification" of financial regulation arises. For regulators, the transformation has only just begun.

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