



Finantsinspeksioon



## FINANTSINSPEKTSIOON INNOVATION HUB REPORT 2022

Financial supervision in the FinTech ecosystem: observations on the work of the Innovation Hub

Information about the Innovation Hub can be found on the Finantsinspektsioon website:

<https://www.fi.ee/en/finantsinspektsioon/innovation-hub>

The Innovation Hub can be contacted by email at [fintech@fi.ee](mailto:fintech@fi.ee).

## FOREWORD

**The Finantsinspektsioon Innovation Hub Report has been written to mark the first full year of operation of the Innovation Hub. The Innovation Hub was opened on 17 June 2021, a few days after the Financial Supervision Authority Act was amended to give Finantsinspektsioon the task of encouraging the development of financial technology within the limits of its responsibilities and in line with its strategy. This task is an important element of the broader goal of financial supervision of protecting the interests of investors and consumers, increasing the stability, reliability, transparency and effective operation of the financial sector, and reducing systemic risks and preventing abuse of the financial sector for criminal ends.**

Innovation plays a very important role in achieving those goals. Using new technology to provide financial products and services and digitalising services helps the market diversify, allowing a larger number of people to benefit from the value offered by the financial sector, increasing competition, and providing services to meet a range of needs, while also lowering the price of financial services. The new solutions also allow the financial sector to become more transparent and easier to understand than before, and allow the introduction of new technology-based risk and compliance controls that are smarter at measuring risks and can keep those who would harm the sector out of the market.

Equally there are principles that have applied in the financial sector for years and that have survived through periods of great innovation, and that are vital for achieving the goals of financial supervision, and for the sustainable and reliable operation of financial institutions. These two worlds of supervision and of innovation planned by entrepreneurs meet in the Innovation Hub and balance one another out. The first year of operation of the Innovation Hub has shown that demand is clearly there for this meeting.

*Andre Nõmm, member the Finantsinspektsioon management board*



## REVIEW

### Why is the Innovation Hub needed?

**That one year has passed since the Innovation Hub was established does not of course mean that Finantsinspeksioon has only been dealing with innovation for a year. A working group to investigate the legal bottlenecks that were restricting innovative financial technology was set up by Finantsinspeksioon in 2016, and it was intended to help companies creating innovative solutions overcome the possible initial legal hurdles. The challenge facing FinTech companies has not essentially changed in six years. The financial sector operates in a strictly regulated and exhaustively defined legal space, which is not easy to orient in and where it can prove quite difficult to interpret the laws correctly, particularly for innovative solutions.**

As FinTech businesses often do not have any previous experience of financial supervision and the regulation of the sector, it is evident that the knowledge and experience of specialists at Finantsinspeksioon can be very useful for guiding new companies along the right track. We decided to set up the separate Innovation Hub because we understood that simply enabling contact is not enough. The Innovation Hub was created so that Finantsinspeksioon could also innovate in estimating the risks of innovation, could take an active role in speaking on issues of financial innovation, and could give the clear message that Finantsinspeksioon is capable and wants to engage in dialogue with business so that new technologies can be introduced smoothly in the financial sector and without hiccups for the financial companies themselves and for the consumers and investors they serve.



The Innovation Hub was created to be a partner for FinTech companies in communicating with financial supervision institutions by helping them to get over the initial obstacles that may arise when bringing a new idea to life because of the complexity of the laws covering the financial sector. The Innovation Hub cannot provide legal assistance services or provide a binding assessment from Finantsinspeksioon, but it can allow businesses to set up direct communications with specialists in Finantsinspeksioon so they can have greater clarity about the possible classification of the service, the need for an operating authorisation, the rules and norms that apply in the sector, and the expectations of the financial supervisor. The day to day work of the Hub is coordinated by a team that also represents Finantsinspeksioon in discussions on innovation and in European working groups, and so is fully up-to-date with the latest technology and business models. At the same time the Hub can resolve specific cases by bringing in specialists in supervising the area concerned, ensuring there is the best combination of knowledge about new opportunities and the existing framework. This means that it is not just the Innovation Hub that promotes innovation at Finantsinspeksioon, as many different experts from different departments contribute to this work when they are involved in evaluating the legal treatment of different business models. This cooperation across departments increases knowledge of financial innovation throughout the whole of Finantsinspeksioon and improves the knowledge and skills of the whole team.

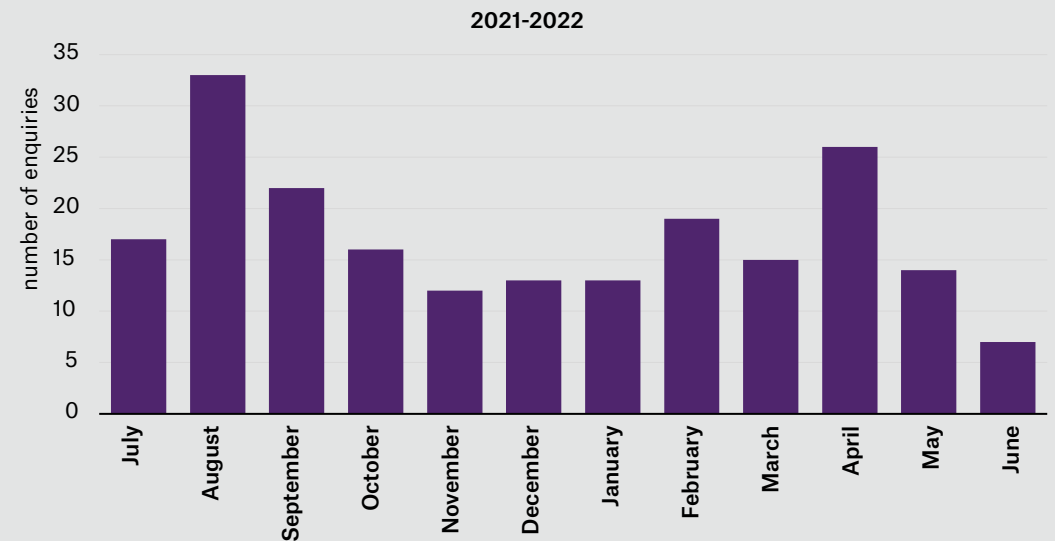
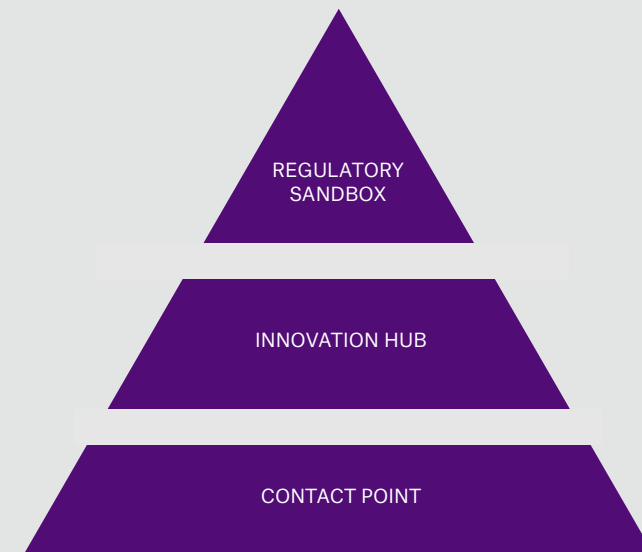


Figure 1. Number of enquiries received by the Innovation Hub by month

The Innovation Hub is not an experiment that Finantsinspeksioon thought of all by itself and that uses trial and error to find the best way to handle innovation. The same problems are found around the world when innovative solutions are brought to the financial markets and the legislation governing them, and there is by now a good understanding of the best tools for solving these problems. The concerns of FinTech and the possible solutions to them are very similar throughout the European Union, where a large part of the financial sector operates under rules agreed jointly between all of the member states. This is why the European Supervisory Authorities (ESAs) issued joint guidelines in 2019 for how financial supervision in member states could work with innovative solutions. The Finantsinspeksioon Innovation Hub follows these guidelines in its work and is part of a network together with other similar hubs in other member states of the European Union (see Figure 2).

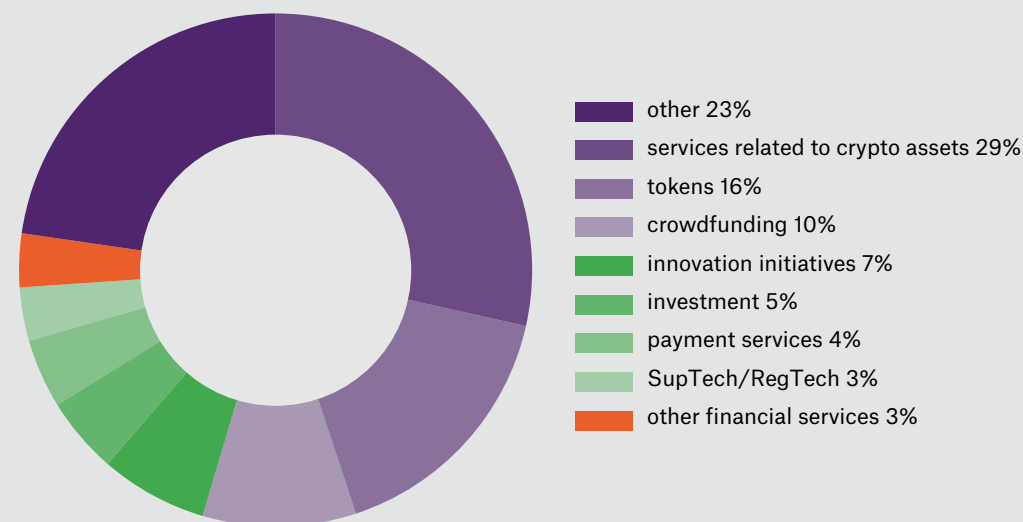


*Figure 2. Three-level support for innovation*

## THE COLOURFUL PALETTE OF INNOVATION

In its first year of operation the Innovation Hub received 207 initial contacts about financial innovation. As those who are well informed about the financial sector may guess, a clear majority of these enquiries concerned either crypto assets in broad terms or different specific crypto tokens. It should be noted that even during this one year the developments in the crypto world were stormy and fast, and in the next report we will probably not be talking about cryptos any more, as we will need to break them down into individual fields. The crypto world has not for a long time contained only cryptocurrencies like bitcoin or ether, as in recent years entirely independent fields have been developed for which the only common denominator is that they use blockchain technology.

Although crypto assets and tokens dominate heavily in the contacts to the Innovation Hub, it should be noted that innovation in finance is not limited only to the blockchain. The colourful picture that stretches between these two concepts is shown by the FinTech companies from many other fields that contacted the Innovation Hub during the year. They included crowdfunding companies, providers of new investment services, credit intermediaries, payment service providers, insurers and even companies that did not provide financial services themselves or plan to, but that created new technological solutions that could help the financial sector in managing legal acts or supervisory requirements better (see Figure 3).



*Figure 3 Topic of enquiries to the Innovation Hub*

The majority of the contacts came from the direct representatives of the company that had created the solution or legal advisers hired by the company, but some also came from various state institutions, the media, or researchers. The contacts also showed that enquiries about FinTech do not generally need answers about specific solutions, but are more interested in understanding the FinTech world in a general sense, with particular interest in the development trends in the sector and the initiatives that Finantsinspektsioon has set up to handle innovation. The main focus of a dozen or so enquiries was the innovation hub itself, and we were invited several times to speak about the work of the Hub at conferences (see Figure 4 and 5).

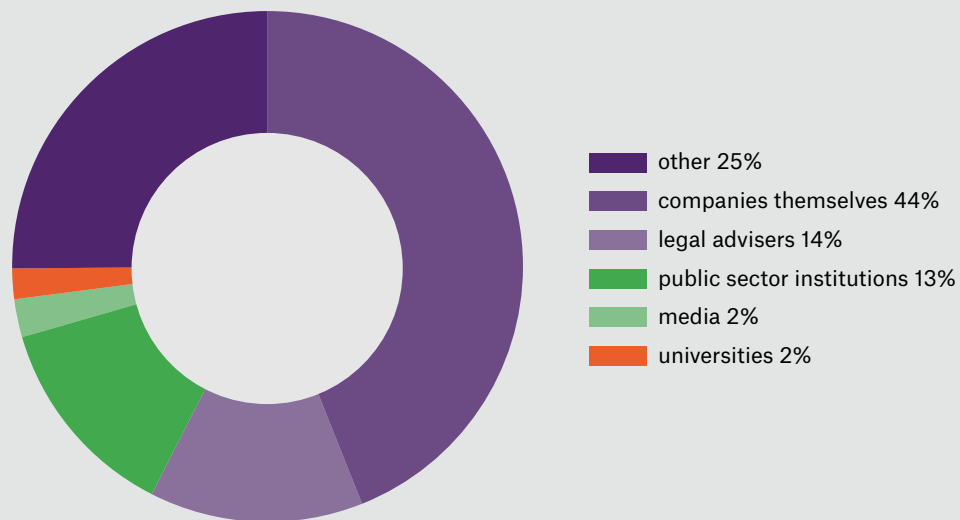


Figure 4. Source of enquiries to the Innovation Hub

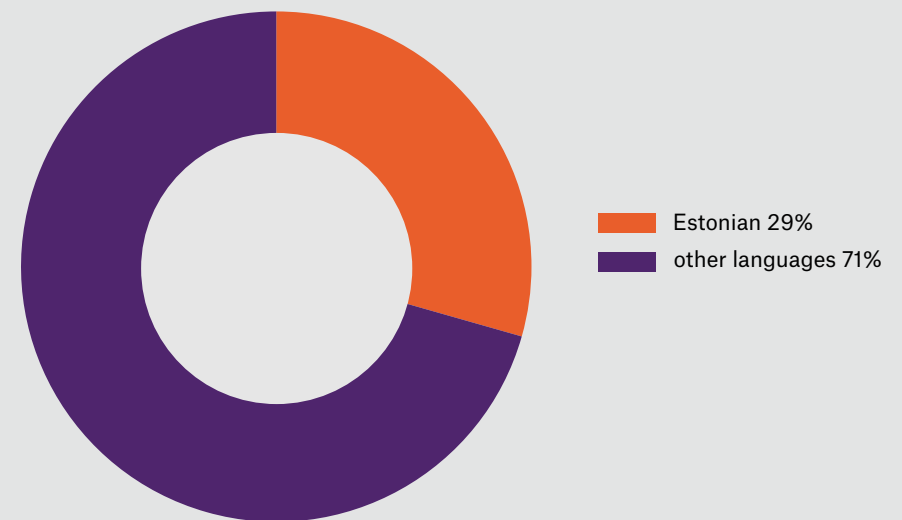


Figure 5. Enquiries received by the Innovation Hub by language



## WHAT WE LEARNED THAT WE CAN GIVE BACK TO YOU

**1. The Innovation Hub works as a virtuous circle.** We were naturally aware when we launched the innovation hub that one benefit it would give us as the supervisory authority is the opportunity to hold dialogue with companies about their innovative business models and technologies and so remain better informed about developments. One year on, we can say that that dialogue brought much more value than we expected. Over the year we analysed questions concerning decentralised financing (DeFi), NFTs, stablecoins, carbon sequestration certificates, the sustainability of blockchain systems, and Buy Now Pay Later systems. We use what we have learned from this in writing opinion pieces and summaries for our website so that market participants would be better informed and able to move forward with their own solutions.

**2. The Estonian FinTech landscape is very lively.** The Innovation Hub team works directly with companies that contact us, and participates in working groups that bring together European supervisory authorities that handle FinTech business models and technologies. This leaves us well placed to understand what is happening in the FinTech landscape in Estonia and elsewhere. The business models that land on the desks of the Estonian Innovation Hub are without any doubt very ambitious and innovative in European terms. It is quite common that if some area of FinTech starts to excite a lot of interest around Europe, there is already some company in Estonia that has experience in that area. We often find ourselves directing the attention of our European colleagues to a new topic that needs to be studied closely. We have also been contacted by a large number of companies with a foreign background that are interested in developing their business in Estonia, as they have observed the success of the ecosystem that has grown up here.

### 3. The support that FinTech companies need depends on their stage of development.

In the same way that the questions directed to us may come from very different fields, so the companies posing the questions may be at very different stages of development. This means that the level of help that they are hoping for from us can be very different. We are sent completely fresh ideas, where the company behind them only needs a quick clarification about which laws or requirements might affect its business, and also business models developed over a longer time that need explanation from the supervisory authority about the interpretation of a particular law, or need information on applying for an operating authorisation. This makes it important for the Innovation Hub to understand how we can best help that business.

**4. Compliance must follow innovation.** It may be apparent in initial meetings that what is wanted is greater clarification about the classification of the service and the legal requirements that will apply to it, but in the later phase the FinTech business itself has to invest in questions of compliance. There are various principles in the financial sector that must be followed strictly if reliability is to be achieved, such as the compliance culture of a business, the suitability of the managers and owners for work in the financial sector, capital management, rules about providing services, avoidance of conflicts of interest, security of IT and other systems, the prohibition of manipulation, the transparency of company operations, separated holding of client assets, and much more. Even the most innovative financial technology company cannot operate without those principles.

**5. Much more scary than the rules is not knowing what the rules are.** The financial sector has a reputation for having very many rules, which is true, and it is generally thought that if the law requires an authorisation for the provision of a service, the conditions for applying for that authorisation can be very difficult to meet. We have seen in our work at the Innovation Hub that although strict rules can be an understandable headache for new and early-stage FinTech companies, and that complying with them can demand a lot of resources, the rules themselves are not generally fatal to innovative solutions. A much greater obstacle appears when it is not possible to reach a clear understanding about the legal attitude that will be taken towards a particular solution. Meeting clear rules is a problem that can be solved, but an unmeasurable risk of breaking the law can be an insurmountable obstacle for businesses. Alongside the work of the Innovation Hub in clarifying the rules, Finantsinspeksioon has worked with professional associations from the financial sector to map rules that unreasonably hinder innovation, and the proposals that have resulted together with the opinions of Finantsinspeksioon can be found on the website of the Innovation Hub.

**6. Good regulation is to be welcomed.** The Innovation Hub has come across cases where the main motivation of the business appears to be to develop a system that would not fit under the current legislation. Innovation that focuses only on sidestepping the rules that protect consumers and investors without creating any extra value for them should be handled very carefully. Such cases have been rare exceptions though, and the longer and further different fields of FinTech develop, the more we see businesses that want to agree on equal rules throughout their area of operation and want requirements to be set for operating authorisations. For new business models to really grow big, they need strong regulation and legal clarity that can reassure consumers and investors that their assets are in good hands.

**7. Technology has a hard time winning trust.** Laws are just one way of solving questions of trust. Even if something is permitted by law, there is no guarantee that it will automatically be trusted. We have particularly seen this at the Innovation Hub with various RegTech and SupTech companies that do not provide financial services themselves, but want to bring technological solutions to the market that would help financial companies cope with legislation and supervisory issues. The financial sector is heavily regulated and final responsibility for the quality of the service is borne by the service provider, and so companies working in the sector are quite cautious about using technology provided by other parties. Finantsinspektsioon has for its own part encouraged market participants to introduce innovative risk control solutions, and the website of the Innovation Hub has a specially written guideline for this that describes the options and approaches of Finantsinspektsioon in applying such solutions.

**8. FinTech is an intriguing topic.** The work of the Innovation Hub has shown clearly that society expects public sector institutions to be more active in dealing with FinTech, taking positions on it, and announcing those positions. The Innovation Hub has been contacted during its first year by international organisations, academics and ordinary citizens who are looking for answers to questions about FinTech in supervisory matters and more broadly. There has been interest in the Innovation Hub itself, in the development of FinTech in Estonia, and in the need for possible legislation in future. As there are few institutions in the public sector that focus on financial innovation, even though the development in the area is storming ahead, we have found ourselves increasingly taking on the role of an information centre. Supervisory institutions play a valuable role in a sector like FinTech that is rapidly developing but mostly not very precisely regulated, as they can direct the attention of consumers and investors to risks that are arising within the sector.

## FEEDBACK

**The Innovation Hub is always open to receiving feedback from market participants so that it can function more efficiently and get better and better. To this end we monitor satisfaction with the services provided by the Innovation Hub by communicating directly with market participants and regularly asking for feedback from businesses and law offices that have contacted us to present their innovative business models and clarify the legislative framework that applies to them.**

We are proud to note that the opinions that market participants have given us have appreciated the initiative of setting up the Innovation Hub and the opportunity to work together with financial supervisors from the earliest phase of a business model. Businesses consider the opinion of the supervisory authority to be important when they are defining their business activities, and they have a high opinion of the skills of Finantsinspektsioon in financial innovation. The Innovation Hub has been praised for how quickly it responds to enquiries and applications for clarifications, and for its openness and cooperation in questions about legal acts. The Innovation Hub is increasingly being contacted by companies that have been recommended to get in touch with us by other market participants who have had a positive experience of working with the Hub.

## Some feedback from market participants:

“It is very good to see that the state structure is making an effort and supporting businesses with their questions and with answering them. It is vitally necessary for businesses and the state to be able to operate together and support each other so that Estonia can be able to develop new technologies. The open and cooperative communication and the expertise of Finantsinspeksioon on the subject matter were excellent”.

“Thank you so much for the speedy response and for helping us find our way through the legal maze. We appreciate it very much and are now much more convinced that Estonia is just the right place for our business”.

“It is a very good thing that the Innovation Hub has been set up and that it has found the resources to work together with businesses”.

“Being able to work together with the Innovation Hub has been a good thing. The statements and opinions of the Hub are very important for giving us confidence to operate”.

“I want to thank you sincerely for all of the attention that you have given us. In our own country we are not at all used to having such careful, quick and effective attention and support for the concerns of business”.



