REGULATING FINTECHS: DEFENCE VS. OFFENCE

"Policymakers must have the humility to accept that the nature and pace of change and innovation is such that one's assessment of where we might stand years into the future may be outdated within weeks."

Andrew Bailey, Governor of the Bank of England, 30 July 2024

Regulator- and policymaker-bashing is, let's face it, like shooting fish in a barrel. Glacial, toothless, fragmented, arbitrary, bureaucratic, overreaching and out-dated are just some of the grenades it is easy to lob into an attack.

And for fintechs, the current regulatory landscape presents a Hobson's choice - either operate within frameworks designed for traditional banks or exit the market entirely, stifling innovation.

But consider the twin goals of the oversight system - **stability**, **safety** and **protection**, while also driving **growth**, **innovation** and a **better deal for the consumer**. Almost contradictory goals for a regulator if the incumbents aren't embracing innovation and doing a better job for the customer, but the new kids on the block aren't tried and tested - how to ensure safety and promote change?

PRAISE WHERE PRAISE IS DUE & A CALL FOR INNOVATION

The goal of this article is to explore and acknowledge the progress made in welcoming new technologies into the financial system, while also highlighting missteps that may prove Bank of England governor Andrew Bailey's 2024 quote prescient. Fostering innovation and driving competition across financial services can only be achieved if policymakers themselves embrace innovation and technology.

As well as giving praise where praise is due - and much progress has been made - it is important to call out a couple of recent critical missteps. The restrictive nature of ECB Decision (EU) 2025/222 springs to mind, with its obvious contradictions.

And rather than just leave the criticisms hanging, a sensible to-do list of how and where to overcome roadblocks is needed. Tempered, of course, by a recognition of the time- and budgetary-constraints policymakers face on a daily basis.

Regulators are literally swamped with applications and new entities. They need new technology to manage this load effectively and efficiently - and this technology is available.

Instead of simply piling straight into the regulators, an understanding of the challenges they face is useful. To do this fairly, it is worth spending two minutes understanding how we got here, because it does rather flesh out the seemingly contradictory challenge that policymakers face. Then it is worth comparing what is going right, where mistakes are being made and where next steps should take us.

LEGACY COMPLEXITY - A HERCULEAN TASK?

What is the purpose, the raison d'etre of a regulator or a central bank? **(Price) stability** and **smooth functioning of markets**, **safety** and **soundness** will always come pretty near the top of any mission statement. **Consumer protection** is also - and rightly so - a key tenet of any regulatory agenda and this facet of policymaking is far more prominent these days than pre-GFC. Supporting **competitiveness** and promoting **innovation** are also widely cited as operational or supervisory goals or duties.

The Federal Reserve System is the central bank of the United States. It performs five general functions to promote the effective operation of the U.S. economy and, more generally, the public interest.

- conducts the nation's monetary policy to promote maximum employment, stable prices, and moderate long-term interest rates in the U.S. economy;
- promotes the stability of the financial system and seeks to minimize and contain systemic risks through active monitoring and engagement in the U.S. and abroad;
- promotes the safety and soundness of individual financial institutions and monitors their impact on the financial system as a whole;
- **fosters payment and settlement system safety and efficiency** through services to the banking industry and the U.S. government that facilitate U.S.-dollar transactions and payments;
- promotes consumer protection and **community development** through consumer-focused supervision and examination, research and analysis of emerging consumer issues and trends, community economic development activities, and the administration of consumer laws and regulations.

Source: *Federal Reserve System*

In the US, the complex web of federal and state agencies overseeing distinct areas sums up the challenge, with the Fed at the heart. As financial markets and products have expanded and innovation and change driven growth, it is no real wonder that there are so many seats (and acronyms and initialisms!) at the table.

Think: the Office of the Comptroller of the Currency **(OCC)**; Federal Deposit Insurance Corporation **(FDIC)**; Securities and Exchange Commission **(SEC)**; Commodity Futures Trading Commission **(CFTC)**; Consumer Financial Protection Bureau **(CFPB)**; Financial Industry Regulatory Authority **(FINRA)**, not to mention state regulator.

THE ECB'S COMPLEX CHALLENGE

While the nexus of players in the US financial system may seem daunting, the challenge for the ECB and the EU as a whole is still more complex with 20 different countries using the euro (across nearly as many different languages) and 30 countries within the European Economic Area.

Objectives of the European Central Bank

The Eurosystem is responsible for:

- defining and implementing monetary policy
- conducting foreign exchange operations
- holding and managing the euro area's foreign currency reserves
- **promoting the smooth operation of payment systems**

The ECB carries out specific tasks in the areas of banking supervision, banknotes, statistics, macroprudential policy and financial stability as well as international and European cooperation.

Source: *European Central Bank*

And regulating such a disparate cultural and geographic area has led to the use of two key terms in EU law: "directives" and "regulations." These are equally important tools to shape the future of the financial system, but they work in slightly different ways, and the differences are important for fintechs and financials. For payments in particular, Directives have paved the way for significant innovation and must be updated to bring fintechs more fully and fairly into the fold.

PRIME DIRECTIVE - MORE FINTECH INCLUSION

Directives are effectively guidelines that the EU gives to its member countries. When the EU issues a directive, it tells each country what the end goal or result should be and it leaves the specific details of how to achieve that goal up to each country's own laws and government. So, member countries have some flexibility in implementing these rules, as long as they achieve the intended outcome.

On the other hand, regulations are more like strict, one-size-fits-all rules. When the EU passes a regulation, it becomes the law in every member country, and each country has to apply it exactly as written. There is less room for individual interpretation or adjustment, critical in today's fast moving and constantly evolving world..

One of the main advantages of the directive is that the European legislator does not have to think about every single payment institution that may be affected by the new text. Each country can adapt the legislation to its own specific payment landscape. This sharing and spreading of responsibility and oversight is key to successful oversight of innovation. On the flip side, the lack of standardisation of the rules on the day-to-day retail payments scope can be challenging, especially for smaller fintechs and payments companies, as well as increasing the flow of traffic into policymakers' intrays.

THE PRAISE: A DECADE OF PROGRESS

Over the past decade, the European Central Bank (ECB), alongside the European Commission and other EU institutions and central banks, have managed to deliver sweeping reforms that have earned plaudits from both policymakers and private industry, notably via the evolution of the Payment Services Directives (PSD1, PSD2, and now PSD3).

These legislative frameworks represent a laudable push towards **transparency**, **interoperability**, and **fairness** in the financial sector. They've challenged entrenched incumbents, empowered consumers, and created a burgeoning fintech ecosystem in Europe that is the envy of many other regions. At the centre of this success has been a key innovation: **the recognition and legitimization of Electronic Money Institutions (EMIs)** and **Payment Institutions (PIs)**.

The first Payment Services Directive (PSD1), launched in 2007, laid the groundwork for a unified payments market. PSD2, adopted in 2015, cracked open the monopoly banks had on customer data, ushering in open banking and a wave of innovation. And PSD3, now underway, continues to push boundaries on security, access, and digital identity.

Crucially, PSD2 and PSD3 recognize non-bank financial institutions—not as fringe actors or disruptors but as integral parts of the financial ecosystem. EMIs and PIs are licensed, regulated, and scrutinized. They operate under stringent safeguarding requirements, consumer protection obligations, and AML/CFT standards.

This recognition has enabled the rise of some of Europe's most important fintech players—companies that provide everything from multicurrency wallets and remittances to real-time business payments and embedded finance. It has also driven investment, created jobs, and provided alternatives to bank-dominated financial services.

In short: The ECB and EU institutions built a solid foundation. And they deserve credit for doing so. But if - as clearly stated - the ECB wants a competitive, innovative financial ecosystem, something has to give.

Support for innovation, digitalisation and a European payments ecosystem

The PSD2 has provided the foundations for opening up the banking system and fuelling the development of innovative payment services by fintech companies. The Eurosystem's retail payments strategy supports efficiency and innovation by promoting competition and a level playing field, taking into account the important role European fintech companies play in offering state-of-the-art services to European end users in the form of modern technologies that provide automated and improved

[14] "ECB to explore cross-currency instant payments", *MIP News*, ECB, 6 October 2020.

Source: *European Central Bank, "The Eurosystem's retail payments strategy - priorities for 2024 and beyond", 2023*

So just as the stage seemed set for a fully modern, inclusive, and competitive payments landscape, the ECB appears to have taken a step back—issuing guidance that seems not only at odds with the spirit of the PSDs but dangerously disconnected from the technological and market realities of 2025.

THE PROBLEM: A CRITICAL MIS-STEP

4. Conclusion

In summary, the NBPSPs key concerns outline above are:

- The Eurosystem Policy rightfully seeks to safeguard the safety and soundness of the financial system. It concluded that extending safeguarding facilities to EMIs and PIs risked compromising this objective. **We urge the Eurosystem to consider a calibrated approach allowing some safeguarding to take place, applying suitable restrictions, in a similar manner to that utilised for the digital euro.** This could provide benefits for the payment system and its users.
- Excluding safeguarded status for settlement funds has the potential to make **direct participation in SEPA, a future digital Euro, and other designated payment systems, economically unworkable**.
- EMIs and PIs, currently benefiting from safeguarding and payment processing services offered by the Bank of Lithuania, will need significantly more time to find alternative services. **9 months is not a realistic timeframe for finding service providers, contracting, integrating, testing and going live. We suggest 18-24 months as a minimum.**

Source: *Joint Letter - ECB Policy Statement on non-bank PSP access, 2024*

The above joint industry letter to the ECB expressed concerns at this policy and made a few sensible suggestions about a middle ground:

- A calibrated approach - allow some safeguarding with suitable restrictions
- Extend the timeframes applied to find service providers
- Restrict the % of safeguarded funds that can be held with central banks

A BACKWARDS STEP IN THE NAME OF PRUDENCE

So, just as the infrastructure has begun to support a truly competitive and modern system, the ECB's guidance was somewhat baffling. Advising national central banks not to allow EMIs and PIs to hold safeguarding accounts directly with the central bank, and not to allow these institutions direct access to SEPA, is clearly a step in the wrong direction.

It feels like the regulatory equivalent of teaching someone to drive, handing them a car, and then refusing them access to the highway.

The ECB's rationale? That allowing non-bank institutions to access central bank accounts or core payment systems like SEPA might **blur the lines between banks and non-banks**. Also, concerns about **supervisory burden, operational risk**, and whether **central banks are equipped to monitor EMIs and PIs at scale.**

TECHNOLOGY TO THE RESCUE?

Certainly, the additional workload from a myriad of new fintechs cannot be ignored. But isn't that what technology is for? To manage risk and oversight more effectively and efficiently as the workload grows. Technology and software is now available - not only for the functioning of EMIs - but also for the oversight and supervision of them.

As for blurring the lines, this feels more of a red herring. EMI status is clearly defined as a regulated financial licence - Electronic Money Directive/EMD2 (Directive 2009/110/EC and Payment Services Directive/PSD2(Directive (EU) 2015/2366).

This allows companies to issue electronic money and provide specified payment services, and disclosure requirements including safeguarding methods (segregated account, insurance); or AML compliance and charges are very clear.

THE IRONY IS NOT LOST....

As the ECB and domestic regulators will be only too aware, the checkered past of the incumbent banking system does raise eyebrows about how prudently the system has been overseen. The world's oldest bank, Monte Paschi, needed several major capital raises and two state bailouts in the past 15 years to survive, with the oversight discretion firmly handed to the Bank of Italy.

The memory of UBS's 'rescue' of Credit Suisse and Santander's 'rescue' of Banco Popular are still fresh in the market's memory, with many many unhappy investors questioning the application of the rules. NatWest's full exit from government ownership is only weeks old, a stark reminder of the failures of the past. But clearly, handing discretion to individual countries to manage the resolution of financial institutions' problems has been a critical component of the ECB and regulatory playbook.

WHY THE ECB'S POSITION ON DEPOSIT ACCESS AND SEPA IS FLAWED

CONTRADICTS LOGIC AND LANGUAGE OF PSD2 AND PSD3

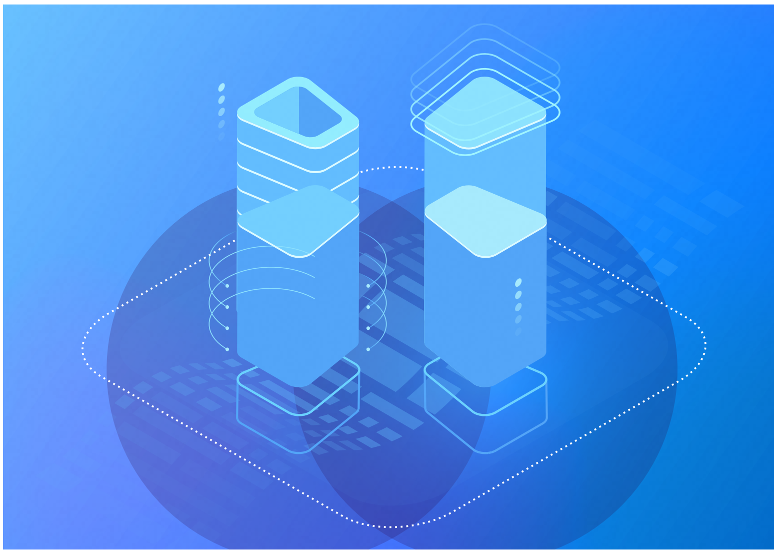
The entire PSD project is premised on competition. The idea is that banks should no longer be gatekeepers to payments. If that's true in theory, why allow them to continue in practice?

Preventing EMIs and PIs from accessing SEPA directly forces them to rely on sponsor banks - the very institutions they were meant to compete with - which not only creates a dependency but reinforces market concentration, as sponsor banks can (and often do) de-risk or delay onboarding their competitors. And now (apologies in advance for the alphabet spaghetti that briefly follows) for the dry - but vitally important bit.

Under Article 10(1)(a) of Directive (EU) 2015/2366 (PSD2), NB-PSPs (non-banks payment service providers) are entitled to safeguard their clients' funds, either with a credit institution or, **at the discretion of the relevant authority**, with a central bank. A similar provision exists under Regulation (EU) 2023/1114 (MiCA) for crypto-asset service providers (CASPs). The legislative instruments intentionally enable safeguarding at central banks, recognizing the systemic safety and neutrality that such institutions offer.

ECB Decision (EU) 2025/222, however, exercises this discretion not as a regulatory filter but as an outright ban. Article 3(1) of the decision **categorically prohibits Eurosystem central banks from offering safeguarding accounts** to NB-PSPs and CASPs.

This prohibition transforms a legally permitted option into a systemic exclusion.



HINDERS, NOT HELPS FINANCIAL STABILITY

Currently, EMIs are basically forced to safeguard customer funds in commercial banks. These banks are subject to counterparty risk, potentially unstable balance sheets (think Silicon Valley Bank), and opaque business models. Central banks, by contrast, offer the safest place to hold customer funds.

In a 2022 report, the World Bank noted that "placing safeguarded funds at the central bank is the gold standard for customer protection." Why deny that to EMIs, especially when - as noted above - the last couple of decades have shown how much damage legacy incumbent banks can wreak?

CREATES UNFAIR COSTS AND COSTS THE CUSTOMER DEAR

EMIs must pay fees to intermediary banks, maintain redundant infrastructure, and deal with service interruptions and account closures. These costs get passed on to consumers and reduce the competitiveness of non-bank providers. We know this from many sources.

Recall that back in 2017, British newspaper The Guardian published an expose suggesting that senior executives of Banco Santander had, in January of that year, been warned by the bank's innovation director that a large chunk of its profits were at risk.

Why? Because the fat margins it was earning on money transfers could potentially be destroyed by new competitors. To prove just how juicy these margins really were, the newspaper cited leaked documents revealing that Santander made €585m from money transfers – equal to nearly a tenth of its 2016 global profit of €6.2bn – and that it charged six times as much as rival TransferWise for sending £10,000 from the UK to Spain.

See the author's feb 2024 piece on now defunct Zing - published by the Payments Association to further explore this.

Back then, the FX margin generated about half of the total money transfer revenues, and nearly double the standard, advertised fees, with its 'correspondent banking' fees boosting profitability still further.

Let's face it - the banks have been overcharging consumers for shoddy cross-border payments services for years already. Consumer protection and competition is a critical goal of all consumer financial regulation and ECB Decision (EU) 2025/222 flies in the face of this.

WHAT NEXT?

As the multi-year credit boom and financial cycle turns - which it is already beginning to do - consumer protection and value for the consumer has to remain atop the policymakers' agenda. The ECB cannot police and monitor everything - even with the introduction of world leading technology - nor should it.

However, as we have seen in countless examples across the banking and financial world over the past few decades, local regulators and overseers have to have the discretion - with appropriate oversight - to prevent disasters and maximise the welfare of the customer - retail and SME and corporate alike.

So in conclusion, if this were a school report for the ECB, for example, it could read a little like

> *"Well done for much good work and progress so far. Further success will require delegation and trust in your fellow students (CBs, local regulators), collaboration, open-mindedness and willingness to embrace technology and new ways of thinking."*

JONATHAN TYCE | DIRECTOR, KENAZ LTD | *jonathantyce@kenaz.uk*

Jonathan Tyce started working in financial services in 1995 and throughout his career has focused solely on the financials space. From launching and running a pan-European financials hedge fund at JO Hambro Capital Management to 12 years helping build out Bloomberg Intelligence (based in U.K. and Hong Kong) and he is running financials research, including payments, his breadth of experience and industry contacts offer a unique mix. Having left the City in May 2023, he now works for himself, having founded Kenaz, a payments consultancy, and TriggerPoint Research, a contributor to the largest alpha capture programs globally. He graduated from St. Anne's College, Oxford University in 1995.