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London, June 15<sup>th</sup> 2017

## **FinTech: A more competitive and innovative European financial sector**

Dear Sirs,

IHS Markit welcomes and is pleased to respond to the European Commission (**EC**) Consultation Document – *FinTech: A more competitive and innovative European financial sector*.

IHS Markit (Nasdaq: INFO) is a world leader in critical information, analytics and solutions for the major industries and markets that drive economies worldwide.<sup>1</sup> The company delivers next-generation information, analytics and solutions to customers in business, finance and government, improving their operational efficiency and providing deep insights that lead to well-informed, confident decisions. IHS Markit has more than 50,000 key business and government customers, including 85 percent of the Fortune Global 500 and the world's leading financial institutions. Headquartered in London, IHS Markit is committed to sustainable, profitable growth.

### **Introduction**

IHS Markit is a leading provider of RegTech and FinTech solutions. Our RegTech services facilitate firms' compliance with regulatory requirements and reduce the related costs and risks, lowering barriers to entry and fostering competition in the market place. Many of these services work by sharing the burden of the solution among the users, enabling firms to adopt higher quality, flexible but standardised approaches to regulatory requirements, without the costs of building entire systems themselves. This also benefits supervisors as they can have confidence in high standards and consistency while not having to assess and monitor different approaches for each firm they supervise. We have also made successful forays into Distributed Ledger Technology (DLT) with proof of concept projects.

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<sup>1</sup>See [www.ihsmarkit.com](http://www.ihsmarkit.com) for more details

Our FinTech services include robo-guidance utilities and software solutions that improve operational efficiency by streamlining processes across the enterprise. Our Markit Digital services support investment managers, wealth managers, and brokers in creating solutions to facilitate their clients' investment decisions. We believe Markit Digital is one of the world's largest employers of web designers focused solely on the presentation of financial information and workflows. During a typical week, our services support more than 2.3 billion page views of dynamic content and more than 2.5 million unique users log into the pages we host.

We strongly support the European Commission's objective to encourage FinTech and RegTech in the European Union and, in the context of this Consultation Paper, think they should focus on:

- i. Ensuring that the regulatory framework and supervisory approaches are clear and consistent in how FinTech and RegTech solutions can be adopted, including endorsing solutions and standards where appropriate;
- ii. Tackling the regulatory obstacles, real and perceived, around data protection laws and data localisation that are inhibiting the use of take up technological solutions, particularly in Cloud Computing and DLT; and
- iii. Review the current and incoming regulatory framework for requirements that could be a break on the adoption of FinTech. This includes disproportionate requirements that limit the ability and appetite of firm to look for innovative approaches

## Comments

### ***1.1. What type of FinTech applications do you use, how often and why? In which area of financial services would you like to see more FinTech solutions and why?***

IHS Markit is a leading provider of FinTech solutions to the financial sector, including market participants, Central Banks, regulators and auditors. IHS Markit's FinTech (including RegTech) applications can be broadly classified into the following categories:

#### **a. Analytics**

IHS Markit provides a range of data and analytical solutions to the financial sector. For example, IHS Markit has developed a tool to assist the management of bank capital calculations under the Fundamental Review of the Trading Book (FRTB).<sup>2</sup> The solution has the ability to handle both internal and standardised model based approaches by leveraging a modular and versatile framework combining a powerful calculation engine with a sophisticated data management framework.

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<sup>2</sup> [www.markit.com/Product/FRTB-Solution-Suite](http://www.markit.com/Product/FRTB-Solution-Suite). Also see the final text of the FRTB framework - [www.bis.org/bcbs/publ/d352.htm](http://www.bis.org/bcbs/publ/d352.htm)

## **b. Shared solutions**

IHS Markit is a leading provider of solutions that centralise operational functions with economies of scale and standardisation of processes which ultimately translate into cost savings for participants. IHS Markit's suite of shared solutions includes:

- i. The Know Your Customer (KYC) and Know Your Third Party<sup>3</sup> (KY3P) platforms which assist in compliance with KYC/AML and critical outsourcing requirements;
- ii. IHS Markit's derivatives processing platform<sup>4</sup> that provides electronic confirmation, regulatory reporting services and connectivity to clearing houses and trade repositories globally; and
- iii. IHS Markit's Outreach 360 platform<sup>5</sup> that provides standardised and auditable outreach for regulatory, due diligence and data gathering purposes.

## **c. Software Solutions**

IHS Markit provides a host of scalable software solutions that helps firms streamline operations. These serve as a solid foundation for risk management and regulatory compliance and include:

- i. IHS Markit's Enterprise Data Management (EDM)<sup>6</sup> allows firms to validate data from different sources, check completeness and manage exceptions to facilitate compliance with various regulatory requirements;
- ii. IHS Markit Digital<sup>7</sup> is a leading provider of software for interpreting, manipulating and displaying financial information as well as robo-guidance and advice; and
- iii. IHS Markit thinkFolio<sup>8</sup> is a cross-asset-class order and portfolio management system.

### ***1.2 Is there evidence that automated financial advice reaches more consumers, firms, investors in the different areas of financial services (investment services, insurance, etc.) and at what pace? Are these services better adapted to user needs? Please explain.***

An unintended consequence of regulation designed to protect investors by addressing issues of conflict of interest in the funding models of financial advice was that investors with relatively small amounts to invest found it more difficult to access meaningful financial guidance or advice. Although fully automated financial advice is still some time away, innovation has opened avenues (particularly around robo-guidance) that we believe to be of great benefit to smaller investors and automation has provided efficiencies for larger operations.

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<sup>3</sup> See [www.KYC.com](http://www.KYC.com) and [www.markit.com/product/ky3p](http://www.markit.com/product/ky3p) for more details

<sup>4</sup> See [www.markit.com/product/markitserv](http://www.markit.com/product/markitserv) for more details.

<sup>5</sup> See [www.markit.com/Product/Outreach360](http://www.markit.com/Product/Outreach360) for more details

<sup>6</sup> See [www.markit.com/Product/EDM](http://www.markit.com/Product/EDM) for more details.

<sup>7</sup> See [www.markit.com/Product/Markit-Digital](http://www.markit.com/Product/Markit-Digital) for more details.

<sup>8</sup> See [www.markit.com/Product/ThinkFolio](http://www.markit.com/Product/ThinkFolio) for more details.

In adapting these systems to the needs of the user, it is important that such automated services are provided in a manner suited to the expertise and education of the intended users and that it is clear where potential deficiencies in such solutions can occur.

***1.11 Can you please provide further examples of other technological applications that improve access to existing specific financial services or offer new services and of the related challenges? Are there combinations of existing and new technologies that you consider particularly innovative?***

There is a large community of people who are keen to take control of their financial situation but lack the appropriate level of knowledge to make sound decisions, often letting emotion drive their activity or uncertainty keeping from investing. Technologies that can provide information around investments tailored to the objectives and expertise of such users potentially provides huge benefits to this community.

Personalisation and visualisation techniques and technology are increasingly effective at providing information on relevant and important elements of investments from the large amount of information and data available. The ability of these tools to go beyond basic reporting to highlight and contrast key factors such as investment costs and performance is an invaluable aspect. IHS Markit is a leading provider of solutions to enable financial organizations to effectively communicate to clients ranging from sophisticated professionals to retail investors with little knowledge of finance. IHS Markit provides tools that present information in the most appropriate form for the viewer, using our personalisation and visualization technology to educate and provide useful context.

***2.1 What are the most promising use cases of FinTech to reduce costs and improve processes at your company? Does this involve collaboration with other market players?***

IHS Markit has been at the forefront of the development of Distributed Ledger Technology (DLT). We are members of the US Chamber of Digital Commerce, are represented on the CFTC Technology Advisory Committee and have invested significant resources – in collaboration with other market players – on DLT initiatives.

IHS Markit believes that DLT has the potential to transform global securities and capital markets. The first effects are likely to be felt in the back office, with a number of processes set to benefit from the efficiencies of DLT in the next 2 to 3 years. IHS Markit has invested in the future of DLT and is working on a number of different applications of DLT, focusing on practical applications where we believe significant benefits will accrue:

- i. **Smart Contracts** – an IHS Markit initiative building contract programs and protocols that autonomously maintain agreements and post-trade events. These protocols change the nature of those agreements throughout the contract lifecycle. Our application is currently focused on OTC Derivatives in Credit, Equity, FX and Rates with the potential to expand into other products;
- ii. **Entity Data** – this DLT initiative addresses a need for capital market participants to meet obligations around entity data. IHS Markit is exploring how to integrate KYC and identity management into DLT networks; and
- iii. **Reference Data** - this initiative addresses the need for consistent standards on the securities that are exchanged between parties. We are exploring how to integrate industry-accepted identifiers and contract standards into DLT networks.

**2.2 What measures (if any) should be taken at EU level to facilitate the development and implementation of the most promising use cases? How can the EU play its role in developing the infrastructure underpinning FinTech innovation for the public good in Europe, be it through cloud computing infrastructure, distributed ledger technology, social media, mobile or security technology?**

We agree with the prevailing view among regulators that it is not appropriate to regulate DLT during these early stages of its development and application.<sup>9</sup> However, there is scope for European policy makers to clarify areas which would help underpin the successful implementation of DLT. We explore a few of these below:

- i. **Definition of Digital Assets** – a working legal definition of digital assets does not exist in EU law. Without a standard accepted definition, it remains ambiguous how digital assets would embody counterparty obligations, facilitate individual transfers of title and constitute ownership in the court of law. Furthermore, many of the DLT proofs-of-concept will be unable to scale to production-grade systems without a definition that clarifies these uncertainties. We consider digital assets to be those items whose value and scarcity is held in a natively digital format (i.e. not warehoused or maintained by a single trusted party in any physical format);
- ii. **Cross border coordination** – In the absence of a legal framework for DLT in the EU, it is imperative to have a framework for cross-border coordination between industry participants and regulators. DLT networks are likely to be supranational and their success will depend on cross border coordination. We would urge regulators globally to cooperate on the development of DLT networks and standards; and
- iii. **Supervisory approach** – we would encourage regulators to clarify where and when DLT systems are acceptable in order to ensure clarity and consistency when firms adopt DLT solutions. This could include endorsement of specific DLT solutions or clear acceptance that DLT solutions can be adopted for specific activities.

**2.4. What are the most promising use cases of technologies for compliance purposes (RegTech)? What are the challenges and what (if any) are the measures that could be taken at EU level to facilitate their development and implementation?**

We believe that RegTech solutions have the potential to help break the so called regulatory cycle. As has been well described,<sup>10</sup> regulatory cycles start with a phase of under regulation leading to a build-up of risks in the economy which can crystallise in the form of a crisis. The natural policy response is then to over-regulate activities for risks that have already crystallised. This results in compliance and other regulatory costs that are a drag on business and ultimately the economy. Eventually, as memories of a crisis recede and tolerance of high compliance burdens reduces, pressure leads to a lifting of regulation and this can return us to the first phase of under regulation and risk build up.

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<sup>9</sup> For example ESMA DP on DLT - [www.esma.europa.eu/sites/default/files/library/2016-773\\_dp\\_dlt.pdf](http://www.esma.europa.eu/sites/default/files/library/2016-773_dp_dlt.pdf)

<sup>10</sup> For example by the then acting CEO of the FCA in [www.fca.org.uk/news/speeches/rapidity-change](http://www.fca.org.uk/news/speeches/rapidity-change)

RegTech solutions potentially provide a different route. They can help regulators maintain high regulatory standards while lowering and sharing the cost of compliance. Many RegTech solutions are shared services which help centralise operational functions that may have been previously duplicated in different divisions, locations or firms. This reduces burden without lowering standards. The participants in service all meet the same requirements, so there is nothing to be gained by trying to undercut each other. Regulators can cooperate with the participants in the design and potentially endorsement of services, which should maintain high standards. Such services can encompass a wide range of activities across including Finance, Operations, IT, Risk or Human Resources and tasks including reconciliations, settlements or clearing.

IHS Markit provides a number of these types of services to our clients but one example is IHS Markit's KYC platform, KYC.com. KYC and Anti Money Laundering (AML) requirements have boosted compliance costs and potential liabilities for banks, sometimes to the extent that they might not be willing to transact with certain types of counterparties (increasing costs or denying these clients access to financial services).<sup>11</sup> KYC.com provides market participants with standardised and repeatable processes designed to facilitate client on boarding. Twelve of the largest global banks are signed up for the service and more than 2,200 buy-side and corporate clients are on the platform. By removing the need for firms to perform duplicative, ad-hoc processes, our service has significantly lowered compliance costs incurred by individual firms and their clients allowing them to easily establish new counterparty relationships in a timely fashion while avoiding a race to the bottom compliance competition. This scalable service also fosters competition by reducing barriers to entry for new entrants that would otherwise need to develop their KYC/AML processes from scratch.

RegTech providers face significant challenges when providing regulatory compliance solutions to the industry. We have highlighted a few of them below:

- i. **Data privacy and data sharing** – RegTech providers receive, transmit and store non-public personal information (NPPI) while discharging their services. Data-privacy laws and data localisation provide significant challenges to RegTech firms and may discourage firms from using RegTech providers. The EU should enact policies that provide a safe harbour or a protocol for the handling of NPPI for qualified RegTech providers;
- ii. **Supervisory expectations in relation to material outsourcing and standards** – classification of RegTech as material outsourcing can result in significant additional compliance burden and costs for the provider of the service. The EU should ensure that supervisory expectations in relation to material outsourcing arrangements are clear, proportionate and consistent;
- iii. **Clarity around RegTech solutions** – firms looking to adopt RegTech solutions are often uncertain as to whether the solutions offered by providers are acceptable to supervisors. We would encourage regulators to clarify where RegTech solutions are acceptable. As with DLT, this could include endorsement of specific solutions or clear acceptance that RegTech solutions can be adopted for specific activities; and

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<sup>11</sup> See, for example, [www.fiercefinanceit.com/story/deutsche-bank-stops-onboarding-new-clients-high-risk-areas-pending-kycrevi/2015-12-01](http://www.fiercefinanceit.com/story/deutsche-bank-stops-onboarding-new-clients-high-risk-areas-pending-kycrevi/2015-12-01)

- iv. **Adoption of RegTech by third parties** – our experience as a RegTech provider is that third party firms are slow to adopt RegTech solutions. For example, the broader adoption of KYC utilities has not materialised as banks' clients are not sufficiently incentivised to support such centralised solutions. Regulators should help ensure that financial services firms are able to insist their clients use RegTech solutions before they can access services.

We believe that the EU can play a role in establishing a framework that is conducive for innovation in the RegTech space by addressing these issues. It would also help to ensure adequate dialogue between RegTech providers and regulators to improve understanding of the issues facing providers. This could include a communication channel or Industry forum, possibly within DG Connect.

### **2.5. What are the regulatory or supervisory obstacles preventing financial services firms from using cloud computing services? Does this warrant measures at EU level?**

The most restrictive regulatory obstacles preventing financial services firms from using cloud computing services are the various data localisation restrictions in Member States within the European Union. By definition public clouds are multi-tenanted data infrastructures which segregate data virtually for each user and hence subjecting these clouds to data localisation restrictions works against the principle reason for using them.

We agree with the observations recently noted by the European Commission in its European Data Economy paper,<sup>12</sup> which noted observations made by the Scale Up Europe manifesto that:

*"Enforced data localisation will mean higher costs for the cloud-driven services upon which so many startups rely... it will add further uncertainty and immensely greater regulatory burden on fast growing enterprises ... localised data is not necessarily safer data".<sup>13</sup>*

The complexity of data law pushes market participants to behave prudently and localise data even where local laws do not specifically require it, as acknowledged by the European Commission in its recent European Data Economy paper.<sup>14</sup> Unless the European Commission acts to ensure that localisation rules are not disproportionate and not applied for protectionist reasons unrelated to data security, the European Union will not to enjoy the advantages that the scale of its markets should bring.

### **2.7. Which DLT applications are likely to offer practical and readily applicable opportunities to enhance access to finance for enterprises, notably SMEs?**

We believe that DLT can warehouse and execute bilateral contracts and assets in a more efficient way that requires less specialisation and less centralised risk than our current financial network. This would help avoid the high costs financial infrastructure that can add significant costs for smaller entities.

However, we believe that one of the biggest challenges holding back investment in SMEs is the high comparative costs of due diligence on target companies and the KYC/AML processes. As due diligence costs are broadly the same regardless of the

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<sup>12</sup> [http://ec.europa.eu/newsroom/dae/document.cfm?doc\\_id=41247](http://ec.europa.eu/newsroom/dae/document.cfm?doc_id=41247) - Page 8

<sup>13</sup> [http://scaleupeuropemanifesto.eu/pdf/Scale\\_Up\\_Europe\\_Brochure.pdf](http://scaleupeuropemanifesto.eu/pdf/Scale_Up_Europe_Brochure.pdf) - Page 10

<sup>14</sup> [http://ec.europa.eu/newsroom/dae/document.cfm?doc\\_id=41247](http://ec.europa.eu/newsroom/dae/document.cfm?doc_id=41247) - Page 8

size of the investment, these costs become a significant burden on anyone making investments in comparatively small companies. If the European Commission is looking to make it easier for SMEs to access finance and increase financial flows to SMEs, it should look at ways to ease these burdens, perhaps through greater standardisation and automation.

**2.8. What are the main challenges for the implementation of DLT solutions (e.g. technological challenges, data standardisation and interoperability of DLT systems)?**

Please see our answer to 2.2

**2.9. What are the main regulatory or supervisory obstacles (stemming from EU regulation or national laws) to the deployment of DLT solutions (and the use of smart contracts) in the financial sector?**

Please see our answer to 2.2

**3.4. Should the EU introduce new licensing categories for FinTech activities with harmonised and proportionate regulatory and supervisory requirements, including passporting of such activities across the EU Single Market? If yes, please specify in which specific areas you think this should happen and what role the ESAs should play in this. For instance, should the ESAs play a role in pan-EU registration and supervision of FinTech firms?**

We believe that there is a healthy proliferation of activities and innovations within the FinTech space and as such any regulatory authority would find it difficult to create categories of FinTech and establish licensing frameworks for them. Furthermore, licensing regimes can create a barrier to entry for innovative FinTech firms. However, licensing or supervisory endorsement around specific problem areas, such as for the treatment of personal data, might be helpful.

**3.7. Are the three principles of technological neutrality, proportionality and integrity appropriate to guide the regulatory approach to the FinTech activities?**

We broadly support the three principles enumerated by the Commission to guide the regulatory approach to the FinTech activities. Technological neutrality is important as we are concerned that focus can be more on the technology and not on the application. The interest in DLT is an example where, we believe, too much focus has been on the technology and not enough on practical circumstances for which it might operate effectively.

We also think the focus on proportionality is important and the Commission should consider the potential impact on innovation and FinTech when reviewing or introducing regulatory standards. Certain disproportionate standards can cause regulated firms to conclude that they cannot consider third parties or innovative approaches or question whether they would be permitted in the regulation.

For example, many counterparties in the OTC derivatives markets currently use shared affirmation/confirmation systems that identify and correct any erroneous trades before they are cleared. MIFID2 Article 29(2) (see also RTS26) introduces a regulatory requirement for derivative transactions executed on electronic trading platforms to be submitted and accepted for clearing “as quickly as technologically practicable” following execution. Also known as Straight-Through processing (STP), this requirement aims to reduce risk in the marketplace. However, our experience has



shown that such a requirement with overly demanding standards, very short timeframes and no margin for unusual trades, severely limits the ability for firms to employ services to improve execution quality. It would be relatively straightforward to calibrate such requirements to ensure the regulatory objectives were met but some flexibility existed to enable and encourage innovation or FinTech providers.

Therefore, we urge the Commission to carefully review its existing and upcoming regulation to consider the potential implications for the use of FinTech. It should, where appropriate, make adjustments to ensure that firms are in a position to use third party solutions where they regard them as the most effective and efficient solution to their needs.

***3.13. In which areas could EU or global level standards facilitate the efficiency and interoperability of FinTech solutions? What would be the most effective and competition-friendly approach to develop these standards?***

Agreed standards have not yet emerged for DLT platforms. We believe that a government led process to agree and implement standards would risk hampering competitive forces that can drive adoption.

***4.2. To what extent could DLT solutions provide a reliable tool for financial information storing and sharing? Are there alternative technological solutions?***

DLT provides an alternative for data warehousing that is likely to change the data security paradigm the financial market has developed since the 1980s. By sharing the existence of data across a network, DLT mitigates the incentive to attack one central owner of valuable data and reduces systemic risk around single points of failure.

***4.4. What are the challenges for using DLT with regard to personal data protection and how could they be overcome?***

Data privacy is a serious issue for any kind of financial technology. Advances in cryptography will be important in solving privacy issues across online financial networks and help ensure that DLT, or any technology, will not threaten data protection.

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We hope that our above comments are helpful. We would be more than happy to elaborate or further discuss any of the points addressed above in more detail. If you have any questions, please do not hesitate to contact us.

Yours sincerely,

***David Cook***

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