

Position Paper by the SFA addressed to Authorities

A. Scope of the Position Paper

This position paper represents the feedback obtained from the members of the Swiss Fintech Association (SFA). The SFA members include, in particular, the five holders of fintech licenses as of October 18, 2024, as well as several members currently undergoing the application process with Swiss Financial Market Supervisory Authority (FINMA) or that have decided to suspend their applications. For the purposes of this position paper, these members shall be referred to as "Fintech Companies."

This position paper is confidential and directed solely to the FINMA and the State Secretariat for International Finance (SIF).

B. Key Points from Discussions with Fintech Companies

In the discussions with the Fintech Companies, four major points have emerged:

1. Stick to the original objective, i.e. maintaining a "Banking Light" status under the Banking Act.

We believe that it is crucial to maintain a banking light license with a well-defined pathway toward obtaining a full banking license (Art. 1a Banking Act). It should not be the legislative aim to establish an Electronic Money Institution (EMI) license or a Payment Service Provider (PSP) license for the Swiss local market of 8 million people.

The Swiss fintech license (FinTech License) was established to introduce a "bank light" model into the Swiss legal and regulatory landscape. This allowed fintech companies to adopt bank-like internal structures under the existing Banking Act with existing legal practices and legal certainty, utilizing existing plug-and-play infrastructure and employing staff with Swiss banking know-how; all, except being able to be called a bank. This model should be maintained.

The European EMI license offers benefits like lower capital requirements, a simpler regulatory framework, and access to a larger market (i.e., the EEA and the UK). However, unlike Switzerland's FinTech License, the EMI license imposes severe limitations on financial innovation that can be developed. This limitation has led many financial innovators to move their operations to Switzerland, which provides a more supportive legal and regulatory environment for broader financial innovation and has become a hub for diverse financial ecosystems. A prime example is Crypto Valley in Zug, a hub that would have been difficult, if not impossible, to establish within the EU or UK. In addition, this success is attributable to FINMA's role as a technologically neutral and proactive regulator, being one of the first worldwide to introduce a clear framework for crypto-related activities.

If the Fintech License going forward were to be made equivalent to an EMI license, it could lead to a situation similar to that observed in the UK post-Brexit. Following Brexit, EMIs regulated by the FCA lost their passporting rights, resulting in a significant contraction of their addressable market from 448

million consumers across the European Economic Area (EEA) to 67 million within just the UK. This reduction in market size was accompanied by an increase in operational costs and compliance requirements, particularly due to the need for cross-border regulatory adherence. Additionally, the loss of passporting rights and the regulatory uncertainty resulting from it, created potential trust issues with clients and partners of UK EMIs. Brexit has also had a noticeable impact on the UK as a financial hub, especially in the fintech sector. Consequently, startups and investors have shown a growing preference for establishing operations within EU member states, where they can access the broader European market without the need for multiple licenses.

A "Swiss EMI" license could lead to a similar situation where Switzerland loses its unique competitive edge., compared to the EU, potentially creating a payment institution license offering only access to a limited domestic market of 8 million people. Moreover, the activities of EU PSPs are similar to those that can already be conducted by members of a Swiss Self-Regulatory Organization (SRO). Therefore, there is no need to introduce a new PSP license in Switzerland.

2. Public Deposit Limit of CHF 100 Million creates challenges for Fintech's, their investors and even the Regulator.

The CHF 100 million limit on public deposits was likely intended to promote financial stability and reduce risk. However, in practice, it has created substantial issues that seem to outweigh these benefits. Under the current Banking Act, FINMA has the authority to adjust this cap, but there is limited clarity on how or when adjustments might occur. This uncertainty poses risks for fintechs nearing the limit, as they may need to turn away deposits, which could weaken their market position. Additionally, the cap impacts valuations because investors evaluating a company's growth potential might see the limit as restricting scalability and revenue opportunities.

One advantage of the current regime under Article 1b Banking Act, compared to the European EMI framework, is the provision of a clear pathway for entities to transition to a full banking license (Art. 1a Banking Act).

Article 1b, paragraph 6 Banking Act, states: *"If the threshold of 100 million Swiss Francs is exceeded, this must be reported to FINMA within 10 days, and an application for authorization under Article 1a must be submitted within 90 days."*

This stringent timeline presents significant challenges for both fintechs and FINMA. Fintechs which are rapidly growing, must prepare and file a complex application under strict time constraints. Meanwhile, FINMA faces the task of reviewing and processing such applications within a short timeframe. This urgency can disrupt operations for fintechs and complicate regulatory oversight, making the conversion process more burdensome than necessary.

In light of this, we propose either removing or increasing the CHF 100 million cap on public deposits. Additionally, we recommend that the application and authorization process be triggered at a lower threshold, such as 75% of the limit, to allow proactive compliance and customer management. Furthermore, irrespective of this cap, entities operating under Article 1b Banking Act, that wish to expand their product offerings beyond its scope should have the option to apply for an Article 1a Banking Act license.

3. Ability to Pass Interest to Clients

The Fintech Companies voice that it is unjustifiable that they are prohibited from passing interest to their clients, meaning the ability to allocate all or part of the interest earned from deposits placed with the Swiss National Bank (SNB), the Swiss Euro Clearing Bank (SECB), or in High-Quality Liquid Assets (HQLA) to their clients. This activity is distinct from traditional interest business ("Zinsgeschäft"), which remains reserved for banks classified under Category 5 and lower, as defined in Art. 1a Banking Act.

The risks associated with "Narrow Banking" (risks to financial stability and the significance of banking activities for the real economy) can be mitigated by imposing limits on client deposits.

4. Recommendation: Reclassification as Category 6 Banks

Instead, the Fintech Companies believe it would be beneficial to be classified and treated by law as Category 6 banks, rather than under the designation of "persons" pursuant to Article 1b Banking Act (Fintech License), which can be unclear and is only generally defined in the law.

A comparable initiative is the UK's small bank license regime, introduced under the New Bank Start-Up Unit in 2013, which proved largely effective. This regime has notably enhanced competition and diversity within the UK banking sector. By streamlining the licensing process and lowering capital requirements, the initiative has facilitated the entry of new, smaller banking institutions into the market, thereby broadening the options available to UK consumers and small businesses, particularly in niche banking sectors.

Over the past decade, the number of banking licenses issued has increased significantly, with challenger banks steadily capturing a larger share of the market. In the credit sector, reports indicate that, as of 2021, these smaller institutions collectively surpassed the traditional high-street banks in small business lending. This shift points to a more competitive financial landscape, with over 60 new licenses granted since 2014, many targeting smaller enterprises. By 2023, the market share in lending held by the four major banks decreased from 63% to 41%, underscoring the growing impact of challenger banks on the UK financial sector.

This change would allow for:

- a) Continued regulation under banking law (deemed essential by all Fintech Companies), with the same restrictions as currently applied, including the prohibition of interest difference business, maturity or transformation, and investment banking activities (security brokerage, asset management).
- b) Enhanced clarity and comprehension regarding the nature of regulation vis-à-vis foreign regulators, correspondent banks, and payment service providers. The designation as FinTech under Article 1b Banking Act is not understood internationally. By being classified as Category 6 banks, FinTech companies could use the designation "bank," which aligns with their core activity of deposit acceptance, which is essentially a banking activity.
- c) Avoidance of the need for special ad hoc regulations for fintech under Article 1b Banking Act, which are poorly integrated into the legal system and not well understood by the public and counterparties.
- d) Maintain access to the Swiss National Bank (SNB) for sight deposit accounts and the SIC, specifically EuroSIC and SECB.

C. Advantages of the Proposed Measure

1. **Supporting Innovation in Switzerland:** The proposals enable the establishment of a competitive licensing framework (Category 6 bank) that can effectively support innovation in Switzerland. This would position Fintech Companies favorably against EMIs in the EU and the UK, enhancing the attractiveness of Switzerland as a hub for fintech innovation.
2. **Creating a Coherent System:** The measures would facilitate the creation of a coherent regulatory system that supports the original concept of the FinTech license as a "light banking license," which permits simple banking activities with specific restrictions. This alignment promotes stability and clarity in the regulatory environment for all stakeholders.
3. **Avoiding Unnecessary New Regulations:** The proposed measures would prevent the creation of a new legal and regulatory framework that is unnecessary for Fintech Companies. Maintaining the current regulatory structure under banking law allows for a more streamlined approach, reducing bureaucratic burdens.
4. **Preventing Confusion with New Categories or Rebranding:** By not establishing a new category or rebranding that may be inconsistent and misunderstood by the public and foreign financial institutions and regulators, the proposals mitigate potential confusion, particularly regarding PSPs under the PSD regulation of the EU. This clarity is essential for maintaining trust and understanding among stakeholders.

D. Subsidiary Proposals from Fintech Companies

Subsidiarily, should the aforementioned proposals not be considered, the Fintech Companies propose the following measures:

1. **Maintain the Status Quo:** That is, FinTechs shall remain regulated under banking law (for the reasons mentioned above) as "persons" pursuant to Article 1b of the Banking Act, in the absence of a new bank category.
2. **Removal of the CHF 100 Million Threshold:** The threshold should be eliminated for the reasons explained above.