

Foreword

FinTech innovation has the potential to drive productivity gains, enhance economic growth, encourage innovation that spurs job creation and improves the quality and diversity of financial services. It can promote financial inclusion for the underserved or underbanked parts of the population, such as SMEs without collateral or prior credit history, or citizens in remote areas of the country. Data is at the core of FinTech financial applications. The provision of many such services is enabled by financial innovations where data usage is a cornerstone. Fostering FinTech innovation can strengthen competition in the market, while at the same time allowing the penetration in international markets.

The innovative nature of FinTech applications leads to a perceived uncertainty by both market participants and regulatory and supervisory authorities about the existence and/or applicability of relevant regulatory/supervisory frameworks. Such uncertainty hinders the full exploitation of the benefits of financial innovation. This highlights the benefit of regulatory sandboxes for the entire ecosystem. In this regard, sandboxes and other innovation facilitator arrangements are critical as they allow small-scale testing of innovation in a controlled environment supervised by the competent authorities, allowing engagement in a constructive dialogue with supervisory and regulatory authorities.

Against this backdrop, a technical support Project has been launched in May 2022, funded by the European Union via the Technical Support Instrument (TSI) and in co-operation with the European Commission's Directorate-General for Structural Reform Support (DG REFORM), together with the Organisation for Economic Co-operation and Development (OECD) as the designated implementing partner. The project falls in the area of administrative and regulatory reform and seeks to unlock the potential of FinTech applications and the use of data in financial services in the Czech Republic and to examine the possible establishment of a sandbox in the country to enable FinTech innovation on the basis of data sharing and usage. The development of the FinTech sandbox features as a milestone of the Digital pillar of the Czech National Recovery and Resilience Plan (RRP), which is focused on digital technologies and aims at creating sandboxes in regulated sectors in line with EU priorities. Its successful completion will have a significant importance from political, economic and social perspectives, contributing to the top EU priorities – Green and Digital Transition.

This report summarises the main findings of the individual outputs (See Annex A, Figure 1.A) delivered to the Commission throughout the duration of the Project and provides recommendations on the design of a feasible regulatory sandbox for FinTechs in the Czech Republic. The main findings stem from an analysis of the FinTech market in the Czech Republic and include an overview of the local FinTech ecosystem, the regulatory and supervisory framework that supports it, existing obstacles to FinTech development, and opportunities for the Czech policy makers to address the identified challenges. The main findings support the subsequent recommendations on the design of a feasible Czech regulatory sandbox presented in the report. The recommendations have been developed in close consultation with the Czech Authorities and European Authorities and draw on past experiences of sandbox models in jurisdictions where these have been established (in OECD and non-OECD member countries with a focus on European Union countries).

The Czech FinTech sector is a nascent market, with more than one hundred regulated or unregulated firms as of 2022. These firms operate in areas such as accounting, payments, savings and personal finance,

peer-to-peer (P2P) lending and investment crowdfunding, as well as crypto-asset services. A large part of the innovation in the Czech Republic is driven by foreign-owned companies and relies on external funding. the Czech FinTechs operate in a market that is heavily dominated by banks with under-developed capital markets and facing competition from the traditional Czech financial service providers who are also pursuing digitalisation and innovation. Though the Czech population is quick to adopt digitalisation, the Czech consumers are conservative when it comes to investment and borrowing, holding very few financial assets outside of the banking system.

The analysis of gaps and barriers in the Czech FinTech environment suggests that the current dialogue between the Czech Authorities and FinTechs operating in the country is suboptimal. This conclusion is supported by findings from a questionnaire by the OECD circulated among FinTechs. Long authorisation times are reported to be prevailing in the payment service providers sector, a prominent sector of operation among local FinTechs, while the Czech Authorities report low quality of applications in this sector. The lacking communication channels between the Czech Authorities and FinTechs poses a hurdle to the growth of the nascent local FinTech sector, which is also facing additional constraints related to access to funding, shortage in ICT specialists in both sides of the market (Czech authorities and private sector), and an under-developed domestic ecosystem to support FinTech development (including equity markets for such risky investments). FinTechs are at a disadvantage compared to established banks when it comes to access to data. Access to banks customers' data and payment initiation via Application Programming Interfaces (APIs), made available under EU Directive on Payment Services in the Internal Market 2 (PSD2), is the basis for the business model of an important part of FinTechs. However, they have reported technical and operational issues that prevent them from connecting directly to banks' APIs, despite the existence of an industry-led standard for APIs (Czech Standard for Open Banking). Implementation of the standard is voluntary and the actual uptake by incumbent banks remains unclear. FinTechs therefore often resort to costlier solutions of data aggregators' services to access data.

Based on the analysis of the Czech FinTech ecosystem, including regulatory and supervisory practices and business/market conditions, and the comparison of the existing framework against best practices observed in many OECD countries, this report concludes that the establishment of an innovation facilitator could be one of the possible ways to alleviate some of the impediments to FinTech development in the Czech Republic. The recommendations consider the hurdles to FinTech growth related to supervision and regulation that were identified in previous reports produced by this project. It is also recommended that, to the extent feasible, such regulatory sandbox could provide data-sharing when the conditions permit. Also, a data sandbox could be envisaged *without a regulatory component*, and such data sandbox could be outsourced and/or exist outside the Czech Authorities, although even in this case the Czech Authorities would need to participate *inter alia* by means of providing data.

The report does not include any analysis of implications of the local legal framework of the Czech Republic (e.g. administrative law provisions and implications of public law for the implementation). Such legal advice can be obtained by the Czech Authorities from competent parties should they require such an assessment.

The European Commission's Digital Finance Strategy highlights that "Firms should be able to rely on close co-operation between national supervisory innovation facilitators within the European Forum of Innovation Facilitators (EFIF), and a new EU digital finance platform" (Chapter 4.1, European Commission, 2020^[122]). The establishment of a regulatory sandbox would allow the Czech innovative companies to participate in cross-border testing in the context of EU initiatives. For example, the EU Digital Finance Platform will allow multi-sandbox testing in two or more regulatory sandboxes in different Member States, facilitating visibility over the tests among national authorities involved in testing.

Although the Fintech contact point of the CNB is participating in the meetings of the European Forum for Innovation Facilitators EFIF, it is a contact point with limited scope. A regulatory sandbox could co-exist with the contact point and would complement the non-binding preliminary guidance provided by the contact point. A regulatory sandbox may also cover for any possible limited capacity of the current contact point

considering possible growing FinTech needs due to new or forthcoming EU regulatory frameworks such as Markets in Crypto-assets (MiCA) Regulation, Distributed ledger technology (DLT) pilot regime, Artificial Intelligence (AI) Act proposal, and proposal for a regulation on information accompanying transfers of funds and certain crypto-assets proposals.

The establishment of a financial sector regulatory sandbox is also envisioned within the Component 1.4, Investment 2.5 of the Czech National Recovery and Resilience Plan (RRP), which states, among other things, *“The investment aims to create and operate sandboxes (i.e. testing environments) in the financial sector and AI, as tools to support (i) the rapid commercialisation of more accessible, secure, and modern services in these areas; (ii) the creation and growth of innovative firms; and (iii) the digitisation of the economy.”*

In particular, the establishment of a facilitator that takes the form of a regulatory sandbox shall allow for the fulfilment of the Milestone 64 – 1.4.2.5 which calls for the establishment of and launch of two regulatory sandboxes in line with EU priorities, one of them in FinTech, by Q4 2023. Within the first year of its operation, the regulatory sandbox would need to support requests by 10 FinTech companies to fulfil Target 65, by Q4 2024. Also, the establishment of the regulatory sandbox could contribute to the fulfilment of other connected milestones and targets of the Czech Republic RRP, such as *1.4.2.3 Pilot co-investment funds for the development of pre-seed investments, strategic technologies and university spin-offs* and *1.4.2.4 Internationalisation of start-ups and others* given the innovative nature of eligible participants to the sandbox, and the potential for cross-border testing in co-operation with other EU authorities' regulatory sandboxes or in the context of EU-wide initiatives for cross-border sandbox collaboration.

The establishment of a regulatory sandbox could not only help drive innovation in the market but also within the supervisory and regulatory bodies, given the possible benefits for Czech Authorities from interacting with innovative business models and close observation of the deployment of technology for financial activity.



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