EUROPEAN UNION INTEGRATION OF THE MEXICAN FINANCIAL TECHNOLOGY INSTITUTIONS LAW AND CAPITAL REQUIREMENTS

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This Note explains the need for greater consumer protection in the financial technology (fintech) sector in the European Union and advocates for the implementation of new laws and regulations to achieve that end. Fintech, used properly, has the potential to close financial equality gaps across the world. By introducing innovative products in a consumable fashion, fintech companies can reach unserved and underserved populations more easily than ever before.

The concern with the increase in fintech, however, is that the breakneck speed of change creates risks for both investors and consumers. Recently, these risks were put on display when Wirecard, a German fintech company, filed for insolvency creating massive losses for both investors and consumers. Prior to its collapse, Wirecard was overseen by regulatory bodies in the European Union which did not provide adequate protection to consumers or investors in regulating fintech companies. The European Union maintains a patchwork of regulations for fintech companies spread across its member states instead of one overarching policy, making it difficult for companies to do business compliantly and for consumers to understand their protections.

In recent years, Mexico has seen a surge in fintech companies within its borders consisting of both newly founded Mexican companies and international companies opening Mexican branches or subsidiaries. Because of this boom and a noted lack of regulation for fintech providers creating concern for investors and consumers, Mexico passed the Financial Technology Institutions Law. This law provides more government oversight of fintech companies in the country, creating a safer environment for investors and consumers. Additionally, the law introduced a sandbox environment allowing certain companies to craft new products and services innovatively, providing additional protections to consumers, and allowing investors to participate at the ground level.

In the European Union, fintech companies are not subject to as much regulation as is now required by the Mexican Financial Technology Institutions Law, and the European Union does not have a minimum capital requirement. Increasing the amount of capital that a company is required to have on hand at any given moment provides protection to both investors and consumers. If a company sustains heavy operating losses, the cash on hand ensures that the company could continue

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operations, meaning that consumers are allowed to continue their use of the service and that investors have a lower likelihood of losing their investment.

The European Union should implement a version of the Mexican Financial Technology Institutions Law across all member states to provide regulation over the fintech industry creating more stability and trust. Additionally, by implementing stricter capital requirements, European Union consumers and investors would be better protected against large operating losses. The implementation of these requirements in the European Union would create a more hospitable environment for fintech companies, consumers, and investors.

I. Introduction

In June of 2020, Wirecard, a leading German fintech company, filed for insolvency after it was caught up in a major accounting scandal.[1] The collapse came as a surprise to both investors and creditors of the company, and the insolvency negatively impacted both investors of the company and consumers using the service.[2] On April 24, 2020, prior to its major accounting scandal, Wirecard stock reached a mid-day high of $145.00 per share[3] but quickly collapsed, trading at $0.8378 during mid-day trading on September 1, 2020.[4] As of May 19, 2023 Wirecard stock was trading at just $0.0001 per share, representing an almost complete loss for investors.[5]

In addition to the risks posed to stock investors, at its collapse, Wirecard had over €3.5 billion[6] in outstanding debt.[7] Of that outstanding amount, over €500 million was owed directly to bond

1. Wirecard *ard: Scandal-Hit Firm Files for Insolvency*, BBC News (June 25, 2020), https://www.bbc.com/news/business-53176003 [https://perma.cc/6QB5-KDUP].

2. *See id.*

3. Wirecard AG (WRDCF), Yahoo Finance, https://finance.yahoo.com/quote/WRCDF/history?period1=1585699200&period2=1588204800&interval=1d&filter=history&frequency=1d&includeAdjustedClose=true [https://perma.cc/5LJM-CGG8].

4. Wirecard AG (WRDCF), Yahoo Finance, https://finance.yahoo.com/quote/WRCDF/history?period1=1594771200&period2=1600128000&interval=1d&filter=history&frequency=1d&includeAdjustedClose=true [https://perma.cc/8Q47-D6JL].

5. Wirecard AG (WRDCF), Yahoo Finance, https://finance.yahoo.com/quote/WRCDF/history?p=WRCDF [https://perma.cc/4LSR-RXQN].

6. On the day that Wirecard filed for insolvency, €3.5 billion equated to approximately $3.93 billion USD. *See Euros (EUR) to US Dollars (USD) Exchange Rate for June 25, 2020*, Exch.-Rates.Org, https://www.exchange-rates.org/Rate/EUR/USD/6-25-2020 [https://perma.cc/AYU4-KYU9].

7. *See* Derek Scally, *Wirecard Collapses Owing €3.5 Billion*, Irish Times (June 25, 2020), https://www.irishtimes.com/business/financial-services/wirecard-collapses-owing-3-5-billion-1.4288246 [https://perma.cc/6DU6-ZZ7S].

investors and another €1.75 billion[8] was owed to other banks.[9] The inability to pay on debts of that size can have reverberations throughout the entire global economy and could even contribute to a possible recession.[10] The collapse could have been avoided by increasing regulations in the fintech space and subjecting Wirecard to stricter capital requirements.

The creation of a new regulatory framework in the European Union would better protect direct investors in companies such as Wirecard, consumers utilizing fintech services where a breach of continuous service could be problematic, and the global economy, preventing mass corporate default.

This Note proposes that the European Union should pass legislation requiring more government oversight for fintech companies with a special focus on virtual payment companies and crowdfunding as well as the implementation of higher capital requirements. The European Union should model regulations after the Mexican Financial Technology Institutions Law (FTIL), which provides more governmental oversight by vesting authority in the National Banking and Securities Commission among others.[11] Additionally, this Note demonstrates why the European Union should set higher minimum capital requirements than are currently required across the European Union or in Mexico following the implementation of the FTIL. Finally, this Note acknowledges some of the limitations and risks in passing such sweeping reforms in the European Union and explains why the benefits of passing these reforms outweigh the potential costs.

Specifically, Part II of this Note focuses on the background of fintech globally, highlighting newly relevant technologies and broad benefits; discusses the prior and current state of regulation in the European Union; further discusses the collapse of Wirecard; explains the situation in Mexico prior to the promulgation of fintech legislation; discusses the benefits that Mexico has seen to date; and explains the interplay between corporate structure and capital

8. On the day that Wirecard filed for insolvency, the €500 million owed directly to investors equated to approximately $560 million USD and the €1.75 billion owed to other banks equated to approximately $1.96 billion USD. *See Euros (EUR) to US Dollars (USD) Exchange Rate for June 25, 2020*, *supra* note 6.

9. *See* Scally, *supra* note 7.

10. *See* Julia Horowitz, *Here's What Could Really Sink the Global Economy: $19 Trillion in Risky Corporate Debt*, CNN: Business (Mar. 14, 2020), https://www.cnn.com/2020/03/14/investing/corporate-debt-coronavirus/index.html [https://perma.cc/928Q-VCCH].

11. *See* Yvette D. Valdez et al., Latham & Watkins LLP, *Mexico Issues First License Under New FinTech Law*, Lexology (Feb. 24, 2020), https://www.lexology.com/library/detail.aspx?g=e54d449f-c4fa-4408-b1a5-5326f3a1cdd0 [https://perma.cc/63SU-5CX2].

requirements. Part III proposes the implementation of legislation in the European Union, like that in Mexico, alongside a requirement of higher minimum capital on hand for companies; highlights issues with passing this type of legislation; and explains how to overcome barriers to passage. Part IV concludes with a summary of the Note and discusses how these changes could propel the European Union to be a leader in the regulation of fintech companies globally for years to come.

II. Background

A. *Fintech Has a Flexible Definition and Global Benefits.*

This Section describes the basics of fintech and the subset of technologies considered fintech examined in this Note. Additionally, this Section reviews the global benefits of fintech and the reasons that fintech innovation is critical in extending benefits to underserved populations. Finally, this Section discusses the risks posed to investors and consumers by fintech innovation.

1. What is fintech?

Fintech—short for financial technology—is a broad term encompassing any technology used in the financial services industry, including technologies for both businesses and consumers.[12] The history of fintech is debated, given that the finance industry has undergone technological transformation since its founding.[13] Now, the prevailing sense is that the current iteration of fintech consumer technologies began after the global economic crisis of 2008.[14]

These consumer technologies provide tools for users to manage their financial lives including their bank accounts, mortgages, investments, and more.[15] The types of services that fintech companies provide include insurance, investing, payment processing, crowdfunding, banking, budgeting, blockchain, cryptocurrency,[16] and more.[17] Given the definition of fintech as any financial technology,

12. *See* Anne Sraders, *What Is Fintech? Uses and Examples in 2020*, The Street (Mar. 8, 2019), https://www.thestreet.com/technology/what-is-fintech-14885154 [https://perma.cc/8F3G-GYFN].

13. *See* Daniel Lowther, *The Three Ages of Fintech*, CCgroup, https://blog.ccgrouppr.com/blog/the-three-ages-of-fintech [https://perma.cc/S7A4-LR52].

14. *See id.*

15. *See* Sraders, *supra* note 12.

16. This Note does not discuss either cryptocurrency or blockchain. Both are emerging areas of fintech with many nuances beyond the scope of regulation described.

17. *See* Sraders, *supra* note 12.

the subsectors that are covered by this umbrella term continue to grow as companies continue to innovate.[18]

Examples of fintech include more established companies such as PayPal and Venmo[19] as well as newer companies such as Clearbanc,[20] Captain401,[21] and Stash.[22] Additionally, several larger companies have started developing their own technologies or purchased stakes in smaller fintech companies, such as Santander's investment in Forteil GmbH in Europe[23] or JPMorgan Chase and Wells Fargo's investments in Greenlight in the United States.[24]

As of 2019, there were nearly 7,000 fintech companies globally[25] and the industry has a 2023 total market value of $245 billion which is expected to reach $1.5 trillion by 2030.[26] Even though fintech captures such large sums of money, there is not a consistent regulatory framework globally for the fintech sector. Instead, there is only a patchwork of systems across different regions and countries.[27] There are, however, common trends in the regulatory frameworks of fintech, and most are moving toward more regulation across even more subsectors

18. *See* Sarah Sharkey, *What Is Fintech?*, BANKRATE (Sept. 2, 2020), https://www.bankrate.com/banking/what-is-fintech/ [https://perma.cc/SU3E-UJK6].

19. *See* Sraders, *supra* note 12.

20. *See* Sandra Ponce de Leon, *Clearbanc Is Using AI to Level the Playing Field in Funding*, FORBES (Apr. 11, 2019), https://www.forbes.com/sites/cognitiveworld/2019/04/11/clearbanc-ai-funding/?sh=13204f857b60 [https://perma.cc/NSX2-4SC8].

21. *Captain401 Raises $3.5 Million to Make Creating a 401K Easier for Businesses*, PR NEWSWIRE (Feb. 25, 2016), https://www.prnewswire.com/news-releases/captain401-raises-35-million-to-make-creating-a-401k-easier-for-businesses-300225945.html [https://perma.cc/QJ9F-LSZ9].

22. *See* Kathleen Elkins, *Wall Street Vets Left 6-Figure Jobs to Launch an App that Makes Investing Easy*, CNBC (Oct. 21, 2016), https://www.cnbc.com/2016/10/21/wall-street-vets-left-6-figure-jobs-to-launch-an-app-that-makes-investing-easy.html [https://perma.cc/4WWP-QL4E].

23. Sophia Furber & Mohammad Abbas Taqi, *VC Funding for Fintech is Down, but Big Banks Are Quietly Investing in Startups*, S&P GLOB. MKT. INTEL. (Oct. 7, 2020), https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/vc-funding-for-fintechs-is-down-but-big-banks-are-quietly-investing-in-startups-60607005 [https://perma.cc/6CCH-Y359].

24. *See* Penny Crosman, *Where Goldman, Citi, JPMorgan Are Putting Fintech Investment Dollars*, AM. BANKER (Mar. 29, 2021), https://www.americanbanker.com/news/where-goldman-citi-jpmorgan-are-putting-fintech-investment-dollars [https://perma.cc/NH59-CKQ2].

25. *See The Global Fintech Index 2020*, FINDEXABLE 4 (2019), https://findexable.com/wp-content/uploads/2019/12/Findexable_Global-Fintech-Rankings-2020exSFA.pdf [https://perma.cc/LD7Z-27CN].

26. Press Release, Boston Consulting Group, Fintech Projected to Become a $1.5 Trillion Industry by 2030 (May 3, 2023), https://www.bcg.com/press/3may2023-fintech-1-5-trillion-industry-by-2030 [https://perma.cc/YBK5-J83Y].

27. *See Overview of Fintech Regulations in the World*, SANCTION SCANNER, https://sanctionscanner.com/blog/overview-of-fintech-regulations-in-the-world-143 [https://perma.cc/7FF7-KXE3].

than previously regulated.[28] This increase in regulations includes requirements for companies to join regulating bodies, stricter review of consumer communications, and higher liquidity requirements.[29]

2. Innovation in the fintech sector provides benefits to consumers.

Continuous fintech innovations impact the broader public and also those individuals that lack access to traditional banking functions.[30] The benefits of fintech are numerous, but one of the largest is increased competition in the financial services space which has created lower prices for customers even from more traditional providers.[31] Additionally, fintech companies with a leaner operating model and lower overall costs due to their digital nature are able to provide services at lower costs than their traditional peers.[32] The development of these new technologies can also deliver more streamlined services to clients such as faster underwriting for insurance policies and delivery of coverage.[33]

The development of new technologies gives those individuals who have not traditionally had access to certain financial services such as credit cards, payment systems, and insurance the ability to utilize resources that have been available to others, creating more global financial equity.[34] Providing financial solutions to underbanked customers also represents a sizable opportunity for companies with estimates of potential revenue up to $1 trillion worldwide.[35] Underbanked

28. *See* Matthew Unger, *5 Trends to Watch in Fintech Regulation*, Finance Magnates (June 20, 2020), https://www.financemagnates.com/fintech/5-trends-to-watch-in-fintech-regulation/ [https://perma.cc/Y63G-KTAE].

29. *See id.*

30. This Section is not all-encompassing. There may be further consumer benefits to continuous fintech innovations besides expanding access to individuals that lack access to traditional banking and lowered pricing.

31. *See* Nik Milanovic, *Now More Than Ever We Need Fintechs to Lead on Consumer Transparency*, TechCrunch (Mar. 17, 2020), https://techcrunch.com/2020/03/17/now-more-than-ever-we-need-fintechs-to-lead-on-consumer-transparency/ [https://perma.cc/7D2U-UQLJ].

32. *See 10 Things Consumers Need to Know About Fintech*, Consumers Int'l, https://www.consumersinternational.org/news-resources/blog/posts/10-things-consumers-need-to-know-about-fintech/ [https://perma.cc/5PSZ-2XKN].

33. *See Why the Insurance Industry Is Ripe for Fintech Disruption*, InGuard (Mar. 30, 2016), https://www.inguard.com/newsroom/why-the-insurance-industry-is-ripe-for-fintech-disruption/ [https://perma.cc/3SPY-MLTM].

34. *See* Bob Legters, *What Banking for the Unbanked Means for You*, Forbes (July 10, 2020), https://www.forbes.com/sites/boblegters/2020/07/10/what-banking-for-the-unbanked-means-for-you/ [https://perma.cc/RWP5-2ZWP].

35. *See* Roman Leal, *How FinTech Can Help Bend the Curve for the Underbanked (Part 1)*, Medium (July 8, 2020), https://romanleal.medium.com/how-fintech-can-help-bend-the-curve-for-the-underbanked-part-1-4a26acfea36 [https://perma.cc/B4DF-B54S].

or unbanked individuals pay more in fees and lose access to services that many fully-banked individuals take for granted.[36] Fintech innovations have the potential to reach these individuals and provide for more financial inclusion and opportunities for those underserved communities.[37]

Many new fintech companies also have a greater opportunity to engage with consumers more frequently through new media such as cell phone notifications, whereas traditional establishments have been reliant on slower means of communication such as mail.[38] Use of these means of communication can improve financial habits in those unbanked and underbanked individuals, inspiring them to make better financial decisions about their accounts, an area where traditional financial service companies have struggled historically.[39] Many fintech companies are also using their increased customer communications to increase financial literacy of their consumers and potential consumers in communities they do not yet serve.[40]

3. Innovation in the fintech space also creates additional risks for consumers and investors.

The financial sector has had many instances of misconduct over the last several years. For example, United Kingdom banks have paid £67.4 billion[41] in restitution since 2000.[42] Many of these payments have been made due to the mis-selling of products by financial institutions.[43] These mis-selling issues have hit several areas of the financial industry including mortgages, pensions, traditional banking, identity

36. *See* Jason Furman, *Financial Inclusion in the United States*, White House Blog (June 10, 2016, 8:00 AM), https://obamawhitehouse.archives.gov/blog/2016/06/10/financial-inclusion-united-states [https://perma.cc/5T6Y-ZSCR].

37. *See id.*

38. *See* Milanovic, *supra* note 31.

39. *See id.*

40. *See* Dmitry Dolgorukov, *How Fintech Is Evolving in 2021*, Forbes (Mar. 10, 2021), https://www.forbes.com/sites/forbesfinancecouncil/2021/03/10/how-fintech-is-evolving-in-2021/ [https://perma.cc/2WYQ-VNCD]; John Sullivan, *Fintech Launches Financial Literacy Platform for Kids*, 401K Specialist (Jan. 14, 2021), https://401kspecialistmag.com/fintech-launches-financial-literacy-platform-for-kids/ [https://perma.cc/4ZFK-FBJT] (Greenlight Financial Technology, a fintech company, launched educational investing platform for kids).

41. As of April 1, 2021, £67.4 billion equates to approximately $93 billion USD. *See British Pound (GBP) to US Dollars (USD) Historical Exchange Rates on 1st April 2021*, Exch.-Rates. Org., https://www.exchangerates.org.uk/GBP-USD-01_04_2021-exchange-rate-history.html [https://perma.cc/V62A-QZEL].

42. *See* Nicholas Megaw, *After PPI, What Could Be the Next Banking Mis-selling Scandal?*, Fin. Times (Aug. 30, 2019), https://www.ft.com/content/2abb8482-c9b3-11e9-a1f4-3669401ba76f.

43. *See id.*

theft, and more.[44] Consumers can also find themselves subject to misinformation on the part of fintech companies themselves, who are not necessarily as regulated as their traditional counterparts.[45] This misinformation is able to spread more rapidly due to a lack of supervision and the agile nature of fintech companies.[46] These risks are compounded for unbanked and underbanked individuals who have less knowledge of and experience dealing with financial institutions, increasing their susceptibility to predatory companies.[47]

Exclusively digital fintech companies,[48] unlike their traditional brick and mortar rivals,[49] face additional risks due to their wholly online nature. These risks include cloud security, hackers, and other threats to their enterprise architecture, which are then passed on to investors.[50] More traditional brick and mortar institutions are becoming prone to similar risks given their online presence and development of their own proprietary fintech, acquisition of fintech startups, and integration of shared data with other companies.[51]

Fintech provides expanded possibilities and benefits to those most underserved by traditional financial institutions, but the rapid pace of change also creates additional risks.

B. *The European Union Has Existing Regulations that Are Meant to Protect Consumers in this Space.*

This Section discusses current regulations in the European Union and in certain member states.[52] This Section is not exhaustive as many

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44. *See id.*

45. *See* Jorge Gaxiola Moraila et al., *The New Mexican Fintech Law – Balancing Innovation, Security and Stability*, The Financier Worldwide 1–2 (Aug. 2018), https://www.financierworldwide.com/the-new-mexican-fintech-law-balancing-innovation-security-and-stability [https://perma.cc/3XQW-24Q3].

46. *See id.*

47. *See* Milanovic, *supra* note 31.

48. Examples of digital fintech firms include Paypal, Venmo, or Acorns.

49. Examples of traditional brick and mortar institutions include banks such as Chase, payment processors such as Visa, and investment companies such as Charles Schwab.

50. *See* Apporv Gehlot, *Cybersecurity: 7 Hidden Risks of Fintech Industry*, Payments J. (Mar. 20, 2020), https://www.paymentsjournal.com/cybersecurity-7-hidden-risks-of-fintech-industry/ [https://perma.cc/2WXL-VASM].

51. *See id.*; Theresa W. Carey, *Robinhood Kicks Cybersecurity Month Off by Getting Hacked*, Investopedia (Oct. 16, 2020), https://www.investopedia.com/robinhood-kicks-cybersecurity-month-off-by-getting-hacked-5082845 [https://perma.cc/QCV8-SWVC]; Steve Andriole, *The Capital One Data Breach Is No Exception & Why We Can Expect Many, Many More*, Forbes (July 30, 2019), https://www.forbes.com/sites/steveandriole/2019/07/30/the-capital-one-data-breach-is-no-exception-why-we-can-expect-many-many-more/ [https://perma.cc/LCX8-MH6M].

52. Because the regulations across the European Union are numerous and inconsistent, only the most important regulations are discussed.

European Union states have their own regulations. Instead, this Section highlights relevant, current regulations in European Union member states that influence fintech or that have been used either well or poorly to regulate fintech companies.

As of 2021, the landscape of fintech regulation in the European Union is a patchwork of national laws, and fintech companies are not covered uniformly or consistently.[53] For example, in Germany, fintech companies are subject to the same general rules as banks and insurance companies in the nation, but no special considerations are given to fintech companies or their inherently digital nature.[54] Each fintech company must register with the appropriate organization under BaFin, Germany's main financial regulator, only if it is required to do so by the laws governing their traditional counterparts.[55] The companies are then regulated by the relevant legislative act for their type of business, such as the German Banking Act for banks.[56] A similar regulatory scheme can be found in Austria, the Netherlands, Belgium, and several other European Union countries.[57] However, "31% of fintech companies in Europe aren't regulated under any regime."[58]

While there is not a sweeping fintech law in place in the European Union, fintech companies in European Union member countries are still subject to European Union regulations targeting financial institutions broadly such as the General Data Protection Regulation (GDPR) and the series of Anti-Money Laundering Directives (most recently AMLD5).[59] Some feel that current regulations in the European

53. *See* Chris Semple, *European Authorities Urged to Rethink Fintech Regulation*, BBVA (Dec. 16, 2019), https://www.bbva.com/en/european-authorities-urged-to-rethink-fintech-regulation/ [https://perma.cc/9QBN-2HJ2].

54. *See Germany: Fintech Laws and Regulations 2021*, ICLG (June 14, 2021), https://iclg.com/practice-areas/fintech-laws-and-regulations/germany [https://perma.cc/QK-8P-Y584].

55. *See id.*

56. *See id.*

57. *See Austria: Fintech Laws and Regulations* 2020, ICLG (June 14, 2021), https://iclg.com/practice-areas/fintech-laws-and-regulations/austria [https://perma.cc/5M9E-G-PGP] *Netherlands: Fintech Laws and Regulations* 2020, ICLG (June 14, 2021), https://iclg.com/practice-areas/fintech-laws-and-regulations/netherlands (last visited Sept. 19, 2021); Muriel Baudoncq, et al., *Belgium: Fintech Laws and Regulations 2020*, ICLG, (June 16, 2020), https://iclg.com/practice-areas/fintech-laws-and-regulations/belgium [https://perma.cc/3ZL3-SDY6].

58. Lionel Laurent, *Germany's BaFin Has Run Out of Wirecard Excuses*, WASH. POST (Sept. 4, 2020), https://www.washingtonpost.com/business/energy/germanys-bafin-has-run-out-of-wirecard-excuses/2020/09/03/97d7174a-edb4-11ea-bd08-1b10132b458f_story.html [https://perma.cc/B5KK-EJF5].

59. *See EU Falling Short on Fintech Regulations*, NEW MONEY REV. (June 4, 2020), https://newmoneyreview.com/index.php/2020/06/04/eu-falling-short-on-fintech-regulations/

Union under the GDPR and the AMLD5 are too overreaching and will only further hamper the development of fintech companies in the European Union without providing protections to consumers.[60] Some of the biggest targets of the AMLD5 regulation were cryptocurrency companies, leaving some traditional financial services untouched.[61] While these regulations impact fintech companies, they do not apply to them exclusively and do not necessarily regulate them to protect consumer financial interests.[62] Instead, both of these regulations mainly target consumer data and consumer privacy concerns without implementing any significant changes to the fintech regulatory structure.[63]

The implementation of the Payment Services Directive 2 (PSD2) across the European Union also impacted fintech companies and was implemented with a focus on consumer protection.[64] This law, as with both GDPR and AMLD5, is not targeted at fintech companies, but payment systems processing companies broadly of which fintech companies may be included.[65] The consumer protection generated by PSD2, though, is about privacy in sharing data across companies, not business continuity or safety of investments with

[https://perma.cc/9NK2-92PA]. The General Data Protection Regulation (GDPR) is a legal framework in the European Union setting standards regarding the collection and use of personal information on the Internet. *See* Jake Frankenfield, *General Data Protection Regulation (GDPR)*, Investopedia (Nov. 11, 2020), https://www.investopedia.com/terms/g/general-data-protection-regulation-gdpr.asp [https://perma.cc/DTP5-4NAW]; The fifth European Union Anti-Money Laundering Directive (AMLD5) is the fifth directive issued by the European Union setting standards for national intelligence units and cooperation with the European Central Bank among other directives. *See What Is AMLD5 (5th EU Anti-Money Laundering Directive)?*, Dow Jones, https://www.dowjones.com/professional/risk/glossary/anti-money-laundering/amld5-definition/ [https://perma.cc/69GL-KXN9].

60. *See EU Falling Short on Fintech Regulations*, *supra* note 59.

61. *See* Marvin Dumont, *EU's AMLD5 Imposes New Requirements on Crypto Firms*, Apollo Fintech (Jan. 13, 2020), https://apollofintech.medium.com/eus-amld5-imposes-new-requirements-on-crypto-firms-c2faded9bbc2 [https://perma.cc/Q2S4-2DT7].

62. *See id.*

63. *See id.*

64. *See* Brian Riley, *Tighten Up on Credit Card Security: From PSD to PSD2 to GDPR, Now SCA*, Payments J. (May 10, 2019), https://www.paymentsjournal.com/credit-card-security-psd-psd2-gdpr-now-sca/ [https://perma.cc/XVU4-8LNS]. Payment Service Providers Directive 2 (PSD2) is an amendment to the original Payment Service Providers Directive implemented by the European Commission to "improve consumer protection, boost competition and innovation in the sector and reinforce security in the payments market, which is expected to facilitate the development of new methods of payment and ecommerce." *Everything You Need to Know About PSD2*, BBVA, https://www.bbva.com/en/everything-need-know-psd2/ [https://perma.cc/7G22-HDP7].

65. *See* Ryan Browne, *Europe's Banks Brace for a Huge Overhaul That Throws Open the Doors to Their Data*, CNBC (Jan. 11, 2018), https://www.cnbc.com/2017/12/25/psd2-europes-banks-brace-for-new-eu-data-sharing-rules.html [https://perma.cc/85P4-XH2M].

companies.[66] Many feel that PSD2 has actually weakened regulation in the fintech space by focusing instead on creating more innovation.[67]

On September 24, 2020 the European Commission released a Digital Finance Package with "four main priorities: removing fragmentation in the digital single market; adapting the European Union regulatory framework to facilitate digital innovation; promoting data-driven finance, and; addressing the challenges and risks with digital transformation."[68] While this step by the European Union is promising, it does not directly address many of the needed areas of focus including stricter oversight by governments for the protection of consumers.[69] Instead, much of the focus is on data sharing between companies, which is important to consumers and companies and also requires regulation but should not be mistaken for real action by the European Union on true oversight of fintech company activities.[70] Instead, this package is a seeming increase in the regulations first introduced in PSD2, GDPR, and AMLD5 with the package even calling for a review of the impacts of prior anti-money laundering regulations and PSD2 on companies.[71]

C. *The Downfall of Wirecard Shows Why Stricter Regulation of Fintech Companies Is Necessary in the European Union.*

This Section examines the situation that unfolded at Wirecard, a payment processing fintech company based in the European Union. The downfall of Wirecard provides proof that the current European Union regulations are insufficient in protecting consumers from the unethical business practices of predatory financial companies.

Due to a lack of financial regulations, Wirecard, a German fintech company, filed for insolvency in June of 2020 creating serious ramifications for investors and consumers.[72] Wirecard was founded in 1999 and focused on e-commerce, digital payment systems, and virtual

66. *See* Riley, *supra* note 63.

67. *See How PSD2 Will Revolutionise FinTech*, AON, https://www.aon.com/unitedkingdom/insights/how-psd2-will-revolutionise-fintech.jsp [https://perma.cc/S2TV-G3Z3].

68. *The EC's Digital Finance Package: A Step in the Right Direction for Global Blockchain Adoption*, Finextra (Oct. 8, 2020), https://www.finextra.com/blogposting/19407/the-ecs-digital-finance-package-a-step-in-the-right-direction-for-global-blockchain-adoption [https://perma.cc/C9BH-HQ8R].

69. *See id.*

70. *See id.*

71. *See* Eoghan Ó hArgáin & Eileen Grace, Eugene F. Collins, *The EU's Digital Finance Package*, Lexology (Feb. 3, 2021), https://www.lexology.com/library/detail.aspx?g=670324ea-a8c2-4d64-b88b-c2731447999b [https://perma.cc/3LL2-LJCL].

72. *See Wirecard: Scandal-hit Firm Files for Insolvency*, *supra* note 1.

cards.[73] In 2019, Wirecard claimed to process €125 billion in transactions through its payment processing technologies.[74] In early 2019, however, The Financial Times launched an investigation into Wirecard's practices, finding that much of Wirecard's purported profit came from only three companies that were suspicious.[75] These investigations came to a head when reporters from the Financial Times visited the offices of Al Alam Solutions (one of the three suspect companies) and found little to no staff on the premises.[76] A further review of Al Alam Solutions' financial documents revealed suspect accounting practices that were used to bolster Wirecard's balance sheet.[77] The Singapore Police Force then conducted a raid on the Singapore offices of Wirecard, and a Munich prosecutor launched a probe into Wirecard's market manipulation.[78] Following these investigations, Wirecard admitted that €1.9 billion did not exist as listed on its balance sheet following auditor's inability to locate the funds in Philippine escrow accounts.[79] In short, Wirecard lied about its revenue streams to increase its balance sheet assets and prop up its business even though it was failing to meet revenue targets.[80]

Wirecard, as a payment processor in Germany, was required to register with BaFin, Germany's financial supervisory authority.[81] While BaFin was supposed to regulate Wirecard during the scandal, it failed to do so, instead threatening those attacking the company's accounting practices and even trading in Wirecard securities itself.[82] While BaFin does not have the same regulatory authority as many of its global counterparts, such as the Securities and Exchange Commission in the United States, many agree that

73. *See* Dan McCrum, *Wirecard's Suspect Accounting Practices Revealed*, Fin. Times (Oct. 15, 2019), https://www.ft.com/content/19c6be2a-ee67-11e9-bfa4-b25f11f42901 [https://perma.cc/T8Q6-YFUH].

74. *See id.*

75. *See* Dan McCrum, *Wirecard Relied on Three Opaque Partners for Almost All Its Profit*, Fin. Times (Apr. 24, 2019), https://www.ft.com/content/a7b43142-6675-11e9-9adc-98bf1d35a056 [https://perma.cc/ZQR5-4HT8].

76. *See id.*

77. *See id.*

78. *See* Elizabeth Schulze, *Wirecard Sues the FT for 'Unethical Reporting,' but Shares Sink After Singapore Raid*, CNBC (Feb. 8, 2019), https://www.cnbc.com/2019/02/08/wirecard-sues-ft-for-unethical-reporting-shares-jump.html [https://perma.cc/XYN7-P6RW].

79. *See* Geir Moulson, *Wirecard Scandal: Missing Billions Likely Don't Exist*, Assoc. Press (June 22, 2020), https://apnews.com/article/technology-business-international-news-europe-9589d524c50766d557de61cd5a6cdd33 [https://perma.cc/SS68-7FPP].

80. *See id.*

81. *See* Guy Chazan & Olaf Storbeck, *BaFin Bosses Forced Out Over Handling of Wirecard Scandal*, Fin. Times (Jan. 29, 2021), https://www.ft.com/content/4f948457-678e-485c-92f7-2837064a5010 [https://perma.cc/373Q-MNJ5].

82. *See* Laurent, *supra* note 58.

Wirecard should have been more closely regulated than it was under the BaFin regime.[83]

Ultimately, the head of BaFin, Felix Hufeld, resigned from his post in the wake of the scandal.[84] Additionally, the German finance ministry plans to give BaFin more authority to "spot and investigate misconduct" and allow it to respond to warnings more readily in response to the Wirecard fiasco.[85]

The European Union began investigating BaFin as well.[86] The European Commission plans to use the outcome to "determine if there is a need for more centralized European Union supervision of markets to stop such scandals from happening again."[87] In its initial report, the European Securities and Markets Authority found problems in both BaFin's oversight of Wirecard as well as its handling of the scandal once the deficient accounting practices were unearthed.[88]

Following the Wirecard scandal, one of the most uncertain reverberations is consumer sentiment due to lack of consumer knowledge of the situation as well as the immensity of other fintech financial service providers.[89] After Wirecard's collapse, some traditional, non-electronic financial institutions reported an increase in deposits.[90] Some fintech companies have also responded by working to become fully compliant with brick and mortar regulations despite no regulatory requirement to do so.[91] While these improvements may impact consumers, it is yet to be seen if these

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83. *See id.*

84. *See* Chazan & Storbeck, *supra* note 81.

85. *See* Michael Nienaber, *Germany Lays Out Reform of Banking Watchdog After Wirecard Fraud*, Reuters (Feb. 2, 2021), https://www.reuters.com/article/wirecard-accounts-germany-reforms/germany-lays-out-reform-of-banking-watchdog-after-wirecard-fraud-idUSL8N2K83ND [https://perma.cc/WZZ3-NRCN].

86. *See* Jörn Poltz, *Prosecutors Arrest Three in Suspected Wirecard Criminal Racket*, Reuters (July 22, 2020), https://www.reuters.com/article/us-wirecard-accounts/prosecutors-arrest-three-in-suspected-wirecard-criminal-racket-idUKKCN24N23V [https://perma.cc/28JS-4M3T].

87. Huw Jones & John O'Donnell, *EU Watchdog Slams Germany for Lapses in Wirecard Fraud*, Reuters (Nov. 3, 2020), https://www.reuters.com/article/us-wirecard-accounts-esma/eu-watchdog-slams-germany-for-lapses-in-wirecard-fraud-idUSKBN27J0S8 [https://perma.cc/D26J-CVJY].

88. *See id.* The European Securities Market Authority (ESMA) was created by the European Union to protect investors and create uniform rules for markets and national supervisors. *See ESMA in Brief*, European Securities and Market Authority, https://www.esma.europa.eu/about-esma/esma-in-brief [https://perma.cc/2XDE-S3NE].

89. *See What Does Wirecard's Collapse Mean for the Future of App-Based Business Banking?*, Fin. Monthly (Aug. 11, 2020), https://www.finance-monthly.com/2020/08/what-does-wirecards-collapse-mean-for-the-future-of-app-based-business-banking/ [https://perma.cc/2ZPT-RW39].

90. *See id.*

91. *See id.* (some app-based digital banks applied for full banking licenses).

changes will also benefit investors in fintech companies. This is especially true of debtors, such as those owed €3.2 billion by Wirecard.[92]

The Wirecard scandal proves that stricter regulations are needed in the European Union if travesties are to be avoided in the future. By passing a law similar to the FTIL, the European Union could limit the possibility of similar events in the future. Additionally, stricter capital requirements would provide greater protection to investors and consumers.

D. *Mexico, Plagued by Similar Issues, Passed Sweeping Legislation in 2018 that the European Union Should Implement.*[93]

This Section discusses the FTIL which regulates the fintech industry for consumer protection.[94] Specifically, this Section discusses the reasons for implementing the law, the structure of the law, and the desired outcomes of the law.[95]

1. Mexico passed a fintech law that should be a framework the European Union follows in regulating the industry going forward.

This Section discusses the origins of the FTIL including its necessity, the creation of the law itself, and an overview of the Mexican fintech landscape.

The Mexican financial services industry has come under high scrutiny since the early 1990s when the country experienced a major recession and several money laundering cases were brought against leading financial service providers in the country.[96] These activities also created rampant distrust on the part of consumers in the traditional financial services sector as well as the associated regulators.[97]

As of 2019, Mexico had 394 fintech companies based in the country.[98] Mexico housed more fintech company headquarters

92. *See Wirecard's Creditors Set for Battle Over Missing Billions*, Straits Times (June 29, 2020), https://www.straitstimes.com/business/banking/wirecards-creditors-set-for-battle-over-missing-billions [https://perma.cc/4R89-HHMK].

93. *See* Moraila et al., *supra* note 45, at 3.

94. *Id.*

95. Of note, the law did not actually take effect until 2020, so the total effects of the law have yet to be realized in Mexico and therefore cannot be fully discussed. *See id.*

96. *See* Moraila et al., *supra* note 45, at 5.

97. *See id.* at 1.

98. *See The Mexican Fintech Ecosystem Recovers the Leading Position in Latin America and Approaches Nearly 400 Fintech Startups*, Finnovista (May 23, 2019), https://www.finnovista.com/en/radar/el-ecosistema-fintech-mexicano-recupera-el-liderazgo-en-america-latina-y-

than any other Latin American Country, surpassing Brazil's 380.[99] These companies operate in many of the traditional fintech subsectors including lending, wealth management, and traditional banking.[100] Despite the creation and relocation of several fintech companies to the country, Mexico lacked regulation of fintech providers which was problematic given the increasing number of fintech companies and their broad scope.[101] Additionally, prior to the implementation of the FTIL, there was a lack of supervision of fintech companies in Mexico, with companies merely regulated by legislation designed for traditional institutions such as brick and mortar banks.[102]

The growth rate of the fintech industry in the country caused issues because the government was unable to regulate companies in codified laws as fast as they were forming, but this was at least partly remedied with the 2018 legislation.[103] Further, Mexican legislators "have a constitutional mandate to seek financial stability" which led to the enactment of the fintech law.[104]

2. Mexico passed the FTIL in 2018, providing oversight of both crowdfunding and virtual payment systems.[105]

This Section discusses the elements of the FTIL including the new oversight systems created, the portions of the fintech industry impacted, and the expected outcome for consumers and shareholders in the fintech space.

Mexico developed and passed the FTIL in 2018, which went into effect in 2020.[106] The law was intended to create incentives for new fintech innovations as well as to regulate and monitor fintech activity in the country.[107] From the time the legislation was passed in 2018 to its full enactment in 2020, the legislation

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se-acerca-a-la-barrera-de-las-400-startups/ [https://perma.cc/FKG8-E7E7].

99. *See id.*; Moraila et al., *supra* note 45, at 1.

100. *See* Moraila et al., *supra* note 45, at 2.

101. *See id.* at 1-2.

102. *See id.* at 2.

103. *See id.* at 2-3.

104. *Id.* at 6.

105. *See* David Feliba, *LatAm Turns to Mexico's Year-Old Fintech Law as a Model for Regulation*, S&P Glob. (Mar. 7, 2019), https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/latam-turns-to-mexico-s-year-old-fintech-law-as-a-model-for-regulation-50081755 [https://perma.cc/R9BP-QTL8].

106. *Id.*

107. *See* Eyanir Chinea, *Mexico's Fintech Law: Open Banking Rules Delayed,* Iupana (Feb. 28, 2020), https://iupana.com/2020/02/28/mexicos-fintech-law-open-banking-rules-delayed/?lang=en [https://perma.cc/64UA-2XHQ].

underwent revisions, though it remained true to its purpose in codifying regulation of the fintech industry with specified oversight bodies to manage consumer privacy complaints and monetary concerns.[108]

The main pillars of the FTIL are regulation of crowdfunding and electronic payment companies; regulation requirements of the National Banking and Securities Commission and the Central Bank; firm liability for damages; codification of permissible payment company services; cryptocurrency regulations; data sharing regulations; and a regulatory sandbox framework.[109]

Some aspects of the Mexican legislation are similar to what has been implemented in the European Union. For example, the data sharing requirements are similar to those in place in the European Union as required by GDPR, PSD2, and AMLD5 and are achieved through similar application programming interfaces.[110] The main restrictions under these regulations focus on the data privacy concerns of personally identifiable information, a thorn in the side of many fintech providers globally and a similar focus of GDPR.[111] These areas are concerned mostly with consumer privacy protection, not continuity of services or investor protection.[112]

The main difference in the FTIL is that it vests supervisory authority of fintech companies in the National Banking and Securities Commission and Bank of Mexico, unlike the provisions of any current European Union legislation.[113] The law also vests surveillance and additional supervisory authority in several other governmental institutions.[114] Together, these institutions form a commission responsible for authorizing all fintech companies before they conduct business in Mexico.[115]

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108. *See id.*

109. *See* Moraila, et al., *supra* note 45, at 3-4.

110. *See id.* at 3. Application Programming Interfaces (APIs) "are mechanisms that enable two software components to communicate with each other." *What Is an API (Application Programming Interface)?*, Amazon, https://aws.amazon.com/what-is/api/ [https://perma.cc/4UXT-DHXE].

111. *See* Moraila, et al., *supra* note 45. Personal data includes "any information that relates to an identified or identifiable living individual" including names, home addresses, email addresses, identification numbers, location data, internet protocol addresses, cookie identifiers, and medical records. *See* Eur. Comm'n, *What is Personal Data?*, https://commission.europa.eu/law/law-topic/data-protection/reform/what-personal-data_en [https://perma.cc/V6TW-ZK73].

112. *See Id.*

113. *See* René Arce Lozano et al., *Mexico's Fintech Law Initiative: What You Need to Know*, Hogan Lovells Debt Capital Market – Global Insights, Summer 2017, at 34.

114. *See id.*

115. *See id.*

Additionally, the FTIL created a sandbox environment for fintech innovation.[116] A regulatory sandbox generally runs for several months and “allows early-stage fintech start-ups to test out their offerings in a limited market environment, under regulatory supervision, but without having to be fully licensed.”[117] The fintech sandbox originated in the United Kingdom in 2016 (ironically while the United Kingdom was part of the European Union).[118] The Financial Conduct Authority of the United Kingdom lists several benefits of the sandbox model including “the ability to test products and services in a controlled environment; reduced time-to market at potentially lower cost; support in identifying appropriate consumer protection safeguards to build into new products and services; [and] better access to finance.”[119] Sandboxes can increase innovation but can also pose risks to consumers without proper protections in place, such as eliminating important disclosures in the name of “financial innovation.”[120]

Following the implementation of Mexico’s fintech law, several other Latin American countries have followed suit using at least parts of Mexico’s legislation as a model for their own laws including Brazil, Colombia, Argentina, Chile, and Peru.[121] Many of the proposed laws in these countries, however, focus on crowdfunding services with the intent to further develop regulations in other key fintech areas after initial implementation.[122]

There are still challenges associated with implementing the FTIL such as truly defining the agency regulatory standards from broad legislative language, creating a reporting structure, and rebuilding lost faith among the consumer public.[123] While the FTIL is not perfect, it can provide a model for the European Union to begin regulating

116. *See* Moraila, et al., *supra* note 45, at 4.

117. Jemima Kelly, *A “Fintech Sandbox” Might Sound Like a Harmless Idea. It’s Not,* FIN. TIMES (Dec. 5, 2018), https://www.ft.com/content/3d551ae2-9691-3dd8-901f-c22c22667e3b [https://perma.cc/JT5U-75W7].

118. *See id.*

119. *Regulatory Sandbox*, FIN. CONDUCT AUTH. (Nov. 5, 2015), https://www.fca.org.uk/firms/innovation/regulatory-sandbox [https://perma.cc/PBS2-SD3Y]. The Financial Conduct Authority (FCA) is one of the chief regulators of the financial services sector in the United Kingdom overseeing approximately 50,000 business and 48,000 firms. *See About the FCA*, FIN. CONDUCT AUTH. (July 19, 2022), https://www.fca.org.uk/about/the-fca [https://perma.cc/CRR4-XNGA].

120. *See* Kelly, *supra* note 117.

121. *See* Feliba, *supra* note 105.

122. *See id.*

123. *See Fintech Law: A New Challenge for Mexican Regulation*, AXIOMSL, https://www.axiomsl.com/fintech-law-a-new-challenge-for-mexican-regulation/ [https://perma.cc/M2B2-N6BL].

fintech companies on a broader scale including the focus on payment systems and crowdfunding fintech companies.

Mexico issued its first license under its fintech law on January 22, 2020, allowing NVIO Pagos México to operate within Mexico.[124] Since the passage of the law, several foreign companies have also opened new operations in Mexico including Argentina's Ualá and Austria's Paysafecash.[125] While it is too early to draw many conclusions, the quick uptake of fintech licenses by domestic companies and the willingness of international companies to subject themselves to a more intense regulatory scheme show the promise of the FTIL.

E. *Stricter Minimum Capital Requirements Can Better Protect Consumers from Poor Behavior on the Part of Companies.*

This Section discusses capital fundraising, the addition of minimum capital requirements, and how this implementation can protect consumers from large operating losses.

Capital requirements are the funds that the government requires companies to set aside in less risky assets to ensure that they can overcome large operating losses and many types of market instability.[126] "Higher bank capital requirements reduce the probability of banking crises."[127] By increasing capital requirements, forcing companies to maintain more capital on hand, the government can better protect company creditors and also create a more compliant culture by "improving incentives for better risk management."[128] Extending the current requirements from banks to fintech companies broadly represents a policy shift, because currently only those companies regulated by national banking laws in the European Union are required to have capital on hand.[129]

There are two main routes that a corporation can take to raise capital: equity and debt.[130] In raising equity, the corporation issues

124. *See* Valdez et al., *supra* note 11.

125. *See Argentine Fintech Ualá Expands into Mexico*, Galileo (Nov. 17, 2020), https://www.prnewswire.com/news-releases/argentine-fintech-uala-expands-into-mexico-powered-by-galileo-301174546.html [https://perma.cc/8VN4-PZ82]; Samantha Hurst, *Austrian Fintech Paysafecash Announces Expansion into Mexico*, Crowdfund Insider, (Aug. 25, 2020), https://www.crowdfundinsider.com/2020/08/165697-austrian-fintech-paysafecash-announces-expansion-into-mexico/ [https://perma.cc/7Q4A-EXK2].

126. *See* James Chen, *Capital Requirements*, Investopedia (Dec. 31, 2020), https://www.investopedia.com/terms/c/capitalrequirement.asp [https://perma.cc/PKV8-W3KU].

127. *See* William R. Cline, *Benefits and Costs of Higher Capital Requirements for Banks* 2 (Peterson Inst. for Int'l Econ., Working Paper No. WP 16-6, 2016).

128. Jihad Dagher et al., Benefits and Costs of Bank Capital 8 (2016).

129. *See* 2013 O.J. (L. 176) (32), (37).

130. *See* Claire Boyte-White, *Top 2 Ways Corporations Raise Capital*, Investopedia (June 11,

ownership shares to an individual in exchange for funds that the corporation can use for its operations.[131] In issuing debt, the corporation issues bonds (or a similar instrument) to individuals which it promises to pay back in full with an interest rate attached, meaning that the holder of the instrument receives a slightly higher amount in return for the capital that they loaned the corporation.[132]

Increasing the capital requirements for companies would necessitate a shift in fintech companies fundraising[133] away from debt toward equity.[134] This change would result in taxes on consumers, lack of government insurance on equity holdings, and consumer market misconceptions.[135] In short, those holding the new equity would be less protected than those individuals who were previously holding the company's debt.[136] However, the increase in capital on hand would create a more stable environment in the case of significant losses of the company, such as those seen at Wirecard.

In the European Union, capital requirements are set by the Investment Firms Regulation (IFR) and currently apply to banks and investment companies only.[137] These requirements for the largest banks represent fractions of overheads, initial capital or other governmental requirements.[138] Because these regulations only apply to banks and investment firms as defined in the IFR, they do not necessarily apply to companies such as Wirecard or other payment system providers. Expanding this regulation to fintech companies would provide the same protection across fintech companies that is provided to consumers at banks and investment firms.

2021), https://www.investopedia.com/ask/answers/032515/what-are-different-ways-corporations-can-raise-capital.asp [https://perma.cc/SW8F-FVXS].

131. *See id.*

132. *Id.*

133. *See* Douglas J. Elliott, *Higher Bank Capital Requirements Would Come at a Price*, Brookings (Feb. 20, 2013), https://www.brookings.edu/research/higher-bank-capital-requirements-would-come-at-a-price/ [https://perma.cc/4ARL-BTSX].

134. *See id.* (treating banks as fintech firms).

135. *See id.*

136. *See id.*

137. *See* Marillia Shewchenko, *How Can Investment Firms Navigate the Upcoming EU Capital Requirements?*, Fin. Monthly (Sept. 30, 2020), https://www.finance-monthly.com/2020/09/how-can-investment-firms-navigate-the-upcoming-eu-capital-requirements/ [https://perma.cc/LZD3-QZ9C]. The Investment Firms Regulation (IFR) is a law of the European Union that went into effect June 26, 2021 and provides oversight mechanisms for investment firms. *See Prudential Rules for Investment Firms*, Eur. Comm'n, https://ec.europa.eu/info/business-economy-euro/banking-and-finance/financial-supervision-and-risk-management/managing-risks-banks-and-financial-institutions/prudential-rules-investment-firms_en [https://perma.cc/5W3U-P444].

138. *See* Shewchenko, *supra* note 137.

III. Analysis

Part II of this Note discussed the current state of fintech, the current regulations in place across the European Union, the Wirecard collapse, the implementation of the FTIL, and the perceived benefits of stricter capital requirements. Part III includes the steps necessary to implement fintech legislation in the European Union, changes to the FTIL to make it a useful model, an analysis of roadblocks to its implementation, and a review of current criticisms of the FTIL. Ultimately, this Note concludes that the European Union should pass a version of the FTIL that also includes stricter capital requirements.

While the European Commission released a Digital Finance Package in September 2020, the outcomes that it seeks to achieve are not far reaching enough and do not provide adequate consumer protections to end-users and investors in fintech companies.[139] The European Union should seek to enact legislation and regulations that expand beyond this initial package, though the implementation of this package could be a good starting point while more meaningful regulations are drafted.

A. *The European Union Should Implement a Version of the FTIL to Better Protect Consumers and Investors.*[140]

As shown in Part II of this Note, the European Union has weak overall protection for consumers in the fintech sector. Mexico was facing a situation similar to the current European Union situation.[141] By implementing a version of the FTIL, the European Union would create more consumer protections and provide closer oversight of fintech companies in the region. The FTIL has been successful in

139. *See The EC's Digital Finance Package: A Step in the Right Direction for Global Blockchain Adoption*, *supra* note 68.

140. For the European Union to promulgate these types of legislation, the European Parliament would need to pass a law in consultation with the European Council which is comprised of the "governments of the 27 EU countries." *How EU Policy Is Decided*, Eur. Union, https://european-union.europa.eu/institutions-law-budget/law/how-eu-policy-decided_en [https://perma.cc/JFK8-J9EK]. If the European Union is unable to pass legislation, the executive arm of European Union, the European Commission, is also capable of regulating member states through the regulation process which it may use to strengthen requirements for fintech firms. It is possible that any constituent country could object to passing legislation through the broader European Union bodies due to individual concerns, but as shown in Part III(A)(1) infra, the timing of the Wirecard fiasco makes this a perfect time to pass this legislation. *See European Commission*, Eur. Union, https://european-union.europa.eu/institutions-law-budget/institutions-and-bodies/search-all-eu-institutions-and-bodies/european-commission_en [https://perma.cc/U3LQ-QWTG].

141. *Cf.* Moraila, et al., *supra* note 45.

early phases of implementation, and a similar law in the European Union should produce similar outcomes across European Union member countries.[142] By implementing this type of law, the European Union would better protect both consumers and investors in fintech companies across the region which would also create a more stable overall economy.

1. This Section discusses the timing of regulations in relation to the recency of the Wirecard scandal and the ability to overcome concerns of stifled innovation by utilizing the sandbox framework proposed in the FTIL. Because of the recency of the Wirecard scandal, this is the perfect time for proponents of this type of regulation to push their agenda forward.

While the Wirecard scandal is fresh in the minds of consumers and lawmakers of both the European Parliament and European Council, those pushing for promulgation of these types of regulations should seize the opportunity. The public outcry over the Wirecard failure has been large and has opened a window that those proponents should seize, especially as individual governments have failed to accept responsibility for the failure.[143] While governments are seeking to pass blame for this scandal, they also do not want to be seen as disallowing regulations that would prevent future scandals. By positioning these regulations to prevent potential future scandals like Wirecard from happening, proponents should be able to gain traction and earn passage of the regulations.

Additionally, several high ranking officials across the European Union have called for changes to the oversight system as a result of the Wirecard Scandal.[144] The General Manager of the Bank for International Settlements, Augustin Carstens, said "his organization will examine how 'non-bank participants and payment service providers can be incorporated into the whole [regulatory] scheme.'"[145] Additionally, Felix Hufeld, the former president of BaFin called the

142. *See* Feliba, *supra* note 105.

143. John O'Donnell, *Who's to Blame for Wirecard? Germany Passes the Buck*, REUTERS (July 2, 2020), https://uk.news.yahoo.com/whos-blame-wirecard-germany-passes-134343700.html [https://perma.cc/A9M6-LV2Q].

144. *See BIS: Wirecard Debacle Could Trigger Revamp of Payment Regs*, PYMNTS (June 30, 2020), https://www.pymnts.com/news/security-and-risk/2020/wirecard-debacle-could-trigger-payment-regulations-revamp/ [https://perma.cc/69UY-JDUL]; Ryan Browne, *'The Enron of Germany': Wirecard Scandal Casts a Shadow on Corporate Governance*, CNBC (June 29, 2020), https://www.cnbc.com/2020/06/29/enron-of-germany-wirecard-scandal-casts-a-shadow-on-governance.html [https://perma.cc/BMS5-BDN6].

145. *See* PYMNTS, *supra* note 144.

Wirecard debacle a "total disaster."[146] While these high ranking officials are focused on driving change, the time is ripe to enact regulations in the European Union to better protect consumers in the fintech market space.

2. Concerns of stifling innovation under the FTIL could be resolved utilizing the sandbox regulatory framework.

In the broader fintech sector, there is concern that by increasing regulations, the European Union could slow innovation.[147] "Economic regulation reduces the scope for innovators and entrepreneurs to experiment and contest markets."[148] By reducing innovation of fintech companies, the products and services that underserved consumers need will take longer to get to market and those consumers that the regulation is seeking to protect may actually be harmed.

While regulation can be a detriment to growth, regulation, when done properly, can also be a springboard for innovation, especially in the digital space.[149] By utilizing in-house compliance managers, companies can increase compliance with regulations and define new ways to innovate to meet the regulations, increase business, and exceed customer expectations.[150] Additionally, the ability to data share or build a payment system in-house to comply with regulations forces more innovation on the part of fintech companies, spurring new ideas for compliance.[151]

Even though regulation may slow the innovation of fintech companies, it is important for governments to protect the vulnerable from predatory companies. While speed to market may decrease because of regulations, it is more important that products and services released by fintech companies adequately protect consumers than have an early release. The European Union should consider how regulations can slow innovation, but even without additional legislation, such as a sandbox environment, the speed to market cannot come at the expense of consumer protections.

Additionally, the European Union can provide for sandbox innovation, to continue to push innovation in the fintech sector like

146. Browne, *supra* note 147.

147. Fredrik Reixon & Bjorn Weigel, Risk, Regulation, and the Innovation Slowdown, Cato Inst. (2016).

148. *Id.*

149. *See* Richie Serna, *Why Smart Regulation Leads to Fintech Innovation*, Forbes (Apr. 17, 2020), https://www.forbes.com/sites/forbestechcouncil/2020/04/17/why-smart-regulation-leads-to-fintech-innovation/ [https://perma.cc/326A-XTBW].

150. *See id.*

151. *See id.*

the sandbox provisions in the FTIL. The sandbox provisions allow companies to operate for a short period of time (two years in Mexico) without having to fully comply with the rules and regulations required under the law.[152] The company is limited to only working with a small number of consumers.[153] The European Union should also implement additional consumer communication requirements to create more consumer protections for those companies regulated in the sandbox regime.

In implementing fintech regulations, the European Union should utilize the sandbox approach to continue pushing innovation in the sector across the bloc. Adopting the sandbox model would permit European Union fintech companies to continue innovating at a high level while not forcing too much risk on fintech consumers or shareholders. This type of regulation (or lack of regulation) can work in the region based on the laws the United Kingdom implemented with success.[154] Seeing that this type of regulation can succeed in a former European Union country (the United Kingdom), the European Union should feel more comfortable adopting the sandbox regulations across the region.

B. *In Addition to the FTIL, the European Union Should Also Implement More Stringent Capital Requirements for Fintech Companies.*

In addition to the contents of the FTIL, the European Union should also implement higher capital requirements for fintech companies extending beyond the new requirements under IFR. Implementing higher capital requirements on fintech companies provides a financial safety net for consumers to fall back on if the company fails.[155] Restricting the funds available for risky investments creates more safety for consumers, equity holders, and debt holders.[156] By requiring fintech companies to maintain a higher level of capital on hand, the government could better protect these classes of individuals.[157]

The implementation of stricter capital requirements will likely meet roadblocks in the European Union because of fintech companies' resistance to increased capital requirements. The increase in

152. *See* Valdez et al., *supra* note 11.
153. *Id.*
154. *See* Trevor Dryer, *It's Time for a Federal Fintech Sandbox*, FORBES (Dec. 6, 2019), https://www.forbes.com/sites/forbesfinancecouncil/2019/12/06/its-time-for-a-federal-fintech-sandbox/ [https://perma.cc/W32G-WA5K]. *See also*, Section II(D)(2), *supra*.
155. *See* Section II(E), *supra*.
156. *But see* Cline, *supra* note 127, at 23.
157. *See id.*

this capital requirement can help protect consumers by insuring the operations of the companies despite any major operating losses. For example, by requiring Wirecard to have more cash on hand more funds would have been available for both equity and debt holders who are now shaken and may not recover their investment in the company. Because the European Union has shown its willingness to put stringent capital requirements on the banking and investment industry, it should implement similar restrictions across all fintech companies. The implementation of these capital requirements would allow for more stability in the overall economy while also better protecting both consumers and investors in the fintech sector.

C. *The Benefits of Enacting a Law to Protect Consumers from Predatory Fintech Companies Greatly Outweighs the Costs, and the European Union Should Use the FTIL as the Model for Its Legislation with the Addition of Capital Requirements*

In evaluating whether a law such as this should be implemented, the European Union must weigh the costs and benefits. It is possible that the increase in capital requirements and stricter requirements for crowdfunding and virtual payments could harm the financial sector in minimal ways. However, these potential harms to companies do not outweigh the costs that consumers pay when these institutions fail or are unable to complete transactions. The Wirecard example shows that consumers need more protection. Passing regulations similar to the FTIL, while also implementing higher capital requirements, will better protect consumers of fintech companies in the European Union.

IV. Conclusion

The European Union should implement a version of the FTIL that reaches at least to the extent of the current FTIL and should seek to expand the reach in the future. Because the FTIL applies only to payment services and crowdfunding companies, there is opportunity to expand to other subsectors of the fintech industry. This will allow European Union regulators to better monitor fintech companies within the European Union's borders and better protect consumers. Additionally, the European Union should implement a minimum capital requirement beyond banking and investment management to other fintech services such as lending and payment services.

The implementation of this type of law will force companies to hold more capital on hand, disallowing certain risky investments protecting both consumers and investors ensuring that companies will be able to sustain large operating losses and even failures of oversight in some cases. This regulation would protect consumers from scandals such as Wirecard across the European Union.

Additionally, the time is ripe for the implementation of laws requiring these types of regulations. Governments have failed to take responsibility for the lack of oversight, and high-ranking officials believe that the time for change to the oversight structure is here.[158] With those conditions in place, this is the best time to pass legislation changing the oversight of fintech companies across the European Union. High ranking officials have stated a desire to see changes happen at the highest level of European Union regulations.[159] The European Union should use these prime conditions as a springboard to promulgate regulations.

While current regulations across the European Union do protect consumers privacy specifically with their data (GDPR, AMLD5, PSD2), the implementation of broader consumer protections could further protect consumers who are financially vulnerable.[160] This is especially important when referencing those individuals who are unbanked or underbanked and can fall victim "to predatory lenders, sky-high interest rates, hefty fees, and other expenses."[161] Steeper regulations would protect consumers using the fintech services providing a continuation of service and create a buffer for investors in case of large operating loss.

This approach, while protecting the consumers of the European Union, would also make the European Union the new standard for fintech consumer protection. Additionally, because many of the largest financial institutions in Europe and many of the startups have a global presence, regulations in the European Union would extend beyond its borders, better protecting consumers worldwide.[162] Implementing a law such as this would also allow the European Union to better regulate cryptocurrencies, an area that no country has regulated heavily yet.[163] The European Union has the

158. *See* O'Donnell, *supra* note 143; PYMNTS, *supra* note 144; Browne, *supra* note 144.

159. *See* Browne, *supra* note 144.

160. *See* Bruce Bennet, et al., *Overlap Between the GDPR and PSD2*, Inside Privacy (Mar. 16, 2018), https://www.insideprivacy.com/financial-institutions/overlap-between-the-gdpr-and-psd2/ [https://perma.cc/5QXV-4EQG].

161. Alex Gailey & Kendall Little, *What You Should Know if You Are Unbanked Right Now*, Time: NextAdvisor (June 4, 2021), https://time.com/nextadvisor/banking/what-to-know-if-you-are-unbanked/ [https://perma.cc/S5KB-BM8R].

162. *Cf. Here Are the 50 Largest Banks in Europe (2019)*, Bus. Insider (Oct. 10, 2019), https://www.insider.com/largest-banks-europe-list [https://perma.cc/EKD8-J7TH].

163. *See* Brian D. Feinstein & Kevin Werbach, *Does Regulation Chill Cryptocurrency Trading?*,

chance to be at the forefront of these regulatory schemes instead of playing catchup. This allows the European Union to not only shape its own policy but shape policy globally. These regulatory changes in the everchanging fintech arena would allow the European Union to shape the global financial sector for years, if not decades, to come.

REGUL. REV. (Aug. 31, 2020), https://www.theregreview.org/2020/08/31/feinstein-werbach-does-regulation-chill-cryptocurrency-trading/ [https://perma.cc/AY6T-UHXY].