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Europe's Single Digital Financial Market - Picking up speed in rapid waters

It remains difficult to accurately pinpoint how exactly new technologies will affect the European financial markets and its actors. Amid the multitude of possible scenarios, many share the underlying finding that new or rapidly advancing technologies act as a catalyst for the well-known three "D´s" of digitalisation: disaggregation, disintermediation and dematerialisation. On an abstract level, these effects already give a good overview over the major effects of new technologies on value chains and ecosystems in finance. With the help of technologies such as Cloud Computing and Artificial Intelligence, highly specialised business models add new value to specific parts of value chains and offer these elements more effectively or efficiently than incumbent providers with holistic value chains, leading to disaggregation both along the product line and between middle and back office functions and the customer interface.

At the same time, developments such as the Distributed Ledger Technology and related concepts such as smart contracts deployed on decentralized, permissionless blockchains have proven that this technology can not only improve efficiency in capital market processes, but may also question the technical necessity of entity-based financial intermediation.

The same technology is also a driver of demateralisation by enabling the tokenisation of assets. The digital representation of the economic value of and rights to physical assets on distributed ledgers could not only enable investment and trade in new, previously non-fungible or illiquid assets classes, but also promote a more inclusive access for retail investors by facilitating fractional ownership.

The technologies and their application are prone to converge, amplifying their potential effect on the financial market structure. On the other hand, adoption levels vary greatly: while investment in and implementation of machine learning and other AI methods is already relatively widespread, many implementations of DLT technology are still in their early stages and rarely part of operational day-to-day business. The different adoption levels in the industry may actually also be a sign of the readiness of current regulation to cope with the different technologies highlighted here.

The transformation of the financial market value chains and ecosystems seems rapid. In particular, the activities of one group of financial market actors can add momentum to this scenario: BigTechs. With their data- and platform-centric business models and the corresponding network and concentration effects, these companies have the potential to substantially transform the financial landscape despite their current primary role as technology providers. Value chains that have been disaggregated by the effects of digitalisation could end up being rebundled in the hands of a few large, non-european companies due to the effects of platform-based business models.

Building on previous work and recognising that the CoViD-19 pandemic highlights the importance of taking up technological innovations in finance, the Commission has been working on two legislative proposals on operational and cyber resilience and on Crypto Assets as well as preparing a Retail Payment and Digital Finance Strategy. Together with the legislative proposal on combating money laundering and terrorism financing expected for early 2021, the Commission is thus addressing key challenges in ensuring that the EU financial services regulatory framework is fit for the digital age.

In order to ensure an innovative and secure European digital finance union, the German Council Presidency will therefore strive to advance the key priorities in this area as far as possible: providing for a secure and innovative financial market union for tokenised financial services, increasing cyber security and resilience of the European financial market and promoting the Retail Payments Strategy. As regards the Digital Finance Strategy, the focus on an innovation-friendly data-driven and sovereign EU financial sector could give the European Union an early-mover advantage in moving from open banking to open finance. ●