How to support effective digitalisation of EU finance and ensure sufficient technological sovereignty?

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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 dematerialisation 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.

> *EU digital sovereignty requires an ambitious approach to key challenges in the EU financial services regulatory framework.*

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. ●

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Digitalisation: the right way forward

Together with the adoption of the EU Fintech action plan in 2018, the European Union has embraced digitalisation and innovation in the financial sector. This improvement was marked by implementing different policies under the Digital Single Market Strategy, Cyber Strategy and the Data Economy. However, this was not enough and the EU took upon itself to create the Digital Finance Strategy. This move is a right way forward as the financial ecosystem is continuously evolving with technologies moving from experimentation to pilot testing and deployment stage and new market players entering the financial sector either directly or through partnership with the incumbent financial institutions. Additionally, the COVID-19 pandemic has emerged as a catalyst for digitalisation as it has shown the importance and the need of digital financial services both for the public and business. The post-COVID-19 finance sector will be more digital than ever before, and Europe will need proper policies that stimulate innovation and help the economy recover back to pre-COVID-19 levels.

In this context, the Digital Finance Strategy should focus on balancing the benefits and risks of digitizing the financial industry. The main goal should be the development of a Digital Single Market. We need to lay the necessary foundation for digital innovation which can lead to a faster, more efficient and better access to financial services for consumers and to help provide finance to the economy in general and the Digital Finance Strategy will play an important role in this development. In this matter, future regulation must be technologically-neutral, without imposing excessive requirements and flexible enough to meet technological challenges of the EU financial sector.

The potential of digitalisation of the EU financial industry and especially of FinTech is in facilitating structural changes in the financial sector, including support for new business models. Accordingly, there is a need for stronger coordination mechanisms to support authorities in supervising innovative cross-border, and potentially cross-sectoral, businesses models and in monitoring effectively the regulatory perimeter to ensure the oversight arrangements remain fit-for-purpose.

Furthermore, there is a need to remove the regulatory fragmentation and to ensure a level playing field between incumbents and new market entrants, both FinTech start-ups and BigTech firms, across the entire EU. For example, BigTech companies are currently pushing into the financial services space, integrating financial services within their digital ecosystems all while changing the established financial order. While these companies are bringing innovation, diversification and efficiency in the provision of financial services, hence, the presence of BigTech firms in financial services also highlights the issue of the appropriate regulatory response, which may be complicated in the case where BigTech firms distribute financial products and services supplied by existing traditional financial institutions.

New financial service providers, who are entering the market, often face less strict regulatory requirements than traditional financial institutions. It is, therefore, crucial to respect the principle of same activities, same risks, and same rules and to strive for a true level playing field to ensure an appropriate and consistent coverage of activities that have implications for financial stability. Removal of potential impediments to the cross-border provision of banking and payment services and facilitation of cross-border access, including via the update of interpretative communications on the cross-border provision of services and further harmonisation of consumer protection, conduct of business and AML/CFT requirements should be among the top priorities of the EU. By tackling fragmentation within Europe, resulting from different approaches the Member States take in adopting the EU directives, as well as divergent supervisory practices, we could achieve the best jurisdiction for financial services in the world. ●

Ugo Bassi

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Towards a new digital finance strategy for Europe

The future of finance is digital: consumers and businesses have been increasingly accessing financial services digitally, innovative market participants are deploying new technologies, challenging traditional business models. Digital finance has helped citizens and businesses tackle the unprecedented situation created by the COVID 19 pandemic.

If there was still any doubt, it is now clear: digital finance has much to offer. Europe must take advantage of this in its recovery strategy, with digital technologies being key to relaunching and modernising the European economy across sectors and to moving Europe forward as a global digital player. Naturally, users of EU financial services must be protected against the associated risks.

Earlier this year, the Commission set out how to "Shape Europe's Digital Future". In the financial sector, we are building on our previous initiatives as well as on insights obtained from various experts. This includes the 2018 FinTech Action Plan, the 2019 report of the expert group on regulatory obstacles to financial innovation (ROFIEG), the 2020 recommendations of the High Level Forum on Capital Markets Union, and the 2020 SME Strategy for a sustainable and digital Europe.

We also take account of the feedback gathered during the extensive Digital Finance outreach events with stakeholders that we carried out in the first half of this year and the results of our recent public consultation on a new digital finance strategy for Europe.

Our strategic objective is to ensure that the EU financial sector embraces all the opportunities offered by the digital revolution and drives it with innovative European market players in the lead, in order to make the benefits of innovative digital finance available to European consumers and businesses, while ensuring proper mitigation of the associated risks.

Against this background, the Commission intends shortly to propose four priorities to guide the EU's actions for promoting digital transformation of the financial sector during this mandate of the European Parliament and the Commission until 2024:

- First, addressing fragmentation in the Digital Single Market for financial services to give European consumers genuine access to cross-border services and to foster the scaling up of European financial firms.

- Second, ensuring that the EU regulatory framework facilitates digital innovation in the interest of consumers and market efficiency. Accelerating innovation cycles call for regular examination of the EU financial services legislation and supervisory practices to ensure that they remain adapted and relevant in the digital age.

- Third, creating a European financial data space to promote data-driven innovation, building on the European data strategy and open data policy. The EU has led the way in opening up data sharing with respect to payments accounts. Further steps towards enhanced data sharing and openness will encourage the financial sector to embrace data-driven innovation, enabling innovative products for consumers and businesses.

- Fourth, addressing new challenges and risks associated with digital transformation. Digital finance creates new risks, in particular for cybersecurity and data protection. Digital finance also challenges the existing regulatory and supervisory frameworks. In this context, we will pay particular attention to the principle "same risk, same rules, same regulation", not least to safeguard the level playing field between existing financial institutions and new market participants.

> *The Commission will promote the new opportunities of digital finance for consumers.*

Across these four priorities, the Commission will pay particular attention to promote the new opportunities of digital finance for consumers and to protect them wherever necessary. We also commit to continue working closely with our international partners, as the benefits of digital finance are best harnessed if their deployment is based on internationally compatible principles and standards. ●

Valentin Stalf

Chief Executive Officer, N26 GmbH

Mobile Banking: serving consumers best, anytime, anywhere

Digitalisation has changed consumer habits: Remember people looking for phone booths, inserting coins to call their relatives after arrival at their holiday destination? Or purchasing travel maps to find their way in a foreign city? Or using eurocheques to pay abroad? Today, thanks to digital technology, our relatives can follow us real time when we travel and make a video call at quasi zero cost; digital maps guide us to any foreign destination; and when we pay, we use our mobile phones and pay fully digital.

Digital services and increased transparency lead to lower prices

Changes in consumer habits will continue to transform the financial sector over the coming years. The number of bank branches will decrease rapidly, because consumers prefer banking via their smartphones. If they have questions regarding their bank account, AI-supported chat bots will provide answers. For more complex issues, they will video call a financial advisor. Consumers want financial services easily, instantly, and combined with a positive user experience, at lower prices and with greater transparency.

COVID-19 has accelerated these trends. Why wait in a queue at a bank branch in order to transfer or withdraw money, if you can pay online? Why pay with unhygienic banknotes if you can pay contactless with your phone? COVID-19 has brought digital banking in particular to the elder generation who is more digitally savvy than most of us would have thought. Today, bank customers above the age of 65 spend a third more on e-commerce than ever before. Meanwhile, cash withdrawals went down by more than 50% in most countries. In the context of ecosystems, digital banking means that at one point, there will be fewer platforms that advise consumers on all their financial needs. Why do we have to manage different accounts with different banks via different apps, whilst in effect one needs only one app to manage all accounts and payments?

Digital talent requires digital education

What we experience today, is an unbundling of the banking service process with all its tiny, intertwined bits and pieces. What banks used to do as big, intransparent black boxes is now disassembled and re-invented by agile FinTechs, but also by BigTech, so that you can reassemble the process in a transparent, optimized way.

To ensure successful digital transformation we need to ensure training and support of digital talents. Digital education will be one of the key principles in achieving the competitiveness of our market, and future success and can only be achieved with a radical change of our current education scheme and content. Digital transformation will also change processes. Today, client onboarding/KYC, AML and CTF are huge cost blocks for the industry. Results, though, as regards prevention, detection, and prosecution of fraud matters are not satisfactory.

A European-wide comprehensive Digital ID will have the potential to lift KYC and AML efforts to a new level. With the private and the public sector working closely together, AML will become more effective, and more efficient, leading to much better results.

Reduce hurdles and enable cross-border banking for consumers

If we were to invent banking today, it would look different to what we currently experience. The idea of IBANs was to make money transfer easier, faster and cheaper. The reality it that they are not user-friendly, unharmonized across the EU, and there is discrimination of non-domestic IBANs.

As regards Open Banking, our perspective should be what consumers want and need, and not only what is technically possible. Products need to be simple to use: it needs to become easier for consumers to switch bank accounts - also cross-border - or to switch standing orders. How can we make sure that all the data the financial world is generating today is used in a smart way to help people make better financial decisions, also in light of GDPR? Do we want consumers to be financially literate, or do we want companies that know more about the consumer than the consumer knows about himself?

A prerequisite for a true single market are standardised banking products (accounts, mortgages, investment products) across Europe, so that the consumer can make cross-border choices. Non-standardised products, and gold-plating of consumer and data protection rules on national level are the main impediment towards a harmonized Single Market.

At N26, we are putting the EU consumer back into the center again. We are setting the bar for digital innovation, and we rethink existing banking products (e.g. joint accounts, what we call Shared Spaces) and make them simple. The EU should empower citizens to choose freely between the best and most suitable financial products. Enabling a completely frictionless common market for banking services will be key to for a better banking experience of European consumers. ●

Bernd Leukert

Member of the Management Board – Chief Technology, Data and Innovation Officer, Deutsche Bank AG

Delivering a digital future for European Financial Services

The adoption of new technology in the financial sector has moved at a tremendous pace and has the potential to deliver significant benefits to firms, their customers and the wider economy. The pace of innovation in the sector also has the potential to disrupt and destabilise the EU financial system, bringing with it risks for market integrity, consumer trust and economic sovereignty. It is a transformation that will need to be carefully navigated not just by financial services firms, but by regulators as well. The ambition should be nothing less than to deliver a single digital market, with consistent, risk-based rules for all participants.

For Deutsche Bank, digitalisation does not only mean developing new products and services but also requires a fundamental rethink of the way in which products and services are delivered. Our technology strategy has focused on expanding engineering expertise and introducing agile delivery to support a culture of innovation. In July 2020 we announced a strategic partnership with Google Cloud that will accelerate our move to 'native' cloud computing, transform our IT architecture and generate considerable value for clients.

These changes to the way we approach technology allow us to be simpler, safer and more efficient. For example, the bank has used robotic process automation to enhance money laundering checks and partnered with the start-up WorkFusion to transform the way we process documents in our Trust & Agency Services businesses. In addition, technology has allowed us to provide innovative products and services to our clients, digitalising cash management for some of Europe's largest corporates and allowing our institutional clients 24/7 instant mobile access to trade on FX pairs.

The benefits of digitalisation have been made clear in the light of the COVID crisis. We have been able to support the majority of our workforce operating remotely without any significant disruption. We have also been able to adapt quickly to support clients and manage unprecedented lending volumes. These positive effects of the digitalisation of Europe's financial services sector need to be preserved through the post-COVID recovery.

Equally the experience of the pandemic highlights some of the risks that could flow from disruption of the existing financial services ecosystem in Europe. Banks have played a critical role in channeling loans to firms and customers in need, leveraging balance sheets, networks and relationships not easily replicated by start-ups or third country technology providers. The market-making role of large universal banks in the EU has been important in ensuring capital markets have kept functioning.

The challenge for policy makers through the recovery will be to preserve competition and innovation without compromising the integrity of the European financial system. In striking that balance, there are a number of key elements that need to be in place:

Continuous dialogue – Investment in innovation requires legal certainty and this demands open communication channels with regulators and stakeholders – for instance within regulatory sandboxes or innovation hubs.

A level playing field – a consistent approach to the regulation and supervision of the risks inherent in particular activities or services is essential to avoid competitive distortions, the potential for regulatory arbitrage and to secure consumer trust.

> *The ambition should be nothing less than to deliver a single digital market.*

An effective framework for data – standardized data access is essential to understand customer needs and provide the right products and services. An effective data framework would offer individuals practical tools to control their data and how it is used. To support innovation, regulation should focus on governance mechanisms for a data driven economy. Rather than designing regulation narrow pre-defined use cases, the framework should focus on protecting the interests of the individual data subject regardless of the specific use case.

A truly single digital market – the development of a fully harmonized framework for the regulation of digital financial services is perhaps the single most important step to ensure competitiveness of the EU in this space. Even where regulation does not directly pose a barrier to digitalisation, fragmentation due to national gold-plating of rules will reduce the scale benefits of investment in digital solutions and discourage cross border solutions.

Frank Fallon

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Digital transformation: cloud's role in building a competitive and secure European Financial Service

As consumer expectations continue to evolve at increasing speed, financial services organizations recognize that they have to move faster and become more efficient than ever before to transform their business and remain competitive in the long-term. At the same time, data is increasingly viewed as an asset, and those firms that can unlock the value of data will have an advantage in the market. Firms need to be able to manage, access, and share their data effectively and securely. Cloud enables financial firms of all sizes to achieve this. By building on the cloud, firms of all sizes, from Fintechs to G-SIFIs, benefit in three key ways: extracting new insights from traditional and alternative financial data; creating the scalability and agility to respond to market and business changes in real-time; and reducing the time and resources needed to manage and maintain technology infrastructure. All this while operating with the highest security standards available that are required in the financial services industry.

Data-led insights, enabled by the cloud, are providing firms with the ability to make business-critical decisions concerning customer segmentation and personalization, market positioning, product pricing, risk, security, compliance, and surveillance. Financial organisations are increasingly looking to artificial intelligence (AI) and machine learning (ML) in the cloud to bring greater efficiency to existing processes and to extract deeper value from data. Further, by moving to the cloud, firms can focus their efforts on innovating and addressing customer challenges.

From continuously and quickly developing, testing, and deploying new applications with a robust and deep set of technological capabilities available at their fingertips to rapidly scaling on global infrastructure, the cloud provides them with more control over their technology decisions and provides the ability to scale up or down depending on their needs.

Organisations no longer need to make large upfront capital investments to build and maintain infrastructure because the cloud provides elastic, reliable and secure IT resources on demand over the internet with pay as you go pricing. Firms can provision exactly the right type and size of resources needed, deploying as many resources as they need when they need them and only paying for what they use, all while benefiting from a level of security trusted by governments for their most sensitive data. At AWS, we use the same secure hardware and software to build and operate each of our regions (geographical locations), so all of our customers benefit from the only commercial cloud that has had its service offerings and associated supply chain vetted and accepted as secure enough for top-secret workloads. This is backed by a deep set of cloud security tools, with more than two hundred security, compliance, and governance services and key features. By using resilient and secure cloud infrastructure that has been built to compensate for major operational disruptions, we are confident well-architected cloud environments reduce risk in the financial system compared to legacy on-premises technology.

> *Firms need to be able to manage, access, and share their data effectively and securely. Cloud enables financial firms of all sizes to achieve this.*

As financial institutions reap the economic benefits from digitalization, cybersecurity becomes a critical priority. As President Von der Leyen noted: "Cybersecurity and digitalization are two sides of the same coin [...] for the competitiveness of European companies, we have to have stringent security requirements and a unified European approach". In this context, the development of a pan-European set of rules on cybersecurity and digital resilience is an opportunity to raise the bar on these critical aspects of an increasingly digitalized financial services sector. For such a framework to be effective, it should prioritize what is important in terms of security and resiliency and use this to proportionately protect financial organizations. Further, given the rapid level of technological innovation, the framework should remain principles-based in order to handle dynamic complexities.

The emerging regulatory framework should have at its core the dual objectives on enabling European financial institutions and consumers to reap the potential of digital transformation, and mitigating the new risks digital finance might bring. It should ensure that financial firms have full access to all the technologies that will be the foundation of the sector's competitiveness, like cloud and machine learning and should neither prescribe nor prevent the use of particular technologies, while ensuring that regulatory objectives continue to be satisfied. This imperative in a context of long-term low interest rates, low returns and facing the post-COVID recovery. At AWS, we remain committed to work with customers and regulators alike to provide the most secure and reliable technology environment for the European financial services sector that enables innovation on behalf of customers. ●

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Effective digitalization of financial services requires a comprehensive approach to systemic risk

Digitalization of financial services continues to benefit the economy through provision of competitively priced innovative services to customers. Covid-19 has shown that digital services can also contribute to resilience of societies in times of crisis. However, the digitalization also brings new risks.

The reliance on digital infrastructure coupled with collection and processing of masses of highly sensitive data through complex value chains with multiple service providers, high speed of innovation and growing pressures to reduce costs create new vulnerabilities and risks on the level of the societies.

There is a growing awareness that these risks need to be properly managed by the financial institutions and their service providers. Requirements for risk management should be further enhanced in the legislation and supervisors should have adequate powers to enforce them. In addition, attention should be given on how to deal with the systemic nature of these risks as operational incidents involving financial services can quickly hamper normal functioning of the society.

Financial markets are strongly interlinked with other critical sectors such as telecommunications and energy networks. Preparing for large scale incidents requires more than financial buffers. Contingency arrangements and redundancy capacities need to be in place, supported by a "whole-of-government-and-society" approach, taking into account also considera-tions of national security.

The "Digital Operational Resilience Act" currently prepared by the Commission provides a good starting point to deal with risks brought about by digitalization. However, the following areas should also be covered to provide a comprehensive approach to address also the systemic nature of the risks:

Legislative framework should provide for a clear and unquestionable obligation for cooperation and immediate infor-mation exchange between all relevant EU and national authorities: financial supervisors, central banks, cyber and other security authorities and government ministries. Provisions on professional secrecy or proprietary information should not impede on the information flow.

Operational incidents have a local impact and may threaten national security, which is why they require action by the relevant national authorities. This implies that these authorities need to have adequate influence on both incident preven-tion and incident handling. National authorities also need to have powers to deal directly with third party service provid-ers (TPPs).

In addition to legislative action the Commission should further non-legislative actions to bolster the operational prepared-ness in the financial sector. These actions could involve joint exercises, operational "playbooks", secure collaboration tools and investments in reinforcements of critical infrastructures and European redundancy capacities. Financial sector should be fully integrated into existing EU cross-sectoral crisis management arrangements. These actions should be re-flected also in the Digital Financial Services Strategy/Fintech Action Plan currently being prepared by the Commission.

> *Attention should be given on how to deal with the systemic nature of these risks as operational incidents involving financial services can quickly hamper normal functioning of the society.*

In many Member States the core financial services have been designated as critical functions and financial infrastructure is considered as part of national arrangements on Critical Infrastructure Protection. However, such designation has not been made at the EU context. Consequently, the EU legislative framework on Critical Infrastructure Protection, which is currently under review, should be amended to include also financial services as discrepancies in definitions may lead into lack of cooperation and information sharing.

Common cross-sectoral EU framework should be complimentary to the existing regulation in financial services. It would contribute to better understanding of interdependencies between differ-ent critical functions and services, including financial services, the changing security environment and emerging risks, in both the physical and in the cyber domains. ●

Michael McGrath

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Encouraging innovation alongside fostering digital inclusion and protection

Technological developments and changes in the area of financial services have continued to grow at pace and sophistication since the Global Financial Crisis. The growth in fintech reflects a trend where companies with the latest technology tend to be better able to service customers and, in some cases, smaller companies may be more agile than current incumbents.

The entry of new fintech firms, supported by changes in European legislation such as PSD II, have provided greater flexibility and ease for consumers. As the digitalisation of financial services continues to grow at pace, we must continue to question if we have the appropriate legislative and regulatory frameworks in place for such entities.

Our goal as policy makers must be to ensure that our frameworks enable firms to harness opportunities, while providing better services for their consumers and users. Our frameworks, while being robust, must allow for start-ups to have a chance to grow and develop. We must avoid rules or frameworks that stifle innovation. Otherwise we will never see the development of European Fintech firms competing globally or truly develop the Capital Markets Union that we all want. This flexibility must be balanced by ensuring that we have the appropriate protections in place for consumers such as potential mis-selling of products, misuse of personal data, liquidity or cyber risks.

We must strive to ensure that we don't create regulatory gaps as this is important due to the cross border nature of digital finance. To maintain confidence in European Single Market and the benefits of the provision of financial services across the Union, the ability for policy makers to react quickly to developments in this area is critical to maintain this confidence.

In Ireland our competent authority has introduced an Innovation Hub that allows for fintech firms to engage with the regulator outside of existing formal regulator / firm engagement processes. This enables an open and activate engagement with start-up fintech firms.

This provides an important route for those firms to understand how to navigate the regulatory landscape and also provides our Regulator with important intelligence on developments and innovation in the sector. We see this approach as an important tool to ensure that we have the correct balance in having a supervisory regime that does not stifle innovation, while being able to react quickly if required to protect consumers.

While it is important that we assist the development of the digitalisation of Europe's financial system, we must also ensure it does not result in disadvantaging certain parts of our population, such as the elderly or the less well off. The need to provide digital inclusion for all of our citizens is as important as improving financial literacy. Both of these associated goals can help us deliver on the objectives of CMU as envisaged in the recent High Level Forum Report.

> *Fostering digital innovation while protecting consumers & securing digital inclusion for all is key.*

To conclude, the digitalisation of the financial sector will continue to accelerate over the coming years. Fostering digital innovation while protecting consumers and securing digital inclusion for all is key. We also must be mindful of the need to have appropriate mechanisms so that our fintech firms are able to finance themselves.

We must be able to support European fintech firms as they move through their different growth phases, from start-ups to global players. Therefore, we must have the flexible regulatory frameworks in conjunction with a deeper and more developed European capital market that provides the necessary financing for our companies to grow and compete globally.