Digital finance policy: key priorities

1. Digital finance trends

The Chair noted that digitalisation is leading to a constant transformation of the financial value chain. For customers, this means a shift to more dematerialised financial services, such as digital savings accounts and loans, and the launch of new financial products and solutions such as cryptocurrencies and buy now pay later services. Back-office processes are also becoming more efficient and faster with the use of automatic payments, blockchain settlements and artificial intelligence (AI) tools that facilitate fraud detection and sophisticated analytical applications.

An industry speaker highlighted that the ongoing trend of digital transformation in financial services is both well underway and inevitable. In sectors like capital markets, insurance and banking, financial institutions are increasingly moving infrastructure to the cloud. Cloud computing also acts as a foundation for the adoption of other technologies, such as AI. For financial firms, the speed at which they are embracing cloud and integrating other technologies thanks to that is becoming a key differentiator.

Financial entities are leveraging digital technology to enhance customer experience, risk management and back-office process optimisation, the industry speaker explained. In the past, discussions about technology and digitalisation were limited to IT departments, but the conversation is now shifting towards the broader benefits and value of technology for financial institutions and their customers. According to a recent survey conducted AWS, there has been a 69% reduction in unplanned IT downtime, a 40% faster time to market for new products, a 40% reduction in costs related to fraudulent transactions and a 20% decrease in customer acquisition costs thanks to technology. These wide-ranging benefits demonstrate the business value that can be derived from digitalisation.

2. Opportunities from digitalisation

2.1 Opportunities for financial market participants and the overall financial market

An industry representative noted that technology brings many opportunities for financial market players. These include faster go to market, the ability to launch tailored products and services and improved customer service, fraud detection and risk assessment. Technology also enables companies to achieve scale, which is crucial for efficiency and competitiveness. Not only can it help individual companies to become more competitive, but it can also potentially benefit the European financial market and sector as a whole. Successful digitalisation however depends on how quickly the related opportunities are seized and how effectively they are leveraged.

Another industry speaker agreed that technology enables faster implementation, time to market and the ability to scale operations quickly without the need for extensive local presence or infrastructure. From a market perspective, the digitalisation of financial services provides huge benefits in terms of competition and cooperation. The possibility to centralise services notably enhances cost effectiveness for all market players, including the more established ones, and facilitates cooperation between market participants.

A regulator stressed that beyond improving the efficiency, speed and competitiveness of the financial sector, digitalisation also allows financial companies to engage with investors and consumers in new ways. Concerning distributed ledger technology (DLT), one promising opportunity is the DLT Pilot Regime, a Commission led initiative which aims to help trading and settlement providers to leverage DLT to handle transactions more efficiently. The first use cases are emerging, showing that there are also opportunities in less visible parts of the market.

A Central Bank official confirmed that digitalisation has fostered greater efficiency for traditional financial institutions, allowing them to offer a wider range of products and expand their customer reach, thereby promoting financial inclusion. These changes will help ensure that banks remain resilient and competitive in the long term. For instance, Hungarian banks now offer online onboarding and online cash loans, enabling citizens to choose a bank based on their product offering rather than branch proximity. Over time, this should also help to reduce fragmentation in the single market.

An official argued that finance is already digital to a large extent and has reached a 'post digitalisation' stage. There has been significant progress in using technology to enhance customer experience, facilitate access and increase the efficiency of financial institutions. Many of the initiatives under the digital finance agenda are moving in the right direction, but the key issues to address are no longer only digital or technological, they relate to data use and legal and fiscal fragmentation in particular.

A public representative added that the improvements enabled by technology in the financial sector, such as greater innovation and higher competitiveness, will play a key role in supporting the Capital Markets Union (CMU) which is essential for channelling investments in the European economy.

2.2 Benefits for customers

An industry speaker remarked that the technological developments in the financial services market over the past decade have greatly benefited customers. Products that were once exclusive to high net worth individuals, such as portfolio management, are now accessible to a much wider audience. Costs are also decreasing, as digitalisation has fostered competition in the market,

allowing previously expensive products and services to become more affordable.

Another major benefit, the industry speaker added, is the increased cross border accessibility of digital financial services, providing customers with access to more competitive products and enabling financial institutions to offer services in different European countries. Additionally, the new digital platforms are more transparent, making it easier for customers to understand product offerings and to track performance without intermediaries, contributing to a more open market with less information asymmetry.

A public representative agreed that digitalisation offers significant benefits for retail customers, including more consumer choice, improved access to products and lower costs. A regulator added that, when properly implemented, digitalisation can empower retail customers to make more informed investment decisions and can enhance inclusiveness and accessibility.

2.3 Potential benefits for regulatory and supervisory activities

A public representative noted that technology offers many opportunities for supporting regulatory and supervisory activities. It notably enables policymakers to process and share the vast amounts of data available in a more effective way, allowing them to create relevant frameworks more swiftly and adapt them in a more responsive way. Secondly, the ability to process and share data in a secure way thanks to technology could make supervision much more efficient. Moreover, the use of technology can facilitate cooperation between the public and private sectors and help the public authorities increase their expertise.

A regulator confirmed that digitalisation and technological innovation present significant opportunities for supervision. For example, supervisors can harness technologies like large language models and natural language processing to improve analytical capabilities and use DLT for market surveillance. Supervisory authorities are sharing their experiences to maximise the benefits of these technologies.

The Chair highlighted that there are several areas of connection between technology and supervision. Technology can help supervisors manage and analyse the data available to them. European supervisory processes could also be optimized with the implementation of a data hub within the European Supervisory Authorities (ESAs) supported by new technologies, where data could be centralised and used by the different national competent authorities (NCAs). A further aspect is that the supervision of digital activities will become an integral part of the role of the ESAs with the implementation of the Digital Operational and Resilience Act (DORA), which tasks the ESAs with the oversight of critical third party providers (CTPPs).

An industry speaker concurred that there are many opportunities to leverage technology in supervisory activities and that the connection between technology and supervision is growing as regulation begins to encompass technology providers. In the implementation of DORA, careful consideration should be given to the implications of the new oversight approach to CTPPs. The primary goal of supervisors and regulators in this area should remain financial stability.

A Central Bank official emphasised the importance of supervisory authorities developing technological expertise and creating standards that may facilitate digitalisation. In the implementation of Payment Services Directive 2 (PSD2), the absence of unified standards led to missed regulatory goals and inconsistent implementation, which eventually necessitated a review of the directive. Establishing clear technology standards can also help align industry efforts and reduce time to market.

3. Challenges associated with the digitalisation of financial services

3.1 Customer related challenges

A regulator emphasized the challenges that digitalisation presents from an investor perspective. While digital services make it easier to develop cross-border business operations, they also introduce questions about how financial activities can be effectively regulated and supervised on a cross-border scale. Furthermore, digitalisation is transforming the way customers engage with financial services. With easier access to complex products, the gamification of financial platforms, and the growing influence of social media, there is a need to adapt regulatory safeguards and supervisory activities to this evolving landscape.

An industry speaker pointed out that in a cross-border environment the EU authorities should play a greater role in combating fraud, in order to accelerate actions against fraudulent websites, which can take several weeks to execute.

A public representative noted that digitalisation increases the risk of fraud. The ongoing review of PSD2 is focused on fraud prevention. The innovative services linked to crypto assets also pose a new risk to customer protection due to low levels of financial literacy. On the positive side, technology can also play a crucial role in detecting and preventing fraud and making the financial ecosystem more secure and efficient.

A Central Bank official agreed that there is a growing need to manage potential fraud risks on digital channels. It is also important to understand the needs and capabilities of different demographic groups in terms of financial and technological literacy, to ensure that the digitalisation of financial services does not leave anyone behind. Targeted education programmes are needed to address these gaps.

3.2 Challenges for financial institutions

An industry representative pointed out that much of the technological development is currently taking place outside the EU, which poses a significant challenge for European financial institutions. The location where technology is developed is important, as it fosters an ecosystem that supports and drives innovation, benefiting

all stakeholders in the region. If European financial institutions are too far removed from where technologies are being developed, this could result in a lag in adopting new innovations, placing them in a reactive position and potentially weakening their competitiveness in an increasingly dynamic and fast-evolving digital landscape.

A public representative agreed that digitalisation poses a challenge to the competitiveness of Europe's traditional financial sector. Additionally, since digital finance transcends borders, overly burdensome regulation within the EU could push innovation elsewhere. This will be a key issue to address in the coming years.

A Central Bank official emphasized that a major challenge for many banks lies in their reliance on outdated legacy IT systems. These systems, which lack connectivity, require scarce specialized expertise for maintenance. This is hampering banks' ability to adapt their business models and compete effectively with fintechs, which offer more flexible and tailored services to customers. To address this issue, banks need to consider replacing their core systems, a task that is both complex and resource-intensive. Public sector support and incentives may be necessary to facilitate this significant transformation.

An official noted that the key challenges financial institutions face with digitalization are less about technology and digital regulation, and more about data management and legal and fiscal fragmentation across the EU. The first challenge lies in making better use of data and promoting data sharing. The second challenge is the fragmentation in legal and fiscal frameworks across member states, which impedes the ability of digital finance to foster cross-border services and enhance competition within the EU financial sector. For instance, differences in national tax systems add complexity and costs, while the fragmented nature of pension systems prevents the creation of large, unified capital pools in the EU. This fragmentation limits the full potential of digital finance. Therefore, the goal of any new regulation should be to make financial intermediation more cost-effective, rather than increasing costs.

An industry representative agreed that market fragmentation continues to be a challenge for the European banking sector and capital market. Europe currently struggles to compete with countries that have access to larger, more unified consumer bases. To drive investment and create better opportunities, a larger and more integrated market is essential, providing the necessary scale.

3.3 Challenges facing fintechs

An industry speaker emphasized that innovative financial companies such as fintechs, which are key drivers of digitalization, face several significant challenges that must be addressed to enhance the European market's attractiveness and prevent firms from relocating to other regions.

First, these companies need sufficient availability of talent, by attracting skilled professionals and also creating a positive and open workplace culture to retain them. In this regard, Europe's high quality of life is a notable advantage. Secondly, fintechs require adequate access to capital to fuel their growth. The CMU project should help channel more funding to innovative companies. Encouraging retail investors to invest in pension products would further expand the capital pool available in Europe for these firms.

Thirdly, these firms need a regulatory environment conducive to business growth and cross-border expansion. Regulatory barriers, caused by the gold plating of national laws and excessive bureaucracy across Europe, must be addressed to facilitate the expansion of firms into new markets. Streamlining authorization processes and harmonizing regulations, such as a unified anti-money laundering (AML) regime, would make it easier for companies to operate across borders. Simplifying consumer protection requirements at the cross-border level is also important. Once a company meets standards in one EU country, those should be recognized across the bloc, particularly for cross-border product authorizations. The forthcoming digital wallet, expected in the next legislative period, could further support cross-border activities by simplifying customer identification processes. Lastly, the industry speaker suggested that greater efforts are needed to digitalize tax processes across Europe, as many member states still rely on inefficient, paper-based systems.

4. Policy priorities for the next political cycle

4.1 Focusing on the implementation of adopted legislations

An industry speaker emphasised the importance of focusing on the implementation of the existing set of digital policies before discussing possible reviews or additional measures. Much of the digital legislation, particularly DORA, has not yet been implemented and some issues still require adjusting. DORA seeks to harmonise the requirements for achieving digital operational resilience. However, the guidance from some national competent authorities (NCAs) contradicts some of these objectives.

A public representative concurred that the next policy cycle should focus on implementation, as many of the measures adopted during the current cycle are not yet in place. Finalising implementation before considering any amendments to the regulations will help maintain the continuity and long term stability of the European business environment. The Chair agreed that the implementation of the agreed frameworks is the priority. These measures need to be tested on the ground before considering possible adjustments or proposing new measures.

A regulator also emphasized the importance of focusing efforts in the upcoming political cycle on the implementation of legislation adopted in the previous cycle and fine-tuning the details of these legislations. Concerning DORA, much of the policy groundwork has already been completed by the European Supervisory Authorities (ESAs) and submitted to the Commission for approval. The focus of the ESAs is shifting now to supervisory aspects in cooperation with the NCAs.

Achieving convergent rules is crucial to ensuring a harmonised approach on the ground. The ESAs also have to prepare for their new oversight duties under DORA in relation to CTPPs, which will require advanced expertise, technology and new methods of operation. The implementation of the Markets in Crypto-Assets Regulation (MiCA), which is happening on the same timeline, also presents a challenge in ensuring convergent implementation and supervision across the EU.

4.2 Ensuring an appropriate balance between risk mitigation and supporting innovation

An industry representative pointed out that regulations can be too prescriptive. While it is important to set clear objectives, businesses should have flexibility in deciding how to achieve these goals. There is a lack of innovation and 'business sense' in some European digital regulations, where data is seen as something to protect rather than a driver of innovation. This contrasts with the data driven innovation cultures in Asia and the US.

The policy approach should also strike a better balance between customer protection and customer accountability, the industry speaker suggested. As digitalization accelerates, customers need to become more comfortable with digital tools and channels. The implications of this shift must be properly managed, and excessive consumer protection measures are not the solution. For instance, placing the bulk of the responsibility for fraud prevention on banks may not be sustainable. Instead, there should be a greater focus on educating customers about both the risks and opportunities of digitalised financial services, and their responsibilities in the digitalized financial value chain.

A Central Bank official emphasised the need to balance innovation and stability when setting new regulations. There is a disparity in AI development between Europe and other regions. Last year, 60% of global AI patents came from China, 20% from the US and only 2% from Europe. The EU's AI Act is highly prescriptive and compliance focused, which might contribute to producing a risk averse environment that stifles innovation and competitiveness. A more flexible approach would be preferable, involving greater supervisory dialogue and the use of regulatory sandboxes to test innovations in controlled settings.

A regulator stressed the importance of providing regulations that are adjustable and flexible to keep pace with the fast evolving market. The level 1 legislation should focus on key principles, but the technical standards should be adaptable to future market developments and technological innovations.

A public representative advocated for the use of experimental environments, such as regulatory sandboxes and enhanced supervisory cooperation, instead of relying solely on rigid regulatory frameworks. The experience with the DLT Pilot Regime has demonstrated that this approach enables regulators to work more closely with businesses, gain valuable expertise, collect data for informed policymaking, and foster a more adaptable supervisory environment. In this context, the inclusion of an EU-wide sandbox in the AI Act is a positive development.