DIGITAL FINANCE: KEY PRIORITIES

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An outlook for the next legislative cycle in Digital Finance

During the von der Leyen I Commission term between 2019 and 2024, we proposed a comprehensive set of new legislation on digital finance.

We were the first jurisdiction with a comprehensive regulatory framework for Crypto Assets. MiCA (the Markets in Crypto Assets Regulation) provides rules for stablecoins which entered into application in June 2023, its other parts are going to become applicable in December 2024. We are monitoring that this set of rules for crypto assets will be correctly implemented. At the same time, we will analyse new trends and assess whether those need a regulatory framework. I am thinking for example on “asset tokenization”. Financial institutions are already issuing bonds, funds or other securities in tokenized form.

Digitalisation brings massive speed and efficiency gains, but it makes markets also more vulnerable for cyber-attacks. Financial firms are working in an ever more symbiotic relationship with technology firms. We see an increasing dependence on third party providers of ICT services (such as cloud or data analytics), as we could witness with the quasi-world-wide outage due to a programming error in July this year. This is why we proposed DORA (Digital Operational Resilience Act), which will start applying in January 2025. DORA requires companies to make sure that they can hold up all sorts of cyber-related disruptions or threats.

The new EU Artificial Intelligence Act opens a truly new chapter. It is worldwide the only regulation on AI. It sets out two so-called high-risk use cases in finance: for creditworthiness assessments and for insurance underwritings. It is crucial to understand where exactly in the value chain of a financial service or product AI systems intervene. AI systems that automate invoicing processes would cause less damage than those that decide who would get a credit and under which conditions. We are in a lively exchange with stakeholders to assess if and how existing financial regulations would benefit from adaptations or at least clarifications through guidance. For this purpose, we launched a series of AI in finance workshops, together with the European Supervisory Authorities. We also launched a targeted consultation, together with DG CNECT.

We have also made efforts to modernise and digitalise payments in the EU. The implementation of the Retail Payments Strategy involves two major legislative proposals. Firstly, a Proposal on Instant Payments in Euro adopted in 2024, which will make Euro credit transfers completed within 10 seconds the norm in Europe. The second proposal, which was adopted in June 2023, was a revision of the second Payment Services Directive. It includes measures to combat and mitigate payment fraud, improve consumer rights, further level the playing field between banks and non-banks, improve the functioning of open banking, improve the availability of cash, and to strengthen harmonisation and enforcement. We hope that the co-legislators will reach agreement on this proposal in the course of 2025. Following the significant legislative activity associated with the Retail Payments Strategy, there will be substantial implementation and enforcement work during the 2025-2029 mandate. The deadlines for banks and other payment services providers to roll out euro instant payments will fall during the early years of the new mandate and must be strictly imposed.

Digital finance remains on the top list of EU deliverables to strengthen our competitiveness, to protect our financial stability and our values.

We would also like to highlight the importance of data-sharing and European financial data spaces, which are part of our broader European Data Strategy. How innovative our companies are will depend on the availability of reliable and high-quality data. We proposed PSD3/PSR and FIDA (Framework on Financial Data Access) to make it easier for customers to share their financial data beyond payment accounts in a protected manner. This opens new opportunities for customers and can also stimulate innovation. We are also making additional efforts for better access to data pools from the public sector, for example with the Data Hub of the Digital Finance Platform. We consider developing a comprehensive financial data strategy to guide this.

Overall, we have achieved a lot in the European Union to create favourable conditions for innovative and responsible digital finance to thrive in the EU. With the von der Leyen Commission II we will continue this path to further promote innovative and secure solutions to retail and business customers.

ANIKÓ SZOMBATI
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Financial innovation shifting to higher gears – policymakers have to follow

The MNB, the Central Bank of Hungary wishes to be at the forefront of financial innovation – we were among the first central banks in Europe to dedicate an executive directorate to financial innovation and FinTech support. The central bank published the FinTech and Digitalization report for the fifth time this year, which identifies key international trends, and provides a comprehensive analysis of the Hungarian FinTech sector, and the digitalization level of the domestic banking, insurance and capital markets.

We base our activity on our FinTech and digitalisation strategy, whereby we put the customers' economic welfare, safety and convenience in the centre, without favouring any form of affiliation of the service provider. Along these lines we see the FinTech sector in Hungary as a rapidly increasing ecosystem, with 212 Hungarian-based fintech companies operating there in 2022. The majority of the firms are serving mostly the B2B market with data analysis and business intelligence services.

Based on our our 7-pillar categorisation of internal and external factors, the digital maturity of the Hungarian banking sector further improved in 2023, starting to emerge from the medium level. The insurance sector has seen progress in the digital accessibility of some functions, but the sector as a whole has been slower to digitalize. The digital maturity of investment service providers shows a heterogeneous picture, which can be improved by developing digital strategies.

The early findings of the abovementioned report led MNB to issue a recommendation on the digital transformation of credit institutions in 2021. The Recommendation, that requires commercial banks to develop a digitalization strategy, aims at setting a minimum level of digitalisation standard for the banking ecosystem so that to remain relevant for the customers even in the age of digital challenger banks. However, the central bank initiative, consisting of recommendations and good practices covers not only front-end developments, but governance, education and cybersecurity as well. As the realisation of these strategies is evaluated since then on a yearly basis, we see that this flexible, consultation-based form of soft law can really be productive, especially amid the fast pace of technological advancement.

In terms of digital finance policy, I believe that the latest adopted frameworks like MiCA, the DLT Pilot Regime and the AI Act are on the right track in grasping emerging trends and enabling new technologies, while also maintaining financial stability. Therefore, focusing on their implementation but also constantly monitoring market developments, potential regulatory shortcomings and acting accordingly will be of key importance.

However, there is always room for improvement. For instance, the substantial client number increase of neobanks highlights some consequences of the current passporting regime that would need to be addressed and fine-tuned in order to provide a truly level playing field for all market players and proper consumer protection for clients. Most neobanks, licensed in one member state provide cross-border services, including savings accounts, to an order of magnitude more clients throughout Europe than those of their home countries. Though some of these entities are already under the direct supervision of the ECB due to significance, should a bank failure occur, home country deposit insurance scheme funds might be insufficient to indemnify all harmed clients EU-wide. In a cross-border service provision setup, host supervisory authorities also have limited information or consumer protection tools available in helping clients with their legal disputes. These issues could be mitigated e.g. by mandating entities to join host country deposit insurance schemes proportional to host country user base size – at least for as long as the European deposit insurance scheme becomes a reality. Along these lines, examining the feasibility of obligatory submission of local consumer disputes arising to host country financial arbitration or dispute resolution bodies would also be beneficial, thereby getting neobanks incentivised to resolve consumer complaints swiftly and effectively on time.

The current passporting regime needs fine tuning amid the spread of cross-border neobanks.

Regarding the next era of open banking and open finance, fostering the development of high-quality, standardized, easily implementable, secure and fast APIs for real-time data sharing, while preserving data privacy and customer choice must be a top priority for the following years. For this to happen, incentives, such as API call compensations or the opportunity to provide so-called "premium APIs" for value-added services would have to be available for financial institutions.

MÄRTEN ROSS
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Digital finance needs help from non-digital agenda

How is digitalisation progressing in the Baltic region's financial sector and is it expected to lead to a significant transformation of the sector in the medium term?

The Baltic financial system is in many respects already in post-digitalisation phase. Supported by reasonable infrastructure and supportive legal environment, much of the payment activity and retail interaction with financial institutions are near fully digitalised. Digitalisation in wider sense has also shown up inside the market participants themselves, including in provision of regtech or digital identity services.

Therefore, it is actually not easy to see major further transformation coming from digitalisation from that angle. Obviously, digitalised services as such is a diverse concept and fundamental changes in the market shares are certainly expected from new technologies and applications, but are difficult to foresee.

However, on the other hand, reaping fully the potential efficiency gains from digitalisation have been also constrained by non-technical limitations such as legal complications with data sharing and cross-border usage, for example for AML procedures or fighting payment fraud. Similarly, constraints to provide cross-border services due to fragmented depositary services is also quite a limitation for further usage of financial services that digitalisation otherwise promises. Limited size of the single Baltic domestic markets have also lead sometimes to temporarily lagging uptake of some digital services and advances, including in payment services.

This means that further digitalisation with more thorough cross-border financial integration in Europe could indeed lead to further structural changes in the market. Even in such highly digitalised markets as Baltic countries. Whether it leads simply to somewhat more competitive market and wider choice for consumers, or would it lead to reshaping incumbent regional banking and payment market shares, remains however to be seen.

What should be the priorities for the next European political cycle in terms of digital finance policy: focusing on the implementation of the frameworks already adopted, addressing emerging trends or new technologies, developing more specific rules for finance, lifting obstacles to digitalisation?

First priority should be the implementation of already enacted or forthcoming regulations. Particularly, as with DORA we have been already quite advanced and with FIDA there are still more questions about implementation than needed. Furthermore, while RIS might be based on good intentions, its ability to handle some of the MiFID/MIFiR overregulation is quite doubtful.

But then - based on this experience - continue working on lifting obstacles and constraints that unnecessarily limit reaping the benefits of digitalised single market and cross-border services. One should not underestimate the ample potential that further digitalisation still provides, particularly for cross-border service providing.

While not willing to downplay the importance of directly digital regulations (e.g. linked to cyber security or data sharing rules), probably more important constraints to digital finance still come from those single-market regulations, or lack of them, that are not so much in the narrow digital agenda sphere. Easier and doable cross-border service penetration, either in everyday banking and investment services (eg opening an account), or how depositories are set up and function, matter still more for digitalised financial services than narrower technical constraints.

The agenda for capital market union is in many respects also a digital finance agenda.

One could even go further – the way how our pension systems still are national in most respects, limits consumers and savers more from getting better returns via digitalisation than any direct digital finance regulation. Or the way how investment accounts are tax-treated, including between the markets, might matter quite a lot. Therefore, the agenda for pushing through the capital market union is in many respects also a digital finance agenda.

Further note of caution here. While in many cases the seemingly obvious answer to those problems tend to bring up proposals for central services, the cure to many of these constraints is not necessarily the centralization or centralized public services. While it is a legitimate option, there is a real threat that instead of benefiting the market, central services could add unnecessarily to the costs of intermediation. Therefore, the quality of impact analyses is of utmost importance.

ONDŘEJ KOVAŘÍK

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Time to take stock - Analysis of current legislation before new legislative proposal

During the most recent political cycle, we have passed a number of new pieces of legislation related to the digital transition which are either horizontal or specific to the financial sector. From the Data and AI Acts, as well as the DMA and DSA on a horizontal level, we're also now just beginning to see the implementation of the new crypto framework - MiCA, as well as digital resilience (DORA), with secondary legislation (including Delegated Acts -DAs - Implementing Acts - IAs - and Regulatory technical standards - RTS) and expect that we will negotiate the remaining acts as we go forward with the Council - most likely beginning in 2025, concerning Financial Data Access.

Last mandate we agreed many new pieces of legislation. I hope we do not rush to bring in more for this new mandate. Regulatory certainty is key for market players and stakeholders in the digital finance sector.[1] I opine that our priorities should be in following up on the implementation of legislation, particularly the secondary legislation, discussing with not only regulators but also understanding the stakeholder experience. We can already see examples of regulators and stakeholders having different interpretations of the final rules, for example most obviously with DMA and DSA, and it's important for all of us to draw lessons from the outcomes there.

For the use of new technologies to become normalised within the financial sector, I am of the view that we already have a good set of legislative pieces of the puzzle completed, and I have concerns that any more could stifle innovation and the uptake of new technologies, ultimately harming the competitiveness of the EU globally. This also applies to the work done by the European supervisory authorities to bring DAs, IAs and RTS to the Commission, but also the co-legislators for adoption of these crucial pieces of legislation which will ultimately shape how MiCA works in practice following its implementation.

Of course we can never rule out new events which may necessitate a legislative reaction, but as we discovered during the MiCA negotiations, market turbulence events should not necessarily lead to a change in approach. First it's important to clarify the effect on the European economy, and then whether any other pieces of legislation should be used first in addressing the issues. Only in the case where we find there is not a sufficient response tool available to regulators and supervisors, should we then consider bringing that as an additional element to the negotiation of pieces of legislation on the table.

I do believe that we need further evolution in terms of the regulatory and supervisory approaches. I have been a consistent proponent of regulatory and supervisory technologies, which can reduce the burden on regulators and supervisors. There are good examples out there of industry-led self regulation based on regtech and suptech, and I hope that national and EU authorities consider engaging with industry further on this, and consider whether some elements could be suitable for supervision on a national or EU level for financial services. This is particularly relevant for those sectors where we see a high crossover between financial and technological players, such as digital assets, tokenisation etc. But it can go further than that. It offers opportunities to regulators and supervisors to harness technology to streamline, reduce administrative burden and cut down on red tape.

As we go forward in the digitalisation of the economy, it's clear that for end-users having simple and understandable data and APIs is very important. It's something that I am convinced that companies should be working towards when it comes to their customer-facing interfaces. The role of legislators here is to ensure that legislation is principles-based rather than the approach we often tend to have in EU legislation, which is more prescriptive. The benefits would be having legislation which can be aimed towards the same ends, namely competitiveness, consumer-friendly, setting clear outcomes-based objectives within the legal texts. Secondary legislation will be crucial across the board, and also while ensuring the core financial stability mandates they have, they should allow companies to innovate in different ways, in competition with each other, but also in collaboration with partners, including regulators and supervisors at different levels of the value chain or across the whole process. It's an approach which we discussed in depth for example with regards to FIDA, which is currently being negotiated in Council and Parliament.

Overall, for the incoming Commission, the most important thing will be to have a clear overview of legislation currently having an impact on digitalisation in finance. Before future legislation in this area is proposed, aside from ensuring level 2 legislation matches the objectives set by the co-legislators, the Commission needs to examine the current policy toolbox available to itself as well as EU and national regulators and supervisors, and this is also something that Parliament and Council should be doing as well before pushing for new legislation in the area. Now is the moment to take stock of the many pieces of legislation we have implemented in recent years, and analyse how effective they are in the financial services sector and specifically the digital finance sphere.

MARIA TSANI

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Financial supervision in the digital age

Digitalization is impacting all aspects of our lives and the financial services sector is not immune to this. A modern financial system thrives on digital infrastructure and the opportunities brought by digitalization. Banks, investment firms and payment companies all leverage digital technologies such as cloud to deliver core day-to-day services in a secure, resilient and efficient way. From instant payments to running secure banking platforms, tech has come to underpin the smooth functioning of the financial ecosystem. The uptake of innovative technologies such as GenAI can further yield tremendous opportunities for the financial sector – and cloud is helping financial entities of all sizes reap the full benefits of the digitalization process.

At the same time, the ubiquitous presence and use of digital technologies in the financial sector has rightly brought increasing regulatory attention to digital resilience. The EU has been leading efforts to address this with the Digital Operational Resilience Act (DORA). Since the proposal was first presented, we have seen other jurisdictions moving forward with initiatives to address operational resilience in the financial sector. At AWS we are committed to raising the bar on security and resilience so we are pleased to see cyber resilience increasingly getting the attention it deserves, with the EU at the forefront in this space globally.

As we look towards the new legislative term, all eyes will be on the implementation of the framework and ensuring DORA is a success.

One of the key objectives of DORA has been to increase convergence and efficiency in supervisory approaches when addressing ICT third-party risk. In the past, Member States exercised their own discretion when it came to cybersecurity and operational resilience in the financial sector, leading to a patchwork of regulatory requirements and expectations. This effectively meant a significant administrative and compliance burden for financial entities, as well as regulatory uncertainty, especially for those firms operating on a cross-border basis.

The DORA framework sets a single, EU-wide high-bar for security and resiliency, while remaining proportionate and risk-based. It is imperative we don't undermine of its raisons d'être by introducing parallel or even conflicting supervisory expectations. On the contrary, if implementation is to be effective, we need to prioritize harmonization to ensure a smooth transition to and consistent application of DORA standards, while reducing the risk of fragmented interpretations across the supervisory chain.

This need also extends to adjacent regulatory frameworks. The EU has grown its cybersecurity rulebook significantly over this past mandate, with much legislation addressing the issue of resilience, and different sets of requirements cropping up across sectors. In this context, it is crucial we minimize the overlap between DORA and parallel frameworks such as NIS2, to reduce regulatory uncertainty and potential for clashing expectations (for instance when it comes to incident reporting requirements). This is particularly important for technology providers, who offer their services to entities that operate outside the financial services sector.

Further, the DORA framework recognizes that it must remain future-proof to accommodate evolving technological developments. It is vital that supervisory expectations also incorporate this principle by not sticking to approaches that are outdated and will not deliver the much-needed level of resiliency and security required in a modern financial system. In this sense, as the financial system evolves, supervisory practices need to evolve themselves.

Merely relying on traditional approaches applicable to financial entities might not be effective.

The specific nature and position of cloud and technology providers in the ecosystem should be taken into account by financial regulators and supervisors by developing a tailored approach that it is fit for purpose. As we are treading uncharted territory, merely relying on traditional approaches applicable to financial entities might not be effective. On the other hand, a tailored approach would mean more efficiency and better risk management.

The journey towards getting cyber resilience right will require robust regulatory and supervisory harmonization as well as new supervisory approaches that are fit for the digital age. Dealing with evolving cyberthreats and delivering digital resilience requires a collective effort and broad collaboration of the industry and all relevant stakeholders. At AWS, we remain ready to play our part and be an active partner to the financial community in this regard.

BARBARA NAVARRO
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Navigating the digital wave in financial services: a difficult regulatory balance

Global Financial Services Industry has been under a steady but relentless digital revolution for more than a decade already. The promise of increased efficiency and convenience along this process have been partially jeopardized by the implementation of a huge amount of regulatory packages. This hasn't been an exception in the EU. Onwards and under this new political cycle that opens now, EU Regulators should revamp competitiveness and safety as the two flipsides of a coin – a delicate act that will imply a right balance of several themes at interplay:

Users needs at the forefront of the regulation

At the heart of this challenge lie evolving user new user's expectations and consumer habits. Today's consumers demand bespoke financial experiences, seamless access, and reinforced transparency. The solution to promote may be enabling the use of Big Data and Artificial Intelligence for the manufacturing of tailored financial products and the performance of risk assessments. Open Banking initiatives, where customers control their data, can further enhance competition and client choice even provide the opportunity to monetize data under certain circumstances.

AI is a double-edged sword

New regulations must be clear to avoid hindering innovation, but also address risks as data protection and cybersecurity threats. Existing regulations already cover many areas, so new rules shouldn't overlap, creating increased complexity. This is crucial for Europe to be competitive in AI. It has the potential to revolutionize financial services, from fraud detection to personalized investment advice. The EU needs to develop Ethical Frameworks where regulations should address potential biases in AI algorithms and ensure fair treatment of clients. Clear guidelines are needed for responsible AI development and deployment, mitigating risks like algorithmic errors. Regulatory frameworks must ensure these technologies serve, not exploit, clients. All this to be done permitting that AI developers can provide a top-notch capable AI to be delivered and implemented in the Block.

The financial industry sees opportunities and challenges

Regulations are overwhelming and costly. We advocate for simpler, phased-in approaches and a playing field where all providers, including FinTechs, are subject to the same rules. Regulations should also be "future-proof" and adaptable to new technologies.

The current regulatory landscape in the EU is still fragmented. This patchwork of national rules creates uncertainty for businesses operating across borders, hampering the development of a truly pan-European digital finance market. Moreover, one could argue that existing regulations were not designed for the digital age, more on the contrary are somehow endangering its development.

The EU's approach must prioritize user needs to create a thriving digital finance ecosystem that empowers citizens and strengthens the EU's global position. This requires continuous adaptation. The focus should be on enforcing existing regulations, eliminating overlaps, and clarifying supervision. This will benefit businesses, consumers, and the overall EU economy.

New Policy Priorities: Addressing the Gaps

The EU has recognized these challenges. Recent policy priorities aim to strengthen the cybersecurity of financial institutions establishing a proper and adjusted regulatory framework. These are positive steps and are recognized internationally as the landmark of regulatory avantgarde, but a critical view is necessary. Failure to address these issues could have significant downsides. European champions might struggle to compete with global players operating under more flexible regulatory regimes. At the same time, and we have witnessed signs of this already, Europeans could enjoy less "clever" AI artifacts than other geographies citizens, something unaffordable in a globalized world. Furthermore, a lack of clear regulations compromises the development of potentially transformative technology as a lever of growth, employment and wealth.

Harnessing our tech potential requires a shift in our regulatory approach. One that places competitiveness in the center.

Conclusion: A competitive Digital Financial Market is at stake

The EU's regulatory approach for digital finance requires a delicate balance over the cycle. By prioritizing citizen's needs, embracing technological advancements while mitigating risks, and ensuring regulatory frameworks are adaptable, the EU can foster a thriving digital finance ecosystem to empower its population and strengthens its competitive position in the global financial landscape. However, achieving this balance will demand continuous vigilance and a willingness to adapt as the landscape continues to evolve.

MARC ROBERTS
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Navigating the future: a positive outlook on FinTech

In the past few years, financial companies have faced significant challenges. Geopolitical unrest has led to economic distress, high inflation, and the highest interest rates in a decade. However, as global crises continue, markets have rebounded, inflation has stabilised, and funding conditions are improving again. The decrease in interest rates indicates that the world has somewhat adapted to the circumstances, and there is now more normality in interest rates than in the last 15 years. As for FinTech companies, after experiencing rapid growth, they have adjusted their focus to achieve sustainable and profitable growth.

Despite the increasingly challenging conditions, FinTech remains one of the most prominent industries globally. Independent research indicates that revenues in the fintech industry are expected to grow nearly three times faster than those in the traditional banking sector between 2023 and 2028.

Looking ahead, the fintech industry will encounter not only challenges but also numerous opportunities. The next five years present a variety of possibilities for the fintech industry, driven by advancements in technology, evolving consumer expectations, and an increasingly digital global economy. These are poised to redefine financial services, creating new avenues for growth and innovation.

Of course, technology is necessary where it's sensible, but it needs to benefit all market participants, including banks and retail customers. Real change for many European citizens comes with access to simple, economically sensible products and the prosperity of a strong European financial system.

The last few years have shown that we are heading in the right direction. In light of harmonisation, we are looking forward to the following steps on several regulatory implementations: the retail investment strategy (RIS), harmonised rules in regards to anti-money-laundering (AML), new approaches and progress on different areas concerning the capital market union, and, as part of it, renewed progress with the ECON vote on EDIS, let us hope for completion of the banking union at last. Those are only a few examples of progress on legislation moving forward to ensure improved unification across the EU. More unification and harmonisation will benefit all market participants and the EU as a relevant global financial market itself.

However, it is not only the regulatory environment that enables positive change. Technological innovation will allow companies to leverage existing technologies, such as remote onboarding and machine learning, making customer due diligence more effective and efficient. Fintech companies can reach a larger audience with the use of mobile apps. Mobile and digital banking apps offer convenience, speed, and lower costs than traditional banking, attracting a new generation of tech-savvy consumers.

Sustainability and ethical finance are emerging trends on which fintech can capitalise on. Consumers and investors are increasingly prioritising ESG criteria in their financial decisions. Fintech firms that develop products aligned with these values, such as green investments and ethical banking options, will attract a growing market segment.

The promising future of fintech is marked by rapid innovation, increased accessibility to financial services, and enhanced user experiences, driven by advancements in technology, transforming the global financial landscape and fostering financial inclusion.

The last few years have shown that we are heading in the right direction.

Also, there are opportunities for partnerships between traditional financial institutions and FinTech that are likely to increase. These collaborations can combine the agility and innovation of fintech with the scale and experience of established banks, creating hybrid models that offer the best of both worlds. Already today, there are a bunch of successful examples to find.

In summary, the next five years will be transformative for the financial industry, characterised by technological advancements, new business models, and evolving consumer demands. Companies that can harness these opportunities will be well-positioned to thrive in this dynamic and rapidly changing industry. With prudent regulation, ambitious objectives, partnerships, and a competitive market, FinTech will continue to thrive and remain one of the fastest-growing industries.