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Digital finance: Confidence and resilience as a foundation for well-functioning financial markets

It is a pleasure to return for the annual FinTech conference and my thanks to Nickolas [Reinhardt, Director, Afore Consulting] and his team for selecting the theme of competitiveness as the focus of this year's programme.

In my remarks today I will explore the role of the financial sector in contributing to the competitiveness of the EU by providing products and services that serve the needs of EU citizens and businesses, and the benefits of FinTech in this context. I will then outline the EBA's thematic priorities in the area of digital finance in 2024/25.

States and economic competitiveness

I will begin with just a few words on the notion of competitiveness, the theme for today.

Many of you will be aware of the various measures of competitiveness for firms or similar metrics at an industry level. Many of these measures are linked with the idea of competition (firm or industry level) and are inherently based on a gaining relative to some other firm or economic sector.

But the concept becomes a bit more tricky when thinking about a country or, in the case of the EU, a supranational region's, measure of competitiveness. Should Nation States be measured for competitiveness and, if so, how? National competitiveness should certainly not come at the cost of other countries either within the EU or globally.

The World Economic Forum, which has been measuring competitiveness among countries since 1979, defines it as "the set of institutions, policies and factors that determine the level of productivity of a country". Other definitions of competitiveness are subtly different, but all generally use the word "productivity".

EU economic competitiveness

In the same context, according to EU Lex: "A competitive economy is an economy whose sustained rate of productivity is able to drive growth and, consequently, income and welfare".[1]

It is clear from these definitions, that competitiveness has to do mainly with enhancing our own capacity to improve productivity over time in a sustainable manner as a means to increase our income levels and hopefully, at the risk of sounding simplistic, improve our well-being.

A key measure to enhance productivity in our societies is through open markets.

The single market is the most important manner to provide an open market to enhance our productivity in the long run. It comprises the four freedoms: the free movement of people, services, goods and capital. It serves nearly 450 million citizens and is the world's largest integrated single market area.[2] And its contribution to the EU's long-term competitiveness can be measured against a wide range of indicators[3] spanning growth, employment, and social indicators and the digital and green transitions. Complementary to the single market, preserving openness, global trade and open markets around the world will also enhance our continued ability to benefit in the future.

A second key measure to enhance our productivity is innovation.

Technological and process innovation are at the core of what will sustain and improve our standards of living going forward.

Role of the EU financial sector in contributing to the competitiveness of the EU

So what is the role of the EU financial sector in contributing to EU competitiveness? How should we assess its performance in those two dimensions of deep, open markets and ability to enhance innovation in a sustained manner? Furthermore, what is the role that financial regulation must play in that respect?

The EU single market: a banking and capital markets Union

The financial sector is at the core of the single market.

The financial sector has a crucial role to play in providing the funding that citizens and businesses need in order to generate employment and finance investment in new technologies, transition our economy, thereby facilitating the attainment of goals of the single market and contributing to the competitiveness of the EU.

[1] Competitiveness - EUR-Lex (europa.eu)

[2] IMF World Economic Outlook, measure: purchasing power parity.

[3] Single Market Scoreboard: https://single-market-scoreboard.ec.europa.eu/

To perform this crucial role the EU financial sector needs to function effectively. This requires it to be sound and resilient and adhere to high standards of consumer protection. These elements are crucial to instil and maintain confidence – the bedrock of a well-functioning financial market.

EU banks have worked to enhance their competitive positions, with capitalisation levels now robust with weighted average CET1 ratio (fully loaded) at 15.8%, higher profitability, liquidity ratios high and asset quality also remaining robust.[4] Banks have been able to provide credit, assess risks and support the economy even in the very difficult recent episodes of COVID and the peaks in geopolitical tensions.

Financial regulation has also helped on this front. In recent years, important regulatory reforms have been adopted in the EU that cover a wide range of elements covering soundness and resilience. The single rule book has been developed. Progress has also been made to foster supervisory convergence, especially with the ECB single supervision of Euro area significant institutions.

The EU has been implementing these reforms to strengthen the single market while at the same time preserving open global financial markets. The approval of the banking package (CRR3/CRD VI),[5] that implements the last part of the Basel package, is also a clear indication of that commitment from the EU to preserve open global markets.

We at the EBA have always been strong supporters of this approach and are committed to execute in the coming years the large number of new EBA regulatory technical standards and guidelines expected from us out of this package.

But we also know that more is needed. The single market for financial markets is still far away. In the banking sector, we know that cross-border banking activity has been stagnant from over a decade. We also know that we need to complete the banking union from a regulatory perspective so as to finally unlock the potential of the single market.

Beyond banks, work on the capital markets union also remains. These two projects should be at the top of our agenda to help enhance the EU competitiveness from the perspective of the financial sector.

Innovation in the EU financial sector

The second aspect in which we would need to focus is on the financial sector's ability to increase long term performance through innovation and the introduction of technologies to improve the long-term productivity of the EU economy.

In this area financial institutions have launched a large number of initiatives to address specific risks arising from technology but also to unlock the potential of the financial sector to improve its capacity to service citizens and businesses through the use of FinTech. We see innovative technologies being leveraged:

[4] EBA risk dashboard. Data Q3 2023: https://www.eba.europa.eu/risk-and-data-analysis/risk-analysis/risk-monitoring/risk-dashboard

[5] https://finance.ec.europa.eu/news/latest-updates-banking-package-2023-12-14_en

- to transform front and back-office processes via the use of cloud data storage, automated credit scoring, risk modelling, regulatory reporting, and suspicious transactions monitoring, thereby creating new efficiencies;
- to transform distribution models, for instance via remote customer onboarding and digital platforms, thereby providing better access to financial products and services;
- to offer new products and services.

But to take full advantage of the potential of innovative technologies, it is necessary to establish common supervisory and regulatory approaches both to the acceptance of the use of technologies and to governance and risk management.

Here again financial regulation has a role to play, and we have seen progress in the EU financial regulation, including:

- the Digital Operational Resilience Act,
- the Markets in Crypto-assets Regulation,
- the Consumer Credit Directive,
- the AI Act, and
- the new AML package that has broadened its scope to introduce crypto related providers.

All of these reforms contribute to both resilience of the sector and to the confidence of consumers, investors, and counterparts by setting parameters for innovation to be leveraged responsibly.

However, as always, the market is not static and we need to remain vigilant to new opportunities and risks that may impact the capacity of the financial sector to play its part in contributing to the long-term competitiveness of the EU.

What can you expect from the EBA in 2024 in the area of digital finance?

So what can you expect from the EBA in the area of digital finance in the year ahead?

From my interventions at previous events, you will be familiar with the EBA's statutory duty[6] to monitor and assess market developments, including financial innovation, and to achieve a coordinated approach to the regulatory and supervisory treatment of new or innovative financial activities.

This role is squarely embedded in the EBA's strategic objectives for 2024-26, with two of our five objectives relating to innovation:

- to set up and start DORA oversight and MiCAR supervision;
- to increase focus on innovation and consumers, and ensure a smooth transition to the new AML/CFT framework.

[6] Article 9(4) of Regulation (EU) No 1093/2010: "The Authority shall establish, as an integral part thereof, a Committee on consumer protection and financial innovation, which brings together all relevant competent authorities and authorities responsible for consumer protection with a view to enhancing consumer protection, achieving a coordinated approach to the regulatory and supervisory treatment of new or innovative financial activities, and providing advice for the Authority to present to the European Parliament, to the Council and to the Commission." […]

In the case of DORA and MiCAR many of you will have been following closely the process to develop a large number of technical standards and guidelines which is now coming to an end. You may have even contributed your input as we go through our public consultations on the different products. I would like to thank you for your input.

In parallel to our policy related work, we are actively engaging with the other ESAs and competent authorities to prepare for our oversight role for critical third-party providers under DORA. We are also working with competent authorities to ensure proper supervision of issuers of asset reference and e-money tokens under MiCAR.

This supervisory work will start in 2025. But active engagement is already taking place to ensure coordination and proper preparation. For instance, for the case of ART and EMT issuers, we have created a crypto supervision coordination group with the involvement of all competent authorities to ensure that proper coordination across the single market takes place as these new players enter the EU market and expand its operations.

Beyond the policy and supervisory work in DORA and MICAR, let me last focus on the work that we will be doing in the area of technological innovation during the next twelve months to monitor the most salient trends. I envisage thematic work from the EBA in three broad areas encompassing: (i) tokenisation, crypto and DeFi, (ii) artificial intelligence/machine learning, and (iii) value chain evolutions.

Tokenisation, Crypto and DeFi

Ongoing EBA monitoring has identified that banks are increasingly leveraging distributed ledger technologies in their business processes and are exploring the possibility to issue tokenised deposits as a settlement instrument. Data from our autumn RAQ exercise,[7] identifies that 62% of respondent banks are exploring, developing, experimenting with or using DLT, and around 50% of respondent banks are specifically exploring tokenisation of traditional financial assets, including deposit tokenisation.

In view of these trends, in 2024 the EBA will be carrying out a stocktake of potential models for deposit tokenisation, to inform supervisory dialogue with a view to promoting a common understanding of opportunities and risks, and developing a common supervisory stance as well as continuously monitoring DLT use. And we are keen to hear from you if you are exploring deposit tokenisation, so please do contact my team via the EBA's FinTech Knowledge Hub.[8]

On crypto-assets and decentralised finance, the EBA will be reporting to the European Commission later this year[9] on some activities that fall outside the scope of MiCAR.

Specifically, crypto lending and staking activities fall outside the scope of MiCAR and have increased in recent years, albeit from a low base.[10] Some risks of consumer detriment have been observed, for instance as regards poor (if any) disclosures of terms and conditions, complex business models,

[7] The summary of the results of the EBA's Autumn 2023 Risk Assessment Questionnaire is available here: RAQ Booklet Autumn 2023.pdf (europa.eu)

[8] The EBA FinTech Knowledge Hub: https://www.eba.europa.eu/fintech-knowledge-hub

[9] Pursuant to Article 142 of the Markets in Crypto-assets Regulation: https://eur-lex.europa.eu/legal-content/en/TXT/?uri=celex:32013R0575

[10] EBA 2022 Report on Non-bank Lending: https://www.eba.europa.eu/publications-and-media/press-releases/eba-provides-its-advice-eu-commission-non-bank-lending

conflicts of interest, and lack of clarity regarding enforceability of claims. We will be exploring these themes again with a view to identifying opportunities and risks, and any recommended supervisory or regulatory actions.

Artificial intelligence/machine learning

The use of AI/ML applications continues to grow with a substantial majority of EU banks using these applications in a range of business processes such as customer profiling, fraud, money laundering and terrorist financing detection, and creditworthiness assessments.[11]

We are aware that many of you have questions as to how the requirements of the horizontal AI Act apply to the EU banking sector. In light of these questions, in 2024 the EBA will take stock of the new AI Act and perform a comprehensive mapping of existing and upcoming prudential and consumer protection requirements on the use of AI in the banking sector, primarily focusing on creditworthiness assessment of natural persons.

The objective is to provide an assessment of the areas where additional guidance, clarity or harmonisation may be needed regarding supervisory expectations on the use of AI. I would expect us to report on the outcome in early 2025. And we will continue to monitor market developments, including potential uses of generative AI in the banking sector, for instance via industry and supervisory dialogue.

Value chain evolution

Turning now to technology-facilitated value chain evolutions, as we know from the joint-ESA response to the Call for Advice on Digital Finance,[12] continuous monitoring is needed to ensure that resilience in the system remains. This year we will be focusing on the growing phenomenon of the distribution of banking products via 'white-labelling' to explore business models, and any related risks.

Beyond these areas of thematic focus, and as a final remark, I would draw attention to our ongoing efforts to facilitate dialogue between industry and supervisors on RegTech and SupTech developments, not only to foster the development of complementary technologies, but to 'deep-dive' into specific cases that could support EBA and competent authorities in performing the new oversight and supervision tasks under MiCAR and DORA. This is important work to ensure that, as a supervisory community, we too reap the benefits of innovation in the performance of these tasks, and in other areas, such as the sustainable finance initiatives.

Overall, I believe the EU's proactive and accommodative stance towards digital finance ensures that the EU financial sector can continue to leverage responsibly new technologies to drive capacity to continue to support citizens and businesses and contribute to the EU's competitiveness. I look forward to the continued dialogue and of course am happy to respond to questions.

[11] RAQ Autumn 2023 data: 80% of respondent banks are using AI/ML for customer support, including chatbots, 74% for creditworthiness assessments/credit scoring, and 73% for AML/CFT transactions monitoring purposes and fraud detection.

[12] https://www.eba.europa.eu/sites/default/files/document_library/Publications/Reports/2022/1026595/ESA%202022%2001%20ESA%20Final%20Report%20on%20Digital%20Finance.pdf