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Digital finance: An enabler for economic transformation

Check Against Delivery
Seul le texte prononcé fait foi
Es gilt das gesprochene Wort

Ladies and Gentleman, I am honoured to join you for this year's Banking Forum.

We meet at a time when peace in Europe is again broken. A time when we see both the worst and best of man. A time when words cannot describe our horror at acts of gross inhumanity and our pride at acts of great benevolence.

A light in this darkness is the astonishing humanitarian response of Poland and its people.

Since 24 February 2022, 2,155,271 refugees from Ukraine[1] have been accommodated, with 1,294,903 fleeing via Poland.

Your countrymen and women have provided food and shelter, warm clothes and toys to those who have had to leave everything behind.

Your policy response has scaled rapidy with the establishment of a government platform for refugees to report their individual needs and humanitarian organisations and private

[1] UNHCR: Situation Ukraine Refugee Situation (unhcr.org) transits via Hungary, Poland, Slovakia, Romania and Moldova. Figures as updated on 8 March 2022.

citizens to provide and report their aid.[2] This week your government has passed a draft Bill to create a 8bn zloty fund to help refugees, enable them to legally work in Poland and access public healthcare and social assistance.[3] EU funds are being made available to support both the immediate and longer term needs.[4]

It is not only the people of Ukraine who owe you a debt of gratitude for this action and I thank you.

As the EU and international community deepens its response, including additional sanctions on Ukraine's aggressors, it is clear that our post-pandemic EU recovery path will be challenged.

Based on our indicators, the Polish banking sector is well-placed to withstand shocks, with a loan to deposit ratio of 83.5% (compared to an EU average of 108.2%), a liquidity coverage ratio at 211.7%, well above EU average,[5] and a cost to income ratio of 49.7% (against an EU average of 62.7%).[6]

The cost to income ratio demonstrates not only the benefits for banks of higher policy rates but also the cost efficiency of Polish banks, in turn a reflection of the gains to be offered by digitisation, a theme on which I would like to reflect today.

How can technology support and transform our economies?

Although we are still at the start of the digital transformation, it is clear that digitisation offers many advantages.

For consumers, mobile and online banking applications can transform experiences, opening up access to financial services on a 24/7 basis, and reducing transaction processing times and costs, for instance in the context of cross-border payments.

Back-office processes can be streamlined, resulting in improved efficiencies and cost reduction, for instance in the context of processes for suspicious transactions monitoring and regulatory reporting.

Supply and demand for financial services can be matched better, for instance through the use of 'robo-advice', and automated credit scoring. And the use of digital platforms is

2 www.pomagamukrainie.gov.pl

3 Poland to set up $1.75 billion fund to assist Ukrainian refugees | Reuters. See further the website of the Polish government: https://www.gov.pl/web/mswia-en/information-for-refugees-from-ukraine

4 https://ec.europa.eu/echo/news-stories/news/ukraine-eu-steps-solidarity-those-fleeing-war-2022-03-08_en (information up-to-date as at 09 March 2022).

5 Liquidity coverage EU average = 174.7%.

6 EBA Q3 2021 data. Q4 2021 data will be published on the EBA's website in early 2022.

rapidly increasing,[7] enabling consumers to access multiple products and services and financial institutions to leverage network effects in distribution.

Capital flows can be improved, including cross-border, for example through the direct provision of banking services through the single market.

The competitiveness of the EU's financial sector can be enhanced, levaraging dynamic competitive forces within the sector.

Crucially, technology can also help support the transition to sustainable finance, for instance in terms of improving the comparability and traceability of products and services.

And in the context of the refugee crisis, technologies can be leveraged to faciliate access to financial and other services for those who are unable to access bank branches.

Poland provides an excellent example of the transformative potential of digital finance against a background of widespread digital adoption: 92.4% of all households have internet access[8] and mobile broadband subscriptions are 132.9 per 100 inhabitants[9] so perhaps many of you are sitting with two phones in your pockets. But a small joke aside, this is a crucial indicator when we consider that 40% of Poland's population lives in rural areas and digital access to financial services is critical.[10]

In line with the broader digital acceleration observed across Europe since the start of the COVID-19 crisis, Polish banks and other financial institutions have expanded online and mobile applications, contactless payments, bank-branded pay-by-link payments, and sector-wide solutions such as the BLIK mobile payment service.[11]

Innovations have been adopted by incumbents and new entrants alike, not only in the context of payments, but also personal finance management applications, crowdfunding, online factoring, financial comparison sites and in many other areas.

Of course, much of the innovation is demand-led but the willingness to invest in digitisation on the supply-side is notable, as is the pragmatism adopted by the KNF towards the use of cloud and innovative technologies such as blockchain, albeit of course still requiring high standards of operational resilience.

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[7] EBA (2021) report on the use of digital platforms in the EU's banking and payment sector: EBA sees rapid growth in the use of digital platforms in the EU's banking and payments sector and identifies steps to enhance the monitoring of market developments | European Banking Authority (europa.eu)

[8] OECD data (2021): Information and communication technology (ICT) - Internet access - OECD Data

[9] OECD data (2021): Broadband access - Mobile broadband subscriptions - OECD Data

[10] OECD data (2014) adjusted for changes: Population by region - National population distribution - OECD Data

[11] BLIK for you BLIK is a system embedded in banking applications and covered by all major Polish banks. Over 90% of all customers of Polish financial institutions have the option of using BLIK in mobile banking applications.

As a wider observation I highlight investment initiatives such as #StartInPoland[12] and the Polish Agency for Developing Entrepreneurship[13] to support newer entrants.[14]

Overall, a very dynamic FinTech landscape in Poland.

Have we got the calibration of the EU regulatory framework right to leverage the opportunities from digital finance and mitigate effectively the risks?

I described briefly the Polish landscape by way of illustration of the broader technology-enabled changes we are witnessing across the EU financial sector. These can be grouped into three broad categories:

1. new financial products and services,
2. new ways of delivering those services by incumbents and newcomers, and
3. deeper and larger interdependencies among players within and beyond the financial industry.

Each presents opportunities and also new challenges for us as regulators and supervisors.

Emerging products and services transforming both front and back-office require close monitoring and may necessitate adaptations to our regulatory and supervisory frameworks.

We have seen, for instance, an acceleration in experimentation and rollout of RegTech solutions and issued a report last year on the benefits, challenges and risks, and steps to ensure the sound adoption and scaling of RegTech solutions in the EU banking sector.[15]

Recently, we also issued a discussion paper and have opened a public consultation on the implications that the use of machine learning techniques have in the context of internal ratings-based (IRB) models to calculate regulatory capital for credit risk to promote knowledge and understanding and convergence in acceptance.[16]

New business models and new entrants also require close monitoring as they drive changes in the structure of the EU financial system. Clearly payments has been an area of faster development. Following the opening up of payment accounts data as a result of the PSD2,

[12] Start In Poland - Polish Development Fund (pfr.pl)

[13] Polish Agency for Enterprise Development (parp.gov.pl)

[14] See further 'The map of Polish Fintech' (2021): mapa-polskiego-fintechu-2021-ang.pdf (cashless.pl)

[15] https://www.eba.europa.eu/eba-assesses-benefits-challenges-and-risks-regtech-use-eu-and-puts-forward-steps-be-taken-support

[16] https://www.eba.europa.eu/regulation-and-policy/model-validation/discussion-paper-machine-learning-irb-models

and with that the growth in the use of APIs to support information sharing, we have seen large innovations and players actively transforming the business. But business model transformation is affecting all areas of banking. Bundling, and the cross-selling of financial and non-financial products by new players will likely rise. And we see growing interactions between incumbent financial institutions, FinTechs and BigTechs through a variety of models, including partnerships, joint ventures, outsourcing and sub-outsourcing, mergers and acquisitions. These firms may also be partnering to co-innovate and provide new products or services leveraging complementary competencies and customer bases, for instance in the context of health insurance, health monitoring and health care.

The inter-dependencies created by these structural changes is the third area requiring closing monitoring. The value chain of many financial products is being disrupted, broken. Who does what in the provision of a financial service is rapidly changing. By now, we are aware of the increase in cyber-related risks or some of the implications of financial institution dependencies on large technology companies, including the BigTechs, for data analytics, cloud, platform and advertising services. But new and more complex interdependencies will continue to arise.

Looking across these three dimensions, and beyond enhanced monitoring, does our regulatory and supervisory framework need to change?

The ESAs' response to the Call for Advice on Digital Finance

Last month the EBA and other European Supervisory Authorities published our response[17] to the European Commission's Call for Advice on Digital Finance.[18] In our report we described the need for changes to ensure that our approaches to regulation and supervision remain fit-for-purpose in the digital age.

Some initiatives are underway already with flagship legislative proposals such as the Digital Operational Resilience Act (DORA) which will strengthen operational resilience across the financial sector and expand the boundary of financial sector supervision to those entities that provide critical ICT services to financial entities.

But in other areas work remains to be done, and here I will turn to some of the key horizontal findings of the ESAs.

First, closer cooperation between financial and relevant non-financial authorities is needed to address new challenges. It is clear from our work that the vast majority of financial sector authorities currently have a limited understanding of platform-based business models, and

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

18 https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/210202-call-advice-esas-digital-finance_en.pdf

value chain evolutions, particularly in the context of interdependencies between financial institutions and technology companies outside the perimeter of competent authorities' direct supervision. Over time, this imperfect understanding of business models could impair the effective monitoring of specific risks, including those arising from financial, operational and reputational interdependencies. As such, closer cooperation between different types of authorities, including financial, data, cyber, consumer protection and competition authorities is needed as the structure and interconnectedness of the financial sector continues to evolve.

Second, and this is a wider point, both public and private sector need to continue to invest in digital skills. For the private sector the benefits are obvious. For the public sector, this is essential to ensure that supervisors have the knowledge and experience they need to understand the opportunities offered by digitisation and anticipate and challenge effectively on risks. Training and also knowledge-building initiatives, for instance through innovation facilitators, can benefit both industry and supervisors.

Third, in light of the emergence of new mixed activity groups combining different types of financial services (and sometimes other services), the existing perimeter of prudential consolidation and financial conglomerates rules may need to change to ensure effective coverage of group-wide prudential risks and may give rise to level playing field issues (e.g. between bank and non-bank groups). In this area the ESAs signalled a need for further business model analysis.

Fourth, although the proposal for DORA provides a framework for the mitigation of ICT risks, regular assessments will need to be carried out to determine whether financial institutions exhibit dependence on certain providers that may not be captured by DORA and represent a risk to financial stability.

Fifth, actions are needed to better protect consumers against this background of market change. There are two aspects to this: (i) supply-side measures, such as measures to ensure that disclosure requirements are fit for the digital age, and (ii) demand-side measures, to ensure consumers have the skills they need to help make informed choices. Here I point to a need to further clarify the proper use of customer data under the ultimate ownership and understanding of the consumer. To help achieve this objective, we are working on further actions to promote a higher level of digital and financial literacy. Our recent joint-ESA High Level conference on Consumer Education and Financial Literacy provided some excellent inspiration for our work. And I would encourage you too to think about how to make disclosures of financial product features most effective and accessible through digital means.

So what else can you expect from the EBA in 2022?

Digital finance remains one of the EBA's strategic priorities and we are taking forward an ambitious programme of work in 2022.

By way of follow-up to the EBA's September 2021 report on digital platforms, we will support competent authorities in developing common questionnaires for regulated financial institutions on digital platform use to improve monitoring capacity.

On digital operational resilience, the EBA will continue its preparatory activities for the implementation of DORA, which is expected to enter into force in 2023. These activities aim to ensure the EBA will be well-prepared to take up any new tasks under DORA.

Moreover, the EBA will be enhancing its focus on cyber security through targeted monitoring of the cyber landscape across the finance sector. We will work along with the other ESAs towards addressing the recently published ESRB recommendation on a pan-European systemic cyber incident coordination framework.[19] This work gains additional importance in the context of the current crisis.

In relation to crypto-assets and DeFi, the EBA will develop in 2022 templates that competent authorities can use to facilitate a more convergent approach to the monitoring of crypto-asset activities at the domestic level. Additionally, the EBA will continue to contribute to ongoing EU and international work streams on crypto-assets, including so-called global stablecoins, and the prudential treatment of banks' exposures to crypto-assets on which a further BCBS consultation can be expected this year.[20]

In the area of artificial intelligence, as mentioned before, the EBA will assess the public feedback received on the Discussion Paper on the use of Machine Learning for IRB models and will consider whether any additional measures should be taken in this regard. Moreover, the EBA will continue following the co-legislative procedure on the proposed AI Act[21] with a focus on its potential impact to finance sector.

We will also be organising a series of RegTech-related events where we will invite financial institutions and RegTech providers to share their experiences. In parallel, the EBA will continue to facilitate the sharing of best practices among competent authorities on how to use SupTech can enhance the effectiveness and efficiency of their work.

[19] https://www.esrb.europa.eu/mppa/recommendations/html/index.en.html

[20] The first consultation was launched in June 2021: Prudential treatment of cryptoasset exposures (bis.org)

[21] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52021PC0206

Finally, it goes without saying that the EBA is looking into the interfaces between technology, sustainability and product innovation, in order to contribute to the green and digital transformation of the EU financial sector and the real economy.

I look forward to continuing to engage with you on these issues and draw your attention to the EBA's FinTech Knowledge Hub for our publications and information about upcoming events.

Thank you very much for your attention.