



March 2021

European Financial Services
Round Table

EFR PAPER ON FINANCIAL SERVICES CONTRIBUTING TO EU COMPETITIVENESS IN THE DIGITAL GEO-ECONOMICAL CONTEXT

Executive Summary

Pending policy issues to ensure Financial Services' contribution to EU's digital strategic autonomy

- EFR welcomes FISMA's Digital Finance Package and the broader EC's digital strategy.
- Building on it, the EFR considers that there are some pressing issues that need to be addressed by current and upcoming policy and legislative proposals.
- Only then will the financial services industry be able to contribute its full potential to the EC's overarching goal of digital strategic autonomy.
- To achieve this the EFR has compiled key recommendations in the main relevant policy areas for digital innovation and competitiveness in Financial Services:
 - o Regarding the indispensable context ("frame of the glass"):
 - Ensuring fair competition in a digitally transformed market (incl. access to infrastructure and data, focusing on cross-sectoral approaches);
 - Revision of prudential rules for banks to reduce the burden of prudential regulation for non-core businesses within regulated groups;
 - Globally consistent regulatory frameworks to keep Europe attractive as global hub for innovation.
 - o Regarding new user experiences ("above the glass"):
 - Evolution from open banking to a cross-sectoral approach to user data sharing for the benefit of European consumers and businesses;
 - Regulatory clarity for crypto-assets, and a careful consideration of the implications and opportunities of CBDCs (Central Bank Digital Currencies).
 - o Regarding the underlying technology and infrastructure ("below the glass"):
 - Coherent risk-based approach for a resilient digital financial ecosystem, incl. third-party risk management (e.g. CSPs);
 - Autonomy in payments through pan-European market-led initiatives.

Financial Services: a strategic sector for EU's competitiveness

The post COVID-19 economy will be more digital than ever, and Europe needs the right public policies to catalyse innovation and help the economy recover as quickly and sustainably as possible. A competitive financial sector is key to support the recovery and the autonomy of the entire European economy. To achieve that, financial services firms must be able to compete fairly in digital markets.

The EC has an opportunity to build the required foundation with its Digital Finance Package, as well as the initiatives stemming from the cross-sectoral Digital Strategy, such as the Data Governance Act (DGA), the Digital Markets Act (DMA) and the upcoming Data Act. Acting now will make markets more competitive, empower users and open up more opportunities for European firms on a global scale.

Digital transformation is based on the convergence of various underlying technologies, and produces geo-economic shifts and sectoral transitions that all influence existing financial services. Therefore, a future-proof regulatory framework needs to be able to address upcoming changes and newly created products in a holistic manner. At the same time, the regulatory and political environment must foster innovation and entrepreneurial initiatives of the private sector to empower the European economy in the global context.

Among the core principles for a regulatory framework enabling Financial Services' contribution to EU's competitiveness the EFR welcomes in particular the following priorities identified in the Digital Finance Strategy:

- **removing obstacles** to the uptake of technology in finance and the promotion of the Single Market;
- assessing the **impact of BigTechs** in finance and adjusting the regulatory and supervisory perimeters to capture new players with the capacity to impact financial stability (e.g. significant crypto assets, critical technology providers);
- **Creating a fair competitive** environment, e.g. via measures to ensure fair access to digital platforms for all financial service providers.

Main relevant policy areas enabling innovation and competitiveness for the European financial market

In the following paragraphs, the EFR would like to inscribe the main relevant policy areas in a conceptual framework that would enable innovation and competitiveness for the European financial market in a safe and secure manner. The EFR therefore differentiates 3 conceptual areas of attention: "above the glass" (of a digital screen, through which clients interact with any digital services, i.e. all digital customer facing aspects, improved, personalised user experiences, innovative products and services), "below the glass" (referring to technologies that work below the surface, that make the former happen, such as infrastructures, efficiency and security elements) and "frame of the glass" (the enabling context):

1. **"frame of the glass"** – the indispensable context:
 - o **Ensuring fair competition** in a digitally transformed market, including fair access to relevant technological infrastructure and data;
 - o **Revision of prudential rules for banking groups** not only to adequately regulate the new entrants, but also to reduce the burden of prudential regulation for non-core businesses within regulated groups, to be able to innovate at speed;
 - o **Globally consistent regulatory frameworks** to avoid the risk of reducing the attractiveness of Europe as a global hub for innovation, compared to other jurisdictions, potentially isolating the EU from a global market of innovators.

2. “above the glass” – new user experiences:

- o Evolution from sector-specific data interventions, such as **open banking, to a cross-sectoral approach to data sharing** for the benefit of European consumers and businesses;
- o **Creating legal and regulatory clarity and international alignment for crypto-assets**, and a careful consideration of the implications and challenges of CBDCs (Central Bank Digital Currencies).

3. “below the glass” – the underlying technology to make it happen, in an efficient and secure way:

- o **Implementing a coherent risk-based approach for a resilient digital ecosystem** which does not restrict access to innovation while ensuring minimum security requirements for all actors in the financial services value chain, including third-party risk management (e.g. Cloud Service Providers);
- o Driving **autonomy in payments** through pan-European market-led initiatives.

1. The frame of the glass

Fair competition with platforms

In the broader context, the EFR supports the EC’s work to ensure that digital markets remain open to competition and innovation. Clear rules and enforcement priorities for large online platforms must address imbalances in the digital economy and ensure all firms can compete on an equal footing.

As proposed in the Digital Markets Act (DMA) and to address anti-competitive dynamics, it is paramount that clear ex-ante rules prohibit certain practices (e.g. self-preferencing) for platforms acting as gatekeepers. This will ensure that digital markets remain fair, competitive and contestable. We support the EC’s intention to limit regulatory action to the very few large platforms with a market-gatekeeper role, rather than affecting the platform business model itself.

This new framework should guarantee fair access to platforms, including app stores and communication technologies that are part of operating systems, and should give platform users (individuals and businesses) effective portability tools to be able to move or share their data and multi-home. This would help to reduce lock-in effects and encourage wider innovation. This would also solve partially the data issue addressed in the point below, which is common in all gatekeeping contexts.

In complement to the ex-ante regulation proposed in the DMA, it is of particular importance to ensure active enforcement of the competition policy framework.

Prudential rules for banks

The consolidated application of prudential requirements implies that financial institutions’ subsidiaries conducting the same activities as BigTechs or FinTechs (e.g. consumer lending, e-money, payment services) face an additional layer of requirements on top of those that are relevant for the activity in question. This leads to several competitive disadvantages for the companies launching technology innovative solutions being part of banking groups, vis-à-vis non-financial entities or non-EU companies.

Authorities should consider how to limit the negative implications of prudential consolidation, advancing towards more activity and risk-based regulation – consistently applying the principle of “same activities, same risks, same rules”.

¹ FSI Paper on Fintech regulation: how to achieve a level playing field, 2 February 2021

Including new players into the regulatory and supervisory perimeter is an important step towards enforcing this principle, in line with the recent Financial Stability Institute recommendations¹ applying for example the same AML / CTF requirements to BigTechs and FinTechs that offer financial services. However, it is only one side of the coin, as it should also apply to better target prudential requirements for financial institutions on the actual risks stemming from their activities. Especially in the context of non-core banking activities, regulatory requirements regarding capital, corporate structure, use of technology, and workforce remuneration are not proportionate and create competitive disadvantages for banks, ultimately reducing innovation.

Therefore, the ESAs' report on the value chains, platformisation, and mixed activity groups - in response to the EC's call for advice as part of the Digital Finance Strategy - should explicitly outline how the proportionality principle embedded in financial regulation could be more consistently applied within banking groups to reduce the duplicated burden.

Globally consistent regulatory framework

The EC should bear in mind that the EU financial sector is part of a globally interconnected market. A globally consistent regulatory framework is therefore critical for maintaining financial stability and protecting end users, to address gaps in supervision across jurisdictions that could create systemic vulnerabilities. Any European development on the regulation of innovative technologies should be coordinated with the ongoing global risk assessments or initiatives (e.g. G7/G20, FSB, BIS, IOSCO) and adhere to global standards in order to maintain interoperability.

Moreover, following the example of the DLT pilot scheme, the testing of innovative technologies across multiple jurisdictions should be accelerated in the EU. Efforts should focus on facilitating knowledge sharing between regulators and a wider network of market participants, and on a joint work on policy and regulatory requirements applied to innovative technologies, ensuring they are safely implemented. In this regard, we recommend for the EC to support global initiatives such as the BIS Innovation Hub and the Global Financial Innovation Network (GFIN) or similar initiatives.

2. Above the glass

Open Finance and Data

Any efforts on data access and sharing should follow a cross-sector approach to avoid deepening the competitive imbalance that follows from the asymmetric data access obligations introduced by PSD2 for banks. The forthcoming Data Act, to be developed before the open finance proposal, should put this cross-sectoral approach to data access into practice.

In a citizen and customer-centric approach, users should have greater control over their data and be able to share it with market participants under an appropriate cross-sector framework, respecting database property protection rules. The DMA takes a first step in that direction by rebalancing current asymmetries. In that regard, further alignment and consideration of country-specific laws and EU laws is necessary to ensure a safe and efficient functioning of data sharing initiatives.

New rules for data intermediaries (as in the DGA) should facilitate the provision and use of these services, but refrain from prescribing particular business models, and allow consumers to choose between porting their data via an intermediary or directly from one firm to another.

These approaches would result in increased opportunities for European consumers and businesses to thrive in the data economy.

Specifically for "Open Finance", it will be important to avoid a direct copy-across of the PSD2 framework to other financial services and products and ensure that a thorough review of the existing framework is undertaken in order to remedy and prevent unintended side effects. It will

also be important to ensure that any potential open finance framework takes a holistic approach to relevant players, regardless of them being financial entities, and that it is coordinated in timing and extent with other initiatives, such as the EU data strategy and governance framework, the upcoming Data Act and the DMA.

Data policies expand the ecosystem of providers that users can use to access financial services. In this context, rules regarding responsibilities and liabilities must be clearly defined between the different participating players. For example, it must be considered how and where to assign liability for a data breach from a third party and for the resulting harm to users.

Crypto-assets and CBDCs

The EFR welcomes the EC's proposal to clarify the classification and regulatory treatment of different types of crypto-assets and the proposal for a DLT infrastructure pilot regime. The former is in general consistent with the principle of "same activity, same risk, same regulation". However, we would welcome some clarity on the treatment of Decentralised Finance (DeFi) within the EU.

The publication of the ECB Report on a digital euro (October 2020) is an important milestone in the central bank exploration of the opportunities and challenges of Central Bank Digital Currencies (CBDCs). The potential issuance of a CBDC requires a careful analysis of the concrete needs it aims to cover, its viability and the effects it may have on financial intermediation, financial stability and monetary policy. In this regard, we welcome the attentive approach of the ECB, whose report rightly identifies some key principles that a "digital euro" should follow: i) avoiding its use as a form of investment and the associated large shifts from bank deposits, ii) creating synergies with private payment solutions, and iii) relying on supervised payment providers for the provision of user-facing services and the development of new business models.

Moreover, we believe that the ECB's exploration phase should analyse regulatory and legal risks, in particular: i) Data privacy, where private data could potentially be exposed to those holding the digital money, especially in the case of retail tokens; ii) Cybersecurity, where the introduction of a "digital euro" would present a completely different cyber resilience challenge for the Central Bank (although cyberthreats are already part of the current payment, clearing and settlement risks); and iii) the AML/KYC risks associated with the use of a "digital euro", that could require further AML due diligence procedures.

We invite authorities to also explore the possibilities to enhance the efficiency and the effectiveness of supervision, embedding supervisory and monitoring frameworks directly into the system.

And finally, before the ECB decides to issue a CBDC, it should be very clear what a CBDC can contribute that is not already covered or can be covered by market-led payment solutions.

3. Below the glass

Digital Operational Resilience

The EFR welcomes the intention to create a strong and robust EU digital operational resilience framework via FISMA's DORA proposal. The suggested framework for **cyber threat information sharing** is a particularly positive step towards building cyber and threat intelligence. In this same context the EFR is working on establishing a circle of trust mechanism for strategic incident information exchange.

Harmonisation of ICT risk management and incident reporting requirements across the financial sector have been a long-standing demand from sector participants and are an important step towards achieving efficiency gains and providing authorities with a clear, overarching picture of ICT-related risks by financial services. For this to become reality, the DORA proposal will have to be **outcome-focused and risk-based**, instead of expanding existing guidance from critical to

all ICT-related contracts and processes. There should be enough flexibility in the framework in order to ensure business models and group structures are able to effectively improve resilience, avoiding divergent or duplicative requirements.

In the medium term, the EFR supports the establishment of an EU hub for major ICT-related **incident reporting**, that could help avoid multiple reporting lines. However, given the sensitivity of the information that would be centralised there, it will be essential to ensure the necessary safeguards and protections. Given the overlap of incident reporting under DORA and horizontal regulation (e.g. NIS), the EC should also consider the role that a non-financial authority, such as ENISA, could play in establishing that single reporting hub. This EU Hub should build trust progressively among Member States and also support national authorities. This could be achieved in stages, initially establishing a central reporting and coordination hub in each Member State with a consistent roll-up reporting scheme from national mechanisms to the EU hub.

Greater **transparency** of cyber-related incidents should be fostered by making anonymised data available. Currently, the data publicly available at EU level is very limited. The information sharing mechanism should be improved to allow a continuous exchange of information between authorities and the private sector. The cyber (re)insurance underwriting community should also be granted access to incident reporting data (on an anonymous basis), given the important role of insurance in promoting cyber resilience.

Given the **global nature** of both finance and the risks posed by cyber-security, it will be imperative that the DORA regime ensures interoperability with other systems established in other jurisdictions. The regulation should as much as possible make use of existing international definitions and standards and should be aligned with widely implemented cyber security frameworks such as NIST CSF and ISO 27001.

On **third-party risk management**, the EC should not introduce too prescriptive provisions aiming at concentration risk, as it could restrict access to innovative technology. In particular, mandatory multi-vendor strategies might not reduce, but may even introduce additional operational risk. Together with mandatory contract termination requirements this would create a barrier to innovation and resilience. Additionally, responsibility and accountability must be clearly allocated between financial institutions and the respective third-party providers, with oversight for DORA naturally resting with the relevant EU entities and supervisory authorities. Furthermore, the interaction between DORA and existing sectoral guidance (EBA/ESMA guidelines) as well as horizontal legislation (NIS Directive/NIS2) in relation to ICT third-party risk needs to be clearly delimited in order to create a coherent framework.

Streamlining and **simplifying outsourcing and delegation procedures** is another important step towards facilitating the use of third-party ICT services. The desired result can only be achieved via a combination of measures with **focus on proportionality**:

- a risk-based approach towards the application of requirements, focusing on material ICT arrangements and in line with the existing outsourcing framework that recognises the different risk levels of arrangements, e.g. intra-group arrangements;
- an effective and efficient direct oversight framework that does deliver added value instead of duplicating compliance effort;
- support for collaboration in form of pooled audits;
- the promotion of standard contractual clauses to streamline negotiation processes with CSPs and to facilitate cloud switching;
- the development of certification schemes that demonstrate that TPPs meet the expected level of risk mitigation and resilience for both supervisory authorities and financial institutions.

With an **appropriate oversight** framework the burden of compliance, currently borne by financial institutions, would be shared with ICT providers. Specifically, the EFR considers that EU companies would greatly benefit from a European approach proposing minimum requirements for cloud providers, such as cloud reversibility to reduce the risks of provider lock-in.

Overall, the EC should **focus on operational resilience outcomes with a non-prescriptive and risk-based approach**. These fundamental design aspects can facilitate interpretation and future implementation, through a more standardised, future-proof and proportionate approach that shall avoid unnecessary compliance efforts.

Autonomous European payments & value-added infrastructures

We welcome the authorities' support of the European Payments Initiative in the **European Retail Payments Strategy**: an industry project to improve customer choice and experience in e-payments.

Its successful development requires the involvement of providers from more countries, but is equally dependent on regulatory certainty and stability, particularly with regards to the business model. Therefore, it is important to avoid introducing new regulatory obligations that would divert funds from innovation to compliance.

Apart from creating an infrastructure independent from international schemes for Europe, such an initiative would also help strengthen the international role of the Euro.

New payment solutions are also an opportunity to develop EU-wide **digital identities**, which are presented in the EC's Digital strategies as a key enabler of the digitisation of the sector and the overall economy. If an effective digital identity framework were to be comprehensively introduced, the potential benefits are vast. A digital identity framework, enabling firms to efficiently and securely prove a consumer's identity online, without the need for physical documents, would likely provide a significant boost for innovation across the economy, while simultaneously reducing fraud levels and costs that industry currently incurs to manually prove consumer identities.

The European Financial Services Round Table (EFR) was formed in 2001. The Members of EFR are Chairmen and Chief Executive Officers of international banks or insurers with headquarters in Europe. EFR Members believe that a fully integrated EU financial market, a Single Market with consistent rules and requirements, combined with a strong, stable and competitive European financial services industry will lead to increased choice and better value for all users of financial services across the Member States of the European Union. An open and integrated market reflecting the diversity of banking and insurance business models will support investment and growth, expanding the overall soundness and competitiveness of the European economy.

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