# DIGITAL FINANCE STRATEGY AND DIGITAL FINANCE PACKAGE: OBJECTIVES AND MAIN PROPOSALS

**Note written by Marc Truchet, EUROFI**

### 1. Opportunities and challenges associated with digitalisation

The European Commission proposed in September 2020 a Digital Finance Strategy (DFS) aiming to support the digital transformation of the EU financial sector. The objectives of the DFS initiative are to adapt the financial regulatory and supervisory framework to the increasing digitalisation of the EU financial sector, identify measures that may support a further digitalisation of the sector, remove potential obstacles to digitalisation and also address possible new risks and level playing field issues related to this digital transformation.

Digitalisation is indeed a key driver of innovation, agility and efficiency in all areas of the financial sector, allowing an optimisation of the products, services and funding sources proposed to customers, facilitating their distribution at a lower cost and supporting operational and process improvements, as well as enhanced collaboration and partnerships along financial value chains. Digitalisation may also help to further integrate EU financial services by reducing the cost of cross-border expansion and facilitating cross-border transactions.

Digitalisation is also bringing major changes to the financial ecosystem, with a fragmentation of value chains, an increasing role played by third-party technology service providers and new forms of competition that potentially require adjustments to the existing EU policy framework. Some challenges are also gaining in importance with the use of new technologies in the financial sector, such as those related to the availability and sharing of data, cyber-security or the fairness and accountability of recommendations with the use of Artificial Intelligence-based (AI) systems.

A number of regulatory and non-regulatory barriers to the further digitalisation of the financial sector also need tackling. First, differences across domestic regulatory requirements may hinder the cross-border development of digital financial services. This may include differences in rules applying to financial services[1] or financial data[2] and differences in supervisory approaches across the EU. Secondly some rules may not be adapted to digital channels or prevent their optimal use (e.g. regarding disclosure, information provision, regulatory approvals). Finally, non-regulatory obstacles have also been identified, including challenges related to data quality, legacy IT systems and insufficient IT skills.

### 2. Priorities of the Digital Finance Strategy proposal

The DFS communication builds on previous EU policy actions concerning digitalisation in the financial sector such as the 2018 Fintech action plan and work conducted by the ESAs and the European Parliament (e.g. regarding cloud services, crypto-assets…), as well as initiatives put in place by several domestic authorities in these areas. It also completes, with a more specific focus on financial services, horizontal policy proposals previously made by the Commission concerning artificial intelligence (AI), data[3] and cybersecurity in particular.

The DFS is structured around four main priorities supported by key actions. These are due to be implemented by 2024, with some first steps to be achieved by the end of 2021 or by 2022:

- **Removing fragmentation in the Digital Single Market for financial services and improving its functioning.** A first objective is to facilitate the access of customers to digital financial services on a cross-border basis and their on-boarding[4] with a proposed harmonization of KYC / AML rules, a simplification of customer due diligence processes and a framework for managing digital identities on a cross-border level across the EU[5]. A second objective is to foster the scaling up of digital services provided by financial firms operating in Europe with an extension of passporting rules to areas of digital finance not yet covered (such as non-bank lending and activities related to crypto-assets) and efforts to enhance supervisory convergence and the cross-border cooperation between private and public stakeholders, building on the experience gained with domestic sandboxes and innovation hubs.
- **Ensuring that the EU regulatory framework is fit for the digital age.** This involves adapting existing financial legislations to new developments such

1. e.g. differing Know Your Customer / Anti-Money Laundering (KYC / AML) requirements, rules applying to financial products and services applied in different ways…
2. e.g. variations in the way GDPR rules are interpreted, different data location requirements, third-country legal requirements that may impact EU users…
3. The White Paper on AI and the European strategy for data published in February 2020
4. In this perspective, the EBA is invited to develop by Q3 2021 and in cooperation with the other ESAs, guidance about how to ensure greater convergence of the elements needed for on-boarding processes and about the conditions under which financial services providers are allowed to rely on customer due diligence processes (CDD) carried out by third parties. Secondly, the Commission will further define and harmonise CDD requirements as part of the new upcoming AML / CFT framework proposals, in order to allow for seamless cross-border financial operations, which require in particular facilitating the use of innovative technologies in this context and specifying elements such as which ID documents are needed for on-boarding and which technologies can be used to check ID remotely.
5. This framework will be determined in the context of the e-IDAS regulation review (framework for electronic identification and trust services for electronic transactions)

as crypto-assets, the use of Artificial Intelligence (AI) and cloud services and reviewing them on an on-going basis to ensure that there are no new obstacles to further digitalisation. In order to achieve this objective, the Commission has proposed as part of the broader Digital Finance Package (*see section 3 of this document*) two new EU legal frameworks for crypto-assets (MiCA) and DLT (the DLT pilot regime), as well as the Digital Operational Resilience Act (DORA), which aims at mitigating ICT (Information and Communication Technology)-related risks. Additional measures are proposed for facilitating the use of cloud services and AI in finance, building on the horizontal data and AI strategies[6]. The Commission is moreover proposing to ensure that potential material regulatory obstacles to digital innovation stemming from existing financial services legislation are removed and to provide interpretative guidance with regard to the application of legislation to new technologies on an on-going basis.

- **Establishing a common European financial data space to facilitate data sharing and promote data-driven innovation, building on the European data strategy**[7]. Firstly, measures are proposed for facilitating the sharing of existing financial information provided through national registries (e.g. corporate disclosures) and of information released under EU financial regulations, as well as actions to facilitate the use of new technologies (including RegTech and SupTech) for supervisory reporting and the sharing of this information. Secondly, the Commission is proposing the establishment of an "open finance" framework by mid-2022[8] aiming to facilitate broader data sharing among market stakeholders in order to allow e.g. the offering of more personalised products and services based on AI systems.
- **Adjusting financial regulatory and supervisory approaches in order to address the challenges and risks associated with digital transformation.** The Commission is finally proposing to identify areas of financial regulation that may need updating in line with 'same activity, same risk, same rules' principles in order to take into account the increasing role played by technology companies in the provision of financial services and the related changes in the financial ecosystem, while preserving financial stability and customer protection[9]. The Commission will moreover assess whether and how customer protection rules may need updating to take into account new digital ways of providing financial services and is proposing a new EU framework for strengthening digital operational resilience (*DORA – see details in section 3*).

## 3. The broader scope of the Digital Finance Package

The DFS is part of a broader Digital Finance Package proposed by the Commission that also includes MiCA (the regulation on Markets in Crypto-Assets), a pilot regime for DLT market infrastructures, DORA (the Digital Operational Resilience Act) and a Retail Payments Strategy.

### 3.1 MiCA (the regulation on Markets in Crypto-Assets)

MiCA proposes a new EU legal framework for crypto-assets that do not fall under existing EU legislation[10] and also for the entities that issue these assets and those that provide services related to them.

MiCA aims to provide legal certainty and clarity for crypto-asset issuers and providers and establish uniform disclosure and transparency rules related to crypto-assets. MiCA also puts forward passporting rules for crypto-asset operators, requirements for the offering and marketing of crypto-assets to the public and a certain number of safeguards for crypto-asset holders (including capital requirements, rules concerning the custody of assets, complaints procedures and investor rights, as well as provisions for the supervision of issuers of significant asset-backed crypo-assets - so called global stablecoins). The Commission is moreover considering the updating of prudential rules for financial firms holding crypto-assets and the implementation of measures for encouraging the use of DLT for SME capital-raising operations. Further work is also being conducted by central banks, in particular the ECB, on the possible issuance of retail central bank digital currencies.

### 3.2 The DLT pilot regime

The DLT pilot regime is designed for market infrastructures that trade and settle transactions in financial instruments that are in crypto-asset form and in crypto-assets that already fall under existing EU

6. The European data strategy proposes notably the development of a European cloud rulebook and of a European cloud services marketplace by the end of 2022. Building on the horizontal White Paper on AI, which applies to all sectors and the upcoming proposal for a new regulatory framework for AI planned in 2021, the Commission is inviting the ESAs and the ECB to explore the possibility of developing specific regulatory and supervisory guidance on the use of AI applications in finance.
7. The EU data strategy rests on 4 main pillars: (i) rules on data access, use and sharing which are defined in the Data Act, (ii) the development of EU data infrastructures and related rules (EU cloud rulebook, setting up of an EU cloud services marketplace); (iii) the enhancement of individual data rights concerning machine-generated data such as IoT; and (iv) the development of sectoral European data spaces including for financial services.
8. This initiative will be coordinated with a review of the Payment Services Directive (PSD2). PSD2 opens access to bank account data in order to allow the development of new payment services, but does not offer the reverse i.e. access to data held by non-financial firms such as online platforms, creating an unbalanced level playing field, according to certain financial players and limiting the overall flow of data. Some other specific issues such as the current issues faced by payment services providers when trying to access certain mobile platforms for effective contactless payments will also be addressed.
9. A certain number of areas and issues that may need adjusting were identified by the Commission including: (i) the payment services and e-money directives; (ii) the way more fragmented value chains and new providers of financial services may be supervised in a cooperative way e.g. by a supervisory college for the ecosystem of a given financial services value chain; (iii) the supervision of conglomerates with the FICOD Conglomerates Directive; and (iv) the micro and macro risks stemming from potential large-scale lending operations by firms outside the banking perimeter.
10. For example utility tokens that provide access to a service, stablecoins that can be used for payments and claim to maintain a stable value.

financial services regulation and will remain subject to that legislation[11].

The pilot regime establishes limitations in terms of DLT transferable securities that can be admitted to trading or recorded by DLT market infrastructures such as trading venues or CSDs. It adopts a 'sand-box' approach with temporary derogations from existing rules for these market infrastructures, so that market infrastructures can test and learn more about the rules in place and regulators can gain experience on the use of DLT in this area, while ensuring an appropriate monitoring of risks. This proposal also sets additional requirements for tackling the novel forms of risk raised by the use of DLT in market infrastructures and proposes amendments to rules that restrict the use of DLT in market infrastructures, with the objective of improving legal certainty for DLT infrastructure users.

**3.3 DORA (the Digital Operational Resilience Act)**

DORA's objective is to ensure that the necessary safeguards are in place to mitigate ICT-related risks for all financial market participants, given the increasing dependence of the financial sector on digital processes and software and the expanding volumes of personal and financial data held by financial firms.

The proposed legislation imposes common ICT risk provisions that all participants of the EU financial system should be subject to on a domestic and cross-border basis in a proportionate manner, in order to ensure that their operations can withstand ICT disruptions and threats of all types, including cyber-attacks. The proposal also mandates the implementation of dedicated ICT risk management capabilities, the reporting of major ICT-related incidents, digital operational resilience testing, the management by financial entities of ICT third-party risk and information sharing among financial entities concerning cyber-threats in particular. DORA moreover introduces an oversight framework for critical ICT providers such as cloud service providers in the context of an increasing use of outsourced services, as well as a harmonisation of key contractual aspects in order to facilitate the monitoring of ICT third-party risk by financial firms.

**3.4 The retail payments strategy (RPS)**

The RPS aims to ensure that the EU's payments market fully reaps the benefits of innovation and the opportunities offered by digitalisation. This strategy endeavours to make instant payments and EU-wide payment solutions more accessible and cost effective for citizens and businesses across Europe and particularly in cross-border situations, while maintaining a high level of consumer protection and safety. The EU retail payments market is indeed still very much fragmented across national borders and many domestic instant payment solutions do not work cross-border, thus consumers often have no choice other than to use services provided by the main international card schemes or large internet platforms.

The RPS is designed around 4 main pillars covering the main components of the payments ecosystem. The first pillar focuses on the promotion of cross-border EU payment solutions and notably the roll-out of instant payments as the 'new normal', with the objective of a full uptake of instant payments in the EU by end-2021. The second pillar is the development of a competitive and innovative EU retail payments markets ensuring a high level of consumer protection, building on the forthcoming review of PSD2 - aiming to remove the main obstacles to the implementation of open banking principles - and its further alignment with EMD2 (Electronic Money Directive). The third pillar seeks to improve the access of payment providers to payment and other technical infrastructures and reinforce the inter-operability of infrastructures processing instant payments. Finally, the fourth pillar aims to improve international payments between the EU and other jurisdictions which are considered to be too expensive and inefficient, by supporting links between payment systems in different jurisdictions and reducing the time to process transactions.

11. For example some crypto-assets qualify as financial instruments and are therefore subject to EU securities market legislation (e.g. MiFID)