Digital finance trends and priorities

1. Digitalisation trends in the financial sector

The Chair observed that the momentum of digital transformation extends to various critical areas of the financial sector, including service delivery, product design, risk management frameworks and overall market operations. Innovations such as AI-enabled financial advice and blockchain settlement solutions appear almost daily, reflecting a shifting landscape fraught with both opportunities and challenges.

An industry representative emphasised that organisations across the global financial ecosystem are increasingly taking advantage of the opportunities of digital technologies such as cloud computing, to deliver their day-to-day operations, including instant payments and banking services, in a secure, resilient and efficient way. There is a marked acceleration in the adoption of AI in particular, especially generative AI and large language models, which is reshaping the financial ecosystem and that of many other sectors. Research shows that AI usage among European businesses has grown by 27% in the past year and that 97% of firms reported a revenue increase attributable to AI. By 2030, the use of AI is expected to be ubiquitous across European firms, fostering European economic growth.

A public representative agreed that innovation in the EU financial sector will largely be shaped by the strategic deployment of AI and leveraging data. The ability to generate, share, use and combine data will be critical to digital finance in the future. The expansion of digital assets, tokenization and new payment infrastructures, such as private stablecoins and central bank digital currencies (CBDC), are other key drivers of innovation in the European and global financial sectors. The EU must take advantage of these inevitable trends going forward.

A Central Bank official noted that Europe is ahead of the US in some aspects of digital finance, such as mobile banking, insurance and instant payments. There nevertheless remains a considerable gap with US banks in terms of market cap and competitiveness. The most valuable European bank has a market cap 10 times smaller than that of the largest US bank, underscoring the challenge of scale in Europe. The creation of a European single market for financial services is at an early stage. A single market for payments exists, supported by robust infrastructure and widespread instant payment adoption, and cross-border investment and consumer lending services are developing. However, the asset side of banks' balance sheets, including mortgages and corporate lending, remains fragmented, with cross-border friction. There is significant potential for digitalisation to help overcome these barriers, provided that the relevant infrastructure is developed and regulatory harmonisation pursued. Digital mortgage services, for example, could allow European customers to access products from banks in other member states.

An industry representative highlighted the growing confidence financial institutions feel in relation to digitalisation. Beyond adopting externally developed technologies, banks are now building proprietary solutions such as cloud-based software. The financial sector has been at the forefront of digitalisation for a long time, but there is now a new sense of urgency, driven by growing opportunities related to the use of AI and cloud for core functions, and also competition.

2. Benefits and opportunities of digitalisation

An industry representative stated that digitalisation, particularly through AI, has the potential to enhance European productivity and close the growth gap with the US. Research suggests that AI could boost productivity by 0.8% to 1.3% over the next decade. This projection is significant in the context of a growing economic divide between Europe and the US and other jurisdictions. The insurance sector, which relies very much on data combined with human expertise, is uniquely placed to benefit from digitalisation. Geolocation technology, for example, allows insurers to locate customers in mere seconds, speeding up service, increasing efficiency and reducing costs. AI and data analytics can also help to better anticipate risk arising from climate change and prevent damage before it takes place. With satellite information, wildfire risk can be assessed and mapped with considerable precision. Between 2013 and 2022, global wildfire-related losses reached $100 billion, underscoring the potential economic impact of such technologies.

Another industry representative identified three main benefits of digitalisation. First, it facilitates enhancement of the customer experience. Services can be personalised through the use of behavioural and know your customer (KYC) data. Second, it can drive operational efficiency in both front and back office activities. Third, it can facilitate financial inclusion, enabling access to digital banking services in underserved regions or populations.

A regulator summarised the opportunities that digitalisation presents in terms of expanding access to financial services, as well as increasing efficiency and EU integration, through the use of new technologies such as tokenisation and distributed ledger technology (DLT). The use of supervisory technology (sup tech) digital tools could also increase supervisory capacity, improving the efficiency of supervision on the ground and enhancing the use of data to better address risks in the financial system.

3. Obstacles to digitalisation

An industry representative emphasised that the fragmented European regulatory framework is an obstacle to digitalisation. In addition, privacy laws are not always adapted to the digital age. Legacy systems are a further challenge when developing new solutions. A Central Bank official agreed that the EU's fragmented regulatory system, which is supervised differently across member states despite the existence of a common rulebook, is an obstacle. This creates additional compliance burdens for firms operating across borders. The jurisdictions with which the EU seeks to compete do not have the same problems, which is an important issue given that digital technologies ignore geographic boundaries. Addressing such obstacles should be one of the primary objectives of the next political cycle.

An industry representative added that regulatory uncertainty may specifically hinder AI adoption, particularly for institutions operating across borders. 44% of businesses recently surveyed by their firm identified that the inconsistent and complex regulatory landscape is a major reason behind their hesitation to deploy AI. The digital skills gap is also impeding firms' ability to innovate. In the same survey, 56% of companies referenced the shortage of relevant digital skills as a challenge, while 53% cited that this shortage leads to an increase in operating costs.

4. Risks posed by digitalisation

A regulator shared three types of risk arising from digitalisation. Firstly, third-party dependencies and the high concentration of service provision amongst a small number of vendors create single points of failure. Secondly, potential bias and opacity in AI models, coupled with a lack of explainability and transparency, can lead to discriminatory outcomes and reduce trust. Thirdly, there is the threat of technology being used maliciously, including for fraud, market manipulation and collusion, which is growing alongside digitalisation.

A Central Bank official emphasised that digitalisation risks must be clearly identified and understood. 90% of financial fraud in the EU is perpetrated through instant payments. Cybercrime and money laundering are other areas of concern where coordinated action at the EU level is required.

A regulator noted that the increasing frequency of cyber-attacks and data breaches poses a particular threat to the insurance sector, which relies heavily on data. Such incidents can damage consumer trust and quickly erode the reputation of insurance firms and the sector as a whole. The 'big data' approach increases data-related risks, and it is expected that AI will exacerbate this issue.

An industry representative noted that cybersecurity risks are also increasing in the banking sector, as its systems become more digitalised and data intensive. Customer data privacy and safety must be preserved as digitalisation progresses.

5. A focus on the implementation of existing digital frameworks

A public representative highlighted that a significant amount of regulation aiming to support the digitalisation of the financial sector was adopted during the previous European political cycle, including the AI Act and data frameworks, and sector-specific rules, such as DORA, MiCA and the new AML framework. EU policymakers must now decide whether they need to continue producing new regulation to address emerging digitalisation issues or to pause and focus on enforcing the existing frameworks. The European Parliament is split on this question, but the speaker favoured the latter. The EU still has much to do in terms of harmonising regulatory and supervisory practices, while making greater use of technology to enhance supervision. In terms of policymaking, the savings and investments union (SIU) should be prioritised in the next political cycle, as it can support the digital and green transitions and help complete the single market. An industry representative agreed that the focus of the next political cycle should be on consistently implementing the legislation already adopted.

A regulator observed that the existing EU frameworks provide safeguards that address the key risks of digitalisation in the financial sector. DORA introduces enhanced ICT risk management rules and oversight of critical third-party providers (CTPPs), which should help tackle third-party dependency risks. The EU data frameworks and the AI Act will also mitigate the risks associated with AI and increasing data usage. The AI Act introduces measures to reduce bias in AI systems, particularly those classified as 'high risk'. Bias poses legal and ethical risks and needs to be mitigated, as it may affect customer trust.

Another regulator stressed that the current focus of supervisors is on implementing legislation adopted during the previous legislative period. The ESAs are actively working on implementing DORA, which requires significant resources from both industry and public authorities. Consistent implementation of the framework is needed to improve digital operational resilience in Europe. This includes designating the CTPPs, with the aim of having their oversight framework operational by the end of 2025. MiCA also poses an implementation challenge, as significant supervisory convergence efforts will be required among the 27 national competent authorities (NCAs). It has also been suggested that moving towards a single point of entry at EU level could be beneficial for large international crypto conglomerates.

An industry representative agreed that DORA can contribute to achieving EU-wide operational resilience and security. However, a proportionate, risk-based and harmonised approach to its implementation is required to achieve the legislation's objectives. New supervisory requirements that contradict or duplicate DORA should be avoided, as should regulatory overlap with closely connected frameworks, such as the Network and Information Security Directive (NIS 2). The regulation and oversight of cloud service providers and other technology providers must also consider their operational specificities and business model.

6. Policy priorities for the present political cycle, beyond the implementation of adopted frameworks

6.1 Enhancing the agility of policymaking

A regulator suggested that regulators must become more agile in how they update and adjust regulation to market developments. Current legislative processes are too slow to keep up with market innovation. A more principle-based approach to legislation at the EU level is needed, enabling quicker and more pragmatic implementation with a stronger role for supervisory guidance and a simplification of legislation.

Another regulator and the Chair agreed that regulators must adapt their approach to regulation in order to keep pace with digital innovation that is currently progressing faster than the rule-making process.

6.2 Reducing fragmentation across Europe

A Central Bank official believed that the EU should prioritise reducing fragmentation in order to support digitalisation. Despite progress in recent years, fragmentation continues to present significant barriers to the European financial sector. Further efforts are needed to establish a single digital financial infrastructure that complements existing payment systems. Financial institutions also need access to tools such as digital notary services and income registries to operate effectively across member states. Issues such as IBAN discrimination also hinder the expansion of cross-border access to digital financial services. While the SIU provides a legislative framework for the development of pan-European capital market activities, there must also be a stronger focus on achieving concrete outcomes, such as increasing the scale of European financial markets, to enhance the sector's ability to leverage technological innovation. The Anti-Money Laundering Authority (AMLA) is a good example of how a common approach can level the playing field and address risk effectively.

A regulator concurred with the importance of reducing fragmentation as an EU-wide objective. Supervisory fragmentation continues to impede effective oversight. A more coherent and coordinated supervisory approach is required, particularly as more and more firms adopt cross-border, digitally-enhanced business models. Supervisors must be equipped with the skills and resources to understand these new digital models and to assess the associated emerging risks in the context of fast market change.

To illustrate the impact of fragmentation on the European economy, an industry representative cited International Monetary Fund (IMF) data indicating that internal barriers within the EU single market are equivalent to internal tariffs of 40%, double those recently imposed by the US.

Another industry representative advocated for regulatory harmonisation as the cornerstone of efforts to improve Europe's global competitiveness. Fragmentation across 27 member states hinders data sharing, scale and technological adoption. To remain competitive at the international level, Europe must align its rules and adopt a risk-based regulatory approach, targeting the areas of greatest risk exposure, without stifling innovation elsewhere.

A regulator observed that, more generally, it is vital to recognise that digital finance is inherently cross-border and must be governed with an international perspective. Efforts to address the risks arising from digitalisation must be coordinated at the international and global levels.

6.3 Simplifying the regulatory framework

A regulator identified simplification as a primary priority for the next political cycle and a guiding principle for future legislative initiatives. In particular, the Financial Data Access Regulation (FiDA) proposal needs to be simplified, with a focus on customer needs and on encouraging the market to make better use of data. It is also important to ensure that the current legislative approach to digitalisation, which combines horizontal and sector-specific frameworks, does not create unnecessary complexity.

An industry representative similarly called for the simplification of European regulatory frameworks. Duplication, inconsistency and unnecessary complexity must be avoided. This should however not go as far as deregulation, as clear and consistent rules are an asset for Europe, making the continent's economic and financial environment predictable and reflective of European values. Overregulation remains a significant barrier to EU competitiveness. As mentioned in the Draghi report, this is demonstrated by the passing of 13,000 legislative acts in the EU between 2019 and 2024, compared to 5,000 in the US. This regulatory burden naturally impedes European growth and innovation. On FiDA, there must be a gradual approach, driven by practical use cases that align with real market needs. In its current form, stakeholders struggle to connect the regulation to actual customer needs.

The Chair acknowledged the importance of simplification, harmonisation and supervisory agility, while noting that between some of these factors there may be tension. Simplification and harmonisation cannot always be comfortably aligned for instance.

6.4 Enhancing financial and digital literacy and clarifying responsibilities

An industry representative emphasised the importance of financial literacy in an increasingly digital age. The more customers have direct access to financial services through digital channels, the more they must understand the associated risks. Investment will always require some level of risk. The solution is not to overprotect customers, but rather to empower and inform them. There are responsibilities in this regard across the value chain. For example, almost 80% of fraud takes place in social networks and not in regulated financial institutions, yet banks often bear the brunt of liability. Accountability should be shared across the entire fraud chain to ensure fairer outcomes and stronger deterrence.

Another industry representative suggested that a virtuous cycle of innovation could be initiated and fostered through increased investment in relevant digital upskilling programmes to meet industry demand, and in regulatory harmonisation to reduce fragmentation and accelerate AI adoption across Europe.

A regulator agreed that enhancing the financial and digital literacy of EU citizens is essential to leverage the advantages and opportunities of digital finance and mitigate risks effectively.