

Central Bank of Cyprus

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# FinTech and the future of financial intermediation

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

I am delighted to join you today at the Central Bank of Cyprus. It has been an excellent opportunity to meet with government officials and colleagues throughout the day. I would like to express my thanks to the Governor for his invitation and hospitality and to you all for your presence.

I would like to focus today on the transformation of the financial sector through the use of technology, specifically the growing role of FinTech in the future financial intermediation.

The focus on transformation is quite topical to discuss in Cyprus - a Member State where we have witnessed significant transformation in the banking sector following the Great Financial Crisis.

Cypriot banks have made a remarkable improvement during the last few years to clean-up their balance sheets from bad assets. They have managed to reduce their non-performing loans (NPLs) to around 3% of total loans, which is substantially lower than reported a few years ago. It is, however, still slightly above the EU average so we encourage Cypriot banks to keep up the good work in this area.

The improvement or return to profitability of Cypriot banks is also a point to highlight. In fact, preliminary Q1 2023 results show the Cypriot banking sector to be among those with the highest return on equity. Profitability has been helped by increasing interest rates and widening margins, and containable costs of funding at low levels. Higher profitability has

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helped Cypriot banks further improve their solvency ratios, while at the same time the sector has been reporting very high levels of liquidity. So all good signs but, of course, continued vigilance is needed.

I turn now to the core theme of my presentation today: the role of FinTech in shaping the future of financial intermediation.

‘FinTech’ is used as a blanket term to describe technology-enabled innovation in the financial sector. However, to understand its role in the financial sector, and the associated opportunities and risks, it is relevant to unpack the three different, and often inter-linked, dimensions of technology-enabled transformation.

The first is the emergence of new products and services, such as crypto-assets and associated services such as custody and exchange.

The second comprises new ways of performing front and back-office processes, such as cloud data storage, credit scoring, customer onboarding, regulatory reporting, risk modelling, and suspicious transactions monitoring.

The third comprises new distribution models, such as mobile and online banking interfaces, and multi-service digital platforms.

The EBA’s regular innovation monitoring work shows that, to-date, the emergence of genuinely novel types of products and services has been rather limited, albeit we certainly expect an uptick in crypto-asset issuance and service provision following the entry into force of the Markets in Crypto-assets Regulation (MiCAR) and the regulatory certainty provided by that framework.

However, our monitoring work shows that new front and back-office processes and distribution channels are having a rapid and significant transformative impact that has significantly increased as a result of COVID-19 crisis. Let me provide four examples to illustrate this point:

- Contactless payments: The first contactless payments were made in the EU in 2007. Use accelerated in the context of the response to the COVID-19 crisis and we now see contactless payments making up over 62% of ‘point of sale’ (PoS) card payments<sup>1</sup>, in line with an overall uptick in the use of digital payments and decline in the use of cash across the EU;

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[https://www.ecb.europa.eu/stats/ecb\\_surveys/space/html/ecb.spacereport202212~783ffdf46e.en.html#:~:text=Contactless%20card%20payments%20at%20the,the%20most%20frequently%20used%20method.](https://www.ecb.europa.eu/stats/ecb_surveys/space/html/ecb.spacereport202212~783ffdf46e.en.html#:~:text=Contactless%20card%20payments%20at%20the,the%20most%20frequently%20used%20method.)

- Remote customer-onboarding: The response to the COVID-19 crisis sparked a sharp acceleration in the development and use of digital interfaces through which customers can access financial products and services without accessing a physical premises;
- Credit scoring: Traditionally, credit scoring involved a manual analysis of loan application forms, potentially coupled with data accessed from other sources. Today, artificial intelligence (AI) and machine learning applications are being increasingly deployed to automate assessments of creditworthiness, potentially accelerating the speed with which credit is made available to borrowers.
- Cloud: Data held by banks and other types of financial institutions is now almost universally held in the cloud, allowing for potentially enhanced storage capacity, security, and interoperability across groups.

These four examples provide just a flavour of transformations to come, as we continue to see new technology innovations emerge, such as digital identity solutions, and increasingly disintermediated, or decentralised, business models.

The Cypriot financial sector is also being transformed by these technologies. For example, the EBA's Spring 2023 Risk Assessment Questionnaire (RAQ) results, which are not yet published, show that the vast majority (85%) of Cypriot banks who responded to the questionnaire are embracing FinTech. For example, between 50% and 100% of banks' customers are reported to be accessing retail and corporate banking services via digital means. 82% are expecting to deploy AI applications for regulatory or supervisory reporting, the monitoring of conduct risk and for fraud detection, and to assess credit worthiness. Approximately 28% of Cypriot respondent banks also reported plans to partner with a BigTech for the distribution of financial services.

This strong demand for FinTech illustrates the competitive impact of technology. Many incumbent financial institutions view technology investments as necessary to maintain market share against a competitive backdrop with increased consumer demand for convenience and competitors with 'digital only' business models.

The strong demand for FinTech also reflects the positive role technology can play in shaping financial intermediation. For example, for consumers FinTech can enhance convenience by facilitating access to financial services 'anytime anywhere'. FinTech may also facilitate access to more tailored products and services, and speed up the processing of account opening and credit provision.

For financial institutions, FinTech can improve efficiencies in internal processes, including for the purposes of compliance and regulatory reporting (RegTech). Outsourcing to specialist technology companies can enable a greater focus on core services. The use of

digital platforms or partnerships with technology groups can enable financial institutions to tap into a broader customer bases, including cross-border, and leverage economies of scale. And, of course, dependencies on technologies may lower costs of operation.

Let's not forget that supervisors too can benefit from supervisory technologies (SupTech) as a complement to RegTech. Indeed, we see increasing interest in this technology and in June hosted at the EBA a workshop on lessons learned from SupTech development and adoption to-date, during which supervisors shared their experiences and reflected on potential future developments.

But for all these opportunities to be leveraged responsibly industry, supervisors and regulators need to be proactive in identifying, monitoring and mitigating risks that are often multi-faceted and inter-related.

For example, the use of digital channels to market and provide access to financial products and services may pose risks to consumer protection in the event of ineffective disclosures of product features. This will make consumers unable to make properly informed decisions or to understand with whom they are ultimately contracting services. Unclear or opaque channels of communication between service providers and users may also open up other vulnerabilities. For instance, digital interfaces may be exploited by criminals masquerading as the service provider with the intent to defraud or commit theft.

Risks may also arise in the context of product and service bundling resulting in the sale of unsuitable or unduly costly products and services to consumers.

Risks of financial exclusion or bias may be elevated, for instance, in the construction of AI applications or excessive dependencies of digital distribution mechanisms to the exclusion of more traditional distribution channels.

Additionally, consumers' data may be exploited in the event consumers fail to be given effective opportunities to understand and consent to data use and monetisation or in the event of poor standards of digital data security and cyber-attacks.

The wider use of data, automated models driven by machine learning and AI may also exacerbate the risk of unintended discrimination and opacity in the decision-making driven by 'black boxes' of models. These risks are specifically on the radar of policymakers and supervisors in the context of GDPR implementation and the more recent proposal of the AI Act which is expected to introduce numerous safeguards to ensure the understandability and explainability of the models and their outcomes and to reduce the risk of discrimination of consumers.

Turning to financial institutions, the use of FinTech may give rise to significant governance and risk management challenges.

Operational risk can be elevated through increased dependencies on technologies, including those provided by third parties. Of course, this is a topic that has been much discussed and has informed the changes that will be brought about by the Digital Operational Resilience Act (DORA), including the enhanced standards for financial institution's management of information and communication technology (ICT risk) and oversight arrangements for critical third-party providers.

Reputational risk can also be significant. For example, a partnership between a financial institution and a comparison website may lead to reputational issues for the institution if product features are ineffectively disclosed. Similarly, reliance on a third party for the storage of customer personal data that is then subject to a successful hack may result in a significant loss of confidence of customers in the financial institution.

Prudential risks may also arise that require specific attention. For instance, although EU banks' exposures to crypto-assets are *de minimis* to-date, pending the implementation of the December 2022 BCBS standard on the prudential treatment of banks' exposures to crypto-assets, they should be subject to a conservative prudential treatment.

In view of the foregoing, we fully expect financial institutions who are increasing their reliance on innovative technologies to implement a commensurate 'skilling up' on technology, risks, and risk mitigation techniques at the level of the management body and throughout institutions and, of course, to have in place updated and robust risk management frameworks.

Looking beyond individual firms, system-wide risks may also arise. One example stems from enhanced interconnectedness and concentration risk from increasing dependencies on common infrastructure and service providers, such as APIs and platforms. Over time, such concentrations could lead to systemic risks which is why the DORA framework, which will bring critical third-party providers of ICT services (CTPPs) into direct oversight, is so important. We also need to remain vigilant over money laundering and terrorist financing risks and how increasingly fragmented value chains may be exploited for illicit financing.

For all of these reasons, as a regulatory and supervisory community, it is necessary that we continue our collective dialogue to share market developments, supervisory and regulatory experience, and monitor and mitigate risk. This is as relevant at a national level with the need for dialogue between consumer protection, data protection and financial sector authorities, as it is on an EU and global level. Indeed, dialogue will become ever more important as we grapple with the impact of new frontiers of innovation, including those

stemming from increased AI adoption, the emergence of central bank digital currencies and digital identity applications, and increasingly disintermediated value chains.

Knowledge-exchange fora such as the Central Bank of Cyprus' innovation hub are extremely useful to help supervisors keep track of innovation developments, and to build knowledge and understanding of the opportunities, challenges and risks involved.

At the EU-level we leverage these insights not only in our work, but also in our cross-sectoral work jointly with the other ESAs via the European Forum for Innovation Facilitators (EFIF), which the EBA is currently chairing. This year, for instance, we have a project underway to further assess the role of BigTech in the EU financial sector.

The insights are also leveraged in the context of the training we provide to national supervisors in the setting of the Supervisory Digital Finance Academy (SDFA) where we help develop the knowledge and skills supervisors need in order to challenge effectively in the context of line supervision.

However, knowledge exchange and skills enhancements are just part of the toolkit needed to ensure the opportunities presented by FinTech can be leveraged to positively shape the future of financial intermediation. Supervisory convergence tools are also essential, which is why we continue to develop instruments to facilitate common approaches to the acceptance and use of technology in the financial sector. Examples include our work on remote customer onboarding and on machine learning for internal models.

That said, of course sometimes new rules are needed to adapt or complement our regulatory framework to ensure it remains fit-for-purpose in light of technology adoption in the financial sector. I have mentioned already DORA and MiCAR. Other examples include the DLT Pilot Regime, and of course the most recent proposals for the third Payment Services Directive and Regulation and the digital euro.

These examples illustrate why FinTech developments can sometimes justify regulatory intervention – for instance, to regulate new products and services that perform the same economic functions as more traditional financial instruments, to regulate new concentration or consumer protection risks, but also to unlock opportunity as a result of the removal of impediments to technology use or scaling across the internal market.

By extension, alignment of supervisory and regulatory expectations at the global level, is also essential, and we see good progress in areas such as the regulation of so-called stablecoins, and on banks' exposures to crypto-assets.

In the last few minutes I will say a few words on EBA's work in the next six months and into 2024.

Unsurprisingly, much of our focus will be on DORA and MiCAR-related activities.

On DORA, the EBA has commenced work, jointly with the other ESAs, on the policy mandates and on the broad parameters of the oversight framework for critical ICT third-party service providers, working also in close cooperation with ENISA. Recently, we published our first set of consultation papers on policy mandates under DORA.

MiCAR has now entered into force, starting the clock on an intensive phase of policy delivery work in relation to issuers of asset-referenced and e-money tokens. I anticipate that our consultation phase on the vast majority of our technical standards and guidelines under MiCAR – which relate primarily to issuers of asset-referenced tokens and e-money tokens - will begin in October 2023, but several consultations papers in the areas of authorisations and governance can be expected between now and the end of September. We are also expanding our market monitoring and supervisory capacities to prepare for our supervision tasks in relation to significant issuers. In addition, we are taking forward important own initiative work to promote convergence in supervisory expectations toward asset-referenced token and e-money token issuance activities in the transition phase to the application of MiCAR, on which you can also expect a publication shortly.

Relatedly, the EBA is taking actions to ensure that money laundering and terrorist financing risks are tackled holistically across the crypto-asset sector. This means that we will bring revisions to our existing AML/CFT guidelines, including the fund transfers guidelines and the ML/TF Risk Factors Guidelines<sup>2</sup> to set common regulatory expectations on the management of financial crime risk in the context of crypto-asset services. We remain committed to ensuring that financial crime has no place in Europe.

And we are continuing to engage in the work of the Basel Committee on Banking Supervision, to ensure a prompt and consistent implementation of the prudential standard on banks' exposures on crypto-assets, where enhance international convergence remains key.

More broadly, consistent with our statutory objectives of monitoring financial innovation, and fostering supervisory knowledge exchange, we will continue to map innovation trends, in particular focusing this year on AI use cases in the financial sector, tokenisation in relation to new financial products and services, digital identity management, DeFi and crypto-asset staking and lending – these being activities that fall outside the scope of MiCAR.

On AI, in addition to monitoring the uptake of innovative AI and ML techniques in financial sector use cases, including generative AI, we are placing the focus on the use of AI for

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<sup>2</sup> <https://www.eba.europa.eu/regulation-and-policy/anti-money-laundering-and-counteracting-financing-terrorism>

creditworthiness assessments. While the AI Act trilogue negotiations have only just started, we can expect this use cases to be classified as a ‘high-risk’ AI system and, in this context, our objective is to enhance our understanding on the opportunities, risks and challenges brought by AI in the context of creditworthiness assessments.

More broadly, the EBA continues to support our European counterparts on issues relating to the digital euro, including in the context of the newly published legislative proposal for a digital euro<sup>3</sup>, and on the proposals for the third Payment Services Directive, the Payment Services Regulation and the framework for Open Financial Data. The EBA welcomes these proposals, as they take on board a large number of the recommendations the EBA had published last year in our response to the Commission’s call for advice on the review of the PSD2.

And, of course, we will continue to engage proactively in ongoing policy work at the EU and international levels, including the work of the Financial Stability Board and Financial Action Task Force.

I conclude by taking this opportunity to thank you for your ongoing active participation in the EBA’s work and I look forward to our continued dialogue on regulatory and supervisory issues in relation to FinTech and beyond.

I thank you for your attention.

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<sup>3</sup> [https://ec.europa.eu/commission/presscorner/detail/en/ip\\_23\\_3501](https://ec.europa.eu/commission/presscorner/detail/en/ip_23_3501)