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Embedding responsible innovation: Culture, conduct and communication

I am delighted to join again the annual conference on FinTech, a topic on which there is a need for ongoing dialogue between industry, regulators and supevisors and I thank Nickolas [Reinhardt, Director, Afore Consulting] and his team for another excellent programme.

In previous years, I have reflected typically on two themes:

(i) the digital transformation of the EU's banking and payments sector, and the opportunities and risks arising in the context of changes to front and back-office processes, delivery mechanisms and business models; and

(ii) the need for balanced regulation to facilitate the use of technologies that show a positive impact – whether on the basis of process efficiency, risk management, consumer choice and experience when accessing financial services.

Three years on from the European Commission's Digital Finance Strategy,[1] I am impressed with the progress made. Flagship initiatives such as the Digital Operational Resilience Act (DORA) and the Markets in Crypto-assets Regulation (MiCA) set the benchmark globally. The proposal for the Artificial Intelligence Act (AI Act) and work on digital identities, show the European Commission's continued ambition and thought-leadership on regulation in the digital age and against a background of continuous technology experimentation and adoption in the financial sector. For

[1] https://finance.ec.europa.eu/publications/digital-finance-package_en

instance, the results of the EBA's Autumn 2022 Risk Assessment Questionnaire[2] indicate that 95% of EU banks are using, pilot testing or developing application programming interfaces (APIs) and artificial intelligence (AI) solutions; reliance on cloud computing continues to grow with 85% of respondent banks now reporting use; and we see the first signs of the pilot and testing of quantum computing solutions within the financial sector.

However, as we enter the phase of implementation for many of these initiatives, I would like to look beyond the regulation itself and reflect on three additional and inter-related elements that are essential if we are to foster responsible innovation: culture, conduct and communication. I believe these elements to be as relevant to the regulatory and supervisory community as they are to the industry.

Culture

As a starting point, we have to ask the question: *What role do we wish technology to play in our financial sector*?

Do we wish it to be deployed in pursuance of societal goals, such as improving the resiliency of the financial sector, mitigating financial exclusion, and facilitating the green transition?

Or do we instead tolerate an environment in which technology is deployed – albeit by a minority – with the express objective of arbitraging regulatory requirements, or for their own benefit while placing customers at risk due to ineffective risk management and controls?

The answer comes down to the culture we instil and the values we uphold.

Consistent with the EBA's Guidelines on Internal Governance,[3] I believe financial institutions should have a culture that encourages a positive attitude towards the application of innovative technologies but with a risk mitigation approach front-and-centre.

What do I mean by this?

Well, top down and bottom up, experimentation, testing and roll-out of innovative technologies should be done with a spirit of open and full dialogue between financial institutions' business, technology and compliance teams and, as appropriate, with supervisors, a point to which I will return shortly.

For example, will a new back-office process create cyber vulnerabilities that need to be addressed to protect consumers from the risk of data loss or identity fraud?

Will a new artificial intelligence application be explainable to consumers or to the supervisor?

Will a partnership with another firm for the distribution of a product or service via a digital platform create operational and reputational risk if things go wrong?

2 https://www.eba.europa.eu/sites/default/documents/files/document_library/Risk%20Analysis%20and%20Data/Risk%20dashboard/Q3%202022/1050801/RAQ%20Booklet%20Autumn%202022.pdf

3 https://www.eba.europa.eu/regulation-and-policy/internal-governance/guidelines-on-internal-governance-revised-

Will a customer receive clear information about how their data may be shared within or beyond a group in order that they can consent in a fully informed manner?

These are the types of questions that should be present from the beginning in any discussion about the deployment of an innovative technology in order to ensure that the use of the technology, and relevant operational processes, are designed in a way that adequately identifies, measures and mitigates risks.

Indeed, this approach is also something we reflect in our own deliverables, such as the Guidelines on Remote Customer Onboarding,[4] where we identify the utility of innovative technologies for customer due diligence and identify safeguards that need to be applied to ensure this technology use is responsible and in line with AML/CFT expectations.

As we see increased roll out of technologies by financial institutions, we expect a commensurate 'skilling up' on technology, risks, and risk mitigation techniques at the level of the management body to set the tone because, if you get the culture right, then you have the foundation on which responsible innovation can thrive.

Similarly, for supervisors, we expect a culture that, on the one hand, promotes an openness towards financial innovation and, on the other, equips supervisors to understand the risks and challenge effectively in the course of supervisory evaluation procedures.

Conduct

Next: conduct.

In my view, and very much linked to the cultural issues I just discussed, responsible innovation requires a forward-looking, proactive 'compliance by design' approach: building processes, systems, products and services that take account of regulatory requirements that apply today but also those that are expected to apply tomorrow.

The Markets in Crypto-assets Regulation (MiCA), on which a final European Parliament vote is expected shortly, will set out extensive requirements for issuers of asset-referenced and e-money tokens, and we expect those requirements to apply from mid-2024.

However, I would encourage any firm anticipating launching such a token during the transition phase already to seek to design their procedures, reserves and so on as if MiCA were already in force. Not only will this prevent the firm from having to implement potentially costly changes at a later stage, it will also give any users of those tokens confidence in the compliance mindset of the issuer.

As another example, taking inspiration for the proposal on the AI Act and following the EBA's report on Big Data and Advanced Analytics,[5] I encourage any financial institution looking to use AI or machine learning in the context of credit worthiness assessments to robustly test the models and

[4] https://www.eba.europa.eu/eba-publishes-guidelines-remote-customer-onboarding

[5] https://www.eba.europa.eu/eba-report-identifies-key-challenges-roll-out-big-data-and-advanced-analytics

ensure that outcomes are aligned with the overall risk appetite of the institution, and that any outcomes are explainable to customers and supervisors.

Equally, every responsible innovation must rely on an approach that takes account of consumer-facing considerations such as the need to ensure that customers:

- have readily accessible and well-presented information on product features and risks to make informed choices when considering financial services online;
- have clear access points in the event of queries, or complaints;
- make fully informed consents regarding the use of their personal data; and
- are not inadvertently excluded from financial services due to technological applications encoding unintended bias.

Communication

Indeed communication is key at many levels. But today let me focus on the role that effective communication has to play in the interaction between industry participants and supervisors.

From the design to implementation stage, I would strongly encourage financial institutions to engage in an open dialogue with their supervisors to understand any supervisory expectations toward the deployment of an innovative technology. Supervisors should also take a proactive approach to enhancing knowledge about financial innovations and building skills to supervise effectively the use of innovative technologies in the financial sector. This dialogue can facilitate a common understanding of opportunities and risk, and can be a very helpful input in shaping supervisors' update or issuance of new supervisory guidance.

Communication is also key when we consider the complementarity of RegTech and SupTech applications, a topic on which I know you focus later this afternoon.

For instance, in the context of regulatory reporting, interoperability may be key but of course cannot be achieved if industry and supervisors design their technology applications in silos, a point we highlighted in the EBA's RegTech report.[6]

Indeed, this is a point we also stressed in the context of our 2022 SupTech monitoring work, which involved a stocktake of SupTech tools developed or deployed by national competent authorities across the EU.

553 SupTech tools were reported by competent authorities, of which 216 are tested and deployed, 163 are at the pilot stage, and 160 are at the scoping stage. The tools span microprudential supervision, AML/CFT, deposit protection, and macroprudential issues.

Notions such as 'embedded supervision' are also increasingly under consideration in the context of the use of monitoring crypto-asset transfers, and increasingly decentralised business applications.

We found that the vast majority of competent authorities represented on the EBA's Board of Supervisors have, or are in the process of developing, a strategy or plan that covers SupTech and

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

making substantial technology investments, for instance to integrate robotic process automation in reviewing supervisory data.

In 2023, we will continue this dialogue to facilitate knowledge and experience exchange.

As an example, we have a workshop for competent authorities tomorrow on social media monitoring SupTech tools, which will allow for an exchange on experience acquired with the application of tools deployed to-date, and to discuss the main benefits and practical considerations. This workshop is very appropriate at a time when we know that social media is being increasingly used as a forum for advertising financial services, and can pose risks, as identified in the joint-ESA crypto-asset warning last year.[7]

We will also continue to contribute to skills development within the supervisory community, including via the EU's recently established Supervisory Digital Finance Academy, which this year will be enhanced with a series of advanced trainings for supervisors on topics such as AI, DLT, and cyber risk.

But again, I must underscore the need for continuous dialogue between industry and supervisors on technology topics in order to facilitate the development of complementary and interoperable applications, and to foster common understandings on opportunities and risks.

What can you expect from us in 2023?

So what else can you expect from us in 2023?

Well, somewhat unsurprisingly, much of our focus this year will be on DORA and MiCA-related activities.

By now DORA needs no introduction – its aims of strengthening EU financial sector rules on ICT risk management, harmonising ICT incident reporting, and introducing an oversight framework for critical ICT third-party providers are well-known.

Following the publication in the Official Journal, 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.

On MiCA, of course we do not yet have a final text but expect its entry into force in late-Spring, starting the clock on an intensive phase also of policy delivery work in relation to issuers of asset-referenced and e-money tokens.

All of our work in this area of course will involve active communication with industry stakeholders and formal consultations.

I currently anticipate that our consultation phase on the vast majority of our technical standards and guidelines under MiCA will begin in October 2023. We will also be commencing activities to expand our market monitoring and supervisory capacity to prepare for our supervision tasks in relation to significant issuers. And, let me use this opportunity to note, we are taking forward

[7] https://www.eba.europa.eu/eu-financial-regulators-warn-consumers-risks-crypto-assets

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 MiCA.

For both DORA and MiCA, we are also preparing responses to the European Commission's Calls for Advice[8] on issues such as oversight and supervisory fees, and significance criteria for issuers, with industry workshops planned in late Spring to inform the work.

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,[9] to set common regulatory expectations on the management of financial crime risk in the context of crypto-asset services. We remain committed to making sure that financial crime has no place in Europe.

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.

We expect to publish a follow-up report on the November 2021 Discussion Paper on the use of Machine Learning for IRB models,[10] and will also keep monitoring the landscape of the use of the most advanced ML models for IRB.

In our capacity as Chair of the European Forum for Innovation Facilitators,[11] this year the EBA will foster cross-sectoral dialogue between the supervisors of the EU's banking, securities and markets, and insurance and pensions authorities on digital trends. We have two specific reports planned. One in the context of the review of experience acquired with innovation hubs and regulatory sandboxes, and similar schemes.

The other, in the context of our latest stocktaking on the role of large mixed activity groups, specifically BigTechs, as providers of financial services, whether directly or in partnership with financial institutions, in the EU. This stocktaking follows the January 2022 joint-ESA response to the Call for Advice on Digital Finance.[12]

Of course we will continue to engage proactively in ongoing policy work at the EU and international levels.

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[8] https://www.eba.europa.eu/about-us/missions-and-tasks/calls-for-advice#:~:text=Calls%20for%20Advice%20%7C%20European%20Banking%20Authority&text=The%20EBA%20receives%20Calls%20for,publishes%20an%20evidence%2Dbased%20Report.

[9] https://www.eba.europa.eu/regulation-and-policy/anti-money-laundering-and-countering-financing-terrorism

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

[11] https://www.eba.europa.eu/financial-innovation-and-fintech/european-forum-for-innovation-facilitators

[12] https://www.eba.europa.eu/esas-recommend-actions-ensure-eu%E2%80%99s-regulatory-and-supervisory-framework-remains-fit-purpose-digital

The EBA will also continue to provide inputs to the work of international standard-setters, such as the Basel Committee on Banking Supervision, in relation to work to promote common classification of crypto-assets under the recently published framework for the prudential treatment of banks' exposures to crypto-assets, and the Financial Stability Board in relation to so-called global stablecoins and the regulation of crypto-asset service providers, and on the monitoring of crypto-asset and DeFi developments.

So, as always, a lot going on and I can only say that if we, collectively as an industry, supervisory and regulatory community, keep in mind those 'three Cs': culture, conduct and communication, we will remain well-placed to ensure that technological innovation can continue to be embedded as a force for good in the EU financial sector.

I look forward to the continued dialogue and of course am happy to respond to questions.