



10th Jubilee Conference on Payments and Market Infrastructures

«Digital transformation in banking – Challenges to regulators»

Speech by Hélder Rosalino, board Member of Banco de Portugal¹

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Good Morning,

First of all, I would like to thank the Governor of the National Bank of Macedonia for the invitation to Banco de Portugal to attend this conference and to have an intervention in this panel.

It is an honour to represent Banco de Portugal in this event.

I also convey my compliments to the Governors and Board Members of the Central Banks that are involved in this Conference, including the ECB.

A special greeting to all the Authorities represented here.

Ladies and Gentlemen

Introduction

Let me begin with a special word of compliment to the National Bank of Macedonia for organising this conference and for being able to gather so many relevant issues and such a vast number of representatives from a diversity of institutions.

Banco de Portugal is very pleased for making a contribution to the event and for seeing the growth and maturity of this series of conferences over the years, now deservedly celebrating its tenth edition with this special session. I am aware of the hard work needed to get to this point and gather all of us in this room today.

¹ Version prepared for presentation.



This is evidence of the importance of institutional cooperation and common goals shared between our central banks with a view to exchanging knowledge among peers and with the industry, constantly improving and finding up-to-date topics to foster dialogue and consolidate this initiative.

I will address the digital trends in banking, influenced by the access to technological tools by customers, their influence on the demand for new and more sophisticated services, setting up new habits that have in retail payments the most visible example.

Associated to this, we are observing a market that is undergoing substantial transformation, with new entities positioning themselves in an area traditionally dominated by banks, who now need to adjust to new products being offered by **fintech** companies, **telcos** and others players.

Furthermore, the legal framework in Europe is also changing to accommodate the new reality, and this also creates a challenge for regulators in general and, in this particular domain, for central banks, so that they successfully combine their key roles as operators and overseers. In this context, cooperation efforts between authorities are a key factor in a borderless world.

Digital transformation trends in banking + Newcomers in a bank-dominated market

Over the last decade, we have seen very significant changes in the provision of financial services, which result in particular from constant evolution in the field of information technologies.

If we look back to the late 2000s, we now see different market players, different concerns either from providers or from end users, as well as a wide-range of different requirements.

Particularly, the payments market has been one of the most, if not the most, affected by this change. However, further changes that can be anticipated for the early 2020s are unprecedented, in both dimension and impact.



The digital experience of the average user of financial services in general, and of payment services in particular, will be shaped by the Millennials and the Digital Natives, who use different communication channels to interact with the institutions with great familiarity.

These constitute a large group of customers that were born and grew with the Internet, have taken its use for granted and assume all services and information are made available online and in real-time, also willing to interact digitally with their providers while demanding complete and robust products, adapted to their needs.

Payment services will more and more be seen as a commodity, with 24/7 availability and with instant settlement, further diversifying the usage of traditional means of payment from cash and cards to online solutions available on any mobile device.

This represents an absolute challenge for financial institutions: permanent search for efficiency, improvement, and providing products and services in line with the users' expectations.

At the same time, for traditional (incumbent) banks, new competitors are willing to increasingly enter in this market and challenge their customer base.

The **Fintech** phenomenon has come to stay. To grow. To reshape the provision of financial services. The European Commission defined fintechs as ***technological innovators with potentially transformative implications for the financial system, its intermediaries and users.***

Fintech are new players that have played an active role in the growth of digital experience and financial innovation, setting up many of the solutions that support the functioning of the digital financial market.

Often they have been responsible for developing new technological platforms that allow the provision of financial products and services in a quicker, convenient and intuitive way, adapted to the needs of end users, frequently with lower costs than those of incumbent banks.



Against this background, banks have reached a crossroad: on the one hand, the need to innovate and follow the pace of the new digital challengers in the payment services market. On the other hand, the need to also anticipate with clarity how the business will evolve and how banks will function in the not-too-distant future.

This implies the need to constantly analyse customers' trends and expectations, with particular focus on Generations Y and Z that will represent the backbone of their customer base in the medium term.

Indeed, these groups have great flexibility to move across entities and naturally observe that new entrants come into the market and compete for the provision of new services.

On top of this, the European Banking Union – still under construction – also brings additional challenges for banks in Europe, associated with low interest rates and a high volume of regulatory requirements resulting from the deep economic crisis that only recently began to be overcome.

As a result of this evolving reality, digital banking and fintechs can be seen together, with common features that represent technological shocks changing the business models of the banking system on a big scale and with worldwide reach. However, both have a varying degree of already visible effects and forecasts for further impacts.

Digital banking has changed the relationship between banks and their customers, which will be reinforced in coming years and will result in the reduction of the physical presence of banks not only in their branch network but also in their workforce.

Over the last five years, forty thousand bank branches were closed in the European Union, while staff numbers have been reduced by two hundred and fifty thousand workers.

And this is still an ongoing process, as banks announce further cuts and adjustments that mainly result from the digital revolution now underway. Once again, payments can be seen as one of the faces of this situation.



With **Fintechs** the uncertainty as regards its impacts is much bigger. Many of the new financial products with a technology-driven base now offered by banks have been developed by startups.

This innovation wave is seen by new developers as a process that will revolutionise and democratise access to financial services, with several immediate benefits:

- i) consumers will have a wider range of options, tailored to their needs and probably at lower prices;
- ii) small and medium-sized companies will gain access to new credit options and better market conditions;
- iii) banks will become more productive with lower transaction costs and better operational robustness;
- iv) the financial sector as a whole will become more resilient, providing greater diversity and depth; and
- v) last but not least, financial inclusion will more and more become a reality, with more informed, better connected and better equipped people (the customers, the end users).

Anyway, it is prudent to conclude that not all companies currently operating in this field will survive, and also, it seems still unclear which can be the new areas where Fintechs can prosper in the future.

And of course, traditional banks will have a role to play and will certainly react to this phenomenon. Though difficult to anticipate how banks will position themselves, there certainly will be an adaptation.

Challenges that arise for regulators/central banks

All these developments represent a very significant challenge for central banks' mission activities. A whole new model implies a new approach and central banks – and regulators in general – need to find ways to be better prepared to follow the



developments while searching for full knowledge of the new products and the new players while efficiently performing their tasks.

The digital revolution can pose risks to financial stability and it is an obligation for central banks to be up to the challenge, ensuring level playing field in the market, supervising institutions and overseeing financial products in order to avoid grey areas that could allow for bad practices.

In the domain of digital banking and Fintechs, the position of Banco de Portugal has been supportive of financial sector developments, with openness to regulate and mediate in a positive way, setting up the right environment that promotes dialogue in the market at national level.

Not only between the central bank and the different market participants but also among themselves. We believe in an intermediation role and there will be room to all innovators in the market that provide financial products. Dialogue is possible, cooperation is possible combined with competition: *coopetition!*

In fact, Banco de Portugal has taken a number of initiatives, such as hosting international conferences, fostering this dialogue and providing the market participants with information, and also reflecting internally the challenges that arise from the digital banking and fintech phenomenon, against a broader context of its mission – as an active part of the Eurosystem – and specifically its role as regulator and supervisor.

Concluding remarks & views for future

Ladies and gentlemen,

Digital transformation, in banking and in society in general, will continue and accelerate. It will be more and more part of our daily lives. This is an unavoidable trend.

For financial services in general, and payments in particular, we are already witnessing new models, for instance Pan-European instant payments are soon to become a reality at EU level.



Furthermore, this is a big challenge for legislators who have been adjusting the applicable framework in recent years, now mostly visible with the redrafted Payment Services Directive that will set up market conditions for more transparency and access by new entrants as well as levelling the playing field.

At the same time, central banks are faced with substantial challenges. They need to constantly learn about the developments taking place in the market and find adequate tools and resources to face the digital and fintech dynamics. The emerging reality with new service providers requires an organised, agile and transparent response, involving all relevant players.

And here, again, cooperation is a key aspect.

Without a harmonised regulatory framework in some jurisdictions, national legislation is being used to tackle Fintech activities, but this risks originating unbalanced approaches and potential distortions at cross-border level that operators can take advantage of.

As opposed to this, I insist, a coordinated approach is the right way for dealing with the new market features. In a borderless world, as the one we live in today – and thankfully – due to technological evolution, a harmonised treatment, also with no borders hindering its applicability, is the right solution.

Faced with all these challenges and opportunities, this conference has a great importance as a space for debate, reflection and knowledge-sharing, from a central bank's perspective.

I would like to thank again the National Bank of Macedonia for organising this important conference, in this especial moment, and to congratulate the organisers for its tenth edition.

Thank you very much for your attention.