



## DIGITAL FINANCE STRATEGY FOR THE EU: A THIRD COUNTRY PERSPECTIVE

### KEY TAKEAWAYS

For a successful European Digital Finance Strategy, joint effort is needed to foster regulatory dialogue and cooperation, together with the private sector, with other global and innovative financial centres, like Switzerland, with a view to:

- Seek alignment, compatibility, and interoperability where possible, starting with digital identities.
- Support technology-neutral regulation that is flexible to ever-evolving innovation while ensuring resilience and security for all participants.
- Guarantee connectivity and cybersecurity of infrastructures, as well as information sharing on cyber incidents.
- Ensure open markets and free flow of data cross-border in full respect of EU data protection rules and equivalent measures.
- Exchange best practices and jointly foster innovation in financial services.

### Digitalisation Needs Seamless Cross-Border Solutions

Digital transformation continues to shape the global financial industry. Technologies such as artificial intelligence (AI)/machine learning, cloud computing, distributed ledger technology, big data analysis and natural language processing are being adopted at an increasing pace everywhere from client-facing activities to the middle- and back office. Digital-based market entrants are disrupting the competitive environment. Technology has increased the focus not only on benefits but also on risks in areas such as data protection and cybersecurity, and so accentuating the need for close dialogue between the industry and the authorities.

Much digital change is driven by changing consumer preferences, exemplified by the increased use of mobile banking; and also by the opportunity to rationalise costly

back office processes. These and similar global drivers will influence how financial institutions deliver financial services to the next generation – and how they stay competitive.

Moreover, the COVID-19 pandemic has underscored the growing use of digital tools by the public and private sector, as well as the essential role of technology in facilitating access to (sometimes basic) services, ensuring business continuity and operational resilience worldwide.

Digitalisation knows no border and finance is no exception. If we erect cross-border barriers in the form of diverging regulatory standards across jurisdictions, we will slow the rollout of digital innovation and delay benefits for consumers.

### Global Cooperation and International Alignment Are Essential

In response to these fast-moving developments and new challenges, the European Commission published a Digital Finance Strategy for the European Union (EU) in September 2020<sup>1</sup>, along with a new Retail Payments Strategy and legislative proposals for both crypto-assets as well as for digital operational resilience in the financial sector.

Importantly, the Digital Finance Strategy reiterates the principle of “same activity, same risks, same rules”. The strategy also stresses the Commission’s enduring commitment to working closely with the EU’s international partners, as benefits of digital finance are best harnessed if their deployment is based on international principles and standards. However, it does not further expand on how to deal with third country access or with services and economic operators based in third countries.

The EU is known for shaping international standards and for working closely on aligning work with international regulatory bodies. The global nature of digital finance is echoed in a resolution voted in October 2020 in the European Parliament which recalls in particular the need to ensure interoperability of the EU’s regulatory framework with internationally agreed principles<sup>2</sup>.

## GLOBAL COOPERATION AND ALIGNMENT

European institutions and authorities should sustain international cooperation and standard-setting and continue to engage in regulatory dialogue with key global financial centres to implement the many concrete actions envisaged in the EU Digital Finance Strategy. Global cooperation and alignment help prevent a fragmented approach to regulation and supervision that would be detrimental to a consistent implementation of rules and standards across jurisdictions and among the variety of financial players and thus could endanger financial stability globally. Furthermore, global cooperation strengthens Europe's competitiveness, facilitates the development of innovative technologies, and avoids regulatory arbitrage.

### Setting an Innovation-Enabling Framework That Works Cross-Border

We believe in technology-neutral regulation, a forward-looking framework which reacts flexibly to ever-evolving innovation (through e.g. a fast and dynamic review of legislation going forward), and is guided by the overall principle of "same activity, same risks, same rules". We need readiness for cross-border interoperability whilst ensuring resilience and security for all participants.

*"We believe that global cooperation and regulatory dialogue in increasingly digitised financial services would strengthen Europe's competitiveness, facilitate the development of innovative technologies, and prevent a fragmented landscape that would be detrimental to the functioning and stability of financial markets internationally."*

Lukas Gähwiler,  
Chairman of the Board, UBS Switzerland AG

To deliver its full potential, a truly integrated digital single market should be seamlessly interconnected with key global non-EU financial centres, such as Switzerland whose Fintech (eco)system and partnership with the EU in technological innovation is described in a box at the end of this Issue Note.

This requires principles-based equivalence decisions for market access in financial services that are becoming increasingly digitised. Considering the borderless impact of technology, global cooperation and better connection with the EU's closest trading partners should form part of a comprehensive approach that encourages financial innovation.

To this end, we support a Capital Markets Union (CMU) that is open to and attractive for international investors as this will leverage global capital and funding available and ready to invest in the technology sector for the benefits of EU consumers.

## AN OPEN AND ATTRACTIVE CMU

To successfully contribute to an open and attractive CMU, we believe that global finance needs an alignment of the broad financial services regulatory framework, through e.g. principles-based equivalence decisions for market access, underpinned by global standards and robust supervisory cooperation while ensuring a level playing field. A CMU that is connected seamlessly to key global financial centres can help deliver the full potential of digitalisation.

### Encouraging Global Coordination on Testing and Licensing

Through its Digital Finance Strategy, the Commission aims to extend the principle of licensing and passporting beyond crowdfunding and crypto-assets to other Fintech areas like non-bank lending and RegTech solutions that can help financial firms in their regulatory compliance obligations. Testing and experimenting with innovative solutions will facilitate their further development and refinement.

Several EU member states have established regulatory sandboxes and innovation hubs which have proved useful. Positive experience was also gained in other jurisdictions like Switzerland. In 2017, the Swiss government created an extended authorisation-exempt area (regulatory sandbox), and in early 2019, the Swiss legislator introduced a new Fintech licence which has less strict requirements than a traditional banking licence. It enables Fintech companies to carry out certain activities within an appropriate regulatory framework without the need for a costly and complex banking or other applicable licence.

Exchanging best practices in a secure environment on the testing and licensing of new firms, services, and products could bring mutual benefit and contribute to jointly foster innovation in financial services while at the same time ensuring resilience and security for all market participants.

## COORDINATION ON REGULATORY SANDBOXES

We support an internationally coordinated approach on regulatory sandboxes between regulators and more specifically the alignment of the entry and exit criteria for the sandboxes, as well as to exchange experience and best practices as regards the licensing of new firms, services, and products.

## Enabling Globally Interoperable Digital Identities

Amongst key actions to tackle fragmentation included in the EU Digital Finance Strategy, we welcome the Commission's commitment to implement an interoperable cross-border framework for digital identities (e-IDs). This will help to further develop and expand Europe's digital economy.

*"If our goal is to build a resilient, digital financial system that works seamlessly across borders then we must align our regulatory approach to innovation, financial services and products — e.g. concerning electronic identification and cybersecurity. Compatibility and interoperability of rules, standards and practices make alignment possible."*

Peter Derendinger, SFC Chairman

For consumers, the main benefit of an e-ID will be portability, i.e. having a digital identity which is readily verified and can be used by them across borders and with multiple parties, for different regulatory and other requirements. This results in a seamless, faster, more secure and predictable application journey.

For banks and other financial institutions, the creation of a digital identity that reuses (home state) national digital identity schemes as well as other member states' digital identity schemes will facilitate client's online onboarding and will thus contribute to significantly reduced costs, fraud and improve due diligence processing.

We welcome the intention of the Commission to extend the use of e-IDs to the private sector and to offer the possibility of private sector provision of digital identities within the framework of a revised Regulation on electronic identification and trust services (eIDAS Regulation).

### INTEROPERABLE CROSS-BORDER DIGITAL IDENTITIES

National e-ID systems should be made easily interoperable not only among EU member states but also with key global financial centres, starting with the EU's closest partners such as Switzerland. Standardisation will enable cross-border transactions and contractual agreements across EU member states' borders, and beyond, through non-physical channels.

## Working Towards Globally Aligned Rules and Practices on Cybersecurity

Security of assets and identity is fundamental for investors, banks' clients and more generally for consumers of financial services to feel sufficiently confident to embark on the digital future. Cyber-attacks are not confined to national or regional borders but occur indiscriminately and globally.

Cybersecurity and resilience are high on regulators' agendas. However, we observe different approaches and limited consensus across jurisdictions on the appropriate level of detail and specificity of the rules.

The public sector needs to work proactively with the private sector, at national level as well as across borders, in pulling together leadership, cybersecurity technologies and better awareness of the risks. A priority should be timely and proper sharing of intelligence and information on cyber threats and cyber incidents among key public and private actors, as seamlessly as possible, including with the main financial centres outside of the EU.

### ALIGNMENT OF RULES AND PRACTICES ON CYBERSECURITY

The EU is well placed to promote and coordinate principles-based and industry-driven standards and practices as well as information sharing on cyber incidents which are globally aligned to avoid unnecessary duplication and conflict of rules. A fragmented regulatory landscape is more likely to be exploited by cyber-criminals to disrupt the functioning of financial markets worldwide.

## Ensuring Free Flow of Data Globally

In recent years, there has been focus on how new technology affects data protection regulation. Particular attention should be paid to legal certainty concerning the collection, processing, and sharing of data and how the implementation of respective EU legislation works in relation to other initiatives. In this respect, the EU General Data Protection Regulation (GDPR) should remain sufficiently flexible to take into account current developments including the use and implications of big data analytics in the financial sector, the digitalisation of financial services, payments or the prospect of open data.

Portability of data is also an important element for consumers. Clarity is required about the circumstances under which personal data can be transferred safely and securely, including to recipients located in other regions.

The GDPR lays the foundation covering the rights of persons in relation to their data. It outlines how to protect data and addresses related cross-border aspects. Reliable and predictable adequacy frameworks are crucial to guaranteeing legal certainty for cross-border data portability and transfers of personal data outside of the EU.

From a legal certainty and operational point of view, we are, however, concerned by the growing number of domestic laws across the world that require data be localised within a certain jurisdiction (e.g. China, India, Russia).

This not only results in extra costs and unnecessary burdens for companies, it also creates regulatory fragmentation that impedes the free flow of data and hampers the development of seamless digital financial services and cross-border solutions to the benefit of consumers.

We therefore commend the Commission for its determination to systematically incorporate specific provisions on data flows and prohibition of data localisation requirements in bilateral and multilateral trade agreements and thus to enable transfers of data.

Technology will also soon make it possible to entirely and securely store and process data in the cloud, thus taking down borders and making requirements for data localisation less pertinent. Linked to that and in the context of the EU proposal for a Regulation on digital operational resilience for the financial sector (DORA)<sup>3</sup>, we believe that financial institutions should have the commercial freedom to choose the third-party infrastructure provider (TPP) that is most fitted to their business and needs irrespective of where this TPP is located.

Finally, we note with interest the Commission's ambition to set up a common financial data space to help integrate European capital markets, channel investments into sustainable activities, support innovation and bring efficiencies for consumers and businesses. We would need more clarity on the type of data to be shared between financial institutions and third-party providers and on what basis. Additionally, the principle of reciprocity in information exchanged should apply.

## DIGITAL FINANCIAL LITERACY

The Commission, together with international bodies such as the OECD and IOSCO, should strive to coordinate initiatives aimed at increasing digital and financial literacy. The Economic and Financial Affairs (ECOFIN) Council rightly called on the Commission and EU member states to facilitate the exchange of best practices and views on national measures in this regard.

## GLOBAL DATA FLOWS

Data must flow freely across borders and not be subject to localisation requirements that go against the commercial freedom to choose the third-party provider most fitted to a firm's business needs. We favour an open market based on choice rather than imposing the use of given solutions or providers. Such an approach, together with the adoption of reliable and predictable adequacy decisions, will benefit individuals, companies, and authorities as well as encourage investment and facilitate trade.

## Promoting Increased Digital Financial Literacy Internationally

Financial literacy is a key pillar of a sustainable financial system, playing a critical role in the empowerment of consumers and investors as well as in the success of the entrepreneurship ecosystem.

In order to educate future generations about the appropriate use of digital financial services and to raise their awareness of the accompanying risks, notably cyber-criminality, a common EU framework could be built to embed secure and responsible financial management in school curricula. These efforts would also feed into the wider objectives of broad and equitable access to financial services as well as skill development. Ultimately, it will foster a positive change in savings and spending habits. Public-private cooperation is an essential element of developing digital financial education and literacy programs. Banks and other financial institutions can play an active role in the many initiatives that are emerging.

The EU could also build on and leverage the availability of quality education and research, including the creation of an academic network that supports a European talent pool for financial services and expertise to grow business within Europe and beyond.



## SWITZERLAND'S FINTECH (ECO)SYSTEM

Swiss authorities take a technology-neutral and innovation-friendly regulatory approach to digital financial transformation. Instead of introducing new laws, it aims to make targeted adjustments to integrate new technologies into the existing legal framework. Swiss authorities began to remove barriers to entry for Fintech back in 2016, introducing a sandbox regime in 2017. In 2018, the Swiss Financial Market Supervisory Authority FINMA became the first regulator in the world to publish clear guidelines on initial coin offerings (ICOs) and classifications for tokens. Since the beginning of 2019, it has been possible to obtain a Fintech licence together with greater differentiation in supervisory models. In June 2020, the Swiss authorities passed a legislative package impacting important parts of civil law and around a dozen financial market laws. This should clarify and improve the conditions for distributed ledger technology (DLT)/blockchain-enabled technologies in finance in particular. Swiss authorities are also committed to opening up and to an industry-driven standardisation of data interfaces in the financial sector. Finally, the Swiss government is evaluating the need for a "Swiss Cloud".

The Swiss Government and Parliament is expected to work on a new law for the introduction of an electronic identity. In doing so, they will take into consideration the reasons that led the Swiss electorate to reject a bill on this matter in a recent referendum. In particular, focus is expected to be on ensuring and increasing legal certainty on the gathering, processing, and sharing of data as a result of the increased use of electronic identities.

As regards financial infrastructures, the Swiss Stock Exchange is building the first market infrastructure in the world to offer a fully integrated trading, settlement and custody service for digital assets (Six Digital Exchange SDX).

At international level, Switzerland is also home to the first BIS Innovation Hub Centre that is examining the integration of central bank digital currencies (CBDC) into a DLT infrastructure. It is against this background that the Swiss National Bank worked with the Swiss Stock Exchange on "Project Helvetia"<sup>4</sup> that explored technological options to make CBDC available.

Finally, worth mentioning is Switzerland's ambition to combine sustainable and digital finance to create new opportunities for the Swiss financial centre. The State Secretariat for International Finance (SIF), together with industry representatives, launched the Green Fintech Network in November 2020. An action plan is expected to be published in spring 2021.

## SWITZERLAND AND THE EU: PARTNERS IN TECHNOLOGICAL INNOVATION

According to the World Economic Forum (WEF), Switzerland is placed amongst the most competitive countries in the world and it regularly tops the global innovation indexes.<sup>5</sup> Switzerland's global performance in technological innovation, combined with its world-class academic and research institutions, offers new opportunities for greater cooperation, connectivity, and partnership with the EU in key areas of the Digital Single Market such as DLT/blockchain, AI, electronic identification, supercomputing, and cybersecurity.

For instance, Switzerland signed the Tallinn Declaration on e-government, which promotes the use of e-ID schemes, and it participates in the European High-Performance Computing Joint Undertaking. As part of its strategy on AI, the European Commission has also joined forces with non-EU countries like Switzerland to foster the development and use of AI in Europe, and further cooperation could be envisaged in the area of blockchain and cybersecurity.

## REFERENCES

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## CONTACT US

Swiss Finance Council  
23 square de Meeûs | 1000 Brussels | Belgium  
brussels@swissfinancecouncil.org  
www.swissfinancecouncil.org

The Swiss Finance Council (SFC) engages in dialogue around policy developments in finance at a European and international level. It represents the interests of internationally active Swiss financial institutions and provides a platform to share their experience, expertise and knowledge through a permanent representative office in Brussels.