1 November 2022

Future of Banking and Payments
Synopsis of the Sector Specific Workshop

With the onset of the digital transformation occurring within the financial services landscape, where operators are increasingly leveraging on technology to innovate and enhance their offering, on the 1 November 2022 the MFSA held a conference on the topic of '*Financial Services of Tomorrow*' that focused on the regulatory approach towards technology enabled financial innovation and digital finance.

In the context of this conference a sector specific workshop, on the '*Future of Banking and Payments*' took place and consisted of two (2) separate panel discussions. In the first panel industry experts expressed their opinions on the future of the banking and payments sectors within the context of this digital transformation. Whereas the following panel reflected on the theme from a regulatory perspective and consisted of the MFSA and external experts sharing their views on the possible regulatory expectations and implications in this respect.

Panel 1: The Future of Banking and Payments – Industry Perspective

Moderator: *Conrad Portanier – Partner, Ganado Advocates*
Panellists: *Kenneth Farrugia – Chief Executive Officer, Bank of Valletta; Marcel Cassar – Chief Executive Officer, APS Bank; Mark Curmi – Chief Risk Officer, Andaria Financial Services; Charlon Scicluna – Managing Director, Finaro*

Panel 2: The Future of Banking and Payments – Regulatory Perspective

Moderator: *Herman Ciappara – Head, FinTech Supervision at MFSA*
Panellists: *Jesmond Gatt – Chief Officer Banking Operations; Central Bank of Malta; Alan Decelis – Head, Supervisory ICT Risk and Cybersecurity, MFSA Eric Micallef – Senior Analyst, Financial Crime Compliance, MFSA; David Eacott – Head, Banking Supervision, MFSA*

Q1 **How has financial innovation disrupted the banking and payments sector? What technologies were embraced to face this disruption?**

Industry Perspective
Throughout the discussion various enabling technologies, such as cloud computing, artificial intelligence ('AI') and application programming interfaces ('APIs'), were identified as one of the prominent drivers of change in the financial markets.

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In terms of the banking sector, it was also highlighted that although technological disruption taking place in the financial markets is beyond the banks' ('Credit Institutions' or 'CI') remit of control, by embracing the evolution of the financial sector and swiftly adopting innovation, such institutions can enhance their products, services, and internal processes. In fact, some local CIs have already embraced innovation and substantially rely on AI and machine learning ('ML') solutions for their cyber defence systems and robotics process automation ('RPA') that automates repetitive and labour-intensive tasks.

Furthermore, the industry representatives indicated that although embracing innovation benefits CIs and their clients in many ways, such institutions should consider financial inclusion implications when offering digital alternatives, as senior citizens remain an integral part of their customer base. Ultimately, CIs must ensure that adoption of innovation does not prevent them from catering for the entire spectrum of their customers.

In the context of payments, specifically embedded finance, it was highlighted that within a ten (10) year period, non-financial institutions will be expected to offer financial services through collaboration with specialised fintech operators. In fact, it was further noted that a local payment service providers ('Financial Institutions' or 'FI') are already providing embedded finance services to the business-to-business ('B2B') market leg. Essentially, FIs will support and enable merchants and businesses in their payment facilities by integrating electronic money or payment accounts into their clients' platform though enabling technologies such as APIs.

Additionally, FIs are using AI and ML to provide clients with data analytics services, essentially assisting them with structuring and understanding their respective revenue streams and profitability models in the context of different sectors and jurisdictions in which the client operates. Similarly, to the local CIs and FIs are making use of RPA systems that optimise their business processes.

Furthermore, it was specified that FinTech operators tend to use a variety of enabling technologies which makes it impractical for established financial service providers to develop internal technology and software development capacity. Instead, such operators often choose to outsource the integration and oversight of enabling technology solutions to specialised third-party technology providers having the necessary capacity and expertise.

MFSA Perspective

From a regulatory perspective it was highlighted that digital transformation is occurring due to various factors, such as the banks' competitiveness in the Fintech environment; the impact of the enabling technology on their operational cost; and the future business model viability of traditional banking.

The MFSA would expect adequate governance arrangements to be in place. The board of directors and senior management team of the authorised person ('AP') must have the necessary knowledge and skills to effectively navigate the CI or FI through its digital transformation or adoption of innovative technology. Additionally, the Authority's focus would be on the bank's operational resilience and quantification of its operational risk. The MFSA also closely collaborates with other competent authorities such as the Financial Intelligence Analysis Unit ('FIAU') in order to ensure that AP has a

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solid understanding of the AML/CFT risk emanating from the innovative financial solutions being proposed as well as sufficient mitigating measures in place to address identified risks.

Also, whereas it may be sensible for APs to outsource their technological infrastructure from third-party technology providers, such arrangements may give rise to concentration risk from a macroprudential perspective. Furthermore, the Authority would expect the APs to have adequate systems and controls to mitigate any risk emanating from the third-party services providers. Additionally, APs that make use of enabling technology such as AI and ML, must ensure that risk pertinent to that technology are effectively mitigated such as sub-standard outputs arising due to poor data quality.

Q2 Does regulation stifle innovation?

Industry Perspective
Whereas the panellists generally agreed that regulation does not stifle innovation, it was noted that it may take time for regulators and the industry participants to identify the relevant regulatory implications with respect to enabling innovative technologies. Nevertheless, in the long-term, regulatory clarity and level playing field between banks and non-bank institutions will be achieved.

In order to minimise regulatory blind spots without stifling evolution of the banking and payments sectors, competent authorities, fintech operations, technology providers and all relevant stakeholders must continuously hold an open dialogue. In this respect it was specified that innovation facilitators such as innovation hubs and regulatory sandbox adopted by various competent authorities across the globe are a necessary tool to explore and test technology-enabled financial innovation in a controlled environment that would protect investors and financial markets from any unintended consequences.

MFSA Perspective
The MFSA strives to be an open and progressive regulator by adopting a technology neutral approach in its regulatory and supervisory initiates. In order to remain up to date with the industry developments the Authority is continuously monitoring, assessing and seeking to understanding the implications of digital transformation and other forms of technologically enabled innovation within the local financial services sector.

In particular, by means of regulatory tools such as the innovation office and revised regulatory sandbox framework as well as provision of regulatory guidance and stakeholder collaboration in this space, the MFSA seeks to continue its efforts towards acting as an enabler of sustainable financial innovation that meets the needs of the wider market.

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Q3 What is the future of Banking and Payments sector?

Industry Perspective
According to the panellists the future of banking and payments financial sectors largely depends on enhancing trust between bank and non-bank financial institutions. CIs also need to adapt to the platform economy and coexist with technology providers.

The discussion was concluded by highlighting that although embracing technological innovation is a costly exercise for both CIs and FIs, embracing technology enabled innovation is imperative as otherwise inaction may negatively impact the future viability of the providers business model.

MFSA Perspective
More often than not, adoption of financial innovation requires significant investment on behalf of the financial service provider. In this respect the Authority would oversee the provider's capacity to manage revenue generation against cost advantages and cost implications posed by innovation.

In line with its 2022 Supervisory Priorities, the Authority is taking active steps to effectively oversee APs activities whilst also assess their business model viability in the current dynamic market environment. More specifically in 2020 the MFSA established dedicated functions on Supervisory ICT Risk and Cybersecurity ('SIRC') function that has become an integrate part of the Authority's supervisory processes and Fintech supervision function specifically focused to build capacity in this area.

Digital operational resilience will become a central element within our supervisory approach especially with the adoption of the EU's Digital Operational Resilience Act ('DORA'). In this respect, this framework seeks to harmonise key digital operational requirements across the EU by addressing operational risks emanating from information and communications technologies. The MFSA, through its SIRC function within the Supervisory Directorate, is currently in the process of aligning itself with the obligations outlined in DORA, in order to ensure that clear regulatory expectations are set upon its enactment.

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