European
Banking
Federation

EBF_015782
June 2015

The European Banking Federation is the voice of the European banking sector, uniting 32 national banking associations in Europe that together represent some 4,500 banks - large and small, wholesale and retail, local and international - employing about 2.5 million people. EBF members represent banks that make available loans to the European economy in excess of €20 trillion and that securely handle more than 300 million payment transactions per day. Launched in 1960, the EBF is committed to creating a single market for financial services in the European Union and to supporting policies that foster economic growth. Website: www.ebf-fbe.eu

EBF DISCUSSION PAPER:

The digital transformation of banks and the Digital Single Market

In light of the rapid emergence of increasingly sophisticated digital banking services and the European Commission's strategy for a Digital Single Market, this paper serves to encourage discussion and reflection among EBF members and EU stakeholders on the impact of digitalisation of banking services in Europe .The subsequent discussion and reflection will feed into the EBF Blueprint for Digital Banking, to be published in September 2015.

European Banking Federation aisbl – 56 Avenue des Arts, B-1000 Brussels
Phone: +32 2 508 37 11 – Website: www.ebf-fbe.eu - EU Transparency register ID number: 4722660838-23

EBF DISCUSSION PAPER:
The digital transformation of banks and the Digital Single Market

The digital revolution is changing the way we live our lives and interact with friends, colleagues, clients and businesses. It has become astonishingly easy to talk and collaborate with friends and colleagues worldwide. We can shop anywhere we wish without leaving our home. We can meet like-minded people online and instantly share our experiences with the rest of the world. We can read any newspaper on our tablets and listen to our own music anywhere at any time. What some call constant, relentless innovation is empowering us all. It is changing the way business is carried out and financial services are not exempt from this rapid change.

In the world of banking, this rapid uptake of digitalisation has led banks to accelerate the rethinking of their traditional business model including their bricks-and-mortar branches. IT systems have become more important. For a digital bank, some argue, a fully secure IT system is its single-biggest asset. It is clear that banks need to respond quickly and efficiently to customer demands while keeping services safe and simple to use.

Security and trust remain critical. Banks over the years have developed innovative banking products and services, including secured systems that reliably protect client data and money. Many banks are already partners with financial technology groups and are investing in innovative FinTechs, financial technology start-ups which aspire to be tomorrow's European leaders in financial services. Digital banking has become a fiercely competitive space.

From birth to retirement, the milestones in our lives remain unchanged. Financial decisions remain financial decisions. What has changed is the way we approach these decisions. We still shop around for the best services, but when we need to compare and apply for loans, mortgages and credit cards, the majority of us now use the Internet instead of visiting a bank branch.

The digital revolution touches the banking sector. This is why it is important to determine how banks can contribute to the Digital Single Market (DSM) that the European Commission (EC) wants to establish. Creating the DSM is one of the ten priorities set out by EC President Jean-Claude Juncker. When Vice-President Ansip in May 2015 presented the DSM Strategy, he underlined the importance of making the European Union's (EU) single market fit for the digital age. It means tearing down regulatory walls and moving from 28 national markets to a single one. According to the European Commission, a single market could contribute €415 billion per year to the EU economy and create some 3.8 million jobs.

For the banking sector it is crucial to build the right framework to facilitate competition, innovation and to ensure that consumer protection, trust and security are maintained.

BANKS IN THE DIGITAL AGE – KEY POINTS TO CONSIDER

1. Banks are at the heart of digital innovation. They are redefining business models; proposing innovative products/apps; engaging in FinTech partnerships and financing innovative starts-ups. Banks keep putting customers at the centre of their strategy.
2. It is crucial to create an EU Digital Single Market that facilitates the development of all European businesses – including European banks – and lets them contribute to growth and employment.
3. The banking sector supports a competitive and innovative EU Digital Single Market which safeguards existing consumer protection, trust and security.
4. European banks – as well as other innovative market players – aspire to be future 'European champions' in the digital age. A level playing field needs to ensure fair competition among existing and new market players.

1. Digital banking: embracing the innovation opportunity

Digital banking is an all-encompassing phrase that is broadly applicable to almost all aspects of banking, ranging from online payments and mobile banking to the use of sophisticated security systems and data analytics (Big Data). This section discusses the digital transformation of the banking sector and reviews how new services let banks strengthen their customer experience.

1.1 Digital trends and current developments in banking

a. Digitalisation of banks leads to **new business models** for the industry. By 2018, more than 50% of incremental revenue in almost all banking products in Western Europe is expected to be digital[1].

b. Digital banking will increasingly provide 'seamless' online services. Many banks are moving towards paper-less bank services. Day-to-day banking will gravitate closer to the underlying transaction. Almost four in five persons - 79% - who use mobile banking in Europe have bought an item using their mobile device in the last 12 months. More than half of those customers surveyed believe that they will either "certainly or probably" use a mobile payment app in the next 12 months[2]. Customers still need to place their savings, make payments and have the option to borrow. **The way people bank will continue to evolve** as customers demand fast, safe and simple banking products and services.

c. Banking products will be aligned with the fast growing digital society and offer more 'tailored-made' customer experiences with products adapted to consumer needs.

d. Analytics of client data, also known as **Big Data**, is expected to become increasingly important in the digital market. This development affects banks because electronic platforms and data-based business models are gaining in importance. Aspects relating to data analytics can be raised as a matter of importance by the EU banking industry, potentially leading to a gradual transformation of the credit institutions' business model, by enhancing their internal data processes and mechanisms.

e. The challenge of new entrants and new models adds a new dimension to the changing role of banking - new entrants establishing **digital-only products and services**. Banks embrace this innovation opportunity and at the same time continue to serve all customers, including those who have not (yet) become "digital".

1.2 Digital banking services support increasing focus on customer experience

a. **The banking sector has actively responded to the rise of the Internet and new information technologies.**

- The bank business model is evolving towards a multichannel environment where financial services are made available through various devices. While online banking penetration increased by 2.6 percentage points globally in 2013, mobile banking penetration grew by 4.4 percentage points[3].
- Modern bank branches have been designed with equipped self-service areas (with tablets and new digital technologies) and private areas (to provide immediate personalised advice to customers who request it), banking instruments (Intelligent ATMs, digital signage, etc.) and digitisation of all processes (internal and external).
- Investing in business incubators and buy-outs, hiring digital innovators and funding FinTechs are examples that show how the banking industry supports technical innovation in financial services, in particular, in payments. Several banks[4] have launched a mobile Point of Sale (mPoS) solution which allows businesses and self-employed professionals to accept card payments using a smartphone. Other banks have built an online community of merchants using a PoS terminal which allow cardholders to access offers and promotions using geolocation technology.

[1] "Bank of the future" McKinsey panorama / McKinsey & Company 2014 report "Global Payments 2014".
[2] The ING International Survey on Mobile Banking, New Technologies and Financial Behaviour 2015: The ING International Survey of 14,829 people was conducted by Ipsos using internet-based polling. Fifteen countries were surveyed overall: Austria, Belgium, Czech Republic, France, Germany, Italy, Luxembourg, the Netherlands, Poland, Romania, Spain, Turkey and the United Kingdom (13 European nations) and respondents from the USA and Australia. Polling took place between 16 January and 2 February 2015.
[3] "Digital and Multichannel benchmarks", Finalta, McKinsey subsidiary, 2013.
[4] See McKinsey & Company 2014 report "Global Payments 2014: A return to sustainable growth brings new challenges".

In many other countries Peer to Peer (P2P) as well as instant payment solutions are flourishing. For example, in some countries banks invested in a new real-time system and developed a shared application for peer-to-peer transfer or have started using video channels for on-boarding and advising customers.

b. **New technologies allow banks to serve customers' individual needs more efficiently, with improved ease-of-use and the possibility to be reached through multiple channels and devices.**

- Customers are becoming more connected and demand immediate availability and direct accessibility of readily-usable information and services. Technology helps consumers to search further and faster for the best deals/value when and how it suits them best. For instance, customised deals at select stores through mobile apps, sent by banks.
- Technology is applied in ever more and different ways, such as biometric, audio, voice and image recognition software, data analytics and high-performance computing infrastructure.
- The vast majority of people who use mobile banking indicate their money management has improved since using the technology, such as feeling more 'in control' of their finances, not missing payments and saving more. In fact, 85% of mobile bank users in Europe list at least one way their money management has improved since they began using a mobile bank. In some countries, such as in Italy, Romania, Poland and Turkey this is even 90% or higher[5].
- Technology can also help people avoid other financial mistakes such as missing bill payments and going into overdraft (and potentially being charged penalty fees).
- Digital technologies also reduce geographical distances and reach customers located in peripheral areas who can benefit from more offers.

c. **Banks take into account all customers: non-digital consumers are not left behind**

- Some people do not like change and want things to stay 'the same'. Digital exclusion should not lead to financial (or social) exclusion. Banks actively support elderly people and non-digital, analogue-minded clients who find it difficult to embrace new digital services and online banking.
- Digital competency should be developed in Europe: consumers should be supported to explore the digital world and the part that banking plays in it:
  - some banks have special teams of employees available to support clients and help them with digital services and internet questions;
  - financial education programmes (also available online) are also a useful tool developed by banks which should be developed further.

[5] See footnote 2

2. The Digital Single Market: Trust and security as key drivers

For the banking sector there is an obvious need to define more clearly certain aspects of the Digital Single Market. Ultimately, it is crucial to build the right framework to facilitate competition, innovation and to ensure that consumer protection, trust and security are maintained.

2.1 Trust in digital is critical for customers

a. New generations are increasingly willing to accept to share data and are inclined to forego privacy in exchange of more personalised services. However, expectations of customers towards social media and banks are different. **Banks are trusted with private financial information while search engines, social media and many FinTech companies build their business on personal information.** Consumers value the fact that banks respect the confidential way their data are used[6]. They would not expect this data to be used by banks in a way that social media and search engines do.

b. When asked which channel they trust most for mobile payment apps, respondents' own banks come out top. Overall, 84% say the channel they trust most is their bank. This compares with 5% for named groups (such as Google and Apple) and other suppliers[7].

c. Consumers must be able to trust the new environment and have confidence to use it. They value a physical point of contact for big decisions or when they face problems. This means full efficiency is an entry-level requirement. According to the Edelman Trust Barometer 2015, trust in the financial sector to innovate, is increasing. Conversely, trust in the technology sector, with specific reference to cloud computing, has decreased[8].

d. Today's customers want banks to provide more than mere transactional services. Customers expect banks to understand their needs and to act as trusted advisers. Customers expect their bank to launch, continuously, new innovative and user-friendly financial products and services that simplify their trade and transaction management experience.

e. **Banks can add value to this digital/data-driven world by**:

- helping customers use the new tools available to them - from how to shop online to protecting privacy - by means of trained employees providing free advice and digital financial education programmes;
- signposting safe and sound ways to transfer value by signalling safe banking mechanisms;
- providing trusted e-identity and e-authentication mechanisms as keys to enter the digital world: creating easier access to distance credit for consumers; facilitating EU cross-border market and the verification of identities to check credit rating and making contact with public administrations; lowering risks etc.

2.2 Security as the top priority

a. The huge volume of data being sent out across the web increases opportunities for criminals to access, hack and/or leak personal data and bank account information. It causes harm to consumers and to businesses.

b. Cybercrime is a growing concern. Addressing this is paramount for the sound functioning of banking services in the Digital Single Market and for access to online banking.

- Studies show that the finance and insurance sectors are among the principal sectors affected by cyberattacks, just after public administrations. Risks are of a reputational nature as well as financial.
- Criminal *modus operandi* become increasingly sophisticated, due to phishing techniques and a multitude of banking malware permutations. Criminals act from locations they consider 'safe', from countries in

[6] It is opportune to differentiate types of data: aggregated/patterns and personal data.
[7] See footnote 2.
[8] Edelman Trust Barometer 2015: Trust in Financial Sector vs. Trust in Industry to Innovate (electronic payments): +10 compared to trust in Technology sector vs. Trust in Industry to Innovate (cloud computing) : -20

which judicial cooperation has traditionally been limited. Activities from these countries are difficult to track down, making evidence-gathering complicated.

- According to the February 2015 Eurobarometer survey on Cyber-security[9], internet users remain very concerned about cybercrime. A clear majority of almost two thirds of those surveyed is concerned about identify theft and discovering malicious software on their device. Internet users also express concern about being the victim of bank card or online banking fraud (63%) and fear their social media or email account being hacked (60%).

c. There is a clear need to maintain the public's confidence in payment systems and infrastructures and in the ability of banks to protect customers' data, especially as consumers have become more sensitive to privacy issues. The banking sector is already organised to fight cyber-crime. The EBF cooperates actively with EC3, the cybercrime unit at Europol and supports plans to create a European platform called European Online Fraud Cyber Centre and Expert Network. This platform will bring together law enforcement agencies, banks, cyber-crime centres and corporate organisations such as national banking associations. The EBF provides its members with a platform on which to exchange critical data and intelligence information among their banks. The EBF also supports actions that can lead to international prosecution via the Joint Cybercrime Action Taskforce known as J-CAT.

2.3 Equal rules and opportunities for all

a. Over the last five years the EU institutions have regulated the financial sector in order to mitigate systemic risks. Such risks should not be allowed to return through the backdoor via unregulated actors. To protect consumers and their data within a new digital economy, companies offering services similar to banks' and facing comparable risks should be subject to appropriate and equivalent rules. Equal rules should apply to all. This implies the need to find the proper balance between competition, innovation, security, and consumer protection. Security should not be sacrificed at the expense of competition and innovation.

b. The EBF believes that the EU Digital Single Market needs to support the development of all European businesses to the benefit of consumers, economic growth and employment. European banks are positioned not only as innovative partners investing in innovative financial technology; they are also keen to see the economic benefits of a truly effective Single Market. This objective warrants further reflection by all EU stakeholders. And more specifically, reflection on the numerous aspects relating to banks in the Digital Single Market and the possible role of digital financial services when it comes to establishing a Capital Markets Union.

c. Particular attention should be given to the need to avoid contradictory obligations for the banking sector in areas such as:

   - faster access to services/e-identification (eIDAS Regulation n. 910/2014) vs. fight against money laundering. The newly adopted 4th Anti-Money Laundering Directive (AML) still considers as "a higher risk non-face-to-face business relationships or transactions, without certain safeguards, such as electronic signatures"[10];
   - consumer protection vs. sharing personal credentials against security and fraud prevention (Payment System Directive 2 (PSD2));
   - fight against over-indebtedness or fraud (Mortgage Credit Directive, international guidelines on fraud prevention) vs. restriction to profiling not adapted to financial services sector (Proposal for a General Data Protection Regulation);
   - 'Internet enablers' not yet included in the scope of the Network and Information Security Directive (NIS) vs. security and fight against cyber-attacks at the source.

---

[9] European Commission Special Eurobarometer 423 on cyber security

[10] see Annex III point 2.c of draft 4th EU AML Directive st05933/15