Opinion of the European Economic and Social Committee on the 'Digitalisation and innovative business models in the European financial sector, impact on employment and customers'

(own-initiative opinion)

(2017/C 246/02)

Rapporteur: **Carlos TRIAS PINTO**

Co-rapporteur: **Pierre GENDRE**

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(for/against/abstentions)	

1. **Conclusions and recommendations**

1.1. In the last few decades, the banking and insurance sector are continuing to be reinvented by technology, regulation, and changing customer needs and expectations. New models of investments, savings, insurance, and fund transfers are allowing the widest range of people to participate in projects of different sizes.

1.2. FinTechs and InsurTechs are **catalysts** and often the **partners** of financial services institutions in modernising their services, amalgamating strengths and weaknesses and generating synergies between each other. In the EESC's view, there is considerable potential to create value by nurturing an innovative coopetition ([1]) ecosystem.

1.3. There is definitely a need to restore trust and stability in the financial sector, with the management of the transition from the old (traditional banking system) to the new system being crucial. In this respect, the EESC calls for the appropriate legislation to be put in place in the EU context of an integrative process of the **Banking Union** and the **Digital Single Market**, allowing for growth and innovation while also ensuring protection for consumers and employees in the finance industry.

1.4. To achieve a truly Single **European Financial Market**, European Commission policy should support a level playing field in terms of innovation. As a general principle, broadly analogous conditions are needed in terms of regulation as well as consumer rights, working conditions and supervisory obligations, both for the traditional finance industry and FinTech companies, in line with the rule of the same activity requiring the same regulation and the same supervision. More specifically:

1.4.1. A risk-based approach to regulation should be consistent throughout the innovation lifecycle, providing a proportional and simplified regulatory framework for both incumbents and new players to experiment with new technologies and business models in interaction with the regulators. The creation of an EU framework for experimentation,

([1]) Not only competition, but collaboration and partnership.

working with industry and wider stakeholders — including consumer and employee representatives — would provide the tools for gearing up to support innovation across its activities ('Sandbox' for FinTech Innovation) ([2]).

1.4.2. To match the conditions with those of third parties, it is necessary to look at the treatment of software as an intangible asset, to avoid subtracting from core equity capital the high investments that the entities based in the EU already make in IT (following the example of the US and Swiss banking systems, or the insurance sector ([3])).

1.4.3. The European Commission, the European Banking Authority and Member States have to strongly commit to a harmonised and effective implementation of the revised Directive on Payment Services (PSD2) which introduces very strict security requirements for the initiation and processing of electronic payments and the protection of consumers' financial data, paying special attention to technological social media and commercial giants.

1.4.4. Consumer challenges and risks linked to the digitalisation of financial services should be carefully examined by the Retail Financial Services Action Plan ([4]) and the Fintech Taskforce, guaranteeing close coordination between DG JUST and DG FISMA, in particular with respect to consumer protection issues, e.g., determining what kind of data should be used to assess creditworthiness, how to ensure the understanding of pre-contractual information and effective identity checks through a screening process.

1.4.5. The measures included in the proposed amendment to the Anti Money Laundering Directive (AMLD) should be immediately transposed ([5]), particularly those tackling terrorist financing risks linked to virtual currencies and risks linked to anonymous prepaid instruments.

1.4.6. Enhancing crowdfunding and other collaborative economy solutions by exploring the potential of establishing a 'quality label' to build users' trust in order to better develop virtual communities and facilitate interaction among cooperative customers.

1.4.7. Support for the introduction of open-source software solutions in the financial sector in order to increase sound market competition, reduce costs and prevent vendor lock-in in the sector.

1.4.8. PtP lending regulations need to be addressed at the same time to encourage smaller balance sheets.

1.4.9. Hybrid lending (driven by Basel 3 capital requirements) needs to be supported by the European Commission.

1.5. The EESC emphasises that digitalisation must never replace good personalised advice from a qualified human advisor (proximity in banking with the help of a network of adapted agencies should not disappear!).

1.6. Understanding FinTech requires new skills from all: regulators, supervisors, financial ecosystem stakeholders and the population as a whole. In order to take advantage of one of the main potential benefits of FinTech as a driver of financial inclusion, EU Member States have to strengthen financial education and digital literacy, anticipating the new scenarios. This needs to start in schools, and should embed information about financial products in the context of how they are presented online and their relationship with the development of the Internet of Things.

([2]) The Commission is considering a single EU-wide licence allowing tech companies in the financial services sector to operate across Europe and the creation of a pan-European 'sandbox', or special regulatory framework, for the whole Union.
([3]) See Solvency ll requirements;
([4]) Launched on the 23rd of March, COM (2017) 139 final, Consumer financial services action plan and a Public Consultation on Fintech.
([5]) OJ C 34, 2/2/2017, p. 121

1.7. Digitalisation in the financial sector threatens many jobs, and this is forcing employees to update their competences and skills. The EESC advocates ensuring that skills training and further education take place on two levels. Internally, by allowing employees to take on new tasks and create a cross-over between current financial employees from 'traditional institutions' and FinTech/InsurTech companies, and externally by preparing employees who cannot remain in the sector for jobs in other sectors.

1.8. The EESC calls on the European Social Fund to provide specific training programmes within the new flag ship initiative 'Digital Skills and Jobs Coalition' ([6]), to support the up-skilling and retraining of the financial sector's workforce to prepare them for new digital technologies.

1.9. The EESC calls on companies to replicate codes of conduct and the best practices on internal rules limiting the requirements for employees to be online at all times of the day and to issue guidelines discouraging employees from working at weekends and during vacation time. If voluntary approaches do not work, the EESC calls for binding rules in this respect.

1.10. Timely information and consultation, in line with the relevant EU Directives on informing and consulting employees, are key to meeting all of these challenges. The European Commission and Member States have to ensure compliance with the provisions of applicable law and, in particular, the rights of the employees' representatives to be involved in intra-company changes.

1.11. The EESC calls for the proposal for a Directive on preventive restructuring and second chances to be strengthened and completed, as this will help to gain access to restructuring procedures before any business insolvency is declared.

2. **A concentrated and diversified sector undergoing rapid transformation**

2.1. The banking and insurance sector in Europe is diverse, marked by the presence of large European and even global institutions, as well as local and regional structures with varying degrees of independence, and certain features specific to individual countries. Despite a process of concentration in most Member States, it is still fragmented at European level. The old dividing lines between banking groups and large insurance companies have virtually disappeared as a result of the establishment of de facto financial conglomerates.

2.2. In the new landscape of volatile markets and low interest rates, strong regulatory pressure, supervision and oversight — imposed on the banking system in the wake of the financial crisis — combined with digital transformation and increasing competition (new FinTech companies), as well as new trends in consumption, the banking sector's results are continuing to be eroded. With the arrival of new non-bank models in the digital economy it is necessary to analyse the interplay of four elements: the traditional banks, the new digital players, the regulatory authorities and consumers.

2.3. As internet use continues to increase, banks are developing online subsidiaries and virtual agencies through which customers can carry out simple transactions and contact an advisor. Company strategies aimed at the radical reduction of HR investment as well as the deterioration in customer reception conditions has led to fewer people visiting bank branches and many branches closing across Europe.

2.4. In the insurance sector, several modes of distribution coexist: salaried producers, brokers, general agents, bancassurance as well as self-employed agents acting for a single company. Insurance is now being sold online and via smartphones. The predominance of each of these multi-channel distribution networks varies across the EU Member States and from product to product. Life insurance, for example, is mainly distributed through bank networks (known as bancassurance).

([6]) https://ec.europa.eu/digital-single-market/en/digital-skills-jobs-coalitionbargaining and soc

2.5. Payment methods are continually evolving, and this is set to intensify. The use of cheques and cash has decreased substantially since the early 1990s. At the same time, there has been an increasing shift towards payment by card, direct debit and bank transfer, which ensure greater traceability, control, and security, and undermine the informal economy. Electronic payments have the capacity for extending the scope even further, i.e. for money transfers between individuals and social benefits payments. New e-money players are joining forces with e-commerce, while new technologies such as contactless payments are evolving and increasing along with bank cards. In addition, particular attention needs to be given to following the development of cryptocurrency markets (bitcoin and others).

3. **Technological advances in the European financial sector and new players**

3.1. Innovation in the financial sector is taking place on the internet, with online banking, big data, artificial intelligence, the blockchain, cybersecurity, etc. Data is exchanged at high speed, enabling risk assessments and financial decision-making to be carried out on the basis of algorithms and big data.

3.2. This technological disruption and the difficulties faced by traditional banks as regards equity problems and a temporary liquidity dry-up, as well as the development of alternative sales channels which are not covered by regulatory obligations for the banking industry, have paved the way for FinTech, InsurTech and the blockchain, and at the same time have opened up new opportunities and created new risks for consumers.

3.3. FinTech and InsurTech companies, which continue to increase in number, combine the concepts of finance, insurance and technology. These companies are using technology to sell financial products in innovative ways. They are growing, particularly in the areas of savings management, personal loans, corporate financing and online payments. They are playing an increasing role in participatory financing (crowdfunding and P2P), through dedicated platforms and the use of mobile applications, virtual currencies and electronic payment via the internet or smartphones. They are exerting considerable pressure on banks and insurance companies by competing in their traditional territory. The largest internet companies, particularly the 'GAFA' (Google, Apple, Facebook, Amazon) are also developing projects related to the financial sector because of their control over big data.

3.4. Distributed ledger technology (DLT)-based applications could prove to have the capacity to deliver a new kind of trust to a wide range of services. The blockchain operates without any central control body, in a transparent and secure way. Both companies and individuals can use this system to carry out certain transactions and bypass the financial sector, particularly by using cryptocurrencies.

Likewise, PayPal offers the possibility of paying for goods in foreign currency without having to provide bank details.

3.5. FinTech is enabling companies and individuals to access crowdfunding for specific projects, by using dedicated platforms to raise funds in the form of donations or loans or even equity investment. These platforms enable peer-to-peer lending, including consumer loans and personal loans, without having to go through the banks, and enables private individuals to directly finance VSEs and SMEs. The platforms are able to supplement or promote venture capital, particularly for innovative businesses, and through their mobile applications, to give customers, in real time, the financial information they need to manage their expenditure or investment choices.

3.6. These new players are competing with the traditional business models of banking and insurance, but both banks and the insurance companies are beginning to coexist with them. Some have already embarked on a process of cooperation with FinTech and InsurTech, and others have their own subsidiary structures. Moreover, investment in FinTech has rapidly increased in recent years, and this interest has spread to InsurTech.

4. **Are customers the winners here?**

4.1. For large companies, this adjustment to the digitalisation of financial services involves changes they are able to build in to their day-to-day management. But the situation is different for many traditional SMEs and especially for very small companies, which do not have the in-house knowledge and resources enabling them to fit easily into a rapidly changing financial world.

4.2. In the era of the internet and the smartphone, customer profiles are no longer the same, but their appetite for digital banking and insurance depends on several factors such as age, level of education and occupation. Yet when it comes to financial advice, there is still a need for human contact based on customer experience, including among young people.

4.3. Virtual branches, online subsidiaries of banking and insurance groups, are offering customers access to credit, loans and insurance on the internet and on smartphones, using new applications. These deals come with more favourable terms: a free bank card, subsidised interest rates, an account opening bonus, and a discount of several months' contributions for insurance and mutuals. These customer benefits form part of the transition period between the traditional business model of banks, insurance companies and mutual societies, and the model that is emerging from digitalisation.

4.4. This new scenario presents both risks and opportunities for the consumer:

— easier access to products, more/better choice, possibilities for price comparison via websites, more personalised, tailored offers, reduction of transaction costs (time and money) and enhancing safety by means of new biometric authentication systems,

— new useful products (e.g. crowdfunding) but also the emergence of new products that are complex, opaque, not easy to understand and risky: e.g. instant loans,

— possible challenges in providing pre-contractual information/disclosure via new sales channels: e.g. smartphones due to their small screens,

— insufficient information on the risks associated with financial products,

— lack of sufficient supervision/enforcement of activities of the new players in the financial services sector,

— legal uncertainty in some cases regarding which legislation applies to new players,

— unregulated areas (e.g. automated advice),

— possible unwarranted discrimination/exclusion linked to the use of big data and lack of digital skills,

— cybersecurity.

4.5. Digitisation should make the dissemination of financial products more transparent, but the apparent simplification of the products on offer may mask a lack of balance in the overall financial relationship. The use of algorithms does not guarantee the absence of hidden deficiencies nor the compliance of the products with European standards. Financial education should therefore embed information about financial products in the context of how they are presented online.

5. **Other sources of financing and the place of ethical and responsible finance**

5.1. The current high dependence of business on bank financing (more than 75 % in Europe, compared to 20 % in the USA) and lack of equity culture in Europe makes SMEs (more than 98 % of all enterprises in Europe, which employ 2 out of 3 employees and create 58 % of all value added) potentially vulnerable to the risk of a credit crunch such as those which occurred during the years of the global financial crisis. Accordingly, methods of complementary non-bank financing, and the risks they entail, particularly in the event of a crisis, should be explored.

5.2. When financing SMEs, there are a number of alternative sources that help to improve business development and reduce risks, in addition to aid from European funds to boost job creation and business competitiveness by reducing the usual financing costs, as envisaged in the Juncker Plan.

5.3. There must be a strengthening of the socially responsible, transparent and sustainable banking model and of a financial system rooted in the real economy, providing stability as well as social and territorial cohesion. Sustainable banks embrace an intentional approach to triple-bottom-line business (that includes financial, social and environmental performance measures in order to finance projects without negative externalities) by focusing on the establishment of strong relationships with their clients and the extended stakeholder community.

5.4. Banks and insurance cooperatives and mutual societies have long focused on creating value for all stakeholders — the 'stakeholder value' model — in developing their business. However, they have also adopted the practices of conventional commercial institutions and have not escaped the difficulties arising from the financial crisis. For the time being, digitalisation does not appear to be a key driver in returning to more ethical business practices, responsive to the real needs of society.

6. **Impact on employment and working conditions**

6.1. According to Bloomberg, banks have cut around 600 000 jobs across the world since the 2008 economic crisis. These massive staff cuts are mainly due to the crisis, but have also resulted from the digitisation process.

6.2. In Europe, banks and insurance companies are estimated to account for nearly four million jobs, of which three million are in banking and nearly one million in insurance. Citigroup projects that the banking sector will cut some 1,8 million jobs in Europe and the US over the next ten years. Europe, whose banks employ almost 2,9 million employees on a full time equivalent basis, would retain only 1,82 million in 2025. This trend is illustrated by the many job cuts recently announced by several major European banking groups. A tendency towards part-time and other forms of employment can be observed in the finance industry in a number of countries.

6.3. There is a need for Active Labour Market Policy measures in order to tackle the ongoing and future changes for the employees concerned. Social partners at all levels play a crucial role in finding appropriate solutions. An example of best practice in this regard is the general retraining fund for all affected bank employees in Austria, established through collective bargaining at sectoral level and funded by both the industry and the public.

6.4. The continuous eroding of the bank branch network has been accompanied by an overhaul of the branch concept in line with the nature of the customers concerned. Prior to the branch closures, staff numbers had dwindled as a result of the automation of transactions. In insurance, the network of general agents and brokers is robust, despite a marked trend towards downsizing. Salaried producers will decline.

6.5. On the trading floor, purchases/sales of company shares, currency and credit default swaps (financial derivatives in which the vendor compensates the buyer in the event of default by a third party) are increasingly being carried out by computers.

6.6. Derived from big data, a new cognitive platform, tested by a major banking group, is able to answer questions posed in natural language in a huge range of areas, and to propose pre-packaged answers to customer advisors. This technology can be used as a virtual assistant in both banking and insurance. The sales force could be among the first affected.

6.7. Working conditions have become unstable and training requirements have increased significantly, both to equip workers with the necessary digital skills and to enable them to change jobs should the need for occupational mobility arise.

6.8. As the digital advances will require a huge change in the tools, skills and competences that employees require, companies must be prepared to invest in the continuous development of skills and qualifications. Collective bargaining and social dialogue has to focus on the importance of adjusting vocational training to future needs and to make this training possible, as well as providing details of the way new technology is already being used in the sector. Which skills are needed for the current finance employees to stay relevant in the future and how these skills can be taught should be explored case by case.

6.9. There are increasing concerns about working hours in connection with the launch of on-line working and the many jobs which are already being cut. It is already apparent that more financial activities will be relocated within the EU and outside Europe to countries with low labour costs and low levels of social protection.

6.10. It is important that digital solutions always serve people and help to improve social standards and working conditions. Sectoral social dialogue needs to be stepped up at all levels, including at the European level, to pinpoint the best

solutions and thus prevent social upheaval. At a sectoral level and in each company, employers must endeavour to enter into negotiations with trade union representatives to ensure that effective measures are taken in terms of income, working conditions, social protection, training and support for internal geographical and occupational mobility, and outplacement. These measures have to take place as soon as possible in advance of restructuring processes, not just when jobs start to be lost.

6.11. Controlled digitisation of the financial sector should maintain quality jobs and improve customer relations, while retaining sufficient access to personalised financial advice. It should ensure effective security of transactions and efficient personal data protection both for customers and employees. Employees and the consumers of financial services should be involved, through their representative organisations, so that their practical knowledge in the field can be taken into account.

7. **Regulation and supervision**

7.1. The growing complexity of financial products and the speed of data-handling — together with anonymous, automated marketing, advice and counselling services — create high-risk situations that often cannot be judged or controlled by the owner of the funds placed or invested. The EESC observes with concern the inadequacy of risk-models and their ability to properly assess the risk-profiles of different categories of unsecured investments.

7.2. According to the governor of the Bank of France, the emergence of digital finance must go hand-in-hand with regulation that must adapt so as not to stifle innovation and continue to ensure a high level of transaction security and consumer protection. The EESC believes that equally high standards have to cover both the traditional finance industry and new FinTech companies/business models.

7.3. MiFID II is one of the key regulatory initiatives that will change the market structure and business models. Firms should manage the regulatory requirements as a strategic opportunity.

7.4. New regulations on digital payments (PSD2) seek to increase security levels of online transactions with the aim of reducing the level of fraud currently present in the channel.

7.5. A new EU anti-money laundering directive will bring into force new customer due diligence checking requirements, together with new obligations to report suspicious transactions and maintain records of payments.

7.6. The updated Consumer Protection Cooperation framework (CPC Regulation) will give more powers to national authorities for enforcing consumer protection laws and will improve the necessary coordination among Member States.

7.7. With the application of the Solvency II legislation for insurance companies and the Basel 3/CRD IV arrangements for banks, the question arises as to how a supplementary regulatory approach can take into account the risks borne by new entrants to the financial system and their impact on this sector as a whole.

7.8. Following the stress tests carried out by the European Banking Authority in 2016, the Commission has presented proposals that reflect the debate currently being led by the Basel Committee on strengthening capital requirements. The universal standards adopted should be proportionate to the size and nature of the credit institutions and financial start-ups. The EESC welcomes the latest Commission package of proposals ([7]).

7.9. The financial crisis has meant big business for direct investment funds — shadow banking — in recent years. The impact of digitisation on these funds should not generate a regulatory deficiency detrimental to the stability of the financial system.

([7]) EESC opinion (ECO/424) on Amendment to the Capital Requirements Regulation (CRR) to incorporate modifications to the BASEL framework (Not yet published in the Official Journal).

7.10. Given the deficiency of traditional risk assessment models that are incapable of properly evaluating non-collateral-based models of financing, European Supervisory Authorities should intensify contacts with FinTech start-ups, on the understanding that FinTech requires new skills from supervisors.

Brussels, 26 April 2017.

The President
of the European Economic and Social Committee
Georges DASSIS

Glossary of terms

Artificial intelligence. Machine with learning capability. 'Roboadvisor' is a machine capable of providing financial advice, functioning in the same way as the human brain.

Bancassurance. Selling insurance products via the office networks of banks. This kind of strategic partnership brings networks together and creates business synergies.

Big data. Storage and processing of many pieces of data which are transmitted at high speed. 'Analytics' refers to the conversion of data into information by means of mathematical and statistical methods for decision-making in the financial sector.

Bigtech. Technology giants such as Google, Apple, Facebook and Amazon (GAFA) which are starting to extend their considerable reach into the banking business.

Bitcoin. Virtual currency in an experimental phase which is increasingly accepted in the market.

Blockchain. A technology platform which supports the bitcoin. It has a very efficient database, which can be used in finances or in multiple applications.

Cloud. Models for provision of services based on the internet.

Connectivity. As a result of technological advances we can now be connected anytime, anywhere. This allows employees to work more flexibly, as they can work from home or from another location (teleworking, smart working) as well as part time. Young people are already used to this way of working, and the value of having a range of options can be put to good use.

Crowdfunding. Financing is provided via internet platforms which connect entrepreneurs with investors. There are platforms which oblige entrepreneurs to offer a share of their business in exchange for investment (equity crowdfunding).

Crowdlending. Financing via the internet for entrepreneurs who receive a loan from a group of people, which has to be repaid on the basis of a set interest rate.

Customer experience. Developing an in-depth knowledge of each customer individually, personalising their experience in all areas of interaction with the bank. Social networks and *web* platforms are essential elements.

Cybersecurity. Covers the risks of cyber-attacks and data theft, and also increases and guarantees customer confidence.

Digitalisation. This concerns technology as a whole (internet, mobile technologies, big data, blockchains, artificial intelligence, cloud computing, robotics, cybersecurity) when applied to new relationship models with customers and to managing the transactions of banks and insurance companies. Technology is a means of achieving digitalisation rather than an end in itself.

Disruption. Digital transformation is not possible without a new organisational and cultural model. Innovation is key to competitiveness in this comprehensive banking process. Change begins with people.

Exponential banking. Uses exponential technologies (which have emerged as a result of the digital revolution) to increase the range and quality of financial services as well as to bring down costs.

Fin Tech/Insur Tech. Innovative start-ups, which offer novel banking or insurance solutions at low cost.

Hybrid lending. It's a combination of lending by bank and private banking customers. This allows the banks to retain more business without significantly increasing their balance sheet while simultaneously satisfying its clients and fellow investors.

Knowmad. New professionals who feel that what they bring to the table is their knowledge, and who therefore prioritise the freedom to manage their work and time.

Millennials. The first generation of digital natives, those born between 1980 and 2000, who will make up 75 % of the workforce in 2025. Typically, they do not visit bank branches.

Multi-channelling. Efficient combination of the usability of digital and face-to-face banking channels. The customer is the focus of the business.

Neobanks. They do not require a financial licence to operate: what they do is develop software on the basis of the infrastructure of an existing bank.

Payment methods. An e-commerce trend, POS-terminal payment is the most extensive mobile form of payment worldwide. This ecosystem also includes the PayPal option and the technological operators Samsung Pay, Apple Pay, etc. Person-to-person (P2P) payment services are a genuine alternative for those living in countries where the banking system is less developed. Nowadays, mobile banking 'apps' are a fact of life.

Regtech. Innovative technologies that are used to facilitate regulatory compliance, reducing the costs and resources needed for such tasks. Digital regulation and surveillance are a challenge for the financial sector (a level playing field must be ensured).

STEM. The study of science, technology, engineering and mathematics. The professions that are currently on the rise are those related to these subject areas, and digital skills are vital in all sectors. Training is therefore a priority.