

## Digital Finance of Today and What to Expect in the Near Future

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By **Jonathan Vassallo**, 23rd February 2023

### **Malta – Innovation and Technology**

Malta is currently implementing a strategy to help ensure that Malta is considered as one of the top jurisdictions in the EU for innovation and technology. It is therefore important to be aware of what exactly the Digital Finance Market is made up of currently and where it is heading.

Malta is a prime locality for a Micro test-bed and there are currently several schemes that have been introduced to attract innovation and technology-based start-up companies.

### **The EU and the Digital Finance Sector**

As early as September 2020, the European Commission adopted a digital finance package, including a digital finance strategy and legislative proposals on crypto-assets and digital operational resilience, to generate a competitive EU financial sector that gives consumers access to innovative financial products, while ensuring consumer protection and financial stability. The aim of having rules which are more digital-friendly and safe for consumers, is to leverage synergies between high innovative start-ups and established firms in the financial sector while addressing any associated risks.

### **Position of Regulators**

The financial services sector has seen a rapid acceleration in the trend towards digitisation, and as a result, many regulators are navigating how to best ensure the regulatory framework manages the risks of these innovations, without impeding their potential to significantly enhance the financial system.

Market interest around crypto-assets, and the underlying distributed ledger technology (DLT), continues to grow. The potential benefits of these innovations is to increase payment efficiency as well as reducing cost and expanding financial inclusion. In doing so there also a list of associated concerns that many regulators have highlighted and they are stepping up warnings to consumers and investors.

In a shift away from traditional business models, big tech players are beginning to offer a variety of platform-based financial services. Artificial intelligence and machine learning techniques are being incorporated into firms' processes and are increasingly being used in tools designed for use by customers. Regulators are also taking note of ethical concerns where AI models insufficiently consider data cleaning, transformation and anonymisation.

### **A Unified Approach**

As firms lean on outsourcing to minimise costs and deliver innovative products, there is growing scrutiny on cyber resilience and third-party outsourcing, and various conferences are being held in order to merge regulators and innovators into one stream with a shared focus. Currently there a number of sandbox projects which encourage innovative start-ups to participate in creating transparency between product offering and regulation.

The fundamental building blocks underpinning all of the emerging technologies and digitisation, are infrastructure and data. Firms need to ensure that they have the expertise to store and analyse their databases and have in place adequate governance and controls. They need to protect confidential customer and market data, while delivering services more efficiently across borders. This raises legal challenges, which regulators continue to debate.

### **Digital Finance Strategy**

The [Digital Finance Strategy](#) sets out a general European position on the digital transformation of financing in the coming years, while regulating its risks. While digital technologies are key for modernising the European economy across sectors, users of financial services must be protected against risks stemming from increased reliance on digital finance.

The Digital Finance Strategy sets out four main priorities that promote digital transformation:

1. Tackles fragmentation in the Digital Single Market for financial services, thereby enabling European consumers to access cross-border services and help European financial firms' scale up their digital operations.
  
1. Ensures that the EU regulatory framework facilitates digital innovation in the interest of consumers and market efficiency.
  
1. Creates a European financial data space to promote data-driven innovation, building on the European data strategy, including enhanced access to data and data sharing within the financial sector.
  
1. Addresses new challenges and risks associated with digital transformation.

Banks should be aware that such a strategy will bring about expectations regarding the implementation of new technologies to deliver financial services, enhanced data sharing that leads to expected better offerings by firms and enhancements of skills to navigate in this new financial eco-system.

Particular initiatives which form part of the Digital Finance Strategy include:

- Enabling EU-wide interoperable use of digital identities
  
- Facilitating the scaling up of digital financial services across the Single Market
  
- Promoting cooperation and the use of cloud computing infrastructures
  
- Promoting the uptake of artificial intelligence tools
  
- Promoting innovative IT tools to facilitate reporting and supervision

## **Digital Operational Resilience (DORA)**

Part of the [Digital Finance Package](#) issued by the European Commission, the legislative proposal on digital operational resilience ([DORA proposal](#)), augments existing Information and Communications Technology (ICT) risk requirements, enabling an IT landscape which is expected to be safe and fit for the future. The proposal tackles various elements and includes; ICT risk management requirements, ICT-related incident reporting, digital operational resilience testing, ICT third-party risk and information sharing.

The proposal aims to address; fragmentation regarding the obligations of financial entities in the area of ICT risk, inconsistencies in incident reporting requirements within and across financial services sectors as well as the threat of information sharing, limited and uncoordinated digital operational resilience testing, and the increasing relevance of ICT third party risk.

Financial entities are expected to maintain resilient ICT systems and tools that minimise ICT risk with effective business continuity policies in place. Institutions are also required to have processes to monitor, classify and report major ICT-related incidents, with the ability to periodically test the system's operational resilience. ICT third party risk is given greater emphasis, with critical ICT third-party service providers subject to a Union Oversight Framework.

In the context of the proposal, banks are expected to undertake a holistic exercise, assessing their ICT framework and plan for the expected changes. The Authority emphasises that banks should continuously monitor all sources of ICT risk whilst having adequate protection and prevention measures in place. Finally, banks should build the necessary expertise and have adequate resources to be compliant with requirements emanating from such proposals.

### **Retail Payments Strategy**

The [Digital Finance Package](#) also includes a dedicated [Retail Payments Strategy](#). This strategy encompasses a new medium-to-long term policy framework that aims to enhance the development of retail payments within the evolving digital world. The four pillars of this strategy are;

1. increasing digital and instant payment solutions with pan-European reach;

1. innovative and competitive retail payment markets;

1. efficient and interoperable retail payment systems and other support infrastructures; and

1. efficient international payments, including remittances.

This strategy aims to broaden the acceptance network for digital payments, with the Commission also supporting the work towards the issuing of a digital euro. In addition, the Commission wants to ensure that the surrounding legal framework regarding payments, covers all of the important players, with a high degree of consumer protection in place.

### **How Can Dixcart Malta Help?**

Dixcart Malta has a wealth of experience across financial services, and can provide a legal and regulatory compliance insight and help to implement transformational, technology and organisational change.

When launching new innovative products and services, the experience of Dixcart Malta can help clients adapt to changing regulatory requirements and recognise and manage emerging risks.

We also identify and assist our clients in accessing various Malta government schemes, including grants and soft loans.

### **Additional Information**

For further information about Digital Finance and the approach taken in Malta, please contact [Jonathan Vassallo](mailto:Jonathan.Vassallo@dixcart.com), at the Dixcart office in Malta: [advice.malta@dixcart.com](mailto:advice.malta@dixcart.com).

Alternatively, please speak to your usual Dixcart contact.