

## **Constantinos Herodotou: Technology-enabled financial services - opportunities and challenges in the payments landscape**

Speech by Mr Constantinos Herodotou, Governor of the Central Bank of Cyprus, at the Association of Cyprus Electronic Money & Payment Institutions, Nicosia, 28 September 2023.

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Ladies and gentlemen,

It is a pleasure to speak to you today and I wish to thank the Association of Cyprus Electronic Money & Payment Institutions for the invitation.

The co-existence of traditional banks and innovative fintech companies is transforming the financial sector landscape. This co-existence represents a dynamic interplay of collaboration and interdependence, fostering a complex, yet promising future for our financial ecosystem. The market in which traditional banks and fintechs operate, is also characterised by competition as fintechs gain market share in payment services. This also enables them to cross-sell other services, such as currency exchange, stock-trading, insurance and commodities.

In this symbiotic relationship, banks and fintechs stand to benefit by capitalising on each other's strengths, in their efforts to deliver high-quality services to their customers. There are significant advantages in combining the network and regulatory expertise of traditional banks with the agile and innovative operating models of fintechs.

However, innovation comes with challenges and risks.

As such, the Central Bank of Cyprus has a dual role to play: it encourages innovation and the opportunities that are created by digitalisation. In parallel, it is its duty to maintain a watchful eye on new and untested technologies in our local market, in order to ensure that no undesired risks are introduced, which may penetrate through the local financial sector due to the interdependence I just referred to.

And this leads me to my next point, which is the Innovation Hub initiative that I recently introduced at the Central Bank of Cyprus. Through the establishment of the Innovation Hub, the Central Bank of Cyprus embarks on an ongoing and constructive dialogue with innovative firms, fostering the implementation of novel ideas and the adoption of pioneering technologies. Our aim is to simplify the process for innovative firms to understand and navigate their regulatory obligations within the financial system. The Innovation Hub aims to offer prompt responses and non-binding guidance to interested firms.

The audience here today is an important representation of the local fintech community, and as such the Central Bank of Cyprus extends an open invitation to all of you to engage with us through the Innovation Hub, in order to build a robust, secure and sustainable financial ecosystem for Cyprus.

Let me now update you on another initiative we actioned at the Central Bank of Cyprus. In our effort to promote the digitalisation of the financial sector, to create an efficient financial ecosystem and to support the economy, the Central Bank of Cyprus issued a tender for the implementation of a remote, digital on-boarding platform for the banking sector. The tender has been completed and we will announce the result in the next few days.

The digital platform will be implemented in three phases and will progressively bring benefits to individual and corporates, such as reducing the time to on-board clients, reducing the time needed for their bank transactions and upgrading the quality of service they receive. This will be achieved through each phase as follows:

Phase 1 is the implementation of the technology for the sector to remotely on-board new customers and remotely update existing customer records via a digitalised process. The digitalization will provide an optimised user-friendly interface without the need for physical presence, which will be customisable by each participating financial institution, in accordance to their needs and customer assessment requirements.

The following phases will be:

- connectivity and interoperability with utilities, such as electricity and water, and governmental services to obtain accurate customer data for verification purposes, thus speeding up the Know Your Customer (KYC) process and ensuring the integrity of data entries, and
- information sharing between participating institutions when there is an update of customers' data for Anti Money Laundering (AML)/KYC compliance purposes or for account opening, which will reduce the need for further engaging the customer in the process, since the customer would have already been on-boarded.

This digital platform will improve the efficiency and openness of banking services, while adhering to relevant European regulations for on-boarding clients. We made sure of that. It will create a comparative advantage for the Cyprus banking system.

Although at first the digital platform will be implemented in the banking sector, my intention is to subsequently scale it to other entities regulated by the Central Bank of Cyprus, such as the payment institutions and electronic money institutions. Adoption will continue to be voluntary for each institution.

Ladies and gentlemen,

We are witnessing transformative challenges due to digitalisation and innovation. In order to address these, the Eurosystem is taking a multi-dimensional approach, by first, promoting instant payments as the 'new norm', and second, by investigating the possible introduction of a digital euro.

Instant payments are a major technological innovation. They allow the release of funds that are locked in the financial system, making them immediately available to consumers and businesses. Today, the clearing and settlement of payment instructions takes a few days according to the payment instrument in use. For example, cheques

and cards take up to 3 days, Single Euro Payments Area (SEPA) credit transfers 1 day and for cross-border payments the time taken is even longer. This offers opportunities for banks and fintechs to develop new solutions at physical points of sale or in e-commerce transactions. At the same time, instant payment solutions should comply with customer and data protection, anti-fraud, anti-money laundering and sanctions legislations.

The deployment of instant payments has been rather slow so far: from November 2017, when the SEPA Instant Credit Transfer scheme was launched, till the second quarter of 2023, instant payments reached about 15% of total volume of credit transfers in the EU. This is a challenge we have been addressing in the Eurosystem's retail payments strategy and in our deliberations with the European legislator. The latter intends to make instant payments available to all holders of a bank account in the European Union (EU) and in parallel make them affordable, such that the price charged for instant payments does not exceed the price charged for traditional credit transfers.

Although Cyprus banks do not yet offer instant payments, certain electronic money institutions and payment institutions that are regulated by the Central Bank of Cyprus are eligible to offer this service to their clients.

Without a doubt, consumers' demand for innovative payments poses a number of challenges. For instance, non-European bigtechs provide front-end solutions to customers, such as stablecoins and applications for making payments, which challenge our strategic autonomy. This is because of the increase in the risk of financial transactions being based on technologies and infrastructures owned and managed outside the EU, with limited powers of intervention or protection by European authorities. Bigtechs also pose a challenge to our competitive edge, because the information contained in digital transactions can be monetised by private, non-European companies, thereby posing a threat to privacy, while also exploiting it for commercial use.

Another challenge lies in safeguarding in the digital era the availability and usability of banknotes and coins that are currently the only kind of central bank money available to the public. It is against this backdrop that the Eurosystem has been conducting a consultation on the possible issuance of a digital euro, to complement the euro in its physical form. The digital euro would offer an additional option for paying with public money, including where this is not possible today, for example in e-commerce. It is worth noting that in addition to banks, other payment service providers are envisaged to also have a role in the distribution of the digital euro to their customers. In other words, citizens would be able to access the digital euro core services, irrespective of whether their account or wallet is kept at a bank or at a payment institution or at an electronic money institution.

Ladies and gentlemen,

In terms of the domestic market developments, the number of payment institutions and electronic money institutions operating in Cyprus has exhibited significant growth in the last few years with the entrance of more service providers. Currently in Cyprus there are 11 licenced payment institutions and 23 licenced electronic money institutions. Furthermore, a number of institutions from other member states of the EU offer these

services in Cyprus through the European passporting system. Despite the relatively large number of licensed institutions for the size of Cyprus, there is continued interest for new licences. At present, 33 applications for new licences are being assessed by the Central Bank of Cyprus.

In this respect, we have effected a number of organisational and technological changes at the Central Bank of Cyprus, in order to be able to address this increased interest for new licences. A couple of examples are the set-up of a dedicated licensing team, the strengthening of the team with additional staff (an increase of 140% in the last two years) and the introduction of an e-platform for the submission of the application documents. The Central Bank of Cyprus is looking for strong governance arrangements and internal control structures within the licensed institutions, in order to promote a culture of compliance and adherence to the relevant regulatory frameworks. The aim is to reduce risks to the financial system, stemming from money laundering, terrorist financing, bypassing of sanctions, cyber-attacks, fraud or leakages of personal information. These elements are the cornerstones of a solid Electronic Money Institutions/Payment Institutions sector, which would benefit all involved parties.

In Cyprus and in the EU, the payments landscape is dynamic and fast changing. In this respect, the relevant EU legislation needs to be updated. Earlier this year the European Commission published legislative proposals with a view to amending the Payment Services Directive 2 (PSD2), aiming to further level the playing field between banks and non-banks. In particular, this is done by proposing that non-bank payment service providers should have access to all EU payment systems, with appropriate safeguards and securing those providers' rights to a bank account. Further to the above, the proposals aim to ensure that the rules are applied consistently across all member states of the EU, and to mitigate the current increasing risk of payment fraud.

The legislative package comprised two proposals, the Payment Services Directive 3 (PSD3) and the Payment Services Regulation (PSR), which are currently being negotiated by the EU legislators.

A third proposal on Open Finance is also included in the package, known as the Financial Data Access Regulation (or FiDA). The aim of FiDA is to give consumers, including firms, new access rights for their financial data to be shared, as well as collected, stored and processed, with other market participants such as financial institutions and fintechs. This framework will lead to more innovative financial products and services, and will stimulate competition in the financial sector.

Let me conclude.

As we navigate through new opportunities and the changing legal and regulatory landscape, we must remain vigilant while continuing on the path of innovation. Challenges and risks accompany innovation. The supervisory and regulatory community must ensure that laws and regulations are upheld, regardless of business models and technological advancements. In conclusion, I am drawn to a quote from the father of macroeconomics, John Maynard Keynes: "The importance of money, flows from it being a link between the present and the future". This is more topical than ever thanks to the ongoing digitalisation and innovations in the financial and economic networks. Indeed, innovation in finance isn't an option, it's a necessity.

Thank you for your attention.