



Summary

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Digital finance: areas of action 2022

In a nutshell

The ongoing digitalisation process is bringing about a sea change for the Swiss financial centre. Established location factors such as economic, financial and political stability, security and trust remain relevant. However, the ability of companies and authorities to use new technologies is becoming more important for the future.

Given the speed and nature of the progress in the area of finance and digitalisation, the Federal Council instructed the FDF to draw up a report on digital finance. It clarifies the Confederation's role and identifies the specific areas of action (Federal Council objectives for 2021, volume II).

1. Why a digital finance report?

Paying, saving, investing, financing and insuring, as well as supervising and regulating, are fundamental functions in the financial system. The key questions are: How and by whom will these functions be performed in the future? Is there a need for action by the Confederation in this regard, and if so, what?

The continuous rise in digital storage capacity and computing power, increased networking via the internet, the development of applications for analysing large volumes of data and of encryption techniques, and the growing use of mobile devices and their applications (apps) are constantly producing new innovative products.

Clients already use information platforms, payment services on mobile devices, platforms for transferring and trading digital currencies and assets, crowd lending/funding and pay-per-use insurance. However, aside from these client-facing products, a multitude of new applications are also emerging in the internal processes of financial institutions, between service providers and at supervisory authorities. If these applications are related to regulatory compliance, they are referred to as RegTech (regulatory technology), while those related to supervision are referred to as suptech (supervisory technology).

These innovative financial services and products are no longer provided solely by traditional financial service providers such as banks and insurance companies, but also by a rapidly growing number of companies specialising in technology in the financial sector (fintechs), as well as big techs, i.e. the globally oriented, mostly US or Chinese technology companies.

Big techs provide indispensable cloud computing solutions for Swiss financial service providers and fintechs. However, their search engines, social networks and trading platforms also give them detailed financial data on their clients worldwide. As a result, they are increasingly offering financial services themselves. Aside from fintechs and big techs, specialised outsourcing and infrastructure services are also being offered by other companies, some of which are outside the industry.

This change process is referred to here as "digital finance".

2. What risks and opportunities are associated with digital finance?

2.1. Formation of ecosystems, redistribution of the value chain, departure from central players

The use of new technologies and the establishment of technological standards make coordination and interaction among the individual players much easier, which also favours the formation of ecosystems. This means, for example, that financial services can also be offered outside the financial sector (e.g. in the "housing ecosystem", with financial services such as mortgages or household insurance, digital heating cost control).

In addition, products and services can be broken down into partial items that can be supplied by various players that do not necessarily have to come from the financial sector.

Decentralised finance (DeFi) promises to create a completely independent value chain. DeFi describes a radically alternative financial ecosystem in which DLT-based financial services can be used in a decentralised manner and independently of financial institutions and regulatory structures. DeFi extends the use of blockchain from the simple transfer of value (as is the case with bitcoin, for example) to more complex financial application scenarios. There are numerous possible applications for DeFi (e.g. trading platforms, loans, insurance, stablecoins) and they have the potential to fundamentally change the financial sector.

Opportunities:

- The fragmentation of the value chains allows for more efficient and better products and services.
- The modularisation of financial services and their dispersion among a larger number of players potentially boosts the system's overall resilience in the event of operational disruptions or cyberattacks.

Risks:

- However, modularisation can also increase vulnerability to cyberattacks, as there are more points of attack.
- The fragmentation of the value chain additionally increases the likelihood of not having an overview of risks, of becoming more dependent on third-party providers within the financial system, and of resulting in lower overall requirements for services than is the case today for comparable services (supplied by a single provider), as supervisory responsibilities are increasingly difficult to assign and service providers sometimes move outside the regulatory supervisory perimeter.
- The anonymity associated with digitalisation and DeFi can heighten the risks of money laundering and the financing of criminal activities in general.

2.2. Growing significance of data

The rise in digitalisation and networking has caused a manifold increase in the volume of data, data sources and analysis methods in recent years. Access to and the handling of data, both within a company and on the financial market itself, have become a key issue for financial market players.

Opportunities:

- For all financial system participants, clients and providers, and regulators and supervisory authorities alike, improving the availability and quality of data offers clear added value in the fight against financial crime and when comparing sustainable financial services, for instance.

Risks:

- At the same time, the risks regarding the protection of privacy and control over personal information are higher. With the volume of data and its use, the vulnerability to cyberattacks likewise rises.

2.3. Automation

The automation of processes means that programmed or self-learning applications perform not only repetitive tasks, but also more and more tasks requiring a certain amount of thought and creativity.

Opportunities:

- Automation boosts the efficiency of the financial system by reducing the cost of providing services and improving their quality for the same cost.

Risks:

- Automation leads to a greater need for skilled workers capable of developing, maintaining and managing applications.
- The accelerated accumulation of automated investment decisions can amplify price fluctuations and market volatility with similarly programmed decision-making criteria, and jeopardise financial market stability.

2.4. Territorial decoupling and boundaries

Geographical distance has also become less relevant with the use of new technologies. Technologically speaking, a growing proportion of bank processes can be carried out digitally. Local physical branches are no longer necessary for many lines of business.

This poses a challenge for the state, which, unlike the private sector, exercises its sovereignty only within its national borders, be it in the area of financial market supervision, financial crime deterrence and prosecution, data protection, cybersecurity, taxation or labour law.

In response to this, greater coordination can be observed at the international level, but also growing barriers to cross-border data flows. A trend towards expanding the provisions on data localisation in financial market legislation can be observed, for instance. This involves requiring the storage and/or processing of certain data within national borders on regulatory or supervisory grounds.

Opportunities:

- There is the possibility of attracting new partners or clients and thus scalability.
- New opportunities are opening up for outsourcing and for recruiting skilled workers abroad.

Risks:

- Cost pressure and the complexity of market positioning are increased.
- The challenge for the state, which, unlike market participants, still exercises its sovereignty only within its national borders, is becoming greater in the area of financial market supervision, financial crime deterrence and prosecution, data protection, cybersecurity, taxation and labour law.

3. What is the role of the Confederation?

The Confederation has to continuously check the suitability of the existing framework conditions for the economic activities changed by new technologies and make adjustments to the legal framework. In the area of digital finance, the focus is on the legally secure use of technology that promotes innovation, financial stability and client protection. Examples of this include the DLT bill, the reduction of formal requirements in financial market law and the creation of a fintech licence.

In addition, the Confederation is increasingly playing the role of an active discussion partner for a growing number of players and, as a coordinator, can help to identify national and international topics and bring players together (FDF roundtables on open finance, digital banking, digital infrastructure and fintech). It advocates Switzerland's interests in the international bodies that deal with these topics (in particular, G20, OECD, FSB).

This digital finance report outlines twelve areas of action with specific measures with which the Confederation is pursuing the ongoing change process. The Federal Council is instructing the FDF to implement these measures. The work will be carried out in close coordination between politicians, authorities, the private sector and academia.

Enclosure: Brief overview of the 12 areas of action

Brief overview of the 12 areas of action

	WHAT?	WHY?	HOW?		WHAT?	WHY?	HOW?
1	Examine the legal and supervisory framework with regard to new configurations and players	<ul style="list-style-type: none"> New products and ways of providing services in the financial sector Arrival of new players on the financial market 	<ul style="list-style-type: none"> Establishment of working group Review and, if need be, initiation of adjustment of the legal and supervisory framework, incl. fintech licence Together with: FINMA, the industry 	7	Foster shared data use in the financial centre	<ul style="list-style-type: none"> Shared data use makes it possible to improve the knowledge gained from data Can be used e.g. to better combat illicit financial flows, mitigate cyber-risks or optimise operations, products and distribution 	<ul style="list-style-type: none"> Establishment of working group and examination of possible measures Promotion of concrete areas of application Together with: the industry and other affected units
2	Promote and expand open finance	<ul style="list-style-type: none"> Standardised interfaces are a significant innovation driver Approach requires active participation of all players involved 	<ul style="list-style-type: none"> SIF is an active dialogue partner/coordinator and examines the need for action If necessary, proposal for adjusting the framework conditions 	8	Ensure free cross-border data flows	<ul style="list-style-type: none"> Secure and cross-border data flows are of great importance for Switzerland 	<ul style="list-style-type: none"> Commitment (internationally & bilaterally) to ensuring free cross-border data flows Taking account of the requirements of Swiss data protection and financial market law
3	Enable the use of RegTech and suptech	<ul style="list-style-type: none"> Growing significance of innovative technologies in financial market regulation & supervision Efficiency and effectiveness gains are opportunities At the same time, risk management is necessary 	<ul style="list-style-type: none"> Establishment of working group Review and, if need be, initiation of adjustment of the legal and supervisory framework SIF is an active dialogue partner/coordinator for data-based supervision Together with: FINMA, Federal Chancellery, the industry 	9	Support the use of artificial intelligence in the financial sector	<ul style="list-style-type: none"> AI use offers major opportunities (e.g. better personalisation, risk mitigation) Risks concerning the origin of data and its use, and the traceability of data processing 	<ul style="list-style-type: none"> Preparation of overview SIF is an active dialogue partner/coordinator and should explore the topic for the financial market
4	Closely monitor developments in cloud computing	<ul style="list-style-type: none"> Cloud services are now an integral part of the ICT procurement strategy of many financial institutions Legal questions are still arising regarding cloud use 	<ul style="list-style-type: none"> SIF is an active dialogue partner/coordinator and examines the need for action If necessary, review of the legal and supervisory framework 	10	Enable innovative and responsible use of DLT in the financial sector	<ul style="list-style-type: none"> Further optimise the framework conditions for the use of DLT Risk mitigation requires coordination between authorities and cooperation with financial intermediaries 	<ul style="list-style-type: none"> SIF is an active dialogue partner/coordinator and explores the topic for the financial market If necessary, initiation of adjustment of the legal and supervisory framework If necessary, drafting of proposal to amend the CISA
5	Continue the cooperation on cybersecurity	<ul style="list-style-type: none"> Cybersecurity is essential for the digital economy to function smoothly Opens up opportunities (e.g. more extensive use of data) and protects against risks (e.g. cyberattacks) 	<ul style="list-style-type: none"> The FDF/NCSC are continuing to enhance the mechanisms for combatting cyber-risks The NCSC is an active dialogue partner and continually examines the need for action Together with: SIF, FINMA, the SNB 	11	Continue to support efforts to make Switzerland a leading green fintech hub	<ul style="list-style-type: none"> Assets will increasingly be invested sustainably and digitally in the future Green fintech offers the opportunity to combat climate change and the decline in biodiversity 	<ul style="list-style-type: none"> SIF seeks dialogue with relevant national and international players SIF actively promotes green fintech in international bodies and initiatives
6	Promote data use in the financial sector	<ul style="list-style-type: none"> The development status of data-based business models relative to the technical possibilities has room for improvement At the same time, secure data rooms are needed 	<ul style="list-style-type: none"> SIF is an active dialogue partner and examines the need for action Development of a more nuanced understanding of the protection and use of data Together with: the FDPIC, FINMA, the industry 	12	Strengthen the innovation potential of the financial sector in the long term by means of an innovation platform	<ul style="list-style-type: none"> To date, Switzerland has been in the middle of the pack as a fintech hub There is no uniform platform for innovation and the exploitation of technology This mirrors the approach of other major financial centres 	<ul style="list-style-type: none"> SIF is working on a proposal with objectives and a structure for an innovation platform for the financial sector Together with the industry and authorities