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The future of the financial system in an uncertain environment

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Margarita Delgado

Deputy Governor

* English translation from the original in Spanish.

Good afternoon and welcome to the annual conference of the Spanish Risk Management Club.

It is an honour for me to open the 22nd edition of this conference.

In my address today, I shall try to explain what, in my view, are the key factors that will shape the future of finance in the medium term, and I will then outline the main challenges facing banks in the not-so-distant future. The title of this year's conference, "New risks, old problems", neatly conveys the landscape that I wish to describe, one in which the banking system will have to respond to the economy's traditional financing needs while navigating new risks.

Clearly, the economy is operating in an environment of extreme uncertainty. In recent years, we have weathered a succession of crises which have had a severe impact not only on the economic situation, but also on fundamental economic principles and strategies. The COVID-19 crisis, the war in Ukraine and, more recently, the conflict in the Middle East, have rocked some of the economic assumptions that we took for granted.

The need to rethink Europe's strategic vision and its dependence on certain commodities, particularly energy, has come to the fore. Although we still have no hard evidence of deglobalisation taking place, only of supplier diversification, we have seen a clear contraction – and disruptions – in global trade, something inconceivable a few years ago.

Moreover, the energy crisis triggered by the aforementioned conflicts has given fresh impetus to the search for more sustainable alternatives that can also reduce Europe's energy dependence. The green transition, in which the financial system plays a key role, has gained momentum.

Aside from the shocks of recent years, we also need to keep a close eye on the technological revolution that is affecting every field, including the financial system. I would like to begin by discussing this last point.

Technological revolution

Our society is witnessing unprecedented technological developments that are affecting all aspects of our lives. Many of these, such as artificial intelligence (AI), machine learning, blockchain technology or distributed ledger technology (DLT), are not confined to the financial sector. Others, however, such as open finance or decentralised finance (DeFi), are unique to this field. How will these elements shape the financial sector in the future?

Like other sectors, **the banking industry is putting customers and their expectations at the core of its strategy**. These expectations are certainly evolving in step with technology and banks will have to keep pace if they wish to remain the predominant players. Responding fully to the needs of customers will be crucial for the future of banking, given the threats and challenges looming over the financial system.

As regards the relationship between consumers and the banking industry, technological developments have led to three types of disruptions:

- First, the **new products** that can be offered to customers. The use of new technologies, such as AI or open finance, can act as a catalyst for products that are less standardised and more tailored to the needs of individual customers. Technology will also have an impact on banks' business models, which will need to be adapted to the new ecosystem and products offered. Successful business models will be those that provide more added value for customers. **In other words, those that better meet their needs with more customised products at a lower cost.**

- Second, the **communication channels** between banks and customers will also be greatly affected by new technologies. We are already witnessing the growing use of digital channels on our mobile devices. But we should not only focus on the unstoppable rise of digital tools for communication over the traditional physical channels. We should also pay attention to the new uses and platforms enabled by open finance, which will no doubt continue to be developed in the future. **Banking as a Platform (BaaP) and Banking as a Service (BaaS)** are two new channels used by financial institutions to reach their customers. BaaP allows banks to use **their own platforms** to provide customers with additional third party services, such as **Fintechs, insurance products, legal services**, etc. Conversely, with BaaS, banks can distribute their products and services through third party platforms.

- Third, **new players** in the financial sphere, be they neobanks, Fintechs or Bigtechs, offering services and products in competition or collaboration with traditional banking. The potential emergence of new competitors will spur the financial sector as a whole, and the banking sector in particular, to **review their business models and look for the most efficient way to successfully exist side by side in the new ecosystem.**

The technological revolution should not be seen as a threat, quite the opposite. It is an opportunity to respond to some of the challenges currently facing the banking sector.

One of them is data management. Banks now have vast amounts of data which they cannot convert into valuable information or exploit fully without sufficient processing capacity. AI and machine learning will be used to exponentially increase the information available to banks. This information, if properly managed, will improve banks' capacity to respond to customer needs. These technologies will bring substantial added value to many areas. For instance, **in fraud detection, loan pricing or risk management**, in the broadest sense.

Moreover, customers are far less loyal to their traditional banks than they used to be, and new technologies are making it easier for them to switch from one to another. Against this backdrop, open finance, as a tool for sharing customers' financial data, will improve the **analysis of risk profiles** and of the needs of citizens and firms. This will enable banks to better adapt their financial products to actual needs and thus increase competition, since everyone will have access to the same information. All this will result in a more efficient financial system.

Another challenge, although it may appear to contradict what I have just said, is the scarcity of data in some areas. I am referring to **climate-related risks**, which I will discuss later. As we all know, managing these risks properly requires vast amounts of data, which are currently unavailable. Technologies such as **machine learning and machine reading**,

combined with **AI**, will allow banks to automatically gain access to non-financial information published by firms, and to manage it more efficiently. These could also be key tools for generating proxy data in the absence of real data.

Lastly, technology can also help respond to the challenge of providing customers with new products that **offer something different** from conventional products. If appropriately managed, this could increase banks' business and, consequently, their profitability. Distributed ledger technology (DLT) can play an important role in this respect. DLT can be used to **“tokenise” traditional assets such as real estate assets or financial instruments**, for example, private equity, making them more widely accessible to customers. Although still at an **early stage of development**, DLT has great potential. Having seen some of the advantages of new technologies and their potential, we should now look at the flip side of these developments, that is, **the risks involved**.

First, the technological environments in which banks operate must be secure. There is no such thing as zero risk, and it is evident that expanding the technological ecosystem in which banks operate will significantly increase the **attack surface and the risk of system failures**. Banks will need to have strong operational frameworks to mitigate these risks and also to be able to respond to incidents **quickly** and as a matter of course and. Operational risks in the financial sector will increase in number, speed and complexity. Although a European regulatory framework establishing requirements for these risks already exists (DORA¹ and NIS2²), banks must ensure that they always have the highest and most updated security standards in place.

Second, the use of technologies such as cloud services often involves having to depend on **external providers**. Although these services have clear advantages in terms of improving firewalls or back-up systems, they also entail concentration risk and the relinquishment of control. The industry's reliance on a very limited number of providers of such services, and the total inability to switch providers as and when required, may generate vulnerabilities.

Finally, there are other risks relating to digitalisation which, although mentioned less frequently, should not be overlooked. For instance, **financial exclusion**. I am not only referring to people who lack digital skills, but also to the fact that the use of technology, particularly AI, may automatically lead to the exclusion of certain segments of **customers because they are perceived as high risk**, or because **they are priced out** on the basis of aspects beyond the pure analysis of financial risk. We therefore need to ensure that digitalisation and the use of AI tools are accompanied by **expert judgement**. Digitalisation will facilitate decision-making, but it cannot replace human experience and perception.

Other elements that will define the future of the financial system are those relating to environmental and social considerations.

¹ DORA: Digital Operational Resilience Act.

² NIS2: Network and Information System Directive.

Environmental and social aspects

As a society, we have become aware of the negative effects that our lifestyle has on the environment. The overconsumption of resources, especially energy, and poor waste management, have a huge impact on all ecosystems and on the climate.

Governments must spearhead this change, since they have the necessary tools and resources to drive the transition. It is their responsibility to lay the foundations, set the objectives, approve the necessary regulation and, of course, strengthen the financing required to bring about change. Governments can also guarantee the global political commitment that action to promote sustainability requires. This is a global challenge that warrants a coordinated response by all the global players involved.

We are still in the early stages of the crucial transition to net-zero emissions. Regulation is moving forward, but is still in its infancy, with areas that have not yet been addressed. However, we are running out of time and must take action now. This is what the different scenario analyses³ recently conducted by several organisations, such as the Network for Greening the Financial System (NGFS), are telling us. A late and disorderly transition would have very negative consequences for our economy, not to mention for the environment.

The finance industry also has an important role to play in this process, not only because of its capacity to channel the necessary funds, but also because of its potential to instigate the changes required in the real economy through financing.

Because of this, the financial sector has gained considerable prominence in this transition. Banks will face the new challenge of properly identifying, analysing, managing and mitigating all climate-related risks and other transition-related elements.

First, the physical risks stemming from extreme weather events and environmental degradation. Banks will need to identify the exposures, including collateral, that could be affected by such phenomena and estimate the potential losses. This is no easy task, as it relies on having quality data that is both measurable and comparable. Since banks have no time to compile comprehensive databases, they must immediately start collecting and processing such data, or failing that, generate information through alternative methods using advanced technology.

Second, we must not forget to mention transition risks. This is a far more complex issue, since it requires longer-term estimations and a higher degree of planning and monitoring. In this respect, transition plans will be key to designing a reliable, measurable and credible road map. As I have already mentioned, regulation in this area is still at an early stage. Using the current taxonomy, and the regulations and guidelines on transition plans that are still being developed, banks will have to draw up their own transition plans, which will then be duly reviewed and supervised.

In turn, these must be based on the plans of the sectors and firms they finance, which should be reviewed by third parties. As we can see, this process is a chain in which each link

³ <https://www.ngfs.net/ngfs-scenarios-portal/>

contributes essential information. It is not just a question of disclosing non-financial information relating to sustainability and social elements, but of establishing a plan that sets out the path towards a more sustainable economic model for firms and banks alike.

In particular, the financial sector must decide where it wants to be 10-15 years from now and monitor exposures and compliance with the milestones established in those plans.

In this transition, the financial sector, in its financing capacity, should help and accompany firms in understanding the importance of these changes.

Besides, the financial sector will be able to benefit from the new opportunities that the growing demand in green project investments will bring. However, it must be watchful for so-called “greenwashing”, a concept that has been clearly defined but that can be difficult to identify in practice. It is essential that greenwashing is identified, since it may erode the trust placed in banks, their most valuable asset.

Adapting to this new scenario, in which environmental and social considerations take on particular importance, will pose major challenges to the financial sector in a number of areas. These not only include the need to compile and manage data for the purpose of collecting information, but also the imperative to analyse and manage these risks appropriately in the broadest sense, including designing and monitoring transition plans.

Conclusion

The financial sector has always proved highly adaptable. In the present circumstances, in which traditional risks are compounded by geopolitical tensions and more uncertain macroeconomic environments, the financial sector overall, and the banking sector in particular, must make every effort to define a clear strategy for addressing the new digital and environmental risks.

On the one hand, banks will have to keep a watchful eye on technological developments, trends and how society adapts to them. They must adopt strategic decisions to position their business models vis-à-vis digital environments and will, of course, need to make substantial investments.

They will also have to assist the productive sector in the transition to more sustainable models. This must be reflected in each bank’s own strategy and in strategies for each of the different economic sectors that they finance.

On the other hand, the authorities, both regulatory and supervisory, face the same scenario, but from a different perspective. Irrespective of new regulations or new areas for supervision that may emerge, we authorities face the task of squaring prudential requirements with a more flexible approach that enables banks to embrace financial innovation and gradually adapt to new environmental and social needs, all based on data that remains substantially incomplete. Flexibility and responsiveness are two qualities that we, the authorities, need to apply to our regulation and supervision of a changing and uncertain financial environment.

Despite all the difficulties and concerns that lie ahead, I am certain that the banking sector will successfully adapt to what the future holds.

The success of a business model lies in its ability to anticipate and adapt to a changing environment.

Thank you.