# Speech by Ms Anita Angelovska Bezhoska, Governor of the National Bank of the Republic of North Macedonia, at the 12th Conference on Payments and Market Infrastructures: Open Doors to the Changing Payments Landscape, 3-5 June 2019, Ohrid, North Macedonia

Distinguished guests, excellences

Ladies and gentlemen, good morning

It is my great pleasure to welcome you to the 12th Conference on Payments and Market Infrastructures hosted by the National Bank of the Republic of North Macedonia. Through the years, the organization of this conference has benefited from the invaluable contribution and unreserved support of the Dutch Central Bank, for which I express my deep gratitude. The presence of the European Central Bank, the Bank for International Settlement and the European Commission is an inherent feature of the conference, as well. And we are privileged and grateful for that, given the prominent role these institutions play in the area of payments.

Financial technologies and innovations are reshaping the financial sector, creating new providers, business models, new products and solutions, thus changing the entire financial ecosystem. It is not imaginary, but rather a real possibility today, with a few swipes on a smart-device, to be able to track payments across accounts, control direct debits, find a better credit card, compare household bills, or cancel unwanted subscriptions or consents. Waves of financial innovations from new players, but also from incumbents on the market, create massive changes in the financial industry. In this light, the highlight of the conference is embracing changes, that is opening doors to financial innovations in the payment landscape, while preventing disruptions to the financial markets and to the overall financial stability.

New wave of digitalization can have wide ranging positive effects on the economy - it spurs innovation and productivity, transforms public and private services, contribute to higher financial inclusion by reaching underserved households and overall, improve wellbeing of the society as information, knowledge and data become more widely available. Benefits go hand in hand with challenges to jobs and skills needed, to taxation, financial markets, and invite new thinking on how to preserve fundamentals such as privacy and security, as well as how to preserve monetary and financial stability.

Financial innovations, underpinned by digitalization, have a potential to gradually reshape the financial sector. “The Pulse of Fintech” report of KPMG [1] shows that Fintech investment globally more than doubled during 2018, and reached $112 billion. In addition, while new startups sprouted across emerging fintech subsectors, highly mature areas like payments saw some consolidation through mergers and acquisitions of big developed players. Reports also show that highest number of fintech service providers are in the payments, clearing and settlement category, thus, giving them the potential to gradually undertake a paradigm shift in the payment landscape. Ernst and Young adoption index for 2017 highlights the impressive and rapid growth in adoption of fintech services among mature and developing markets with highest adoption rate among younger generations (25-34 years). On average, about 33% of digitally active consumers have used at least two fintech services in the last six months (compared to just 16% two years ago), with payments and money transfer being the most popular segments (used by 50% of digitally active consumers). Perhaps even more importantly, there is an increasing awareness:

84% of customers are aware of fintech services compared with 62%, two years ago. Thus, rising investments in fintech segment, as well as growing awareness and adoption of fintech services indicates that fintechs are embraced and will continue to gain momentum in the future.

Financial innovations change the environment not only for customers, but for traditional banking industry and policy makers, as well. Customers may benefit from increased and cost effective access to financial services, although in some instances at the cost of privacy and consumer protection. As for traditional financial institutions, such as banks, they may face strong competition by new entrants, on the one hand, but may benefit from increased cost efficiency, competiveness and ability to offer new state-of-the-art services, on the other hand. The impact on policymakers and regulators is also large, as they have to first properly understand innovations/new services, foresee possible consequences for financial intermediation and stability, and react in a timely and proper manner.

Rising importance of this topic is clearly demonstrated by the adoption of the Bali Fintech Agenda of the IMF that provides guidance for national authorities on how to cope with new and evolving financial landscape, and underlines the need for stronger international cooperation as financial services are blurring boundaries, both institutionally and geographically.

In what follows, I would like to briefly focus on the challenges of fintech developments for the banking industry and policy makers.

We do have to take into account that digitalization of banking is not a new phenomenon; it has been present for more than 3 decades (in the form of automated teller machines, electronic payments, e-banking). The emergence of fintech is only the latest wave of innovation to affect the banking industry. Still, in the last decade, a significant change has occurred in the way of using technology, thus creating environment in which disruption can happen more quickly, and urging traditional banks to adjust faster to maintain market share.

Besides the advancement in technology, a few other factors have also contributed to proliferation of financial innovation. The fact that banking industry was dealing with the legacy issues of the global financial crisis-impaired balance sheets, perhaps was important factor that provided space for non-banks to penetrate in financial business. Also, banks' resources to a great extent were tilted towards implementation of the new Basel 3 requirements aimed at increasing the resilience of the banking system. The increased competitive pressure has been further amplified with the regulatory changes in the payments segment-PSD2, such as elimination of barriers to entry for third parties by providing access to data and accounts of the customers in the banks - so called "open banking". According to the research by PricewaterhouseCoopers [2], banks have very firmly moved from viewing open banking as a compliance exercise to an opportunity to compete, innovate, and deliver value and more than 33m people are expected to have signed up to open banking driven services by 2022. Against these background many fintech firms, that are not regulated entities, have launched new, differentiated and tailor made products, putting a significant pressure on traditional financial institutions.
Very important factor that most probably will shape the future of the traditional banking industry is the way how traditional banks approach and embrace the financial innovations, be it directly on their own or through cooperation with new fintech companies. Not only will fintech companies try to behave like banks, but banks will also try to behave like fintechs. While some market observers estimate that a significant portion of banks' revenues, especially in retail banking, is at risk over the next 10 years, others claim that banks will be able to absorb or outcompete the new competitors, while improving their own efficiency and capabilities.

In this context, the BIS envisages 5 different scenarios on how the fintech explosion might impact banks that range from a scenario where the incumbent banks digitize and modernize themselves to retain the customer relationship and core banking services, leveraging the technologies to change their current business models (which is not far away from the currently observed trends) to a scenario where banks have become irrelevant as customers interact directly with individual financial services providers as the need for balance sheet intermediation or for a trusted third party is removed and banks are displaced by agile platforms and technologies.

Following the example of the European Banking Association, early this year, we made a short survey of domestic banks to obtain information regarding their experience with modern-day technological solutions. The results of the survey indicate that almost two thirds of domestic banks do not have any experience with fintech companies and even surprisingly, they do not have plans to establish any relationship in the near future. The banks that have some experience with fintech companies point that it is rather a commercial partnership with existing fintech firms for launching new products or services. In addition, a few banks answered that they prefer to develop in-house fintech solutions without formal cooperation with external parties. The most frequently mentioned motives of the banks that have formal partnership with fintech firms or develop their own solutions for usage of new technologies included attracting new or maintaining the existing customers as well as cost savings. Among the technological solutions which are already in use or are in testing phase, most of the banks cited cloud services, usage of biometric properties for client identification purposes and using of big data analysis for credit scoring. Currently, the banks do not have experience neither with algorithms used for the purpose of investment advice or decisions nor with any DLT based solutions.

The regulators and policymakers also face challenges. Rules and regulations should keep pace with innovation, providing supportive environment but also adequately assessing and mitigating potential risks. Consequently, to apprehend the full benefits of digitalization, the authorities need to reach across traditional policy reluctances and across different levels of institutions, and develop a unified approach to policymaking. The Financial Stability Board stocktake of regulatory approaches to fintech finds that majority of jurisdictions surveyed have already taken or plan to take regulatory measures to respond to fintech. The scope and scale of changes or planned changes vary substantially, depending, among other things, on the relevant size and structure of domestic financial and fintech sectors and the flexibility already provided by the existing regulatory framework. An example of innovation in the legislative area has been set up by the European Union with the revised Payment Service Directive (PSD2). This directive, which has been considered one of the more substantial regulatory changes of its kind in Europe, is set to be a regulatory response to the game-changing finance and payment landscape. In addition, several jurisdictions have introduced regulatory sandboxes, innovation hubs or accelerators in order to promote innovation and improve interactions with new fintech firms. In general, the policy actions have been mostly focused on strengthening consumer and investor protection, market integrity, increasing financial inclusion and encouraging competition. The ongoing regulatory changes, in turn are conducive to rising interest in regtech-new technological solutions helping financial industry to better manage their compliance obligations.

As an impetus for innovation and responding to the rising challenges, the National Bank and the Ministry of Finance have continued joint activities on the Draft Law on payment services and payment systems, which transposes the PSD2 as well as other relevant European Union regulations in the payments area. The very broad and ambitious scope of the new Law makes it one of the most significant and comprehensive pieces of financial services legislation. It embodies objectives that seek to make payments safer, increase consumer protection and foster innovation while ensuring a level playing field for all players, including newcomers. Following the examples of other central banks, we are also in the process of creating an innovation hub for closely monitoring of fintech developments, interacting with institutions that plan to launch new services, which will help them better understand the regulatory environment, but it will also help us adequately comprehend the fintech developments, assessing the risks and possibly recalibrating the regulatory framework.

To sum up, innovation in digital finance, underpinning the nexus between digitalization and finance, offers wide-ranging opportunities, which authorities are keen to foster. It holds the promise of reducing costs and frictions, increasing efficiency and competition, narrowing information asymmetry, and broadening access to financial services - especially in low-income countries and for underserved populations. Ongoing innovations and technological advances support broader economic development and inclusive growth, facilitate international payments and remittances, and simplify and strengthen regulatory compliance and supervisory processes. At the same time, authorities are concerned about potential risks posed to the financial system and to its customers. Moreover, the adoption process may also pose transition challenges, and policy vigilance will be needed to make economies resilient and inclusive, so as to capture the full benefits. In response, policymaking will need to be nimble, innovative, and cooperative and importantly will need to strike the right balance between enabling financial innovation on the one hand and addressing challenges to market and financial integrity, consumer protection, and financial stability on the other. This balance is critical to deliver the welfare benefits of financial innovation and avoid stalling the development of digital finance with the risk of leaving someone behind.

I look forward to the presentations and discussions by the participants at the conference that I am sure will provide interesting reflections on the abovementioned challenges casting light on the fast changing financial innovation landscape, especially in the payments area.

I wish all of you an enjoyable and rewarding conference in Ohrid, our charming city, protected by UNESCO for its natural and cultural heritage.

Thank you!

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[1] The Pulse of Fintech 2018: Biannual global analysis of investment in fintech, 2019, KPMG, https://assets.kpmg/content/dam/kpmg/xx/pdf/2019/02/the-pulse-of-fintech-2018.pdf

[2] The future of banking is open: How to seize the Open Banking opportunity, 2018, PricewaterhouseCoopers LLP, https://retailbankinginnovation.fintecnet.com/uploads/2/4/3/8/24384857/the_future_of_banking_is_open.pdf