Andreas Dombret: On the prospects of growing electronification in the capital markets

Statement by Dr Andreas Dombret, Member of the Executive Board of the Deutsche Bundesbank, at the Eurofi High Level Seminar 2016, Amsterdam, 25 April 2016.

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When we talk, in broad terms, about the electronification of capital markets, we are in fact addressing very divergent matters. Market infrastructure is being challenged by blockchain applications that have the potential to render contracting and settlement between market participants cheaper and faster. Electronic marketplace crowdfunding platforms are oiling the wheels of the capital markets, helping to bring together demand-side and supply-side participants. Other fintechs are working to provide cheaper, quicker or more convenient services across the financial industry.

The directions that these developments are taking are not entirely clear. For example, it will most likely take some years before blockchain will have a real, potentially disruptive, impact on parts of the financial services industry. We have to remain aware of the fact that, given the many different policy fields involved and the significant level of uncertainty, our most pressing issue should be to work out a strategy for policy development.

Where should we head from here? Taking the European Capital Market Union project as a blueprint, I think we can agree that we want capital markets to prosper and yet also be reliable and resilient. So the key question is whether there is a reason to assume that electronification would, on the whole, eliminate the prevailing risks of the capital markets.

While it is certainly true that digital applications have promising attributes, it is simply wrong to assume that digital finance is immune to errors. The collective intelligence attributed to crowdfunding platforms is no guarantee that the herd is running in the right direction; nor can it prevent panic from setting in during a future recession. Algorithms may be transparent, reliable, and even intelligent, but in complex applications, bugs or manipulations can easily occur. As a colleague of mine noted the other day, even the self-driving Google car can knock down pedestrians. The self-regulation of blockchain technology is no panacea either: legal issues have already arisen and any application involving risks to the financial sector will still require supervision.

We should therefore not attempt to create an artificial separation in financial regulation, but should instead treat technology neutrally. In Banking supervision, the “same business, same risk, same rules” principle has so far proven to be a good standard for innovations.

Technology will not regulate itself. In whatever direction financial innovations are heading, we need to ensure that sector supervisors can continue to assume that a concrete entity will be responsible for future operational risks. Because of the uncertainties involved, it is vital that developments are closely monitored.

Let me turn, now, to the growth potential of financial technology. I assume there is little doubt about the potential gains in terms of lower transaction costs, shorter delays and greater convenience. However, with regard to policy development, we should avoid entering a discourse that pits innovation against prudence.

With a level-playing field and up-to-date-rules, I believe that we can trust market forces to work well in the long run. So, rather than bolstering innovation, we should first of all strive to remove superfluous hurdles. Our regulation partly ignores digital realities, where participants interact differently than in an analogue world. Legal ideas have to be adapted to digital contexts, and innovators need a reliable planning horizon.

A consistent, long-term regulatory framework, synchronised on a European scale, would, in my view, be the best service we can provide to promote financial innovation.