

## François Villeroy de Galhau: Financial stability in the age of digital industry

Introducing speech by Mr François Villeroy de Galhau, Governor of the Bank of France, at the Paris Europlace International Financial Forum, New York City, 18 April 2016.

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Ladies and gentlemen,

I would like to introduce this third round table by presenting the latest issue of the Banque de France *Financial Stability Review* entitled “Financial Stability in the Digital Era”. This new edition of the FSR addresses a very topical issue in the financial world, the impact of digitalisation and how to regulate such changes where necessary. I am keen to hear today’s exchange of views.

In this FSR, we have gathered contributions from prominent academics, practitioners and policy-makers in order to shed light on the impact of innovation on financial stability.

I would like to express my sincere thanks to all the contributors who have provided their views and analyses on such a technical and forward-looking topic. I cannot list all the contributors just now but I would like to give a special mention to Ms Karen Gifford who is with us today. The contributions presented in the FSR are very diverse in nature. The aim of the FSR is to help readers form an opinion; it is not designed to convey the explicit message of the Banque de France. The core aims of our *Review* are to exchange ideas, explore a given theme from various angles, and juxtapose different analyses and opinions. I hope this new edition will be appreciated as much as, or even more than the previous ones.

***Before we start the discussion, let me briefly share with you some personal thoughts on this subject.***

The digitalisation of financial services is clearly a fascinating subject. It is also an issue that is particularly relevant at the moment, as the emergence of digital technologies is coinciding with a period of burgeoning recovery.

The fact that regulators, and notably the Banque de France, are turning their attention to these issues should come as no surprise. It is our responsibility, as central bankers and regulators, to strike the right balance between the obvious benefits that digital innovation can bring to the financial sector, and the need for an adequate framework to mitigate risks and guarantee financial stability. The search for this subtle balance can best be represented as a trinity comprising innovation, stability and regulation.

We are thus facing a form of “trilemma”, and our role is to build a “possible trinity”.

1. ***With regard to the first element: innovation.*** The Banque de France is a proponent of digital innovation in financial services.

There is no denying that technology has opened up a wealth of opportunities for innovation, and that we still haven’t unlocked its full potential. However, in finance, the majority of these innovations also have the potential to be highly disruptive, be it in payments, in financing (think of crowdfunding) or in financial markets (think of HFT, which has more questionable objectives).

We are witnessing the emergence of a fully-fledged and constantly evolving digital ecosystem. Faced with the competitive threat from innovative newcomers, traditional players can respond using different strategies: establishing partnerships, acquiring fintechs or competing for new markets and activities.

2. ***The second element is stability.*** Although banking and financial innovations can stimulate growth in the financial system and foster economic expansion, we know

only too well that they can also be a source of instability, as evidenced by the subprime crisis. Digital innovations actually expose the financial system to new forms of risk.

First of all, the digitalisation of financial services presents a new issue for central banks as they perform their task of ensuring safe financial transactions (payment, delivery and settlement). In particular, the significant growth of decentralised trading systems, driven for example by blockchain technology, could change the conditions in which central banks perform their duties.

The transition to cyberspace has also left finance exposed to the increased threat of cyber-crime.

Lastly, the rise of digital innovation could also provide an opportunity for criminals to develop new methods of laundering money and financing terrorism. In this context, the new players in this digital era must also be fully subject to all anti-money laundering and counter-terrorist financing regulations.

3. ***The third element needed in order to reconcile innovation and stability and construct our “possible trinity” for digital finance is regulation.***

The regulation of financial services created in the wake of the digital wave must be tailored to its specific risks. To this end, we must adhere to two principles of action.

***The first principle is an absolute guarantee of payment and transaction security.*** In the framework of its mandate to oversee the security of payment instruments, the Banque de France strives to promote innovative, effective and safe payment solutions. In this respect, it ensures that the emergence of new players and new solutions does not reduce security.

Central banks are also trying to take a proactive approach towards the digital transition, to avoid being left behind by the highly technical nature of certain innovations. For instance, discussions are underway at the Banque de France over how to monitor the development of initiatives concerning blockchain technology, both in terms of the possibilities it offers and the issues it raises notably in terms of security.

***The second principle is a proportionate adaptation of regulations and supervision to address the development of fintechs.*** The regulation applied to these new players should avoid stifling innovations that may be beneficial to consumers and, more generally, to the economy and society; but at the same time it should also guarantee consumer protection and address issues of financial stability. Specific regulations, allowing for a gradual adjustment of regulatory intensity, might be better suited to preventing the risks generated by fintech firms. I prefer to talk of “gradualism” rather than the “sandbox” approach, which is another frequently mentioned solution: when precisely should fintechs be placed inside or outside of a regulatory sandbox? Segregation may be less manageable than a process of proportionate adaptation. That said, both approaches may be combined.

Moreover, fintech companies, which mainly operate on the Internet, are not bound by borders. This raises questions as to the efficacy of regulations which are still largely domestic or based on residency criteria. The cross-border nature of technological innovation in the area of banking and financial services is a strong incentive for the regulatory authorities to coordinate their policies at the international level.

Constructing the possible trinity between innovation, stability and regulation for digital finance requires the regulator to improve vulnerability analysis, enhance the security of transactions, adapt regulations and relax supervision, while all the time remaining vigilant. More precisely, the need to adapt supervision to the specific features of fintech companies will require setting up dedicated teams to assist them in obtaining the necessary authorisations and to organise their supervision: this will be the case in France thanks to the creation of a Joint Unit by the ACPR (the French regulator for banks and payment institutions) and the AMF (the French market regulator). However, this is only the first stage. In the long run, it will be necessary to

ensure that the same rules apply to the same activities, irrespective of the players performing them. In order to ensure a level playing field, financial players must be regulated according to what they do and not what they are. Addressing the growing influence of borderless technology on the financial system will also require an international coordination effort. Such are the challenges that the public authorities will have to meet.

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**To discuss these important issues, we are extremely fortunate to have an excellent panel today, including:**

- **Mrs Sarah Dalhgren, Partner at McKinsey**, formerly Head of the Financial Institution Supervision at the Federal Reserve Bank of New York (FRBNY). Dear Sarah, your expertise in supervision, which you demonstrated through most of the financial crisis, will be extremely useful to assess the current situation of financial institutions in the context of financial innovation.
- We also have **Mrs Sandie O'Connor, Manager Director and Chief Regulatory Affairs Officer at JPMorgan Chase & Co.** Dear Sandie, you are deeply involved in your firm's regulatory strategy and your views on how financial innovation should affect regulation from the industry's point of view will be extremely valuable.
- I would also like to introduce **Mr Alain Papiasse, Deputy Chief Operating Officer (COO) at BNP Paribas**, representing the group in North America. Alain is a top market practitioner with extensive experience in both asset management and investment banking. So, dear Alain, I hope you will provide us with "insider" and complementary views on what the fintech industry can usefully bring to banks.
- And finally let me introduce **Mrs Karen Gifford, Special Advisor for Global Regulatory Affairs for Ripple**, and formerly an attorney in the private sector and at the Federal Reserve Bank of New York. Dear Karen, you have been a distinguished contributor to the *Financial Stability Review* and you will tell us about blockchain technology and its potential benefits.

Thank you all for being with us today.

Now I give the floor to our panelists.