Vitas Vasiliauskas: Opening speech - China Financial Summit

Opening speech by Mr Vitas Vasiliauskas, Governor of the Bank of Lithuania, at the China Financial Summit 2018, Beijing, 16 May 2018.

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Good morning, Ladies and Gentlemen,

It is an honour to be here today and address you in the opening session of this distinguished summit intended to discuss the opportunities that the new financial era holds.

I will start with a bright Chinese proverb, which says that ‘opportunity knocks at the door only once’. And – if you allow – I will add a European twist to it: ‘if opportunity does not knock – build a door’.

I believe that in our times, opportunity lies in novel financial technologies. And we – by this I mean both businesses and public authorities – should act decisively to capture it.

Here in China, as far as I know, the doors to innovative financial technologies have been opened quite widely. The country is one of the largest and most vibrant FinTech markets in the world. It ranks among global leaders in terms of capital investments in the industry and enjoys some of the most developed e‑payments and online lending sectors. It is thus no coincidence that one in three most successful FinTech start-ups worldwide – the so-called ‘unicorns’ – originate from China.

For businesses, FinTech allows opening new doors not only domestically, but also globally. Let’s take, for example, Lithuanian start-ups: dozens of them have taken the chance to surpass the limits of the domestic market and jump into international waters. Today we have Lithuanian FinTech firms making instant money transfers across the globe and providing international mobile payment services, with substantial attention from international investors.

In this vein, Lithuania has been pushing actively for increased FinTech cooperation within the ‘16+1’ framework, as we strongly believe that formats like this are crucial for unlocking new markets and taking most of what FinTech has to offer. We are willing to host a high-level FinTech forum for Central and Eastern European countries and China. I would be glad indeed to see your delegation next year in our capital Vilnius.

The potential of financial innovation

In terms of FinTech’s potential, I would underline three of its benefits that I find key. First, novel financial technologies may boost growth by providing additional credit sources, especially for small and medium enterprises and households. It is estimated that by 2024 the global peer-to-peer market will be worth nearly USD 900 billion – growing by around 50% annually. An impressive trend, indicating the scale of opportunities that alternative funding sources hold.

Second, FinTech may help increase financial inclusion. World Bank data shows that around 40% of the global population still do not have access to the formal financial system. At the same time we have got remarkable examples proving that technological innovations allow underbanked societies to skip the step of conventional banking expansion and move directly to the latest financial instruments, such as instant mobile payments.

And third, by digitalising the financial system, FinTech limits space for the ‘shadow economy’. Due to increased transparency, digitalisation allows authorities to curb illegal economic activities more effectively. With the amount of money laundered globally, ranging from USD 800 billion to USD 2 trillion on an annual basis, financial innovations can offer substantial gains.

I could go on about the benefits that FinTech brings, but…

I suppose there is no need to prove the obvious, so let us now move to the challenges.

FinTech calls for increased flexibility

Financial innovations alter the way the whole financial system functions. While providing better quality and more efficient services, FinTech challenges the operative models of established financial institutions. In fact, more than 80% of actors on the global market believe that their businesses are at risk due to competition from innovators. This suggests that the traditional players either have to change, or face a risk to be pushed out of the market.

On top of this, FinTech renders some of the long-standing regulatory practices ineffective. This means that regulators need to become more flexible. If they do not, they risk not fitting through the doors opened up by new technologies. To put it bluntly, without adapting to rapidly changing financial developments, regulators may find themselves sidelined and unable to meet expectations. More and more authorities across the world seem to be realising this.

Back in 2016, the UK Financial Conduct Authority was the first in the world to set up a 'regulatory sandbox'. In essence, it functions as a 'playground' for testing novel instruments before they reach the market. This is done under the guidance of the regulator, allowing it to keep up with market developments and build the necessary know-how.

In other words, such formats serve two purposes. First, they allow innovative start-ups to test their ideas and grasp the regulatory requirements. Second, 'sandboxes' enable regulators to upgrade their toolkits, aligning them with the new generation of business models and technological solutions brought about by FinTech.

In recent years, similar formats for regulator engagement with the industry have sprung up widely – from Canada to Australia. Arguably, these developments mark a shift in authorities' thinking – facilitating innovation instead of aiming to restrict it.

In this regard, the idea of developing a central bank digital currency has recently been gaining traction. The task of issuing a central bank digital currency is indeed complex and requires extensive long-term efforts. Yet it also offers substantial gains. These include increased transparency, more efficient payment and settlement systems and enhanced instruments for financial risk monitoring.

With more flexibility come new responsibilities

Nevertheless – and here I have to put the strongest emphasis – with more flexibility come new responsibilities. While becoming more open to innovations, we – I mean both industry and regulators – cannot turn a blind eye on the associated risks.

First of all – cyber risks, which, under intensifying digitalisation processes, attract elevated regulator attention. Financial institutions increasingly base their operations on novel technological solutions, such as cloud computing. This certainly brings efficiency gains. But also makes financial firms more vulnerable to hacking and malware, placing vast amounts of data and critical ICT infrastructure in a potential danger zone. Today this challenge is particularly relevant in Europe due to the ongoing regulatory shift towards 'open banking'.

It is therefore no surprise that international standard setters, such as the Bank for International Settlements, have recently become more active in this domain. As a result, today financial institutions and regulators are offered guidance – including the recent steps taken by the European Central Bank – that they can implement to enhance the level of cyber resilience. To strengthen these efforts, the International Monetary Fund has lately been putting more emphasis on cyber risks within its surveillance and policy advice frameworks.

Nevertheless, digitalisation-induced risks for the financial system stem beyond cyber threats. Financial innovations also tend to create additional room for ‘shadow banking’ to expand.

It takes time to identify and fully understand these new and often obscure financial services, sometimes revealing regulatory and supervisory loopholes. Through interlinkages with other financial institutions, this may eventually lead to a build-up of hidden systemic risk. In other words, in absence of adequate regulation, ‘shadow banking’ operations risk putting the whole financial system under threat.

In the last several years, we have witnessed an increase in scrutiny towards ‘shadow banking’ activities on a global scale. It seems that regulators are not willing to take chances and wait for a ‘Minsky moment’ to occur on the back of technological innovation. Looking from the perspective of international financial stability, this is a highly welcome and reassuring development.

Treating FinTech as an opportunity, not as a headache

So: an opportunity or a headache? Adapting the regulatory framework to ever-changing financial innovations is not an easy task. Yet instead of treating this as a problem, we should see it as an ideal chance. This is exactly the strategy that we are pursuing at the Bank of Lithuania.

A couple of years ago, our institution set out on a mission to turn Lithuania into a regional FinTech hub. The Nordic-Baltic region is known for its highly digitalised economies and financial systems. Yet Lithuania has managed to stand out as a particularly FinTech-focused and open jurisdiction. Of course, this does not undermine our core mission – to ensure stability and credibility of our financial system.

Looking into specific FinTech-supporting regulatory elements, the Bank of Lithuania is one of the few central banks globally providing direct access to its payments infrastructure for non-bank financial firms. This means that FinTechs can provide payment services across the euro area on their own, cutting out the middleman. In other words, innovative financial institutions are placed on a truly equal footing with established banks, fostering competition in the sector.

While ‘regulatory sandboxes’ for interacting with new market entrants have become quite widespread by now, we have taken a step further. Next year, we are preparing to launch a ‘technological sandbox’, codenamed LBChain. It will function as a service-based platform for cooperating with private actors both nationally and internationally. The platform’s central goal is developing and testing state-of-the-art solutions based on the emerging blockchain technology.

Being a FinTech frontrunner regionally, Lithuania also offers one of the most favourable regulatory environments in Europe. Take, for example, licensing. As we are highly speed-oriented, an electronic money or payments institution licence will be ready in 3 months – compared with roughly 12 months in most other European countries.

On top of this, we have introduced a unique ‘specialised bank’ licence, which allows FinTech firms to transform themselves into banks, but with lower capital requirements. And it is not just a Lithuanian licence that you get. It also enables FinTechs to offer their services across Europe, with basically no additional documentation or fees. Such openness and flexibility is what allowed Lithuania to take up the role of a FinTech gateway to Europe’s payments and banking sectors.

The Lithuanian doorway has been used by FinTechs from a broad set of jurisdictions. Firms with origins ranging from the US to Singapore have established presence in Lithuania. Recently, we have also been witnessing elevated attention from China. Several Chinese FinTech companies have already entered the European financial market via Lithuania, with more currently in the consultative phase. Yet there is still plenty of room inside.

Embracing the change

Dear Colleagues,

FinTech is shaking the foundations of the financial system as we know it. It is also pushing for a shake-up in the regulatory mindset. This is challenging. Yet change is never easy.

But it does offer substantial benefits. Innovations create better, more effective financial services and facilitate their provision on a cross-border basis. Under the right circumstances, this may give a new boost to globalisation, which is much-needed in the uncertain times that we live in.

To wrap up, I would like to come back to the thought that I mentioned before – opportunity knocking at the door. I am sure that the knock has already been heard – it is FinTech. And this is the very moment for us to learn to embrace it. If we do not, we risk missing out on what may be the once-in-a-generation opportunity.

Thank you for your attention.