



Banque de France conference

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**Speech by François Villeroy de Galhau,
Governor of the Banque de France**

"Financial markets: what innovations for the Paris financial centre?"

Press contact: Mark Deen (mark.deen@banque-france.fr).

Ladies and gentlemen,

Welcome to the Banque de France. Talking about innovation in the markets at the Banque de France may seem surprising given the Bank's 218 years of history. However, even if the Banque de France's tasks adhere to a long tradition, the current financial environment compels us to speed up financial innovation. We don't very often speak about these topics as they are technical and sometimes deemed austere, but they are essential to the smooth financing of the economy and also to the Paris financial centre. And so it is what we, with Nathalie Aufauvre, Alain Duchateau and the teams at the DGSO, wish to discuss at this morning's symposium. I would like to open with some thoughts on why we should speed up financial innovation and how the Banque de France is contributing.

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I – Why we should speed up financial innovation

Three major forces are at work in Europe to enhance the capital markets' ability to finance innovation:

1/ The needs of businesses

The Capital Markets Union proposed by the European Commission should channel the savings surplus available in Europe towards **equity** financing, which is more favourable to innovation than debt financing. The euro area has an advantage: a EUR 400 billion savings surplus. But it also faces a challenge: equity financing in France only represents 74% of GDP, against 125% in the United States.

2/ Brexit

Capital market integration in Europe is even more essential given the prospect of Brexit. Brexit is, and remains, bad news not only for the United Kingdom, but for Europe as well. It does, however, represent an opportunity to restructure the European financial system. There will not be a single City for the continent, but instead an integrated polycentric network, with specialisations based on area of expertise.

In this respect, the Paris financial centre has numerous advantages to become a major hub for innovation financing in Europe. We have seen lots of positive signs with regard to the future hosting of major global banks' market activities. France is already the leading investor in private-equity funds in continental Europe. France has four of the euro area's eight systemic banks. France's asset management sector, with EUR 4,000 billion under management in the country, comprises 11,000 investment funds and 630 asset management

firms, including Europe's leading asset manager. As for post-trade services, a vital cog in the financial industry, France is also one of the market leaders: one-third of the 55,000 European funds are controlled by French depositaries, three of which feature among the world's top 10 depositary service providers.

3/ Technological developments, with big data today, and artificial intelligence and blockchain to come

We are witnessing an unprecedented acceleration in technological innovation with the capacity to process substantial volumes of data. These developments have a particular impact on the financial industry, which has always been a pioneer in the use of new technologies. Obviously, this is not without risk: cybersecurity, ethics and financial stability are all concerns. And we remain attentive to these risks, but we also need to be watchful that they never prevent us from striving to progress.

Why is **the Banque de France** involved in financial innovation? Because we are at the crossroads of a European choice and a national ambition. The European choice is that of a federal Eurosystem, with a single monetary policy that is naturally decided centrally but whose implementation is decentralised at the level of each national central bank. The national ambition is to be the central bank for markets within the Eurosystem. For the Banque de France, this is a tradition recognised over the 20 years of the euro, backed by its high-quality teams, and is the first of our Ambitions 2020 strategic plan commitments. This is a win-win situation: for the Eurosystem – which will benefit from many of these innovations – but also for the French economy and the Paris financial centre.

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II – How the Banque de France contributes to innovation

I would like to illustrate our commitment with five examples of this "central bank for the markets" that we take pride in, which you will come back to further as the morning progresses.

1/ First, the reform of short-term securities in June 2016 gave rise to the market for NEU CP (Negotiable European Commercial Paper) – formerly referred to as *certificats de dépôts* – and NEU MTN (Negotiable European Medium Term Note) – the old *billets de trésorerie*. This market is important to economic players as it gives them access to liquidity in euro in the euro area. Two years after the reform, we can safely say that it has been a genuine collective success: with the entry of new issuers, outstandings increased by almost 16% from

around EUR 291 billion in June 2016 to EUR 338 billion at the end of April 2018. The reform acted as a catalyst for other important innovations.

The NEU CP market has robust infrastructures, a diverse range of players and a high level of transparency. It should continue to be modernised to reduce costs and improve services. Therefore, the Banque de France has undertaken a major project to digitalise the service offered for access to the market – the NEUSGATE project –, which will be carried out in partnership with the Paris financial centre. And the innovations do not end there: in particular, platforms are being introduced to smooth the exchanges between intermediaries, issuers and investors.

2/ For the Banque de France, being the central bank for the markets also means supporting initiatives to develop a single market for collateral in the euro area

Today, cash can virtually be transferred instantly from Dublin to Rome, but not securities. We need to work within the Eurosystem to speed up collateral circulation in the euro area and to bring together a larger number of players; in particular, further opening the collateral market to asset management players comes to mind.

We also need to see the development of an electronic trading tool with advanced functionalities; for example to facilitate the exchange of individual securities against standardised collateral baskets, or even liquidity in dollars against standardised baskets of euro-denominated securities. Furthermore, we have to be able to execute these exchanges in a fully automated manner, either applying a tri-party approach, under the legal framework of the repurchase agreement as is the case at the moment, or directly in a "security against security lending" mode as employed in bilateral transactions. In order to ensure the security of transactions, a clearing solution will have to be made available to those participants who require it.

Such a tool is no longer simply in the project phase but is now a reality. The Elixium platform launched its operations in the Paris financial centre on 14 May 2018 with an initial trade of EUR 750 million to which the Banque de France was a counterparty.

With the current support of banks and Euroclear, and the future participation of LCH SA and asset managers, we are forging ahead with the development of a new collateral management ecosystem in Paris, which, with EuroGC+, has already had a tri-party repo clearing solution in place since 2015.

3/ The central bank for the markets, also in terms of the implementation of asset purchase programmes (more than EUR 2,400 billion of public and private assets acquired by the Eurosystem)

The Banque de France is innovating in this respect by regularly carrying out **reverse auctions** for the purchase of securities issued by supranational bodies and French public agencies. Thanks to this mechanism, the execution of purchases complies with the principle of "market neutrality": these auctions have allowed us to meet our purchase targets while respecting the liquidity of each market segment. The Bundesbank has since used this reverse auction mechanism to acquire securities issued by German public agencies.

With regard to the repo market, the Banque de France was also the first to put in place, as of July 2017, a unique daily auction system to lend French government bonds to its market counterparties against cash collateral. This scheme has done much to help improve the functioning of the securities lending and borrowing market, particularly at quarter-ends when the system is particularly called upon. These auctions have just been successfully expanded to securities lending transactions and we intend to unfurl lending by auction to the entirety of our portfolio acquired within the framework of the PSPP in the very near future.

4/ A more directly technical type of innovation: IT infrastructures

The Eurosystem has developed its Vision 2020 programme, comprising instant payments (TIPS – TARGET Instant Payment Settlement), the T2-T2S consolidation, and the ECMS (Eurosystem Collateral Management System).

The Banque de France, alongside the German, Italian and Spanish central banks ("4 CB"), plays a key role in the development and operational management of these Eurosystem platforms. Here too innovation is thriving.

The implementation of the **instant payment settlement service** is planned for November 2018. It aims to harmonise the different national systems already in operation and facilitate communication between them.

The **T2-T2S consolidation** should optimise and enhance liquidity management and cash and securities settlement services, using – for securities settlement – technology developed by the Banque de France, which allows a maximum number of transactions to be settled with a minimum amount of securities and liquidity resources.

The **ECMS** (European Collateral Management System) project will provide a unified platform developed by the Banque de France and the Banco d'Espana for the management of standard monetary policy operations and the associated collateral. It will contribute

significantly to the unification of capital markets within the euro area and the harmonisation of market practices, over and above monetary policy activities alone (tri-party collateral management, securities transaction management, etc.) and drives a process of simplification for monetary policy counterparties with its identical access conditions and streamlined cross-border collateral management.

5/ From IT to new technologies

In the field of **blockchain** technology, the Banque de France launched an experiment involving the example of a relatively simple reference, the SEPA Creditor Identifier (SCI). After testing a prototype, we approached the French Banking Federation in July 2016 and proposed that it work on the project and involve other institutions on a voluntary basis.

The Banque de France was the first to go into production on 15 December 2017, and was joined in April 2018 by two institutions belonging to the Crédit Mutuel group. Other banks will join this blockchain in 2018, representing in total more than 60% of identifier requests.

Thanks to this technology, identifiers are attributed immediately, online, whereas in the past, institutions had to wait up to two weeks to receive them. Above all, though, the project allowed participating banks to better appropriate blockchain technology.

For the Banque de France, this represents a profound shift in its data management methods: from being the "owner" of the identifier reference, we have evolved towards a governance model of "co-ownership" with the institutions participating in this interbank blockchain.

As far as I am aware, this project is also the first blockchain to be put into production by a central bank and we are now investigating which other services could be shared with the participating banks. Expanding the pilot project is more straightforward.

This morning, you will also discuss the technological revolution in the **foreign exchange market**. Ten days ago, on Monday, 14 May 2018, the Banque de France published its statement of commitment to the Foreign Exchange Global Code of Conduct and invites the participants in this market to do the same.

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I would like to conclude by drawing your attention to a coincidence of timing: on Tuesday, the Banque de France inaugurated its new Lab, which aims to combine central bank activities with new technologies and experiment with new solutions. So welcome to the central bank for markets to all of you – all stakeholders in financial innovation. We will continue to

supervise you and monitor you – it's our duty – but equally, we are and will continue to be your partner, and even more than that, one of your strengths. I wish you an excellent morning and thank you for your attention.