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Europe in a disruptive world

Opening address by François Villeroy de Galhau,

Governor of the Banque de France

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

Ladies and Gentlemen,

It is a pleasure to be here today to open this International Financial Forum on "Europe in a disruptive world". We are in 2018, in Paris. But let me first go back several millennia, and to Mesopotamia. The invention of writing was certainly one of the most stunning breakthroughs in the history of humanity, and in terms of accessing and spreading knowledge. This was precisely what we can call a real *disruption*. So, the French philosopher Michel Serres often compares our time of digital revolution to the invention of writing. In my remarks today, I wish to stress that we are now at a turning point: we are living the end of a cycle of restoring order after the financial crisis; and we are witnessing the emergence of another cycle of disruption in Europe.

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I. <u>The end of a cycle</u>

The issues that have dominated the post-crisis era – strengthening financial regulation and implementing non-standard monetary policy measures – are progressively coming to an end. The very welcome finalisation of Basel III – to be integrated in the European legislation in a timely manner – concludes a decade of regulatory efforts on the banking system. We are obviously not done yet. Above all, two priorities remain on the agenda: first, the European review of the Solvency II directive on insurance; the main challenge will be to better reconcile prudential requirements with increased investment in equity and infrastructure. Let me say it clearly: revision cannot mean the status quo. The second priority is the regulation of shadow banking, and first and foremost its liquidity. Indeed, the regulatory priority is no longer the solvency of banks, but the liquidity of non-banks.

In the euro area, economic growth and inflation have been successfully supported by our unconventional monetary policy measures. GDP per capita and employment have overtaken their levels of 2007. The ECB Governing Council is now implementing its strategy of gradual and predictable normalisation. Net asset purchases should end in December; the first interest rate rise could take place at the earliest through the summer of 2019 depending on the inflation outlook. That said, monetary policy shouldn't remain the only game in town, and the euro area should equip itself with other economic instruments. A stronger economic Union is an efficient combination of private risk-sharing – Banking Union plus Capital Markets Union – and public risk-sharing – strengthened ESM plus Budget.

The progressive end of this “restoring” cycle means that the focus of our dialogue between the financial industry and the public authorities will shift. It will be less on our well-known mantras: are capital requirements too high? Are interest rates too low? And we will hopefully focus more on the issues of tomorrow. Let me, at the start of this new cycle of disruption, elaborate on three challenges: a new financial constellation in Europe; new needs and new players; new technologies and hence new regulations.

II. The beginning of another cycle?

The first challenge is the emergence of **a new financial constellation in Europe**. Brexit is, and remains, bad news not only for the United Kingdom but also for Europe. Achieving an agreement is highly desirable to protect prosperity on both sides of the Channel: The latest efforts seem to be moving in that direction. Brexit will, however, lead to a restructuring of the European financial system. There will not be a single City for the continent, but rather an integrated polycentric network of financial centres, with specialisations based on areas of expertise. This structure needs to help to improve the circulation of the abundant savings in the euro area – a surplus of over EUR 400 billion – channelling them more towards equity financing and innovation. The Capital Markets Union in Europe – and what I more broadly call a “Financing Union for Investment and Innovation in Europe” – is even more essential given the prospect of Brexit.

In this new environment, the euro area must keep control of the risks regarding euro-based transactions. Some financial market infrastructure located in London will soon become off-shore to the EU. Reducing the dependencies vis-à-vis such infrastructures is vital for the EU both in terms of financial stability and the transmission of monetary policy. This is the reason why the Commission proposed a location policy for CCPs, as part of the revision of the European Market Infrastructure Regulation (EMIR). We – like Germany and most Member States – strongly support this. It is under discussion at the European Parliament and Council. We also need to ensure that critical actors do not become too big to fail: a monopoly for clearing activities serving the European financial market should be excluded. The example – and success – of the development of a competing CDS clearing offer in Paris demonstrates that it is possible to break a monopoly if there is a convergence of wills between players.

In this respect, Paris has numerous advantages to become a major hub for innovation financing in Europe. France has four of the euro area's eight systemic banks. Besides, with EUR 4 Trillion under management in the country, France's asset management sector includes Europe's leading asset manager. The French insurance sector represents more than one third of the insurance sector of the euro area. I observe that beyond the legal decisions concerning European structures, an ever-growing number of international banks are choosing to transfer the majority of their market activities to Paris. Paris has all the qualities necessary to become the market hub of this new constellation in the euro area.

2/ Second challenge: **new needs and new players**. Banking activity, as we know it, with deposits, savings and loans, will remain key. But the **payment industry**, for instance, is constantly evolving, notably with Fintechs. In the past, payments were looked at as a technical, back office matter. No longer. We can identify three major trends: first, instantaneity of payments "anytime anywhere"; dematerialisation; and finally dissemination – a host of players entering the market. Against this backdrop, there is a need to develop a genuine European industrial strategy, and European players, within a harmonised and competitive framework. And the related business model here is obviously different, based no longer on intermediation margins or services fees, but on the value of data, to which I'll return later.

Another growing need is **equity financing** in Europe: this is crucial in innovative economies. Equity financing is better suited than debt financing to the uncertain and often long-term returns associated with innovative projects. Corporate equity in the euro area only represents 74% of GDP, against 125% in the United States. The EU venture capital ecosystem is still lagging behind that of the US. In 2017, venture capitalists invested about EUR 9 billion[i] in the euro area, compared to EUR 60 billion[ii] in the US. Moreover, capital funds in the US are on average three times bigger than European ones[iii]. As a result, above a certain amount, European start-ups have to find their financing abroad, mostly in the United States. In this respect, France is closing the gap. In 2017, the French VC ecosystem overtook that of the UK by number of VC-backed rounds and is expected to thrive in 2018.

Last, we also have to promote the financing of **green and low carbon investments**, while taking into account climate-related risks. To this end, the Banque de France has successfully initiated the Network of Central Banks and Supervisors for Greening the Financial System (NGFS) that is already bringing together 21 central banks, supervisors and international organizations.

3/ Let me now turn to the third challenge of this new era: **new technologies** implying **new regulations**. It goes without saying that French Tech is a strategic priority for Paris: take for example the recent opening of the Station F start-up campus. But it is not only – not mainly even – a question of Fintechs: it is potentially one of Big Techs – the huge data platforms based in the US or in China –; and it is certainly a question for the existing large financial institutions. These incumbents now all agree that the digital revolution is their overriding and even existential challenge. The ability of financial institutions to retain customers, from branches to the smartphone, has been particularly put to the test. The response must come first of all from the institutions themselves. But regulations must also adapt: "same activity, same regulation" of course, and the Big Techs will have to apply the same rules as banks and insurance companies if they start to perform the same regulated financial activities.

That said, the challenge for supervisors extends beyond financial regulation alone; the challenge is how to apply to all players, in a fair and proper manner, regulations in three broader areas: data protection, monitoring competition and concentration, and cyber-security. Data protection is strengthened by the entry into force of the General Data Protection Regulation on 25 May. Competition is increasingly challenged by “the winner takes all” situations. Cyber-security will be one of the priorities of the French presidency of the G7 next year. The only way to meet these three challenges – data protection, antitrust, cybersecurity – is through a much stronger international cooperation. However, when adapting to the digital revolution, no one should expect that these necessary regulations will protect existing situations. Innovation is naturally the only effective response.

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To conclude, let me quote a sentence often attributed to Albert Einstein: “Creativity is contagious. Pass it on.” We, at the Banque de France and at the ACPR, do not claim to have the genius of Albert Einstein, but we have a strong desire to foster innovation. The ACPR Fintech Innovation Unit and its task force on artificial intelligence are a good illustration of these efforts. But it goes far beyond this: the Banque de France is committed to be one of the best central banks for markets within the Eurosystem. Our expertise is recognised, and supports the Paris financial centre. We will continue to supervise 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. Thank you for your attention.

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[i] https://blog.dealroom.co/wp-content/uploads/2018/02/Dealroom-2017-vFINAL.pdf

[ii] https://www.statista.com/statistics/277501/venture-capital-amount-invested-in-the-united-states-since-1995/

[iii] http://europa.eu/rapid/attachment/MEMO-18-2764/en/Factsheet%20VentureEU.pdf