Denis Beau: What policy framework to help building innovation and growth into Europe's capital market?

Speech by Mr Denis Beau, First Deputy Governor of the Bank of France, at the AFME (The Association for Financial Markets in Europe) Annual Capital Markets Technology and Innovation Conference, Paris, 21 November 2019.

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Ladies and Gentlemen,

The past decades have clearly shown how innovation – in particular technological innovation – have brought new services, reduced barriers and contributed globally to progress and economic growth.

However, innovation does not necessarily implies growth for everyone, everywhere. Innovation can weaken some actors, create imbalances and its long-term benefits for society may be, in some cases, uncertain. In addition, I would say that speaking solely about growth is not enough today, in the context in particular of climate change and lowering social mobility. Growth should be **sustainable, inclusive** and compatible with a necessary level of **resilience**.

Here Central Bankers and Supervisors, in charge of financial stability, have a contribution to make. But what does that mean in the European context for the innovation and growth of our capital markets? My perspective on this rather complex issue is simple: **we have to identify clearly the challenges raised by innovation and be ready to adapt our policy framework if we want that innovation goes with sustainable, inclusive and resilient growth of the European financial market**. To support my point, I would like first to explain how we at the Banque de France and the ACPR approach this twofold issue (identify the challenges and adapt when necessary our policy framework) **(1)**. I will then illustrate our approach by addressing the case of financial market infrastructures **(2)**.

1. Identify the challenges and be ready to change our policy framework

Technological innovation has the power to create new services for consumers but also to reshape financial market structures. I will not elaborate on a phenomenon that everybody can see developing in the financial sector. **The whole value chain is being impacted by Fintechs as well as by Bigtechs**, which are introducing almost every day new ways to pay, to provide credit, to get insurance and, of course, to invest within capital markets. **By doing so, they are also modifying the financial ecosystem that we supervise and may contribute to an increase or a shift of risks in the financial system.**

Data and consumer protection issues raised by new technologies, anti-money laundering challenges posed by new usages, operational risks specific to third party providers and cloud outsourcing, including cyber-risks, competition impacts: the list of issues is quite long! I should also mention **the systemic threats that large actors can represent if they use their huge consumer base and leverage on worldwide networks effects without sufficient regard for financial stability consequences**.

Facing these changes, Central Banks and Supervisors need to adopt the right mindset. In my view, they should not take the current regulatory framework for granted and operate under the assumption that this framework, which was mainly designed before the technological « disruptions » we see currently spreading through the financial system, does not need to evolve. On the contrary, to continue delivering well on their financial stability mandate, through their three classical roles, namely as catalyst, supervisor and service provider, they should aim first at promoting the necessary regulatory adjustments so that the ultimate goal of financial stability is well preserved. In other words, we should contribute to providing the market with **a sound, adapted and updated regulatory framework**, **which is, in my opinion, needed to support innovation, and even to foster it**.

To deliver on such a contribution, **an open-minded approach and an in-depth understanding of innovation is required. To that end, we need to engage with innovators, observe the ecosystem, test and learn.** I think it is fair to say that the global central bank and supervisory community is heading in that direction as testified by the recent launch of the BIS innovation Hub. **In any case, at the ACPR and the Banque de France, it has been our motto for a while, according to our digitalization strategy.** It is indeed in this spirit that we set up in 2016, within the supervisory authority (the ACPR), a dedicated Fintech-Innovation Hub to have a direct contact with innovators and anticipate the effects of innovation trends. In addition, Banque de France has launched in June 2017 "Le Lab". Le Lab is a genuine Open Innovation laboratory: its goal is to bring new practices and technologies into our activities, and to that end experiment where necessary within short and flexible cycles. To do so, it works in close collaboration with innovative firms. And, we launched this year our first "suptech" program to promote the use of artificial intelligence in the performance of supervisory tasks.

To illustrate how we can leverage on the daily contact with innovators, to help changing regulation or defining supervisory expectations, I will take the example of the on-going work on **artificial intelligence** by the ACPR Fintech team. When the ACPR published their report on AI in 2018, we made it clear that the purpose was not to regulate *ex ante*, with a risk of hindering a promising technology. However, **it seemed to us important to raise at an early stage the key issues of governance, ethics, auditability and explainability, in order to promote a sound development of AI in the financial sector**.

And the Fintech team did not stop there. They have been conducting experimentations with voluntary financial institutions or providers to explore these issues further, on a few significant AI use cases (AML-CT, internal models and consumer protection). Bilateral meetings were complemented by tests in real conditions, where ACPR experts and data scientists from the Banque de France were able to run algorithms, modulate parameters, test new population samples or compare different models. This concrete type of approach will give our experts a vision of the diversity of cases and thus the maturity necessary to provide the market with relevant and operational guidance.

Obviously, all this work shall be considered as a contribution to the evolution of a more global framework – at European and international level.

The European level is of course the most relevant one to promote innovation for financial services in the single European market. The success of the two payment services directives (PSD1 and PSD2) clearly illustrates how European legislation can identify new trends, trigger innovation and create a true momentum in the Fintech ecosystem. More recently, the GDPR provided the European Union with a clear framework for data protection and circulation: this regulation is now a reference for many third countries, which identify the risk that unregulated data exploitation can pose to consumers' confidence.

However, the European market cannot be considered in isolation and this will remain the case in the post-Brexit era. Innovation – and growth – benefit from open ecosystems. Risks in a digitalised world do not recognize borders. Ensuring a better coherence of national (or regional) regulatory frameworks in the world is therefore a key element for their effectiveness. **Cross-sector and cross border cooperation is necessary.** Our initiative for a G7 cyber-attack simulation exercise or our contribution to the G7 working group on global stable coins are two recent examples of our commitment to this necessary worldwide cooperation.

2. Focus on financial market infrastructures

Let me now focus on the case of market infrastructures to illustrate how the mindset and tools I have just described can also feed into the way we perform our roles, and in particular our role as service provider.

From the first-generation of the Target system twenty years ago, **the Eurosystem has demonstrated a strong political will to foster innovation and support capital markets integration and development**, through the provision of clearing and settlement services in central bank money for financial intermediaries. These services, namely T2 and T2S, have established themselves as the backbone of the financial market infrastructures for the euro.

More recently, the Eurosystem has developed its Vision 2020 program comprising:

- TIPS, an instant payment solution, launched in November 2018 to settle instant payments ;
- the T2-T2S consolidation to optimize and enhance liquidity management and cash and securities services planned for 2021 ;
- last but not least, the ECMS (European Collateral Management System) planned to be launched in 2022, and designed to provide a unified platform for the management of standard monetary policy operations and the associated collateral.

These are European successes and ambition. Nevertheless, **we have to address new challenges.**

In the recent years, there has been a strong demand for quick and safe cross-border payment solutions, available 24/7, enabling smooth exchanges. In Europe, various domestic instant payment solutions have emerged in a certain number of countries, available 24/7, settling retail payment orders up to 15 000 euros in less than 15 seconds. However, **cross-border payment solutions are still costly for end users, slow and unsafe across the world, in particular in emerging countries**.

Regarding the wholesale infrastructures, they still present various shortcomings, as market infrastructures are not interoperable around the world. The correspondent banking model is often considered as the only solution to transfer money across borders, but it is also costly, and lacks traceability and efficiency. The perimeter of the AML/CTF and KYC checks is in some cases uncertain for the counterparties of a payment order.

The tokenisation of financial assets combined with the recourse to blockchain-based solutions and more broadly Distributed Ledger Technologies to store and transfer those assets could help answering market's demands. At the same time, they could help remedy the current limits of the existing wholesale market infrastructures by exploring new avenues. The implementation of those innovations could have an important impact on the financial industry in particular to facilitate gross and simultaneous Delivery-versus-Payment processes, cross-currency settlement, resilience, and recovery from operational incidents.

The risk there is that such developments lead to disorderly approaches and heterogeneous adaptations of market infrastructures, in particular when it comes to the modalities of settlement. Several initiatives or projects are in effect considered by the industry in the post-trade area, pointing to the role central banks could play in this regard, as they have done in the past.

Therefore, **the Eurosystem, as a major provider of critical wholesale clearing and settlement services in euro, should be open to experimenting these innovations in**

order to revisit and possibly improve the conditions under which we make available central bank money as a settlement asset. We, at the Banque de France, have started gaining exposure and experience with those innovations and in particular DLT. We were the first central bank to develop, regarding the specific use of SEPA creditor credentials, a decentralised register system based on a blockchain infrastructure, the “MADRE” register. Of course, this is only a first step, which does not exhaust an extremely vast and diversified field of experimentation. One possibility often mentioned would be for us to issue a central bank digital currency to support wholesale clearing and settlement services on a decentralised basis using DLT. **We, at the Banque de France, are therefore quite open for experiments in that direction, together with the ECB and other central banks of the Eurosystem, in particular with regard to a wholesale Central Bank Digital Currency.**

Another operational contribution, which could be worth considering – and experimenting – by central banks, is related to one of the major failings of the current payment systems, which is cross-border retail payments. One solution to the weaknesses of private initiatives in the field of cross-border payments could be to interconnect these systems. It is technically and legally feasible for a given area, for example, in the euro zone. However, at the global scale, between systems of different areas, it is more complex, in particular when several currencies are involved. Central banks through their operational role could look for ways to contribute to the emergence of a solution to promote faster, more reliable and less costly payment solutions.

Conclusion

To conclude, let me underline that technological innovations create opportunities and risks, and therefore challenges, not only for financial intermediares but also for public authorities. Central Bankers and Supervisors can and should contribute to meet those challenges. **To that end, we should have an open-minded approach and develop an in-depth understanding of innovations currently spreading through the financial sector. This is critical for our capacity to help delivering a sound, adapted and updated regulatory framework supporting innovation, mitigating adequately their inherent risks. This is also critical for our capacity to adapt the performance of the different roles we play to fulfil our financial stability mandate.**

This is the reason why we are, at the Banque de France and the ACPR, determined and ready to further engage with innovators, be they financial sector incumbents or new comers, observe the ecosystem, test and learn.

Thank you for your attention.