

# How to ensure the good functioning of our payment system in the digital age?

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## France Payments Forum

9 November 2021

### How to ensure the good functioning of our payment system in the digital age?

#### Closing speech

Denis Beau,  
First Deputy Governor

#### Introduction:

- The landscape of payments and market infrastructures is undergoing a transformation as a result of the changing payment expectations and habits associated with the digitalisation of our economies, the implementation of new technologies such as distributed ledger, the emergence of new players such as fintechs and bigtechs, and the increasing use of new settlement assets such as crypto-assets.
- The health crisis and the resulting social distancing have contributed to accelerating these changes. For a central bank such as the Banque de France, which is responsible for ensuring the smooth functioning of our payment system, this acceleration has made it all the more necessary for us to be vigilant with regard to the attendant opportunities and risks.
- Against this backdrop, I would like to share with you some observations on the changes in risks associated with this transformation, and the implementation of the three-pronged strategy - regulation, facilitation and experimentation - that we are pursuing to mitigate them.

#### I) Changes in risks

1- Thanks to the rich and diverse ecosystem, innovations in the payments field are currently flourishing. **These innovations, and in particular the use of distributed ledger technologies (DLT) have the potential** to significantly improve the functioning of our payment system, in particular by making payment means simpler, easier and cheaper to use, and faster if not instantaneous.

- these innovations also **entail the risk of setbacks, particularly in terms of efficiency**. As they develop and spread, two risks might become more significant:
- **the risk of fragmentation** if the coexistence and interoperability between existing and new systems is not managed;
- **the risk of concentration**, or even the emergence of **monopolistic situations**. This latter risk stems from the growing interest of global digital giants in digital payment services. Thanks to their huge user bases and expertise in end-to-end technology, **bigtechs have the potential to pose a major competitive threat to European payment system players**, who are less experienced in the digital sphere. They could also **increase Europe's reliance on foreign players for payment services, with all the data privacy and sovereignty challenges that this entails**.

2- On the security front, there are also a growing number of major concerns. **Prior to the health crisis, the risks to monetary sovereignty and financial stability associated with the large-scale use of stablecoins by bigtechs had been clearly identified. With the crisis and the acceleration of the digital transformation, IT risk has also taken on a new dimension. Indeed, the digital transformation considerably increases financial system participants' potential exposure to cyber-threats, and hence their vulnerability to this risk.** This stems in particular from their internal transformations, which rely in large part on the development of open-platform IT systems and on greater use of outsourcing, especially via the cloud.

**The public health crisis has significantly amplified this exposure:** the widespread use of remote working has been accompanied by a massive roll-out of new collaboration tools and new software. This (sometimes hasty) deployment of third-party software and new methods of labour organisation has raised the overall vulnerability of the financial sector.

**The need for vigilance is being even further heightened by the fact that cyber-attacks are constantly evolving and are becoming increasingly sophisticated.** On a technical level, this phenomenon can in part be explained by the diffusion of "turnkey" hacking tools and a general increase in computer skills. On an economic level, the huge financial rewards to be gained from attacks is leading to a surge in the number of potential hacking targets. Fortunately, the levels of payment fraud remain under control, as shown by the figures from the *Observatoire de la sécurité des moyens de*

*paiement* ("OSMP" - Observatory for the Security of Payment Means). In 2020, the fraud rate for payment cards remained stable at 0.068%, the fraud rate for credit transfers was very low (one euro of fraud for EUR 120,000 worth of transactions), and the fraud rate for direct debits fell sharply, to one euro of fraud for every one million euro transactions. However, during the crisis, fraudsters have demonstrated their ability to constantly adapt and seize the slightest opportunity: now that strong authentication is widespread, fraud involving manipulation of the payer, such as technical support fraud, is on the rise, and the greatest vigilance must therefore be maintained

**II) In order to address the increase in these risks, the Banque de France is working on three complementary areas: regulation, facilitation and experimentation.**

**1- The first area is very important in our view, because the smooth functioning of our payment system depends on a regulatory framework that is clear, fair ("same activity, same risk, same rule") and balanced,** i.e. capable of both encouraging innovation and maintaining the stability of our payment system.

It is against this background that we have welcomed and are supporting the proposed **Markets in Crypto-Assets (MiCA)** regulation and the **Digital Operational Resilience Act (DORA)**, presented in September 2020.

Nevertheless, the discussions on these proposals illustrate **the need to bring together the knowledge, the operational realities of professionals and the general risk management objectives** in order to achieve the **balance between innovation and financial stability** that I mentioned previously. From my perspective as a central banker and supervisor, there is still progress to be made on these texts in order to reconcile pragmatism and flexibility with the necessary requirements in terms of risk control and the prevention of regulatory arbitrage. DORA should allow for better supervision of large technology players, such as specialised cloud computing and electronic payments firms, but it only aims to regulate the emergence of new digital players in the areas of operational and cyber-risk.

This is why a **targeted review of the regulatory framework for payment services would also be advisable**. Firstly, for simplification purposes: through merging the prudential regimes applicable to PIs and EMIs, where the differences have become less significant and clear due to the advent of digital technology. Secondly, to strengthen the framework, via the introduction of liquidity requirements and rules to enable supervision on a consolidated basis, which are currently lacking in the prudential monitoring of these institutions. Moreover, other regulatory changes will have to be introduced which are also very important. I'm referring in particular to the **supervision of the development of decentralised finance**, where the usual regulatory frameworks are constrained by the fact that issuers and service providers are not easily identifiable in an environment where protocols are automatically executed without intermediaries, and there is no fixed jurisdiction for the services offered. In this case, the regulator could designate, on the basis of a set of indicators to be determined, the players that maintain control over applications that fall within the scope of decentralised finance, as responsible entities, and subject them to specific regulation. Conversely, where no player is identifiable, the regulator could consider a risk-based approach, and introduce disincentives that aim to discourage the exposure of financial players to decentralised finance.

Assuming that these players in decentralised finance and/or bigtechs continue to gain ground in the financial sector, we must also ensure that they do not become players of systemic importance in this sector without having to apply for authorisation. Such a scenario would leave the supervisors with no power to act while the other regulated entities, banks in particular, increasingly dependent on these players to whom they would have had to cede a large share of the value chain, would bear the full weight of regulation and risks on their balance sheet, without having the full capacity to properly manage these risks, which are in fact decided on by their partners.

**Lastly, in order to be effective, regulation must be multidimensional and coordinated at national and international level.** At the Banque de France, we are very attached to coordination with other national and European regulators, which seems all the more essential given the increasingly cross-cutting nature of the issues. This is also a priority for us, to limit regulatory arbitrage or indeed prevent it altogether. For this reason, **we are closely involved in the work of multilateral fora** (G7, G20, FSB, CPMI), **especially on crypto-assets and the improvement of cross-border payments**.

**2- However, adapting the regulatory framework does not, on its own, address all the challenges posed by financial digitalisation. We firmly believe, at the Banque de France, that to help meet these challenges, we also need to play an active role in innovation.**

- For us, becoming part of the European innovation ecosystem means, first and foremost, committing to helping initiatives that can create a diverse and competitive market for efficient solutions, tailored to user needs. Our institutions – such as the Banque de France's Lab, its Infrastructure, Innovation and Payments Directorate (DIIP), the ACPR's Fintech-Innovation Unit, with its ACPR-AMF Fintech Forum – are fully mobilised to facilitate these initiatives and help them grow.
- Among these initiatives, three in particular are worth highlighting. First, those in the field of instant payments, which open a new chapter in the payments industry. Second, the continuing development of open banking, thanks to the European financial sector's work on APIs. Last but not least, the European Payments Initiative (EPI) which will provide European citizens with a pan-European solution for everyday payments, via both a payment card and a smartphone, covering all retail use cases. With some major decisions scheduled to be taken in the coming weeks about EPI, I would like to remind you here that the Banque de France fully supports this initiative, alongside the other Eurosystem national central banks and the European Commission. We are counting on you all, as participants in the financial ecosystem, to make this unique opportunity for European payments into a reality.
- Lastly, as regards the initiatives and experiments on a central bank digital currency, which are another way for central banks to be innovative players, several central banks have begun working seriously on the idea of issuing a CBDC, if it were to prove necessary, to preserve the **anchoring role of central bank money in the digital era**. This is a major issue given the trend towards the digitalisation of financial markets and payments, and the emergence of new, non-bank players in financial intermediation.
- At the Banque de France, we are convinced of the benefits of **taking an experimental approach to a CBDC**: we are currently in the process of **finalising our programme of experiments on an interbank or "wholesale" CBDC**, to test **whether and how** it could improve the performance, speed, transparency and security of transactions between major financial players, especially for cross-border payments.
- The main lessons learned from this programme were presented yesterday. I would like now to highlight three of them:
  - A CBDC circulating as tokens on a distributed ledger ("tokenised") could improve the efficiency and speed of financial securities settlements by providing end-to-end processing from purchase to transfer of ownership, thereby generating capital and liquidity savings;
  - These gains could be particularly beneficial for cross-border payments, including multi-currency payments, which are currently time-consuming and expensive. Distributed ledger technologies could facilitate the interoperability of CBDC systems between different jurisdictions;
  - However, interoperability must be ensured at several levels: between the current infrastructures in which transactions between banks are settled today and future DLT-based systems: this will require effective coexistence to ensure a smoothly functioning integrated market, as well as between

the DLT technologies used, in order to ensure the long-term sustainability of any systems deployed in the future.

These lessons clearly show that central banks' work on a wholesale CBDC and the subject of interoperability between CBDCs must therefore continue.

- In parallel, the Banque de France **is closely involved in the investigation phase for the retail digital euro**, for use by the general public in everyday payments, and which the Eurosystem decided to launch in July, and about which Ulrich Bindseil talked earlier today.

**To conclude**, I would like to share with you this last observation: to meet the challenge of the digital transformation of the financial sector towards greater efficiency and stability, we feel it is vital **to ensure that public and private initiatives complement each other and are properly coordinated, in order to support the innovation ecosystem and safeguard the stability of the financial system**. It is in this spirit that we intend to continue developing our initiatives.

Thank you for your attention.

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SPEECH | DENIS BEAU, SOUS-GOUVERNEUR DE LA BANQUE DE FRANCE

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