Introduction

Ladies and gentlemen, good morning.

It is a pleasure to open this conference celebrating the 20th anniversary of the FSI. Over those 20 years, the FSI has been a key instrument for the BIS to accomplish its goal of promoting financial stability through international cooperation. In particular, the FSI has contributed significantly to capacity-building in central banks and supervisory authorities worldwide, helping them strengthen their financial systems.

The establishment of the FSI in 1999 was the result of a joint proposal made by the BIS and the Basel Committee on Banking Supervision in response to G7 leaders’ call to strengthen financial stability worldwide after several crises that took place earlier that decade. At the time, the initial idea was for the FSI to assist countries with the implementation of the Core Principles for Effective Banking Supervision and to gradually broaden the scope of its activities with time, but always with a focus on helping jurisdictions in their pursuit of financial stability.

Twenty years later, much has happened that has affected the landscape of the global financial system and shaped the FSI that we have today. For example, the institutional architecture for financial sector oversight has changed markedly. We have seen a pendular movement in which supervisory authorities in some jurisdictions have been separated from the central bank, and then reunited with it after the crisis. In some cases, this was accompanied by an expansion of the roles played by the central bank to include, in addition to microprudential supervision, macroprudential and resolution functions. More recently, central banks and supervisory agencies have also been asked to contribute to other policy objectives such as financial innovation, financial inclusion or even environmental protection.

This trend shows how potential synergies across policy objectives have gained relevance in the design of the institutional architecture. Yet a plurality of objectives within a single agency could generate policy conflicts that may not always be solved in a socially optimal way. Moreover, the accumulation of power within a single agency may be used as the basis for challenging the independence of central banks vis-à-vis elected officials.

Let me touch upon those issues in the rest of this talk. In particular, I would like to discuss the additional complexity currently faced by central banks in their decision-making process and how their independence remains crucial for their actions to fully serve the public interest. I will start by discussing some of the challenges arising from the assumption of financial stability responsibilities by central banks, and then I will address the issue of how recent technological developments could affect the relevant policy framework and the role of financial sector authorities. Finally, I want to talk about how the BIS can help shed light on this relevant policy debate and support its stakeholders in addressing the challenges posed by the current institutional and technological environment.
Central banks and financial stability

The crisis did not offer conclusive evidence on the general superiority of specific models for the organisation of financial supervision. Yet in recent years, central banks have tended to assume more financial stability-related responsibilities. According to a recent FSI publication,\(^1\) about two thirds of central banks (out of a sample of 82) are currently the leading authority for the microprudential or macroprudential function in their respective jurisdiction.

Of course, the main rationale for allocating prudential responsibilities to central banks is the existence of important synergies between the pursuit of macroeconomic stability and the preservation of financial stability. Not only are economic and financial stability deeply interrelated concepts, but most relevant policy instruments (such as interest rates, capital requirements and maximum loan-to-value ratios) do affect both real and financial sector developments.

From a conceptual point of view, if we think of the set of interrelations between policy objectives and instruments as a system of equations, the view that the macroeconomic and financial stability objectives could be pursued separately would imply that equations in that system could be solved recursively one by one. However, it is now clear that the system is composed of correlated equations with common variables which must be solved simultaneously. In other words, to deliver both financial and economic stability on a sustainable basis, the interactions across policy domains should be fully considered in the decisions taken by responsible authorities. Arguably, that is easier to achieve if both responsibilities lie with the same agency than by ensuring the required coordination across different agencies.

Yet the addition of financial stability responsibilities to central banks’ mandates significantly complicates decision-making. In monetary policy, the goal is for inflation to be stable and close enough to the target. Thus, the assessment of whether the goal has been achieved is relatively straightforward. The same kind of evaluation with respect to financial stability objectives is significantly more complex. First, there is no unique number or metric to define the target. Second, the number of prudential policy instruments that could eventually be used to preserve financial stability is large, each of them having different characteristics but also a variety of potential side effects.

More importantly, the addition of prudential policy to central banks’ mission makes them more exposed to public scrutiny and political debate. In particular, financial stability responsibilities imply taking actions on sensitive matters with consequences along several dimensions, such as credit availability and the structure and degree of competition of the financial system. Moreover, actions and possible mistakes in this domain may directly affect customers and investors of financial institutions and have budgetary and distributive repercussions. The latter adds to the differentiated impact of monetary policy actions on different segments of the population.

As a consequence, the enlargement of central banks’ functions has helped ignite the debate on their independence in different parts of the world. The argument is always that the accumulation of powers in agencies which are not subject to public control via the electoral system can make their policies deviate from the social interest.

Yet central banks’ independence is, if anything, needed now more than ever before. Everybody in this room is familiar with the strong historical and theoretical underpinnings of the independence of monetary authorities.\(^2\) Indeed, independence helps mitigate the time-inconsistency problem for monetary policy that typically translates in the long term into higher average inflation without achieving higher employment.

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\(^1\) Calvo et al (2018).

\(^2\) See eg Kydland and Prescott (1977) and Barro and Gordon (1983a,b).
Equally solid arguments support regulatory and supervisory independence. Supervisory authorities which are not sufficiently independent from governments are bound to give more weight to the short-term benefits of lax regulation – in terms, for example, of credit availability – than to the long-term costs of a higher risk of a systemic crisis. This myopic behaviour on the part of authorities affected by the electoral cycle can have only adverse social welfare implications. That is precisely why supervisory operational independence is one of the Core Principles.

Therefore, independence is just as important for financial stability as it is for price stability. As a consequence, the assumption of financial stability objectives by a central bank strengthens the case for independence, and not the other way around. To be sure, enlarging central banks' powers while at the same time constraining their independence is likely to generate severely suboptimal social outcomes.

That said, it is clear that the broader the mission of central banks, the stronger the case to enhance transparency and accountability. Moreover, the increased complexity of central banks' mission obliges them to strengthen their efforts to develop the required technical and human capacity to address the relevant challenges.

**Technological developments**

Recent technological developments further complicate the framework in which central banks and supervisory authorities should perform their responsibilities. This is typically the case because accelerated innovation in the market for financial services does generate new, complex trade-offs for policy actions.

In principle, innovation could contribute to financial inclusion, increased competition, enlarged savings and investment opportunities, and to the provision of more affordable services and products. While these are very relevant benefits, there are also important risks.

First, the reliance on automated systems and external providers of technological services raises the risk of cyber-incidents with a potential systemic impact. In addition, the extensive use of personal data by a possibly large number of players may affect the protection of sensitive information. Moreover, the supply of new products and services can attract customers who may not have the proper understanding of their characteristics and risks, thus raising consumer protection issues. Furthermore, some of these products, such as cryptoassets, can be used for the remittance of funds of illicit origin and, therefore, for money laundering, thus compromising market integrity. Lastly, a disorderly interaction of market forces may end up creating socially undesirable distortions if the competitive advantage of new (fintech or big tech) entrants vis-à-vis incumbent financial institutions relies solely on regulatory gaps.

The challenging trade-offs suggest that authorities need to act prudently, but they can hardly remain passive given the rapid and potentially disruptive developments. The challenge for policymakers is, naturally, to maximise the benefits of fintech while minimising risks to the financial system.

In order to move forward, authorities need to consider at least four important aspects:

- First, they must develop a comprehensive understanding of the fintech businesses in their jurisdiction. A useful mapping of new innovative activities could be developed by characterising the nature of each of the new the services provided (which may be new or just reformatted), the enabling technologies for those services – such as distributed ledger technology, cloud

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3 See eg Quintyn and Taylor (2002).
computing or artificial intelligence – and the underpinning regulatory framework, if any, which may be specific to that activity, entity-based or a combination of the two.

- Second, careful consideration should be given to the need to adjust the regulatory perimeter to accommodate new entities or activities in order to ensure adequate control of risks and a level playing field. As a minimum, regulation on aspects such as anti-money laundering, consumer and data protection, and possibly also operational resilience should, as a rule, be applied to all professional providers of financial services and payment platforms. Yet the same activity may entail different risks depending on the nature of the entities performing it and, in particular, whether or not they are deposit-takers. Therefore, activity-based regulation seems to be more a complement than a substitute for the traditional entity-based regulation.

- Third, regulatory actions should be coordinated at the global level to the extent possible. Financial innovations are a worldwide phenomenon given that providers of these new services and products often act on a cross-border basis, taking advantage of the new virtual distribution channels. It is therefore essential to guarantee appropriate coordination and cooperation among relevant authorities worldwide and, once sufficient experience is accumulated, to start developing new global regulatory standards to address the relevant policy issues.

- Fourth, regulators should also embrace technology. In recent years, advances in artificial intelligence and its practical application in machine learning, natural language processing and other advanced analytic capabilities have provided opportunities for developing tools that would enhance supervisory capacity. Here again, much is to be gained from international cooperation, not only to exchange experiences but potentially also to jointly develop applications that could then be adapted to the specific needs of each jurisdiction.

In sum, recent developments point to an emerging need for regulatory actions. Those actions should be proportionate, holistic and, ideally, internationally coordinated. Yet it is important for authorities not to lose sight of their policy objectives. In particular, while the benefits of the new technologies may be substantial, central banks and supervisory authorities could hardly take a leading role in promoting them by explicitly or implicitly embracing a pure industrial policy objective. Their focus should remain on their core functions relating to financial stability and adequate market functioning.

The (new) role of central banks

Indeed, despite the potential for disruption of new technologies, there seems to be no strong case to substantively modify supervisory authorities’ key objectives. Moreover, the arguments for the involvement of central banks in financial stability – with the caveats that I expressed before – remain solid. Going back to my algebraic analogy, the inclusion of new (fintech) players might make the system of policy objectives and instruments more complex, with more relevant variables subject to non-linear interactions, but it is still a system of equations that, normally, need to be solved simultaneously.

By the same token, technological developments have, if anything, strengthened the case for the independence of central banks and supervisory authorities. Promoting technology may pay off in the short term, as it typically delivers clear benefits in the form of better and more affordable services, while its risks may only materialise after some time, and possibly with low probability, albeit with a great adverse impact. Accordingly, independent regulators could be in a better position to take time-consistent actions, and pay due attention to different scenarios – and not only to the most likely ones – to ensure that new technologies develop in an orderly way without undermining financial stability.

That said, in order to properly perform the functions that society has delegated to them, independent central banks – particularly if they hold financial stability responsibilities – need to develop sufficient capacity and to adapt their internal procedures and decision-making processes to cope with
the new challenges. In particular, the ideas I developed before point to two clear tasks for central bankers: to develop a comprehensive and integrated analysis of economic and financial stability, and to incorporate in the policy analysis and decision-making processes all relevant implications of technological innovation for the financial system.

The BIS is determined to contribute substantially to both objectives. In fact, the new BIS medium-term strategy, Innovation BIS 2025, has several elements that could support these endeavours:

- First, we will continue our efforts to develop as much as possible a conceptually integrated framework for monetary and financial stability policies. Future work in this area will cover both advanced economies and their challenge to normalise monetary policy, and emerging market economies and their challenge to respond to cross-border financial spillovers.

- Second, we will take several initiatives to better understand the implications of technological developments for the financial system and help our stakeholders to make effective use of them in their own policy formation. For example, we plan to establish a multidisciplinary Innovation Hub at the BIS in order to foster collaboration in innovation-related work, as well as a new unit which will undertake policy analysis and research on how key innovations and increased data availability should inform policy and shape central banks' responses.

- Third, we will strengthen our efforts to contribute to the dissemination of good policy practices, to support capacity-building and to facilitate interaction among regulators.

  The FSI will play a key role in several of these initiatives. The new regulatory environment that emerged from the post-crisis reforms and recent technological developments have added much complexity to the financial oversight function. As such, financial sector authorities worldwide need to strengthen capacity-building to address these new challenges, and the FSI can contribute to those efforts by facilitating the dissemination of information and analysis on relevant topics and by fostering the exchange of practices and experiences among supervisors.

  Moreover, the FSI will also play a prominent role in our pursuit of understanding the regulatory and supervisory implications of innovative technologies. In particular, the FSI will create a repository of technology-related regulatory developments. In addition, it will continue developing comparative studies on distinct regulatory and supervisory approaches followed in different jurisdictions. Finally, it will further develop a recently created informal network of technology specialists in supervisory organisations to exchange practices and experiences on technological developments.

  As you can see, the FSI has come a long way over the last 20 years, but its goal remains the same: to assist supervisors around the world in improving and strengthening their financial systems. I have no doubt that the FSI will continue to rise to the challenge of meeting this goal in the years to come.

  Congratulations, and keep taking this invaluable work forward.

  Thank you.
References


