

23.04.18

“Central banks and new technologies in the financial sector”

Closing address of the Workshop “La Revolución Fintech” (“The Fintech revolution”), organised by Garrigues and IEAF-FEF

Javier Alonso
Deputy Governor

Good morning.

Let me begin by thanking the organisers – Garrigues, IEAF (the Spanish Institute of Financial Analysts) and FEF (the Financial Studies Foundation) – for inviting me to close this workshop dedicated to analysing the effect that technological development is having on the provision of financial services.

I believe you will agree with me that the changes such development entails are far-reaching; indeed, they go beyond a mere adaptation or a simple investment, and may ultimately affect both the number and type of agents that participate in the market, and the groups that accede to specific products or the way in which use is made of specific services.

Against this background, my address today will have a twin focus. In the first part, I aim to explain how, at the Banco de España, we are paying increasing attention to a phenomenon whose scope, global dimension and speed of transformation exceed the parameters that used to characterise changes in the banking industry. In the second part, I would like to share with you some thoughts on one product in particular, namely cryptoassets. The latter have been subject to a degree of “informative exuberance” in recent months and I would like to highlight certain aspects that I consider important to bear in mind.

Organisational changes to address the challenge of financial innovation

Starting with the first part, technological development is, as I stated, altering the financial system in several respects. New services providers are emerging which, in some cases, are competing with traditional banks in specific market niches; and, in other cases, they are offering novelty financial products or products aimed at groups which previously only had access to a very limited number of financial instruments. Traditional banks are reacting to this change with different types of strategies.

Some of these strategies are based on cooperation, e.g. to use blockchain technology to make digital identification processes more efficient.

Others are based on alliances or on investment in new entities. You are all aware of joint projects developed by banks and new fintech companies, and of investment platforms promoted by banks to invest in new companies in this area.

There are also strategies which simply seek to incorporate the new technologies into the way in which banks pursue their activity in order to place greater emphasis on aspects such as improved accessibility to banking services through mobile phones or the proliferation of bank online applications to advise us in an individualised fashion on how to manage a household’s current expenses.

Finally, I must also mention banks’ systematic request for “intense dialogue” with the authorities to re-define the regulatory framework, on the understanding that they are not on a level playing field when it comes to competing with the new firms. And both these firms and banks set out the need to create test spaces or so-called sandboxes. These sandboxes would, in any event, be applicable to the initiatives that provide improvements to society at large and not only gains to entrepreneurs at the expense of greater risks.

Such transformation marks a genuine change to the financial eco-system in the face of which central banks and financial regulators must react. The nature of these trends means that several areas come into play, including, inter alia, consumer protection, risk control and management, authorisations to engage in licensed activities, data protection, and the prevention of money laundering and the financing of terrorism.

In this connection, unsurprisingly, the initial reaction of many authorities has been to organise both internal and inter-authority coordination committees to assess the impact of financial innovation. The Banco de España has been no exception here and, in February 2016, we set up the so-called Financial Innovation Group, on which all our Directorates General were represented.

This initial effort was along the right lines but, probably, it was insufficient since, in addition to reinforcing coordination and sharing information, specific resources must be assigned to: (i) seeking to understand the dimension of the change under way; (ii) analysing the consequences that aspects such as blockchain technology or the use of artificial intelligence may ultimately have; and (iii) maintaining permanent contact with authorities from other jurisdictions to share experiences and coordinate responses, having regard to the global nature of this transformation.

Hence, at the Banco de España we have recently created a new Associate Directorate General with the aim of reinforcing these aspects. This area will necessarily work in a cross-departmental fashion, given the numerous central bank functions affected. In addition, it will maintain fluid dialogue with other Spanish authorities (such as the CNMV and the General Secretariat of the Treasury and Financial Policy); with the market, both through the fora already in place and through bilateral meetings; and with international institutions, particularly with the European institutions, to share experiences and improve information on the importance of some of the trends.

The ultimate aim is to develop an overview of the main characteristics of and challenges facing financial services provision in the near future, including the consequences for already established institutions.

In this respect, I am convinced that the new technologies – and the new intermediaries – will offer the possibility of enhancing the quality of the services provided, increasing efficiency in many of the processes currently used by traditional banks and cutting costs.

However, it is also likely that these changes will call for a review of the current body of regulations to determine whether reform must be undertaken on key aspects such as the information requirements that new participants must provide to the authorities and supervisory intensity in aspects relating to security, data protection and consumer protection.

Cryptoassets

Allow me to conclude my address with some brief thoughts on what are popularly known as cryptoassets or cryptotokens. As you know, the CNMV and the Banco de España recently released a joint statement on this matter in which we sought to warn the general public about the limitations and dangers associated with this type of investment.

Specifically, we stressed that they are not legally considered to be money or deposits and that, therefore, they do not enjoy the protection and safeguards envisaged in the regulations governing banking and investment products. We likewise highlighted their speculative nature, the absence of support by supervisory agencies and their vulnerabilities in respect both of fraud and possible price manipulation. Finally, we further used the statement to underscore the liquidity problems they may evidence.

Nonetheless, given that interest in this area remains high, I believe it is appropriate to insist once more on the matter. Since the emergence of Bitcoin in 2009, there has been a sustained increase in the number of cryptoassets, with more than 1,500 initiatives now having been launched. Moreover, their market value has increased fivefold in the past year.

Both circumstances and, above all, the extensiveness of their modes of commercialisation – either directly, through contracts for differences, or by means of other structured products such as futures contracts or swaps – make for greater diversity of uses and mean that economies worldwide are increasingly exposed to their risks.

While their relative weight remains admittedly limited (scarcely 1% of global GDP), it is a fact that cryptoassets are becoming more attractive to retail investors. This, combined with their extreme volatility and the heavy losses they have experienced as a result of operational failings and other cybernetic threats, outlines a scenario ahead of which it is crucial that the authorities take a position. And not only in terms of improving our level of information and knowledge but, especially, also in rolling out potential public policy measures.

As regulators and supervisors, our main concern is their potential repercussions for financial stability, without forgetting the ramifications they may have for customer protection, data protection, market integrity, tax evasion and the avoidance of laundering controls. In short, we must be capable of adopting appropriate safeguards without losing the necessary flexibility to harness the potential benefits stemming from the underlying technologies, especially that of distributed ledgers.

Since a global phenomenon is involved, the effectiveness of any measure will mean adopting a cooperative approach, a matter in which we are all fully involved both in Europe and in other multilateral fora. Specifically, one of the notable commitments of the Financial Stability Board (FSB) and the European Commission for 2018 is, precisely, to identify information needs and to formulate appropriate indicators enabling us to strengthen emerging risk-monitoring and measurement tasks.

This drive to increase the transparency and traceability of operations with cryptoassets must be viewed as a first step as part of a more ambitious strategy aimed at evaluating potential risks more accurately, without ultimately ruling out regulatory changes that provide a response to the vulnerabilities detected, eliminate arbitrage opportunities and provide a sound basis for the development of an industry compatible with a safe and global financial system.

In my view, the response to this challenge does not lie in seeking a rupture but rather in identifying the existing parallels with other financial instruments and, where this is not possible, in applying the current guiding principles of international financial regulation.

Accordingly, the resulting framework should be geared to ensuring a homogeneous treatment of equivalent situations, adapting requirements to the specific risk profile of the economic functions performed by each family of cryptoassets and to that of the activities pursued in their vicinity.

In this respect, it is reasonable to extend to this sector not only the very provisions of the regulations aimed at preventing money-laundering and terrorism-financing, but also others relating to operational risk management and the transparency and protection of the rights of financial services users.

To conclude, I shall briefly refer to two matters. The first is central bank digital currencies. The possibility of central banks issuing digital currency, using a similar technology to that used by certain cryptotokens, has aroused growing interest.

True, the new technologies pave the way for re-designing traditional functions assigned to central banks, even some as deep-rooted as the issuance and distribution of money. Evidently, however, beyond purely operational questions such as the technological capacity to digitally record transactions which at present are conducted with cash in its physical form, the implications of issuing digital currency are far-reaching in numerous areas.

At central banks we have begun to analyse this matter, paying heed to the main implications and to the various aspects that need addressing. In this connection, the report recently published by the Bank for International Settlements (in March) entitled “Central Bank Digital Currencies” serves as a good reference for the current state of the – still preliminary – discussions among central banks.

I would recommend that those interested in this matter should read it. I would encourage them, in particular, to carefully consider the scope and complexity of some of the issues it raises. Personally, for me they elicit many doubts about the future viability of this initiative.

The second issue I wish briefly to tackle is the situation of cryptoassets in Spain. While in the absence of official data it is complicated to gain an idea of the real size of this market in our country, we are aware of the existence of a certain level of activity involving individuals resident in Spain. Mostly, such activity is undertaken through providers located abroad, which furnish a series of services ranging from exchange platforms to loans in cryptocurrencies, or brokers acting as intermediaries between buyers and sellers of contracts for differences.

We are moreover aware of the existence of more than twenty ICO (Initial Coin Offerings) initiatives undertaken by Spanish promoters, practically all of which from countries such as Switzerland, Singapore and Estonia, or territories such as Gibraltar.

Given the potential implications, we are working at the Banco de España on improving the quality and volume of information available to us at present. In this connection, we have open channels of cooperation, at all levels, with other national institutions and authorities. We trust that this dialogue will soon prove fruitful, yielding visible results.

Conclusion

By way of conclusion, allow me to stress how, as in other transformation processes we have seen in the past, opportunities arise to increase efficiency, improving, in this case, financial services. But let us nevertheless not forget that changes also pose substantial challenges in the form of new risks.

Little is said of such risks. That is why I have given them a good deal of attention during my address, because it is in our DNA. We are in favour of innovation but we are regulators, supervisors and guardians of financial stability.

Thank you for your attention.