Non-bank finance - a central bank/oversight perspective

Non-Bank Finance and Financial Intermediation
Naples, 18-19 June 2019

The views expressed are those of the speaker and do not necessarily reflect those of the ECB.
Many trends in payments are driven by non-traditional banks

RTGS Updates
- Access
- Opening hours
- Interconnectivity
- Endpoint security / Cyber resilience

Retail payment improvements
- Instant (24/7/365) services
- New access channels (mobile, internet)

DLT/blockchain
- Digital assets/currencies
- Payment tokens
- Ledger function
- Validation models
- “Smart contracts”

Changing end-user needs/expectations
- Speed, cost, transparency
- Financial access & financial inclusion

Cross-border services
- Cross border retail payments
- Correspondent banking
- CLS

New service providers
- FinTech startups & Challenger banks
- IT companies & BigTechs
- Telcos

Regulatory developments
- On global & national level
Implications of new providers/technical innovations for central banks

- understanding and assessing the impact of new providers/technology adoption on overseen entities’ business models and safety/efficiency
- adapting central bank data collection and handling

Promote the smooth operation of payments and market infrastructures

- assessing potential of innovations for central bank infrastructure services for settlement of payments and securities
- assessing impact of non-bank access to central bank infrastructures

Operator Role

Catalyst role

• facilitating private sector efforts to improve market efficiency
• promoting work on standardisation and interoperability

Oversight Role
1. Implications for overseers

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2. Work of standard setting bodies

3. Conclusions
New providers & technological innovation - points of attention for overseers

<table>
<thead>
<tr>
<th>Technological neutrality</th>
<th>• neither impose nor discriminate in favour of the use of a particular technology/provider</th>
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<tbody>
<tr>
<td>Proportionality</td>
<td>• requirements may vary in proportion to the risk brought into the system</td>
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<td>Consistency</td>
<td>• of outcomes, with global standards, across jurisdictions</td>
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<tr>
<td>Subject of oversight</td>
<td>• operator / governance authority of the system / scheme</td>
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<td>Co-operation of authorities</td>
<td>• at domestic and cross-border level</td>
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Technological neutrality

• **Challenge of distributed ledger technology:** oversight principles and FMI regulation predate DLT
  – Centralised systems and centralised governance under a responsible operator are two premises on which regulation and oversight is conducted today
  – The use of new technologies might create new sources of risks that are not yet included in the scope of existing oversight principles

• **Particular areas of concern:**
  – Legal basis: legal underpinning for services that avoid relying on a central party
  – Governance: allocation of responsibilities and decision making
  – Settlement finality: accommodation of consensus based settlement that is probabilistic
  – Operational risk: scalability, latency, cyber-resilience
Consistency

- Consistency of outcomes
- Consistency with global standards
- Consistency across jurisdictions

- Important where systems, markets or jurisdictions are in competition with each other
- Central banks should indicate criteria for “comparability” (e.g. types of instruments, value, types of participants, risk attributes)
- Consistency also needed where a central bank operates a system itself to avoid competition issues and conflict of interests (e.g. by organisational separation)
Proportionality & subject of oversight

Different type of payment systems / schemes:

- Systemically important payment systems
- Non-systemically important large-value payment systems
- Prominently important retail payment systems
- Other retail payment systems
- Payment instruments/schemes

Different type of payment service providers:

- Payment institutions
  - Electronic money institutions
    - Taking deposits
    - Issuing e-money
  - Providing payment services

Diverging licensing criteria depending on risk
Co-operation of authorities: national & cross border

- **Align** conflicting **objectives**
- Promote **consistency** of regulatory requirements and approaches and avoid duplication
- **Access to comprehensive and timely information** on factors that may impact on the safety and resilience of infrastructures, institutions or markets
- Ex-ante **clarification of responsibilities and procedures** for cooperation among authorities during crisis situations

Arrangements can take many forms (e.g. based on *mutually consistent regulation, bilateral or multilateral treaties or MoUs*), i.a.:

- **Information-sharing arrangements**
- **Allocation of responsibilities** *(home/host supervision, lead overseer, etc.)*
- **Colleges** *(supervisors/overseer/others; national/regional/global; single entity/group)*
- Crisis management and resolution groups
Effective cooperation can help to avoid the possibility of gaps, duplication or inconsistencies in the oversight of multicurrency/offshore FMIs.

*Central bank oversight of payment and settlement systems, May 2005*

**PFMI Responsibility E**

- Relevant authorities should cooperate with each other in fulfilling their respective mandates with respect to FMIs:
  - both domestically and internationally;
  - to foster efficient and effective communication and consultation in order to support each other;

- Cooperation needs to be effective in normal circumstances;

- Cooperation should be adequately flexible to facilitate effective communication, consultation, or coordination, as appropriate, during periods of market stress, crisis situations, and the potential recovery, wind-down, or resolution of an FMI.
1. Implications for overseers

2. Work of standard setting bodies

3. Conclusions

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CPMI Working Group on Digital Innovations and Currencies

• Established in **February 2016** to assess the:
  - potential impact on the financial market infrastructure
  - potential impact on central bank functions

Development of an analytical framework (February 2017) to understand and analyse the implications of innovative technology for payments, clearing and settlement

Further work underway, including on *wholesale digital currencies*, *legal aspects* and *cross-border issues*

CPMI-Markets Committee joint report on *central bank digital currencies* (March 2018)
Analytical framework for DLT in payment, clearing & settlement

• Guidance on understanding the arrangement (scope)
  • Functionality and nature of the arrangement
  • Key factors for an effective implementation

• Potential implications for efficiency, safety and the broader financial markets

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<th>Safety</th>
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<td>Speed of end-to-end settlement</td>
<td>Operational and security risk</td>
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<td>Costs of processing</td>
<td>Settlement issues</td>
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<td>Reconciliation (speed, transparency)</td>
<td>Legal risk</td>
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<tr>
<td>Credit and liquidity management</td>
<td>Governance</td>
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<tr>
<td>Automated contract tools</td>
<td>Data management and protection</td>
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Broader financial market implications

- Connectivity issues and standards development
- Financial market architecture (actors, markets, regulators)
- Broader financial market risks (micro- and macro-level)

Source: BIS, 2017
Focus of global regulatory standard-setting bodies

- BCBS, CGFS, CPMI, FSB, IAIS, IOSCO, and Markets Committee have established dedicated fintech workgroups/work programmes
  - focus on stocktaking efforts of relevant fintech and identification of material risks arising from fintech

- **Sectoral and cross-sectoral analysis and evaluation**
  - security and operational (cyber) resilience of products and services
  - regulatory compliance (AML / TF), privacy and data secrecy
  - impact on regulated services and entities
  - impact on financial intermediation and market architecture
  - wider impact on financial stability

- Assessment of need for global regulatory guidance

- **Information sharing and coordination** between global standard-setting bodies to avoid inconsistent policy views across committees
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Central banks need to understand technological innovations and new business models to assess its impact, being mindful of hype.

The ECB monitors innovation to safeguard the payment system against fragmentation and new risks.

The ECB explores ways to take advantage of innovation in the fulfilment of its mandate, both via internal experimentation and by leveraging collaboration with market stakeholders and other public authorities.

Further need for cooperation and coordination of central banks and regulatory authorities (at the national and international level).
Conclusions

1. **EVALUATE**
   Need to evaluate the suitability of oversight standards as regards market developments

2. **RETHINK**
   Possible need to rethink certain concepts (settlement finality, DvP, liquidity risk management)

3. **INNOVATE**
   RegTech solutions could enable contemporary monitoring of new arrangements and facilitate oversight activities

4. **BALANCE**
   Avoid creating a competitive advantage for disrupters compared to traditional infrastructures by applying less stringent standards
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