Central Banks Should Emerge as Innovation Leaders

Opening speech delivered by

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The Minister of Finance of Curaçao, Mr. Kenneth Gijsbertha
Distinguished guests, ladies and gentlemen, good morning.

It gives me great pleasure to welcome you all, and in particular, our guests coming from abroad, to the second day of the **Bridging Financial Innovation and Regulation Seminar**, hosted by the Centrale Bank van Curaçao en Sint Maarten (CBCS). The topic of this seminar is one that most central bankers are currently struggling with nowadays: How is the digital revolution affecting the financial system? What is the impact on consumers, the economy, and on central banks themselves?

As I noted yesterday, the central bank of the monetary union of Curaçao and Sint Maarten is responsible for, amongst other things, promoting a sound and efficient functioning of the financial system in Curaçao and Sint Maarten. This is why the main focus of today's session is on financial innovation, the rise of FinTechs, and the regulatory challenges that regulators are facing in this new era.

FinTechs are innovative financial technology firms with the capacity to provide a variety of financial services that can include enhanced benefits such as lower transaction costs, a more efficient financial intermediation process, and better access to financial services for a larger section of the society. However, FinTechs also can present potential problems. Recently, the General Manager of the Bank of International Settlements (BIS), Agustin Carstens[1], stated that "financial authorities may not clearly understand the risks attached to some of the services being offered by FinTechs, leading to unforeseen accidents and then delays in the adoption of financial innovations". Therefore, the challenge for central banks is to ensure that the FinTech industry progresses in a way that maximizes the opportunities and minimizes the risks for society.

Ladies and gentleman, regulators are currently searching for ways to safeguard their financial system while exploiting the benefits of FinTechs. In fact, numerous agencies are piloting new approaches based on technological solutions developed by two subsets of FinTech: RegTech and SupTech. Important business opportunities arise for RegTech from the trade-off between the need

[1] **Banker to central bankers -** Interview with Mr Agustín Carstens, General Manager of the BIS, conducted by Mr Vikram Khanna from *Business Times* and published on 24 March 2018.

for organizations to stay compliant with the rapidly changing regulations and the need to remain profitable, while SupTech is focusing on the challenges faced by supervisory agencies[2].

The payment infrastructure is one of the examples where innovation has developed quickly with payment tools available directly through an app on a smartphone or even on a smartwatch nowadays. The issuance of Central Bank digital currency, which is a digital version of cash, could be seen as a natural consequence of the broader process of digitization of the financial system. In a world where assets are being traded electronically and payments are being made with smartphones, should there only be room for physical cash?

- Central Bank Digital Currency -

Ladies and gentlemen, distributed ledger technology is currently reshaping the financial system and is here to stay in one form or another. If this financial revolution is not embraced by regulators, private players will continue to innovate and drive the development of alternative technologies, new payment methods, and digital currencies. Central Banks need to become active shapers in the current debate to fulfill their mandates and drive change as active agents rather than passive bystanders.

Given some of the shortcomings of cryptocurrencies pointed out by the BIS, some people have supported the idea of central banks issuing their own digital forms of currency as more stable and reliable alternatives to cryptocurrencies. Let's face it: a central bank digital currency could overcome the volatility risks of an unbacked asset with no intrinsic value. In addition, central banks are in better position to develop a robust financial infrastructure that provides a secure environment for both domestic and cross-border transactions. With the recent shift in the interest of central banks, it is not unthinkable to assume that digital cash will one day dominate the payment infrastructure.

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[2] Reference: **Toronto Centre** - FinTech, RegTech and SupTech: What They Mean for Financial Supervision – Published on August 2017

- Financial Innovation -

Ladies and gentlemen, as I noted a few minutes ago, the FinTech industry is designing new services that better adapt to users' needs in order to expand its business. In doing so, FinTechs try to find the right balance between the opportunities in the market place and the financial regulation they have to comply with. However, FinTech will aim at enhancing profitability and, therefore, may not have the right incentives to reach a socially viable equilibrium.

The greatest challenge for central banks is to find the right balance between the clear benefits that financial innovations have on growth and identifying and mitigating the associated risks. The interaction between regulation and innovation is a two-way street. It is not just that change in the financial sector will impact the way regulatory bodies implement regulations, but also that the regulatory framework will affect the speed and direction of transformation in the financial sector. Thus, a sound regulatory framework is imperative for private services providers to develop secure and efficient financial services and for authorities to keep the confidence of user in the regular functioning of the financial system.

Regulators who are not willing to embrace (regulatory) innovation are at risk of being left out of the potential advantages and benefits of the current financial revolution. If that happens, then the emerging FinTech financial services sector may not be able to develop its technology further, and businesses and households will be deprived of the benefit of the technological revolution. Furthermore, financial services can migrate to the less-regulated parts of the financial system. Allowing risk to build up in an unregulated sector may impair financial stability in the long run and reverse all the progress that has been achieved in the past.

- Closing Remarks -

Ladies and gentlemen, to bridge regulation with financial innovation, we first need to understand innovation and how technological advances can aid regulation and vice versa. Regulation should not stifle creativity, innovation, and technological advances that can aid our markets and market participants.

New technologies entail new types of risks. Although risk related to cyberattacks and data theft is what first comes to mind, authorities also have to recognize the risks that financial innovations pose to the stability of the financial system as a whole. Finding the right balance between facilitating innovation and ensuring financial stability and consumer protection is an inherently difficult task. Unfortunately, no quick fix exists.

Innovation and technology are transforming and reshaping the existing financial system in a way we still do not fully comprehend. Therefore, bridging regulation with financial innovation requires central banks to emerge as innovation leaders.

Ladies and gentlemen, let me conclude by emphasizing that the main asset of a Central Bank today is not the cash stored in the vaults, but the trust of the public. Recognizing the FinTech revolution and adapting to continue to meet regulatory objectives, ensures that financial innovation can contribute to economic stability and social welfare. Only by doing can central banks remain worthy of the public's trust.

I thank you for your attention and wish you a fruitful second day at the conference.