Derville Rowland: Change and challenges - responding to uncertainty, transforming for the future and driving innovation

Remarks by Ms Derville Rowland, Deputy Governor of the Central Bank of Ireland, at the Association for Financial Markets in Europe (AFME) 8th Annual European Compliance and Legal Conference, London, 23 September 2024.

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Good afternoon. Many thanks to AFME for the invitation to speak at this conference again this year. Today I will focus on the regulatory outlook for financial services in Europe and Ireland in the context of a rapidly changing, more uncertain and ever challenging world.

The old adage, attributed to Harold Wilson, that "a week is a long time in politics" is equally applicable in many walks of life – but it has often been the case in financial markets. The last period has been no different and week to week we have seen things change rapidly. At the start of August we saw a turbulent trading period following fears of an imminent US recession. More recently, we have seen markets respond to the Fed's half-point interest rate reduction and the Bank of England and Bank of Japan hold rates steady. While conditions have improved since, significant downside risks remain.

In particular, geo-political events remain potential sources of fragility over the coming months, including uncertainty around electoral outcomes, continuing conflict in the middle-east and Ukraine, turbulent economic conditions. Closely linked to the issue of geopolitical tensions, there is now heightened focus on the centrality of cyber risk and operational resilience. The Crowdstrike cyber incident in July, while contained early and brought under control, caused significant disruption and highlighted the fragilities in the system. Cyber risk, and the link to geopolitical tensions, has been flagged by ESMA, EBA and EIOPA and are increasingly recognised as a significant and likely risk by regulated firms. Positively, we have also seen the European Supervisory Authorities (ESAs) and the EU Agency for Cybersecurity announce the signing of a multilateral MoU to strengthen their cooperation and information exchange on cybersecurity risk in the financial sector. In light of heightened cyber risks, the importance of operational resilience remains paramount. The implementation of the Digital Operational Resilience Act (DORA) remains a key focus for regulators and firms. Digital operational resilience is a fundamental underpinning of a resilient and well-functioning financial system supporting the economy and serving the needs of citizens. That said, ensuring proportionality has been a central focus of the work to develop the DORA framework. This is an important requirement of all regulation, but is certainly the case with DORA given it is cross-sectoral and applies to almost all financial firms. As implementation work progresses, it will be important for authorities to be mindful of ensuring that smaller firms, in particular, are not disproportionately burdened by the same requirements as larger institutions.

In Europe, we have seen significant institutional change as European Commission President Ursula von der Leyen takes up her second term in office and the process is underway to appoint new Commissioners. The broad parameters of the forthcoming European legislative and regulatory agenda have been signalled. International competitiveness remains at the centre of the Commission's programme, as we have seen from the recent Draghi and Letta reports. It seems likely that there will be a continued focus on reducing and simplifying existing EU law. That is an approach which all policy makers, including national authorities and the European Supervisory Authorities, should be mindful of. However, effective regulation which safeguards consumers, fosters market integrity and supports resilience is key to supporting financial stability. Financial stability and the resilience of the financial sector are prerequisites for sustainable economic growth and promoting competitiveness. In a drive to streamline regulation we must not lose sight of this. It is important to retain the outcomes achieved via legislative and regulatory initiatives enacted since the great financial crisis.

At the centre of policy makers thinking is the need to finance the EU's ambitious policy agenda. A significant challenge facing Europe is to secure the public and private finance for the economic and other programmes, including the digital transformation and green deal. At the centre of this is the concept of a Savings and Investment Union, building on the progress made under the Capital Markets Union agenda. In April, Commission President Ursula von der Leyen summed this up by saying that "European start-ups should not need to look at the US or Asia to finance their expansion. They must find what they need to grow right here in Europe. We need a deep and liquid capital market. And we need a competition policy that supports companies to scale up. Europe must be the home of opportunity and innovation."

There is much still to determine – including the level of ambition for this Savings Union and whether it should be a top-down exercise or if the lead should be taken at a Member State level. But I suspect, like most things, the answer is likely somewhere in the middle. While details remain to be worked out, the Letta and Draghi reports likely set out the broad roadmap for how this may be pursued. That said, there will be a need to radically prioritise. Implementing the Letta report alone would require a number of new legislative proposals, in addition to legislative reviews already committed to and implementation work that is required following the last Commission term.

As the Draghi report outlines, Europe must refocus its collective efforts on closing the innovation gap with the US and China, especially in advanced technologies. This is important for many reasons, including that faster innovation will, in turn, help raise the EU's productivity growth, leading to stronger growth in household incomes and stronger domestic demand. At the Central Bank of Ireland, we recognise the many potential benefits and opportunities that new technologies bring to financial services and consumers in Ireland and in Europe. It is important that these benefits can be realised, whilst also ensuring that the risks are well understood and managed. Regulation plays a crucial role in the safe, and therefore enduring, adoption of innovation into the system.

Innovation has brought in new entrants, new products and new ways of serving customers and the economy. As a result, technological innovation continues to be a focus for the Central Bank. This is one of the reasons why we have enhanced our innovation facilities – with the establishment of an innovation sandbox programme which is due to commence for the first time later this year - so that we can continue to engage, learn and develop a deeper understanding of the ecosystem, the opportunities, the benefits and the risks. Our goal is not to remain stagnant but to evolve and iterate so that we continue to regulate and supervise effectively.

Recent years have seen tremendous innovations in financial services. Amongst the most notable have been the development of blockchain-based technologies. We can see the many areas where the blockchain has significant potential to bring about positive change, even transformation, in how we do things. Whether this be tokenisation of investment products or improvements in post-trade infrastructure and interoperability, there are important positive stories to tell.

The European Commission's 2020 digital finance package has set Europe up well to take advantage of these developments. The package reflected the EU's ambition to embrace a digital transition, to help modernise the European economy across sectors, and to turn Europe into a global digital player. Almost 4 years later, we are about to implement the Markets in Crypto-Asset Regulation, or MiCAR.

This is an important step forward in the regulation of crypto activities in Europe while also leading the way on the regulation of the crypto sector globally. The potential for crypto and blockchain to build financial inclusivity or democratise finance has long been a theme of discussion in the sector. Crypto enthusiasts speak readily to how crypto and blockchain technologies, paired with global internet access, can provide easy and immediate access to people across the world to financial services and achieve a level of financial inclusivity that the traditional financial services cannot. While this is an exciting prospect, it cannot be achieved without guardrails. For the first time, MiCAR will introduce a harmonised regulatory framework for the sector that introduces prudential and conduct obligations for issuers of e-money tokens, asset-referenced tokens, and for crypto-asset service providers. There are also obligations for offers to the public of crypto-assets other than asset-referenced tokens or e-money tokens.

There are two priorities I would signal with respect to MiCAR implementation. Firstly, we are working closely with our EU Peers and the ESAs to ensure the necessary coordination and consistency across Europe. The ESAs are, correctly, focused on driving a convergent approach to the implementation of MiCAR in national authorities authorisation and supervision processes. We see this as highly important work. MiCAR, being a first attempt at regulation in this area, is an important opportunity to avoid divergent approaches emerging in different jurisdictions.

Secondly, over recent years, we have been working to continually improve our authorisation process. Through engagement with industry, other public bodies and applicants, we have sought to better explain our expectations, resulting in increased clarity and predictability. Better risk assessment, better communication and better supervisory outcomes have been the output of that work. We have produced new publications, enhanced our internal processes and responded to the changes in the authorisation landscape, including the increase in the number of complex applications. Under MiCAR, you can expect our approach of continuous improvement to continue.

Innovation and new technologies can play an increasingly important role in facilitating retail investors participating in capital markets. As we shortly approach IOSCO's World Investor Week, which is a global campaign to raise awareness of the importance of investor education and protection, it is timely for regulatory authorities and policy makers to take stock and redouble our efforts to support investor education, investor protection and financial literacy.

Protecting consumers is at the heart of what we do at the Central Bank. We know that consumers who are well-informed and understand financial products and services are better placed to make good financial decisions and to look after their interests. These consumers are less likely to be vulnerable to harm from firms that are not securing their interests, and they are less vulnerable to frauds and scams. This is why high levels of financial literacy empower consumers to make effective and informed choices to safeguard their financial well-being. Irish authorities are currently in the process of developing a national Financial Literacy Strategy for Ireland, something which we at the Central Bank strongly support.

Ireland's financial sector has an important role to play in supporting the Savings and Investment Union and providing opportunities for retail investors to participate in capital markets. The sector has demonstrated high levels of resilience while continuing provide critical services to households and business in Ireland and abroad. As with the European economy as a whole, over the last decade, the Irish financial services sector has also continued evolve, in terms of its size, complexity and international connectedness. These developments are, of course, a positive for Ireland, and positive for their contribution to European financial markets. We of course must be mindful that an expanding and more complex financial sector may poses risks that need to be managed. This reinforces the importance of effective regulation and supervision – to maintain financial stability and to protect consumers and investors, both within Ireland, Europe and globally.

As I mentioned earlier, we recognise that we too must change to keep pace with the changing world. I would like to finish by outlining some of the work we are doing in this regard.

As you will be aware, we have introduced the Individual Accountability Framework (IAF). The IAF is all about helping underpin sound governance across the financial sector by setting out clearly what is expected of well-run firms. For both firms and the regulator it should be seen as a complement to the wider focus on governance, culture and behaviour. For the Central Bank our hope is that along with wider efforts, the IAF will help make firms take more ownership and responsibility for running their business and addressing any risks or deficiencies they may have. In an increasingly technological and rapidly changing world, the need for effective governance underpinned by a strong ethical culture and robust systems of delivery is becoming more and more essential.

We are also transforming our supervisory approach – to ensure consumers of financial services are protected in all respects in this changing and increasingly complex environment. Building on the strong foundations of our current approach to supervision, we are moving to an integrated supervisory framework where directorates with oversight of banks, insurance companies and capital markets will be responsible for the supervision of all the functions in their respective sectors. Our approach will continue to be risk-based; but the new framework will ensure we are more efficient and effective in our supervisory work. It will make it easier to direct our supervisory resources to the areas of most risk to consumers or the system. Importantly, it will also place consumer and investor protection at the heart of day to day supervision. This change will maximise the benefit of our integrated mandate – enabling us to continue to deliver on our mission and ensure the financial system operates in the best interests of consumers and the wider economy. These changes are not just important; they are necessary – so that in a changing world we continue to deliver in the public interest.

Conclusion

The EU will also need to take a number of very important decisions in the coming years, especially in terms of what elements of the legislative and regulatory agenda to prioritise, the level of ambition to apply in harnessing the EU's investment potential, and how to navigate geo-political tensions. All of these – to different degrees - will have an impact on financial markets and firms. The speed of these developments – and their potential to cause ripple effects – will not decrease. And so the onus is on us – firms and regulatory authorities alike – to increasingly evolve our approach, innovate and prepare for what the future may hold.

Thank you.