Learning the value of resilience and technology: the global financial system after Covid-19

Remarks by Benoît Cœuré, Head of the Bank for International Settlements Innovation Hub, at the Reinventing Bretton Woods Committee – Chamber of Digital Commerce webinar on "The world economy transformed", 17 April 2020

Thank you for inviting me to speak at this webinar.[1] I will not venture to describe the world after Covid-19. I don't know how this crisis will unfold nor when it will end. The shockwaves it sends across the global economy are just starting to be felt in the emerging and developing world – and they will spill back to us.

I would only like to suggest that two themes will shape the conversation on the "day after Covid-19": resilience and technology. Let me elaborate on what it means for international finance.

1. The value of resilience in international finance

The global financial system has withstood the Covid-19 shock better than the Great Financial Crisis. This success owes much to central banks bold action. With hindsight, it also owes a lot to action taken by regulators in the decade after the G20 Pittsburgh Summit.

Spurred by regulators, banks have built capital and liquidity buffers, improved risk management practices and internalised the social cost of risk-taking. As a result of these efforts, they were much better prepared to cope with a major shock in 2020 than they were in 2008. They can use buffers which were simply not there at the time.

But despite progress made by macro prudential policy, we have been less good at making the global financial system more resilient *as an interconnected system*. We knew it before Covid-19 and the crisis has confirmed it.

Market-based finance is a well-identified gap in our macroprudential framework. We lack instruments to curb procyclicality in non-bank lending. In recent years, asset managers and funds have filled the gap left by the retrenchment of large systemic banks. Today, in the face of outflows, they may be forced to sell assets and amplify price adjustment.

Worse, the first weeks of the Covid-19 crisis have uncovered the fragility of the price discovery mechanism in large swathes of our capital markets. Market liquidity has deteriorated faster and more broadly than in the Great Financial Crisis – when money markets had been the most affected. Major funding markets have been

[1] All views expressed here are mine and not those of the Bank for International Settlements.

strained in advanced economies[2]. And strains are spreading fast to emerging markets, exacerbated by their uneven access to short-term dollar funding[3].

As a result, in the past few weeks, not only had central banks to address aggregate demand shortage, as they traditionally do, but they had to perform laser surgery on a number of market segments to make them functional again, crossing into unchartered territory.

The jury is still out yet as to whether combined central bank and government intervention will be enough to avoid the liquidity crisis morphing into a solvency one – which would raise a host of new issues.

While it is too early to start the post-mortem, there are already lessons for central banks and regulators in the post-Covid-19 world.

Efforts to make the global financial system more resilient should not be dialled back, and if anything, they should be increased.

Flexibility embedded in rules can be fully used[4] but the rulebook itself should be protected and public support should come with conditions, such as restrictions on dividends and bonuses.[5] And we should renew the impulse to improve the resilience of market-based finance.

We should complete the global financial safety net as a matter of urgency, focussing on the smallest and most vulnerable economies.

The extension of the global foreign currency swap and repo network is an important step to address dollar funding needs, but it doesn't benefit all. I see lots of merits in the proposal of a new allocation of IMF Special Drawing Rights: by providing liquidity to all IMF members, large and small, it would "get in all the cracks" of the global financial system.

2. The value of technology

The crisis has exposed the value of technologies which enable the economy to operate at arm's length and partially overcome social distancing. Such drastic

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[2] See International Monetary Fund, Global Financial Stability Report, April 2020. For a discussion of price action in Treasuries and corporate bond markets, see Schrimpf, A., Shin, H.S., and V. Sushko, "Leverage and margin spirals in fixed income markets during the Covid-19 crisis", BIS Bulletin, No. 2, 2 April 2020, and Aramonte, S., and F. Avalos, "The recent distress in corporate bond markets: cues from ETFs", BIS Bulletin, No. 6, 14 April 2020.
[3] See Avdjiev, S., Eren, E., and P. McGuire, "Dollar funding costs during the Covid-19 crisis through the lens of the FX swap market", BIS Bulletin, No. 1, 1 April 2020.
[4] See Basel Committee on Banking Supervision, "Measures to reflect the impact of Covid-19", 3 April 2020.
[5] See Borio, C., and F. Restoy, "Reflections on regulatory responses to the Covid-19 pandemic", FSI Briefs, April 2020.

changes in work and consumption patterns, such as the dramatic shift to online shopping[6], will have a lasting impact on economic relationships.

The payment industry immediately comes to mind. Payments have been at the forefront of technological change recently. A rapid shift towards digital payments can improve cost, transparency and convenience for billions of consumers. International cooperation is needed to support technological capacity in developing economies, ensure interoperability between national systems, enhance cross-border payments and remittances, and support financial inclusion – in short, to avoid spatial and social fragmentation.

The Financial Stability Board (FSB) and Committee on Payments and Market Infrastructures (CPMI) action plan on cross-border payments, which was released last week, comes timely, as well as the FSB consultative report on the regulatory implications of stablecoins[7].

The current discussion on central bank digital currency also comes into sharper focus. Whether Covid-19 will accelerate the demise of cash is an open question. But already, it highlights the value of having access to diverse means of payments, and the need for any means of payments to be resilient against a broad range of threats[8].

Covid-19 will accelerate the digital transition beyond payments. Will customers find their way back to banking branches when lockdowns are lifted and economies restart? Will this accelerate the shift towards virtual banking? In the next months and years, the BIS Innovation Hub will remain busy scanning technological trends in finance and their consequences for central banks and financial regulators, based on practical projects. Issues such as tokenisation, open banking, and using technology to support regulatory and supervisory compliance ("regtech" and "suptech") are high on our agenda.

Let me conclude by coming back to today's urgency.

Technology can help mitigate the economic and social impact of the Covid-19 crisis.

The debate is raging on how technology can help track the virus spread, enforce quarantines and administer remote consultations – and on which safeguards are needed to protect privacy. Technology can also help mitigate the economic cost of lockdowns and avoid irreversible damage to the social fabric. The most vulnerable in our societies are less likely to be reached by traditional support measures. This is particularly the case in economies where direct tax infrastructures are less developed and the informal economy is pervasive. Digital payments can enable

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[6] See Leatherby, L., and D. Gelles, "How the Virus Transformed the Way Americans Spend Their Money", The New York Times, 11 April.
[7] See Financial Stability Board, "Enhancing Cross-border Payments - Stage 1 report to the G20", 9 April 2020, and "Addressing the regulatory, supervisory and oversight challenges raised by "global stablecoin" arrangements: Consultative document", 14 April 2020.
[8] See Auer, R., Cornelli, G., and J. Frost, "Covid-19, cash, and the future of payments", BIS Bulletin, No. 3, 3 April 2020.

governments to provide emergency support to households and small businesses affected by the virus. They can help "pump the rescue funds down the last mile"[9].

Jurisdictions which have established retail payment and identity rails are already leveraging them to enhance their crisis response. As noted by the World Bank, the ID-linked basic account in Chile, Cuenta Rut, will allow 2 million vulnerable Chileans to benefit from Covid-related support already this month[10]. International coordination is key, for example to keep remittances flowing, as those normally sending them are disproportionately affected by the crisis.

For those jurisdictions which haven't established digital infrastructures, it is not too late to do so. Recent guidance by the CPMI and World Bank helps them design the right strategies to advance financial inclusion through innovation in payments.[11]

Learning the right lessons from this crisis is not enough – there is still time to act.

Thank you.

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[9] See Carstens, A., "Bold steps required to pump corona virus rescue funds down the last mile", Financial Times, 29 March 2020.

[10] See Rutkowski, M., Garcia Mora, A., Bull, G., Guermazi, B., and C. Grown, "Responding to crisis with digital payments for social protection: Short-term measures with long-term benefits", World Bank Blogs, 31 March 2020.

[11] See Committee on Payments and Market Infrastructures and World Bank, "Payment aspects of financial inclusion in the Fintech era", 14 April 2020.