

# **Gabriel Makhlouf: Meeting challenges of a changing financial system**

Remarks by Mr Gabriel Makhlouf, Governor of the Central Bank of Ireland, at the Central Bank of Ireland Financial System Conference, Dublin, 18 November 2024.

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Fáilte, good morning and welcome to our Financial System Conference. Today's theme is delivering a well-functioning financial system in a changing economy. We have an excellent group of speakers but I'd like to welcome in particular Minister Pascal Donohue, President of the Eurogroup, and Pablo Hernández de Cos, the former Governor of Banco de España, a former colleague at the ECB's Governing Council and a future colleague as Head of the Bank for International Settlements, the central bankers' central bank as some describe it.

In these opening remarks I will briefly discuss the evolution of the global financial system, and how we at the Central Bank are transforming to meet the changes we are seeing in Ireland's financial sector. I'll also look further ahead at some of the changes we are expecting to see and how we are likely to respond.

## **Evolution of the financial system**

Allow me for a moment to reflect on some of the change that we have seen in the structure of the financial system through history, from early beginnings to today's digital world.

The earliest form of trade was conducted through the barter of goods and services, and slowly evolved into using commodity or representative money. In fact virtual money did not arrive with the digital age but was created around 5000 years ago by the Sumerians who developed a financial architecture based on accounting, a legal system and a variable rate of interest. The Lydians brought us the concept of physical money through the creation of coins and laid the foundations for modern finance.

Fast forward a thousand years or so, and medieval times witnessed the emergence of new financial instruments, such as bills of exchange and letters of credit, facilitating long distance trade and reducing the risks associated with transporting large sums of money across both land and sea.

The Industrial Revolution marked a turning point as financial institutions emerged to support a thriving industrial sector. Banks, stock markets and insurance companies played important roles in mobilising capital, managing risk and facilitating economic growth. I won't go on.

One thing that hasn't changed for some time is that modern (post-Westphalian) nation-states have also adopted fiat currency systems. And their central banks have become the guardians of stability in the value of money relative to goods and services, and the use of monetary policy tools to influence economic activity.

As technology continues to develop, we are seeing our monetary and financial system also evolve and we all need to be ready for change.

## Meeting the challenge: transforming regulation and supervision

Now, it's becoming something of a truism to say that the global economy is fragmenting while the world, including countries such as ours, starts to undergo significant economic transitions – in demography, in technology, in climate – while also experiencing a period of unprecedented innovation<sup>1</sup>. And change isn't just coming; in some parts of the world it is already here.

In the face of a changing ecosystem, central banks, regulators, businesses and consumers all have to adapt, transform and evolve.

For our part, we are changing how we work and how our frameworks reflect an increasingly digital world.

While this transformation is across the whole of the Central Bank, I want to point to some of what we've done so far.

We have been changing how we engage with innovation in financial services, enabling us to deepen our understanding of innovation, better inform our regulatory approach, better explain to innovative firms what being regulated entails and better embed a regulatory culture in fledgling and fast growing firms.

Since last year's conference, where we announced a consultation on our approach to innovation engagement, we have successfully launched an Innovation Sandbox Programme.<sup>2</sup>

We have already received a substantial number of applications to our Combating Financial Crime Sandbox, from across the innovation ecosystem (from early-stage start-ups, scaling firms, established financial services firms, and forward-thinking partnerships). The projects submitted are exploring new technologies and developing innovative methods to tackle financial crime, benefiting both the financial system and consumers.

In the coming weeks, we will be announcing the selected participants and we look forward to sharing the insights and learnings that emerge from that work.

In addition to our engagement with innovation, we'll continue to modernise our other frameworks. These include our Consumer Protection Code while we work with our European partners on the Digital Euro and on negotiations regarding the new EU Financial Data Access Regulation, among other things.

Our most comprehensive response to the changing financial system comes in the form of our new supervisory framework.<sup>3</sup>

This is a direct response to the rapidly-changing and interconnected financial system which we supervise, recognising that we need to change to make sure we can deliver our supervisory and regulatory mandate effectively, both today and in the future.

## **Our new supervisory framework**

Our new supervisory model is building on strong foundations. It will of course remain risk-based but is evolving to deliver a more integrated approach drawing on all elements of our mandate (consumer and investor protection, safety and soundness, financial stability and integrity of the system).

This enhanced approach is based on accumulated experience, on insight, on best practice and is built for a faster moving and more complex financial services sector.

Importantly, it will also place consumer protection at the heart of day-to-day supervision.

It will position us better as an organisation to meet our objectives to ensure consumers of financial services are protected in a changing financial landscape.

Firms will hear one consistent voice from the Bank, with more coordinated messaging and more streamlined demands across the full span of our regulatory and supervisory mandate.

We will promote a more open and transparent supervisory approach. Strategic supervisory priorities will be clearly identified and communicated in a proportionate and timely manner.

To enable and implement our new supervisory framework we need the right operational approach and organisational structure. We are moving to an organisational structure where our regulatory and supervisory directorates will have teams responsible for integrated supervision across all our regulatory outcomes. The changes come into effect in January and you can read more about them on our website.

## **Looking further ahead: innovation in payments, AI & tokenisation**

A core theme of the Central Bank's Strategy is being future-focused. And looking over the horizon, there are three areas in particular which are likely to be the next significant widespread technological developments in the financial system.

The payments landscape is changing very rapidly, amid both technological and business model innovation. Significant frictions remain, especially in cross-border payments. We also need to strengthen our capabilities around Tokenisation and AI.

We recognise that public innovation in payment systems must keep pace with private innovation, otherwise challenges may arise in maintaining financial stability and monetary sovereignty in a digitally disruptive era. The development of a National Payments Strategy is one example of the importance of coordination to balance competing interests for the betterment of consumers and small businesses.

In an increasingly digital world, it is also important that we ensure public money is available in digital form. The introduction of a digital euro is a logical next step in the evolution of our currency, while also responding to the shift in customer preferences for digital payments, in order to 'future-proof' our money.

It would be a digital form of cash, issued by the central bank and available to everyone in the euro area.

A digital euro would go hand in hand with banknotes, providing an all-in-one digital payment option across the euro area, free for basic use. It will blend the simplicity of cash with digital convenience while maintaining the highest levels of privacy.

A further disruptive trend is the wider tokenisation of financial assets. To be clear this is not the same as speculative crypto assets, about which I continue to have concerns, not least for consumers. Rather this is about using distributed ledger technology, or similar technologies, to 'tokenise' real assets with real value. This has the vast potential to realise advancements in both real-time and dynamic transaction processing

This technology may have a lot of potential and we have seen early engagement from industry who are exploring using this technology for different use cases including cross border payments, remittance, tokenisation of assets and units in a fund.

Such technologies could provide greater access and choice to people across the world to financial services. It could enhance co-ordination between participants in the financial and payments ecosystem, reduce costs and increase efficiency.

It could also provide benefit to regulators in terms of real time information access.

As for AI, its impact on the financial system could transform the risk landscape firms by transforming existing challenges like interpretability, fairness, and ethical data use and accentuating other ones, such as cyber risk and governance.<sup>4</sup>

All of us – industry and policy makers – have a role to play and collaboration will be vital to realising the potential of this technology while managing the risks.

## Conclusion

Let me conclude with a brief look ahead to the future of the European economy and financial sector, one of the themes of our conference, and I look forward to hearing different views throughout the day.

There has been much discussion on this topic of late, in the context of a challenging international environment and the great economic transitions I mentioned, including climate change, demography and digitalisation.

I think it is a good thing we are having this debate, and note the ambitions set out in the Budapest Declaration by EU leaders just over a week ago.<sup>5</sup>

For my part, I would just make a few observations.

Europe's strength has always been the combination of harnessing its internal market – by balancing single rule-books, level playing fields, and a belief in both the centre and the periphery as well as the equal interest of states big and small – alongside an international openness, outlook and leadership. As we pursue our ambitions for European competitiveness, I hope we continue to put this combination at its heart

I also hope we recognise that long-term productivity and competitiveness are built through sustainable long-term policy. In financial regulation that means not pursuing short-term growth through lower standards, but rather long-term stability (an absolute pre-condition for sustainable growth), by ensuring those that finance our economy are safe, sound and resilient to the increasingly difficult external environment.

Finally, on regulation and in particular on building bigger capital markets in Europe to help finance the economic transitions, I would hope that we don't take the option of thinking we can simply regulate it into existence. We need to concentrate on delivering structural market reforms to pensions, to retail savings, to the supply of investable assets and, at the end of the day, to the way our capital market works with the real economy.

But that is a whole other speech. I hope you enjoy the conference.

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<sup>1</sup> [The transformative power of innovation in the financial system - Speech by Cecilia Skingsley](#)

<sup>2</sup> [Central Bank of Ireland Innovation Sandbox Programme](#)

<sup>3</sup> [https://www.centralbank.ie/docs/default-source/publications/corporate-reports/strategic-plan/our-strategy/central-bank-of-ireland---our-strategy-2024.pdf?sfvrsn=d64b671a\\_3 \(PDF 2.57MB\)](https://www.centralbank.ie/docs/default-source/publications/corporate-reports/strategic-plan/our-strategy/central-bank-of-ireland---our-strategy-2024.pdf?sfvrsn=d64b671a_3) – Our 2024 Strategy

<sup>4</sup> We have described this in more detail in our [Supervisory Risk Outlook Report \(PDF 2.08MB\)](#) from earlier in 2024.

<sup>5</sup> [Budapest Declaration on the New European Competitiveness Deal](#)