Remarks by Acting Assistant Secretary for International Markets Mitchell A. Silk at the Fourth Annual Conference on Fintech and Digital Innovation

March 3, 2020

As prepared for delivery:

March 3, 2020

Brussels, Belgium

The Importance of Financial Innovation to Economic Growth and Financial Stability

Thank you to Nick and Afore for putting together today's impressive program. It is so great to see many old friends and also to spend time with many of you who are quickly becoming new ones.

The mere fact that such a distinguished group is gathered to discuss financial innovation is a testament to the dramatic nature of the technological innovations sweeping across the financial sector today.

I'd like to share some thinking on the issues of speed and velocity of financial innovation in the context of balancing market growth and stability. In particular, here are few thoughts on how the policy maker and regulator may, will and should consider and respond to cutting edge developments in disruptive financial innovation to support a number of policy goals: healthy growth; appropriate access; market stability and security; and consumer protection.

FINANCIAL INNOVATION IN HISTORICAL CONTEXT

To project into the future and as context to the present, let's take a brief visit to the past. In order to do that, I'd like to tell you about our crown jewel at the Main Treasury Building in Washington, D.C., the Cash Room. Let me tell you a little about its aesthetics, the operations and function, and safeguards of the Cash Room, as it was originally designed, in order to highlight the impact of innovation on financial services and some of the challenges that confront us all.

A small bit of trivia is that the room was unveiled 151 years ago tomorrow for the inauguration of President Ulysses S. Grant in 1869. The event was so crowded that it took guests two hours to retrieve their coats.

No expense was spared in creating this very grand and majestic room. It was meant to be a roofed version of an all-marble traditional Italian palazzo bank to provide confidence in the strength of the U.S. Dollar. At the time it was completed it was believed to be one of the most expensive rooms in the world.

The Cash Room is of truly grand dimensions – it is 22m long and 10m wide, with vaulted ceilings that rise over 10m – and extraordinary design and architecture.

The Cash Room served a number of functions.

As its name indicates, a key function of the Cash Room was to store currency and to provide the public with check cashing services for transactions with the federal government.

To give you a sense of scale, in 1974, tellers at the Cash Room cashed almost eight million local checks for the public. That's over 30,000 checks per business day.

The Cash Room also served as a 'Bankers bank', to sell coin and currency to local banks. Again, as a measure of scale, Treasury processed over 650 million dollars in coins and 41 million dollars in currency for local banks in 1974. That's over 3 billion dollars in today's terms – or over 100 million kilograms (or roughly 250 million pounds) in coins. For those who associate with wildlife, think of the weight of over 25 thousand African Elephants or over 1,200 Blue Whales. That's a lot of blubber.

As to security, the Cash Room's money was stored in one of four working vaults in the Main Treasury Building. The Cash Room's vault was no ordinary vault. The vault had a truly ingenious security design that you can see in our building that was patented by Isaiah Rogers, then Supervising Architect of the Treasury, in 1864. The vault's unique burglar proof lining consisted of two layers of cast iron balls between plates of wrought iron and hardened steel. The balls rotated freely when in contact with a drill preventing penetration and breaching of the vault.

That was from the 1860s through the 1970s. With the advent of electronic banking, we closed the Cash Room in 1976 for operational purposes. We realized that local banks offered the same services at lower unit cost, and that the Federal Reserve could provide the same currency services. Closing the Cash Room saved the Treasury almost two million dollars per year in operating expenditures.

The aesthetics of this grand room remain the same. However, the financial operations and security features have been rendered completely obsolete as a result of financial innovation. As such, the Cash Room and its vault now serve as a meeting space and a wonderful place to provide historically significant tours.

FINANCIAL INNOVATION TODAY

Against that backdrop, let me focus on the present day. Fortunately, we at the Treasury Department have learned to be more forward thinking and forward leaning when it comes to innovation.

President Trump and Secretary Mnuchin have been leaders in this area, recognizing that actively cultivating technology expertise in finance ministries and other authorities is a critical means to execute on our core mandates.

Financial innovation has been at the heart of the administration's regulatory reform efforts, which have focused on appropriately calibrating regulation to better enable growth, while maintaining high-quality regulatory standards. For example, Treasury's fourth and final report in response to President Trump's Executive Order 13772 on financial regulation, titled "Nonbank Financials, Fintech, and Innovation," provided a roadmap to a streamlined regulatory environment that will foster growth and stability in the context of financial innovation.

However, in the international sphere, I worry about a different dynamic. It sometimes seems that the late Paul Volcker's maxim that the "the ATM has been the only useful innovation in banking for the past 20 years," still guides some authorities' approach. After all, we were told in the lead up to the crisis that innovative new financial instruments like collateralized debt obligations and credit default swaps would help mitigate excessive risk-taking.

It is undeniable that today, international financial authorities face a range of new challenges on the horizon as a result of financial innovation. Much of this challenge is driven by the precise element that makes financial innovation so compelling – its speed and velocity – and all the consequential consumer benefits as well as attending regulatory challenges.

Here are but a few:

- *So-called "stablecoins" that have the potential to become widely adopted in multiple jurisdictions have raised questions regarding their potential implications for both financial institutions and central banks in the financial system.*
- *Artificial intelligence and machine learning pose novel questions about how we should regulate financial decisions made exclusively by machines.*

- *Banks, already facing increased regulatory pressure and compressed margins, face competition from both startups and large technology companies.*

Our view is that it would be a grave mistake to remain in a defensive crouch. As authorities, we should confidently rise to these challenges and embrace the opportunities they represent.

- *The concerns raised by global stablecoins also has sparked a long-overdue discussion on improving cross-border payments.*
- *The adoption of artificial intelligence for supervisory purposes could potentially free up previously occupied human capital and ease regulatory burdens.*
- *Banks are able to leverage new forms of partnerships with both fintech and BigTech firms to expand their reach and access new markets.*

The increased speed and velocity, complexity, and cross-border nature of financial innovation raises legitimate questions about whether a new forward-leaning mindset is needed for policy makers, regulators and supervisors.

New business models provide avenues to offer services to the underbanked or unbanked, both domestically and abroad. The unbundling of financial services allows for specialization, allowing smaller fintech firms to focus on one specific and customized product or offering. Firms may offer new financial tools to save consumers money and increase efficiency, driving additional capital formation and productivity gains.

Continued international engagement will be of critical importance going forward, especially as it pertains to financial innovation. Given the space is so dynamic, it will require continued and thorough cooperation to usher in policy recommendations that achieve responsible innovation while safeguarding global financial stability.

Treasury’s Office of International Affairs is leading the Administration’s engagement across the international financial ecosystem.

In the multilateral context, we cooperate with our friends in Europe and throughout the globe on a number of efforts with our international counterparts, many of whom are in this room.

In the Financial Stability Board’s (FSB) Standing Committee on Assessment of Vulnerabilities, we are actively examining the changes to the financial system as a result of the entrance of technology companies and new forms of third party service suppliers, and whether these changes in market structure could present new vulnerabilities to financial stability.

We have stepped up our engagement on data connectivity. Unnecessary restraints on financial institutions' ability to move data across borders are a significant threat to both productivity growth and financial stability, and we are responding to the challenges posed by countries who are erecting harmful barriers like data localization requirements.

We are using our G7 presidency in increase focus on the issue. We recently formed a new G7 experts group on cross-border data flows to coordinate the G7 response to this emerging challenge.

We have also been leading on the topic de jour in today's financial world: payment systems and digital assets.

- Undersecretary McIntosh is Co-Chairing the FSB's Regulatory Issues of Stablecoins (RIS) working group that is leading the response to global stablecoins.
- My colleagues in the Office of Terrorism and Financial Intelligence are leading at the Financial Action Task Force (FATF), the global standard setter for combatting money laundering and the financing and terrorism and proliferation, as it implements new virtual asset standards agreed under the U.S. presidency of the FATF last year.
- We have also recently stood up a new G7 digital payments expert group under the U.S.'s G7 presidency.

We have also stepped up our bilateral engagement with key jurisdictions around the globe.

- Financial innovation and its implications are a central topic in our standing bilateral dialogues, including with Japan, India, the EU, and the UK.
- We have stood up a standalone partnership on financial innovation with the UK.
- And just last week, I hosted a full day program with our Israeli counterparts and key members of the Israeli private sector to deepen our cooperation and further efforts to calibrate the regulatory environment to support growth and stability.

These are examples of how we are rising to the challenge globally. But these challenges will continue to evolve at a breathtaking pace. As stakeholders in the international financial system, we need to consider how respond.

Let’s return to the issue of the speed and velocity of financial innovation. Do our goals of growth and stability require us to slow down to speed up? Or, do they require us to speed up to slow down? Or neither?

Most certainly, financial regulation could benefit by speeding up to meet the pace of technology and innovation. At the same time, innovators – particularly those developing novel and disruptive technologies or business models – could benefit from a measured pace to allow a considered policy and regulatory approach.

We at Treasury look forward to continuing to work with our European and international counterparts to further our mission of healthy growth, appropriate access, market stability and security, and consumer protection, all in the context of a rapidly changing financial landscape.

Thank you.

####