Data’s Transformative Power
Opportunities, Risks and Privacy

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About the Authors

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Introduction

This conference report summarizes the key points and discussions from the Centre for International Governance Innovation (CIGI) and Oliver Wyman’s ninth annual Financial Regulatory Outlook Conference, held in Rome at Palazzo Taverna on May 10, 2022. The evening before the conference, in the same venue, many of the panellists engaged in a preparatory conversation about the disruptive power of the fintech revolution and its implications for regulation.

The conference was opened by Pietro Carlo Padoan, chairman of UniCredit Group and former minister of economy and finance for Italy, followed by three discussion panels and a keynote address by Giovanni Tria, a CIGI distinguished fellow and also a former Italian minister of economy and finance, and included the participation of former ministers, high-level officials, senior central bank executives and private sector representatives.

The conference focused on data and technological changes as a disruptive force impacting financial markets (firms and consumers), regulation and supervision. The opening address set the scene for the discussion, recalling the evolving landscape we currently see in financial markets; the keynote addressed the impact on financial stability of possible challenges to central banks’ monopoly on monetary supply; and three panels drove the debate on issues of data’s disruptive power, digital currencies and their impact on monetary supply, and the evolution of payments systems internationally.

The coronavirus disease 2019 (COVID-19) pandemic further accelerated the evolution of financial services that benefitted from increased access to data and better technology, such as machine learning, to use the enhanced data that is available. What has this evolution meant for the financial industry and its regulation, and what will it mean going forward?

Policy makers will need to make important decisions in each of these areas, including:

→ how best to modernize payments processes;

→ how to regulate stablecoins and other crypto-assets;

→ whether to launch central bank digital currencies (CBDCs) and how to structure them if they do;

→ how to balance regulations based on activities versus entities when non-banks are picking up market share;

→ how to protect privacy rights while capturing economic gains from data usage; and

→ how to bolster cybersecurity.

Main Findings

Several evolving events appear to have contributed to a fast-changing environment in recent years. In fact, data-driven and digitally enabled innovation in the financial sector only grew with the COVID-19 pandemic, which forced many to work remotely and digitally, and accelerated a cultural shift and openness toward digital products and services.

This evolution is particularly pertinent to the financial sector in terms of payments and digital currencies, mostly driven by non-banks, especially stand-alone entities or those in partnership with traditional players.

Accelerating the environmental, social and governance (ESG) agenda also gained traction amid a significant focus on health and safety. But hyperactivity of digitally enabled services can pose risks within and outside the financial sector. Fraud, money laundering and cyberattacks are worrisome as countries deploy significant public funds to support the economy, while operational resilience and third-party management are a systemic concern as businesses migrate online.

There are still mixed views on how to manage risks in the financial sector with the increased participation of non-banks. Privacy issues are becoming more relevant: financial institutions face growing concerns over data rights and privacy. Major policy issues are also emerging as society and the financial sector accelerate toward data-driven business models. The coming years will see the policy-making debate heat up over tech and data regulation, regulatory and supervisory architectures, and cross-border arrangements.
While authorities and regulators consider how to deal with new technologies, we are seeing the private sector quickly evolving. It would be very beneficial to redefine the interaction between the private sector and regulators, to establish common fora for discussing issues in an evolving environment. Furthermore, it may be important to balance social responsibility and inclusion with economics and recognize that, due to human nature, there will be both uses and misuses of this approach.

The current geopolitical backdrop shows that it would not be appropriate to take the current rules-based world order for granted. We are only starting to see misuses of data and digital currencies, the weaponization of payments and varied levels of restrictions by geography.

There is a need for increased global economic cooperation, including to address the current disconnect between the highly digitalized Generation Z, the private sector and society’s fundamental institutions. We still see big gaps in understanding current events and the possible evolutionary path, as well as the appetite and readiness for change.

The Current Macroeconomic Scenario: Europe and Financial Markets

The international macroeconomic scenario is getting more complex and uncertain by the day and is characterized by deteriorating performance and higher risks. In fact, Europe is seeing increased deceleration. In the euro zone, in the first quarter of 2022, GDP increased by just 0.2 percent (quarter on quarter), with significant differences, such as high growth in a few surprising outliers (for example, Portugal at 2.6 percent and Austria at 2.5 percent), while larger economies were close to stagnation (Germany grew by just 0.2 percent, France’s growth was flat and Italy was even at -0.2 percent). At the same time, headline inflation in Europe increased to 7.5 percent in April 2022, driven by energy (+38 percent), but also core inflation moved higher to 3.5 percent, partly as inflation in the service sector picked up as post-COVID activities were improving.

The global outlook has worsened. Some forecasters anticipate a possible recession later in 2022 as the triple whammy of higher commodity prices, growing concerns about the Russian invasion of Ukraine, and a difficult global environment (both in terms of demand and supply-chain issues) takes hold. Scars of the COVID-19 crisis are still present. Risks are increasing from several sources:

→ volatility in energy prices linked to geopolitical tensions;
→ supply-chain bottlenecks;
→ worsening conditions on global financial markets after the invasion of Ukraine (leading to rising long-term interest rates in both the United States and the euro area);
→ greater pressure on public finances;
→ growing financial vulnerability of firms, despite the cyclical improvement in 2021; and
→ more acute cyber and environmental risks.

In such a scenario, it is important to connect the short-term picture to longer-term, structural changes that present both challenges and opportunities. This is not a cyclical shock, so what kind of crisis are we in? There is intense debate over the use of economic terminology. One can suggest that, in the current picture, there are elements of stagflation and (pre-COVID-19) elements of secular stagnation pointing at structural obstacles to growth. But beyond terminology, the coexistence of macroeconomic and structural imbalances requires a wide-ranging policy strategy, even more so as the policy space has been progressively reduced. In both the short term and long term (for instance, as the declining level of R*, the natural real rate of interest, indicates), policy space needs to be re-established at the macro level and at the structural level.

There are also deep and mounting geopolitical imbalances. The Russian-Ukrainian conflict has accelerated a fragmentation process that was already under way. This process may be exacerbated by the weakening of global governance. In fact, we see, for example, that global entities (such as the Group of Twenty) are
possibly being overtaken by regional entities. But for Europe to play a major role in supporting global governance and producing global public goods, this goal should accelerate the transformation of its growth model, moving toward a green and digitally driven strategy. This approach was already clearly stated before the COVID-19 crisis.

The focus should be on investments aimed at reducing greenhouse gas emissions; increasing the share of renewable energy; and fostering energy efficiency, clean energy technologies as well as energy system integration. However, opportunities arise from synergies between green and digital policies, especially in areas such as energy networks, mobility and transport (via automated and connected vehicles), smart buildings and precision farming, just to name a few. Artificial intelligence, supercomputing and pooled data would enable better analysis and decision making on the climate crisis and the environment, contributing to better policy making. How can we exploit these opportunities?

**Economic Policy Implications**

Economic policy has the main responsibility to support, facilitate and direct the reallocation of resources required to cope with structural and macroeconomic challenges. In the case of Europe, this means fostering green and technological transition within the context of social cohesion. To paraphrase a well-known expression, we may be entering the phase of the “great reallocation.”

Reallocation, which would entail reshaping the economic environment toward policy targets at the EU and national levels and on the markets, requires large investment plans to mobilize unprecedented amounts of public and private resources. This means, in essence, the European Union needs to act to revamp growth by putting pressure on existing technologies and environmentally unfriendly practices to replace them. The European Commission estimates that the goal to cut greenhouse gas emissions in the European Union by at least 55 percent before the end of this decade will require about €500 billion per year in additional investment, compared to the previous decade. The private and public sectors must both participate in this process to fill the investment gap.

Given the COVID-19 shock, the European Commission has suspended the Stability and Growth Pact (SGP) (recently extending the stop through 2023) and introduced a temporary framework on state aid. In addition, also in response to the COVID-19 crisis, Europe has put in place new policy tools. The European Instrument for Temporary Support to Mitigate Unemployment Risks in an Emergency has been established to support adjustments in labour markets.

In addition, the NextGenerationEU (NGEU) program and the Recovery and Resilience Facility instrument have also been created. The NGEU, although a temporary tool, is a “growth machine” that aims to support growth-enhancing demand and supply through investment and structural reforms, as well as by innovating financing mechanisms (European bonds). Growth will be strengthened, but the content of growth will also change. This will be the first line of the reallocation process. But it also brings important governance implications, as it is based on agreements (not mechanical rules) between member countries and the European Commission. Such agreements contribute to a truly European ownership of the process. The NGEU’s features could be very valuable for renewing the EU governance framework, including the EU budget and the SGP.

The second line of the reallocation mechanism is the role of financial markets. In Europe, the Banking Union and the Capital Markets Union are key to strengthening the intermediation mechanism between savings and investments. The European Financial Union (comprised of the Banking Union and the Capital Markets Union) should evolve as a platform of market-based finance, with particular attention to support innovation and productivity growth. Both banks and market institutions will be needed. Sectors rich in tangible assets expand faster in bank-based economies, while innovative sectors, such as green and tech-based ones, grow faster in economies with deeper stock markets. The sources of financing for companies that are highly tilted on bank credit must be diversified, as market instruments are the most effective in financing innovation.

Challenges will arise from the need to finance the green and digital transformation, while keeping risks (including cyber) in check, as well as
avoiding large social costs. Banks are evolving to cope with the new challenges and opportunities. They can provide valuable advisory assistance and financing to support the process aimed at rethinking firms’ supply-chain strategies. To implement this process, all available tools should be exploited, including open finance and digital currencies. This process requires a new approach to competitiveness for the financial sector as a whole.

Banks in Europe need to invest in technology and data management, review their business models and link to fintech to be able to compete with US and Asian players. Regulators can contribute by striking the right balance between maintaining stability and the need to remove obstacles to investment that are reflected in higher costs and, consequently, reduce the financial system’s capacity to support the economy. Supervisors are pushing banks to price climate risks into their loans. Enhanced disclosure guidelines and the increased awareness of climate stress are widening the borrowing costs between green and brown loans. Acknowledging climate risk will help “greening the economy” gain strength and diffusion.

All this requires progress in the Banking Union and the Capital Markets Union, which has been lagging behind, reflecting the still ongoing controversy between member states. Major players’ strategic areas are fully consistent with such an approach, as they focus heavily on:

→ investing in digital and data transformation;

→ implementing a clear ESG strategy to help clients, leading by example in their own business through a just and sustainable transition;

→ contributing toward a better society by properly channelling the huge amount of managed deposits; and

→ leveraging the European footprint to better serve clients and regions, allowing them to benefit from valuable advisory and best-in-class products and to access financial markets.

In conclusion, the global economy is likely facing the initial phase of a great reallocation of resources and a reshaping of institutions. This transition period will require managing higher risks and supporting growth. This process, after all, is not new. It is a challenging task that can be successfully met through sound economic governance, which itself needs to be readjusted to make it more consistent with the emerging global power distribution.

In Europe, this strategy also implies the need to achieve sustainable and robust growth. This approach will be instrumental:

→ to progressively reduce debt, both private and public;

→ to push the transformation of the current development model toward digital technologies, environmental protection and social sustainability;

→ to facilitate economic convergence between EU member countries, which has been interrupted since the 2008 financial crisis; and

→ to acknowledge that the financial system can provide a key contribution to this transformation and act to facilitate its role.

Data Disruption and Its Impact Panel

This panel addressed a very large topic; in particular, it considered the correlation between new tools and their prospective impact on financial markets and monetary policy. Of course, there are opportunities and challenges in the digital disruption of financial services and policy questions that result from this disruption, such as to what extent the blockchain represents a paradigm shift.

The relevance of data and the value of proper management of information are impacting financial markets in a significant way. Today, it is clear that intangible value is growing in importance, and the role of regulation (and data security) is increasing and changing. Data security is essential to preserve and define the value of assets based on intangibles, and the rules need to start being applied to the world and not only to specific markets and geographies.

In general, in the debate between regulators and private sector operators, a key finding that appeared relevant to all participants is that the evolution of private sector innovation needs to be more cooperatively brought to
the attention of regulators, and that both the public and private sectors would need to work together to define rules and perspectives. The “old” regulatory scheme that saw institutions intervening in markets from a distant perspective risks putting regulators in an unfavourable position given the fast-changing environment, both in technologies and in their application.

Digital Currencies Panel

In this panel, the main message was that digital assets are here to stay and will grow still more important, even if there is a “crypto winter” in the near term. These digital assets will be even more interwoven with the financial system over time, and their regulation needs substantial revision to work well, which will require legislation in almost every jurisdiction.

The panel discussed several issues, starting with the possible shape and balancing the policy argument pros and cons of an eventual retail CBDC, which now seems nearly inevitable. Today, there is a wide range of views among policy makers about the fundamental societal value of digital assets and CBDCs. Clearly, these views will impact the roles and evolution of banks, tech players and other non-bank financial institutions as a result of the rise of digital currencies. Design choices for CBDCs are complex and very important: for example, those choices will heavily affect the level and type of impact on the banking system.

Also, stablecoins and CBDCs will need to interact, and the “how” is still something to be understood in terms of monetary policy impacts. In fact, doubts arise about the right regulatory structure for stablecoins, given their multiple current and potential uses. On one hand, the design of a CBDC is very complex and requires making a number of tradeoffs or prioritization decisions. And, significantly, we can expect that digital currencies will affect monetary policy.

On the other hand, the diversity of the digital asset world requires policy approaches to be adapted accordingly, as traditional crypto-assets, for example, provide little social value and create large risks. A stringent regulatory approach (as currently envisaged in China and the European Union) is needed. Stablecoins bring potential social benefits (for example, enhancing cross-border payments) but are currently facilitating digital asset trading. Their expansion into the retail world raises additional issues, including financial stability and the need for a banking-type regulation. But regulation cannot be the only policy response. Public goods (such as CBDCs) could help achieve the benefits of private stablecoins while minimizing risks.

The panel also explored the potential of digital assets in terms of innovation (positive motivation) versus fear of missing out (overlooking risks), the much higher use of digital assets by the underbanked population and the potential impact of digital assets on the intermediation role of banks.

Payments Panel

This panel focused on issues arising in the payment environment, both from a technological change perspective and a geopolitical perspective. In fact, the resilience of the payments system has been stressed by the recent Ukraine crisis, including by attack factors, such as cyberthreats, and by the impact of sanctions, mainly those focusing on banks and payments systems (for example, the Society for Worldwide Interbank Financial Telecommunication). On one hand, many public jurisdictions feel under-resourced and unprepared or concerned about their resilience capabilities and cyber defence preparedness.

But, on the other hand, the crisis also started to force several countries, in particular China, to consider the scope for the West to use the payments system as a tool to project policy targets over the coming decades — a kind of “weaponization” of the financial system. In fact, when the possible weaponization of the dollar by the United States became a discussion, many scholars pointed out the risks for market stability associated with this attitude. But, as the entire financial system can be part of the tools used for policy targets and to apply pressure on competing powers, the possible “decoupling” (the formation of a parallel financial environment) is becoming a more concrete possibility. However, alternatives in place now are limited: we are likely to see an acceleration of investment into
and a shift toward those alternatives. Which payments system will be used is likely to become an issue of diplomacy and alliances and a pre-condition of development investment.

Will a “payments system competition” landscape see large innovation investments and new players coming into the market? The answer will likely be different in different areas of the world. For example, there are concerns for Europe about the fact that, to date, the European Payments Initiative has not really taken off, leaving Asian and US players largely vying for supremacy in global payments.

Regulators will have to monitor system safety carefully over the coming years and may need further regulation beyond the revised Payment Services Directive to manage for stability. Account-to-account payment facilitation (without the rails) could be a huge discontinuous gamechanger; right now, the rails players (Mastercard and others) are buying up and absorbing the account-to-account firms, which may become a competition issue.

Also, customer experience will be relevant, and, currently, one can note that digital payments remain below where policymakers want them to be. But will the forthcoming focus be on cash markets such as taxis, restaurant tips and home improvements? This remains a difficult question as it depends on technological constraints and barriers and on regulatory capability and policies. The European Commission is about to release recommendations on this topic but these will likely be mostly focused on public bodies rather than on how private sector operators should behave.

One of the main conclusions is that the private sector needs to evolve and find its path in terms of being a credible alternative to public schemes.

Unlike in the past, the future of regulation might entail closer cooperation between the public and private sectors in setting rules and defining control mechanisms, in particular, ensuring efficient and stable development of markets to maintain a safe and sound environment. In fact, quickly growing digitally enabled services could cause an increase in new risks (fraud, money laundering, cyberattacks) impacting not only the operators but also the customer base. This means that regulatory activity needs a more “holistic” view of the markets, including aspects such as privacy, data flow control or ESG issues, which only a few years ago were a lower priority from the perspective of regulators.

New technologies are quickly leading to a new definition of who the financial sector players are, and to a new understanding of the end customers. In fact, users of financial services, being the primary owners of data, now need to be seen in a global perspective, which is a game changer for both operators and regulators and might entail significant perspective changes. The future may differ from what is currently foreseen.

**Conclusion**

The digital revolution in financial services has just begun. Currently, the continuously changing environment is leading to a new evolution, which is pushing central banks and regulators to imagine a new model for their role, especially regarding their supervision of payments systems and their regulation mandate (for example, how to deal with the growing business driven by non-banks).
Agenda

May 10, 2022

11:00–11:10  Welcome
→ Rohinton P. Medhora, President, Centre for International Governance Innovation
→ Dominik Weh, Co-head of Public Sector and Policy Practice, Europe, Oliver Wyman

11:15–11:45  Opening Address
→ Pietro Carlo Padoan, Chairman of the Board of Directors, UniCredit

11:45–13:00  Panel I: Data Disruption and Its Impact
→ Andreas Dombret, Global Senior Advisor, Oliver Wyman (moderator)
→ Margarita Delgado, Deputy Governor, Bank of Spain
→ Kimmo Soramäki, Founder and CEO, FNA
→ Ambre Soubiran, CEO, Kaiko
→ Sam Woods, CEO, Prudential Regulation Authority, Bank of England

13:00–14:00  Networking Lunch

14:00–14:20  Keynote Address
→ Giovanni Tria, Chairman, Fondazione ENEA Tech e Biomedical; Former Minister of Economy and Finance, Italy

14:20–15:35  Panel II: Digital Currencies: How Far Do We Go?
→ Douglas Elliott, Partner, Oliver Wyman (moderator)
→ Edward Bowles, Global Director, Public Policy, Meta Financial Technologies
→ Sylvie Goulard, Second Deputy Governor, Banque de France
→ Hedwige Nuyens, Managing Director, International Banking Federation
→ Fernando Restoy, Chair of Financial Stability Institute, Bank for International Settlements
15:35–16:00  Coffee Break

16:00–17:15  Panel III: The Future of Payments

  →  Ted Moynihan, Global Head of Financial Services, Oliver Wyman (moderator)
  →  Maria Tereza Cavaco, Head of Payment Systems Department, Banco de Portugal
  →  Lorenzo Malagola, Group Public Affairs Director, Nexi Group
  →  Sheldon Mills, Executive Director of Consumers and Competition, Financial Conduct Authority
  →  Dominik Smoniewski, Head of Department Surveillance of Financial Market Infrastructures, National Bank of Belgium

17:15–17:40  Closing Remarks

  →  John Romeo, CEO, Oliver Wyman Forum