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Regulating innovation in the financial system to power a resilient recovery:

Squaring the circle between regulation, finance,
innovation, and sustainability

Prof. Paolo Savona's Opening Remarks

Following President Filippo Patroni Griffi's welcoming address, we are here in this beautiful location of the Italian Council of State, for our first G20 session as Consob, the Italian Financial Market Authority.

I would like to start my contribution today by thanking all of you here, speakers and audience in presence and in remote. We thought in this challenging time for the world, that it was important for us to contribute to the work of the G20.

I have been given the task of introducing to you, this conference, which is developed under three main themes: regulation, innovation and financial sustainability.

We are living in a very interesting time. Perhaps too-much interesting. Tech innovations for finance create a discontinuity in the ways and means that market operators and public authorities usually know and use. Market operators run faster than public authorities and communicate through social and traditional media instead of using large and heavy official documents, as authorities usually do. People follow short and incisive messages.

The question we are posing today at the conference which connects these three themes is: Can we square the circle?

Although a difficult task, it is nevertheless possible to achieve. The core of my contribution will be to explain how we now have the opportunity to square this circle, thanks to the collaboration and connections that we can create first and foremost across regulators.

At the base of the current debate on Fintech there is a social dilemma between economic freedom and protection of less informed savers. It is well known that information asymmetry undermines efficient competition. Tech innovation in finance can exacerbate



this asymmetry and, in principle, it can affect the allocative performance of financial markets to produce income and employment, and is now enlarged to Environmental Social Governance (ESG) issues.

G20 has already acknowledged the relevance of the technological transformation and is planning to regulate the new financial landscape. In the meeting held on 13th October, G7 has reaffirmed the importance of a strong international coordination and cooperation on innovation in digital money and payments and endorsed 13 Public Policy Principles for Retail Central Bank Digital Currencies to support and inform domestic policies in this field.

Consob, like many regulators around the world, in fulfilling its statutory objectives of safeguarding integrity, stability and transparency of the financial market as well as protecting savings, as guaranteed by our Constitution, must define detailed rules and norms to identify the regulatory framework. In doing this Consob would be remiss if it did not fully take into account these booming waves of innovation. This process leads also to a greater diversity of players, services, and products that have highly increased the possibility of regulatory blind spots and blind activities lying outside the stringent and well-known regulatory perimeters. These trends have produced, as a consequence, not only a fragmentation in the actions by several regulatory agencies, but also an asymmetry in the definition of rules, since national and international regulatory agencies often respond differently to different priorities and mandates.

Regulators are sometimes acting as if trapped within a pendulum motion, moving from light touch regulation to more stringent regulation. In this context the real risk is the proliferation of a hodgepodge of several regulatory frameworks across different regulatory agencies, which may be very fragmented, and perhaps have many overlapping and inconsistent aspects.

The cause of this risk may be found in the current silos system of sector-specific regulation agencies, each operating in its own field. This system is ill equipped to deal with the pressing technological disruptions that we are experiencing. For instance, the operational and stability risks, such as those posed by the spread of cryptocurrencies, are often moving outside the current regulatory and supervisory perimeters, thus showing that the boundaries of these perimeters are becoming more and more blurred.



In addition, the unprecedented development spurred by the digital and technological innovations are enabling many more countries (particularly developing countries) to enter financial markets. These countries are often the birth place of many innovative financial products and services, and thus rely on specific regulatory bodies often aiming not only at financial stability but also at inclusion and sustainable growth. This two-pronged approach poses new regulatory challenges, as global rules and standards have rarely considered these values within their scope.

We have the necessity to support a regulatory dialectic with innovations, but I would like to place emphasis here on the notion that financial innovation technology and digital disruptions not only hold the promise of many benefits for society, such as broadening financial inclusion, but also raise many distinct threats. Such threats relate to some of our most important economic and social values at the epicentre of our lives, such as privacy, competitiveness, integrity, and stability of the overall macroeconomic system.

On one side of the coin we realize that, in order to encourage technological innovation, regulatory authorities will need to revise their processes and operations, but let us examine the other side of the same coin. Among the many financial technological innovations, for example, there are machine learning algorithms used to identify our credit scores, robo-advising platforms that help us decide how to invest our pensions, and blockchain systems that issue new currencies for our daily life.

It is patently true that all technological financial innovations will always work more effectively and efficiently when they are built on the foundation that comes from the experience of independent authorities acknowledged by governments. Regulation provides not only a boundary but also legitimacy for innovation.

From this standpoint, I believe that regulation should be at the forefront in the digital innovation process and development because it provides a confidence building and trust in the financial system. In this important role given to the regulation, regulators should rise to the challenge. But what do I mean by rising to the challenge?

As regulators, we need to aim to strike a correct balance between innovation and risk and to adopt an affirmative but cautious approach to the significant conceptual and technical progress of this period. Three elements are needed to lead us towards this shift in regulatory paradigm. These three elements are: experimentation, transversality and international coordination.



First, I strongly believe that regulation should be considered as a complementary source of innovation. I will give you just one example to strengthen this assertion. The economic and financial crisis of 2008 resulted one major regulatory reform in the Basel III reform. Basel III financial reform has been seen by many as the possible gravestone for financial innovation. Instead, the opposite has happened and we've witnessed in the last decade an incredible flourish of financial innovations never seen before.

Within this context, it is of critical importance for regulators to develop and test new approaches. Experimentation and live-testing allows regulators to understand and reduce the emerging risks from the new technologies, ensure compliance, and ultimately spur improvements in regulation. There is an increasing need to experiment and exchange ideas and learn from each other. This amplified pace of change pushes regulators to embrace a more proactive approach and ensure that new skill sets are put in place to effectively supervise and regulate. A digital innovation hub, accelerator, innovation facilitator, and regulatory sandbox are all the testing-laboratories that Consob has recently developed to facilitate interactions and partnerships within the financial ecosystem.

The second aspect is the transversal approach. In this case, I would propose a way to reorganise regulators to work within, for example, a hub-and-spoke system that focuses on activity-based regulation replacing the more traditional entity-based remits.

The transversal approach, I believe, is at the centre of a true collaborative and thus innovative approach to regulation.

I mean a regulator akin to sharing information and experience across boundaries and well-defined perimeters. Doing so requires a new collaborative approach to regulation, where regulators not only engage proactively with industry participants and vice versa, but also collaborate with the other regulatory agencies.

We will need to break down the system of silos and barriers that at present are created between specialised regulatory agencies. This will also require changes in the way regulators work. I think that regulators will have a significant role to play in the future and that such role will be strengthened only if complementariness and a transversal approach across agencies gets embedded in both processes and actions.



Establishing complementary knowledge and capabilities at the national as well as the international level to tackle the thorniest problems we face today will inspire trust in those we serve. Using an international regulatory framework to address the problem of the growth and development of the cryptocurrencies in the market is one such problem to be tackled.

My third and last point is a proposition within the G20 Summit.

In 2009 the G20 leaders agreed to set up the Financial Inclusion Experts Group and acknowledge a set of core values for sustainable economic activity. In 2016, the technical team of the Global Partnership for Financial Inclusion launched the High-level Principles for Digital Financial Inclusion. I am going to propose a further step in this process.

I have been talking up till now about the new role of a regulatory framework and how this role is the cornerstone in the innovation development. In so doing, regulation may therefore transcend traditional boundaries and expand their mandate to incorporate financial inclusion and sustainability.

As we have experienced, the Covid-19 pandemic has unleashed a twin global crisis: a health crisis and an economic crisis from which we are just emerging after a long period. Nonetheless, the Covid-19 crisis has also accelerated the trend towards a more sustainable approach to investing and strengthened the need to connect sustainability and digital and financial inclusion. This conference has the aim to get underway the dialogue across boundaries, across agencies and across players in order to address the most significant problems through a collaborative approach to regulation. And this is because we strongly believe in a more inter-sectorial approach to financial market regulation.

I would therefore like to propose that this conference be an opportunity to reflect on the need to launch a new International Conference on financial and monetary issues, and to proactively take charge and regulate technological innovations under the aegis of a sustainable and inclusive finance for all.