

Conference Report – Rome, Italy, November 26, 2019

Open Finance

A Game-changing Reform



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About the Authors

Maria Fernandes is a principal with Oliver Wyman's Public Policy and Finance & Risk practices in the London office. Maria has been working in consulting for more than eight years, leading engagements with private banks, supervisors and policy makers across Europe, on a range of topics covering risk and policy for the financial sector, including risk and credit management, restructuring and resolution, regulatory response, supervision and public policy analysis in the financial services sector, development finance and anti-money laundering (anti-money laundering/ combatting the financing of terrorism). In 2018, Maria started focusing on topics related to open finance and implications of digital trends for the public sector, having led the research for and co-authored Oliver Wyman's publication *Supervising Tomorrow* (March 2019) and a study on financing models for digitalization of Portuguese small and medium-sized enterprises with the European Investment Bank (September 2019). Maria holds a bachelor's degree in economics from Nova University and an M.Sc. in applied economics from Católica University in Lisbon, Portugal.

Angelo Federico Arcelli is currently a CIGI senior fellow and a professor of economics of international institutions at Guglielmo Marconi University in Rome. Federico has served in several adviser roles, including at the European Investment Bank and at the Independent Evaluation Group (World Bank Group) and as a member of the executive board of the World Bank (in Washington, DC, 2008-2009) and of the consultative committee ("Osservatorio") on the European constitution in Italy's Ministry of European Union Affairs (2002-2004). In the private sector, he currently holds positions at Oliver Wyman and Marsh and McLennan Group. He holds an M.Sc. in economics and a Ph.D. in economic history, both from Bocconi University in Milan.

Introduction

This conference report summarizes the key points and discussions of plenary sessions at CIGI and Oliver Wyman's sixth annual Financial Regulatory Outlook Conference, held in Rome on November 26, 2019.¹ Many other bilateral exchanges were no doubt sparked during and outside of the conference.

Looking ahead, addressing the challenges stemming from digitalization will continue to be a major theme in the financial sector. Digitalization will continue to have implications for supervisors and regulators to consider.

The first part of this conference report gives an overview of the main changes affecting financial institutions as a result of the digital revolution, inspired by the conference's first panel. The second part focuses on the specific challenges for regulation and supervision in the new financial ecosystem.

Finally, these issues are then revisited through a private sector lens, informed by the conference's "chat rooms" (restricted seminars behind closed doors that were open to the conference participants) and subsequent panel discussion that brought together policy makers and representatives from banks and fintech companies.

Main Topics Addressed

At an accelerating pace, more and more banking services are being performed outside traditional banks. This is driven by both push and pull factors. New and increasingly digitalized financial services are being provided by innovative players responding to increasing customer demands and preferences.

But two major regulatory reforms in Europe — the second Payment Services Directive and the General Data Protection Regulation — are also forcing banks to share their customer data with

competitors and put the individual in control of how their data is — and is not — used.

These regulatory reforms are opening the way for increased competition and for new players to enter the market, many of which are contributing to improved customer outcomes and financial inclusion.

These new players, which may even be from different industry sectors, each capture a slice of the financial value chain: fintech developers, telecommunications providers, energy companies, retailers and, of course, the global tech giants. This only adds to the growing pressure on European banks to cut costs and improve their service offerings.

What are the broader implications of this disruption for the financial system as a whole? What new or changed risks does it bring to incumbents and new players alike? And what are the challenges they pose, in particular, for financial supervisors, and other policy makers?

These and other questions are starting to emerge globally across jurisdictions, blurring the traditional boundaries between regulated and unregulated firms and even across financial and non-financial industries.

Financial Markets and the Digital Revolution

The financial sector has always been a key information and communications technology sector as well as a sector that invests and evolves with technology. So why do we speak of a "digital revolution" today and why is this a challenge, especially for banks?

While not a new topic, digitalization and the new players entering financial markets are creating key challenges for banks and society as a whole, at least in the following areas:

- posing new types of risks (namely, cyber risks, data privacy, anti-money laundering [AML]/combatting the financing of terrorism, and so on);

¹ Maria Fernandes and Angelo Federico Arcelli are the co-authors of this conference report. Maria was the principal writer.

- changing customer and society expectations in terms of services, pricing and the value of bank-led (physical) relationships, which will place additional pressure on efficiency, in particular as more agile players take on the interface and distribution functions; and
- learning and adapting to new technologies to compete with agile new players while managing legacy information technology infrastructure and systems — this is particularly challenging today in an environment of low profitability for banks, which hampers investment.

Digital disruption may, however, also create new opportunities for incumbents, be it in designing new products and services, partnering up with innovative businesses or cutting costs.

Banks may even realize they have specific strengths that they can capitalize on for competitive advantages, in particular, the ability to exploit economies of scale (including in different jurisdictions), develop good processes to manage risks and gain (at least some) consumer trust. Many have indeed started experimenting with new technologies or business partnerships, primarily with smaller players.

A positive message echoed at the conference is that banks are no longer only seeing new players as a possible threat but instead are willing to compete (or partner) as long as it is on a level playing field and with a clear regulatory framework that also includes the assessment of and means for possible mitigation of new risks.

Ultimately, the financial sector is highly regulated for many important reasons and due to the nature of the services it provides. In Europe, given the challenge of profitability, it may be even more important that banks, as well as regulators, have a good understanding of the opportunities and risks of open finance.

Regulation and Supervision in the New Financial Ecosystem

Open finance is indeed bringing benefits to customers, but it is also creating fundamental disruption in the structure of the financial sector. As with any change, this can create new risks and issues for consumers, financial institutions, financial instability and competition.

Financial supervisors and regulators must confront important questions and challenges to ensure that the “change process” taking place in the industry is well managed. There should be benefits for consumers while adequately controlling for risks.

Many regulators and authorities seem to be taking action to have a more active role in shaping the industry to absorb this change, even if this is still asymmetric across global jurisdictions. What are the challenges for financial supervisors?

First, digital disruption blurs the traditional regulatory perimeter in terms of which entities fall under direct supervision. Activity-based regulation and supervision could be helpful in overcoming this — that is, for instance, payments could be regulated irrespective of whether they are being provided by a bank or a technology company.

But growing cross-border, cross-industry and cross-entity service offerings may mean current regulation standards are not flexible enough for future change (for instance, where telecommunication companies are providing financial services in different locations).

Second, disruption is also increasing business-model risk and industry dynamics. Especially as new (including virtual/digital) licences are granted to promote competition, we may observe insurers and funds entering traditionally retail banking activities or vice versa, not to mention global tech giants and smaller, agile players such as fintech companies.

On the other hand, as technology and data firms grow in importance and scale, they become not only “service providers” to incumbent banks but (often larger) business partners, which makes it

difficult for regulated bank standards to be imposed across the full (partly outsourced) value chain.

Third, new risks arise from inherently different cultures entering the financial market. New and technology-led players may be more agile and fast in delivering service offerings but may lack awareness and sophistication in risk management, creating a conflict with supervisory objectives.

One example is ensuring technology-led players are conscious of the reputational risks of events driven by rumours and social media, which can trigger significant effects such as runs on liquidity. Supervisors may need to acknowledge and be alert to “coach” new players of the broader implications of their business models.

Fourth, the current regulatory framework may not be fit for purpose to adequately mitigate new risks (in particular those around third-party dependence from banks, data privacy, cyber, AML/Know Your Customer standards or other conduct issues), and ensure a level playing field (in particular given differences in standards across jurisdictions and increasing activity across borders and outside the regulated entities).

Policy makers will need to consider new or enhanced regulations, while making sure they are technology neutral (to avoid favouring a particular technology or business model), respect a risk-based approach (even if activities are the same) and are based on a solid understanding of technologies and their risks (which may require increased interactions with the ecosystem for expert knowledge).

The processes involved could also be simplified: the paper-based requirements could be removed, information sharing with other authorities could be improved and principles-based regulation could be increased.

Overall, the new digitally led financial sector is fast, cross-border, consumer-driven and, in many cases, uncertain, which conflicts with how most regulation, and indeed how most regulators, are set up. At the same time, the technologies that are disrupting the industry also provide opportunities to improve the supervisory models themselves. Some authorities see it as an exciting opportunity to shape the industry and increase supervision efficiency and effectiveness, while still controlling for risks and consumer protection.

Embracing Change: Evolution and Revolution in Financial Institutions

New players are certainly taking advantage of the opportunity to carve out their own space in the financial market and get a slice of the value chain. This creates competition for incumbents as most new players are, in effect, largely changing interfaces and infrastructure but not changing the economic functions of products themselves.

This means that new players are disrupting existing value chains. Perhaps the exception to this are peer-to-peer lending and crypto assets, which can be considered “new,” yet their overall scale is still small when compared to payments, lending or insurance.

New players are able to dispute a slice of traditionally vertically integrated value chains given their digital, fast and agile operation, selective bets on specific activities (for example, payments), integrated offerings that please consumers (such as linking with social media) and primary focus on scale and market share over profitability.

In many instances, banks are already learning from this and trying to enhance business models, for instance, via increasing customer centricity (for example, with simplified products and better analytics), or partnering with new players (such as via business to business to consumer, or B2B2C, platforms).

For now, big tech companies are still largely outside most financial markets, while incumbents and fintech groups are still in the driver’s seat in most markets outside China, even if they are entering new territories. But there are signs this may change, with big tech companies venturing into new initiatives such as Facebook’s Libra project.

Both the private and the public sectors will continue to be faced with these challenges in the coming years. Time will tell how the structure of the financial industry will ultimately change; it will certainly be an interesting time to observe its evolution. We look forward to the next Financial Regulatory Outlook Conference and to continuing discussion of these important developments.

Agenda

November 26, 2019

- 11:30–11:50 a.m.** **Registrations and appetizers**
- 11:50 a.m.–12:00 p.m.** **Welcome: Oliver Wyman and CIGI**
- **Rohinton Medhora**, President, CIGI
 - **John Romeo**, Managing Partner, Oliver Wyman Forum
- 12:00–12:20 p.m.** **Opening address**
- **Lorenzo Bini Smaghi**, Chairman of the Board of Directors, Société Générale
- 12:20–1:20 p.m.** **PANEL I: Financial markets and the digital revolution**
- **Pentti Hakkarainen**, Member of the Supervisory Board, ECB
 - **Peter Kerstens**, European Commission’s Taskforce on Fintech Professor
 - **David Robertson**, Chair of Applied Logic, Vice Principal and Head of College of Science & Engineering, University of Edinburgh
 - **Tatyana Zharkova**, Executive Director, Fintech Association Russia
- 1:20–2:20 p.m.** **Networking lunch**
- 2:20–2:40 p.m.** **Keynote address**
- **Jim Sensenbrenner**, Member of US Congress
- 2:40–3:40 p.m.** **PANEL II: Regulation and supervision in the new financial ecosystem**
- **Andreas Dombret**, Former Member of the Executive Board, Deutsche Bundesbank
 - **Bertrand Peyret**, Deputy Secretary General, Autorité de Contrôle Prudentiel et de Résolution
 - **Carolyn Rogers**, Secretary General of the Basel Committee, Bank for International Settlements
 - **Victoria Saporta**, Executive Director, Prudential Policy, Bank of England
 - **Arthur Yuen**, Deputy Chief Executive, Hong Kong Monetary Authority

3:40-4:40 p.m.

Chat rooms: Embracing change — evolution and revolution for financial institutions

→ SME Lending

Moderator/Speaker: **Ignazio Rocco di Torrepadula**, Founder and CEO, Credimi

→ Customer Centricity

Moderator/Speaker: **Finja Kütz**, Group Transformation Officer and Deputy COO, UniCredit

→ Personal Savings and Risk Management

Moderator/Speaker: **Homa Siddiqui**, Chief Operating Officer Compliance and Regulatory Affairs, Credit Suisse

4:40-5:00 p.m.

Coffee break

5:00-6:00 p.m.

Panel discussion from the chat rooms with Q&A

6:00-6:30 p.m.

Closing remarks

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