

Conference Report – Rome, Italy, October 17, 2024

A New Age of Finance

Daniele Franco and Angelo Federico Arcelli



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Table of Contents

vi	About the Authors
1	Introduction
1	Discussions
5	Conclusion
6	Agenda
7	Panellists
8	Works Cited

About the Authors

Daniele Franco holds a degree in political science (University of Padua), an M.A. in business administration (University of Padua) and an M.Sc. in economics (University of York). He joined the Bank of Italy in 1979. From 1994 to 1997, he served as economic adviser at the European Commission. From 1997 to 2013, he was at the Bank of Italy, and from 2011 served as managing director of economics, research and international relations. From 1999 to 2007, he was chairman of the Working Group on Public Finance at the European Central Bank. From May 2013 to May 2019, he was state general accountant at the Ministry of Economics and Finance. In May 2019, he joined the Governing Board of the Bank of Italy; from January 2020 to February 2021, he was senior deputy governor and president of the insurance supervisory authority. From February 2021 to October 2022, he was minister of the economy and finance. In 2020, he chaired the Group of Twenty meetings of finance ministers and central bank governors. He taught courses at the Universities of Bergamo and Trieste, at the Università Cattolica in Milan and at the Scuola Superiore della Pubblica Amministrazione in Rome. He has written several books and papers on public finance, fiscal policy and macroeconomic issues. He is currently scientific director of the Fondazione Cini in Venice and chairman of the Fondazione Ospedale A. Gemelli in Rome.

Angelo Federico Arcelli is a CIGI senior fellow and a professor of economic policy at Università Cattolica. He has served in several advisory 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 EU Affairs (2002–2004). In the private sector, he is currently a senior adviser at Oliver Wyman. He held positions at Marsh and McLennan Group, McKinsey & Company and IMI Bank. 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 from the eleventh Financial Regulatory Outlook Conference, “A New Age of Finance” co-hosted by the Oliver Wyman Forum and the Centre for International Governance Innovation (CIGI) and held at Palazzo Taverna in Rome, Italy, on October 17, 2024. The evening before the conference, a fireside chat was held on “The Impact of Artificial Intelligence on Financial Services,” a topic already discussed in the tenth conference but in need of continuous reassessment.

The objective of the conference is to cast light on and discuss the issues arising in the European financial landscape, which is undergoing a transformative shift as new capital providers are emerging to compete with banks. In this “new age of finance,” the defining question is: Can the system deliver the investment needed for Europe’s growth while dealing with the climate, energy and technology transitions and the imperative to bolster defences?

The conference was opened by addresses from Paul Samson, CIGI president, and Élie Farah, partner and head of financial services, Europe, at Oliver Wyman. They were followed by a keynote speech by Daniele Franco, former minister of finance (Italy), who discussed extensively the impact of environmental changes on sustainable economic development.

The conference then proceeded with its first panel discussion on “The Financing Continuum between Banks and Non-banks and the Role of Capital Markets in Growing the Economy,” featuring Elizabeth McCaul, member of the Supervisory Board, European Central Bank (ECB); Margarita Delgado, former deputy governor, Bank of Spain; Christophe Bories, head of the Financial Sector Department, French Treasury; and Lisa Quest, partner at Oliver Wyman.

The conference continued with a keynote conversation on the tenth anniversary of the Single Supervisory Mechanism, featuring a conversation between Pier Carlo Padoan, chairman of UniCredit; Andreas Dombret, senior adviser at Oliver Wyman; and Lorenzo Bini Smaghi, chairman of Société Générale. The discussion was moderated by Davide Taliente, partner at Oliver Wyman.

The second panel, on “The Role of Banks, Non-banks and Markets in Financing Growth

and Transition,” was moderated by Douglas J. Elliott, partner at Oliver Wyman. He was joined by Francesca Carlesi, CEO of Revolut UK; Charlotte Hogg, CEO of Visa Europe; and Tracey McDermott, group head of conduct, financial crime and compliance, Standard Chartered.

Discussions

While the pre-conference fireside chat, focusing on the impact of artificial intelligence (AI) on financial services, resulted in a dynamic conversation about how AI has completely transformed the financial services industry — sparking a critical need for careful consideration of regulatory frameworks, changes to the operating model, and workforce reskilling and evolution — the keynote focused on the issue of financial sustainability, in particular relating to environmental and climate costs and long-term intergenerational issues.

The concept of sustainability is an analytical tool for looking to the future. The definition of sustainability is simple and intuitive: an economic policy is “sustainable” when it can be maintained unchanged over time. The technical debate on defining and measuring the conditions of sustainability underlies a concern for the future: unsustainable policy tends to harm future generations. For example, the failure to repay public debt has heavy and lingering effects on the economy, society and international relations; worsening environmental conditions affect people’s life expectancy and well-being.

The crucial issue is the balancing of the needs of current and future generations, which is essentially an ethical problem. To deal with this problem analytically, economists use the intertemporal preference rate, which is the interest rate that translates future flows (income, consumption and so forth) into their present value. A low interest rate implies that the future has much weight in current choices; a high interest rate implies that the future has little weight in the same choices.

In general, when a policy is not sustainable, the later the action is taken, the greater the future burdens. However, the need for prompt adoption of corrective measures may clash with the timing of politics and the preferences of citizens and voters. In fact, consensus aggregation mechanisms often tend to give more weight to what happens in the short term. Therefore, collective decision-making processes do not necessarily ensure

financial and environmental sustainability. Reflecting on the weight that we give to the future in our collective choices is necessary.

The debate on financial sustainability has, for a long time, been centred on the dynamics of public debt. Public debt is a fundamental tool of economic policy, but excessive borrowing can create problems. High debt can lead to higher interest rates, higher future tax levies, less flexibility in the government budget, negative effects on capital accumulation and greater uncertainty; it can also expose the country to greater financial risks. Therefore, imprudent fiscal policies, particularly in the good phases of the economic cycle, and inappropriate use of debt can lead to situations that are unsustainable and detrimental to the future welfare of citizens and taxpayers.

In the 1970s and 1980s, the debate on financial sustainability broadened to include the entire public budget and, particularly, the components of the public budget most closely related to the changing population structure associated with longer life expectancy and falling birth rates. Indeed, it became evident that demographic changes were making the social security and health-care systems much more burdensome.

International institutions made a key contribution to the development of long-term forecasts of public accounts. Currently, almost all advanced countries formulate long-term projections of the main items of public spending; these projections are used to calculate summary indicators of the sustainability of public accounts. On the financial sustainability side, national governments, the European Commission and international financial institutions have made significant investments, equipping themselves with indicators and procedures that give policy makers — and the public — a reasonably clear picture of the long-term outlook for public accounts. The welfare reforms introduced in many countries, including Italy, also reflect the availability of these indicators.

In recent decades, many countries have introduced fiscal rules to strengthen the weight of sustainability considerations in collective decision-making processes. Fiscal rules primarily aim to enhance the soundness of public accounts, avoiding high deficits and unsustainable debt levels. They also aim to avoid fiscal policies that are pro-cyclical and prone to high instability. In essence, the rules are introduced to limit discretion in fiscal policy.

They reflect the fear that unconstrained fiscal policies may lead to unsustainable or suboptimal outcomes (for example, pro-cyclical or unstable policies over time) in relation to: opportunistic choices (for example, in a pre-election context); short-sightedness in assessing the effects of debt recourse; and failures in coordination among different actors, each of whom is inclined to overlook the implications of its actions on the public finance complex (common pool problem).

Both economic literature and empirical evidence show that fiscal rules cannot be regarded as a magic wand that ensures the sustainability of public accounts. Ultimately, policy makers can always modify them or even abolish them and, of course, fail to comply with them. However, rules — especially when assisted by independent fiscal authorities — are tools that policy makers can equip themselves with to help make more forward-looking decisions. Once introduced, these rules make unsustainable choices more obvious and can increase their political cost. The behaviour of public opinion and markets is crucial in this regard.

More recently, the sustainability debate has also focused on the implications of climate change. The definition of environmental sustainability is, again, straightforward and like that of financial sustainability: one should not compromise the ability of future generations to meet their own needs. Awareness about the existence of environmental risks to well-being — and, in borderline situations, to the very survival of humanity — has been developing since the 1970s. Initially, the focus was on resource availability, which seemed to be thinning in the face of an ever-growing population and industrialization processes.

In recent decades, the attention of the scientific community has focused on global warming and its effects on the climate. Global warming, or the increase in the average temperature of the Earth's surface compared to the pre-industrial period, is producing increasingly detrimental effects on the planet's climate. These effects include rising sea levels, melting polar ice, extreme weather events such as floods and droughts, changes in precipitation patterns, and mutations in animal and plant species. The consequences for the planet are potentially catastrophic.

Global warming is largely attributable to the increase in the presence of certain gases in the atmosphere. These gases trap the sun's heat and

prevent it from returning to space, producing a greenhouse effect. About three-quarters of emissions are carbon dioxide (CO₂). By far the most important factor is burning coal, oil and gas, which produces CO₂. Less than five billion tons of CO₂ were produced per year after the Second World War; this amount increased to nearly 20 billion tons in 1980 and more than 35 billion tons in 2010. The growth is essentially linear, with fluctuations due to the business cycle.

In 1988, the United Nations and the World Meteorological Organization created the Intergovernmental Panel on Climate Change (IPCC), which aims to aggregate scientific consensus worldwide. In defining future scenarios, the IPCC refers to globally agreed targets, particularly those of the 2015 Paris Accords, which set a goal of containing the global temperature increase in 2050 to within 1.5°C of pre-industrial levels, indicating a second threshold of 2°C not be exceeded. If the global temperature rose above the latter, the consequences of climate change would be very critical.

In the IPCC's Sixth Assessment Report, it becomes clear that the margins of uncertainty about the severity of the situation are getting smaller and smaller; the prospective picture has worsened from that outlined in the previous report. If emissions remain constant at about 35 billion tons per year, the global temperature could exceed the pre-industrial level by 1.5°C before 2040; at the end of the century, the increase would be between 2°C and 4.5°C (IPCC 2023, 92).

How to bring about this change? There is broad consensus that several tools need to be used: from research and development to carbon pricing, from emissions regulation to financial regulation. Significant public investment will also be needed. Carbon pricing (the taxation of emissions) incentivizes energy efficiency and investment in clean technologies and generates revenue that can be used in the transition.

On the goal to bring net gas emissions to zero in a relatively short time (a few decades), there is now almost complete consensus among scientists. The path to zero, however, can be traced in very different ways. The open issues are many. The crucial one is the distribution of emissions among countries and economic sectors in the transition. How should the timing of zeroing pathways be differentiated? What should be the

role of different energy sources in the transition? What role should natural gas play? How long are hydrocarbon-powered engines eligible?

Zeroing net emissions does not imply that gross emissions are zero. How much can be offset with forests and the carbon capture? How can the relative margins be used? What can be the role of nuclear energy? Can net emissions be reduced to zero without the latter? What forms of nuclear energy would be appropriate to use? The enormous technical, financial and political difficulties of this path are obvious.

From a technical standpoint, an unprecedented effort of technology diffusion and infrastructure replacement is needed. In some sectors, there are currently no technologies that allow for avoiding gas emissions. History shows that the timescales for transitions between different energy sources (for example, from coal to oil and gas) are generally long. Manufacturing systems are complex, using different technologies with huge investments and many facilities. Housing systems are also complex, with millions of residential units, each with several types of appliances. Transportation systems include a significant number of different types of vehicles, with huge infrastructure investments. A very strong acceleration from past standards is required.

Financially, the transition will have very significant costs. Facilities and vehicles will need to be replaced; housing and infrastructure assets will need to be renewed. According to the International Monetary Fund, the effect on public finances will be negative (Gardes-Landolfini et al. 2023, 12). The burden on direct investment and support for households and businesses will be greater than the probable revenue on emissions (ibid.). Without the latter, the negative impact on public finances would be much greater.

It is well known that public goods are characterized by the absence of rivalry in consumption (the consumption of a service by one individual does not prevent another individual from consuming it at the same time); and non-excludability in consumption (once the public good is produced, other individuals cannot be prevented from enjoying it). This results in a market failure: the price mechanism fails to determine the correct incentives to produce a public good. Therefore, an entity is needed to maximize society's welfare: it is usually the state (through regulation or through direct forms of production of the public

good). In the case of climate, the issue becomes more complex. Temperature is a global public good: it is jointly determined by all countries, all businesses and all individuals. It is, in fact, global emissions that influence global temperature.

In the case of a global public good, therefore, all countries must be involved. National sovereignty (the Westphalian principle) must be reconciled with global welfare. This concept raises complex political and technical issues. A first solution is voluntary international agreements. A successful case in point here is the control of ozone emissions: in a relatively short period from the identification of the problem by the scientific community, the 1987 Montreal Protocol on Substances that Deplete the Ozone Layer was reached. The agreement, signed by 197 countries, provided for restrictions on the use of chlorofluorocarbons. Because of this action, the so-called ozone hole has been shrinking since 2000.

The ozone issue, while important, was nonetheless very specific, requiring relatively small-scale action. Global warming, on the other hand, requires radical changes in our ways of producing, consuming and travelling. There has been significant progress to date:

- Since 1988, the IPCC has been aggregating global scientific consensus.
- Annual UN Climate Change Conferences create continuity in the global discussion, albeit with varying impacts and with slowdowns and accelerations.
- Global targets have been set, notably with the 2015 Paris Agreement.
- Many countries are reducing the carbon intensity of their GDP.
- Many countries have set a time frame for the net-zero emissions target (for example, the European Union and the United States in 2050, China in 2060 and India in 2070).

The issue of sustainability has long been at the centre of economic analysis. In recent decades, it has become more prominent in relation to two developments: the changing population structure and global warming. Much has been done to address these new critical issues, but much remains to be done. In all dimensions, from public debt to welfare systems to the environment, prevention and early corrective actions are more effective and

less costly than emergency measures taken when the situation has deteriorated. Foresight is needed, but public decision-making processes, often based on relatively high intertemporal discount rates, frequently tend to lead to late action.

Therefore, it is important to strengthen the weight of the future in decision-making processes. Action can be taken through legislation, procedures and technical bodies. It is also crucial to build consensus on the changes to be introduced: investment in information and education for sustainability is needed. Increased demand for sustainability can lead to lowering the discount rate adopted in public decision-making processes, thereby attributing greater value to the future. In the case of climate change, the scientific consensus is now unambiguous: net emissions must be reduced as soon as possible. It is crucial to inform policy makers and the public in a systematic and understandable way. There is no other way to address the complex trilemma represented by climate goals, financial sustainability and political feasibility.

While the demographic transition is predominantly a national issue, requiring national action, global warming requires shared international solutions. International cooperation is a key factor, and the Group of Twenty can play a leading role. Voluntary agreements are complex but should not be underestimated. Climate clubs can be a second-best solution. We need to be aware that climate change affects income distribution and can widen gaps between countries. It is important that we act by limiting tensions at the national and international levels, managing redistributive effects, and making the best use of new technologies and economic and regulatory mechanisms.

Taking stock of the remarks of the keynote speaker, one participant in the panel that followed, “The Financing Continuum between Banks and Non-banks and the Role of Capital Markets in Growing the Economy,” focused on how the past 10 years of expansionary policy have led to big growth in debt in the euro system.

These issues also clearly represent a major constraint for global warming and climate investments and to any further reaction to the forthcoming issues as outlined in the introductory remarks. Regulation and constrained capital have led banks to pivot toward less risky and more liquid assets while non-bank financial

institutions (NBFIs), such as insurers, pension funds and asset managers, are playing an increasingly important role in financing the economy, particularly through private credit.

However, Europe's capital and securitization markets lack the depth of their American counterparts, which leaves borrowers suffering from a financing disadvantage just as they need to increase investment in climate and digital transitions.

The panellists focused on public sector views, including how regulators and states can react to the impacts of the current environment and the consequences in terms of future growth and geopolitical implications. It was again stressed (we could remember similar assessments from the previous year's conference) how much the needed green and digital transitions, which demand significant investments with implications on priorities and reforms, are relevant to cope with the uncertainty of current times.

How can banks and NBFIs work together to finance Europe's growing needs? What roles should capital markets and securitization play? How will bank and NBFI valuations be impacted? These questions were elaborated in the second panel, on "The Role of Banks, Non-banks, and Markets in Financing Growth and Transition." The discussion has shifted about how EU policy makers have adopted a number of measures in recent years to forge a Capital Markets Union (CMU) capable of spurring investment and growth in the economy, yet the bloc's own indicators show little improvement in the share or cost of financing provided by the markets. The European Commission estimates the green transition alone will require an additional €477 billion a year in public and private investment through 2030, and that may require new funding vehicles given the European Union's separate push for new fiscal rules to reduce government deficits and debt.

How should EU policy best encourage an expansion of efficient credit provision while preserving safety? What role will the CMU play in this? What balance should policy makers aim for between bank and NBFI credit provision? Should development banks step up their support for financing in Europe? If so, what is the best way to complement the private sector's role? Such questions were partially elaborated by a panellist, who stressed how important it is to

have available new tools in assessing risks as the magnitude of the financial transactions, and the connection between risks and frauds, can jeopardize the bank role if not properly addressed.

Conclusion

The conference cast new light on the interaction between more economic issues, such as the potential evolution of the monetary order, and the significant issues and challenges arising from climate risks, intergenerational issues and the threats as well as opportunities connected to possible difficult choices ahead. The overall feeling at the event was prudence, acknowledging the growing uncertainty that geopolitics and the economy seem to condition for the future. The ability of governments and leaders to manage challenges in multiple priority areas relating to the green and digital transitions and significant geopolitical and regional conflicts will determine the world we live in.

Agenda

October 17, 2024

- 10:30-11:00** **Registration and Welcome Coffee**
- 11:00-11:15** **Organizers' Welcome**
- **Paul Samson**, President, CIGI
 - **Élie Farah**, Head of Financial Services, Europe, Oliver Wyman
- 11:15-11:45** **Keynote Address**
- **Daniele Franco**, Former Minister of Economy and Finance, Italy
- 11:45-12:45** **Panel Discussion: The Financing Continuum Between Banks and Non-banks and the Role of a Revitalized Capital Markets Union in Mobilizing Growth in Europe**
- **Abdulaziz Abdulmohsen bin Hassan**, Board Commissioner, Capital Markets Authority, Saudi Arabia
 - **Christophe Bories**, Head, Financial Sector Department, French Treasury
 - **Margarita Delgado**, Former Deputy Governor, Bank of Spain
 - **Elizabeth McCaul**, Member, Supervisory Board, ECB
 - **Moderator: Lisa Quest**, Head of UK and Ireland, Co-head of Government and Public Institutions Practice Europe, Oliver Wyman
- 12:45-13:30** **Keynote Conversation: Ten Years of the Single Supervisory Mechanism**
- **Lorenzo Bini Smaghi**, Chairman, Société Générale
 - **Pier Carlo Padoan**, Chairman, UniCredit
 - **Andreas Dombret**, Senior Advisor, Oliver Wyman
 - **Moderator: Davide Taliente**, Partner, Oliver Wyman
- 13:30-14:45** **Buffet Lunch**
- 14:45-16:00** **Panel Discussion: The Role of Banks, Non-banks and Markets in Financing Growth and Transition**
- **Francesca Carlesi**, CEO, Revolut UK
 - **Charlotte Hogg**, CEO, Visa Europe
 - **Tracey McDermott**, Group Head of Conduct, Financial Crime and Compliance, Standard Chartered
 - **Mauro Micillo**, Chief, IMI Corporate & Investment Banking Division, Intesa Sanpaolo
 - **Moderator: Douglas J. Elliott**, Partner, Oliver Wyman
- 16:00-16:15** **Closing Remarks**
- **Claudio Torcellan**, Market Leader, South East Europe, Oliver Wyman

Panellists

Abdulaziz Abdulmohsen bin Hassan
Board Commissioner, Capital Markets
Authority, Saudi Arabia

Christophe Bories
Head, Financial Sector Department,
French Treasury

Francesca Carlesi
CEO, Revolut UK

Margarita Delgado
Deputy Governor, Bank of Spain

Andreas Dombret
Senior Advisor, Oliver Wyman

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Partner, Oliver Wyman

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Former Minister of Economy and
Finance, Italy

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