Annual meeting with the financial market

Speech by the Chairman Professor Paolo Savona

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CONSOB

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Speech by the Chairman to the financial market

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1 Consob's 2022 activity at a glance

Last year the Commission held 81 meetings to examine 1,023 files; their contents are detailed in the 2022 Annual Report sent to the Minister of Economy and Finance on 31 March 2023 (available at https://www.consob.it/web/consob-and-its-activities/annual-report).

A large part of the activities carried out by Consob falls within the tasks thereto entrusted by law, detailed as follows:

- ✓ Ensuring market transparency within the supervisory perimeter established by law, in order to provide savers with the needed information to make rational investment decisions;
- ✓ Overseeing traders' fair conduct and orderly trading, to safeguard trust and competitiveness in the financial market, by preventing and, where appropriate, sanctioning violations;
- ✓ Contributing to fine-tuning national financial regulations and to convergence of European and international supervisory standards and practices.

In order to ensure transparency, 719 decisions were made on issues related to corporate disclosure and ownership structures; 17 prospectuses were approved on public offerings and admission to trading of equity instruments (3 related to new listings). With a view to ensuring fair conducts and market integrity, 480 reports of suspicious market transactions were examined, 17 market abuse investigations were carried out, 350 investigations were conducted into market abuse allegations; 397 measures were taken for unauthorised provision of investment services, and 2,742 complaints were examined, of which 2,535 were identified as relevant. Furthermore, 456 requests for data and other information were addressed to issuers and intermediaries, and more than 200 meetings were held with corporate representatives of supervised entities. Consob's financial dispute arbitrator (ACF) received 1,116 complaints and ruled in favour of 678 claimants; the vast majority of involved intermediaries accepted the decisions made by the ACF.

In particular, across 2022, Consob followed the complex process of Borsa Italiana (Italian Stock Exchange) Group integration into the Euronext Group. In cooperation with universities, schools and operators interested in ensuring smooth market functioning, Consob also incisively contributed to the financial education programme by implementing as many as 50 initiatives in October 2022 (Financial Education Month) and on the occasion of the World Investor Week. Consob furthermore contributed to the environmental sustainability regulation aimed at enhancing ESG criteria, financial instruments digitisation, and building a single market for capital across the EU. A large part of these activities take place at ESMA (European Securities and Markets Authority), as well as at IOSCO (International Organisation of Securities Commissions) – of its Board Consob has recently been confirmed member – and at the OECD (Organisation for Economic Cooperation and Development). Consob chairs committees and working groups within such organisations, and cooperates, in other fora, to the definition of operational guidelines on the abovementioned topics.

Consob's activities involved 650 people, to whom I newly address my sincere thanks and the invitation to pay constant attention to technological innovation and its use in enhancing Consob's internal activities.

In discharging our institutional tasks, we maintained constant relations with MEF (Ministry of the Economy and Finance), the Bank of Italy, the AGCM (Italian competition and market authority), IVASS (insurance supervisory authority), COVIP (national supervisory authority on Italian pension funds), the Avvocatura dello Stato, the Council of State, the Guardia di Finanza, the Corte dei Conti (our Court of Auditors), Italy's Postal Police, and the OCF (supervisory body and keeper of the consolidated register of financial advisers). We also benefitted from the cooperation of COMI, the market operators and investors committee established within Consob. To all of them go our sincere thanks, together with our heartfelt gratitude for their valuable contributions to the fulfilment of Consob's supervisory, regulatory and sanctioning activities.

2 Savings and exports remain the pillars of our wealth; yet they are exposed to the effects of inflation and ongoing geopolitical changes and must gain consensus on their importance to our Country's solvency

The analyses proposed since my first *Speech to the financial market* in June 2019 have retained their validity and have been enriched with new contents. Savings, encouraged and protected by the Italian Constitution, remain the main object of Consob's activity aimed at contributing, through correct functioning of the financial market, to the economic and social stability of an ageing country that needs to increase real growth to sustain the general welfare level so far achieved and improve its fair distribution among citizens.

Italy's economic growth is export-led; hence exports remain the engine of our growth. Yet, to sustain exports, we need a trade-friendly international environment, which in 2022 was severely disrupted by Russia's invasion of Ukraine and heavily affected by the political tensions between China and the US. The utility function priorities of economic geopolitics tend to change, shifting from global free trade and social welfare for all people on Earth (Roosevelt's 1941 dream of the four freedoms) to national security and fighting against climate change.

World trade is suffering the consequences of this geopolitical reversal and, with it, so are Italian exports. Exports had withstood the weight of the 2008 global economic and financial crisis and attained excellent results over the past decade. This positive trend came to a halt in 2022 due to rising energy prices, which negatively affected our foreign trade balance by about 5%. If, as suggested by early 2023 data, such burden is bound to ease, Italian companies' ability to preserve their good international competitiveness level will resume in all evidence, primarily thanks to their technological innovation strengths and skills to satisfy customers' preferences. A positive contribution to these talents can come from capital market strengthening, mainly represented by Milan Stock Exchange, which is already an objective on Italy's economic policy agenda.

In 2022, savings held up well, although the saving propensity went down due to inflation surge. The rest of the world benefitted from our savings abundance, as shown by Italy's positive overseas balance sheet and by a sound current account balance of payments, which several other important competitor countries lack instead.

The underestimation of our ability to cope with political, economic and financial shocks, embedded in the spread required on the yields of our government bonds, cannot be identified in our companies' insufficient competitiveness and in domestic savings, but, as often repeated, it instead lies in our high public debt-to-GDP ratio. Structurally favourable terms of trade and our high level of financial wealth adequacy deserve to be assessed by unprejudiced minds. Lack of a last-resort support mechanism characterised by guarantee of intervention to counter speculative attacks does have an impact on valuations, as highlighted by the sharp reduction in the spread between BTP and BUND yields recorded after the 2012 ECB's decision to purchase government bonds. Instead of pursuing public debt reduction, which would certainly have deflationary effects, a quick return to a public budget primary surplus is important and urgent, complemented with new debt issuance trend that must be proportionate to GDP growth rate and to the private savings trend that must match the new debt.

3 Reasons for reconsidering the institutional monetary and financial architecture

Despite several evident contradictions in the solutions provided to major individual crises of large banks, since 2008, monetary policy has performed well to protect the systemic stability threatened by the global financial crisis and, in 2020-2021, to cope with the effects of the decreases in output and aggregate demand resulting from the Covid-19 pandemic. The close interdependence between money governance and the real and financial economy performance calls for a reconsideration of the current institutional architecture. Worldwide stock prices are increasingly reactive to FED decisions in the US and ECB decisions in Europe, respectively, confirming the close link between monetary choices and financial market behaviour.

As far as money is concerned, the current architecture is characterised by the independence of monetary authorities' choices aimed at price stability, introduced in compliance with the democratic principle that considers the "inflation tax" as inequitable, because it lacks the indispensable approval of those who suffer it. As for financial activities, supervisory authorities' independence does not benefit from an equally sound democratic reference as money, although in Italy it receives equal institutional dignity pursuant to Article 47 of the Italian Constitution, which prescribes encouraging and protecting savings "in all their forms". Consequently, the different legal treatments reserved to money versus the financial assets that savings assume do not appear entirely coherent. Consequently, it is urgent to ensure joint consideration of the two markets in order to surpass the current privileged treatment reserved to bank deposit as part of money creation.

The market success of cryptocurrencies and platforms for their trading and integration with traditional financial instruments has made it more difficult to find a solution to the set of problems they bring to supervisory authorities' attention. Some measures have been proposed or enacted on the subject, yet a joint treatment for the instruments used and the underlying Decentralised Ledger Technologies (DLT/blockchain) is still lacking. It is advisable to clarify the concept of "technological neutrality" of the regulations agreed upon and explain why separate regulation of technological innovations is being carried out. If it means that the wide array of virtual instruments used and the decentralised ledger accounting forms can be considered on a separate basis, then the established rules are unlikely to attain stable integration into the functioning of money and financial market. If, on the other hand, the objective pursued is to make these new accounting techniques irrelevant in determining the stability of money and savings, more than one doubt then arises as to whether this is really possible.

A contribution to the joint solution of the issue lies in the application of these techniques to the creation of new forms of official money – so-called "digital currency" or Central Bank Digital

Currency (CBDC) – which, if properly regulated, would enable ruling out the legal monetary use of cryptocurrencies. Introducing and disseminating official currencies with a truly decentralised ledger, such as the bitcoin blockchain, would result in demonetising bank deposits and directing bank operations to the domain of savings management, without preventing them from possibly continuing their services within a competitive payments system.

As economic theory has long pointed out, this reform would benefit both monetary policy, as it would more directly convey their effects to the real economy, and banks management. Relieved from the burden of a possible deposit flight, bank managers could thus better match the maturity balance of their assets and liabilities, being their alteration the main cause of bank crises and frequent source of systemic risks. Furthermore, such reform would ease the constraints on monetary choices aiming to prevent banks' lack of liquidity and insolvency, reduce the burden of operating deposit guarantee and resolution schemes, and avoid discriminating – under bail-in rules – between holders of protected deposits and holders of any other unsecured bank liability, respectively.

Innovations in decentralised financial accounting system, a.k.a. "tokenisation", are spreading alongside traditional instruments, with advantages in terms of cost and pace of implementation of fully de-securitised transactions, specifically within foreign financial relations. Such dissemination also calls for an urgent coordinated treatment of all financial instruments, avoiding to proceed, as is being done, by layering new rules over the existing ones. In Italy, this development would entail a reunification of the Consolidated Law on Banking (*Testo Unico Bancario – TUB*) and the Consolidated Law on Finance (*Testo Unico della Finanza – TUF*), which would also go beyond what Carlo Azeglio Ciampi suggested, following his Government's 1993 reform of the banking regime (from specialised to universal), together with the launch of mutual funds.

As a result of delayed regulation of virtual instruments, wrongful conduct in this domain is judged in civil law regimes by applying criteria analogous to those implemented within common law regimes, i.e. through decisions taken by courts (ordinary courts or administrative judiciary) and by supervisory authorities endowed with regulatory and sanctioning powers. The regulatory vacuum is triggering disharmonious distribution of tasks between the three organs of democracy, not only restricted to the financial sphere.

4 Inflation and its remedies

In 2021, following the end of supply constraints resulting from the Covid-19 pandemic, the fast recovery of aggregate demand was fuelled by abundant liquidity and promptly mirrored onto energy prices, thus driving inflation higher. After some hesitation due to general weakness in the forecasting models used, major monetary authorities were induced to re-prioritise their original mandate, naming it "normalisation". The reversal operated mainly on the interest rate side, which had remained close to zero for years. In an economic system where investment and production growth has been driven by a long period of low-credit costs reflected in rising nominal profits, the change triggered inevitably negative effects on real growth and financial stability. This added to inherent effects of inflation on the decrease in purchasing power of disposable incomes and greater uncertainty in market expectations. Due to the multiple instances to be reconciled, the short blanket has been pulled towards one side or the other of the several economic policy targets searching for fine-tuning, which remains economists' dream and politicians' illusion.

Part of the burden borne by monetary policy in the pursuit of real and financial stability has been eased by the launch of generous fiscal policies, including the NGEU in Europe (named National Recovery and Resilience Plan in Italy). For the time being, inflation remains misaligned with forecasts, as monetary authorities themselves admit, while insisting that they remain committed towards their 2% target. Persistently negative real interest rates confirm financial savings will definitely bear the main cost of inflation.

Inflation is like a multi-headed Hydra. If one of its heads is cut off and cauterised, the others act in its place. If consumer prices rise and money surplus is sterilised, the increase cannot be prevented from flowing through to wages. If labour cost can be curbed but commodity prices rise instead, the Hydra will not cease to operate. Politics does not have a Heracles, the mythological giant who confronted the Hydra, nor a Iolaus, who cauterised the severed heads to prevent them from regenerating.

Inflation's negative effects on savings and financial market functioning are not the only ones requiring efforts from private and public economic leaders, because history teaches us that high inflation also creates the preconditions for democracy distortion and social violence, which would harm everyone.

The path usually sought after to avoid the depression inherent both in inflation and in the instruments used to treat it lies in increasing public investment and stimulating private initiative. In current circumstances, such instruments proved insufficient in both domains, even considering the moderately good results achieved in 2022. A policy that urges savings towards investments in productive activities could allow for a head-on exit from the current inflationary crisis, i.e. not to the detriment of real growth.

The involved authorities point out that convergence timing towards the 2% target will be determined by firms' behaviour in setting prices for goods and services and by workers' conducts in demanding wage increases to offset their reduced purchasing power. The authorities themselves suggest focussing on productivity growth, a principle that always applies albeit depending on a currently decreasing aggregate demand trend.

An economic policy aimed at interrupting the knock-on effects of inflation should seek consensus by distinguishing exogenous variables from endogenous ones. In the 1970s, following the rise in energy prices (characterising the current inflationary process), a distinction was made between external drivers (i.e., the then "sheikh's tax", today's "war tax") and internal drivers (the then "wage indexation" (a.k.a. "*Scala Mobile*"), today's "supply constraints"), respectively. A commitment was made to accept the consequences of the former on incomes via agreements setting inflation targets, and to remove the causes of the latter by working with traditional instruments.

Governments have the power, frequently called upon and at times wielded, to block the increases in prices of goods and services from being conveyed to the cost of production factors, i.e. capital and labour. However, experience shows that the exercise of such power negatively impacts on the smooth functioning of the real and financial economy, resulting in greater damage than inflation itself. A wise redistribution of the "inflation tax" requires democratic institutions to assess each component of the problem and limit sequential interventions aimed at satisfying partisan pressures. Bringing down inflation without triggering depression and social imbalances is a very difficult task, which requires strong political commitment to choosing an acceptable level of distributive equity, based on consensus among citizens and relying on productive world capacity.

5 The different impact of inflation and its possible mitigations

In 2022, consumer goods prices increased, on an average, by 8.7% (of which: 5% attributable to energy costs), labour costs by 1%, tax revenues by 9.8%, and disposable income by 6%, respectively.

Albeit sought by the political initiatives undertaken, so far the fine-tuning between the arising economic and social pressures has not produced the expected effects, nor has it interrupted the unfolding of the circular process between inflationary impulses. Cost of living increases have been conveyed to fiscal drag, but not to wages, which have so far proved more rigid. The real value of financial wealth continues to experience a serious fall.

In spite of the numerous difficulties, productive capital has been able to react and indeed has successfully responded, improving profitability and acting as a store of value for the savings therein invested. Conversely, that part of savings invested otherwise has not yielded analogous results, altering the income and savings life-cycle plans of individuals and households, in line with the ideas that were worth the Nobel Prize to Franco Modigliani. Nor has the fiscal support provided been able to compensate for the damage caused by inflation, due to objective constraints on increases in public expenditure, fiscal revenue and Government debt. Fiscal policies, like monetary policies, cannot be used as far as to offset the inflation effects on the budgets of individuals and households, thus urging for alternative solutions.

Amongst these solutions, it still seems appropriate to build portfolios whose securities and real estate assets shield household financial plans against inflation, provided they enjoy the same regulatory and tax treatments. The free choice of currencies of denomination for portfolio assets would also help protect savings from exchange rate fluctuations, common in times of inflation or geopolitical upheaval such as the current one. Available data confirm the protective nature of such a solution, despite the discriminatory effects of rules built up over time, inspired by ideologies with diverging ends from the primary purpose of linking savings to productive activity and fostered by contingent needs to benefit one form of investment over another. Regulation neutrality does not exclude that exceptions can be made to address specific contingencies – as long as they are short-lived – so as to avoid newly inducing structural distortions to the rational use of savings.

The array of technical solutions that could improve portfolio management and financial market functioning includes the use of algorithms produced by "enhanced" human intelligence (a more appropriate term than "artificial"), capable of following even economic sectoral trends and, within certain limits, anticipating the onset of shocks by using neural logics, swarm intelligence and genetic algorithms. Such algorithms, together with "generative" intelligence (e.g., machine learning and chatbots), have proven well suited to the purpose of managing savings, provided that they are governed by rules that dictate their rational use. To such end, nevertheless, it is necessary to determine the technical and legal treatment of data storage and use, rather than the forms taken by virtual instruments; for these, the principle is confirmed that the same rules regulating traditional financial assets and liabilities should apply, with due distinctions. Innovations in the scientific processing of data would also enable for effective preventive supervision by authorities and enterprises on an objective basis, to rationally pursue their aims.

With a view to speeding up the adoption of technological innovations, it would also be appropriate to test the role of Board advisors, widespread in Anglo-Saxon countries. They would attend

Board meetings without voting rights to suggest which of the several available innovative techniques should be adopted. Board advisors would open up new spaces in the already existing financial advisory system; it will be the market, as already is the case for several professions, that will indicate who is adequately qualified.

A joint initiative between the various supervisory authorities involved would reduce the burdens and increase the effectiveness of their actions if they were to set up an interfungible decentralised ledger accounting and data access system to serve collective interests. Based on authoritative opinions, due to the decisive role that money plays in the financial market and in the real economy, central banks should provide the necessary technological infrastructure, ensuring its security against external attacks and making it available to the institutions that need it, in compliance with clear and transparent rules to be established.

6 Features of the action plan we should undertake

Based on the analysis so far performed, it turns out that monetary policy contributes significantly to effective pursuit of Consob's tasks pursuant to law, both in terms of quantitative variables and interests it has the power to set, and because of the close relationship it establishes with financial market functioning, in particular the stock exchanges. To that end, it is essential to review the institutional architecture within which money and finance interact, to achieve the common goal of using savings for real growth. This is necessary to address the Country's future in the context of an ageing population and to support individuals and households' income and savings life-cycle plans as a form of private welfare to compensate for the public one, constantly exposed to a problematic balance. Success in pursuing the goal also depends on: the decision to create a single "decentralised digital ledger money", as the only legal tender and means of account; the extension of the same accounting technique to traditional financial instruments; and the regulated use of constantly evolving methods developed by data processing science (Artificial Intelligence techniques).

Implementing this design requires a common legal treatment for money and financial assets, now unbalanced in favour of the former, due to the underestimated dominant role of the latter in modern economic development, specifically in the present circumstances. The size of financial credit already exceeds that of bank credit. Due to fears of insolvency and of a sudden withdrawal of deposits and, in the Eurosystem, to the attraction of safe assets with an interesting yield offered by the ECB, the reduction of bank credit would impose financial credit expansion backed by one or more forms of funding with maturity matched with that of the related investments. Knowledge of the financial wealth holding period and the likely maturity of investments thus becomes urgent.

Pending these reforms, recent initiatives undertaken by the Government go in the right direction. The Fintech Decree-Law, just passed by Parliament, introduced the option for issuers to make use of abovementioned DLT infrastructures. Furthermore, the draft law on measures to support capital competitiveness ("*Interventi a sostegno della competitività dei capitali*"), to which Consob contributed, provide incentives for enterprises to make use of market opportunities, such as the increase in multiple voting rights, new rules on the composition of board of directors and internal auditors, setting of deadlines for authorities to approve and/or reject initiatives to raise capital on the market, the obligation to reply to requests from supervisory authorities, the restriction to gold plating practices and the granting of higher tax deductions. We hope that Parliament, in agreement with the Government, will clarify the wording of Article 17 of the said Decree-Law to avoid litigation overflow that could disrupt the simplification sought after and undermine the very efficiency of supervisory activity. Amongst the motivations underlying the proposals put forward are the reduction of distortions caused by regulatory competition with foreign countries (including taxation) and the removal of constraints caused by factors that, for simplicity's sake, we will define "pre-rational". The latter purpose should be explicitly included in the initiative undertaken for citizens' financial education.

In conclusion, money, banks and capital markets are pushed in the same direction by the power of technology, which already plays an important role within real development and social stability. An urgent need thus arises to reconsider how to realign burdens and regulations, including fiscal ones, among the various forms of savings investments by healing those distortions that have stratified over time and by countering the distributive inequality they involve.

Contemporary mankind lives immersed in the technological environment, and technical knowledge drives forms of exercising power, which influence internal relations among citizens of the same country as well as international relations among States.

Nevertheless, technologies are not all the same and, once implemented, many become indecipherable in their short-term and, even more so, long-term effects.

Primo Levi once wrote: «*Don't hide behind the hypocrisy of neutral science: You are educated enough to be able to evaluate whether a dove or a cobra or a chimera or perhaps nothing at all will issue from the egg you are hatching.*»

This sagacity should certainly lie in everyone, and first and foremost in the authorities delegated to our Country's welfare, engaging advisors who are experts in "matching" the goals and values of human beings with the results of the progress automatically enabled by the technology created by human beings. We should certainly not hide behind the hypocrisy of science neutrality, and neither should we ignore its negative impacts on mankind, while avoiding being drawn into an impossible attempt to halt technological progress. There will always be someone or some country that will pursue such progress; and those who do not will be lagging behind.

Italy has always been able to cope with difficulties, many of which far more serious than the ones we are currently experiencing. There is no reason why our Country should not be so in the current difficult international circumstances where, among other things, the winds of war are blowing more strongly, driven by unquenched national egoisms. Italy has given its best at all times and in all and any circumstances. Why should the opposite happen today, knowing we have cultural and material means in stock that are just waiting to be mobilised?