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An Ethical Debate on Finance and Technology

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Introduction

Two months ago, at the beginning of november in Madrid, I had the chance to participate with Domingo Sugranyes and Josina Kamerling in a fruitful debate where we discussed the recent document “*Oeconomicae et pecuniariae quaestiones*”¹, that proposed a new formulation of the fundamental considerations on economics and finance from the perspective of Catholic Social Teaching. In the very first paragraph of this document, edited under the Congregation for the Doctrine of the Faith, we can read the following:

“What is needed, on the one hand, is an appropriate regulation of the dynamics of financial markets and, on the other hand, a clear ethical foundation that assures a well-being realized through the quality of human relationships rather than merely through economic mechanisms that by themselves cannot attain it.”

About Regulation

Let me start by talking about regulation of the dynamics of financial markets. Indeed, traditional regulation has played an essential role in the development of the financial sector to date, seeking four objectives: i) promote the stability of the financial system, avoiding systemic risk, bank runs and the malfunctioning of payment services; ii) maintain the safety and solvency of banks; iii) protect consumers of financial services, and iv) improve the efficiency and competence of the system.

¹ Considerations for an Ethical Discernment Regarding Some Aspects of the Present Economic-Financial System, May 17, 2018

All four should be conducive to the common good. Is not always the case, as for example during 2007/2008 crisis (credit crunch, contagion, manipulation of libor, opacity, fraud)... Since then regulators have made efforts in most fronts of tradicional finance (Basel III, MIFID, International Cooperation, Governance..). But the necessary regulation in the new world of digitisation is significantly behind the curve: new risks urge new rules.

Over the past few years we have seen several drivers that have been accelerators of change in the financial markets and that have clearly affected the overall current situation of the financial system:

1. First, new technologies: either underway or yet to come: mobile, Artificial Intelligence, Big Data, Cloud or Blockchain that are facilitating a network of products and services based on the interconnection of its users. A globalized and hyperconnected world immersed in technology that engages not only sight and hearing but also touch.
2. Second, users or clients are shifting their consumer needs: being permanently connected and accessing a service (24x7), looking for positive experiences that give them value in a daily basis. In this new environment, customers have more power than ever. They feel they need to be connected, anywhere, anytime. They also want their needs to be met immediately, including the consumption of relevant and useful content. It is crucial to understand the services that are being and will continue to be demanded by these younger generations, millennials and centennials, and by older “non-native” generations which are rapidly becoming digitised.
3. Third, an increase in the number of new players coming from the digital world (Fintechs & Big Techs) that are entering the incumbents’ value chain. The financial sector will have to compete not only with providers emerging from the financial sector (these companies start without the burden of having to maintain a physical distribution network, the rigidities of corporate culture, the upkeep of obsolescent technological systems or tough banking regulations...), but also with those arriving from other areas, in particular, the major digital companies Google, Apple, Facebook and Amazon (which we refer to under the acronym GAFA) or BATs from China: Baidu (search engine), Alibaba (e-commerce) and Tencent (social with WeChat). All this will open the way to different modes of participation in the digital ecosystem, such as by acquiring or taking equity stakes in “fintechs”, by developing

internal capabilities, through open innovation or by competing with GAFA.

Thus, it is clear that the digital transformation of the economy and society is changing everything. In this context of disruptive change, two forces will be fundamental for determining the speed of change and the scenario towards which the sector will move.

- On the one hand, banks will have to adapt their strategies radically to survive this unbridled competition from new entrants (taking care of their main asset: the customer, re-establishing their reputation and reaching more competitive prices).
- On the other hand, authorities will be forced to adopt an active stance, as opposed to passively oversee developments. Regulation and supervision are now challenged to provide a regulatory framework that facilitates the development of the new digital value propositions – which benefit the customer and introduce efficiency gains in the market – while ensuring protection against the associated new risks.

Indeed, the new digital paradigm presents new challenges, such as data protection, cybersecurity, or competition. These are not fully covered by the traditional supervisory and regulatory approach. What we really need is a joined up approach to those challenges and a global regulation, across countries, and across sectors². Open an international debate, with the G20 for example, on the key issues that demand coordinated action in order to define a common set of principles should be a key priority.

In this context, there is a need for a rejuvenated regulatory and supervisory framework that fully captures the potential of digital innovation and makes the financial system more resilient against future crises. In this sense, it is necessary to work on promoting harmonized regulatory environments to benefit from scale economies, standardization and ensuring level-playing field.

Let me focus on level-playing field challenges. Ensuring a level-playing field is not only an issue of fair competition but also of appropriately managing the risks for consumers and for the overall economy. Achieving a level playing field requires meeting two conditions:

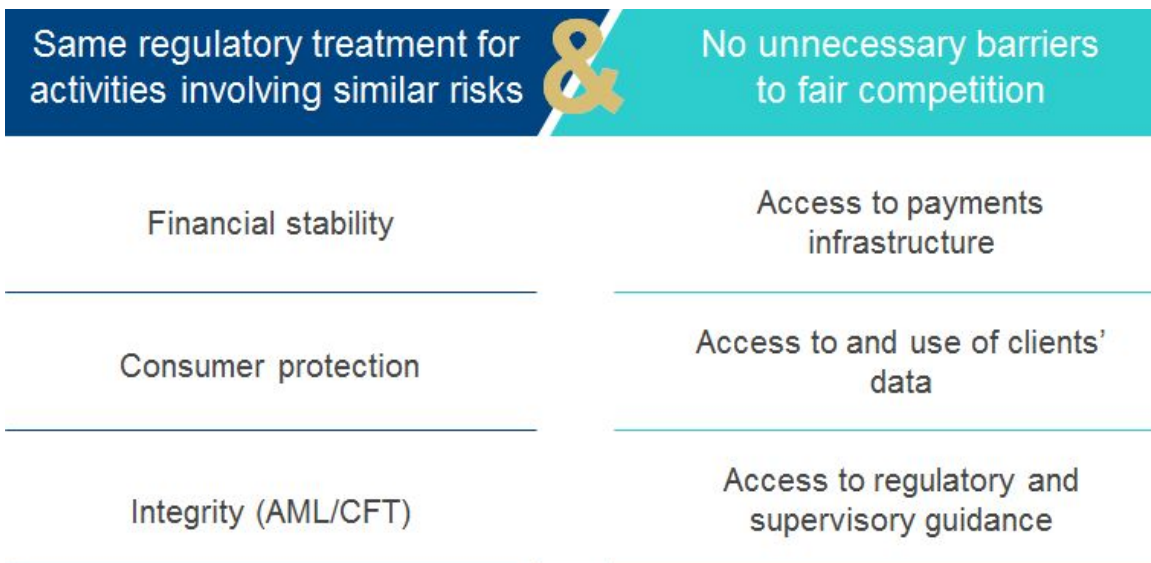
- First, that activities that generate the same risks receive a similar regulatory treatment. Two

² Carlos Torres Vila, Group Executive Chairman of BBVA, said at Paris Fintech Forum (29&30 of January 2019) “*what was really needed was a joined up approach to those challenges and that regulation needs to happen globally, across countries, and across sectors*”. See complete reference here: <https://www.bbva.com/en/collaboration-technology-and-globalised-regulation-will-be-the-drivers-for-success-in-banking/>

examples of current asymmetries between incumbents and new players:

- Banking groups are subject to prudential regulations that have implications for most of their businesses, including those in which they compete with non-bank players that are only subject to activity-specific regulations or benefit from regulatory loopholes.
- Thinking on consumer protection, some new services or business models as P2P are not yet covered under existing regulations, particularly in relation to transparency which may impact on consumer protection and integrity (unexpected losses, scandals).
- Second, there should be no unnecessary barriers to competition in the market beyond those justified by risk considerations. Given the strategic role of data in the digital economy, the latter condition refers to, to a great extent, granting different types of players access under fair conditions to customer data.

Fig.1 The meaning of Level Playing Field



Finally competition is a growing area of concern in terms level-playing field that deserves careful consideration. Our competition is really coming now increasingly from the big tech players. And as we move into deriving financial insights (actionable financial insights that support decision making from data) it will be the big tech players who will be offering those services and they don't have the financial regulation now that we have. Could we carve out things from our activity that are not

subject to production regulation? If we don't, I think we're going to be an increasingly at the risk of not being able to play on a level playing field. And that is a risk to banking.

To address the new risks for common good, it is also of paramount importance to improve the cooperation between regulators and the industry, whilst avoiding any confusion over their respective roles³:

- On the one hand, the *private sector* needs to have well-defined policies on the control and management of technological risks (cybersecurity, data protection, etc.) associated with the new value propositions.
- On the other hand, the *public sector* is currently being challenged to find ways to support innovation in order to alleviate uncertainty, sum up the efforts of the different agents while retaining knowledge that can be used to improve their regulatory tasks (some of them already launching initiatives to promote digital financial ecosystems such as innovation hubs, regulatory sandboxes, and new skills and collaborative mindset).

Overall, these initiatives allow authorities to have early and direct knowledge of these innovations, which is essential for the regulatory and supervisory framework to be kept up-to date and to face any new challenges effectively.

Such a holistic approach is the most reasonable way to seeking a balance between the promotion of the new digital value propositions and the protection against the risks involved.

About Ethical Foundation

But, as I said at the beginning, apart from an appropriate regulation of the dynamics of the markets we also need a clear ethical foundation that assures a well-being realized through the quality of human relationships.

In this new era, financial institutions face an enormous challenge: regaining trust and reputation.

³ A good example of this new collaborative mindset in Spain is Bizum: An example, which allows to make peer-to-peer instant payments between mobile phones. This initiative was possible thanks to the collaboration of almost all Spanish banks and the support of the Bank of Spain. BBVA was one of them; who acted like an innovation hub to deliver an innovation where banks can create their own value proposition.

Another example could be Fintech Collaboration, to stress the importance of fostering collaboration with fintech ecosystems in order for banks to improve their products and value proposition to customers: our Open Talent Challenge, a contest which attracts the most promising Fintech start-ups, which celebrated its tenth edition and which has already served as a platform for startup from over 80 countries in previous years. With this action we prove that we want to take further steps in our relationship with the ecosystem, by encouraging the creation of new value propositions through open innovation.

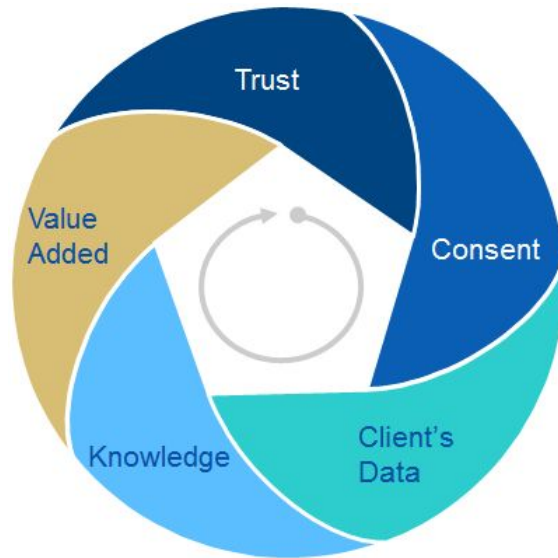
None of these can be carried out unless we recover the social license, understood as the commitment to the "public good" given the weight of the financial sector. This can be seen from two dimensions:

- The first is how does banking activity affect society? And at this point we talk about sustainability, inclusion, diversity, ethics in finance and how, the bank is involved in all these aspects. A good way to measure this is through the fulfillment of the 17 Sustainable Development Goals (SGD) of the United Nations that address a series of social needs, among which include education, health, social protection and opportunities for employment development, as well as the fight against climate change and the protection of the environment.
- The second dimension would have to do more with the bank itself and its ordinary activity. And in this sense, acting with integrity, prudence and transparency are the principles we want to achieve.
 - The principle of integrity in all our actions and in all relations with all stakeholders.
 - The principle of prudence, understood basically as the precautionary principle in the assumption of risk.
 - And the principle of transparency, as transparent and clear information facilitates the best decision making to all the groups of interest.

The most important asset in the banking business is the consumer's trust. As such, it is a responsibility of the bank and new players to operate in a way that inspires confidence to its customers. This confidence depends on the bank's ability to store and protect the depositor's savings and money and to provide a reliable, competitive and efficient service to its customers.

In the digital world, customers' trust is key to obtaining their consent to access their data. The more data we have, the more knowledge and more personalized value-added services we can offer. Customer satisfaction will generate additional trust. So, as you can see, it resembles a virtuous circle: *"Without trust there is no data, without data there is no creation of value and without creation of value there are no opportunities for people"*.

Fig.2 The virtuous circle of trust



With these we want to help people in their whole financial life. Not just in the money side of things, but in the decision making process too. Bad decision making creates a lot of frustration in people's lives and a lot of unhappiness. And I think banks that contribute to solving that problem, that really help people in their lives, in their decisions around money, and reducing the stress involved in that decision making process, they will have a strong value proposition.