PRIORITIES FOR THE UPCOMING COMMISSION

1. Realising Banking Union

While Banking Union has promoted a more resilient banking sector, there is still no integrated market for banking. There are several obstacles to Banking Union being effective: the lack of trust between member states and in European institutions; EDIS and its potential to solve home-host issues; and the need to abolish ring-fencing. Banking Union must deliver on the promise of an integrated market or lose the support of Europe.

1.1. The Banking Union has been successful in promoting a more resilient banking sector, but it is still failing to deliver an integrated market for banking business

An industry representative noted that Banking Union is about the creation of a safe and efficient banking sector and the free allocation of capital and liquidity across the eurozone. Europe needs to become a high quality brand name with a single financial market while accelerating economic efficiency and shock absorption capacity. Banking Union is about ensuring a level playing field both within the eurozone and at the global level. The industry representative considered that the Commission has achieved something very significant in the SSM, which plays an important role. The Single Resolution Board and the Single Resolution Fund have also been created, but in practice there have been no bail-ins where some banks were likely to fail. Additionally, there is increasing banking fragmentation associated with liquidity, capital and MREL. There are serious questions there including the free flow of dividends within eurozone banking groups and the unlevel playing field issues linked to the difference between TLAC and MREL requirements.

Europe is currently in a situation of prolonged low interest rates, a flat interest rate curve and ample liquidity. Monetary policy is causing a squeeze on banking margins. There are also ongoing requirements for more capital and a need to invest in technology. The industry must invest because of increased competition, especially from bigtechs. At the same time, the lack of restructuring or consolidation in the banking sector has created unhealthy competition. Ultimately, the consequences are low profitability, squeezed margins and the risk of excessive lending. Politicians like lending, but banks create NPLs when they use volume to compensate for a lack of margins. An official cautioned against underestimating what Europe has achieved. There is now a Single Resolution Fund, for which the backstop has recently been agreed. Priorities in realising Banking Union include: EDIS, the sovereign-bank loop, safe assets, liquidity, resolution, market fragmentation, cross-border banking and home-host issues.

1.2. There is a lack of trust between member states and in European institutions

An official considered the process of creating Banking Union incomplete. Europe has invested a substantial amount of political credibility in the project. It is a huge step in terms of the transfer of sovereignty. The industry is not seeing the expected benefits of Banking Union and a centrally supervised system. The discussion of home-host issues remains 'tense' and 'destructive', which reflects the worrying lack of confidence across member states and towards EU institutions. Europe has appointed one institution to supervise its banks and another to manage bank resolution, but the poisonous home-host discussion reflects the lack of confidence in the capacity of those institutions to manage financial institutions in case of difficulties. In order to make progress the industry needs clarity on the Banking Union framework and be ensured that this central project for Europe is moving in the right direction. Otherwise, the financial industry and member states' citizens will lose confidence in the process.

1.3. An EU agreement on EDIS might not be sufficient to resolve the home-host issues

Europe must complete the Banking Union. An official highlighted EDIS as the outstanding element. EDIS should solve home-host issues, because it will remove any technical reason for hosts to raise such issues. However, there is no consensus on the expected benefits from EDIS. Indeed, another official suggested that the introduction of EDIS will not solve home-host issues because many host countries also consider resolution and supervision as pending issues. Another official expressed optimism, however. Host countries could not agree on liquidity and equity waivers for pan-European banking groups because of concerns over national deposit guarantee schemes ultimately being liable if something went wrong with a subsidiary. This claim can no longer be made for resolution, because host countries will no longer have to pay for this. A third official felt the subject is not as simple as the first official had suggested. If it were, there would not be so many issues between home and host jurisdictions. An industry representative felt there is more to the home-host issue than EDIS and doubted that it would ever exist. An official felt that Europe has made big steps forward under significant pressure, such as the SSM or SRF. It is essential to explain why Europe needs these policies: because risk is being shared with people across Europe.

1.4. The SSM and host national authorities must reach an agreement on abolishing ring-fencing

An official felt that fragmentation and ring-fencing cannot be reduced by a simple fiat at the European level. Europe must give valid, credible and enforceable reassurance to economies with large foreign owned banking systems. Otherwise, there will be debate but no agreement. An industry representative stressed the importance of improving the relationship between home and host countries in order to limit fragmentation. It is necessary for market participants to see clarity on the long-term home-host framework.

2. Achieving progress on capital markets union

A strong EU will necessarily rely on deep, integrated capital markets. By channelling the high savings of European households toward the real economy, these capital markets will reduce the cost of capital for European corporates and funding innovation. Deeper capital markets will also give firms an alternative to bank credit, thereby diversifying their sources of financing and improving the resilience of their operations. Europe must deepen the single market and develop larger capital markets with increased long-term investment. Progress has been slow, including specifically on the harmonisation of insolvency and tax laws.

2.1. Europe must deepen the single market

An industry representative agreed that Europe must continue to work on Banking Union and the CMU. Taking a broader view, the industry representative suggested that Europe should consider the importance of its financial sector within the wider service sector. Considering the top 30 companies by capitalisation, the industry representative pointed out that 25 years ago over 70% of these companies were in manufacturing goods and energy, and fewer than 30% were into services. 25 years later, 60% of these companies are into services and 88% of these companies are American. There is not a single EU company in the top 30. Without an integrated service sector, it is very hard for European companies to scale up and be competitive at the global level. This is a difficult subject because the service sector is extremely complicated. Its fundamental components are its legal framework, the framework for human capital and its technological capability. Human capital is a particularly difficult issue because professions and the labour market are delicate national priorities.

2.2. Europe needs larger capital markets and increased long-term investment

An official emphasised the importance of cross-border long-term investment. Cross- border Investment is crucial for optimizing the allocation of capital, but it is also important because of the need to benefit from private risk-sharing in the eurozone, which public instruments are not yet delivering. An industry representative stressed the importance of remaining optimistic, articulate and modest in this respect. Clearly, Europe is faced with political, geopolitical, demographic and environmental challenges, but there are some reasons for being optimistic. Europe's finance sector is resilient. Brexit should teach the industry the importance of taking part in public debate and sharing its knowledge and expertise. It is also important to remain modest. Improving financial services can increase economic growth, but it has little influence on many of the most important drivers of economic growth: education, technological development and population growth. Ultimately, Europe needs more investment and better investment. 'More investment' means larger capital markets. The single biggest action the industry can take to increase investment is to increase the size and capabilities of the capital markets. 'Better investments' means better capital markets, and better capital markets means capital markets with a sufficiently long-time horizon and a diversity of participants to encourage and facilitate right decision-making. Fiscal, regulatory and supervisory frameworks for financial markets have a systemic bias towards short-termism. The industry representative suggested that Europe could achieve bigger and better capital markets by taking practical measures. The industry must develop and stimulate pension funds and pension products as mechanisms to channel savings into long-term investments. Additionally, there must be fairness and simplicity in the taxation of financial investments. The concept of investment saving accounts is valuable here. Europe must also grow cross-border market access, especially to smaller and retail investors. It is important not to underestimate millenials. They also need to save for their pensions, and approximately 78% of them consider Environmental Social and Governance (ESG) factors in investment decisions. ESG assets are growing globally by 12% per annum. Europe must ensure it takes a fair share of that growth.

2.3. Progress on CMU has been slow

An official agreed that Europe is lagging behind in the financing of the economy and investment in start ups. A substantial amount of work has been done on risk capital, but it is difficult for start ups to find sufficient capital within Europe to grow and compete globally. Europe also needs to maintain the ability to play a global role. Whatever the specific outcome is, Brexit will completely change the position of the European Union. It is important for Europe to build and control its own key source of financing and to have a common vision for its marketplace. Additionally, the financing of climate change should be a key priority. Climate change will not only be addressed by finance, but the financial industry can contribute significantly. The official observed that the progress made on the review of the ESAs has been positive but very limited, suggesting that this reflects the risk of a return to national considerations and a lack of ambition in terms of developing a European framework for banking and capital markets. Conceding the slow progress on CMU, another official pointed out that between 2015 and 2018 only three pieces of legislation on CMU were passed, but between 2018 and 2019 this increased to 12. The CMU agenda is very large, however. The official agreed that sustainable finance should be included in the CMU. Europe's 'biggest miss' on CMU has been its failure to agree on a taxonomy.

2.4. An EU harmonisation of insolvency and tax laws is crucial, but this is an area where progress is very difficult to obtain

An official suggested that there is a mixed picture on capital markets union. Europe has not come as far as it wished, but there has been progress. The incoming Commission's agenda should be broad: it should be about insolvency, taxation, securities and supervision. Another official agreed that Europe must complete the CMU. Europe has made positive progress although the original proposals were not very ambitious, especially in the field of insolvency. The problem is that finance ministers are responsible for the CMU, but justice ministers are responsible for insolvency, and justice ministers do not view the CMU as a priority. Additionally, the industry needs a truly European securities law. At present there is no European definition of a security. The official concluded by expressing doubt that tax could ever be part of the capital markets union project. In relation to insolvency, a third official felt that there should be some differentiation between corporate and bank insolvency. It would be a significant step forward to be able to use the specific legislation on bank insolvency, which has already been passed, harmonised and European ised, to make more progress towards harmonisation and integration. A fourth official stated that progress on tax and insolvency would take time. The Chair agreed on the importance of insolvency and queried whether a 28th regime could be of assistance here. An official considered that a 28th regime would not work for insolvency. At some point, the superimposed rules of the 28th regime must be connected with the national regime, because insolvency is ultimately about the same creditors. If a company goes bust, there will be creditors in the national realm and external bond holders, but the assets and priorities are the same. There cannot be preferential treatment of creditors, so a 28th regime probably will not work. The Chair hoped that this will not be the case.

The official emphasised the importance of tax. The Commission made a very sensible and modest proposal on moving to a qualified majority, which would have been a significant step forward. This also would have been a step forward for the CMU and the select subset of tax legislation. Unanimity is needed to change unanimity, and Europe is 'lightyears away' from unanimity. As long as the process demands unanimity, it will be hard to make progress. Feeling somewhat provoked on the subject of taxes, another official suggested that it is not necessary to have a harmonised tax regime due to capital markets. This does not exist in the US, where every state has the power of taxation, but Europe needs it where there is a cross-border element linked to an individual, such as in pension products. A pan-European pension product can only work with a harmonised tax system, regardless of where people move during their lifetime.

3. Future approaches – new ways of thinking and working

The panellists expressed different views on the way forward, variously suggesting that Europe should redefine its long-term view on the key priorities and escape the debate of 'risk reduction versus risk-sharing'. However, progress has become increasingly difficult due to an increasing domestic focus of public decision makers. In this context, advancing Banking Union slowly might be the only feasible way to make progress.

3.1. Europe must 'step back' and redefine its long-term view on the key priorities

An official highlighted the importance of taking a step back, re establishing agreement on the priorities and reiterating the long-term implications of banking and capital markets union. The official noted that France, Germany and other countries intend to establish a group to consider and advise on what should be done in these two areas. Another official suggested that a short report on 'the cost of non Europe' be produced, similar in style to the Cecchini report. The official stressed the need to ensure that Europe has sufficient funding capacity in its capital markets and banking system notably to facilitate the creation of European equivalents of BigTech companies. The development of these companies demonstrates how important financing is, especially equity and risk financing. Europe does not have the means to create bigtech companies of its own. It will remain a dream if nothing changes.

3.2. Escaping the debate of 'risk reduction versus risk sharing'

An official suggested that, under the right leadership, Europe could escape the Groundhog Day like discussion where one country says, 'We must do more risk reduction before further integration,' and another country says, 'We have reduced risk, so now we must integrate further.' It is a painful discussion, which leads to very little. Without anyone giving up their red lines, the conversation at the EU level has recently moved towards a situation in which participants are trying to imagine how future Banking Union might function in terms of the home-host issue, fragmentation, segmentation, EDIS and the regulatory treatment of sovereign exposures. The participants of a working group of the Council are also analysing how they could conduct further risk reduction and the industry is considering what it could learn from the FDIC. This approach has led to a fruitful discussion and some interesting perspectives. This group should publish a report in June.

3.3. Making progress on EU financial integration has become increasingly difficult as the political and social context increasingly turns towards domestic agendas

An official suggested that the Eurogroup has tried to avoid the 'real traps', such as the 'trap' of EDIS versus sovereign exposure. This is a toxic proposal which does not work. Instead, the Eurogroup enlarged the project by discussing cross-border issues. This is one way to do it, but ultimately it is very hard to build a union of 27 or 28 countries where national parliaments are pushing for their own national self-interest. Everything is connected to a big project; everything is connected to political circumstances. This is the reason so much work was done on a euro budget. That is how Europe will make progress. It will not make progress by telling politicians that they are stupid or that they are not doing the right actions. Another official stressed the importance of producing economic evidence to inform decision-making. One of the difficulties facing Europe is the entrenchment of certain concepts at the political level. Politicians focus on topics such as risk reduction and risk-sharing, EDIS and the prudential treatment of Sovereign exposures while missing out serious risks such as money laundering. This was not an area of focus and or a key risk, but suddenly it has become a key risk in terms of real risk and credibility risk for the European system.

An industry representative felt that the openness of European financial markets is important. If Europe wants to develop into a major reference financial market, it must be open. It must be open if it wants to be attractive to external financial investors. After Brexit, Europe should return to a more rational approach. Another industry representative felt that the discussions on these subjects often focus on the hurdles to progress. Perhaps it would be better to bring together a smart group of people into a room and allow them to play around with new technology to bring things to the next level. The effects of disruptive technology and other external factors on capital markets are often underestimated. This will not be the next crisis, but there will be events related to these topics which are not being considered.

3.4. Taking small steps might be the only feasible way to make progress

An official stressed his belief that people who believe in 'big steps' make 'big mistakes'. Taking small steps is the only feasible way to make progress and, crucially, it encourages the involvement of citizens. Europe should have learned how essential it is to convince citizens of the importance of this work. The industry must explain and discuss this process with citizens. Market participants need to sit on panels with citizens and explain the importance of this work. It is important to continue to work steadily, as Europe has been doing over the past few years.

3.5. Europe should not wait until the next crisis to fix these issues

An industry representative considered it vital that Europe should not wait for the next crisis to fix these issues. There is a deep belief in the EU that a crisis is necessary to move things forward. There is a belief that the political gap cannot be reduced unless there is the tension of a crisis. Europe must behave in a different way. There will always be a crisis; that is part of life. It is better to be prepared for a downturn in the economic cycle. The approach to these topics should be bold and yet humble. Over recent months, there have been serious difficulties in respect of money laundering. The decision taken to monitor this is very important. The industry must be aware that this will happen, and it must react without endless discussions on fragmentation. The industry representative noted the worrying trend of politicians imposing preconditions before discussing certain points. In discussions on fragmentation, someone will say, 'We cannot discuss this without fiscal union', or, 'We cannot discuss this without political union'. This is simply a nice way of saying that something will never happen. If this is not the message, the industry representative advised that this should be made clear. To avoid this kind of conversation, the Commission should have a simple agenda. The investors need an agenda with clear steps. The French like concepts, but the world prefers a clear agenda with simple steps. It is important to announce what action the Commission will take. If the Commission does this, Europe will take action. Europe needs to stick to a well-constructed agenda. This is what a company would do.