KEY PRIORITIES FOR THE INCOMING COMMISSION

1. The EU financial system is more resilient but poorly integrated

1.1 The EU financial system is more resilient

An official stated that Europe's financial system is more stable today than 10 or 15 years ago. The question is whether that is enough to face the challenges globally or closer to home. Another official noted that, between 2015 and 2019, the Banking Union and Capital Markets Union (CMU) progressed towards a more resilient and consistent framework for European financial services, covering aspects such as prudential ratios, central clearing or transparency. This deepened approach began after the financial crisis, and aimed to restore buffers, increase reporting and tighten supervision.

1.2. European financial markets remain underdeveloped and poorly integrated and the Banking Union is far from effective

An official advised that time was spent after the financial crisis to enhance the financial framework, bank capital and financial regulation. Institutions such as the Single Supervisory Mechanism (SSM), Single Resolution Fund (SRF) and Single Resolution Board (SRB) were created but fragmentation in the banking area is worse than before the global financial crisis and policies have not been implemented to support growth. Market integration in Europe also lags despite high household savings. This is the reason why a group of German, Dutch and French experts were asked to work on CMU to define priorities and bring sufficient political support and dynamic to focus on delivering regulation which reaches that outcome.

1.3. The global competitiveness of EU financial markets is challenging

An official considered Europe in the world as an important element. The US is challenging on international cooperation. China is becoming a major financial industrial and technological player. For Europe to remain in the global picture, it must be able to act as a global entity at a global level.

Competing with major players at a global level is relatively new in the European agenda considering EU sovereignty and the domestic market's capacity for major global players. This is evident in technology, with Google, Amazon, Facebook, Apple (GAFA) and others, as well as in the financial sector, where trends are not favourable for European companies. European banking remains domestic, limiting the ability to compete globally.

1.4. Deeper integration, fostering growth and improved financial stability do not conflict

An official considered that deepening integration, boosting growth or strengthening financial stability are key priorities that do not conflict. The single market helps to deepen integration. The destination has not been reached in areas like services, but deeper integration and a single market will boost growth. Strengthening financial stability does not conflict with boosting economic growth. If not done well, it can, but a reliable financial system gives confidence and is growth-boosting. Getting the balance right is a task for the next Commission and the Council, especially the Markets in Financial Instruments Directive (MiFID) and Solvency II reviews, Alternative Investment Fund Managers Directive (AIFMD) and other issues that arise. Lessons are usually learned from past mistakes, in an ongoing process.

Another official stated there is no prioritising between the three goals or priorities. Financial stability is a prerequisite for growth is agreed. A public decisionmaker also agreed that fostering integration, growth and financial stability should be priorities and there is no reason to rank them. There are many uncertainties, with major risks including trade, Brexit, geopolitical tension and others, so caution is needed. The economy is slowing, so avoiding recession is key and being ready to act is important. There are margins of manoeuvre and the European Central Bank (ECB) has taken some steps. The work on the European dimension of revamping and relaunching new investment plans is crucial and linked to financial-related issues and so financial policies require reflection. Financial regulation requires acting to support growth and not impede it with negative impact.

An industry representative advised that growth is Europe's goal. Integration and stability are fundamental ingredients to achieve long term and sustainable growth. The priorities have already been stated. The two main streams are completing the Banking Union and strengthening the CMU, as it is lagging behind. Stability is further along than integration. Stability must not be forgotten, but a concentrated effort is needed on banking sector fragmentation and the CMU components. An integrated and concentrated banking sector is required, as is building up the CMU. That is tantamount to creating a single market in services because the difficulties touch all the delicate points of a single market for services. A Banking Union looks simple compared to a CMU.

Implementing structural reforms, making the Banking Union effective and strengthening the CMU are key priorities that were discussed during this session.

2. Implementing structural reforms within each member state with a view to achieving a steady real convergence towards resilient economies is fundamental

2.1. Member States need to accelerate their homework and implement structural reforms in order to improve the competitiveness of firms and increase trust between member states

Monetary policy cannot do everything. High sustainable growth in Europe can only be achieved by reducing reliance on debt and reinvigorating productive strength. An official advised that recent years have seen an expansionary monetary policy. Analysing that policy's effects is vital. Limited progress was made on economic performance and new vulnerabilities were brought into the financial system. The focus should have been on convergence, even if it is easier said than done. There is more focus and pressure on policymakers, particularly in the field of fiscal policy and on structural reforms.

Structural policies can accelerate re-allocation, innovation and the diffusion of technology. Structural reforms suggest areas like pensions, healthcare or social security systems and public administration face challenges from demographic trends. Structural reforms also relate to skills, education, innovation and digitalisation. Any action in the pension system cannot improve a ratio of 1.3 employees per one pensioner. It can assist, but nothing can be done without sound growth, new jobs and increased productivity. Demographic challenges are an additional stress and must be emphasised alongside the four key priority areas, in line with the strategic goals to grow, connect, protect citizens and be more visible globally.

2.2. Defining the appropriate policy mix in the euro area

2.2.1. Fiscal policy could play a more supportive role in Germany

A public decisionmaker stated that there is room for providing budgetary support in the EU at this stage, with different margins of manoeuvre in different countries. The work on the European dimension of revamping and relaunching new investment plans is crucial. An official advised that the fiscal situation is being monitored carefully in Germany and diverging economic signals noted. The draft budget for 2020 is balanced but Germany is willing and able to act if there is further economic deterioration.

2.2.2. A dedicated centralised fiscal capacity is still needed

An official noted the work on the eurozone budget via the Budgetary Instrument for Convergence and Competitiveness (BICC). Consensus was not achieved that stabilisation should be part of the eurozone budget but is needed. An ambitious proposal for national unemployment schemes to provide liquidity to each other in a crisis did not find a majority in Europe to continue the debate. The topic will reappear in the next crisis, as will the centralised fiscal capacity.

3. Strengthening the CMU is a key priority

3.1. A great political interest for improving the CMU

An official stated that the CMU is popular. The finance ministers' expert group is grounds for optimism. If other member states ask to be included, it shows interest in the topic and provides encouragement. The work so far encourages ambition. Decisions must follow on inter alia harmonising insolvency and capital markets-related tax laws. A decision must also be made on the proposal to introduce qualified majority voting for tax legislation. It would help with the relevant and difficult CMU-related topics of taxation. Germany has changed its position on taxation and is open to the proposals, so it will be interesting to see how that is taken up.

3.2. Improving small to medium sized enterprises (SME) financing

An official emphasised the need for deepening capital markets and hearing similar arguments from several member states is encouraging. SMEs still fear capital markets, so the banking sector must improve further in a challenging monetary environment where yields are still historically low and even negative. Another challenge is the real estate market. Lessons that should have been learned from the financial crisis have not been. There is a need for a further improvement of financial literacy and better information for institutional and retail investors, as household citizens have savings that should be used directly or indirectly through institutional investors. Strengthening local markets is key.

The Chair noted that SME financing has been an omnipresent issue for Eurofi. Europe is still not doing well enough. A paper was written 20 years ago without much advancement since. Brilliant and innovative SMEs do not grow into world-beating top companies. No European companies appear in the top 50 global bigtechs. This is key for the Banking Union and particularly the CMU. An official gave examples of local innovation in electrical cars or in IT. Founders often talk about requiring financing support early in their history. It is also needed when preparing for the next step.

3.3. Priorities in insolvency, accounting and tax issues to strengthen the CMU

An official advised that the same problems are faced. A full and true CMU is important. The focus should be on improving the retail client's experience and encouraging the investment that is key to creating a more equity-owning culture in Europe. The financial system is one for efficient risk-sharing. Issues need to be remedied for that to happen, such as a harmonised system of insolvency rules. The outcome for the bondholders in a cross-border insolvency shows why this is important.

A neglected element is financial information, especially for SMEs. A large, publicly listed company uses International Financial Reporting Standards (IFRS), but SMEs are likely to use one of 28 different EU accounting systems that are not well understood outside national borders. This obstacle will not be easily remedied. Harmonisation is obvious, but insolvency rules seem to be part of the national heritage in some countries and people are attached to national accounting systems. This is true for another key area: there is indeed no harmonised European definition of a security. The concept exists in European legal texts but is defined in national law, which is a problem for crypto assets. They fall under national rules in some countries but not others. The CMU requires this to be harmonised. The tax issue also exists and is even more complicated. Another official added that PEPP was agreed. It may not be successful, although it is a good idea, as taxation is difficult.

The CMU has not progressed as far yet. There is not as much evidence on growth as there is no proof that either a capital markets finance-based system or a bank-based finance system is better for growth. However, there is academic proof that a capital-market-based system is better at financing innovative and risky new companies. That is why the US has Google and Amazon and Europe does not. There is a chance to get that growth boosting element right.

The Chair noted that a European Electronic Data Gathering, Analysis and Retrieval (EDGAR) would benefit cross-border investment. The technology exists, and language is not a problem. It is an achievable bonus.

In addition, securitisation can be reviewed when enabling regulations are right. An industry representative advised that solvency laws and procedures link with securitisation. Packaging assets from different countries with different insolvency procedures is impossible. Progress will be difficult but must follow. Europe must look inwards to strengthen and create capital markets while remaining at the centre of the global stage. Creating an open market is vital to ensure the best possible condition for capital in Europe.

Furthermore, the industry representative stated that the CMU has acted on stability in the event of banking failure; however, a technical issue is central counterparty clearing houses (CCPs). The issues of a CCP failure are still there and must be confronted.

3.4. Linking capital markets with the green agenda

The Chair asked if the language should change to link capital markets with the green agenda. An official agreed. Taxonomy must be done quickly, and work is being done to get agreement soon. The EU must demonstrate that it has uniform criteria. Forthcoming presidencies offer opportunities to work together to move agenda items forward and discussions with the Commission have already taken place.

An industry representative responded that Europe is a global leader in sustainable finance. Customers need clarity and transparency; financial firms need consistent corporate level disclosure of useful information for investment decisions. There is demand in the market, with a generational push. Europe can be the benchmark for rule-setting, as the US is not focused. There is interest from China. Europe can provide integration and excellence. EU authorities should approach climate and environmental factors for financial institutions from a risk-based perspective and appreciate that firms have varying exposure to them.

An industry representative advised that Europe can be a global thought leader on sustainability. People want it to happen. An official considered that Europe was right to pioneer the sustainable finance field. A drawback of dramatic uptake is the risk of further market fragmentation across labels and definitions. The Commission should harmonise the concepts of sustainable and green finance, with a standard that can be referenced globally. The taxonomy of sustainable activities will be crucial.

3.5. Securitisation, MiFID and AML are also important issues

3.5.1. Securitisation should be a key pillar of the CMU

An industry representative stated that Europe should implement Basel IV with care and mitigate the impact of regulatory pressure with a workable securitization framework that allows banks to shift assets into capital markets and provides investors with access to previously illiquid exposures such as mortgages or loans to corporates and infrastructure projects. Securitization should be a key pillar of the CMU. It can be a major driver for private sector risk sharing across the Banking Union and serve as quasi-safe asset if combined with appropriate high-quality criteria. This is the main gap compared to the US financial system. Every banking regulation has a disproportionate impact on the European economy compared to the US due to the importance of bank financing in the EU economy.

3.5.2. Revisiting MiFID is also necessary

An official stated that MiFID is at the intersection of the CMU and the Banking Union. Papers on retail investor participation in capital markets have been well-received. Retail investors' access to products like corporate bonds has been restrained. The proposed legislative changes on secondary MiFID II issues such as data provision, open access and share trading obligations are needed and MiFID should be revisited.

3.5.3. Greater efforts are required on AML to increase confidence in financial services

An industry representative raised the issue of anti money laundering (AML). A sustainable world benchmark in capital markets and banking requires more in anti-money laundering. Europe must have an integrated approach. A single institutional authority would be a positive step, but there must be single rules before that can exist. It is best to think about regulation and then a single authority. The Chair recalled that current rules allow for the identification of 1% of money laundering and maybe the new rules will double it to 2%. A new collaborative approach that uses technology should be supported.

4. Making the Banking Union effective is also needed

4.1. The Banking Union needs to be completed

An official noted the progress on deepening economic and monetary union, particularly the Banking Union. The two pillars (Supervision, Resolution) already enacted can be further strengthened as the third pillar (European Deposit Insurance Scheme) is awaited. An official advised that the steps taken on banking package and establishing the common backstop are deeper than credited. Progress is vital but discussions with bank representatives confirm a dilemma. Despite the progress made on fragmentation and establishing a true internal market for banking services, the subjective perspectives of the banks and the empirics show a more disintegrated market. That must end.

4.2. Going beyond the risk reduction risk sharing issue

Progress must be made on complex issues ranging from establishing an internal market for banking services to thinking about the kind of capital and liquidity waivers for cross-border banking groups, and burden-sharing instruments needed. That should consider all the legitimate financial stability concern in countries with large foreign ownership of their banking systems. Those issues must be taken extremely seriously and addressed.

Substantial gains have been made in reducing non performing loans (NPLs). Consensus must be found on issues that hinder progress towards completion of the Banking Union, notably deposit insurance and the regulatory treatment of sovereign exposures which are not consensual. It is important to be cautious and proposals must avoid financial stability risks, while enabling progress.

An industry representative stated that it is crucial to transcend the host and home debates. Without that, a truly integrated banking sector with stronger, larger, more competitive European banks will not be achieved.

4.3. Towards pan EU competitive banks and an interconnected, modern payment system

An industry representative stated that Europe needs large banks that can operate and compete with the US global banks. They are lucky in having a large, liquid single market that is well-priced. American financial institutions benefit from good shareholders and huge economies of scale. Europe is fragmented by comparison. Achieving a market-based economy in Europe and a corporate sector able to compete requires strategic decisions to strengthen banks with the capacity, business model and willingness to do that job.

Europe is lagging on payment system technology, but an interconnected, modern payment system is a must have. It is critical but easy to do and efforts must be made in the official and the private sector.

An official advised that Europe must make progress in the intersection of digital financial markets and payments. Implementation of the second Payment Services Directive (PSD2) shows either non-existent transition periods or three to 18 months. There is a patchwork across the EU that should not happen in an internal market for banking services. Existing payment systems must be digital and integrated, with positive elements leveraged. This is a priority for Europe to compete with platform economics in the US and China.

5. A new financial agenda is called upon

5.1. Europe needs a political vision and momentum for financial markets without the UK

There is a question about how to deal with the UK after Brexit. A large part of the financial system is in London. The perception that Europe is fragmented may increase. Europe must set the vision for its financial markets without the UK. The last three years have been tactical; now it is vital to be more strategic about setting deadlines, executing and getting political momentum behind the CMU. The initial excitement has faded to feeling underwhelmed by the progress made. It requires strategic thinking and political momentum.

5.2. A renewed financial framework is needed

An industry representative noted that there is a new Commission, Parliament and chair of the ECB. A renewed framework would be positive. There are many nationalistic reasons not to act but the euro would not exist without the willingness to act for a European common good bigger than nationalistic interest. It is urgent to renew this in difficult times. Research and industrial policy are not always popular but require consideration. Sustainable priorities for the collective good must be discussed. Banking is about serving this.

The Germans like stability and the French prefer growth. It is about the justification for operating. It is vital to be proud, to have vision and to know what is required to manage the policy mix. That is the politician's job, not the banker's. The bank's job is to allocate capital and resources according to policy. In difficult times, consistency and understanding the framework are key.

5.3. Securitisation is key in the current monetary context of the "Basel IV" agreements

It is vital to be honest and prepare for the new increased of capital requirements. Finalised Basel III will come and there is a question of whether the system is ready. It must be reviewed so if it is not, it can be made ready. There is a serious discussion to have about Europe's banking infrastructure.

There are two ways to address increased capital requirements: one is to make more money, which is not easy with a decreasing interest rate curve, the other one is securitisation. The US banking sector in the 1960s and 1970s shows that securitisation was key in the move from bank-based financing to a market-based system. A bank-based or market-based system is not important, but it is not possible to be half pregnant. If the market-based system is chosen, it is important that banks should be able to offload assets from their balance sheets otherwise capital cannot be reused. That is key to preparing for finalised Basel III. The system will not work without it. Much time has been spent but the situation is blocked. Implementing increased capital requirements is key to avoid future difficulties but the EU financing system as it is today cannot be final. It is in the middle of the road and it is dangerous.

The Chair asked whether securitisation could work without a Freddie Mac and Fannie Mae, which is not being argued for. An industry representative stated that the US in the 1970s created a fully marked-based system dependent on government support. Europe has neither market nor official support but wants more capital in banks. This is wrong. The next Eurofi meeting should discuss securitisation. It should be possible to create an efficient asset class of securitising mortgages in Europe which are not subprime loans.

European savings are hunting for yield. It is not found in the bund or in mortgages, but in US Treasuries so there is a flow of savings from Europe to the US. German savers such as insurance companies are looking for better than negative interest rates. That is fair but having a class of assets at home that give a better investment than foreign sovereign bonds would be a better use of the money.

The usefulness of the head of treasury has always been to think about how savings circulate in the economy, while taking part of it for the state. Insurance companies and investors need a new, secure and safe class of assets with some return. The official sector's support may not be needed if the gap in the yield is enough. That is an open discussion. It is on unsafe ground, but that is how to think about it.

5.4. Getting political momentum is essential to make progress

5.4.1. Getting inter-institutional agreement before starting work on the regulation

The Chair noted the need for political arbitrage. The Commission will make proposals and draw on other proposals such as the capital markets work. There is the question of process and whether priorities should be driven by economic value added, also measures to dynamise Europe's economy. A tripartite agreement between the Commission, the Council and the Parliament to deliver proposals by a date would avoid drift. An official agreed. A key priority is to define the objective and not the regulation as an objective. The outcome must be defined, and the process assessed rather than adopting texts that do not deliver. An inter-institutional agreement ex ante before starting to work on the regulation would be useful.

An official noted that agreement on the concepts should be possible because they are often discussed at ECOFIN meetings. There should be a message of consensus. Agreements are usually made; sometimes there is a compromise, but the work is generally intensive and constructive. An official underlined that the tripartite agreement is often mentioned but there is the question of whether it can create the necessary political momentum. The Council lays out roadmaps and then there is a debate around what they mean, and dates are missed. It is difficult to see how that would be different with a tripartite agreement. Leadership must come from the top. There must be political will at the top level because it requires ministries of justice and the interior as well as finance. Only the top people can create that consensus.

An official agreed that everyone is aware of the responsibilities and what should be delivered. Much has been achieved, but there are more challenges and work ahead. Each of the headline goals must be worked on or covered in parallel. The consequences of collapse are clear. It is difficult to prioritise between them, but the focus should be on growth, jobs, productivity and everything to enhance and fight these challenges, not only in respect of the financial system but more broadly.

5.4.2. Improving the EU legislative process

An industry representative stated that without better institutional cooperation and a mandate for authorities to act, EU institutions could face difficulties in making decisions on achieving financial stability and economic growth through an efficient financial sector. The national regulators' focus on their own markets' financial stability makes sense from a country perspective but leads to inefficiencies and traps financial resources. The definition of home and host member states highlights the lack of integration between regulators; a system founded on flows of information between authorities is needed with robust processes to guide cooperation. Any new regulatory framework should be flexible, graduated and principle-based with oversight tied to scale and risk.

An industry representative advised that using digital technology to improve the efficiency of regulatory regimes is tactical but nonetheless important for regulators and users of compliance regimes. When setting rules, how much goes into level 1 text versus outside is important. It is currently complex if regulatory evolutions are required when the modification is in level 1. Regulators will say it is impossible and continue with a system that nobody likes. Therefore, the EU legislative process needs to adapt and contribute to competitive and efficient financial markets. Re-establishing the distinction between level 1 and 2 is the right way forward.