Q&A

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Strengthening the European financial system after Brexit and the Covid crisis

What are the priority measures for the EU financial industry that would enable a strong and rapid economic recovery in Europe?

The EU financial sector has shown its resilience during the pandemic. Banks and other institutions started the crisis with strong capital positions and liquidity. Markets and infrastructures proved robust and efficient. It's thanks to the great efforts by industry, regulators and supervisors over the past decade, learning the lessons of the global financial crisis. This strength has been vital. Lending and other forms of finance grew considerably throughout the crisis, helping the economy to bridge liquidity needs.

The Commission has supported these efforts, maximising banks' capacity to lend and absorb losses with its Banking Package and making it easier for capital markets to help businesses recover with the Capital Markets Recovery Package. We want to maintain the strength of our financial system so that it can finance the recovery.

Against this background, we must make sure that our financial industry:

- *Remains stable.* While navigating the gradual reduction in public support, banks should continue to measure risks in an accurate, transparent manner. Banks must also be able to address the likely rise in non-performing loans and keep space on their balance sheets to finance new projects. We will swiftly implement December's Action Plan on non-performing loans.
- *Develops market-based channels to complement bank finance.* Capital markets will be key for the re-equitisation of companies, so we will need to implement our Capital Markets Union (CMU) Action Plan of September 2020 effectively.
- *Accelerates its support for the transition towards a low-carbon, circular and sustainable economy, while preserving its stability.*
- *Embraces the digital revolution to guarantee the sustainability of business models in a post-pandemic world where customer behaviour has changed.*

Has the Covid crisis further fragmented the Banking Union? Which measures are needed to address banking overcapacity challenges and reduce the fragmentation within the Banking Union?

Activating flexibility in fiscal and state aid rules allowed Member States to provide a decisive, coordinated response to the COVID crisis. Fiscal support in 2020 is estimated at 8% of GDP in the euro area, in addition to liquidity schemes of about 19% of GDP. And the flexibility provided by supervisors and regulators to banks has helped them channel funds to affected households and businesses. However, the heterogeneity of national support measures may have unevenly shielded the banking sector from eventual losses.

This situation, combined with varying exposure to sectors most affected by the crisis, might lead to increased market fragmentation if left unaddressed. The quick implementation of the NextGeneration EU recovery plan will be important to reinforce cohesion.

This year will be important as we move towards completing the Banking Union. In December 2020, the Euro Summit invited the Eurogroup to prepare a stepwise and time-bound work plan on all outstanding elements needed to complete the Banking Union, which includes market integration. In parallel, the ongoing work on revising the crisis management and deposit insurance (CMDI) framework and creating a stronger financial safety net (European common deposit insurance) will result in a first package of measures later this year.

Our framework could be improved to cater for the failure of smaller and medium-sized banks. In practice we've seen that these banks may be more prone to failure than large, diversified banks. The review of the CMDI framework will aim to ensure that the failure of any bank (irrespective of size or business model) can be managed without recourse to taxpayer money and while fostering financial stability, a level playing field and depositor confidence.

This review, and progress in setting up a European Deposit Insurance Scheme, should be a precursor to completing the Banking Union in the longer term and unlock further reforms, including on reducing market fragmentation. Importantly, measures touching on the home-host balance need to be accompanied by credible, enforceable safeguards for host Member States to ensure the right balance between integration and financial stability.

What is the state of progress of the CMU initiative and what results have been achieved so far? What are the key next steps and priorities?

Since its inception in 2015, the CMU has delivered results on several fronts. For example, it has simplified access to capital market finance for companies with measures such as the new Prospectus rules and targeted legislation to facilitate SME access to public markets with the SME Listing Act. We also strengthened the supervisory framework, including with the European Supervisory Authorities review.

Our new CMU Action Plan from September 2020 builds on earlier work and aims to make progress in all areas where barriers to the free movement of capital still exist. It raises the ambition in areas like long-term investments, the quality of investment advice and rules for listing on public markets. It also expands into new fields such as company data, company law and financial literacy.

In the short-term, we will table a legislative proposal for a European Single Access Point this year to provide investors with seamless access to company data. We will review the framework of European long-term investment funds to encourage more sustainability-related and digital investments, as well as investment in infrastructure. We will revise the prudential treatment of insurers to foster the re-equitisation of businesses. And in the context of our Markets in Financial Instruments Regulation (MiFIR) review, we will deliver on trade transparency and consolidation of data to further integrate our capital markets.

Also this year we will report on supervisory convergence within the EU and the functioning of our Single rulebook for Capital Markets. And we will continue to work on financial education. Structural measures, such as non-bank insolvency procedures and cross-border taxation procedures, require more preparation but we remain determined to act on them.

To succeed, the CMU requires strong cooperation from all stakeholders including EU institutions and market participants. We need to tackle structural barriers to the free movement of capital embedded in national legal systems or behaviour patterns across Member States.

Do the post-Covid situation and Brexit developments create any new challenges in this respect?

The COVID crisis has shown that deep and efficient capital markets are more necessary than ever. Given possible difficulties banks may face in providing credit and rising corporate debt levels, firms need to tap into equity and other capital market instruments.

Post-Brexit, we will continue to strengthen the efficiency and robustness of the EU's financial system by advancing the Banking Union and the CMU, deepening the integration of the Economic and Monetary Union.

At the same time, we're continuing to monitor the significant level of interconnectedness between the EU and the UK to ensure we avoid any level of dependency that would undermine the stability of the EU's financial system.

Is ensuring the financial autonomy of the EU a relevant objective in the current macro-economic and political context (e.g. Brexit) and if so what does it imply in terms of public policy?

Recent global trends point to an increasingly multipolar geopolitical context and a departure from multilateralism.

The withdrawal of the UK from the EU was a fragmenting event that has highlighted some of the vulnerabilities of EU capital markets, such as dependence on UK market infrastructures.

Against this backdrop, the EU remains open to the rest of the world and continues to advocate for multilateralism and rules-based global economic governance. The EU financial system is globally interconnected via credit and financial markets, as well as payment systems. We want to continue enjoying the benefits of openness. But we cannot be naïve. We are determined to develop a stronger, more resilient EU economic and financial system commensurate with the size of the European economy.

This is in essence the concept of 'open strategic autonomy' that the Commission presented in its January communication, "The European economic and financial system: fostering openness, strength and resilience".

First, we will work towards strengthening the Economic and Monetary Union, building on the Banking Union and the CMU. This will increase the resilience of our financial system by diversifying funding sources for EU businesses, including for innovative and sustainable investment projects. This will also help bolster confidence in the euro and contribute to reducing stability risk at international level, thanks to greater currency diversification.

Second, we need to make EU financial market infrastructures more resilient to ensure uninterrupted provisions of critical financial services in the EU. For instance, in the area of derivatives clearing, we will identify impediments and incentives to scale back EU market participants' exposures to UK central counterparties (CCPs).

Lastly, we will protect EU operators by acting against the unlawful extra-territorial application of sanctions by third countries, while also ensuring more effective implementation of the EU's sanctions regime.