

European open strategic autonomy: way forward for the financial sector

Introduction

The Chair reminded the audience that discussion on 'open strategic autonomy' was generated by Brexit, which moved a reasonable part of the financial infrastructure outside of the European Union, and tensions with the previous US administration, mainly on sanctions for Iran and the extraterritorial extent of the US sanctions. Later, the broader weaponization of finance brought another ingredient to the subject. It can be asked what the current degree of autonomy is, what else is needed, what the main ingredients of open strategic autonomy are and whether they include the Capital Markets Union (CMU), the Banking Union (BU) and financial infrastructures, what risks, costs and trade-offs will be faced, and what the prerequisites are in terms of broader integration.

1. What does strategic autonomy mean in the financial sector

1.1 Open strategic autonomy: a theoretical concept that has become concrete

A policy-maker noted the Commission issued a communication in 2019 on open strategic autonomy. The context has evolved since then in a way that makes it easier to explain and to justify what that communication was about.

The discussion was initially largely theoretical, covering what Brexit and US sanctions, and the extraterritorial effects, might or might not mean, but the pandemic and the war in Ukraine made this matter much more concrete. Supply chain vulnerabilities can and do exist, both in the economy and the financial system. Moreover, the unthinkable can and does happen.

The EU must identify and address the strategic vulnerabilities in the economy and the financial system, even if the consensus view is that the materialisation of some of these risks and vulnerabilities is unthinkable. Strategic vulnerabilities have to be addressed as they are there, even if they do not seem very likely.

1.2 European financial autonomy: a means to an end

An industry representative suggested the concept of strategic autonomy is especially tricky for financial market infrastructures. Their organisation has a strong base in Europe but is a global institution. To be strategically autonomous, international outreach should be strengthened and enhanced, meaning a base in Europe with a global perspective. Strategic autonomy is a means to achieving an objective. The main objective of strategic autonomy is for the euro to become a widely accepted international currency. That will not happen without a

proper mechanism to preserve, prevent and manage crises, i.e. with no common safe assets or a complete Capital Markets Union.

Achieving autonomy depends on what is done at the European level and in each of Europe's institutions to strengthen the resilience of the financial sector, reduce dependency on third countries for key services and technology, and minimise transaction costs.

An industry representative's organisation can be a gateway for international investors and has strong interest from them to access the European market and even to settle in central bank money. It decided to integrate its platform and connect it with the TARGET2 securities platform, which would mean giving the option to settle both in commercial bank money and in central bank money. This has received a great deal of interest from international investors. Autonomy means integrating further in global capital markets and eliminating the barriers that remain within Europe to trade securities cross-border.

A public representative highlighted the difficulty in defining 'strategic autonomy' when talking about the financial sector because issues are so deeply interconnected. There is a need for stronger European banks and financial institutions, and an appropriate ecosystem not only for European banking groups but also for foreign entities. The competitiveness of banks is not only about regulation. The industry has been very vocal in light of the Basel III review and has constantly highlighted that the problem in Europe is regulation and that Europe cannot be competitive because of the regulation.

The notion of strategic autonomy not being an end in itself but rather a tool can also be applied to Banking Union. Banking Union is always mentioned as the final objective, but it is a tool many things cannot be achieved without. It is needed, and not only for European banks and financial institutions that are strong and believe in the European market.

1.3 What strategic autonomy can mean in practice for capital markets

An industry representative suggested strategic autonomy is based on having enough domestic capacity and control to transform the savings of 450 million Europeans into investments by EU companies. Some European companies try, in a corporate consolidation way, to rectify the fragmentation of European markets to realise the CMU.

The debate on strategic autonomy in the financial sector is very similar to the debate in the industrial sector on antitrust and competition issues. It is asked whether the European Union is working for consumers or producers, and if it is working to build a continent of finance takers who benefit from services provided by the rest of the world. Some non-EU players are present to only cherry-

pick the juiciest segments, and, for them, Europe is just part of the division called Europe, Middle East and Africa (EMEA). For an industry representative's organisation, Europe is home, and there is a collective ambition that goes beyond finance. That is the core of the strategic autonomy debate.

The more strategic autonomy sought, the more open Europe must decide to be, and the more honest it must be on what it does in terms of 'open bar' regulations or unilateral disarmament regulations. Seven years ago, the six largest global banks, which are US banks, had a 44% market share in Europe. Today, they have a 58% market share. There cannot be meetings promoting strategic autonomy and then a return to the office to build an open bar set of rules and an environment such that it will be realised some years later Microsoft is the leader of operating systems everywhere, like Amazon in e-commerce and Google in search engines.

1.4 Open strategic autonomy does not mean "fortress in Europe"

A policy-maker remarked that the Commission's communication was also clear that addressing strategic vulnerabilities cannot mean disengagement from the globalised financial system and adopting a protectionist stance. It is about continued international engagement, but on a basis that is as resilient as possible to shocks. 'Open' is implicit in strategic autonomy, but it was included for clarity. Open strategic autonomy means that the EU develops, in financial services and elsewhere, its domestic capacity within the single market while continuing to attract participation and investment from outside.

Panellists have different views on the balance between building domestic capacity and how to handle foreign participation, but all agree that there has to be a balance. The rules also need to be the same even if those playing by those rules are themselves uneven.

1.5 Stop transforming Financial Europe into an open bar

An industry representative stated that the fundamental issue is how to stop unilateral disarmament regulations, stop an open bar for the rest of the world or having non-reciprocal regulations. The way the US players act in Europe is very different from the way European institutions can act in the US.

There is also the issue of how to create a consolidated vision. Europe's strategic autonomy is stronger with a strong Santander, BNP, Deutsche Bank, Intesa, with strong European insurers - Allianz, Generali, AXA -, with strong financial infrastructures - Deutsche Börse and Euronext. The weaker those financial organisations are, the weaker the strategic autonomy is. The trade-off is to carefully manage a world such that there are continental leaders, as otherwise Europe will be extremely weak.

1.6 Open strategic autonomy means crisis resilience autonomy and the ability to keep the financial system operating in extreme conditions

An industry representative noted the importance of agreeing or at least defining what strategic autonomy is about, and there are many different opinions. There has

to be resilient, deep, diversified and complete markets and institutions in Europe that guarantee a constant supply of funding for the economy to grow. That takes care of clients and producers, but the crucial part is that whatever the nationality, the entity is a committed participant in the European landscape.

There could be different approaches to having a deep committed, resilient, complete market. There can be a more closed or more open economy type. For Europe, the open economy approach is the winning one. It is an open economy in all dimensions. It relies on open trade. That is where its comparative advantage is, and it would be very strange to have an open economy approach for everything except financial markets. Currently in the financial market, if it is looked at superficially, there is a large market share for non-European banks but to make European banks or institutions stronger, which is needed, the best approach is not to cut off the non-European banks. An ecosystem which is highly attractive for everyone to come to and stay in should be created, so the system guarantees competition and European institutions can grow, become stronger and compete everywhere in Europe and the world.

Some American institutions have perhaps gained some comparative advantages that come from huge economies of scale, which does not come out of regulation per se but, for example, a home market which is not as fragmented as Europe's. The way forward is continuing to build the European market in a deep, complete and non-fragmented way. Banking Union and CMU are necessary; Europe will never have true strategic autonomy if it does not complete its own financial market. The first thing to do to ensure Europe is financially autonomous is to keep building its own unions and to make the fragmentation of the financial sector less and less important.

An official remarked that usually the way Europe operates most important reforms are made in response to crises. When the focus is fully on solving the crisis, it is harder to keep focusing on long-term strategic behaviours. That may be something policymakers also have to integrate in the way they operate.

The digital euro, which will allow citizens to access central bank money in digital form and enhances or preserves the role of public money as a money anchor, also presents two strategic autonomy benefits. The first is reducing the dependence on a specific handful of foreign providers, particularly in terms of digital payments. It also enhances the role of the euro, particularly in these very challenging geopolitical contexts.

An industry representative suggested building a great ecosystem will also guarantee resilience under extreme stress. The open approach is the route to take. Then there is working on the weaknesses and the completion. The objective, or at least the interpretation of what financial autonomy is, has changed from 2019 because of what has happened since. One additional lesson from the pandemic and the war in Ukraine is that the way through them is with cooperation and further integration at the European level, with the like-minded countries around the world. Part of strategic autonomy under extreme stress is making sure everything needed is at

home, with the cooperation of like-minded countries that believe in the rule of law.

A policy-maker stated it is possible to build an open ecosystem and to become resilient. There is not a need to choose between open versus autonomous. Financial people understand the notion of diversification. Not everything has to be at home, but there should not be over-reliance on any individual external source of supply.

1.7 Autonomy is not about picking champions, but about fostering horizontal policies and strategies

A Central Bank official noted the puzzle has many pieces and it is not possible to only implement one of them because a holistic perspective is required. Banking Union and CMU are two of those pieces. If there is an attempt to build European strategic autonomy in finance and compete on cross-border activities, there will be a need to harmonise national insolvency and taxation regimes among European Member States.

The European Union consists of many countries, and how decisions are taken is important. This European strategic autonomy must not be built on national or local champions. The pitfalls of picking national or binational winners should be avoided, and the focus should be on European goals rather than national goals, with standards set in areas where Europe is not technologically competitive. Doing so would stifle innovation and put the SMEs from smaller EU member states at a disadvantage.

The EU should identify key European ecosystems that deserve support and foster deeper EU-wide cooperation. Horizontal rather than vertical policies should be pursued, with vertical policies embraced only where they contribute to EU-wide strategic autonomy without undermining the level playing field.

While completing all pieces is a prerequisite for achieving European strategic autonomy that is not the goal itself. The goal is to achieve the key economic policy items, such as the recovery of economies after Covid, overcoming the most recent challenges stemming from Russia's war in Ukraine and ensuring the twin transitions towards a digital and more sustainable economy are successes.

1.8 Moving towards a true single banking market

A public representative was shocked by the limited numbers for cross-border mergers and acquisitions in the banking system in the European Union. In the five years between 2014 and 2019, there were less than 10 cross-border mergers and acquisitions compared to 180 national deals. That means that bankers do not believe in the European market. So, there is a need to create an ecosystem where banks believe in the European banking market. All have to believe in building a European banking and financial sector that will lead to more open strategic autonomy. This is a shared responsibility.

Autonomy must be assessed on the basis of the ability of the European banking system to efficiently and effectively support the real economy of the EU as a whole. It is clear that currently the situation in the EU is not good. Banking Union is at a standstill; European

finance is still largely segmented along national lines. To unblock the debate on Banking Union the issues should be addressed from another angle by asking why Banking Union is important for tomorrow's challenges.

Moving towards a true single banking market through cross-border restructuring is above all a matter of strategic autonomy. Genuine pan-European banking groups could operate more effectively, raise their profitability through scale and better face up to foreign competition, especially from the USA. Banking Union would enable, in conjunction with progress towards a CMU, a better channelling of our abundant savings toward the EU targets in terms of digitalization and green transformation of our economies. Moreover, Banking Union would decisively enhance private risk sharing within Europe. The political discussion remains primarily focused on public stabilisation mechanisms, but private stabilisers are important as well.

2. Moving forward remains challenging, especially without political leadership

The Chair noted that one issue was open strategic autonomy meaning crisis resilience autonomy or industrial policies and the 'Europeanisation' of finance in a more general sense. There is also the question of whether to emphasise openness or autonomy, and which strategic considerations are paramount. Then there is a question of whether to count on creating so attractive an ecosystem that European finance is made into a powerhouse, and autonomy created that way, or whether it is more defensive.

2.1 Wake-up calls in recent years

An official remarked that with Brexit the first financial centre of Europe exited. There was then the pandemic. Guaranteed loans had to be provided to corporates in a matter of days or weeks, and having a functioning financial sector was key. Trump was another wake-up call. It has to be possible to rely on allies, and when allies are not trustworthy ways to be autonomous must be found.

Europe must be resilient under stress, but it must also be ensured that it has an ecosystem which provides for the upcoming investment need for digitalisation and the green transition. There are strong assets, a very strong infrastructure, strong banks, strong financial institutions and a great deal of savings, but the question is whether Europe is at the point where those savings can match the investment needs.

2.2 Prerequisites for moving forward

An official explained that for the twin transition needs there are public and private investment needs that will be faced in the next decades. Then there is the impact of uncertainty and the consequences of Russia's invasion of Ukraine, and the way financial sanctions in these areas are being managed. All of these are very good reasons to discuss strategic autonomy in the financial sector.

There are some prerequisites for moving forward. First is reducing the dependence on foreign critical operators. Second is increasing the funding potential of both the banking and non-banking systems, which means the capital markets depth. This would improve the overall resilience of the financial system against all threats, including the challenges coming from the technological improvements and cyber. Openness should not come at the cost of undermining the defence of our multilateral approach.

2.3 Areas to progress: Banking Union, CMU and digital transition

An official stated there are three issues that are in the minds of everyone and part of the preferred discussions within the Economic and Financial committee (EFC) and the Eurogroup. The first is completion of Banking Union. The third pillar is one of the main elements still missing and there is the importance of the European deposit insurance scheme (EDIS). There was an agreement at the Eurogroup level last June in terms of asking Commission colleagues to come forward with a proposal on one specific area related to crisis management. The ambition should be retained, and further steps should be taken in that area.

Having stronger and deeper capital markets is one main objective. The securitisation segment is a good example of what can be done to fully unlock the potential of capital markets to help with funding for the challenges there will be. One specific area that is a clear example of the importance of the EU's financial and strategic autonomy over the course of the last few weeks or months, is enhancing its clearing capacity and reducing over-reliance on third countries' central counterparties (CCPs).

The third element is trying to reap all the benefits of the digital transition. The positive side of this is the digital euro project. The other side is facing the challenges that come with technological improvements related to cyber risks or integrating all the developments related to the crypto world.

2.4 Deepening the CMU

The Chair noted a key question is about how to proceed with CMU. It looks like a slow grind of working on small things for the next few decades. There are huge deliverables like insolvency, taxation and common supervision. These are difficult but hugely important.

2.4.1 Deepening the CMU is crucial

A Central Bank official remarked that finance is a very regulated area. Building European strategic autonomy is about regulation. The funding of companies in Europe is very bank based, and the call for banks to believe in something before financing it is understandable. However, this is about having alternatives and picking priorities. It is about the completion of CMU, which will reduce the debt-overhang risk for corporates and put less pressure on fiscal and monetary policies. CMU has to be built to accelerate the economy's growth and move towards greener financing and innovative technologies. For companies that are at the edge of innovation attracting funding in the capital markets should be easier.

2.4.2 Going beyond words for combining financial integration and resiliency

An official remarked the aim is not to create a 'Fortress Europe'. Europe is very open to foreign banks. The issue is to assess whether Europe has structural weakness in times of crisis and how to enhance the financial markets and Banking Union in order to finance the great investment needs upcoming.

There is a need to go beyond words and make sure the commitment to build a strong, competitive home market for financial services is delivered. If strategic autonomy is taken seriously, final agreements on Basel transposition and Solvency II should be ensured collectively in order to support the capacity of the banking and insurance sectors to provide sufficient funds for the digital, green and energy transitions.

On CMU, the MiFID review has been progressing with the project to create a consolidated tape for key financial asset classes. It is an important project, but the EU has fallen behind the US and that needs to be addressed. Beyond the current text on the table, France remains firmly committed to making sure strategic autonomy becomes one of the pillars of the upcoming financial legislation, in particular on CMU. There are projects on the Listing Act. The harmonisation of insolvency proceedings is being supported, as it remains one of the key barriers to cross-border investment. The European financial sector should fully embrace the digital transformation, in particular the upcoming legislation on digital issues, AI and data. European consumers need to benefit, and European financial actors need to be strengthened.

The European Banking Authority (EBA) study on the assessment of current dependencies of the European financial sector is welcome and will provide a good analysis of the strengths and the weaknesses and further guide policy in the area. This is the beginning of a long journey but there are political deadlocks.

2.4.3 Four measures for transforming the ambitions for capital markets into actions

An industry representative stated the European Union is the most open financial space on the planet. Nowhere else is as easy for external players to settle in and do business. It is far easier than in the US or anywhere else.

There is a need to be very careful about where physical financial infrastructure is located. It makes a big difference for European strategic autonomy when the physical infrastructure where the trading is happening is ultimately under the supervision or the arbitration of the European Court of Justice. There is no such thing as the 'cloud', which is like referring to slavery as a predictable labour relationship. There is no cloud; there are large Amazon or Google data centres. Having a strong view on where the physical infrastructures of European financial institutions are, is important.

Second, there must be a focus on Europe's aspirations for more simplification in EU rules. The Listing Act and the possibility of having the equivalent of the US single S-1 form in Europe are welcome.

Third, the consolidated tape story should be amended, because everyone is suggesting it is going to create a new

data vendor in Europe. The proposed framework, if enacted, will mainly benefit players outside Europe. The reality is that the life of existing data vendors is going to be made easier and Bloomberg, MSCI and Tradeweb have decided to work together to be the European data vendors.

The last point is consolidation. Unless the rules of the game for the consolidation of European players are changed, there will be on one side, enormous companies and on the other tiny companies that are desperately trying to consolidate.

2.4.4 Focusing on what is urgently needed in Europe

An industry representative noted Europe needs a huge amount of capital for the energy transformation. The green transition is one of the key pillars of the European strategy. The financial sector has to accommodate and support the green transition. There is a sense of urgency and a need to attract capital from wherever is possible to serve those needs.

Of the proposals being made, such as the Central Securities Deposit Regulation (CSDR) proposal to simplify the cross-border transactions, some are very controversial. The most controversial ones sometimes halt the less controversial ones. The less controversial ones, like the simplification of passporting throughout Europe, should be moved forward and then the implementation of CMU can be considered.

2.5 A need for a Hamilton moment but political leadership is missing

2.5.1 A Hamilton moment

A public representative agreed there is a need to push, but at the same time there is concern that there might not be the preferred degree of political attention on these issues in the upcoming months due to the war and the energy crisis. There will always be emergencies, and attention will need to be brought back to these issues because they are also part of the solution. They are part of the system needed to address the challenges, including the energy and security crises.

There has been a great deal of discussion recently on building the public resilience stabilisation mechanism. Private stabilisers are also needed, because it is not possible to address all of these crises requiring enormous investment with only a public stabilisation mechanism. There should be clarity about the need to work on both tracks if the upcoming challenges are to be addressed. There will need to be some bold moves and maybe not the Listing Act but one listing for Europe, which would be some sort of Hamilton moment.

2.5.2 Becoming less of a priority due to the war in Ukraine and the energy crisis

A policy-maker noted that, given the current emergency, where energy markets are in difficulty and the economy is deeply stressed, there is the understandable risk that political oxygen will be absorbed by these subjects and the financial agenda will slip down the priorities. The DG-FISMA has not become less important, but it now has to compete with many other equally important files. Letting it slip too far down the list of priorities would be a mistake because developed and integrated capital

markets, and what they do in terms of efficient resource allocation and private risk sharing, will be needed even more going into what will be a structural change in how the global economy will work. If Europe is to come out the other side of that in good shape, the financial system needs to be fully functioning.

2.5.3 Two ways to proceed on CMU

A policy-maker suggested the frictions between separate national markets can be addressed in order to build a single market in financial services, this is the very purpose of the Capital Markets Union. It is then possible to ask what the fundamentals of a single market are. There can be single laws on taxation, single laws on accounting or securities. There can be single laws and single supervision. These are harder and take longer, so it is necessary to go for the easier issues first.

2.5.4 Proceeding differently for the Banking Union

A public representative suggested all Member States should abandon their respective red lines and make an effort to identify new objectives that will make it possible to move towards greater financial autonomy.