



EU priorities for the 5 next years in the banking and financial services area

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Axel Weber

Let me welcome you to this wrap-up session. It is an honour and a privilege to have Jacques de Larosière with us again. Jacques has been a continuous source of wisdom for me in my career for as long as I can remember being in finance.

I thought it was a fascinating speech that Enrico Letta just gave. I was particularly moved by three points. The first one is that he teed up the four areas that we have ongoing debates about, energy, banking, defence and telecom, as the ones that were excluded from the discussion of EU integration at the start. It is obvious that, having been excluded, we did not make as much progress, but if you look at where Europe is now, it is exactly these areas where we need the biggest progress. Having delayed action for some time, we probably need to move faster on them than in most of the other areas. That is a very important message that he started with.

I am also very impressed how he framed the lessons learned from the financial crisis and the European debt crisis. He made a double reference to 2008 and 2011 as events that have dominated our thinking about how Europe should move forward. Maybe we should look at it more as a legacy rather than a *modus operandi*. That legacy might have prevented us from doing certain things over time that, with all the changes in geopolitics, we need to embark on now. The need has never been more obvious than it is now, so moving bold and moving fast is an important lesson.

Last but not least, what was music to my ears as a former banker is the word 'scale'. For 10 years, I chaired a large Swiss bank, which is now even larger, and I can tell you that the worst way to gain scale in banking is through accidents of others, because that means

you are taking big decisions on scale in a very short period of time, often over weekends. We have had that experience before in the financial crisis. Sometimes crises happen, but it cannot be that the only way that US or European banks can gain scale is through emergency meetings over weekends, which have all their own dynamics and lead to idiosyncratic risks.

It is worthwhile to think about scale by recognizing that only profitable banks are good banks. Profitable banks need to have a recurring revenue base which covers all of their costs of operation, in particular their fixed costs, which is easier for larger, as opposed to smaller banks. We have a very fragmented market, and gaining scale has to be part of the process of making banks more profitable and safer.

I thought that was a perfect setup for our discussion on the stage now. Let me make the usual joke which I make when I come to Eurofi meetings, to which Didier has invited me for the last two years. I moved to Switzerland 10 years ago. I come back to Europe 10 years later, and nothing has changed. That is usually the joke that I make in the context of European banking union, because it is more than nine years ago that we started to discuss the concept of banking union. We are also still talking about capital markets union, which is also badly needed.

Markus, I want to start with you. The progress we have made could be better. Of course, Mr Letta also gave you some coverage in terms of where some of the resistance comes from. It basically comes from member states, not excluding the one where I hold a passport from, Germany. I do not want you to talk about Germany and some of its resistance on elements of the banking union, but where do you see the main reasons why in general, we have not progressed that much over the last 10 years?

Markus Ferber

Thank you very much. I can share your analysis and even say that you said it already. If we look at how we regulate and organise Europe, we speak about a single market, but honestly, we have 27 markets in all areas, on the real economy side as well as on the banking side. When you speak about banking union, we have been able to have progress after a huge crisis. The good old phrase in Europe is, 'Never miss a good crisis,' but now the next steps need to be taken without a crisis.

Then, of course, we have to answer what I call the chicken-egg issue. What is more needed as a frontrunner: a more united real economy or a more united banking sector? Ultimately, we need both. If I take the four areas Mr Letta has described, there is clearly a need for more European cooperation.

Telecommunications is the most integrated market although we are still a big step away from a fully integrated market. There are 27 different markets with 27 rules, and there are about 100 telecom providers, all of which are too large to die but too small to survive and compete globally.

Regarding the defence sector, everyone knows that action is needed. If you look at the figures, together the EU spends more money and has more soldiers than the United States, but with less capabilities. This is a misspending of European taxpayers' money. We are spending more money than the United States, yet we are not able to deepen cooperation.

This shows very clearly that more Europe is needed. If the headline for the next five years will be "competitiveness", it is necessary to Europeanise many aspects. Although there are already some well-integrated markets, the EU is unable to make the last step and fully integrate them. To Europeanise, the Commission must rethink its competition rules. Competition inside a single market would create an environment that encourages the creation of a banking union, which is needed because larger entities in the real economy need larger entities to finance them and to organise financial products and services. Without taking this next step, Europe will be diminished by developments around the globe.

Axel Weber

David, one thing I learned is that, when you talk in front of European audiences, the best equivalent you can make is to refer to soccer, because in soccer we are world leading. The US has no soccer to offer. They have some teams, but it is often retired European players. How do we get to that stage when it comes to banking? At the moment in banking, it is the other way around.

I have two questions for you more specifically. The first is that, in soccer, you need to have a good defence and you need people who score the goals. We have built a single supervisory mechanism. We have really upped our defence, but who is going to score the goals for European banks? How do we get to scale? Would that require a mindset change with the supervisors?

Secondly, do you see any gamechangers that would lead us to think about scale differently? That is what Mr

Letta asked for. That might be the view that he voices in his report for European industry, but how do we get that view to gain traction among European regulators, supervisors and policymakers?

David Wright

It is very difficult, but let me just go back a bit here, Axel, if I may. What we need in Europe is to create the excitement of the European dimension.

The feeling that Europe is a capital market, or a banking market is lacking. Europe is fragmented and costly. The emergence of a European dimension must be encouraged. The articulation between the European and local levels is extremely important. This model does not need to be threatening.

Secondly, progress cannot be made without the right politics. To create this European dimension and European excitement, there must be an agreement between the incoming Parliament, the European Council and the Commission. The top people in all the key positions should have the single-minded objective of delivering this. The scale will come from markets deepening and widening, not from trying to close off or protect markets. Thirdly, the argument has not yet been won that this will be hugely beneficial for all member states.

The treaty should be used. The treaty has enhanced cooperation mechanisms, so these mechanisms should be utilised. Given the competitiveness situation, Europe cannot afford for this to drag on for years in technocracy with a pan-European dimension not emerging. Governance is very important. Key objectives, although not too many should be set with the European Parliament and the Council, including some bold technology targets. Governor Villeroy de Galhau mentioned a European Union digital ledger. This is an exciting combination of capital markets and banking union. It should be possible to reach agreements and create this excitement, as Jacques Delors did, although it requires a huge effort.

Finally, when Michel Barnier was working on the Brexit negotiations, he took a totally inclusive approach. He worked with all the member states. He worked very closely with the European Parliament. This was the right thing to do. Crucially, he formed a superb team of people in his cabinet to drive forward the negotiations, and he delivered a very good result.

Axel Weber

Thank you. Jacques, you have been a long-time observer of the European road to capital markets union. Also, in your previous capacities both as governor of the Banque de France and an outstanding IMF managing director, you have given advice to countries on how to get their acts together when they ran into trouble. What would be your advice to the current leadership in Europe?

Jacques de Larosière

I have spent a great part of my life giving advice to governments, and I must say the results have been rather poor, but if you ask me my impressions, I have

been in many of these Eurofi meetings over the last decades, and I would say this: Europe has delved into three orientations that we should be careful not to follow too closely.

The first orientation is that we speak of regulation. Over the last 25 or 30 years, I have been hearing about regulations to prevent the 27 countries from hurting each other. That attitude was mistaken. We should be opening our windows. We should be competing in the world and not competing against each other. That is the first point. Let us open the windows. Let us participate in the world of competitiveness.

Secondly, the excessive role of the public sector. We have been moving, over the last 20 years, from a reasonably situated public sector at around 20% or 30% of public debt to GDP, which is manageable, to now skirting with 100% or 110%. This does not apply to all countries. I know that Germany is much more sedate in that field, but the tendency has been to increase the role of the public sector. When looking at the efficiency of the system, as Markus Ferber has just said, the results are not there. We have a very large public sector without the desired efficiency that we should be asking for. That is my second regret.

The challenges are exactly the opposite of what we have been doing. The challenge is to participate in the world more actively and more with a common view of things, instead of looking in a narcissistic way to our own regulatory systems. That is the first thing I would like us to do.

The second issue is to shrink the public sector. Why? Because the big challenges, which are the energy revolution and the geopolitical presence that we all desire, need us to have a private sector that is willing and able to move. The energy revolution that we are craving will only come through the private sector, not the public sector. It will come through the private sector, so let the private sector live. Do not overtax the private sector. Do not think that you can reduce, by automatic and administrative ways, the remuneration of private sector savings. This is crazy, and this is what we have been doing for years. Let the private sector live. Do not overtax it, but if you do not want to overtax it, you have to have a smaller public sector.

These are the things we should be doing. Of course, it is very important to have a capital market. It is very important to have banks that can really exchange in an efficient way. I take on board all the remarks by David Wright on that, but I would say that we have too much regulation and not enough strategy.

Axel Weber

Thank you, Jacques. John Berrigan was on a previous preparatory call, and he also made this distinction. As we do not have the honor of his presence, I just want to briefly portray this. He made the distinction between changing the system or building and running the system. For a long time, it was viewed by the Commission that their job was running or maintaining the system. Take the example of the four areas Mr Letta has talked about, where we have not acted because we have largely maintained them as they

were when we entered into the European Union, and they have not changed a lot. If you want to now create momentum in these four areas, there are two ways of doing it.

One is that we take action in these areas at the European level. Then you and Mr Letta asked the right question: how do we engage and create a euphoria, or at least a positive mood for Europe? If we try to do it by command and control, it will not happen. Is there a way to engage on this that is more driven by the markets and market players themselves?

This reminds me of something I have talked about at Eurofi conferences in the past. The US-wide banking market was not created by ordering all US banks to be operating across the US as federal banks. It was achieved in 1860 by offering a choice to US banks to be state-chartered or federally chartered. The Federal Deposit Insurance Corporation (FDIC) was invented as a deposit insurance scheme across all US states, and the Office of the Comptroller of the Currency (OCC) was created as a supervisor for state-chartered banks. Maybe Europe is at the point where it should look at what the US did 160 years ago as a more viable option, giving banks a choice to be truly European as opposed to ordering all of them to become more European.

One of the biggest hurdles for banks is the way in which banking union and EU supervision are constructed. The single supervisor is now 10 years old. 50% of every country's banking market was to be supervised centrally, instead of the top 50% of the banks within the European union. The single supervisor faces a complete continuum of entities, from purely domestic banks in small countries to major global players. A better way of creating the European dimension could be to move towards a banking union that creates more momentum for those that want to have a European licence, giving them a single license with a single supervisor, a single resolution regime and a single European passport. This is a better way to create some euphoria and momentum towards Europe, rather than allowing the momentum towards banking union and capital markets union at the European level to depend on the lowest speed in the most opposing member states, which is what currently determines the speed at which Europe moves.

Given that the system is under pressure, maybe it is time not to maintain the system, but rather to change the system and to move to the next level. This can only happen with changes in how we organise ourselves. Schengen was not ordered by member states; it was a voluntary contractual arrangement for those member states that wanted to be part of it, without being held back by the speed of those that did not want to move ahead within the EU. On banking union within the euro area, those member states wanting more global, more dynamic and more competitive European banks should sign up for a special agreement and a special passporting system that allows for pan-European banks but does not impact the choice of the smaller local banks to stay local or some member countries' preference to maintain a more grassroots banking systems.

Markus Ferber

That could fit, but could lead to other problems with some member states being covered more than others. The SSM thresholds came about in order to have a balanced approach that covers almost all member states and types of banks. While it is always possible to identify problems and solutions, there is no political power and willingness to achieve these objectives.

Many things that have been clear for decades are no longer clear. Rules-based trade is being challenged, meaning that the single market must be strengthened. Instead of member states competing within the European Union, Europe must compete against other markets in the world, as Jacques said.

Ideas are needed. Schengen was never an idea during a treaty change; it started with a decision by 10 sovereign states and was ultimately incorporated into the treaties. The European Parliament is wrong to always ask for a new convention. Frontrunners with ideas for deeper integration are needed; the others will then join in. At the end of the process, new ideas will be incorporated into the treaty. Integration was never the result of the treaties; the treaties consolidated the integration that had already been achieved. Schengen is the best example of what is possible.

A French-German initiative could be the cornerstone; others will join in immediately. Without such initiatives by a few member states, there can only be failure. The issue will not be solved through treaty changes or the next working programme of the European Commission. We need a few member states that go forward, and the others will follow.

Axel Weber

David, there is a light at the end of the tunnel. Do not say it is a headlight of a train coming towards us. Add to the positivism that Markus has just talked about.

David Wright

Just on your points here, we are going to need more flexibilities in the system in the future. We are 27 member states now. How many are we going to be in the future? 35 or something like that, and maybe even more. It seems to me that whether we are talking about some 28th regime now, that is one method of flexibility. Enhanced cooperation under the treaty rules could be another, but we are going to have to use that to move forward, as Markus was saying.

Now, I am referring here to the report I had the honour to work on with Jacques de Larosière. When the European supervisory authorities were set up, there was significant resistance from Germany. The Sparkassen were worried about the articulation of a new European supervisory authority, and the Landesbank feared competitive disadvantage. Time was spent trying to reassure them that this was in their own interests.

It is always important to engage and to demonstrate that these ideas are in the best interests of everybody. It must be shown that there is a level playing field for everybody. There cannot be a biased system in Europe that favours one area of the market. Not enough has

been done to reassure people that this is beneficial to everyone, as Delors did with the Cecchini studies. Without ensuring a fair and level playing field, Europe will experience major headwinds.

Axel Weber

Yes, and I think you said the right thing. As we are adding more countries that are even more diverse than the existing European average, any change in governance will be slowed down. We need to find a way for those countries that started Montanunion, or the original founders, to move to the next level of integration without really waiting for the speed of everyone to convert to the average first. Jacques, you talked about the fiscal dimension.

Jacques de Larosière

I am very interested in what you said. I would like to come back to something that David said, which is very important. He said that we have to use the intergovernmental reinforced systems. If people are asked about concrete outputs of the European Union, they might point to Airbus. Airbus is not a European construction; it is an intergovernmental European construction. There has been too much regulation and too little action. More Airbuses are needed in the new digital systems. There is no European equivalent of Google (Alphabet), Apple, Facebook (Meta), Amazon, and Microsoft (GAFAM). Would it not be adequate to try to make something or do something concretely? This is what I would like.

Energy-wise, we will always be a dwarf in the geopolitical system if we do not have energy. It is important to concentrate on clean energy, which is now the object of a proliferation. The clean energy revolution is happening, and it is emanating from the private sector. Nuclear energy, which the Germans have abandoned for political reasons, is important for the future. France has understood that the recent reductions in electricity of nuclear origin were a mistake. There must be negotiations between states within the cooperation of Europe.

In other words, Europe is a framework for intelligent cooperation of nations rather than an entity in itself that must be serviced.

It is often said that union is the source of force. In fact, it is the forces that make the union more so than the reverse. There has been so much focus on the importance of having a strong union that it has been forgotten that the union does not exist without the nations.

Axel Weber

Thank you, Jacques. You raised one important issue that I would like to ask the other two gentlemen to also comment on. You mentioned the green transition, which is an important project for Europe. My question to both of you would be: if you also add the digital transformation, which is a similar project in a different dimension, does that not require more and faster progress on banking union and capital markets union? How can we go about that? My question is: since it has to be driven by the private sector, who will finance that?

We do not have the deep capital markets the US has, and so capital market progress is probably slower than banking union, and the banks do not operate European-wide. How do we finance those needed transitions, and is that not, in itself, requiring a gamechanger?

David Wright

Absolutely. No, it cannot be done unless we have deeper, more efficient and linked capital markets. This is not a European capital market to the exclusion of local capital markets. We have to find an articulation between that, as I said. I fully agree.

I just want to make one point on what Jacques said. The Commission sometimes forgets that it works on behalf of the member states to determine the European public interest. It is important to engage with member states and to work in a cooperative way with the European Parliament. However, there are some dimensions where there is a need for the European Union as a whole. For example, under the treaty, the European Union has a responsibility to negotiate trade on behalf of member states. In my time, when I was in the cabinet of Sir Leon Brittan, we did a deal on the Uruguay Round. Who negotiated that? The European Union on behalf of the member states, and most people would say we did pretty well. In fact, we did very well, in my view.

On the other hand, when we turn up at Basel, what happens? This is competence of the European Union under the treaty. My view is it should be the European Commission that negotiates on behalf of the member states. All the member states turn up in Basel and we get perhaps a less than optimal outcome from the point of view of European banks.

In the future, the EU will need to move further into areas such as defence and digital. In the areas where the treaty defines responsibilities for Europe, it is important to have a unified European Union, with the Commission always working closely with the member states to define the common interest.

Markus Ferber

I have only two remarks. Firstly, as Jacques said, where are the European GAFAMs? Where are we? For 10 years I have been asking, 'Where is the European cloud?' Microsoft, one of the GAFAMs, is now investing €3.5 billion in Germany to create a European cloud to fulfil our data protection requirements, but it is a US company investing US money in Europe, and the benefits will go back to the US. Where is Europe?

Digitalisation will not work if Asia is producing the hardware, America is producing the software, and Europe is organising data protection. That does not create enough value for money for our economies. While the public sector can take some risks, it is the private sector that must finance digitalisation.

When people throughout Europe and political groups in the European Parliament use the phrase 'capital markets union', they are often speaking about completely different things. The Commission could help by describing what is needed. Capital markets union is not only about transferring money throughout the European Union; it is about having a financial sector

that is delivering all financial services inside Europe to meet all the demands of the real economy.

Currently, Europe is not able to deliver that. In Germany, there is not a single bank that is able to finance large investments; consortiums must be organised to manage this. This shows that the real economy is already ahead of the banking sector in a member state. At the European level, huge developments are needed over the next five years. Otherwise, only outside investors will benefit, as is happening currently.

Axel Weber

Thank you, Markus. This being the last panel, let me close with two remarks. First, Jacques, I want to give you the floor,

The ministers have sent me a short message that, if Jacques de Larosière has a single request, they will decide about it today and do it today, so what would your request be? What is the one thing you want the ministers to do to move us on the right track to capital and banking market union?

Jacques de Larosière

Stop easy fiscal policies.

Axel Weber

Very good. I knew that he would bring it down to less big government. Thank you all for listening to this final panel.