Open strategic autonomy: implications for finance

The concept of strategic autonomy has emerged as a key policy objective of the EU to protect the European way of life. Initially limited to defence and security issues, this concept of strategic autonomy has found echoes in all EU policies. In the area of finance, Brexit raised the question of our financial autonomy, in particular when it came to market-related economies. It has highlighted a key question: can our continent be satisfied with being an importer of financial services developed and produced outside the EU or should it build some form of strategic autonomy in finance. The real challenge is whether the EU financial system is agile and powerful enough to back the most EU promising entrepreneurs and businesses, to invest in the rest of the world, to deliver attractive returns to savers and to remain at the frontier of innovation.

The session assessed the state of EU's financial autonomy, discussed the prerequisites to progress towards a Europe 's strategic autonomy in the financial area and the priorities to move forward. The speakers also underlined that the Russian invasion of Ukraine reinforces the need for Europe's strategic autonomy.

1. The Russian invasion of Ukraine reinforces the need for Europe's strategic autonomy

The Chair stated that the EU condemns the current war in its entirety. The European response goes beyond the policy of sanctions. For the first time in its history the EU has decided to send war material to a third country. The challenge is firstly energy, but it is also security, economic and financial. It is important to express solidarity with the Ukrainian people. Sanctions have been decided.

An official noted that Russia's attack on Ukraine has a link to what is being discussed. The consequences of what has happened cannot be underestimated. Europe has to stand together. Sanctions are necessary and must be proportionate to the full invasion undergoing in Ukraine. Europe will have to develop a new strategic approach in terms of diplomacy, defence and regarding the economic consequences the shift has.

He added that Western countries and Eastern Asian countries who share democratic values and beliefs will have to cooperate more closely. Europe wants to be more competitive, but strategic autonomy will differentiate and distinguish between relationships with other democracies and Western countries, and societies with social or political models that do not share European principal values and beliefs.

An industry representative observed that Europe is united with people who share fundamental values of freedom of speech and democracy. The way the UK government has reacted on sanctions of Russian assets and investors in London is consistent with the EU's way of looking at the world. It is important to think about what financial market infrastructure Europe wants for the next 20 years. There will be days where Europe will not be aligned with the strategic perspective of the UK, nor with the strategic perspective of the US.

2. The open strategic autonomy in the financial area: the state of play

The Chair underlined that the financial sector is a key area which open strategy can be ensured. The Commission published a communication in January 2021 that outlined EU priorities regarding the EU's economic and financial autonomy. The French Presidency is willing to maintain the impetus created by this communication.

A policy-maker explained that the Commission has based its strategy on three pillars: strengthening the international role of the euro; boosting the resilience of financial market infrastructures and the EU's broader financial sector, mainly linked with the banking union (BU) and capital markets union (CMU); and protecting the EU's financial system against the extraterritorial application of third-country measures. A common sanctions' regime is vital.

2.1 Openness: an advantage for the EU?

2.1.1 Openness is an advantage for the EU

A policy-maker observed that when the Commission undertook the communication on open strategic autonomy last year it was not a theoretical project. Openness is a big advantage for the European Union. Integrated markets and the EU single market are success stories. The European Commission appreciates the participation of third-country operators in the EU financial system because it is good for competition, and for a wide range and quality of services. However, there is a need to reinforce the EU's strategic autonomy by addressing some vulnerabilities linked to the commitment to openness.

2.1.2 Financial Europe has been transformed over the past 20 years into an open bar

An industry representative highlighted that the perception in the financial sector is that Europe has transformed over the past 20 years into an open bar for the rest of the world contrary to the US or China, which do not discuss whether they need an open or a closed door to be innovative and competitive. These countries decide when they open the door and when they close it.

In Europe over the past 70 years there have been big successes that have been built on the business like trade policy, aerospace policy, agriculture and telecommunications not on an open bar. Europe must decide collectively if it wants to exist in certain sectors, if it has a common interest in having financial infrastructure, both for finance-takers and finance-makers and how it uses the culture of the EU to make it happen.

2.1.3 Actions need to be taken to reap the benefits of this openness and mitigate any associated risks

A policy-maker remarked that the global geopolitical situation and the EU financial landscape have dramatically changed in the last years. It is important that the Commission is mindful that Europe may face a challenging geopolitical context, and the Commission should not shy away from the fact that legitimate economic and financial interests have to be upheld and defended.

Autonomy is key. It is important not to become excessively reliant on critical service providers that are not in the European Union. The EU needs to protect its financial industry from the effects of extraterritorial sanctions or other harmful practices where third countries impose sanctions and restrictions related to the use of their currencies or access to their markets.

An industry representative stated that Brexit has created a new challenge and a new fragmentation. The City is moving fast to retain its competitive advantage, notably in equity, and is at the forefront of the innovation that was previously mentioned. London is taking the lead on key innovations like the legal framework for blockchain in trade and is undergoing significant changes in the regulations of company listings in order to promote the City as a financial centre. Open financial autonomy and sovereignty are even more essential.

2.2 Some progress has been made

A policy-maker added that many activities are ongoing since the Commission started to set up the process. An important discussion amongst ministers will take place about fostering the EU's financial autonomy and the euro. The Commission has made progress with the CMU recovery package. The issuing of the EU green bond is a major achievement in the list of activities that contribute to an open strategic autonomy of the European Union, in particular in the context of fostering the international role of the euro. Many projects are ongoing in digital finance, including the digital euro.

A policy-maker noted that the third block of the Commission's strategy relates to the protection aspects, what the EU can do to better protect its system, and where it has to be united when it needs to react to unlawful activities of third countries. The blocking statute is an important piece of legislation, but it creates a dilemma for the industry. The question is whether EU companies adhere to third country sanctions and then get into trouble with the blocking statute, or if it is done the other way around. The Commission has also put forward an ambitious package on anti-coercion measures in the trade area.

An industry representative stated that the financial autonomy and resilience of the EU and its banking system was demonstrated in the face of the economic crisis during Covid. Domestic banks proved essential in reacting swiftly to the unprecedented emergency measures that had to be taken to protect the economy and give liquidity to corporates. In France €140 billion of loans were distributed very quickly to 700,000 corporates, and for the vast majority it was done by national banks. The corporate bond market in the EU functioned well during the crisis, including the high yield. The equity markets quickly recovered, and primary markets adapted very quickly and with great agility to a new world of digital interactions.

The positive attitude of all domestic banks in every major European country restored the image of bankers in the eyes of the general public and with public authorities, and enabled domestic banks to compete with US banks, which mostly did not react in the same way or respond at the same level. This one-off effect should force banks to continue this trend, giving themselves all the necessary elements for their capital markets expertise and investment banking capabilities to be on par with US banks, and to be fully recognised by government, corporates and institutional clients.

The Chair noted that the Commission has a very broad agenda which also goes beyond finance. There are instruments for trade in terms of autonomy. The German coalition agreement indicates that it would support Europe's strategic sovereignty.

2.3 Achieving strategic autonomy would increase Europe's capacity to act strategically and autonomously on the global stage

A policy-maker observed that if the EU manages to stand as a coordinated jurisdiction, especially when it comes to the banking sector and financial markets, it will naturally take on a much bigger role in the global landscape. The EU sees the internal market more as an achievement within itself, but it is important to be aware that it makes the EU very strong in the global landscape. It is important to examine what EU policy-makers bring to the system, but also what are the effects on ensuring better global competitiveness.

An official added that the ambitions will not only increase the EU's financial autonomy by strengthening European financial markets, but also have the potential to shape forward looking and rules based policy internationally.

3. Prerequisites to progress towards Europe's strategic autonomy in the financial area

3.1 Macroeconomic stability is a crucial prerequisite for such autonomy

An official stated that discussion is welcome regarding the open strategic autonomy strategy. Macroeconomic stability is a crucial prerequisite for autonomy in the financial sector. Post-pandemic stability challenges for economies will need to be addressed, including growth, fiscal sustainability, price and financial stability, and the ability of governments to act in a time of crisis, which requires building fiscal buffers in economically good times.

3.2 Strong EU banks and capital markets players are of the essence

An industry representative underlined that it is essential that the rebound is financed, which must also be economically sustainable, to finance the energy transition and to accompany the EU recovery programme. Strong EU banks and capital markets players are essential to finance the innovations and the technology start-ups, and to ensure technological sovereignty in the Cloud. The level playing field must be ensured and promoted by European policy-makers and regulators. Incentive measures could be put in place to compensate the prudential impacts of Basel III reforms, such as by having a green-supporting factor. The CMU must be at the forefront of the political agenda if Europe wants to have all the ingredients of a powerful ecosystem of institutions that are capable of investing in the future, notably in equity and investment banks. Europe's financial autonomy depends on having very strong EU banking institutions.

An industry representative added that there is a need to support strategic autonomy through a resilient, well-risk-managed and competitive financial sector in Europe.

An official observed that strategic sovereignty in the financial sector cannot be addressed without acknowledging that competitive financial actors are needed. The EU has to commit to wanting a competitive industry, but competition must show which business model is best. Regarding the challenges lying ahead for the industry, particularly digitalisation and the enormous investment necessary to roll out digital business products, the EU must provide a better integrated European market. The EU should allow the use of capital and speak about anti-money laundering (AML). Discussions are ongoing with the Anti-Money Laundering Authority (AMLA) regarding a regulation which will better harmonise the rules.

He added that the alternative is that the EU supports economic recovery by facilitating union-wide banking businesses and services, which will not only be a competitive advantage to European industry and a contribution to strategic autonomy, but also a contribution to the economic recovery that is so desperately needed after the pandemic.

The Chair summarised that there is a commitment to financial autonomy, but at the same time there is a need for competitive actors to have a real integration of the market in order to avoid fragmentation.

3.3 Policy-makers need to set the right framework to enable a flourishing financial market ecosystem

An official stated that European markets need to be resilient, dynamic, and well integrated to maintain the EU's financial autonomy. A strong, world leading European financial ecosystem is required that is up to date with recent trends such as sustainable finance, digitalisation, and digital finance. Europe needs to enable and facilitate the free flow of capital and the free use of financial means within itself as one aspect of financial autonomy. If there is a common supervisor, then Europe should trust in its capacity to manage cross-border risks. The infrastructure of financial markets is crucial because dependencies may arise. The clearing of euro-denominated derivatives is an aspect where more sovereignty needs to be gained, and where appropriate proposals need to be worked on. Digitalisation is a key area, and the funding and financing of young, new technology companies needs to be addressed. The Scale-Up Europe initiative is one contribution.

The Chair noted that the previous speaker had touched on a number of initiatives that are ongoing under the French Presidency, but Europe needs strong players for real financial autonomy.

An industry representative reminded the audience that competition in Europe remains intense. US investment banks can subsidise their European activities through the very high level of profitability they have on their domestic and integrated market. They are dominant in the EU in many market segments such as equity capital markets, high yield, technology investments and their perceived expertise. They are supported by their regulators' neutral approach on the final Basel III framework and the market structures in the US, including securitisation, allowing banks to have fewer capital buffers and to be less sensitive to output floors.

3.4 The EU financial sector should not be at the mercy of non-European actors due to Basel III

An industry representative emphasized that a significant question is how clients perceive financial autonomy. During the Covid crisis Europe has seen a reversal of a trend that previously existed around provision of service and financing to European corporates by foreign banks. Up until 2020 foreign banks had been the fastest segment when it came to provision of loans to German corporates, but from the second half of 2020 onwards they ended up being the lowest. Foreign banks saw a 5% yearly contraction of their provision of lending to Germany. Europe is still heavily dependent on bank funding. The Basel III framework will likely see significant impacts by 2030.

With US regulators indicating a capital-neutral approach for US banks, industry representatives stressed that there is a risk that European implementation of Basel III in its current form may weaken the competitive position of European banks, which would undermine the strategic autonomy agenda.

An industry representative added that it is vital to not create uncertainty or incentives to deal away from the European banking sector. Basel III is forcing corporates to obtain an external rating in order for them to have access to relatively inexpensive funding capital, when 70% to 80% of European corporates are currently unrated. Basel III also increases costs for European corporates to hedge their interest rates activities, credit exposures, and pools that are split between the UK and Europe.

4. Priority measures to move forward

4.1 Closing the gap between European banks (especially GSIBs) and their non European competitors

An industry representative observed that European banking clients are choosing US banks for many of the critical services that Europe will need in the next decade. US banks enjoy advantages that Europe does not yet have. European banks need to be more efficient, more profitable and have available capital. US banks can subsidise services in Europe, do not have to fund resolution funds, and have the ability to transfer very significant amounts of risk to securitisation markets or government-sponsored enterprises (GSE) for their mortgage businesses. The Banking Union and a European deposit insurance scheme (EDIS) that works are critical elements.

4.2 Accelerate the implementation of the CMU

An industry representative stated that the CMU is critical. Steps such as the harmonisation of regulatory and supervisory activities around capital markets are important, as well as having one supervisor instead of 27. The same also applies to a harmonisation of the insolvency regime. If a bond is issued in Europe, then the question is whether 27 experts need to be hired, one for each country, in case insolvency occurs. That makes it prohibitively expensive, particularly for smaller countries. Europe will need a great deal of money in the next decade for repaying some of the Covid costs that have been collectively incurred as an economy and funding a green transition.

4.3 Reducing the EU's exposure to offshore clearing

An official noted that the large amounts of derivatives that are currently cleared outside the EU show a high exposure of EU market participants and raise financial stability concerns for the EU. It is important for the EU to enlarge its clearing base in order to increase liquidity in EU CCPs and to make clearing in the EU more attractive.

A policy-maker observed that there is a great deal of interest in the issue of clearing abroad. The EU Commissioner made it clear that Europe needs to act now. A positive agenda is needed to see what can be done to make clearing in Europe attractive without creating problems in the end.

4.4 Accelerating the consolidation of the financial infrastructure sector

An industry representative stated that there is no tangible outcome without continuous European consolidation. The amalgamation of the exchanges is a way to show that Europe can build an integrated market through a corporate angle. Europe is very close to being able to have one single form to file an IPO in Europe, because the rules are similar, but they are not identical. In the US it is filed as one.

4.5 Promoting equity holdings with European households

An industry representative underlined that Europe needs to be promoting equity with European households. The finalisation of the CMU must have equity at the heart of its next steps. The European Commission's consultation on the Listing Act is timely. It will be necessary to develop Europe's tech sector, its energy transition and to face the needs of the energy transition. There is a link between finance and energy, and autonomy in energy supply. Brexit can be an opportunity to rebalance the weight of different financial centres and to have stronger financial centres in Europe.

4.6 European companies should contribute to concretely build the strategic autonomy of the EU

An industry representative explained that Euronext has a long track record of building a pan European federal model connecting local companies to global markets. Euronext has tried to build an integrated single liquidity pool or single order book, which represents 20% of the shares traded in Europe, including the UK. It has aggregate market capitalisations of €6.9 trillion, which is about three times the size of the aggregate market capitalisations of the Frankfurt exchange, and twice that of the London exchange. The process of consolidation or integration can work, provided that it has a proper federal governance, that finance makers and finance takers feel at home, and that compromises are accepted. Strategic autonomy is about accepting how to create European champions and building the compromises between national interest and the upside.

4.7 Sequencing the measures will be important

An industry representative emphasized that caution is needed regarding the sequencing of when Europe will have the ability to introduce a stricter stance on some of these measures. A complete ban on European operators accessing UK liquidity for central counterparties or making it impossible for European corporates to access fintechs, providers of artificial intelligence and data analytics suppliers would ultimately not help Europe to move fast enough towards strategic autonomy.

The Chair summarised that there is some convergence from public authorities and the private sector around the idea that Europe should move from the narrative of risk reduction to the competitiveness of its institutions. A strong currency is needed in order to be autonomous. Strong financial institutions are needed. Europe needs to consolidate the resilience and competitiveness of its financial institutions, and sovereignty is needed in its decisions.