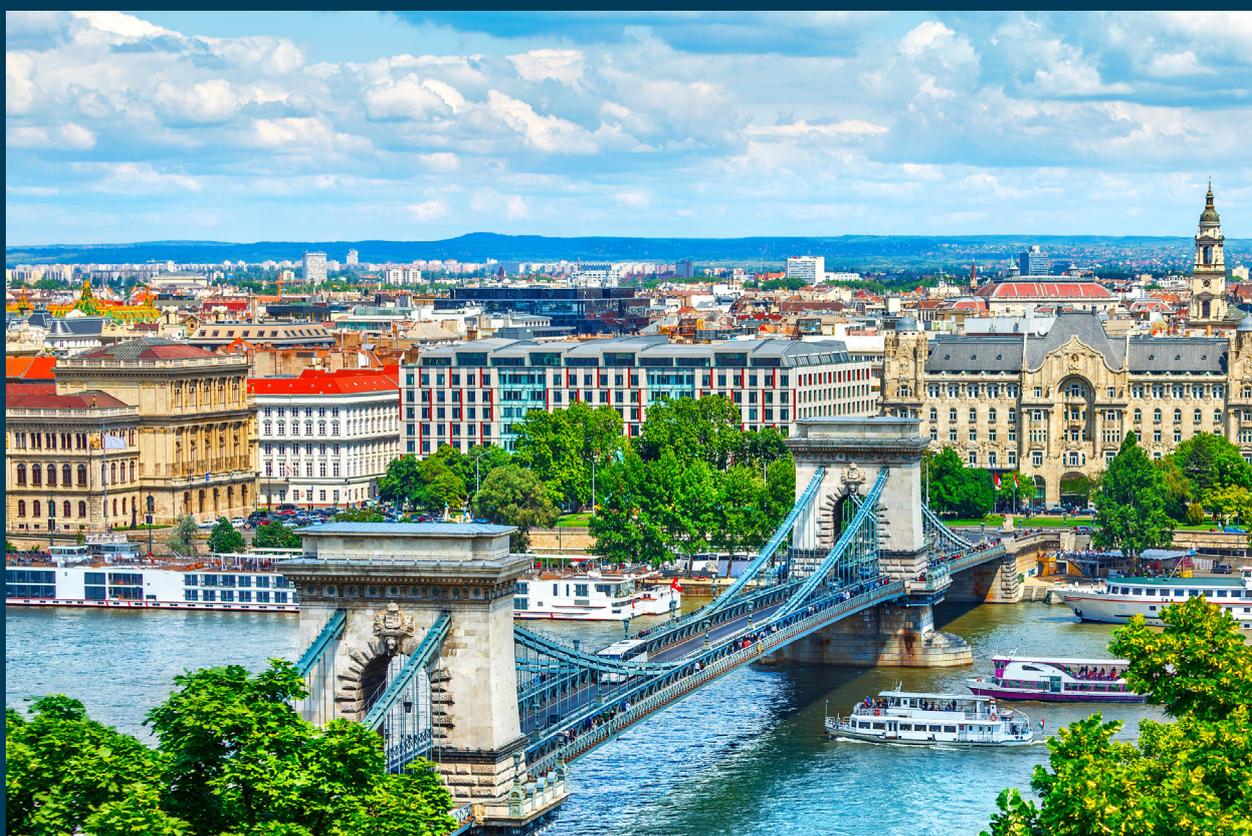


EUROFI

FINANCIAL FORUM BUDAPEST SEPTEMBER 2024

Organised in association with the Hungarian EU Council Presidency

Summary



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Foreword

The Eurofi September 2024 Financial Forum took place in Budapest ahead of the informal Ecofin meeting and was organised in association with the Hungarian EU Council Presidency. Over 1100 participants from the public and private sectors attended the 40 sessions of this Forum and the interventions of key representatives from the public and private sectors and the civil society.

The Forum addressed Europe's macroeconomic challenges and examined major regulatory and supervisory developments in the financial sector at both European and global levels. Additionally, several sessions explored key industry trends such as digitalisation and sustainable finance, along with the policy implications these developments entail. With the start of a new political cycle in Europe, discussions also highlighted the priorities for the new European Commission in the financial services area.

The following pages contain summaries of the Forum's panel discussions and transcripts of the speeches, providing a comprehensive overview of the current trends and issues affecting the financial sector, and the policy measures needed to address them. We hope you find this summary informative.

This report, together with the other documents published for the Forum - including the latest editions of the Eurofi Regulatory Update, the Monetary and Macroeconomic Scoreboards and the September issue of the Eurofi Views magazine - are available on our website, www.eurofi.net.



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EU economic competitiveness challenges

The euro area is lagging behind other regions in global competition. In his interview with Eurofi Magazine, the Governor of the Central Bank of Hungary notes that “the weight of the euro area in global GDP has fallen from 21.8 percent in 1999 with 12 member states to 14.7 percent in 2023 with 20 member states. The 12 founding countries achieved an average annual GDP growth of 1.5 per cent in the last 25 years, less than the over 2 per cent figure achieved by the United States of America”.

The moderator of the session stated that competitiveness for Europe is not only about efficiency gains and wages but is also about being able to offer a social model that is simply unique in the world and one that makes Europe the most attractive place to live in the world. The panel identified the problem in terms of where this gap comes from and the solution.

All speakers acknowledged that Europe is falling further and further behind when it comes to innovation, especially when it comes to growth in intangible investment and productivity. At European level, priority must be given to completing the single market and implementing the CMU. There was little mention of reforms and national solutions to help Member States regain competitiveness.

1. The economic gap between the EU and its global competitors has widened since the Global financial crisis

1.1 This worrying observation for the future of Europe was shared by all the speakers

1.1.1 Our house is burning

An official stated that the number one priority for Hungary's presidency is the competitiveness issue. Former French President Jacques Chirac once said, ‘Our house is burning, and we look away’. The bad news is that its house is really burning, but the good news is that it is finally not looking away.

In 2008, Europe was the biggest economy globally and had a 25% share of global GDP. This share has now decreased to 16%, while the US has increased its market share from 23% to 26%. The IMF has predicted that the lowest growth rates worldwide are going to be in Europe. The prediction is a growth of around 1.5% maximum, while other regions are all growing at much faster rates. An economy that is growing by 1% will double its size in 72 years, while one growing at 2% will double its size in 36 years.

1.1.2 Europe's startling income divergence from the US began around the turn of the century, coinciding with the onset of the tech boom in the US, and has deep firm-level roots

An official stated that it is an important time for Europe to focus on some of the problems that have been lingering for too long. The Noyer letter and the Draghi report are trying to address those, but it is also apparent that there is a clear diagnostic and there are solutions on the way forward.

Europe's per capita GDP is one third lower than that of the US. 70% of that gap is explained by productivity. Productivity development since 2005 in the tech sector improved by 40% in the US but was stagnant in Europe. Research and development (R&D) and innovation spending of these tech companies is twice as high in the US as in Europe. 10% of revenue generated by US tech firms is going into R&D, and 4% is in Europe.

The productivity gap is deeply rooted at the firm level. The market valuation of listed US companies since 2005 has tripled, while it has only increased by 60% in Europe.

1.1.3 The competitiveness gap is large, although whether Europe is seen as lagging or leading depends on the measure used

An official outlined that there were several ways of looking at the gap between the EU and the US. Looking at GDP at PPP, the gap between the US and the EU is now roughly a third. But if you compare GDP at PPP per hour worked, many EU countries have actually grown faster than the US. But the key issue is, as the IMF has pointed out, productivity in the corporate sector, especially innovative firms, where the US is much better than Europe. Weak innovative capacity is reflected in the trade balance, and the EU imports significantly more intellectual property and R&D services than it exports.

An industry representative noted that the Draghi report identified productivity and GDP growth, but it should not be forgotten that there are other social economic indicators where there is a lead in Europe. European economies exhibit consistently improving life expectancy rates, while US life expectancy has declined to the shortest in nearly two decades. Income inequality in the US is substantially wider than in any European economy.

1.1.4 Our way of life will be threatened sooner than expected if Europeans continue on a downward path

An official noted that the productivity and income gap between the EU and the United States has been widening for a long time. Although both economies were of the same size in 2011 with GDP in current prices of around \$15 billion according to the IMF, the US economy is 52% larger today.

An official highlighted the issue of competitiveness and stated that the analysis has been there for decades. The

political agenda was focused on growth, whereas there is now more of a granular analysis, at least by the politicians. The major theme is how to convince political leaders to make decisions.

The Draghi report includes many ideas that have been discussed. Poland's prime minister proposed the energy union when Russia annexed Crimea 10 years ago. Poland also suggested that the EU needed to buy gas on the global market as the EU, and very little has been done. Poland has grown this year by about 3%. While it will grow by around 4% next year, it is not enough.

1.2 Unlike their US counterparts, EU firms operate in a macroeconomic, financial and regulatory environment that is less favourable to investment and innovation

1.2.1 Europe lacks the productivity gains coming from innovative young firms that expand rapidly due to constraints in scaling up

An official stated that Europe lacks the productivity gains that come from innovative young firms that expand rapidly and has an overabundance of very small firms that grow little. Firms with 10 employees at most account for nearly twice as much of employment in Europe as in the US. Firms that are under two years old represent 20% of all firms in the US versus only 8% in Europe.

Europe's weaker business dynamism reflects constraints to scaling up, and the main reason for these big differences in productivity gap is market size. A European firm cannot exploit economies of scale as a US firm does. When a company operates across country lines in Europe, the frictions and barriers are high compared to state lines in the US. Trade intensity in the US is twice as high as in Europe.

1.2.2 Access to finance is another key explanation of the lagging performance of European firms

An official highlighted that US listed firms access equity issuance at twice the rate of European firms. The available venture capital sector in the US is four times larger than in Europe. Even in terms of borrowing and debt issuance, small European tech companies pay interest rates that are two percentage points higher than in the US. When looking at the service sector, there is an issue of intangibles, which cannot easily be pledged as collateral. Equity also matters in order to give young, dynamic companies a start to grow. To scale up, market size matters. Europe needs to work on both of these issues.

1.2.3 The absence of a true single market

An official highlighted the incomplete nature of the single market as a problem. Fragmentation relates to national regulation, taxes and insolvency regimes. Barriers have remained particularly high in services trade, limiting economies of scale. Accordingly, intra-EU trade in services has barely grown during the past years and the EU has been unable to benefit from the global rise in services trade. This does not bode well for an advanced economy that generates 65% of its GDP from services.

Supply chain disruptions, coercive practices by trade partners and Russia's war in Ukraine have eventually exposed trade-related vulnerabilities. Strategic

autonomy and economic security concerns have since reshaped the EU's policy agenda. The increase in energy prices is just the tip of the iceberg, yet the answer to vulnerabilities arising from political decisions elsewhere cannot be putting EU money at the service of external competitiveness. Political threats must be addressed by political means, even if this implies foregoing some of the benefits from trade.

European firms lack political support while the USA, which is their main competitor, introduced the Inflation Reduction Act in 2022. This allocates \$400 billion in federal aid until 2030 to support clean energy, electromobility and the rebuilding of the US industrial base.

An official noted that the Draghi report says that one of the most important issues is to find an additional €800 billion for investment annually. Currently, the only available additional funds and initiative from the EU comes from the NextGenerationEU (NGEU) fund. The financing instrument has a total amount of €750 billion, but it is not an annual financing opportunity. Of the €750 billion, only 40% has been disbursed. One year ago, the same figure was 33%.

There is a common debt that is already borrowed from the market. It is in the accounts as €750 billion. In the last three and a half years, only 40% of this has been disbursed, and in the last year, only €50 billion has been at a time when there would be a desperate need for an additional €800 billion annually according to M. Draghi. This is a clear example of why there is a competitiveness issue in Europe.

2. At European level, priority must be given to completing the single market and implementing the capital markets union (CMU)

The EU strategies to strengthen competitiveness are well known but need to be pursued more rigorously. The single market should be prioritised over external competitiveness. The momentum regarding the CMU should be exploited to achieve a truly single, efficient and attractive EU capital market.

2.1 Policies can revive Europe's dynamism by strategic adaptation to technology and climate shifts

An industry representative predicted that there is going to be a very profound shift in demographic geopolitics, climate and technology. There are three areas to highlight in the problem statement: it is key to build the political consensus to implement some of the boldest plans; there is a question of how the EU will translate policy thought leadership into effective execution; and in areas where the EU has traditionally lagged, and in a time of even more rapid change, there is a question of how quickly the EU can reverse those legacy under-investments.

He added that Europe has an entrepreneurial artificial intelligence (AI) ecosystem, as evidenced by about 370 new AI companies in 2023; the US has nearly 900, i.e. the double. 61 states of the art AI models came out of the US

in 2023 versus 25 of Europe. The investment that is going into this space outpaced Europe by nearly sixfold in 2023. That starts to drive that gap. The speed at which this is happening is very different from, again, the policies that were in place in the past. What you see here is that, where you may be a fast mover, what you then contend with is fast implementers. This comes back to execution.

2.2 Implementing CMU

2.2.1 For a truly single, efficient and attractive EU capital market

An industry representative stated that European capital markets are fragmented across national lines and are not deep enough. There are not enough flows of savings that enter the capital market for financing the real economy. The CMU is an important concept designed to overcome this. Single supervision is extremely important to broaden the scope of the mandate of the European Securities and Markets Authority (ESMA), and there is a single rulebook. The bar for this has been lowered somewhat because of the successful experience of the European Central Bank (ECB) for the banking union.

A catalyst could be provided for further integration going forward. There are then the issues of harmonisation and convergence on structural issues, such as withholding tax procedures and harmonisation of the insolvency frameworks. This is important, although the hurdle here is probably higher.

To provide the right funding, it is a matter of changing the perception as well as the approach to capital markets: correct the preferential treatment for debt over equity and stimulate equity financing; encourage long-term equity financing from banks, insurance companies, institutional investors and households.

Private equity and venture capital are playing important roles. Easy, simple and transparent securitisation is positive. A review of capital requirements for securitisation tranches is necessary. Capital requirements for different tranches are sometimes higher than those on the underlying pool of assets, which does not make much sense. The securitisation liquidity regime also needs to be improved. Additionally, it is important to start creating a culture at the household level to promote financial literacy and increase the number of households that put their money to work and avoid leaving it stuck in their bank account.

The common safe asset is extremely important and politically very difficult. There is also a need to create the preconditions for this to be politically acceptable. There are two instruments. The first is delivering timely and effectively on NGEU investment. Secondly, Europe has a big issue, which is that disbursement needs to be linked to conditionality.

The main hurdle towards common debt is the lack of mutual trust across member states. Much has been said about setting up ad hoc funds for specific investment areas. To make this a bit more politically acceptable, Europe should look at Support to mitigate Unemployment Risks in an Emergency (SURE) bonds. However, over the medium to long term, there is a need for a big central capacity with a bigger role for the EU budget and more

tax-raising capacity. The budget also needs to be given a larger amount of own resources to be able to meet the challenges of future investment.

2.2.2 Incentives, education and financial literacy should help to shift the mindset in favour of CMU

An industry representative likened CMU and all the important initiatives to greasing an engine in terms of making European capital markets more efficient. However, the engine needs to be fuelled. There is a question of how to mobilise the capital to get into equity markets and into debt markets, as well as how to change the culture of the willingness to accept risk for return in order to close a future pension gap.

Incentives and education/financial literacy can help to shift the mindset. A couple of European countries have already made good progress in terms of supplementary pension schemes, while Japan introduced a Nippon Individual Savings Account (NISA) investment scheme at the beginning of the year.

2.2.3 Improving securitization and facilitating capital flows from third countries to Europe are doable in the near term

An industry representative highlighted what is doable over the near term. Capital rules for banks related to securitisation are proving preventative. Equally, one could argue that the capitalisation rules under Solvency II for insurance companies to participate in the type of project finance that are needed to finance the energy transition are also preventative.

Some stakeholders in New York have expressed a high degree of scepticism as to whether the EU will be able to deliver on the CMU. Small items such as the securitisation market will help to create momentum that can be built upon.

Article 21c of Capital Requirements Directive (CRD) VI will go live in 2026 and is going to restrict the ability to provide banking services in the future, including lending from third countries into the EU.

2.2.4 The CMU requires a capital-funded pension base and is not, politically speaking, so complex

An official stated that all the details on securitisation regarding CMU are correct. The main difference in market structure is the availability of pension assets. Europe has a very dominant pillar 1, but if there is not a more dominant capital-funded pension base, it will not be possible to match this.

The Chair noted that the issue of pensions has been repeatedly highlighted.

An official stated that, politically speaking, the CMU discussion is not quite so complex. The economic model and the welfare state are threatened, and societies are threatened by the challenges that they are facing.

Decades ago, European leaders were able to agree that they would cease their national currencies. If people on the street were asked about a single supervision mechanism or CMU, they would laugh. Politically speaking, it is a non-issue. Therefore, for politicians, it is a 'low-hanging fruit'. Leaders need to determine how to tackle that and where the focus is.

The Chair summarised that the tasks to make CMU are not as politically difficult as they were 10 years ago.

2.3 To enable the corporate sector to flourish, the full forces of markets and capitalism need to be unleashed

2.3.1 Looking at the burning house

An official highlighted the issue of productivity. The reports sometimes ask for more state aids, subsidies, European champions or common debt, and all of this is going completely in the wrong direction.

The Draghi report includes many positive points, but the ones that focus on joint debt are disappointing. Productivity in Europe normally fluctuates cyclically with growth because European companies are normally very fond of labour retention. The support measures in the US during the pandemic focused on protection of income, whereas Europe focused on the protection of jobs. The protection of jobs leads to the protection of older industries that are less productive.

Europe is not too fond of 'creative destruction', so Europe does not have a tech sector like the US. There is a chance that, should Europe talk about items like safe assets and common debt, it will miss the point again and not look at the burning house. Such a focus on joint debt is utterly disappointing. If we want to implement such projects, we need to go into the technical details, on which all of these reports are extremely short: who is going to issue the debt? Who is going to decide which share of the debt goes to which country? How are we going to deal with the existing negative pledge clauses? There are many technical details that will lead to a situation where, if we start discussing this, even if everybody wanted it, it would take 10 to 15 years from the start to the implementation. By then we will not have solved any of the productivity issues.

2.3.2 The single market should be prioritised, and Europe should become more business friendly

An official suggested that the single market be prioritised over external competitiveness. EU funds should be used only for purposes with positive externalities, such as innovation or projects of common interest. The Recovery and Resilience Facility (RRF) can clearly not be a model, as it allocates the largest amounts of funds to the economically weakest spots. Similarly, pouring money into ailing firms will not generate the innovation needed to remain competitive on the world stage.

An official highlighted productivity as an area of focus. One solution is the single market, while another is CMU

and the banking union. Pensions should be more portable because people need to move to where productivity is highest. Housing affordability needs to be fixed.

An official suggested that industrial policy is the wrong way to go. The EU has been benefiting from an open trade system, and that is something to support. Economic security and resilience lie in the single market. The single most important thing to do for economic security is make this market stronger and strengthen supply chains within that single market.

An official stated that much of the legislation that Poland has been implementing for the six months that the government has been in office has come from Brussels. He added that cheap and reliable energy is key for the competitiveness of European companies. Poland is working from day one on the structural reform of its innovative ecosystem that will be able to help tech companies from the energy sector, as well as those in biotech and AI, to access equity.

2.3.3 Incentivising the private sector to foster investment

An industry representative stated that it is not feasible for just the government balance sheet to bear the brunt of the reversal of the investments. There is a need to discuss changes to regulatory regimes, enable scale and productivity, and broaden and deepen capital markets to enable funding much further than the banking sector in Europe.

2.3.4 We must be able to protect ourselves

An official explained that Poland is spending 4.2% on defence this year and will need to spend 4.7% next year. Poland hopes to establish a pan-European fund.

An official stated that the Hungarian presidency is trying to tackle the recommendations in the Draghi report. Its primary goals are to reach a new competitiveness pact and to focus on setting up a common industrial strategy and a new R&D strategy.

There are three issues on which the Hungarian presidency does not see a real consensus among EU countries: the extended use of qualified majority voting, single supervision and the common issuance of new debt. Progress can be attained through securitisation, moving the deposits of the European banking sector into a long-term savings product, the deepening of CMU on the funding side and better leveraging of existing tools through the European Investment Bank (EIB) and NGEU.

Addressing Europe's investment needs

The Chair stated that Mario Draghi published a report on the economic challenges facing the EU, which is struggling to keep up with dynamic productivity growth. This is linked to the challenges of aging populations, climate, digital transition, geopolitical risk and market fragmentation. The report recommends a step change in the levels of public and private investment. Private investment is substantially below the levels seen prior to the global financial crisis and Covid. Public investment has improved as a result of NextGenerationEU (NGEU) since 2019, but Draghi recommends substantially higher levels especially of private investment.

1. Europe suffers from a lack of skills, economic invertibility and energy costs

The Chair noted that European firms have underinvested in productive capacities relative to US peers since 2008 and is losing ground relative to fast growing emerging economies. Over this period, EU firms have faced a macroeconomic, financial and regulatory environment that has proved less favourable to investment and innovation.

1.1 The easy monetary and fiscal stance of the last 20 years has discouraged productive investment in the euro

A market expert observed that economic disparities in living standards between euro areas have widened considerably since the launch of the euro as investment has lagged behind. Europe lags behind the US in terms of productive investment, research and development, and size of firms. Only 40% of NGEU funds have been disbursed, and this is partly due to the lack of private sector projects. There has been a slow deterioration as states have opted for economic models that are detrimental to the supply side of their economy. This has contributed to a loss of economic dynamism and has consolidated Europe's position behind the US in terms of growth, productivity and investment. Since the 2008 financial crisis, most member states have focused on stimulating private demand through public spending. Fiscal policies have sought to preserve household consumption at the expense of productive investment, leading to a slowdown in productivity growth.

With interest rates remaining at zero for an indefinite period, investors have been discouraged from investing in risky projects and have turned to high-yielding speculative assets. Low or negative interest rates induce a state of mind that decreases the propensity to invest. In what John Maynard Keynes called the 'liquidity trap', investors play safe by placing savings in short-term instruments as longer-term low interest rates generate inadequate returns for higher risks.

A significant proportion of European savings has moved outside Europe, in particular to the US, where interest

rates are consistently higher. Despite interesting and valuable initiatives, the situation is deteriorating to such an extent that the large additional investment recommended by Draghi may not materialise.

1.2 Europe has lost the IT revolution

An industry representative cited Mario Draghi's suggestion that Europe needs €700 billion to €800 billion annually to face its ecological, economic, security-related and sovereignty-related challenges. Europe's 2023 savings surplus was €370 billion, representing 2.6% of GDP. However, most of these savings are invested in the US and need to be redirected.

The difference in growth between the US and Europe can be explained by the gap between investment in new technologies, which amounts to 5.8% growth in the US versus 2.8% in Europe. Furthermore, the gap with China is becoming more obvious. China is dominant in 57 technological research areas. The principal reason for the gap with the US is that it is less risk averse than Europe. 80% of US institutional portfolios are invested in equity versus 40% in Europe.

Europe's savings need to be channelled more effectively, with a focus on long-term investments. This can be achieved by providing the right incentives (standardisation, simplification and improvement of the quality of available financial and extra-financial information, appropriate regulatory framework, financial and tax incentives where necessary), while ensuring the necessary protection in return for increased risk-taking.

1.3 Europe has lost the IT revolution

One IFI representative said it was positive that investment was a top priority for the new Commission. The EIB is one of a number of institutions that have stressed the need for more productive investment in Europe.

The main obstacles to public sector investment are planning and implementation capacity, not a lack of public resources. The Recovery and Resilience Facility (RRF) and other resources could be used. In the case of renewables, slow and complex permitting procedures in Europe and the US are hampering the deployment of new technologies. Draghi also says that the size of the EU market matters. More integration is needed, which means regulatory harmonisation, consolidation of companies and coordinated procurement.

When it comes to private sector investment, the EIB's recent survey of companies points to three main obstacles. The first is the lack of skills, economic uncertainty and energy costs. This means that new technologies and innovations are not used and activities in traditional sectors are not developed. The second is business regulation, which is cited as the main obstacle by 60% of companies surveyed. Regulations and consumer laws have made it difficult to trade across borders in the single market. The third is the ability to finance scaling up. Companies in Europe targeting valuations between €500m and €10bn are constrained by

the lack of availability of finance. As a result, companies often list in the US or are acquired by US investors. Instruments are being explored to support the growth of these companies in Europe.

1.4 Europe lacks venture capital investment

An official explained that 99% of EU businesses are SMEs, employing around 100 million people, or a third of the workforce. Start-ups and SMEs in Europe rely on bank financing. In the US, companies find angel investors and then sell shares to grow the business, which increases their valuation. The EU needs a funnel of angel investment, venture capital, private equity and IPOs. This flow has dried up and there are fewer IPOs.

Europe lacks venture capital investment, which is five to seven times greater in the US. To get money into European companies, you need to invest pensions. Some European countries have pension systems that channel money through defined contribution schemes, but many countries have defined benefit schemes.

Insolvency regimes need to be sorted out. Winding up and getting money back is different in each European country. On securitisation, the US has projects to buy yellow and pink paper from SMEs, which are high-risk, high-return investments, which is not happening in Europe.

1.5 Unfavourable demographics and structural rigidities limit business dynamism and undermine productivity in Europe

An industry representative pointed out that Europe is ageing and older people are more risk averse, which is one reason for the problem of risk taking and long-term investment. There has been a relentless production of norms, standards, procedures and regulations that have demonstrated the extent to which fear of risk has permeated society.

A central bank official said that recent research on productivity outcomes after the pandemic points to some striking differences across countries. US productivity has grown quickly because labour productivity has traditionally been countercyclical in a recession, rising there while typically falling in other countries. Another key development is investment: US has seen quite robust activity while a gap relative to pre-pandemic trends opened up in others, including Europe.

A key driver of these differences is that the US has a dynamic and flexible economy. This is evidenced by structural measures, labour flexibility and the ease of starting a business and access to credit, all of which are designed to generate churn and stimulate the economy. There was a general shock during the pandemic. The US approach was to extend unemployment benefits. Other countries used job retention schemes to maintain relationships between employers and employees. In the medium and longer term, if the shock is not permanent and there are no further shocks, there are productivity benefits from job retention schemes because there is no erosion of skills. However, with the energy shock in Europe, the cleansing effect of firing and hiring and the reallocation of resources across sectors became more important. Resources had to be reallocated. The lack of reallocation and dynamism hurt productivity in Europe.

2. Policy recommendations for the next EU political cycle

Speakers focused on European solutions to revive productive investment in Europe. A stable and predictable macroeconomic environment is essential. Deepening the Single Market significantly reduces constraints on business growth and should be prioritised. Progress on the Capital Markets Union (CMU) is also essential to ensure that capital can flow where it is most productive.

The main challenge is the misallocation of available funds, which is hampered by the prohibitive costs of operating in different jurisdictions, complex regulations and tax treatments, accounting and bankruptcy frameworks and supervisory rules. These costs are a particular problem for start-ups in accessing venture capital and scaling up. The RRF could encourage public and private productive investment. In addition, it would be valuable for Europe to design and implement a real industrial recovery plan.

2.1 Investment requires a stable and predictable macroeconomic environment

A central bank official stated that central banks aim to maintain and preserve macro-financial stability. Without low and stable inflation and a predictable macroeconomic outlook, Europe cannot have well-functioning, resilient financial markets and investment. Central banks have a powerful tool in monetary policy, but it is possible to do too much and face unintended consequences. Pushing the economy too hard through fiscal policy creates vulnerabilities, misallocations and the risk of a financial crisis. The sound policies that central banks and fiscal policymakers can implement are the foundation for economies to achieve their potential, but structural policies are the key to prosperity.

2.2 The EU must address critical investment needs through a comprehensive economic strategy

One official said that there seems to be a consensus about the diagnosis regarding the EU's deteriorating competitiveness. The right therapy, however, is still to be agreed. The discussion on European competitiveness cannot be limited to the financial sector, because finance is a tool rather than the goal of improved European competitiveness and productivity.

The Hungarian Presidency's planned competitiveness package to be presented in the coming months will be based on three pillars. The first aims at promoting a clean and digital transition, in which the improvement of the internal market is key. Connectivity and infrastructure links within the EU is an underdeveloped European public good, it must be improved. The first pillar also includes a targeted industrial policy, which should be combined with well-focused support policies. Burdensome over-regulation should be streamlined and made transparent and predictable.

The second pillar addresses labour shortages and demographic challenges and promotes innovation through targeted investment in research and education, extension of Erasmus and Horizon programs to all students and researchers

The third pillar deals with public and private financing. Cohesion policy, as a regional and cross-border equaliser in the single market, should be one of the main channels for competitiveness. Underdeveloped regions are an obstacle to greater EU competitiveness, as a more homogeneous economic area will mean a more competitive background.

Better mobilisation of European private savings for investment could improve productivity by accelerating the CMU and the Banking Union (BU). The CMU process should take into account the need to better educate EU citizens about investing, the different levels of capital market development and the diverging investment cultures and patterns of savings and. €250 billion a year leaves the EU on net basis due to a lack of good investment opportunities. This should be kept within the EU that would be an achievement.

2.3. Implementing the CMU

2.3.1 The use of pensions and private savings, supported by a standardised infrastructure and harmonised tax procedures, can bridge the gap to a more effective market system

One industry representative commented that a key mistake in comparing US and European financial and capital markets is to focus too much on public sector interventions such as the Inflation Reduction Act (IRA) and the NGEU. The depth and breadth of private sector capital in the US is the key to what is needed in Europe, not public sector spending. Europe should not aspire to the US public sector. The answer is private capital.

The Letta report says that €300 billion a year leaves Europe and is mostly invested in the US, largely because there is no harmonised European approach to workers' pension savings going into European stock markets. This is a policy measure that could be taken. You can argue about what market infrastructures should look like, including the CMU and the number of central counterparties (CCPs), but these ownership decisions are difficult to correct from a political point of view. A European pension product would unlock much of the €300bn. Letta suggests that a savings and investment union would be easier than a CMU. A pan-European pension scheme would unlock private capital and not require public spending.

2.3.2 Delivering bigger, more efficient and more liquid capital markets will eliminate some of the major obstacles on the road to greater productive investment

An industry representative noted that there has been movement on productive investment and better underwriting across the EU, but there is still work to be done. The US has a deeper and more developed securitisation market. Doing the same in Europe for SME loans and commercial bank loans would help move forward the CMU that the EU needs to complete. For BNY to operate in each custody market, individual custody licences and depositories are required. This means that small, medium and some larger European markets will not be served.

For cross-border investments within Europe, a company investing in more than one country will face different procedures for reclaiming cross-border tax certificates.

This can be resolved politically and has been resolved in relation to VAT, where there is a European framework that works very well. Adjustments for VAT on cross-border transactions cannot currently be made for equity and bond investments.

One official suggested a common European approach to market supervision to support CMU and safe assets. The ESM, EIB and the EU are issuers of safe assets, with a figure of €1 trillion in the market since April 2024. If all of the NGEU and ESM were used, a figure of €3 trillion could be reached.

A central bank official agreed that the Banking Union and the CMU need to be completed as a priority.

2.3.3 Pioneering new financing instruments to serve as building blocks for a CMU

An IFI representative explained that the EIB had adopted a new strategic roadmap. More than 50% of the EIB's annual business is related to climate action. The roadmap also includes the need to promote increased competitiveness, security and defence, digitalisation and innovation, as well as more traditional elements such as strengthening cohesion policy and mobilising funding for agriculture and infrastructure.

The new Commission will have new investment initiatives and legislators will develop frameworks that are simpler, less bureaucratic and easier to implement, allowing for stronger partnerships with actors such as national or regional development banks. There is a need for initiatives that allow the creation of products that can be scaled up on a pan-European basis.

The European Investment Bank Group will launch new financing programmes to support investment in cutting-edge technologies and infrastructure. The Strategic Tech-EU programme aims to strengthen Europe's strategic autonomy, home-grown innovation and productivity growth.

The Strategic Roadmap will replicate the model of standardised financial instruments to leverage private investment. With public finances under pressure, Europe needs to ensure that all public funds have an impact. The European Investment Bank Group has a unique capacity to leverage public and private investment. With a paid-up capital of EUR 22 billion, the EIB Group has mobilised EUR 5 trillion of investment. There is a new momentum for the CMU that should be harnessed. Lessons from pioneering innovative finance can also catalyse private sector investment. Experience with green bonds has led to new products that will make it easier to face external competition.

2.4 The Recovery and Resilience Facility (RFF) is reinforcing Europe's competitiveness

A policy maker explained that the Recovery and Resilience Facility (RFF) was created to support the recovery from the Covid crisis and to make Europe more resilient. In the spring of 2024, the European Commission published a mid-term review and assessment of its implementation. Bond spreads narrowed when it was announced that the Commission would issue joint EU bonds to finance the NGEU, helping to avoid fragmentation within the single market. The gradual funding of Member States as they

implement the measures has helped to maintain or increase public sector investment. Allocations to Member States have varied according to their economic situation.

Member states have invested in EU policy priorities: digital, green, infrastructure, transport and skills. Under the Recovery and Resilience Plans, key public sector investments will be implemented until 2026 and funds will be disbursed to Member States as they implement reforms. The main reforms affecting public investment are public procurement reforms, simplification of public administration and public services, digitalisation of administration to simplify procedures, reforms to support the green and digital transition and key structural reforms.

Overall, the RRF maintains and increases public investment. More than €265 billion has been disbursed and Member States are on track to implement the reforms and investments that will help Europe become more resilient

One lesson is that public investment is not all that is needed. The NGEU has provided direct financial support to around 1 million enterprises, but the business environment is even more important. Some Member States are introducing reforms to create a business-friendly environment, reducing regulatory and administrative burdens and barriers to entry to stimulate competition. Investment in skills is also needed. The Commission is considering incentives for such investment. The Important Projects of Common European Interest instrument has been funded, stimulating investment in hydrogen, micro-enterprises, cloud infrastructure, health and other areas.

2.5 Promoting productive supply policy

A market expert said that the aim was to reverse the trend towards under-competitiveness, under-use of available financial instruments and under-investment. Investors must be rewarded for the risks they take. Businesses need to be able to propose projects and innovate. Start-ups need help to scale up and find buyers in Europe.

A favourable environment for business and private capital is needed. This requires a change of criteria in competition policy, which has so far focused on assessing effects on the European market. The global market needs to be taken into account in strategic sectors and European champions need to be encouraged. Europe has an

Integrated Policy Crisis Response (IPCR) that needs to be strengthened and used. Many proposals have been made to extend and enforce the CMU. It is also important to promote securitisation procedures to help banks play their role in the right capital market. The aim is to have a real supply-side policy and a selective industrial policy. This implies a complete change of paradigm.

One industrialist noted that liberal economists and business leaders have called for the withdrawal of the state and public bodies from the economy. However, public and semi-public authorities have an important role to play. National development banks and institutions (NPBIs) are a bridge between policy objectives, targets and market practices. Public money should be a catalyst for private money. There can be no sustainable growth without social harmony. Regional cohesion is key to growth in Europe and will be part of the challenge in the future.

2.6 The new fiscal rules agreed at the European level are compatible with supporting adequate levels of public investment

An official stated that the new fiscal framework is more supportive of public investment than the former ones. It allows a return to the required deficit and debt level at a slower pace, as a trade-off between growth and the cost of corrective measures. New public investment can increase growth and three years additional time may be "purchased". Recognising the potential medium-term benefits of public investment in improving the fiscal stance is a step in the right direction. But there are risks involved. The scheme has been rushed through and not all the details have been worked out precisely, leading to a 'learning by doing'. There have been some worrisome experiences with the NGEU and the RRF identified by the ECA. Thus, the foreseen combination of the fiscal governance reform, the European Semester recommendations and the RRF could lead to a more bureaucratic and less efficient outcome. The bilateral dialogue between the COM and the MS about the fiscal path may lead to bias. National ownership remains key, the new rules seem to be more flexible in this regard. However, application of double standards vis-à-vis Member States should be avoided. It is crucial to ensure equal standards for each member state in implementation of the new rules.

Monetary policy to promote growth and stability in the EU

Introduction

The first part of the panel looked at the evolution of disinflation, inflation dynamics and views on monetary policy, including what needs to be done in the coming quarters to bring inflation back to the 2% target. The second part looked at the medium term, taking a step back for a broader perspective, including to think about the future of the European Central Bank's (ECB) balance sheet and Quantitative Tightening (QT). With the ECB's strategy review coming up the timing was opportune to reflect on what has been learned in terms of the conduct of monetary policy and the challenges it is likely to face in the future.

1. Monetary policy and the outlook for the euro area economy

1.1 Disinflation has been accelerating in recent months

The Chair set the scene by observing that following synchronised global monetary tightening, disinflation is progressing, reverting from the high levels seen after the twin shocks of the pandemic and the Russian gas cut-off to Europe. At the same time, the labour market remains resilient, with the unemployment rate at very low levels, and the recovery is expected to accelerate next year. Financial stability risks, which are usually imminent in such a situation, have not materialised. From a macroeconomic perspective, the situation could be described as a "goldilocks" moment – will it last?

Core inflation, excluding energy and food, fell to 2.8% in August, but services inflation has been stick around 4%. At the same time, ECB staff reaffirmed their inflation projections which continue to show inflation reaching the 2 percent target in the second half of 2025. The US is also beginning a gradual easing cycle.

1.2 A weaker economic outlook

A central bank official confirmed that the unanimous decision for a further 25 basis points change was driven by new data and the confidence that the transition mechanism continues to work. Despite the increase in real incomes due to past wage increases, consumers and households are holding back their spending, consequently saving rates are increasing. Decisions will continue to be made on the basis of data, including forecasts and not just actual data. The current path will lead to the medium-term inflation target by the end of 2025. However, the world is facing uncertainty and there is a lot of downside risk.

1.3 Risks and uncertainties in the global macroeconomic situation

The Chair pointed out that ECB projections are predicated on profit margins being compressed and labour

productivity starting to grow. A central bank official reported that there is a lot of comfort in the inflation and general macroeconomic outlook, as well as in the transmission of the ECB policy moves. Before the ECB decided to change the course of its policy and started to remove some restrictions, it clarified the three main criteria that will be in focus when making further decisions.

There was enough certainty for yesterday's decision, but looking ahead, there are many risks and uncertainties surrounding the overall macroeconomic situation, especially in terms of inflation developments. The main risks to growth come from the international environment, partly due to macroeconomic developments and the geopolitical situation. A worsening of global tensions would have an almost immediate impact on the macroeconomic situation, both globally and in the euro area.

Some favourable data is being received on inflation, but, looking forward, there is insufficient certainty that the positive trends will continue. This is especially true for labour markets, which are reacting very slowly to developments in the real economy. However, in many parts of Europe, labour market tightness is easing from month to month. The main uncertainties are coming from higher wages and developments of profit margins.

The Chair suggested that it is reassuring to see improved confidence in our understanding of the disinflation process. As inflation spiked, economic models performed poorly for several quarters, increasing uncertainty. In the ECB staff projections, forecast errors have been greatly reduced. Turning to the panel, the chair asked what the implications for the balance of risk and policy are.

A central bank official agreed that uncertainty has decreased, as evidenced by the accuracy of the ECB's forecast, but this does not mean that uncertainty has completely disappeared. For example, the forecast for wage growth has improved, and it was right to emphasise that profits will absorb much of the wage growth. Looking ahead, however, there are still risks and uncertainties. For example, profit margins and profits have now fallen to a level where they are much less likely to absorb wage pressures in the future. Inflation in services is sticky, partly due to the cost-push element and wage growth, especially in wage-sensitive services, but to a large extent it is also a demand effect.

The ECB has long been forecasting that productivity will grow and that the overall recovery in output will be faster than it has turned out to be. This is still the forecast, but there is uncertainty about the outcome, which then affects unit labour costs as the main driver of inflationary pressures.

Given the data dependency, it is not possible to give a path for the next 12 months. The current situation is good; there is a soft landing, with inflation falling and

output recovering, but there are still risks to this outcome over the next 12 to 24 months. The forecast horizon for inflation to reach the medium-term target is only 12 months. There needs to be a sustained change in the data stream before the reaction changes. There has not yet been any discussion of the neutral rate on the way down, but that will come relatively soon.

1.4 Lessons need to be learned about how to manage supply shocks

The Chair emphasised that we have seen a World with multiple supply shocks, and more is likely to come. This includes the green transition and geopolitical fragmentation; and of course, there was the pandemic and the Russian gas cut-off. There will be more supply shocks in the future. One central bank official noted that the EU is doing relatively well given all the shocks it has experienced in recent years. Lessons have been learned on how to deal with the shocks. The pandemic and the energy shock after the Russian invasion of Ukraine confirmed that supply shocks, if they are temporary, can be looked through, but if they are not temporary and have a longer lasting impact, they cannot be looked through. They require a response from monetary and fiscal policy. In the case of very large shocks, such as the one in 2020, very decisive fiscal and monetary policy responses can be effective.

With hindsight, it may be said that too much was done, and that the outcome could have been achieved with less, but that is probably not fair. In March and April 2020, some people thought it was almost the end of the world and feared for their lives. In such situations, people tend to overreact.

The events of the past few years provide useful guidance for the future responses of both monetary and fiscal policy. There are likely to be new supply shocks. It is difficult to say what kind of supply shocks they will be. No one could have predicted the last two shocks, but the geopolitical situation is much more tense and much more complicated than it has been in the last 25 years. Work is being done to try to assess the potential impact of different outcomes for this geopolitical situation, particularly in terms of trade policy for monetary policy. There is a need to learn along the way and to react accordingly.

1.5 The ECB's decision was premature and motivated by level of debt in Europe

A public representative stated that the results of monetary policy in terms of falling inflation were not surprising. However, the latest ECB decision to cut the policy rate was somewhat premature. Headline inflation is now at 2.2%, down from 2.6% last month, the difference being due to volatile energy prices. Core inflation is still at 2.8% and has stubbornly remained at that level. This means that real interest rates are now below 1%, which is not enough.

In the US, real interest rates are close to 3%, which is probably too high. The case for a rate cut in the US is clear. In Europe, the ECB's primary objective is price stability, and only a few days before Thursday's Governing Council meeting the ECB's chief economist said that the path to the target was not yet assured, so there should have been caution about further interest rate action.

There has been monetary accommodation, probably often too much, for 25 years. Sometimes it has been justified, as in the financial crisis or Covid. But overall, it has contributed to a huge increase in private and public sector debt. It has also led to very leveraged positions. Debt and leverage may look quite reasonable and sustainable at 1% interest rates, but they look very different at 5%. In yesterday's deliberations, the debt situation in the private and public sectors played an important role in the decision. However, the primary objective of the ECB is price stability, and this is not served by the decision because the signal given is that this cycle of increasing debt and high leverage can continue.

1.6 Persistently low real interest rates disincentivise productive investment and should be openly discussed in Frankfurt

One market expert emphasised that it is very difficult to forecast inflation over the medium term and that caution is called for. Inflation in services prices remains stubbornly high, partly due to nominal wage increases and slowing productivity gains.

The ECB lowered its interest rate yesterday to reduce the restrictive aspect of monetary policy. However, it is doubtful whether monetary policy is restrictive today. Wages are rising and catching up in a labour market that is quite tight. Productivity growth is lagging. This combination does not bode well for the prospect of lower and lower inflation. One should be sceptical about the idea that monetary policy is too restrictive and needs to be loosened. If you look at the liquidity overhang created by years of quantitative easing (QE) and the size of the ECB's balance sheet, the amount of liquidity created by the central bank in recent years is still there. QT is very modest. There is a large liquidity overhang.

Europe is widening the interest rate gap with the US. Experience has shown that lower interest rates in Europe than in the US tend to encourage capital movements towards the US. In the medium term, if real interest rates are too low for too long, instead of encouraging investment, they discourage productive investment and encourage short-term placements and asset bubbles. Savings that would normally have been invested in long-term assets are diverted to capital appreciation. Capital gains become more important than growth and the contribution of these placements to real investment.

This is not the view of the ECB governors. They believe that the lower interest rates are, the more favourable the investment outcome will be. It is very difficult for the ECB to counter the alternative position, given that real investment has fallen in real terms during the last 20 years of zero interest rates. It is very difficult to explain that monetary policy has favoured investment, because investment has not been favoured. There will be a repetition of the liquidity trap by going to short-term placements and avoiding long-term concerns. Yesterday's 0.25 percentage point is a prelude to a return to zero interest rates for a long time to come. The main risk is that real investment will be attacked again.

In the medium term, there should be an open mind. There is a very clear contradiction to the ECB's view that the more interest rates are cut, the more long-term investment is favoured. The ECB's view is wrong. It is not

borne out by the events of the last 25 years. It deserves to be discussed. If the alternative view is correct, and long-term very low interest rates are conducive to less investment, then monetary policy and the desire of central banks to cut interest rates more and more should be reconsidered.

2. The medium-term outlook for monetary policy

2.1 Excess liquidity unwinding process started without stress

The Chair highlighted that following the period of QE, the ECB's balance sheet remains large with continued excess liquidity in the financial system. At the same time, the broader macroeconomic environment under which monetary policy has to operate is changing – be it high debt levels, global fragmentation, the green transition. QT has been on autopilot so far and will accelerate, but no financial stability risks have emerged so far. What is the outlook for the ECB balance sheet and what are the risks?

One central bank official emphasised that the ECB decided to take a very careful and attentive approach to the balance sheet normalisation, taking into account vast amounts of assets purchased during and after Covid. This is important for the good functioning and behaviour of the financial market, including the banking sector. The ECB decided to start the relatively slow process of removing this excess liquidity, with the aim of accelerating it in the later stages. Markets are responding positively and there has been little stress. Banks are slowly shifting from a heavy reliance on programmes such as TLTRO to more market operations. The Transmission Protection Instrument (TPI) was designed to be used in case of unwarranted market stress. There is vigilance about what is happening in the markets and the possible risks, but at the moment there is nothing of particular concern.

2.2 QT will be a long process

A central bank official explained that repeating unconventional monetary policy e.g. QE, as used in the past, would not remove the problems with respect to the balance sheet of central banks. Projections show that it would take many years, probably until 2030 or 2040, before central banks could build up their reserves again. There are interventions such as reserve requirements to improve the balance sheet. It is also important that central banks are cautious if QE has to be applied again.

There is a need to consider what can be done to raise the equilibrium interest rate r^* . The discussion on capital markets union is part of this as a dynamic capital market could raise r^* . Another aspect is demography as raising the retirement age can make a significant contribution to r^* . Further, capital flows from the global North to the global South should be used to finance investments in renewable energy. This may unlock productivity gains.

The Chairman noted that the ECB implemented a new operational framework. Liquidity will be tightened. We

are also entering a period in which the ECB will undertake a new strategy review of its instruments, taking into account the lessons of QE and the disinflation period.

2.3 National structural reforms and effective progress towards the capital markets union (CMU) are essential for restoring growth

A public representative said that central banks and the ECB are in a unique situation with the balance sheets they have, which have ballooned enormously, especially during the Covid. It would be irresponsible to try to unwind these balance sheets quickly. It would destabilise not only the financial system but the whole economy.

After the Second World War, when debt was very high and central bank balance sheets were also inflated, they were brought down without destroying the economy or the financial system. The main factor that allowed that to happen was economic growth. President Lagarde has rightly said that it is time for the political world to wake up and start making the necessary reforms to achieve a structurally higher rate of growth and productivity growth. Central banks cannot do this alone. They need an environment in which they can use the appropriate instruments. One thing that is absolutely crucial for this environment is to work on the CMU, which is essential for economic growth.

The Draghi report gives a very precise list of what needs to be done to at least take important steps towards the CMU. 10 years ago, Jonathan Hill, who was then Commissioner for Financial Services in the then new European Commission, drew up a list of steps to be taken on the way to the CMU. Not surprisingly, Jonathan Hill's list and Mario Draghi's list are exactly the same. This is a disgrace for politicians. It has not been possible to take serious steps to complete this CMU. Such steps are necessary to allow central banks, including the ECB, to bring their balance sheets back to what should be considered normal levels.

2.4 Fiscal discipline must be restored in the euro area

The Chair agreed that monetary policy takes place in a specific context and cannot replace structured policies to generate growth. This is one of the issues that needs to be discussed among the lessons learned from QE. There was a lack of action on the supply side, and that was crucial. There is another related issue, which is fiscal policy. Monetary policy cannot be a substitute for fiscal policy, because monetary policy first and foremost has a price stability objective.

A market expert said that in Europe there is a group of countries that, more or less follow the prescriptions of the Stability and Growth Pact. Their public debt is around 60% of their GDP. Another group of countries has percentages closer to 110% or 120%. The main rules of the Stability and Growth Pact are not followed by very large players. Instead of having a cooperative system, we have an uncooperative system.

It is very difficult to have a stable monetary policy when a number of very important states have very strong deficit-oriented fiscal policies. It is very difficult to combine a stable monetary policy with a very unstable fiscal policy. There has to be some convergence. We have yet to see the beginning of that convergence.

Discipline has to be restored in the system, and particularly in those parts of the system that are hovering around 110% or 120% of GDP and running deficits of 5-6% a year. If this is not done, the system will become increasingly uncooperative, and the future of the Union will be at stake.

The Chair suggested that there is a consensus that when it comes to investment opportunities, what matters is whether the returns and productivity will be there. That is the key question. There is also the importance of fiscal policy in a monetary union. At the end of the day, it is a union and a cooperative effort is required. Countries cannot go in opposite directions.

2.5 Chair's wrap-up

The Chair summed up the need to work on inflation. Monetary policy must stay the course. An important lesson is that monetary policy is part of the policy mix, and by itself will not generate sustainable growth. This requires political will on the supply side. On the fiscal side, a cooperative environment is needed to support growth and also to allow monetary policy to operate without undue constraints. Draghi has provided a blueprint, but what is needed is action and political will.

Deepening the banking and financial single market

Introduction

Several points emerged from the discussion. To deepen banking and financial markets, there needs to be a coherent vision with the right narrative, a clear strategy with a focused agenda, competitive financial players and strong political ownership. Several priorities emerged for building the Union of Savings and Investment in Europe, including promoting equity financing, enabling the emergence of funded pension schemes, revitalising the EU securitisation market, developing long term savings products, reaching an agreement on a single prudential supervisor for EU financial market actors and addressing the overly burdensome European regulatory environment, which hampers the competitiveness of small and medium sized enterprises (SMEs).

1. There are good reasons to be optimistic about deepening the financial single market

A market expert stated that there is one key message: now is the time. The European legislative session has begun. The Draghi and Letta reports have been published. Under Paschal Donohoe's leadership, the Eurogroup and the Economic and Financial Affairs Council (ECOFIN) have published important work. Under Christine Lagarde's leadership, the European Central Bank (ECB) has also taken a position. There is momentum. Ursula von der Leyen's mandate is extremely strong. In her speech to the European Parliament, she expressed a very clear position on these issues and committed to the brand of Savings and Investment Union, instead of Capital Markets Union (CMU). The strong legitimacy of the Commission should shape the timetable of future decisions. This might sound over optimistic, but there has never been such strong political awareness of the importance of finance and the role of European finance in European competitiveness. The word 'competitiveness' has never been as central to the European political debate as it is now. The awareness of competitiveness is part of the dynamic. It is now a question of overcoming the familiar obstacles and moving in the right direction.

In the response to the Letta report, it was encouraging to see the positive reaction to securitisation. While a degree of caution is appropriate, there has been an unnecessary stigma attached to securitisation since the crisis. Perhaps the EU financial sector should be bolder when it comes to securitisation and savings. There is a general awareness that the savings system could be the protagonist of development. Savings are the engine of growth. If they are not used correctly, it will be impossible to achieve Europe's objectives. The real rationale for the

Savings and Investment Union is that there is no other way to finance the transition. Without a strong mandatory contribution from the private sector and the financial sector, there will not be enough money to stimulate investment. By coincidence, the presentation of the Letta report to the European Council took place on the same day as the European Council discussion on CMU. The feeling at the meeting was that it is possible to overcome the problems in the architecture of the EU's regulatory framework. The meeting focused on the roles of the European Securities and Markets Authority (ESMA) and the national authorities. Exactly how this interaction works is a political question that will be resolved with political intelligence. In this respect, the Polish Presidency next year will be very important. There are reasons to be optimistic, but the EU financial industry also needs to be proactive. The time is now, and hopefully results will follow.

A market expert emphasised the need for institutional cooperation. The Council, ECOFIN and the Eurogroup all have roles to play, alongside the Parliament. The resistance is mainly in the European Council. Ursula von der Leyen should include this issue in the portfolio negotiations and try to reach agreement. It will be difficult, but it is important to start immediately. The President has a strong mandate and she needs to use it. If she does, the targets will be achievable; if she does not, it will be business as usual without much progress.

2. Key success factors

2.1 Deepening the banking and financial markets requires the right narrative, a clear strategy and a focused agenda

An official suggested that the starting point of this exercise should be creating the right narrative. The first part of this narrative is, 'Europe has huge demands'. This message can reach citizens, including the younger generations. It is about funding innovation for a new and decarbonised Europe. The second part is, 'Europe has the savings to meet these challenges'. There also needs to be an appropriate institutional set up. There should be agreement on the basic principles and clarity on how to organise and implement the agenda. This would provide optimism and positivity to European economic and financial strategy.

Secondly, this work should go beyond lip service. There is a consensus on CMU among ministers, MEPs and other stakeholders. It is time to look at the concrete issues. The disagreements between member states are the starting point of the debate. There will be compromises on securitisation or supervision. All that is needed is a clear strategy with a focused agenda.

2.2 Improving returns for savers, increasing competitiveness and financing investment are compatible objectives

An official stressed that Italy strongly supports the idea of the Savings and Investment Union. The goals of improving returns for savers, increasing competitiveness and financing investment are compatible. One way to improve returns for savers would be to improve financial literacy. Most people do not understand finance or the trade offs between risk and return. There should be education in the basics of economics and investing alongside lessons in constitutional affairs and European institutions.

There are also many untapped investment opportunities that would improve returns for savers, such as SME funding, infrastructure development or energy transition funding. However, regulatory barriers are significant; policy is as important as funding in unlocking the potential for investment. Furthermore, the strength of the US economy is not only its capital markets but also its dynamism, labour market flexibility and risk taking attitude. The Noyer report talks about developing a European savings product. Given the diversity of tax systems in Europe, it will be difficult to create a product that is equally attractive in all jurisdictions. Indeed, taxation is an important consideration in the promotion of savings and pension products. Secondly, in terms of competitiveness, the removal of cross border barriers would encourage investment. The Letta report suggests that supervisory agencies should have permanent members, which should help to remove barriers and gold plating by national supervisors. Finally, to finance investment needs, it is worth considering using guarantees more actively to promote public private partnerships and private investment.

2.3 A competitive Europe needs competitive financial actors

An official pointed out that Europe needs competitive financial players that are able to withstand and overcome international competition. Otherwise, there will be no alternative to dependency on third country groups for key financing and services to Europe. The problem is that European financial players are losing ground on the global stage and even in most of the relevant segments in their own markets. In asset management, the market share of US firms among the top 30 players has risen from 30% to more than 42% from 2013 to 2023, while the market share of European players in the US has stagnated at 2%. At the global level, the market share of European asset managers among the top 20 global players has fallen from 48% to 20% from 2008 to 2022. The market share of European corporate and investment banks (CIBs) has been steadily eroding over time due to competition from their US counterparts. Between 2012 and 2022 the US banks' share of all CIB income increased from 53% to 64% globally and from 39% to 51% in EMEA. In 2022, only three of the 10 largest CIBs in EMEA will be European.

A similar trend can be seen in trading platforms, with increasing competition from non continental players focused on the secondary market and blue chips. In February 2024, the US firm Cboe Europe had a 24%

market share in European equities traded on trading platforms, which is equivalent to the whole volume traded on Euronext's primary markets. US brokers have taken an increasingly dominant role in transactions at the expense of European banks and local brokers. This shift will weaken the ecosystem, to the detriment of small and mid cap companies. This state of affairs is worrying, but Europe holds all the cards to reverse the trend.

2.4 Higher capital requirements cannot translate into more lending

2.4.1 Strong European banks should be at the heart of Europe's financial future

An industry speaker agreed there is no contradiction between the objectives of competitiveness, increasing returns and investment. The business of banks is largely to finance investment needs. Banks bridge the gap between savers and companies' financing needs by either converting deposits into loans to companies or by bringing liquidity to the capital markets. Banks are not just lenders; they are the heart of vibrant capital markets. Both lending and capital markets activities involve risk taking: credit risk in lending and market and counterparty risk in capital markets activity. To take risk, banks need to have enough capital, but in this context 'enough' only means the level of capital that meets regulatory and supervisory expectations.

2.4.2 The EU must take a more pragmatic stance as regards as further prudential requirements

The industry speaker commented that the single market for financial services has been 'deliberately kept outside the integration process', as the Letta report suggests. Over the past 15 years, banking regulation and supervision has been driven by a search for greater safety. This was justified in the immediate aftermath of the financial crisis, but it has not stopped. While banks' regulatory capital increased by 50% between 2014 and 2024, their risk weighted assets (RWA) increased by only 10%. 80% of banks' capital generation has been devoted to increasing their Common Equity Tier 1 (CET1) ratio. Indeed, the CET1 ratio of European banks rose to over 15% during this period. In the rest of the world, the average CET1 ratio stabilised between 12% and 12.5%. European banks are extremely well capitalised. This has come at a cost of a skeletal 1% annual increase in RWAs. Given the current level of funding needs, Europe should now consider allowing banks to use 100% of new capital generation to RWA growth. It is a condition to increase capital market activities and lending.

2.5 Strong political ownership has to be complemented by a consistent vision

An industry representative noted that the publication of the Letta, Draghi and Noyer reports has been a welcome boost to the legislative process. Nothing significant has happened over the last 10 years because of the lack of political leadership. The concept was clear when Jonathan Hill decided to pursue the CMU project. He had ownership, determination and vision. The other member states were happy for London to be Europe's great financial centre, but without Britain the issue has become a political orphan. The good news is that there is now real political ownership of the problem, but this needs to

be complemented by a coherent vision. If Europe takes a bottom up approach and discusses single supervision or securitisation on a case by case basis, it will not make progress. If the Parliament thinks it is too complicated, MEPs will not understand and will make compromises for the sake of making compromises. That is a very European solution, but it will not work in this case.

3. Priorities for building a Savings and Investment Union in Europe

3.1 Developing the securitisation market, long term savings products and single supervision

An official stated that the Commission should come forward with an ambitious proposal to ensure there is proper securitisation in the European banking sector. Limiting this proposal to green securitisation would be nonsense; the securitisation package should cover the whole economy. There is also a lack of long term savings products. The differences between national systems make this a difficult problem to solve. Poland and France, with the help of Christian Noyer, are trying to find an appropriate solution to this issue. Poland has a well developed Pillar 2 system and is developing Pillar 3 through auto enrolment. It will be important to take a similarly ambitious approach at the European level. The final key issue is supervision. If the EU financial services sector is serious about CMU, any discussion on supervision must include the smaller member states and address the home-host dilemma. A solution without Luxembourg, Ireland or any other country is impossible. The European Union has seats in three countries. The new supervisor does not necessarily have to be based in 27 countries, but it should be possible to find a creative solution to this problem if there is political will.

3.2 Encouraging equity financing and enabling the emergence of funded pension schemes

3.2.1 Eliminating the diversion of long term savings from equity to debt

An industry representative explained that it will also be necessary to remove tax distortions for households and review the prudential ratios of institutional investors. Increasing the share of European savings that is invested in equities will generate higher long term returns and support competitiveness, economic development and employment. Europe needs to incentivise more people to invest in European equities to reduce the liquidity gap with the United States. This will not happen as long as European households and insurance companies are incentivised to buy debt rather than equity.

3.2.2 Enabling the emergence of funded pension schemes

An industry representative remarked that the European agenda should be complemented by domestic efforts to tackle the challenges with equity. The success of the Savings and Investment Union will depend on member states' ability to channel savings into listed companies. The average savings rate in the EU is 13%. Europe exports savings and imports equity from the US. The first source of this leakage is the export of savings to US asset management companies, which then invest in European

companies. There should be a way of converting European savings into European equity without going through BlackRock or Fidelity.

The second source of leakage is the money that goes into fixed income. For many reasons, it is easier to invest in fixed income than in equities. There are strong incentives in all member states to link retail savings to fixed income. When EU financial industry players appear on panels, they advocate for the CMU project, but in their domestic markets there are guaranteed fees and build operate transfer (BOT) contracts. Member states need to create consistency, which means addressing the issue of pensions. 30% of the US equity market is retail, but in the US people know that they need to buy shares when they are young if they want to have an income when they are too old to work. In Europe, people simply hope that others will continue to pay their taxes. The incentive to buy shares is fundamentally different.

Importantly, there is no political sweet spot on these issues. There are very few issues that have a structural impact on growth or competitiveness that also have limited political costs. If there is ownership, progress can be made. One of Europe's main diseases is resignation. In reality, political will has allowed the EU to tackle issues like vaccine procurement, Next Generation EU, support for Ukraine and the restructuring of the energy market. If these issues can be addressed, so can the fundamentals of CMU. There is reason for optimism, if Europe's leaders have a coherent vision and do not give up easily.

3.2.3 Unless the lack of risk in portfolios is addressed, there will be no competitiveness

An industry representative observed that people often claim that ratios are a bad way to understand solvency. The interesting punchline is that, while in 2007 and 2010 the macroeconomic problem was an excess of risk in portfolios, in 2024 it is the lack of risk. The European Insurance and Occupational Pensions Authority (EIOPA) needs to wake up to this new reality: if the lack of risk in portfolios is not addressed, there will be no competitiveness.

3.2.4 The overly burdensome European regulatory environment is hampering competitiveness

An official noted that it seems like there are some 'landing zones' where progress will be possible on competitiveness, although this 'landing' may not be particularly easy. There is broad agreement around the EU27 table on the need to harness private capital to finance the green transition, digitalisation and defence spending. Indeed, the fact Europe's political leaders are still talking about competitiveness is telling. Competitiveness used to be an economic concept, but now it is at the top of the political agenda. However, there is another key aspect which was mentioned in the Draghi report: deregulation. Regulations are killing the European economy and European companies. The current system does not work. The European financial industry needs better regulation, but it is also important to roll back bad regulation. Whenever the Commission wants to introduce something new, it should roll back something else. Europe should not be producing three times as much legislation as the US. If this situation continues, it will be pointless to talk about competitiveness.

The Chair agreed that the issue of deregulation is an emerging topic. The Draghi report proposed the establishment of a competitiveness council. Each commissioner, according to President von der Leyen, will be tasked with reducing administrative burdens. There is going to be a vice president for implementation, simplification and institutional relations to stress test the entire acquis.

3.2.5 Leveraging the political will

A market expert emphasised that Europe should consider using the European Stability Mechanism (ESM) to fund defence spending. As other panellists have suggested, it is essential to harness political will. The way to finance defence is to do it together. It is important to bring people together. This approach can help Europe achieve strategic autonomy and create the conditions to finance the EU's

common needs. There is reason for optimism because the political conditions are right, but it is still necessary to be proactive. All stakeholders need to push their national governments to act. If national governments do not deliver, nothing will happen. The spirit of the panel discussion shows that all the necessary conditions are there. An official agreed that everybody should start lobbying ministers, prime ministers, CEOs and presidents of industry associations. This kind of political lobbying is important, and it works.

The Chair thanked the panellists for a rich and interesting discussion, adding that there is more positivity now than there has been for many years. If the European political community does not seize the moment, it will slip away.

Enhancing rule-making and the legislative process

The Chair said that the panel would discuss improving regulation and the legislative process to help finance the EU economy. Many people say that the EU is over-regulated, which hurts competitiveness. The Draghi report calls for a Competitiveness Coordination Committee. President von der Leyen will ask each Commissioner to reduce administrative burdens. In the new Commission, there will be a Vice-President for Implementation, Simplification and Inter-Institutional Relations who will stress test the entire acquis. In 2000, Paul Volcker said that the US Generally Accepted Accounting Principles (GAAP) were unintelligible to anyone on the planet and that they ran to 100 000 pages at last count. One question is whether Europe is worse than the US.

It is clear from this discussion that there are legitimate reasons for the complexity of the EU regulatory and supervisory framework. However, the burden of compliance has become a pressing concern for many financial market participants and needs to be reduced. A number of proposals have been put forward to improve the EU legislative and regulatory process and thereby enhance the competitiveness of EU financial actors.

1. Reducing the weight of the administrative burden

Administrative burden refers to the rules, requirements and guidelines that organisations have to deal with in order to comply with the regulatory framework. In the financial sector, the regulatory framework has grown significantly over the years as a result of the numerous directives, regulations and supervisory requirements imposed by the ESAs. While these measures are intended to reduce risk and increase transparency, they often impose high costs on financial institutions as they often lack the resources and expertise of larger firms. It is important to examine why reducing the administrative burden and cutting red tape is essential to improving competitiveness in the EU. While reducing administrative burdens is essential, it is equally important to ensure that robust regulatory standards remain in place. The challenge is to strike the right balance between mitigating risk and avoiding excessive bureaucracy.

1.1 Regulatory inflation leads to a costly regulatory burden on financial institutions

An industry representative stressed that the facts and figures show that there are productivity, innovation and competitiveness problems in Europe, including in the financial sector. There are structural causes, including a slowdown in the European economy with limited productivity, investment and innovation. But there are also the costs of over-regulation, including market fragmentation due to regulatory barriers, gold-plating, excessive capital requirements, over-taxation, fee caps and regulated pricing at national and European level.

Regulatory inflation affects not only level 1 (directives and regulations) but also level 2, i.e. delegated acts, regulatory technical standards (RTS), implementing technical standards (ITS) and level 3 (guidelines, letters, guides and questions and answers). At the beginning of the last decade, there were a few delegated acts, whereas in 2022 there will be almost 200. This requires a huge effort and cost (i.e. burdensome IT changes). The lack of systematic impact assessment, proportionality, transparency and meaningful dialogue with stakeholders in the rule-making process aggravates this situation. This leads to conflicting/overlapping rules, timing/implementation problems and uncertainty about the impact of EU soft law, which is binding in practice even if not in principle.

The increase in delegated acts is also problematic from a democratic point of view, as the texts can go beyond level 1. What is needed is streamlined regulation with more stability, simplicity and common sense. An inventory of existing rules must be drawn up to ensure consistency and make things operational. This would go a long way towards improving the EU's competitiveness.

1.2 More complicated rules benefit incumbents

An official suggested that at the national level, the most important aspect of regulation in the financial sector is having a level playing field. Stability is an issue, but enabling competition is very important. This also means that the rules should be as simple as possible. The more complicated the rules are, the more they benefit incumbents and large companies. For smaller companies and smaller banks, the costs are disproportionately difficult to bear. This can hamper innovation, limit growth opportunities and stifle competition.

1.3 Simplifying the EU rulebook

One regulator stated that less regulation is needed to achieve the strongest possible supervision. The key to strong supervision is a simpler approach. Too much detail and overly complex regulation misses the essential part of the financial industry. However, calling for less regulation does not mean weaker regulation.

1.4 A pause on new regulation and having impact assessments

One regulator stressed that the EU is good at regulation. However, there should be a regulatory pause to allow time for reflection to see if there is overlap, consistency or things that need to be adjusted.

There is a gap between level 1 and levels 2 and 3. Mandates are given in the legislative process, and politicians say that things are going further than they expected. There should also be consistent and better impact assessments. The Commission does an excellent job in preparing proposals, but the methodology does not exist for Parliament and the Council. The final legislation is often very different from the original

proposals. Robust impact assessments will help to ensure that new legislation achieves its stated objectives.

The Chair suggested that it is a problem that the Parliament does not see itself as being required to carry out impact assessments. There is no easy solution when MEPs or Member States insist on amendments that the majority thinks are unnecessary, but a vote is needed.

1.5 A reliable and consistent regulatory framework

An industry representative commented on the need for strong regulators and better regulation. There are three dimensions to regulation and legislation: calibration, complexity and competitiveness. In terms of calibration, there should be no softer regulation. Capital level and liquidity ratios are not a problem per se, as long as they are risk-based. The lessons of the global financial crisis should not be forgotten.

However, complexity and competitiveness are challenges. There should be no micromanagement by drilling down to the lowest level of detail. Principle-based regulation would help and give supervisors, authorities and banks enough room to manoeuvre. A debate on what is important and what is urgent would be helpful.

Regarding the Digital Operation Resilience Act (DORA), the technical standards for implementation continue to grow, but the implementation date is January 2025. There needs to be an acceptance of the need to be compliant, but with a risk-based view.

In terms of competitiveness, one of the main roles of regulation should be to ensure a level playing field. One question is with whom there is a level playing field. We have worked hard to comply with the new Basel rules. Then it turns out that the United States does not necessarily want to follow suit. At European level, the fundamental review of the trading book (FRTB) has been postponed for a year. This is not helpful, because then both regimes will have to be maintained in parallel and while the question of the international level-playing field remains open. When drafting legislation or regulations, a test question could be whether, in a globalised world, it helps competitiveness, weakens competitiveness or is neutral.

The Chairman reminded the audience that Level 1 was supposed to be principle-based, and level 2 was for the detail. Increasingly, more and more level 2 has been moved into level 1. In a way, the EU has become more American. A lot of American financial firms want the detail, because they want legal certainty. The UK, for example, is very much in favour of a principles-based approach. Many American companies do not want that. They want absolute legal certainty that they can do something. There are a number of cultural issues here.

2. The EU regulatory and supervisory framework

2.1 The complexities of ensuring financial sustainability

One regulator said that there are two reasons for the complexity: the regulated issues are complex, and the way to achieve the regulatory outcome is complex. Not

only are the issues being regulated complex, but they are becoming more complex in some places. The process by which the regulation is constructed adds to the complexity. There are many Level 1 mandates that go into Level 2. Level 1 also often goes into too much detail that is better dealt with in Level 2. For Basel III, Europe has had five years of co-decision with the parliament and 27 governments involved. The rules there may not be at the right level.

Since the global financial crisis, there has been a revolution in banking and finance. Regulation has increased across the board, and the way regulation is implemented in Europe has changed. There has been a shift from national to supranational in a systemic way. There are not many other sectors that have put as much effort into global standards as banking. The challenge in Europe is always to meet the minimum common standards of Basel. Except perhaps in the financial sector, Europe does not have many more rules than other jurisdictions, although it may not enforce them effectively.

The Federal Reserve Bank, along with the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC), will come together to agree on the Basel proposal. Then there is the implementation phase, during which there may be secondary implementation. At the Bank of England, implementation will rely primarily on the PRA, which will provide secondary rules, guidance, "dear CEO" letters, and tools.

2.2 Maintaining stability and implementing global standards

A policy maker pointed out that the *acquis* for financial services and markets is indeed large and quite complex. The sector is very attached to the *raison d'être* of people's money, so the approach is to avoid risks, safeguard financial stability and protect investors. This requires a fairly high density of legislation. The rulebook has over the years become more comprehensive because it deals with an increasing range of financial products and new emerging risks and challenges.

The EU-*acquis* is large but if there were 27 national rulebooks, the situation would be much more complex. Each Member State would see the need for banking and insurance in a slightly different way. A lot of regulation comes from international agreements, especially when it comes to capital requirements and stability. What was in Basel I and Basel II was much more principles based. When the financial crisis came, there was a shift that meant that things had to be done differently with Basel III.

2.3 Opposition to changes

A policymaker stated that where there is a desire to scrap rules, there will always be someone who wants to keep them. A balance needs to be found. Proportionality should be looked at in accordance with the EU Treaty. There are inconsistencies because the *acquis* is not stable but constantly evolving. and those inconsistencies need to be redressed. There is a need to assess reporting obligations and in the assessment the questions need to be tackled if the required information to report is needed, would be useful.

There is a lot of shifting to level 2, and a way has to be found, together with the European Supervisory Authorities (ESAs), to do this in accordance with the L 1 mandate without overstepping this mandate or creating disproportionate layers

The Commission's legal proposals undergo strict scrutiny by the Commission's Regulatory Scrutiny Board. There are arguments for and against having more impact assessments in the legislative process.

The Chair suggested that some possible solutions. The Commission could improve its consultation process. The Commission could push for more qualified majority voting if the text starts to move away from the structure. It could move towards enhanced cooperation. It could even withdraw its proposals if it sees that they are moving in a completely wrong direction. A more radical proposal would be for the Council and the European Parliament to demand impact assessments when they make significant changes to Commission proposals. That would begin to impose discipline. Another rather radical idea would be to give the ESA's more authority to contest whether the mandates are necessary, under the supervision of the European Parliament and the Council

2.4 The driving force of political will

One official agreed with the proposals in theory, but there could be problems in practice. At national level, there are also impact assessments of local laws, but it would be a very brave assessor who would dare to use an impact assessment to reject a politically approved law. Behind all the gold-plating, the bureaucracy, the destruction of productivity and competitiveness, there is political will. When the Financial Services Committee discusses the Corporate Sustainability Due Diligence (CSDD) Directive, every Member State thinks it is a terrible piece of legislation that will completely destroy productivity and lead to the deindustrialisation of developing countries, because no European SME will be able to meet the requirements and will simply withdraw from the markets. However, the Committee on Financial Services is not responsible for the CSDD. It has a different Council composition and a different view of what is politically necessary.

It is a very good idea to be principle-based. In common law countries, there is a lot of principle-based legislation. The idea is to change with the times, and it changes with court decisions. However, that may not be the kind of stability you are looking for. Someone may think they know what something means, and then the court says it means something else.

Giving the EBA 100 mandates and letting them decide whether they are necessary is a political death sentence. Someone who has to make decisions that might be politically sensitive will want a very solid, detailed legal basis that says exactly what is allowed and what is not. Without that, someone very powerful at a political level could come along and suggest that the mandate be refused, while pointing out that the decision-maker's contract is up for renewal. This could, of course, colour the decision-maker's view of which mandates are necessary and which are not.

3. Improving the EU legislative and rule-making to foster competitiveness

3.1 International competitiveness and long-term economic growth should be added to public authorities' mandate

An industry representative advised that concrete solutions should be proposed and worked on. Competitiveness is a priority. There should be a credible, independent competitiveness test before any regulatory proposal. The objective of international competitiveness and long-term economic growth should be added to the mandate of public authorities. It is not irrelevant to give such an objective to regulators or supervisors as well, as is common practice in the US and the UK. This is well illustrated by the example of the implementation of Basel III and the UK package, which is very pragmatic. It also does not contradict the objective of financial stability. A competitive financial sector will be more robust and better able to finance the EU economy. A competitiveness test and competitiveness mandates and objectives are key aspects.

3.2 Seeking quality compromises at Level 1

One official stated that compliance is difficult because the EU's democratic rule-making process is not designed for simplicity. A legislative act is the product of compromises, and sometimes bad compromises. The gaps then have to be filled by level 2 legislation. Level 2 legislation sometimes goes beyond Level 1 legislation because there is a perception that a risk is not being adequately addressed. The proposal for new committees to deal with bureaucracy and to go through the *acquis* sounds like another layer of bureaucracy, which is even worse.

3.3 Ensuring that the ESAs are fully accountable to the co-legislators

An industry representative noted that there is a question of the different levels in terms of institutional balance and democratic principles, by ensuring that the ESAs are fully accountable to the co-legislators. Delegation should be limited, and its scope clarified, because there should be a culture of real impact assessment, both *ex ante* and *ex post*, to ensure that there are no negative consequences and no overlaps.

It is good to improve the consultation process, and there should also be more effective judicial control of Level 3 acts, as there is limited scope for stakeholders to have recourse to the European Court of Justice. The governance of the ESAs should also be strengthened. A board would usefully include representatives from finance ministries or non-conflicted former industry professionals and reflect the EU as a whole. This could improve the normative role of the ESAs.

3.4 Redefining the success criterion for an EU presidency

The Chair asked whether there was a responsibility for Parliament and Member States as well as the Commission, as co-decisions determine the outcomes. A regulator suggested that what is being done is complex. One could

take inspiration from the Bank of England and its proposal for a strong and simple regime. It has done a lot of work on proportionality, and some ideas could be taken from there. The idea of redefining the success of a presidency is also inspiring. If the criterion for success is to take over as much as possible, then more and more will be added. The success criterion for a presidency should be redefined.

3.5 Delegation comes with responsibility

One regulator% suggested that some of the proposals on the table are being implemented. The ESAs have tools to try to go back to the co-legislators if the ESAs think that some things are not working. There is a call for advice when the regulation is changed, usually by the Commission before a proposal, which gives the ESAs an opportunity to give their views on what needs to be changed. The ESAs often give opinions. For example, on crypto, the ESAs gave very strong opinions, which led to legislation. There are no-action letters, where certain parts of legislation are stopped and not implemented. For example, this was done for a small part of the postponement of the fundamental review of the trading book (FRTB). The available tools are working better than before. The ESAs' ability to influence the legislative process at an early stage has probably improved in this area.

Better rules are needed. The reality is complex, but there is no contradiction that these rules are better explained at level 1 or below. If there is a desire to go to a lower level, we need to be comfortable with a situation where delegation comes with responsibility. You cannot ask for more detail at Level 1 while increasing the mandate of a regulator, because then the regulator would have much less capacity to implement. It is not the right way to have more at level 1 and give the authorities a competition mandate. It should be the other way round. They should have more delegation and more responsibility, because the scope of their actions can have a greater impact.

3.6 Taking a more qualitative approach

One industry representative stressed that there is no real internal market because there is gold-plating everywhere. On top of that, supervisory practices shape and fragment the market. Impact assessments are a good idea for changes and any new regulation. Instead of esoteric, quantitative impact studies, we should be looking at what kind of problem will actually be solved if the proposal is implemented and whether there is an input-output symmetry, for example whether the cost of implementation bears any resemblance to the problem being solved. The Chairman stressed the need for fresh thinking and new ways of approaching the problem.

Tackling EU pension gaps

1. Current challenges faced by pension systems

1.1 The current structure of European pension systems

The Chair outlined the three pillar structure of European pension systems. Pillar 1, the state pension system, is funded on a pay as you go basis. Pillar 2 covers employment related pensions and Pillar 3 is based on individual pension savings. Only a few European countries, such as Sweden, Denmark and the Netherlands, have successfully implemented Pillar 2 and 3 schemes. In the Netherlands for example, 80% of workers participate in these systems. However, the full potential of Pillars 2 and 3 remains largely untapped at EU level, as the direct competences in this area, such as pension legislation, taxation and labour market policies rest with member states rather than the EU.

An official explained that Sweden's public pension system was reformed in the 1990s. One of the specificities of the Pillar 1 system is that it does not rely solely on the pay as you go model. A small portion of mandatory contributions (2.5%) is invested in investment funds via the premium pension component. Sweden also has a strong tradition of unions and employee organisations administering Pillar 2 schemes through collective agreements, but there are also privately managed pension funds. Approximately 90% of Swedes have an occupational pension. Swedish savers hold assets worth nearly 140% of Swedish GDP in Pillars 1 and 2, with additional significant savings in Pillar 3. The capital invested in Pillar 1 alone equals 40% of Sweden's GDP, which contributes significantly to the depth of the Swedish capital market.

A regulator emphasized the need for a holistic approach to pensions that considers all three pillars. Pillar 1 is mainly about redistribution and ensuring minimum pensions for all individuals including those who might not have had a continuous working career. Many EU member states are yet to develop Pillar 2 and 3 schemes to deal with the future pension gap. There are also indirect benefits from these schemes, such as a higher level of financial literacy and a higher trust in the future, which drives savings and spending.

1.2 Demographic and economic pressures

The Chair noted that Pillar 1 is under significant pressure due to demographic changes. As populations age, there are fewer workers to support the growing number of retirees and the capacity for state budgets to compensate is limited. It is uncertain whether Pillar 1 pensions can be sustained at their present levels in the future.

A regulator illustrated the demographic challenges that Pillar 1 pension systems are facing. Currently, there are three working Europeans for every pensioner, but this ratio is expected to drop to 1.5 in the future. Some member states are already fairly close to reaching this level. On average, Pillar 1 pensions cover 47% of people's pension

needs, but this will decline to the low 30% over the next 30 to 40 years. Only 47% of EU citizens believe they will live comfortably in retirement. The reality is that 20% of people will not.

A policy maker stated that the issue with pensions is relatively simple. It boils down to a trade off between pension adequacy and financial sustainability. For many years the adjustment variable was financial sustainability, but now this has become the constraint and pension adequacy has become the adjustment variable. This change is concerning for future pensioners. Every year until 2050, 1 million European workers will stop working and become pensioners. The macroeconomic situation with regard to pensions differs greatly across different member states. Ireland, the youngest country in Europe, spends just 3.8% of its GDP on pensions; Italy, the oldest country, spends 15.6%. Despite these challenges, pension systems across Europe have generally performed well, even during critical moments like the Covid 19 pandemic.

A consumer representative agreed that Pillar 1 pensions are not sustainable in their present state, but many EU citizens cannot afford to save sufficiently for retirement, and their ability to save is only declining. As a result, many of these people will continue to depend on Pillar 1, making reform critical.

An official noted that the European Commission's 2024 Ageing Report shows that the old-age dependency ratio will rise to 59% in the coming decades in Europe (versus 36% today). The overall population of the EU is expected to slightly decrease, while the proportion of elderly people will rise significantly. In 50 years, one third of the population over 20 will be older than 65. This will put immense pressure on Pillar 1 pensions and increase GDP related pension expenditure in the majority of member states. Currently, 80% of pension expenditure happens via Pillar 1, which urgently needs reform.

The official added that ultimately, the size and age profile of a society is determined by factors such as fertility rates, life expectancy and migration. Fertility rates across the EU are well below the natural replacement rate of 2.1, currently averaging around 1.5. No European country reaches 2 and even optimistic forecasts predict only a slight increase to 1.6 in the future. Life expectancy is also expected to increase by six to eight years over the next 50 years, which will further strain the public pension system and also health systems, as the number of years that people spend in good health does not increase in parallel. This demography shift, which is common to all EU member states, is a critical issue that needs urgent attention.

1.3 Gender inequality

A regulator stressed that women face higher pension gap issues in the current system. The percentage of EU citizens expected to not be able to live comfortably in retirement is 20%, but for women this risk is 35% higher. Even in the Netherlands, which is often seen as a leader in pensions, 40% of women face a significant pension gap, highlighting

the vulnerability of women to poverty in retirement. Increasing the participation of women in the workforce is often seen as a solution to demographic and economic challenges, but this should not be seen as a panacea.

A policy maker agreed that women face specific disadvantages due to interrupted careers, extended periods of part time work, lower contributions and the underutilisation of pension care credits that need considering.

2. Solutions to address the pension gap

2.1 Addressing the demographic challenge

An official emphasized that demographic issues should be a central focus of the discussions on reforming the pension system. If nothing is done to correct Europe's very low fertility ratios, member states will have to further reform Pillar 1 pension systems. Economic growth is also necessary to sustain the income from Pillar 2 and 3 pension schemes, which in turn requires a stable workforce. Increasing the birth rate is essential to solving these problems. Hungary has been successful in increasing fertility rates from 1.2 to 1.6 over the past 14 years by increasing the amount of state support available to families.

A policy maker remarked that legal migration offers a potential solution. The recently adopted European Migration Pact aims to bring in 500,000 workers each year, which will partially offset the 1 million workers leaving the labour market.

An industry speaker agreed that immigration can contribute to addressing the pension challenges, but it cannot be the sole solution.

2.2 Pillar 1 reforms

The Chair noted that solutions to reform Pillar 1 pensions exist. They typically involve raising contributions, increasing the retirement age or cutting benefits. The problem is that they are unpopular with voters, as demonstrated by the experiences of member states that have attempted to introduce such reforms recently.

A policy maker pointed out that many countries have successfully introduced incentives for older workers to continue working, particularly those over 55, whose employment rates have seen the largest increase in recent years.

An official agreed that fixing the pay as you go Pillar 1 pension system is challenging. One potential solution might be to follow Sweden's premium pension model, which requires individuals to invest a small proportion of their Pillar 1 contributions in investment funds.

Another official stated that if fertility rates cannot be sufficiently increased in the EU, three other responses will have to be considered: raising the retirement age further, although some countries are already moving toward a retirement age of 70; reducing pension benefits, which would undermine pension adequacy; or increasing taxes, which would harm economic growth and competitiveness.

2.3 Auto enrolment in Pillar 2 pensions

A regulator emphasised that addressing the pension gap should not stop at Pillar 1; it must include Pillars 2 and 3. Implementing auto enrolment in Pillar 2 pensions will help people to save. Some people have argued that this is difficult to implement in countries with lower GDPs, but the Dutch pension system was established in the 1960s when the country's GDP was relatively low. Politicians and policy makers need to take a long term view to solutions to solve the pension gap. One challenge however is that this involves asking individuals to transfer money from guaranteed bank accounts into riskier pension products without guarantees.

An official noted that one way to encourage occupational pension savings is to use a gradual approach taking small contributions from individuals' salaries. Sweden's pension reforms included auto enrolment in Pillar 2 schemes through collective agreements. Today, 90% of Swedes have an occupational pension.

An industry speaker agreed that auto enrolment will be crucial to ensure that everyone is included in the system. In the Dutch market, about 90% of people are covered by the Pillar 2 system, which is not the case in most EU countries. Without auto enrolment into supplementary pension schemes, many individuals will face severe financial difficulties in 20 years. However, with auto enrolment comes responsibility. There will have to be strong governance to ensure that individuals have access to the right financial products.

A consumer representative concurred that auto enrolment is an adequate solution, as seen in Sweden and the UK. Product performance must be a key focus if an auto enrolment approach is taken, however. Pension products must be cost efficient and deliver good returns.

2.4 Enhancing long term investment products

A consumer representative highlighted the significant disparity in returns from Pillar 2 pensions across Europe. According to a Better Finance report, some countries have experienced very low returns in Pillar 2 products, ranging from just 1% to 3% over the past decade, while Sweden achieved a 9.4% return after inflation correction and the UK's Nest product delivered 7.3%. These differences emphasize the need to reduce costs, which directly impact performance and to implement regulatory and supervisory measures to enhance value-for-money in pension products, including possible market interventions. Simplifying pension products is also crucial. Distribution is another key factor, as people need access to suitable and simpler products. Swift action is necessary to encourage citizens to save for retirement, and regulators and supervisors must have the powers and resources to enforce these changes effectively.

An industry speaker emphasized that the key factors for developing an effective Pillar 2 pension system are governance and risk-return, which countries like the Netherlands and Sweden have managed successfully. Political motivation is also essential to develop such systems and ensure that no one is left behind, but the objective of developing Pillar 2 systems is not yet shared by all member states. The financial industry is ready to implement supplementary pension solutions, as evidenced

by successes in certain countries. Products such as European Long-Term Investment Funds (ELTIFs) should play a role in these solutions. Regarding costs, the industry speaker warned that if Europe's asset management industry continues to face cost compression, it risks becoming dominated by large, US-style exchange-traded funds (ETFs). The ultimate goal should be to achieve an attractive balance between risk and return.

A regulator agreed that suitable long-term savings products that are simple and cost-effective are needed, as they encourage people to save for the future. Both the Letta and Draghi reports highlight the importance of creating adequate long-term retail savings products, but if meant as retirement products, they must be designed as products that people hold until retirement and include a structured payout phase. Revisiting the Pan European Pension Product (PEPP) is part of the solution. Regulators and supervisors also have an important role to play in this area by sharing data, ensuring value for money, and providing oversight to guarantee that pension products deliver adequate returns for consumers.

An industry representative remarked that a key issue for improving pensions in Europe is determining who will pay the costs of Pillar 2 and 3 products. Offering guaranteed pension products that satisfy both consumers and regulators is expensive because it requires hedging against a variety of risks. Some smaller businesses may face trade offs between contributing more to Pillar 2 pension structures for their employees and demonstrating profitability or financial resilience to investors. Additionally, if tax incentives are introduced to encourage savings, someone will have to pay for them. The US uses matching contributions, but this also carries a cost, with the government paying a portion for those earning below a certain threshold. Ultimately, economic growth and robust capital markets are the key to the viability of all three pension pillars. Much of the capital market investments in the US are controlled by the wealthiest 1%. It is also important to understand where the top 1% of Europeans have invested their assets.

2.5 Dashboards and pension tracking systems

A regulator explained that the European Insurance and Occupational Pensions Authority (EIOPA) has provided formal advice to the Commission on how to set up pension dashboards and tracking systems across the EU. Dashboards provide governments with a comprehensive overview on the national pension system and the different pillars. Tracking systems help individuals to understand their future pension revenues, identify potential gaps and make informed decisions. Currently, only seven member states have pension tracking systems in place.

An official agreed that pension tracking systems are important, as they foster awareness, transparency and credibility and can increase citizens' engagement. Such systems can be developed at national or EU level. In Sweden, the government, the Swedish Pension Agency and the insurance industry have cooperated to develop a national pension tracking system. This system provides clarity and transparency for citizens by projecting their expected pensions across all three pillars.

A consumer representative was in favour of behavioural measures such as pension tracking systems which aim to

increase awareness, but highlighted that people will not be able to save if they lack the financial means to do so.

2.6 Improving communication and awareness around pension issues

An industry representative highlighted the need to improve communication around Pillar 1 pensions. There is inadequate communication on pensions from both member states and the EU. The lack of comprehensive information about the sustainability of pension systems and the state of the economy in general makes it hard for people to understand their overall pension situation and does not encourage them to take action. Citizens do not know what they need to do to prepare for retirement and many economic players are not sure who will bear the costs. Without clear information on what to expect from Pillar 1, people are unlikely to engage with Pillars 2 and 3. People need to understand that they must contribute more towards retirement alongside their other financial priorities.

The industry speaker noted that in the US, the Social Security Administration provides individuals with annual updates on their projected pension benefits, which help them to understand their pension situation. This kind of regular communication also needs to be implemented in Europe. However, the US model often uses fear tactics, warning people of the potential collapse of the social security system, which should be avoided. Developing financial literacy would be preferable, because people only save when they understand the context and the benefits.

A consumer representative commented that many people prioritise short term financial concerns, such as paying school fees, buying a home or simply making it to the end of the month. Both social and market interventions are therefore needed to help citizens balance these needs with a longer term focus on pension savings.

2.7 Connecting pensions with the Capital Markets Union (CMU)

The Chair observed that the discussion on pensions is linked to the CMU initiative. CMU requires risk bearing capital to function, and the long term investment horizons of pension funds are ideally suited to this role. A policy maker agreed that the issue of pensions is closely tied to both CMU and EU competitiveness.

A regulator agreed that retail pension savings could fuel the capital markets and support the EU's green and digital transitions. However, people might be reticent to transfer savings from guaranteed bank savings accounts into riskier pension products. What could help to build the trust of consumers is the introduction of an insurance guarantee scheme and better supervision at the EU level.

3. Conclusion

The Chair emphasised that trust, cost, and performance must be improved throughout all 3 pillars. This is an area where regulators and supervisors can contribute. There is also a clear need for political courage and a long-term view to make the right decisions about pensions and implement the adequate reforms. Countries like Sweden and the Netherlands have found an answer by forcing people to save for the longer term.

CEE region growth and financing challenges

The Chair opened the session by highlighting its focus on the growth and financing challenges facing the Central and Eastern European (CEE) region amid a turbulent macroeconomic and geopolitical context. Two key areas were explored: first, the region's opportunities and challenges in terms of economic growth and financing resources, and how these are expected to evolve in the coming years; second, the impact of key EU initiatives and potential regional actions, as well as assessing further steps needed to support the region's growth and competitiveness.

1. Main opportunities and challenges facing the CEE region

1.1. Macroeconomic and geopolitical challenges

A Central Bank official stated that the challenges faced by CEE countries are manifold. The economic environment has changed significantly over the last two decades, and the new conditions are more challenging for emerging economies. The most important consequences of the recent inflation shock are the elevated price levels for consumers and firms and the decline in business sentiment. It was anticipated that CEE price levels would eventually align with those in Western Europe over a 20-year period, but inflation has caused prices to rise in just two years by the same amount expected over a decade, while the pace of real economic convergence has remained unchanged.

The geopolitical environment is also a major concern for the CEE region, where the growth strategy is largely export-driven and relies in part on foreign direct investment (FDI). The export-per-GDP ratio of CEE countries ranges from 60% to over 90%, which is high by international standards.

An official emphasized that some economic challenges are common to the CEE region, such as inflation, and others are more country specific such as those related to the war in Ukraine. The war has led to a large influx of refugees into Poland, which has placed additional strain on the national budget, but it has had positive economic effects as well, with a 64% labour participation rate among the refugees. This has helped alleviate some labour market pressures, contributing positively to the Polish economy. The war in Ukraine has also had fiscal consequences. Poland's defence spending has significantly increased and is currently 4.2% of GDP; in the provisional budget for the upcoming year, it will rise to 4.7% of GDP, which requires making sufficient fiscal space in the budget. Poland has a debt level below 60%, so there is room to go into deficit for a period of time to finance the additional important security needs. However, Poland should not bear the brunt alone of reinforcing

security in the whole CEE region. The effort should potentially be more evenly distributed.

Another official agreed that recent geopolitical tensions and crises have increased security risks, disrupted the business environment, and reduced the willingness to invest in the CEE region. Latvia has also significantly increased its defence expenditures, which will be the new normal for the coming years. However, countries in the region have demonstrated adaptability and resilience in responding to these major shocks, as evidenced by their performance during the pandemic. Recessionary periods in the CEE region have tended to be shorter compared to other parts of the EU.

A Central Bank official explained that Romania managed to maintain dynamic growth throughout the recent challenging period due to a mix of supply and demand factors. On the supply side, three key sectors stand out: IT, transportation and automotive. Romania's highly-skilled workforce, extensive broadband internet access and competitive cost structure have helped attract significant foreign investment, particularly in the digital and automotive industries. Romania's strategic location between Western Europe and the Balkans makes its transportation and automotive sectors key drivers of growth also, supported by significant infrastructure and manufacturing investments, particularly in automotive components and vehicle assembly.

On the demand side, Romania's growth has been supported by robust private consumption, rising incomes, and relatively low unemployment. Nevertheless, maintaining this growth remains a challenge due to the negative contribution of net exports. Romania's reliance on imports for essential goods, especially in the processed food industry, exposes it to risks related to global supply chain disruptions. A further challenge comes from the unprovoked war in Ukraine. From the outset of the conflict, Romania has been a steadfast supporter of Ukraine, while also maintaining solid economic partnerships with Moldova, whose economy remains deeply affected by the war.

1.2. Long-term structural challenges

A Central Bank official highlighted that demographic projections for CEE countries indicate a substantial decline in the labour force. This trend, which began several years ago, is expected to intensify during the current decade. In Hungary, for example, the working-age population is projected to decrease by 5%. In addition to demographic challenges, rising energy prices and higher financing costs than in the previous decade pose significant challenges for CEE economies. These economies, which are energy-intensive and reliant on capital to drive their economic convergence process with Western Europe, are particularly vulnerable in this context. Notably, nine out of the ten most energy-intensive economies in the EU are located in the CEE region.

An official agreed that demographic changes are a common challenge for CEE countries, making the long-term outlook uncertain. The security of assets and their ownership is another area of focus in Poland. Major efforts are being made to restore the rule of law, which has been infringed in recent years. Rule of law is important for financial markets because business can only be done if the title and ownership of the assets are secure.

Another official further illustrated the challenges associated with energy supply. Following the Russian invasion of Ukraine, Latvia quickly decided to cut energy imports from Russia for security reasons. The decision was supported by the expansion of the existing regional liquefied natural gas (LNG) infrastructure. The challenge now is to further improve interconnectivity with the rest of Europe and to enhance renewable energy capacities. Additionally, the CEE region faces structural issues such as low productivity, demographic decline and the necessity of adapting to the green and digital transitions. The significant challenge is how to balance investment needs and tax policies while remaining competitive, taking into account the fact that fiscal policy will tighten.

1.3. Opportunities and challenges related to the EU enlargement process

A Central Bank official emphasized the significant opportunities and challenges posed by the ongoing EU enlargement process for the CEE region. While the enlargement offers potential for greater regional consolidation, increased trade, and enhanced political stability and governance, integrating new economies, particularly Moldova and Ukraine, presents complex challenges. These countries, transitioning from conflict-affected economies to market-oriented systems, will require substantial investments in infrastructure, institutional capacity, and regulatory alignment.

The official stressed that collaboration across CEE countries and candidate nations is crucial to ensure that enlargement strengthens rather than divides the European economic landscape. The process must be approached with unity to maximize its benefits for the region.

2. Policy priorities for economic growth and competitiveness in the CEE region

2.1. Priorities for the incoming Polish EU Presidency

An official stated that when Poland takes on the upcoming European Presidency, it will be pursuing trilogues on ongoing policy measures and driving the files forward with other member states, the Parliament and the Commission. These files include the Retail Investment Strategy (RIS) and the review of the Payment Services Directive (PSD). Some new measures will also be potentially proposed as a member state initiative.

The incoming Polish EU Presidency will also be focusing on several broader economic and financial areas. The European Semester and the related adjustment process within the EU will be a priority for which national buy-in is essential. Countries will implement what is negotiated with the Commission only if they feel genuinely involved in the thinking of the process.

In relation to financial markets, the official noted that developing funding capacity at the EU level is important. This is also mentioned in the Draghi Report and has already been done within the Recovery and Resilience Facility (RRF) scheme where the EU has tapped into the financial markets. However, the EU will have to reassess which approach is best for achieving this moving forward. A further issue is finding the right balance between reducing unnecessary regulatory burden and maintaining the necessary rules in place. Many stakeholders rightly complain about the complexity and strictness of EU frameworks and the administrative workload, but EU rules provide a common framework that ensures operational consistency. Additionally, assets and transactions are only safe if there are enforceable rules for financial markets.

2.2. Structural reforms and infrastructure investment to drive growth

An industry representative stated that there has been much discussion about the need to find an adjusted growth model for the CEE region, as the previous one is less effective than before. There is slightly more capital available, but labour is decreasing, and available land is limited, so more intensive, quality-driven growth is needed. Improvements are needed in four specific areas to achieve this growth. The first is investing in quality infrastructure, such as faster trains across the region. The second is convincing investors to invest in the region to help reduce the brain drain, which is a major issue in the CEE region, rather than allowing talent to migrate to other countries. The third is developing the local capital market and building on the comparatively higher interest in equities of investors in the region than in some Western European countries. The fourth is investment in the green transition. While politicians tend to think that banks can solve this issue alone, a broader financing ecosystem and political guidance are needed. A report recently co-written by the former President of the Eurogroup, Thomas Wieser, and published by the Vienna Institute for international economic studies¹ offers further insights on these questions.

A Central Bank official agreed that investments are essential for overcoming the effects of recent crises and for ensuring future sustainable development. Many of these investments in the CEE region are significantly funded through European programmes. In Romania however, the economy struggles to meet the demands and to supply the necessary goods and materials, leading to increased reliance on imports.

1. A Stronger CEE for a Stronger Europe, The Vienna Institute for International Economic Studies, June 2024.

2.3. Enhancing competitiveness through human capital development and the digital and green transitions

A Central Bank official noted that as the CEE region faces shrinking and more expensive resources, it is essential to use available resources more efficiently by improving productivity. This includes enhancing human capital, fair competition regulation, and making sure that all types of companies have access to adequate financing. The region also needs an environment that encourages both companies and employees to innovate. A key challenge for the region is the lack of world-class universities, which worsens the brain drain issue. Investing in human capital, particularly in education, is essential for reversing this trend.

However, human capital is not sufficient for innovation, the official stressed. About fifty years ago, CEE countries aspired to be economies of iron and steel, but the future is now green and digital. The development of these economies must be redirected towards those objectives, but this requires much more investment in related fields and knowledge, not only in physical infrastructure. Proper financial resources are also vital for the growth of innovative companies. The fact that about 25 startup companies from the CEE region have become unicorns so far demonstrates that this is feasible.

A Central Bank official emphasized that improving external competitiveness is among the most important challenges for CEE countries and Romania in particular. Despite growth in technology and service sectors, Romania's external balance remains affected by lower competitiveness in the agrifood and high-tech sectors. Investments, especially those funded by European programmes, will be critical for overcoming recent crises and ensuring future sustainable development. Targeted policies will be needed to improve the structure of the Romanian economy and reduce reliance on imports for key goods.

The official added that both climate action and digitalisation present significant investment opportunities and avenues for developing a more resilient economic framework in the region. The need for intensified climate action is becoming increasingly urgent as time passes, with stronger effects on the environment, society and economy. Simultaneously, advancements in digitalisation could enhance efficiency in administrative activities, boost productivity and alleviate pressure on labour markets.

2.4. Further developing capital markets and private pensions for long-term investment

An industry representative highlighted the importance of building the Capital Markets Union (CMU) for the EU and the CEE region. Capital markets are essential for boosting the competitiveness and productivity of European economies and for financing local companies, particularly innovative ones. However, they currently play a limited role in the CEE region. Recent reports on the next steps of the CMU indicate that, despite significant improvements in the regulatory framework, the results in terms of market development so far have been unsatisfactory.

A first issue is that the CMU has primarily focused on secondary markets and market structures, which are not the most pressing areas for strengthening capital markets.

Regulatory priorities should shift toward primary markets and enabling companies to issue new equity and bonds more easily. Additionally, companies need access to deeper capital pools, which requires encouraging households to invest more of their long-term savings in equities and increasing institutional investments from insurance companies and pension funds.

The industry speaker also pointed out the cultural barriers to investing in Europe, particularly the conservative attitude of both households and institutional investors toward risky assets. Improving this situation requires enhanced financial education. Moreover, there needs to be an increase in the availability of well-performing, cost-effective products like exchange-traded funds (ETFs), which are easily accessible to investors. The way investment services firms and banks sell risky assets must also be improved, including how advice is provided to investors. Furthermore, capital rules for banks and insurance companies need to be reconsidered to better support investment in riskier assets.

A second industry representative highlighted two areas that need improving for building a stronger CMU. The first is the fiscal treatment of cross-border investments and dividends. Investors currently have to pay tax in different countries, which can be reclaimed; there are bilateral agreements to facilitate this, but the process is often complex and many people do not make the effort. The second issue is the lack of adequately funded pension systems. 20 years ago, building up Pillar 2 and Pillar 3 pre-funded pensions was a key objective in the region, but this is no longer the case. Developing capital-funded pensions is also needed to support the development of capital markets in the region. One way of encouraging governments to develop these systems would be to publish both the explicit and implicit statistics of public debt, including the burden represented by the funding of Pillar 1 pensions, which is quite huge in certain EU member states.

A third industry representative emphasized that while developing capital markets is a key priority for Europe as a whole, progress must be adapted to the maturity and development levels of financial markets in different member states. In the CEE region, traditional banking finance should remain the primary source of funding in the short to medium term to drive productivity improvements.

The industry speaker identified three main factors that make it less likely for capital markets to become the primary driver of funding for companies and particularly small and medium enterprises (SMEs) in the CEE region, compared to other parts of Europe. First, savings are expected to progress more slowly over the next 20 years in the region than in Western Europe, as people prioritize spending on their standard of living over wealth accumulation. Second, financial literacy remains low and will take a long time to improve. Third, data quality, particularly for SMEs, is not sufficient to ensure that funding is efficiently allocated to the region's businesses, representing high residual risk of fraud and misallocation.

2.5. Enhancing the financing of SMEs

An industry representative explained that SMEs are crucial for the region's economy. While multinational

companies contribute significantly to GDP, SMEs form the backbone of employment. Listing more SMEs on the stock market would help them access essential capital and financing, enhance their productivity, and support their growth. On a broader scale, this could have a significant positive impact on the CEE region's growth and productivity. This requires building an effective local capital market ecosystem. Additionally, SME entrepreneurs need to adjust their strategies and management practices to meet the expectations of investors in listed companies. One notable success story in the CEE region is the SME growth market, with more than 500 SMEs currently listed across various markets in the region.

Another industry representative agreed that SMEs are a very important part of all CEE economies because they are the largest source of employment. While stock exchanges are important for financing the most innovative SMEs, most SMEs currently rely on bank lending for their financing. In addition, the experience of the past 30 years shows that European frameworks and approaches alone are insufficient to develop local financing. When local banks have failed in the past to provide adequate financing or have had to be recapitalised, it was not because of deficiencies in the regulatory framework, but due to shortcomings in more fundamental elements such as capacity, skills, accountability among market participants, and financial literacy among clients. The lesson from this is that issues relating to implementation and execution need to be considered upfront.

The local Hungarian SME financing ecosystem, which took more than 10 years to build, is a good example of the actions that can be implemented for enhancing the financing of SMEs. The banks part of the ecosystem have aligned their practices with Western European banks, using the same credit policies and risk expertise. Hungary also has a well-working state guarantee system. Currently, 70% of Hungarian banks' lending to micro and SME companies is guaranteed by a state institution, which allows risk sharing and accountability, with the majority of risk staying with the banks. Government support is also significant. Throughout the last three or four crises more than 30% of bank lending in Hungary has been subsidised on the interest side from various EU and government sources.

2.6. Regional economic cooperation and policies

An official emphasised the importance of regional cooperation in developing capital markets and attracting FDI. Strengthening capital markets in the region is a priority to increase access to finance. One way of achieving this is regional cooperation. Latvia and other Baltic countries where SMEs represent the largest part of the economy have proved that successful cooperation around joint capital market boosting initiatives can help to create a regional cluster that benefits the whole of the Nordic and Baltic region.

Regional cooperation is also important for developing FDI, the official added. The Draghi Report mentions that FDI has substantially increased in recent years, especially in the CEE region. This increase in FDI can play a significant role in fostering technological progress and promoting development and prosperity in the region. By cooperating regionally, CEE countries can create a more attractive environment for investors, encouraging further FDI inflows. This would also help to enhance their bargaining power, potentially reducing the risks associated with concessions granted to large foreign investors. A common approach to FDI policy at EU level would be beneficial aiming for example at reducing the current fragmentation of investment screening at the national level.

Another official stated that the EU needs to determine the best way to utilize EU money effectively to fund projects. In Poland's experience, a regional policy approach has proven to be most efficient. This process involves identifying and proposing projects at the regional level, establishing a multi-year financial plan for their funding, engaging with relevant stakeholders who can contribute to the projects, and designing operational programmes funded through EU resources with the involvement of the European Commission. These projects are then overseen by monitoring committees to ensure their progress and the proper use of funds.

A Central Bank official stressed that collaboration across CEE region member states is also needed to address the ongoing challenges posed by the Ukraine war, completing the role played by individual countries.

Sessions



BANKING AND INSURANCE REGULATION

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Priorities for the banking sector

During this session, the panellists assessed the regulatory and supervisory framework in which banks operate, taking into account new developments related to the implementation of Basel III regulatory requirements (notably in the UK and the US). They also expressed their views on the issues that may hinder or help European banks to improve their global competitiveness.

1. The decline in the global competitiveness of European banks has a number of structural and cyclical causes and has negative consequences for the financing of the European economy and the strategic autonomy of the EU

1.1 Some figures

An industry representative observed that European banks have been experiencing low profitability for 15 years. Figures from the European Central Bank (ECB) and the Federal Reserve show that the return on equity (ROE) of US banks has been at least 200 basis points higher than that of their European counterparts since 2010. The ROE of EU banks improved last year, mainly due to a temporary lag in the adjustment of the cost of funds. ROE declined again in the second quarter of 2024 and remains lower than in the US.

1.2 Weaker growth in the European economy and the absence of a single financial market are factors in the lower profitability of European banks

One policymaker noted that one reason for the slower growth of the European banking sector compared to the US is the slower economic growth, but there are other variables affecting the European market share, such as the organisational structure and the 1%

lack of an integrated market. Cooperation is needed to address the latter.

1.3 Other factors behind the decline in the overall competitiveness of European banks

One industry representative suggested that the declining market share of EU banks is affecting their competitiveness. There are also structural causes such as a weak European economy, market fragmentation, over-regulation, excessive capital requirements, over-taxation and fee caps. Lack of profitability makes it harder for EU banks to digitise, invest, develop abroad, reduce costs by scaling up and take risks due to high concentration ratios and the perception that annual profits are the first line of defence.

The chairman countered that it was the bank's choice, not the regulator's edict, to maintain large management buffers. An industry representative explained that banks grow with the economy, which is why US banks have grown faster than EU banks. The US consumer has also been in better shape than the EU consumer, supporting banks' earnings capacity in the US than in Europe; this reflects an issue of consumer confidence.

There are also structural differences between US and EU banks. The EU system is regionally and nationally focused and lacks global scale. It is difficult to compete with larger, global players. EU banks' profitability relies heavily on traditional lending activities, while international competitors focus on investment banking and trading. Market fragmentation in Europe is also a factor. It seems that securitisation could be an easy win that can be achieved in the next 18 months with the necessary political will. As a comparison it was mentioned that the US securitisation volume in 2023 was \$500 billion, compared to \$200 billion in the EU.

The bank levy, which still exists in nine European countries, hampers banks' ability to generate profits, which is unattractive to investors. The levy needs to be abolished to bring EU banks in line with their Asian and North American counterparts. The US Federal Deposit Insurance Corporation (FDIC) also has a role to play. By comparison, the Spanish government has blocked the acquisition of one bank by another. Win-win cross-border consolidation needs to increase if the profitability of the EU banking sector is to improve. In this respect, the outcome of the talks between an Italian and a German bank will be important for the progress of the Banking Union and for increasing the profitability of European banks. The Chairman noted that the question was whether banks should finance the economy or vice versa.

1.4 Negative consequences for the financing of the European economy and the strategic autonomy of the EU

An industry representative highlighted that a lack of profitability has negative consequences for the financing of the European economy. The monitoring report of the Basel Committee on Banking Supervision (BCBS) shows that the global share of European banks has fallen by 16% by 2011. The share of rest of the world banks has increased and the UK share remains stable. In 2023, business lending by EU banks fell back to levels last seen in 2008.

1.5 Three key steps to stop the decline

An industry representative stated that the first step is to stop developing new regulations and capital requirements. According to the BCBS, EU banks are better capitalised than their US counterparts and have sufficient liquidity reserves. Second, duplicative capital requirements need to be streamlined. The European

Banking Authority (EBA) recently showed that there are 10 such overlapping requirements. Third, regulation needs to be stabilised. Regulatory instability and uncertainty are the main reasons for the high management buffers of EU banks, which are almost 500 basis points higher than in the US.

2. The Prudential Regulation Authority (PRA) has published its near-final policy statement and rules on the implementation of Basel 3.1 standards for credit risk, the output floor and reporting and disclosure requirements

A central bank official stated that the aim of the PRA's rules are to ensure that risk is properly captured in the capital framework and through that help ensure there is no disruption to the sectors' ability to lend. This is consistent with the Bank of England's primary objective of promoting the safety and soundness of firms and its secondary objectives of promoting competition, competitiveness and growth in the UK, subject to alignment with international standards. While certain elements of the package are tailored to the UK, overall it remains aligned with core Basel standards.

The implementation date has been delayed after the original pre-summer publication date was pushed back by the UK general election. The implementation of the package as a whole is delayed until 1 January 2026, in line with the EU's implementation of trading book rules and to allow additional time for preparation. The transitional period for the output floor has been reduced to four years, so the floor will be fully implemented by January 2030.

2.1 No increase in capital market requirements for SME and infrastructure exposures compared to today

A central bank official explained that, following consultation on the removal of support factors for lending to small and medium-sized enterprises (SMEs), the PRA considers it right to remove support factors from Pillar 1 so that risk weights are calibrated to reflect the risk of the loans. However, the PRA recognises that, even though the impact of removing the support factors is small, SME and infrastructure lending matters for growth. So mindful of competitiveness and growth considerations the PRA is implementing a structural adjustment to Pillar 2 to ensure that the removal of the support factors do not result in an overall increase in capital requirements for SME or infrastructure lending.

Where clear evidence was provided through the consultation to support this, lower, more risk-sensitive conversion factors have been introduced, along with more dynamic approaches to property revaluations. The treatment of provisions under the internal ratings-

based (IRB) and standardised approaches for the purpose of calculating the output floor has been harmonised and simplified.

2.2 Tier 1 capital requirements for large UK firms will be virtually unchanged, with an overall increase of less than 1% when the transitional arrangements end in January 2030

A central bank official noted that the impact of implementing Basel 3 in the UK by 2030 was expected to increase capital requirements for the major UK banks by less than 1%. This is partly because risks previously captured in the UK under Pillar 2, but not in other jurisdictions, will now be included under Pillar 1. The official noted, as an example, that Pillar 1 risk weights would increase by 5-6% but be largely offset by reductions in Pillar 2 requirements. The UK will be left with a capital stack roughly the same size as the EU. A comparison with the US is more difficult as the full details of the proposed changes in the US have not yet been announced.

2.3 A simpler, more risk-sensitive approach to residential property valuation

A central bank official added that the strong and simple regime currently under consultation will be available to the UK's smallest banks with less than £20 billion in assets and at least 85% exposure to UK borrowers, representing 3% of UK lending. Around 80 banks would be eligible for this simplified regime. They must not have significant trading books or IRB modelling authorisations, nor provide complex services such as clearing and settlement. This sector is vital to UK economic growth through lending to niche sectors and specific regions. The regime remains robust and, while capital requirements remain broadly unchanged, the calculation and application will be simplified, reducing compliance costs, providing certainty and facilitating future planning. The Pillar 1 and Pillar 2 methodologies have also been simplified. For example, there is no requirement for firms under the strong and simple regimes to calculate market and counterparty credit risk using the Basel approach.

2.4 A single, more constant and predictable capital buffer

A central bank official highlighted that the three existing buffers will be removed and replaced by a single, firm-specific buffer based on a non-cyclical stress test and capped at 3.5% of risk-weighted assets. Pillar 1, Pillar 2 and the buffer framework will be significantly simplified, with corresponding simplifications in the Internal Capital Adequacy Assessment Process (ICAAP), Internal Liquidity Adequacy Assessment Process (ILAAP) and reporting and disclosure requirements. However, the level of resilience will remain the same.

The Chairman noted that there is a lot to read from the PRA on this issue. It appears that the US Federal Reserve intends to follow a similar path. The European Commission took the important decision to extend the implementation of the fundamental review of the trading book (FRTB) to January 2026.

3. Implementing the Basel III framework consistently across jurisdictions

3.1 Minimising divergence in the implementation of the Basel framework

One industry representative noted that regulators have taken a pragmatic approach. However, Japan and other jurisdictions have already implemented Basel III and are in compliance. This international framework will be strengthened by consistent implementation, minimising fragmentation and ensuring fair competition and high standards.

Jurisdictions have understandably taken into account the specificities of their markets, but this has led to some inconsistencies. For example, under the standardised approach to credit, different risk weights are applied to unrated corporate exposures, which can have an impact on the financing of corporate customers and the real economy. Similarly, the implementation of private ratings is not fully aligned with Basel. Indeed, some jurisdictions have chosen to apply a lower alpha factor for counterparty credit risk (SA-CCR) than the original Basel proposals, which may create some competitive disadvantage.

It is essential that global systemically important banks (G-SIBs) have a level playing field to do more business with European clients.

3.2 Implementation of the Basel III framework in Europe strikes the right balance between resilience and competitiveness

One policymaker described the implementation of the Basel III framework in Europe as the best possible outcome. The implementation plan has been achieved in a short timeframe and strikes the right balance between resilience and competitiveness. The EU framework applies to all banks, further ensuring resilience and stability. The EBA will play a key role and the Commission will continue to monitor developments, in particular to ensure a level playing field internationally.

It is a positive sign that there is an intention to deliver in the US, but the details remain to be worked out. The developments announced by the Bank of England are welcome, particularly in view of the aim to continue to align with international standards and agreements at European level. It is to be hoped that the postponement of the effective date of the market risk element of the package will be the last necessary adjustment.

The Chairman stated that the EBA is ready to act on the Commission's instructions and hopes that there will be no further changes to provide certainty to the industry. The EBA's implementation roadmap aims to provide predictability and ensure convergence over the next two and a half years. There must be no double counting of risks now addressed under Pillar 1, and Europe must follow the Bank of England's lead in conducting a quantitative impact assessment.

3.3 Taking into account the specificities of the EU in the implementation of Basel III

An official stressed the importance of taking into account European specificities in banking regulation, including the needs of the industry and the specificities of the economy. Europe has achieved a balanced outcome with long transition periods and the UK is taking a similar approach. The postponement of the FRTB is supported by member states. There are areas where the framework can be improved. The Bank of England's strong and simple regime could be analysed and considered to be applied in the EU, where complex rules are a challenge for small banks. The original US proposal to lower the threshold to \$100 billion could also be relevant in the EU.

It is difficult for banks to plan for compliance with rules that have not yet been finalised. Perhaps Europe should review its processes in the future to allow banks sufficient planning time. The Chairman described the EBA as a small peon in a larger process that is relevant to all market participants. Basel III needs to be implemented in all banks and at all levels, specifically the European approach.

3.4 European banks need a level playing field to regain their competitiveness

An industry representative pointed out that, according to the BCBS and the EBA, the finalisation of Basel III will increase minimum capital requirements in the EU by 18% for Group 1 banks and by 16% for large international EU banks, but only by 1% for America and the UK and -1% for the rest of the world. It is therefore in the interests of US and Japanese firms to implement Basel III. The EU should follow the UK's example.

In such a context, the implementation of Basel III will reduce the competitiveness of EU banks. The competitiveness gap can be reduced firstly by EU regulators clearly distinguishing Level 1 from Levels 2 and 3 when implementing the banking package, while recalibrating buffer requirements to avoid double counting, as has been done in the UK. Second, the review of the macroprudential framework should be capital neutral and not add to existing buffers or other requirements. Third, it should neutralise the impact of the MREL on the output floor, which is well above the TLAC requirements. Finally, European regulators and supervisors should have competitiveness as a long-term objective.

3.5 What kind of banking regulation is needed to improve the competitiveness of European banks?

An industry representative suggested that regulation is a factor affecting competitiveness. Banks compete in international markets and with a broad range of players, including bigtechs and non-bank financial intermediaries. It is very challenging to ensure minimum consistency with standard regulatory tools – such as capital requirements. Much more would be with price-based tools such as intricate approaches for Value for Money in the Retail Investment Strategy or hard binding caps on interest rates for credit. Regulation should aim to ensure that prices work efficiently, rather than acting on prices themselves.

On the ESG front, lot of progress has been achieved during the last EU legislature. Now appears to be the time to focus on implementation and to ensure an efficient, stable and predictable ESG regulatory framework. Regarding digital regulation – for instance on cyber-risk, cyber-resilience and Artificial Intelligence, there is a need for new and more flexible approaches and tools.

3.6 International convergence beyond Basel III, particularly on sustainability, is essential

An industry representative explained that for internationally operating banks such as SMBC, harmonisation and alignment in terms of regulatory compliance with other jurisdictions is key. This applies to Basel III, the Digital Operational Resilience Act (DORA) and others. Investments in sustainability need to be justified as they impact profitability, especially in Europe. It is hoped that other jurisdictions will follow the EU standards in this area, but some, such as Japan, are creating their own, aligned with the International Sustainability Standards Board (ISSB). Any gap between the ISSB and the Corporate Sustainability Reporting Directive (CSRD) will affect profitability and competitiveness.

4. Towards a period of prudential regulatory stability?

4.1 Ensuring a period of regulatory stability

A policy-maker indicated his intention to recommend a period of regulatory stability to the new EU political leadership. Legislators have intended to do this at the turn of each cycle since 2008 but have been prevented by various crises requiring timely action. It is useful to take a step back and look at the overall functioning and coherence of the framework from a distance. Nevertheless, targeted improvements to the framework are proposed under the umbrella of the Capital Markets Union. Capital markets need to go hand in hand with the banking sector.

A savings and investment union would facilitate the contribution of capital markets, banking and insurance to the financing of the real economy. The European Council is drawing up a list of initiatives for the Commission, and the Eurogroup statement of March 2024 sets out the priorities. Strong political support from Member States will be needed.

4.2 The prudential agenda on digital risks, climate change and operational resilience will prevent a regulatory pause

One central bank official suggested that the regulatory pause mentioned above may not become a reality. The PRA's top banking policy priority is the implementation of Basel III and the strong and simple regime, alongside its agenda on operational resilience and cyber risk. This will involve interaction with DORA and international alignment. The sector continues to learn from the events of March 2023 in the US in relation to Credit Suisse,

although the implications for the implementation of Basel III have yet to be finalised. The PRA's will continue to consider whether more targeted changes are needed to support its secondary objective to promote the competition, competitiveness and growth in the UK.

4.3 Improving the EU regulatory and supervisory framework for securitisation

One official reiterated the need for progress on securitisation. EU bureaucracy and complexity need to be reduced, following the UK example. Supervisors should review the Basel III rules relevant to securitisation, as not all jurisdictions have fully implemented the Basel approach. The rules may be too stringent and possible improvements should be considered during the next policy cycle.

4.4 While greater stability and predictability is welcome, climate change and digital risks will require the regulatory and supervisory framework to evolve

One industry representative explained that his main concern relates to the next iteration of the Basel framework and how it will incorporate new risks, which will make regulatory and international convergence more challenging. Bankers find the changes to Basel III difficult to understand, as the marginal benefits are not always clear. It is welcome that the capital framework will remain largely unchanged, but it remains uncertain how Basel intends to address emerging digital and environmental, social and governance (ESG) risks. A more flexible approach will be needed. The right way forward is to improve the existing guidance.

Emerging risks will make consistent oversight of the next Basel framework more challenging. There will be new players to consider, and there is the question of entity versus activity-based regulation. There are improvements to be made to the existing framework as it is implemented, but the main concern is the next framework and how to deal with emerging risks.

4.5 Policy choices are key for the future of the European banking system

One industry representative suggested that the pace of regulatory projects should be improved. It is challenging for large banks but for smaller banks with fewer resources, it is less manageable to simultaneously implement the wide variety of existing regulations. Regulatory harmonisation with a lead regulator could help. More dialogue between regulators is needed, with a formalised agreement on communication and objectives. Securitisation across the EU, which is often a topic of discussion between legislators and regulators, should be addressed as soon as possible.

The Chairman identified implementation as the key issue. The European Commission has responsibilities in this regard. Securitisation, digital risks, sustainability and macroprudential risks must all be taken into account in the future. The pace of regulation and reform must be improved. The implementation of Basel III must be effective, consistent and coordinated.

Banking Union challenges

This discussion was divided into three parts: The first part looked at the reasons and concerns of host countries that explain these ring-fencing practices by host countries. The second part focused on the heterogeneity of national macroprudential regimes in Europe and ways to address this issue. The speakers then presented their views on measures to improve the competitiveness of the European banking system.

1. Main concerns of host countries

1.1 Host member states insist on the fulfilment of individual, not just consolidated, prudential requirements for financial stability reasons

An official stated that host countries remain important players in the Banking Union, providing capital adequacy, liquidity, macroprudential supervision and effective resolution. In Slovenia, as in other host countries, foreign banks play a crucial role in financing the local economy and providing employment. However, the interests of subsidiary banks may not be aligned with those of the banking group as a whole. Capital requirements on a consolidated basis may reduce the willingness of groups to provide sufficient recapitalisation to subsidiaries or branches. Host countries are concerned that foreign banks will transfer profits to the parent bank, reducing the resources available to finance local needs and raising concerns about maintaining adequate liquidity and meeting regulatory requirements. Host countries want to ensure that sufficient liquidity is available to support a stable banking system in the European Union.

The Commission's proposed capital and liquidity waivers at the level of individual banks in cross-border groups would allow groups to reallocate resources, creating an unlevel playing field compared to local banks, which have to comply with all capital and other prudential requirements. Such exemptions could also increase the likelihood of the transfer of group problems to subsidiaries and vice versa. On the similar issue of Basel III and the output floor, and the proposal to set capital requirements on a consolidated basis, host countries successfully argued that the output floor should also be applied at the individual level.

1.2 The Banking Union is an unfinished business

1.2.1 Despite EU supervision and resolution mechanisms, there is no internal market in the banking sector

An official commented that there is no internal market in the banking sector, despite partially or fully harmonised supervision and resolution. The benefits of the internal market or economies of scale are not being realised. There are costs associated with inaction. There has been much criticism of host Member States on ring-fencing, but host Member States are only

doing what is required by the Treaty, as financial stability is the responsibility of national Member States. Home bias or national bias is rarely mentioned in the context of sovereign risk. This is very important, especially as the so-called bank-sovereign nexus is an initial objective of the Banking Union that has not yet been achieved. The European Deposit Insurance Scheme (EDIS) could address many host country concerns. EDIS would also benefit home Member States in financial difficulty.

The Banking Union is in the interest of host countries but should not be at the expense of their financial stability. The wider economic consequences of bank failures are a concern for host Member States, in particular the supply of credit in the event of difficulties with a systemic bank in the host Member State. Moreover, the so-called piecemeal approach to macroprudential regulation will not work, as has been demonstrated recently with regard to the output floor. Clarification, harmonisation and avoidance of overlaps between the systemic risk buffer and the countercyclical buffer should be addressed through a holistic approach. Capital markets union (CMU) without Banking Union will not work, as noted by Fabio Panetta. The European Stability Mechanism (ESM) treaty has been reformed. The backstop for the Single Resolution Fund (SRF) will soon be established. 26 member states have already ratified the treaty change.

1.2.2 The European banking system remains a collection of national sectors

A Central Bank official noted that much has been achieved in the last 10 years. The Single Supervisory Mechanism (SSM) and the Single Resolution Board (SRB) have been established, and there is extensive cooperation between supervisors and regulators. External shocks in recent years have demonstrated the resilience of the banking system.

However, more was expected from integration and cross-border banking. The Banking Union should allow banks to operate across borders and provide efficient cross-border supervision and deposit insurance. Currently, there is a collection of national banking systems and limited integration. Supervisors have tried to improve the relationship between group support and recovery plans and have also promoted the use of waivers. The legislation provides for the use of a waiver to transfer liquidity between the home bank and subsidiaries, but host authorities are still concerned that there will be insufficient support for subsidiaries in a crisis situation. There are no incentives for real cross-border banking in Europe and the framework is not perfect. Deposit insurance is crucial in this area. The establishment of the third pillar (EDIS) will build trust between home and host authorities and ensure that the banking union works as expected.

1.3 A dialogue about the technicalities and setup of liquidity waivers must be established and trust built between supervisors

An industry representative noted that several banks have attempted to build liquidity buffers within the current regulatory framework. Sufficient safeguards need to be in place when liquidity waivers are applied. Dialogue on the technicalities of such liquidity waivers has been lacking in recent years. If host countries or other authorities within the SSM have a principled objection, it will be very difficult to make progress. Instead of rejecting the principle, in this case the single liquidity subgroup for cross-border liquidity, there should be a dialogue on the substance.

One official noted that the Banking Union is a confidence-building exercise. Trust needs to be built between and among Member States and supervisors. This may require some institutional changes. The SRB and the SSM could be improved.

The Chair noted that collective work among supervisory Member States is essential, as a Member State may be both home and host.

1.4 Preserving the interests of host countries which may not be aligned with the interests of the countries where banking groups are headquartered

An official commented that changes in the regulatory environment are only possible if appropriate safeguards are in place to protect the economic interests of the Banking Union as a whole. Level 1 safeguards are preferable to contractual obligations, as contractual obligations between group entities may not be strong enough. The latest proposal for the reform of crisis management and deposit insurance (CMDI) has addressed many of the doubts and concerns of small host Member States to prevent excessive use of deposit guarantee scheme (DGS) funds for resolution purposes which could require additional contributions from the bank and cause negative consequences for small local banks and financial stability.

The minimum requirement for own funds and eligible liabilities (MREL) is the first line of defence and additional safeguards, such as a regulated procedure for the use of DGS funds, are needed. Authorities or Member States must have discretion to use DGS funds for alternative or preventive measures. With regard to the Daisy Chain Directive, which is also part of the CMDI reform, a national resolution authority must have the discretion to set internal MREL for intermediate entities on a consolidated basis. Many safeguards focus on a backstop mechanism in case a bank gets into difficulties. Appropriate safeguards or mechanisms for the bank in liquidation will be available when EDIS comes into force, so this is also very important.

1.5 Europe's failure to foster large banks operating across a pan-European market creates risks

An industry representative outlined three risks. First, by restricting capital flows and liquidity across borders, ring-fencing practices limit banks' ability to diversify risks and funding, resulting in reduced resilience to economic shocks. Secondly, by protecting the borders of

national banking systems, ring-fencing can create pockets of vulnerability. Insufficient coordination among national authorities in crises can exacerbate systemic risk and impair financial stability. Thirdly, by operating mainly within national borders, European banks struggle to compete with large non-European firms, resulting in diminished financial strategic autonomy. During times of crisis these global firms tend to retrench to their home markets

1.6 Completing the Banking Union would benefit growth, financial stability and financial integration

An industry representative stated that the best use should be made of the existing framework. The Commission focuses on the proper implementation of the legal framework and should play a more active role in financial services in this respect. This would, for example, support the implementation of the cross-border liquidity subgroup.

The European Deposit Guarantee Scheme is needed. The European Commission should be ambitious and follow Mario Draghi's recommendations for the 28th regime. This would create a European DGS only for the largest banks, under the direct supervision of the ECB. Completing the Banking Union is crucial for the EU's competitiveness. Recent reports have concluded that the completion of the Banking Union will lead to a structural increase in euro area GDP of between 0.3 and 0.8 basis points. An effective Banking Union is a powerful engine for growth and would also be a step towards a single market for banking services. In this context, the macroprudential framework should be simplified and optimised. The ECB should be given responsibility. The waiver of capital liquidity should also be considered.

The Chair noted that in Europe more than €130 billion is allocated to national DGS and the Single Resolution Fund (SRF). This is comparable to the US. However, the US is able to mobilise these funds, while in Europe they are frozen. EDIS will help but negotiations on the EU crisis management framework also need to be completed to increase the contribution of national DGS to the the funding gap in resolution for medium sized banks.

2. The EU needs an overhaul of the macroprudential framework

The Chair noted that the macroprudential framework is based on minimal harmonisation and is governed by national designated authorities and member states. The framework should be reformed with a focus on harmonisation and predictability.

2.1 Harmonising the macroprudential stance

A central bank official observed that level playing field issues arise when banks of similar size and footprint across the Banking Union are subject to different buffer requirements by their home macroprudential authorities. In addition, the complexity of the framework increases as some countries have chosen to activate systemic risk buffers while others have not. The

macroprudential framework should take a Union-wide perspective to ensure consistency and minimise potential overlaps. This can be done without changing the existing balance of competences between national authorities and the ECB, for example by updating the commonly agreed methodologies for determining banks' macroprudential buffer requirements.

2.2 The way macroprudential buffers are calibrated and activated creates inconsistencies that weaken the competitiveness of EU banking groups

An industry representative remarked that the buffer landscape is extremely complicated. The unpredictability and inconsistency of buffers may make banks more conservative in their lending. Cross-border business models are discouraged because each member state has its own macroprudential approach, which can change at short notice. Moreover, there is currently no authority responsible for assessing whether the aggregate capital requirements of a banking group are commensurate with its overall risk profile.

The formulation of the systemic risk buffer is problematic, as it can cover basically any risk, and there is also pressure to apply it to new risk issues that fall within the scope of microprudential supervision. The global/other systemically important institutions (O-SII) buffer is another source of concern. The methodologies are more refined, but the way the scores are mapped to capital buffers is not known. The same score in different countries may result in a different buffer. This discourages cross-border activity and consolidation and penalises growth in the domestic market.

One problem with the countercyclical buffer is the issue of positive neutrality, which is not clearly aligned with the Capital Requirements Directive (CRD). This is compounded by the fact that responsibility and power should be aligned. In the context of risk management, the real authority, knowledge and competence lies with the micro-prudential supervisor, the SSM. However, neither the macroprudential supervisors nor the EU authorities have an overview of the micro-prudential supervisor's actions in the first or second pillar. The terms 'systemic risk' and 'macroprudential issue' are not clearly defined, leading to overlaps.

These problems reveal an internal market problem. There is no free movement of services in banking, which creates regulatory risk for cross-border banks. The more jurisdictions a bank operates in, the greater the risk that capital requirements will suddenly increase by 100 or 200 basis points. Incentives need to be increased to allow competitiveness and economies of scale.

2.3 Common methodologies and metrics for determining banks' macroprudential buffer requirements

An industry representative explained that macroprudential requirements are a problem in the context of a competitive Banking Union. A significant part of a bank's capital requirements (1/3) can be macroprudential buffers. This amount has risen sharply in recent years and continues to do so, which is difficult to explain in economic terms.

The underlying measure of the countercyclical capital buffer (CCyB) is the credit-to-GDP gap, which has been negative in most European countries over the past two years. Despite this, the CCyB has been increased in many countries. Pillar one and pillar two are very prescriptive and are rightly closely scrutinised by the SSM and the regulatory framework. This scrutiny is lacking in the macroprudential area. Stronger macroprudential authorities in the ECB would provide a countervailing power to challenge countries that set macroprudential buffers. Data and information on banks are centralised. Macroprudential competence should be more closely linked to national authorities and to the euro area as a whole.

The Chairman explained that the CCyB methodology is the reason why Italy opted for the systemic risk buffer, as the underlying methodology discussed in Basel many years ago is still based on credit to GDP.

2.4 Three priorities to move forward

An industry representative noted that capital is the biggest cost of lending. Covid raised awareness about capital and buffers. Buffers do not necessarily need to be reduced at a systemic level, but there is an issue of a level playing field. Excessive capital in the EU is not a big problem. The problem is that where the buffers are and where the risk is are not always aligned. Solvency is also an issue. High buffers are no help in a crisis if they are not clearly releasable.

The CRD should be revised with a focus on three main areas. First, a radical simplification of the tools and decision-making. For example, the three buffers for structural risks - the systemic risk buffer and the G/O-SII buffers - should be reassessed. The level of risk posed by a large bank in a small country should also be reviewed in the light of the Banking Union. Second, standardisation and decision-making at the EU level should be strengthened. Methodologies used in the EU and the European Economic Area (EEA) should be aligned as far as possible. Finally, the micro-prudential supervisor, in this case the SSM, should be able to determine the appropriate level of aggregate capital for a group. At a minimum, the micro-prudential supervisor's assessment should be an integral part of the macroprudential supervisor's decisions. Ideally, micro-prudential tools should take precedence over macroprudential tools.

3. Strengthening the competitiveness of the European banking system

3.1 Banking Union could significantly benefit from greater focus on CMU

An official commented that CMU will likely be the top priority of the new Commission, possibly with more focus on the host member states' perspective. Other features that are important for the host include the attractiveness of the capital market, the visibility of the market and the start-up phase.

The Chair remarked that the reduction of banking market fragmentation was closely linked to the creation of the CMU. Deeper integration of capital markets would facilitate the provision of cross-border financial services, leading to better access for banks to host countries, but it is also true that the Banking Union is a prerequisite for the CMU.

3.2 The focus should shift to strengthening the competitiveness of the European banking system

An industry representative commented that the current system is safe but not necessarily competitive. European banks have suffered since the global financial crisis, especially compared to their US counterparts. Many global banks call their capital markets business 'global markets' because it is a global business. European banks have lost market share in this area every year since the global financial crisis. Resilience is a problem and there is no cross-border diversification. Cross-border lending is still in the low single digits, leading to concentration from a market risk perspective and highly skewed sector exposures within countries. The ability to respond quickly to a crisis in the EU is a concern. Previous crises have shown that containment is possible as long as action is taken quickly, but the need for coordination across different levels of jurisdiction will affect speed. Finally, strategic autonomy is a concern if banks are not strengthened. In times of crisis, banks move their capital back to their home market.

The Chairman noted that the trade-off between resilience and competitiveness is a recurring theme. The outcome in Europe in 2023 could have been very different if the Basel standards had not been applied to all banks.

3.3 Harmonising tax, accounting, insolvency regimes and consumer protection rules

A central bank official noted that banks would welcome greater harmonisation of accounting and tax rules. National consumer protection and anti-money laundering rules also need to allow banks to operate cross-border with subsidiaries. Much can be achieved in terms of harmonisation by improving current macroprudential policies and focusing on cooperation. The subprime crisis showed that very few authorities and

countries had introduced and activated macroprudential buffers. During the crisis, ensuring sufficient capital in the banking system was a top priority. There was also a recognition that it should be possible to unwind buffers if necessary. In the aftermath of the Covid crisis, the authorities in most countries of the Banking Union activated countercyclical buffers.

The Chair commented that there is no need to "reinvent the wheel" if the appropriate tools are already available and that many issues relate to implementation.

3.4 A radical top-down approach is needed to achieve competitive pan-European banks

An industry representative shared that a report for the European Banking Federation showed that the CET1 ratio in the US has stagnated at around 12% in recent years, while it has continued to rise in European banks. The simplicity of the US approach to buffers is noteworthy and should be taken into account. The suggestion around EDIS in the Draghi paper for cross-border active institutions is interesting. An alternative is a reinsurance-type model. This would initially be national, with a European level that could intervene if a crisis became systemic. There is still no common backstop for the SRF, which is particularly important for the resolution of complex organisations. The global systemically important financial institution (G-SIFI) buffer for the larger institutions is counterintuitive. Expanding across Europe spreads risk and capital requirements should therefore be reduced for more diversified European banks. Harmonisation of tax, mortgage, bankruptcy and consumer protection laws will enable banks to operate across borders.

The Chair concluded that the progress made over the past 10 years should not be forgotten. However, the unprecedented pace of change outside Europe has led to higher expectations and a need for faster action. The framework has become too complex, and it is difficult to find the appropriate balance between competitiveness and safety. Political will is needed to implement the proposals raised in recent years.

EU bank crisis management framework and EDIS

The Chair explained that the panel would focus on crisis management and deposit insurance (CMDI). In June 2022, the Eurogroup decided that it should be at the centre of discussions on the Banking Union. The banking turmoil of the previous year provided an opportunity to reflect on how modern banking crises are managed in other jurisdictions. The European Commission presented a comprehensive package on the CMDI in April 2023. The review of the CMDI has to take into account different business models and numerous, sometimes conflicting, policy objectives.

The discussion consisted of general comments on the design of the EU framework, including the issue of the scope of resolution, a discussion on the financing of resolution from internal resources and safety nets, and a discussion on liquidity in crisis management.

1. The EU bank crisis management framework

1.1 An ex ante non-credible and ex post inefficient system

One public representative stressed that Europe is still far from having a fully credible ex ante and efficient ex post crisis management system. National Supervisory Authority (NSA) colleagues still believe that ring-fencing is the optimal solution for some of their concerns. There is a persistent home/host problem in Europe. Financial crises in Europe are more protracted and have longer-lasting macroeconomic, social and political effects, demonstrating the distance from an ex-post efficient system.

The European approach tries to be extremely detailed and precise. There are attempts to have complete legislation covering all possible cases, but this is not achievable. While it is positive to have legislation that is as precise as possible, it is important to always have the possibility for competent, accountable and legally protected authorities to exercise discretion.

Without the third pillar, the European Deposit Insurance Scheme (EDIS), the system remains incomplete. The European Stability Mechanism (ESM) must be on the table to add firepower to what is in place. Without meaningful steps in this direction, the system will continue to lack ex-ante credibility and be inefficient ex-post.

It would also be appropriate to make the resolution principles more macroprudential and medium-term oriented, in terms of minimising the use of public funds. Contagion must also be taken into account. The work cannot be done on a bank-by-bank basis, as that is too narrow. There must be broader linkages and a medium-term orientation to minimise the cost to the taxpayer.

We need a financial system that allocates capital efficiently across countries, industries and companies. There are many inefficiencies associated with ring-fencing. Without a credible resolution regime, the banking sector will not be able to work together to attract more investment to Europe.

1.2 Key components of crisis prevention

Successful crisis prevention and management needs to be embedded in a broader framework covering all stages of a crisis. This starts with a strong risk culture and a sound capital base and includes early intervention at the onset of a crisis, as well as flexible resolution tools once it has crystallised.

1.2.1 Having a strong risk culture

An industry representative noted that crisis management is part of a continuum that begins with business as usual. Deficiencies in the governance framework and risk culture of banks have been identified as common causes of past crises. The Credit Suisse case showed that a lack of sound governance and risk culture is linked to unsustainable business models. From a European perspective, there has already been significant investment in governance since the financial crisis, including through the annual supervisory and review assessment process. However, these efforts have often been perceived as prescriptive and more of a paper exercise, particularly from an international perspective.

Building on the lessons of the recent crisis, this paradigm appears to have shifted, with a move away from prescriptive governance towards more practical mechanisms. These include quantitative parameters and behavioural elements to promote a good risk culture, such as clear lines of responsibility and decision-making processes, a strong tone from the top on risk and compliance, a culture of constructive challenge on all types of risk, long-term incentives in compensation, performance management and promotion frameworks, and strong boards.

1.2.2 The exercise of early intervention powers

An industry representative stated that if a bank's efforts to address the causes of distress are insufficiently determined, authorities need to be able to exercise early intervention powers to prevent further deterioration. Regulators across jurisdictions should strengthen their early intervention frameworks, ensuring that supervisory measures are based on clearly defined, objective criteria. Supervisors need to be able to use their powers effectively, even when reported prudential ratios are in line with regulatory requirements, and to ensure timely escalation and appropriate remedial action to avoid critical failures in areas such as governance and risk culture.

1.3 The availability of a public liquidity backstop

Improving access to central bank liquidity in times of market stress is crucial: commercial and central banks need to work together to ensure that they have well-planned operational and legal arrangements for pledging and receiving a wide range of less liquid assets as collateral for central bank funds.

An industry representative stressed that the prompt availability of and access to central bank liquidity was critical to restoring market confidence, as demonstrated by the Credit Suisse crisis. The residual risk of losses to taxpayers from the public liquidity backstop was considered relatively low, given the requirements for a credible restructuring plan to be approved by the Swiss Financial Market Supervisory Authority (FINMA) and the privileged status from a credit perspective in bankruptcy. Banks eligible for a public liquidity backstop must have comprehensive measures in place to prepare for a recurrent resolution under the "too big to fail" regime.

In the context of the Banking Union, the question is who pays and how ECB lending could rely on a potential public backstop. The difference between Switzerland and Europe is that such backstop would require several Member States' political support to be implemented at European level.

2. Resolution should not be the general solution

2.1 The need for a more holistic view

An official explained that, although financial services are changing very rapidly, the resolution framework is relatively new in the EU. The benefits of crisis preparedness through resolution plans and the building up of Minimum Requirement for Own Funds and Eligible Liabilities (MREL) were demonstrated in the last crisis. Thus, the CMDI is a logical next step. The Council and the Parliament has given its opinion on the proposal, and the negotiations can start when the Parliament is ready. This a complex dossier, so difficult negotiations are expected in the trilogue with the Parliament. It took time to set up the resolution framework in the EU, the MREL and the Single Resolution Fund (SRF). Widening the scope and looking at the efficiency and scale of the instruments are logical next steps.

There is a need to recognise the synergies and possible interactions between the different resolution tools. MREL and the bail-in tool are well developed, but there are other tools too. Taxpayers' money should be protected, and the still viable part of the bank should be saved. The financing burden is borne first by shareholders and creditors. However, the nature of crises means that it is not possible to be fully prepared, and this is where other sources of financing should come into play. Moreover, in several cases only liquidity support is needed, so the safety nets are expected to be replenished.

Attention should be paid to the diversity of banks and crises situations, which may become even more complex in the highly integrated framework of the Banking Union.

Credibility of funding is a key issue. The build-up of loss-absorbing capacity, typically through the successful issuance of eligible instruments, and the conditionality of access to safety nets, such as resolution funds or deposit guarantee schemes, are all elements of this credibility. Greater consideration should also be given to transfer instruments.

2.2 Applicability of the resolution process to a broader range of smaller banks

A regulator agreed on the need for an appropriate amount of discretion on the part of the competent authorities. National resolution authorities and national supervisors should have discretion to determine the public interest and the scope of circumstances taken into account for the purposes of the public interest assessment.

This assessment should not be mainly based on the size of the bank. There are more than 500 cooperative banks in the Polish market, for example. Most of them are not systemic at the national level, from the perspective of the country's financial system, but many of them are relevant to the local environment. The public interest should be assessed, taking into account local circumstances and the impact of the potential failure on the local business environment, as well as the risk of contagion. The risk of contagion from the failure of one cooperative bank to the cooperative banking sector as a whole must be considered. There should be a pragmatic approach to assessing whether the public interest condition is met.

One question is why there is such a detailed and sometimes quite dogmatic set of rules governing crisis management and resolution. In most cases, a very detailed set of rules is a consequence of a lack of trust between the authorities and the relevant actors. There has to be trust that the relevant authorities will exercise their discretion in good faith to preserve financial stability and minimise the use of taxpayers' money. If the pan-European resolution regime is designed too narrowly or too rigidly, national authorities or countries will circumvent the system by using non-harmonised national insolvency procedures and public funds outside the common regime. Another problem for harmonization is the lack of EDIS.

Many of the small banks that would ideally be dealt with on the basis of the resolution regime may have difficulties issuing MREL liabilities. There are still areas that need to be improved in the CMDI proposal to make resolution a viable strategy for small banks.

2.3 Insolvency as the default exit strategy for small credit institutions

An industry representative noted that the tools, and MREL in particular, were designed for systemically important institutions because their failure would have a major impact on financial stability. One question is what is the right approach for smaller banks. Part of the task is to ask what a small bank is. Common sense would suggest that a small bank does not pose as great a risk of systemic impact. There should be clear size thresholds for resolution. For smaller institutions, resolution should remain the default option. For example, a threshold of at least €30 billion in total assets could be appropriate for

the application of the resolution regime. Smaller and regional banks should be able to remain competitive. Detailed and complex resolution tools would increase their administrative burden and reduce their competitiveness.

2.4 Liquidation as the general solution for small banks

Not all failing banks should be resolved. One supervisor pointed out that there are both significant and less-significant institutions within the Single Resolution Mechanism. Around 100 SIs groups have been earmarked for resolution. These larger banks are within the direct remit of the SRB. A further 70 less-significant institutions, in the direct remit of National Resolution Authorities, have also been identified by the market as systemic. The original objective of the CMDI proposal is to expand the scope of resolution to more small and medium-sized thus increasing financial stability. However, according to SRB's analyses, the banks "switching" from liquidation to resolution would not be a large number. That means that all the other banks, ie. the vast majority, will stay with a preferred strategy based on liquidation.

Why earmarking some banks for resolution? Because resolution works better than liquidation. To make a couple of examples, 1. resolution explicitly excludes the use of taxpayers' money. 2. when a failed bank reopens after resolution, customers continue to have access to its full range of services. This is not the case in liquidation.

2.5 Consequences of the extension to the scope of resolution

An industry representative noted that any bank that is earmarked for resolution could be resolved. This implies that they should be ready by being able to finance the resolution with their own resources and thanks to their own creditors and be prepared for it. For smaller or medium-sized banks, the obvious resolution strategy is to sell the business. However, they may not know what that means as they may not have experience in mergers and acquisitions. They should therefore specifically prepare themselves to understand what is involved, e.g. for the preparation of a proper data room. Flexibility to determine which bank should be earmarked for resolution should remain in the hands of the resolution authorities.

3. Contentiousness of funding in resolution

3.1 Ensuring a level playing field

A regulator stated that when banks are earmarked for resolution, they will need to work to become resolvable. Among other things, they will have to reach MREL compliance. Post CMDI this will not change. MREL will remain the first line of defence for absorbing losses and recapitalising the failing bank. By broadening the scope of resolution and leaving the MREL requirements unchanged, CMDI will increase the total amount of MREL in the system and not reduce it. CMDI will also give resolution authorities

the flexibility to deal with smaller banks at a limited cost to the industry. Banks need time to become resolvable. The big banks have been given eight to ten years reach their current level of resolvability (including MREL). If one of the banks that enters in the scope of resolution via CMDI fails in the following year, it will not be ready in terms of loss-absorbing capacity, for example. Among other things, the Commission's CMDI initiative offers a pragmatic and flexible solution to this problem.

In a crisis, resolution authorities should have the tools that are flexible enough to take a successful resolution decision. If that is not possible, resolution authorities have no other choice but liquidation. Some of the amendments proposed by the Parliament and Council may curtail the flexibility provided by the Commission's proposal. Flexibility is essential to restore confidence. We hope that the trilogues will produce a compromise that is in line with the original objectives of the reform – a broader scope of resolution for more financial stability.

An industry representative suggested that the SRB's initiative to anticipate possible MREL reductions has been positive, and it can only be encouraged to go further in this direction. For smaller banks, the resolution strategy would be to sell the business. A MREL around 16% of risk-weighted assets (RWA) should be a minimum, in addition to the combined buffer, which means that if they fail and the authorities intervene early enough, they will still be able to recapitalise at the regulatory minimum. Parliament went in the right direction by setting a minimum, although it should be set at a higher level.

The SRF should not be used repeatedly. It is seen by investors in the European banking system as a guarantee of financial stability in Europe. If they see the fund being used repeatedly, they will be even more reluctant than they are now.

3.2 Addressing the funding gap in resolution for medium-sized banks

An official explained that the problem in Europe is that there is no effective mechanism to deal with the crises of small and medium-sized banks. At present, there are no effective ways to operationalise sale-of-business resolution strategies, which have proven to be the most effective approach for such banks. This is related to insufficient funding. Funding can come from several sources. The first is internal resources: ie loss-absorbing liabilities that can be left behind in a residual entity while their asset counterparts can be transferred to an acquirer as a compensation for taking over some sensitive liabilities, including deposits. The second source is external support, which is often required, as the experience of other jurisdictions shows. In Europe, this support can in principle come from deposit guarantee schemes (DGS) or the Single Resolution Fund (SRF) but only if very stringent conditions are met. In the case of the DGS the available support is capped by the expected costs that it would have to bear by paying out covered deposits in liquidation. The SRF can only provide support after bailing-in 8% of banks' liabilities.

The CMDI goes a long way towards addressing these issues. By removing the priority of deposit insurance

claims in liquidation, it is possible for deposit insurance funds to support the sale of businesses, even under the least cost constraint. Moreover, the funds provided by the DGS would count to bridge the gap between available bail-inable liabilities (MREL) and the minimum bail-in for access to the Single Resolution Fund. CMDI would therefore make the availability of funds from both the Deposit Guarantee Fund and the Single Resolution Fund more flexible.

However, there are concerns about the current state of the negotiations. The compromise proposed by the Council and the Parliament completely dismantles the good ideas contained in the CMDI. In particular, it is unwise to maintain the super-preferential treatment of DGS claims in insolvency. Even if a more flexible interpretation of the least cost constraint is accepted, that super-preference makes it very difficult, and often impossible, for deposit guarantee funds to contribute to the resolution of small and medium-sized banks. Moreover, the introductions of as many as 22 conditions for activating the bridging function of the Deposit Guarantee Fund, would make it very difficult to even verify that the conditions can be met within the short available time to activate resolution actions. In effect, it undermines the possibility of using funds from the SRF. Therefore, the available support from external funds to support the sale of businesses would remain severely impaired. The result is that, in the best-case scenario, nothing will really change, and the flaws of the current regime will remain.

In that scenario, the Single Resolution Board will continue being unable to deal with the crisis of mid-sized significant banks that are earmarked for resolution, and the ticket will have to be handed back, as we have seen in 2017 to national authorities for them to apply insolvency rules with large amounts of public support. This undermines not only the objectives of the Banking Union, but also the more general agreement reached at the global level to try to resolve the crisis of significant banks by minimising the contribution of taxpayers' money.

An industry representative stated that the unlimited financial involvement of Deposit Guarantee Schemes (DGS) in the financing of resolution and the deterioration of their ranking and creditor hierarchy undermines

financial stability. Confidence is the only important aspect, but the extensive use of DGSs for resolution measures would seriously weaken existing well-functioning DGSs and undermine depositor confidence. It would therefore be counterproductive.

3.3 Addressing the issue of banks' unfair advantage

One supervisor pointed out that there may be cases where the public interest and least cost assessments lead to the conclusion that resolution is the more pragmatic approach, but the banks concerned are not prepared because they have not had the capacity to issue MREL. Part of the discussion at Eurofi in Ghent was about these banks getting an unfair advantage by becoming resolvable without bearing the costs of preparing for resolution. This argument should be dismantled. There have been similar cases in the Polish market, and the decisions taken on the fate of such institutions were not about providing them with an advantage. Rather, it was about minimising costs for the entire financial sector and others. The measure is not for the benefit of those companies that are not prepared. It is for financial stability, and it is the right thing to do.

3.4 The Council's compromise text

One supervisor explained that when a bank is earmarked for resolution it will need to build the right capabilities to become resolvable. There is no point in having additional conditions for the use of the DGS. Banks entering into the scope of resolution will be treated as their peers – proportionally.

Resolution authorities (in the Banking Union), according to the Council compromise text, will need to satisfy 22 conditions during the resolution weekend. However, there are just so many hours in a weekend. If there is not enough time, the best thing to do from a legal point of view is not to take the risk of implementing an unsuccessful and, possibly, illegal resolution decision. The bank will therefore be allowed to go into liquidation with more risks for financial stability (and / or waste of taxpayers' money).

Too much rigidity may get in the way of fulfilling the original objective of the reform.

Diversity in the EU banking system

The Chairman noted that there was broad agreement on the need to ensure banking diversity in Europe. European banks should be able to offer business models tailored to the needs of individuals, small and medium-sized enterprises (SMEs), large corporations and start-ups, and to the needs of both young, tech-savvy customers and older, tech-averse customers. Digitalisation has been a game changer for the diversity of the banking system. New players have emerged, and more are on the way.

The first round of contributions considered how to ensure the existence of different banking business models in the EU and how to incorporate the nuances of these business models into the regulatory and supervisory framework, ensuring that the risks are properly assessed, and the business models are sufficiently profitable. The second round of discussions focused on the new legislation and regulation proposed at EU level in the area of digitalisation and the impact these proposals might have on the diversity of the EU banking system.

1. Incorporating the nuances of business models into the regulatory and supervisory framework

1.1 Creating the right regulatory environment for a diversified EU banking sector

1.1.1 Diversity must be supported by strong regulatory and supervisory frameworks

A supervisor stressed that the European banking system is well diversified in terms of size, geographical presence and business model. This contributes to the financing of the economy and the maintenance of financial stability. The proportionality principle is crucial to this diversity by facilitating market entry and allowing new players to grow. While the EU regulatory framework already applies a proportionate approach to some requirements, the full application of a common set of standards to all banks helps raise the resilience of the European banking sector. There should not be a tiered approach to regulation depending on the size of the actors involved but rather, as is the case today, simplified and conservative approaches to be applied to smaller players. The single rulebook is critical to support a strong and effective European supervisory framework.

This is the very purpose of supervision to address the specific risks of each institution's business model, activity and risk profile. Supervision, including the implementation of proportionality, should follow a risk-based approach. Further incorporating differences between business models into the EU regulatory and/or supervisory framework should be considered only to address clear cases of unfair treatment.

1.1.2 Improving and simplifying the EU regulatory framework

An industry representative stated that the EU regulatory framework has made the banking sector very resilient, but its high cost and complexity disproportionately affect smaller players and new entrants. This does not mean deregulation, but smart, fair, simple and forward-looking regulation that takes into account the real risk profile of an institution.

For smaller institutions, the administrative costs of compliance are very high. The large institutions can cope with the high administrative requirements, and the new entrants find it easy because they are starting from scratch, but these regulatory burdens make it extremely difficult for medium-sized banks to grow.

1.1.3 Assessing business model sustainability in an evolving financial landscape

A Central Bank official reminded that the Basel Committee on Banking Supervision (BCBS) in its analysis of the March 2023 turmoil pointed out that one of the main causes was inappropriate and unsustainable business models, including an excessive focus on growth and short-term profitability, fuelled by remuneration policies at the expense of adequate risk management.

It is essential for EU supervisors to understand banks' forward-looking strategies and to assess whether banks will be able to generate sustainable returns. Supervisors need to be able to identify when an institution is 'out on a limb' or outside its risk management framework. Business model supervision was incorporated into the original Single Supervisory Mechanism (SSM) framework through the Supervisory Review and Evaluation Process (SREP), and the European Central Bank (ECB) conducted a thematic review on the topic in 2018. The ECB is business model neutral, and the sustainability of a business model is inextricably linked to an institution's governance.

The ECB is currently stepping up its efforts to understand business model sustainability and structural weaknesses. The ECB's assessment of business model sustainability involves reviewing a bank's framework for designing strategic business plans and forecasting profitability, and then assessing the bank's execution of its strategic plans and its ability to assess whether its plans are working as intended. If there are deficiencies in the bank's governance framework or if the sustainability of the business model is threatened by excessive risk-taking, the ECB may impose measures such as enhanced reporting to the management body, the implementation of action plans or even restrictions on business activities.

1.2 Digital banks require pan European frameworks

An industry speaker argued that the European regulatory framework must evolve with digital banks. Digital banks need a pan-European framework because, unlike traditional banks, they are European from the outset and

do not follow the model of growing in a European market before expanding to a pan-European level. This can be done by strengthening the digital single market for financial services, increasing consumer confidence in the banking system and promoting interoperable pan-European payment solutions.

1.2.1 Enhancing the digital single market for financial services

An industry speaker noted that the EU regulatory framework is extensive and difficult to comply with: The EU banking system needs to encourage the emergence of new players. The single market is wonderful in theory, but in practice it does not exist for growing businesses that want to operate across borders. In this context, the first priority is to tackle discrimination in the use of the International Bank Account Number (IBAN). IBANs are rejected in some Member States due to bad practices and non-compliance with Single Euro Payments Area (SEPA) rules. This prevents an emerging player from growing its business outside its home country, which means that bigger players do not emerge to stimulate competition. As Commissioner Mairead McGuinness said, this practice is "a brick in our shoe". The only viable solution is to move to a European IBAN, reaffirming the unity of the single market and allowing consumers and businesses to benefit from the free movement of goods and services.

1.2.2 Solving payments fragmentation

An industry speaker noted that the fragmentation of European payment systems is also limiting the growth of smaller players. There are many different national alternative payment methods (APMs) across Europe. This continued fragmentation hinders competition and limits the benefits for businesses and consumers. This could be addressed by creating a single access point for these solutions, similar to the European Digital Identity Wallet created by the European Digital Identity Regulation (EUDI).

1.2.3 Growing consumer trust in the system

An industry speaker emphasised the lack of a European Deposit Guarantee Scheme (EDIS) makes it difficult for companies to sell their products across borders. Consumers in a new country will be reluctant to trust a new brand if they do not recognise the deposit guarantee scheme (DGS) that covers it. The creation of EDIS and the development of banking union would create a true single market for financial services by building consumer confidence in the system.

1.3 Balancing national interests and the need for a harmonised approach

An official noted that 2024 is the 10th anniversary of the Banking Union project. The aim of the project is to create a single set of rules that will work for all member states of the Banking Union. Diversity in the banking system drives competition and innovation, but this need for diversity has been an obstacle to the realisation of the banking union. Europe has created the SSM and the Single Resolution Mechanism (SRM) but has been blocked in creating EDIS. There are significant differences between the deposit guarantee schemes (DGS) and institutional protection schemes (IPS) that exist in the member states.

The only way forward is to integrate these different entities into the EU regulatory framework, taking into account their unique characteristics and risk profiles. In this context, there remain challenging issues in the current proposal on revision of crisis management and deposit insurance (CMDI) as the Council's negotiating mandate is being loudly criticised that has not fulfilled the obligation to facilitate the resolution of smaller institutions. Ultimately, diversity does not always help to create a unified set of rules.

1.4 The need to assess new EU regulation and day to day supervision

An industry speaker agreed that the regulatory regime should be business model neutral and take a risk-based approach. Supervisors and regulators often appear to support business model diversity at a high level, but the reality of day-to-day supervision is different. Every new decision on the part of regulators and supervisors should be subject to an impact assessment to measure its effect on the financing of the economy and on business model diversity. If this does not happen, nothing will change. These assessments should also take into account cooperative performance, i.e. the diversity of a bank's geographical and social coverage.

1.5 The effects of business model homogeneity

A central bank official explained that the closure of local bank branches can deprive customers of tailor-made financial products. Larger financial institutions offer SMEs a small number of relatively simple products with a correspondingly narrow credit scoring system and an automated customer service model, but smaller institutions are likely to have complex customer interactions and use a wider range of information to make credit decisions, which means they can offer more demand-driven solutions to small businesses.

Decisions that make perfect business and even prudential sense can have a negative impact on customers. To some extent, homogenisation of business models is an inevitable by-product of consolidation driven by perfectly legitimate reasons, especially in markets where consolidation is needed. This homogenisation can increase the robustness of the financial sector if the larger institutions have more diversified portfolios and are therefore more resilient. Nevertheless, institutions and supervisors need to balance the benefits and costs. Frictions in the system should be reduced as much as possible, and there must be healthy competitive pressures in the system to drive customer service levels and innovation.

2. Technological shifts: impacts on business model diversity and key policy priorities

The Chairman explained that some of the EU regulations currently under discussion could have an impact on business models in the banking sector, including Financial Data Access (FiDA) or the Retail Investment Strategy (RIS). After Open Banking, FiDA is the next step

towards open data access in the financial sector, which will promote competition and efficiency. FiDA will give consumers and SMEs the right to authorise third parties to access data held by traditional financial institutions. The Retail Investment Strategy should strengthen investor protection by increasing transparency, protecting consumers and ensuring that retail investment products are marketed fairly and offer value for money.

2.1 The digital euro must use a fair remuneration model

One industry representative argued that the digital euro will pose significant challenges to European banks' balance sheets and profitability, especially for small banks without access to capital market funding. Banks need to be paid for their services. It would be a mistake not to pay for the digital euro. Implementing and executing legislation, like KYC, AML and Sanctions is extremely costly. If the digital euro is unremunerated and FiDA forces banks to share data without compensation, the negative impact on banks' revenues will have a corresponding negative impact on financial stability.

Instead of positioning retail banks as utility providers, it is crucial to offer them a proper compensation for the tasks EU banks are required to mandatorily perform as (semi-) public services and that allows them to develop innovative products and services that meet market needs.

Another industry representative noted that the introduction of the digital euro will change banks' business models. It will entail huge costs and banks will have to decide what they can do in the face of these costs. The digital euro introduces another player into the market, which will have a negative impact on banks' revenues. In this context, the remuneration model must provide incentives for banks and payment service providers. At the same time, it must be avoided that the digital euro favours large technology companies in order to monopolise their control of the market.

2.2 New EU legislation must not lead to unfair competition between banks and big techs

An industry representative stressed the importance of considering the scope of new regulations. FiDA could give big tech companies access to the valuable financial data held by banks without giving banks reciprocal access to the data collected by big techs. EUDI aims to open up the EU market for digital services and allow individuals to prove their identity digitally, but it could impose disproportionate costs on banks. EU banks and financial service providers should be able to access the data held by big tech companies. If they cannot, Europe's new digital legislation could weaken the EU banking and payments sector and strengthen non-European conglomerates.

2.3 Open finance data will change the financial system slowly

An industry speaker agreed on the importance of understanding the impact of legislation on different players in the system. Open banking will mean that customer data belongs to the customer. It will create room for innovation and allow new services to be developed. However, existing rules need to be implemented across

Europe. The use of open financial data could transform the financial system, albeit very slowly. It will create the potential for new and innovative offerings. To ensure that open finance is a success, it would be useful to bring forward deadlines and set high standards for implementation, including for account switching.

2.4 The impact of the EU's digital legislation should be considered holistically

An industry representative emphasised that EU legislative initiatives should be considered holistically. If legislation is implemented without a holistic perspective, it will not be possible to maintain the diversity and competitiveness of the EU banking sector. Regulation should be risk-based; it should not be used to implement structural policies.

An industry representative agreed on the need to take a holistic view of the EU's digital initiatives. The financial professionals who implement the legislation look at the combination of regulatory effects. To prevent the regulatory framework from weakening the European banking sector, a holistic approach based on well-designed impact studies is essential. Rather than positioning retail banks as utilities, they should be properly compensated for the tasks they are mandated to perform as semi-public services. The European digital regulatory framework should include safeguards to prevent the development of a one-size-fits-all approach and ensure that vulnerable and less digitally literate Europeans are not excluded. While many of these initiatives have positive objectives, it is important to understand exactly how they will affect the EU banking sector. These initiatives should drive efficiency and make customer products more inclusive, but the framework needs to be carefully calibrated to ensure that it does not inadvertently undermine these objectives.

2.5 The conditions to ensuring technology neutral regulation

A central bank official explained that there are several key pillars to ensure that regulation is technology-neutral. First, the regulatory approach should be principles-based. This means focusing on outcomes rather than the means used to achieve them. Of course, this is easier said than done. Market participants want regulators to lay down clear rules for them to follow. Creating effective principles-based regulation requires a clear and thorough understanding of the market. To achieve this level of understanding, regulators and supervisors must constantly monitor market developments and regularly engage with industry stakeholders to understand new and emerging technologies.

Second, the most important pillar of technology neutrality is capacity building within regulators and supervisors. There needs to be greater investment in education and training for supervisors. Third, regulations must be adaptable to technological change. Finally, regulatory expectations should be communicated transparently to market participants.

2.6 Policy measures to address regulatory gaps in relation to non bank activities

A supervisor argued that digitalisation will inevitably change business models. The question is not only how to

maintain diversity within the banking system, but also how to deal with financial activities developed by non-banks. European regulations such as DORA and DMA help address some issues. However, further increase of bigtechs' financial activities may create level playing field issues, as these entities are not subject to the same regulatory requirements as traditional financial institutions. This may also raise financial stability risks, including contagion effects, funding access issues and concentration risks. Further policy measures to address such risks could include: close monitoring of the nature and scope of financial service activities developed by non-banks; enhanced regulation and supervision of non-banks, that could include requiring them to group their financial services activities in a dedicated structure subject to relevant prudential requirements and consolidated supervision at EU level; backstop supervisory powers to address specific scenarios, such as excessive concentration of services distributed by platforms; and the development of a harmonised regime for non-bank lending.

A central bank official noted that technology is reshaping the entire financial services landscape. These changes might be positive, but supervisors need to focus on the gaps in oversight that might be created. Increasingly, non-bank financial conglomerates are working in partnership with banks. This shows that banks are

embracing technology and trying to make banking more accessible to their customers, but this relationship needs to be carefully calibrated. The bigger question is how to supervise non-banks. In this regard, the key issues are the heterogeneity of licensing requirements across jurisdictions and at cross-cutting points, the transmission of crypto risks to the banking sector, the need for greater cooperation between supervisors, and the potential expansion of the regulatory perimeter.

In this context, the regulatory toolkit should be enhanced to avoid gaps in supervision. The toolkit should be robust and versatile enough to supervise disintermediated, interdependent or distributed ledger-based business models. The need to regulate the big tech conglomerates requires a thorough understanding of the financial activities of large non-banks across jurisdictions and sectors. The ideal response to these challenges would be the creation of global standards for non-bank supervision and the promotion of cross-border cooperation and information sharing among supervisors. There should not be a regulatory "race to the bottom" driven by a myopic vision of innovation and growth at any cost, which will not be good for society. The EU is likely to need to continue to lead the regulatory evolution in the supervision of non-bank financial conglomerates and crypto asset services. Simplification should be prioritised.

Priorities for the insurance sector

1. At the global level, insurance standard setters are finalising common quantitative and supervisory standards and monitoring the risks to the insurance sector, and their implications for financial stability

A regulator explained that the International Association of Insurance Supervisors' (IAIS) five-year plan emphasises the importance of monitoring, identifying and addressing emerging risks to ensure macroprudential soundness in the insurance sector. The qualitative element of the IAIS' Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame) was adopted in 2019, with the Insurance Capital Standard (ICS), the quantitative element of the ComFrame, to be finalised by the end of the year.

The Holistic Framework for the assessment and mitigation of systemic risk in the global insurance sector was also adopted in 2019 as the IAIS' monitoring framework. As part of the Holistic Framework, the IAIS' annual Global Monitoring Exercise (GME) collects data from supervisors and industry and provides a robust framework that presents the basis for global supervisory discussions. In 2024, the GME will focus on two areas: first, interest rates, liquidity and credit risks, including the transmission channels for geopolitical risks, second round effects from commercial real estate exposures, the debt sustainability of fixed-income assets, the impact of digitalisation and AI, and secondly, structural shifts in the life insurance sector, including increasing investment in alternative assets and growth in asset-intensive reinsurance, with an IAIS issues paper to be published in H1 2025.

A special topic in the Global Insurance Market Report (GIMAR) next year will be dedicated to the financial stability implications of natural catastrophe (NatCat) protection gaps.

The IAIS remains vigilant in monitoring emerging risks, and collaborates with all relevant stakeholders, including policymakers, other standard-setting bodies, the Financial Stability Board (FSB) and industry, in order to contribute to global financial stability. In this context, the IAIS' Targeted Jurisdictional Assessments (TJAs) of the Holistic Framework supervisory material have also demonstrated that there has been consistent and strong implementation of the Holistic Framework supervisory standards, which is the evidence that enhanced macroprudential supervisory practices have been seen in the insurance sector in recent years.

On the way forward of the implementation assessment of supervisory standards, the ICS will be finalised by the end of 2024. In 2026, IAIS will coordinate a baseline self-assessment process. In 2027, the aim will be to start an in-depth TJA on ICS implementation.

2. In the EU, at the start of a political cycle, many challenges for the insurance sector exist

The Chair noted the value of seeking the views of experts at the start of a new political cycle on the positives and negatives of the current framework, as well as priorities for the future in terms of regulation and political initiatives. The risk and business context for insurance must also be considered, alongside demographic and geopolitical trends and the sustainability and digital transitions underway. The fundamentals of the insurance process may be impacted, as the sector is asked to play an enhanced role supporting the economy and filling protection gaps.

3. The current EU regulatory framework for the insurance sector, which is world-leading, is an asset for the sector

An industry representative characterised Europe's regulatory framework as world leading. Solvency II has provided insight into how the ICS might impact the insurance market. In Japan, insurance companies are already calculating their internal economic solvency ratio (ESR) in preparation for ICS implementation, to ensure financial soundness and to consider how companies might best benefit policyholders and society.

Europe's climate risk disclosure requirements had a global impact. Insurance companies must engage with investment and funding partners to encourage behaviour change, despite the difficulties and costs required by EU regulations. It is impossible to address every issue with a one-size-fits-all approach, which may cause a significant challenge such as widening protection gap.

3.1 Recent adjustments facilitate long-term investment by insurance companies

A policymaker suggested that the framework, which is solid and respected, delivers on its objectives and ensures insurance sector stability through economic and geopolitical challenges. Nevertheless, a stocktake following first years of application showed a need to fine tune certain aspects. The new rules agreed end of last year can help the sector to deliver in more general terms. They address gaps in the framework in terms of investor and policyholder protection and the role of the European Insurance and Occupational Pensions Authority (EIOPA). They create the conditions by which investment capacity can be boosted, though preferential treatment for long-term investments in equity. This has relevance for the capital markets union (CMU). The finetuning of the long-term guarantee measures, including the volatility adjustments are another welcome change.

These rules can also be used in service of the Green Deal, including through the introduction of prudential transition plans. The European Commission wishes to see more made of the cooperation between home and host in terms of cross-border service provision and the strengthened power of EIOPA.

3.2 Covering new risks (technology, cyber and climate) requires swift implementation of the revised framework and enhanced insurance undertakings contribution to the CMU, envisaging additional adjustments

A regulator warned against complacency, despite the robustness of the framework. Regulation has expanded over the past five years to cover new technology, cyber and climate risks. The measures agreed by the European Parliament are yet to be implemented. Pragmatic implementation after levels 2 and 3 will be essential.

An official highlighted that the Solvency II review will give insurers leeway to invest in the European economy and green transition. In this regard the specific prudential treatment for long-term equity investment is most welcome. Along the same lines, adapting the prudential treatment of securitisation, a cornerstone of the CMU, will be key. France is eager to work closely with the European Commission during level 2 deliberations to deliver on these issues. Competitiveness was one of the objectives of the Solvency II review and must also be put at the heart of upcoming ICS discussions.

An industry representative emphasised that the Solvency II is a robust prudential framework as well as a good economic risk management tool for companies that should be protected, particularly with regard to the ICS discussions. The ongoing review is going in the right direction following the line of the political agreement of December 2023, wherein welcome changes were introduced to facilitate investment in Europe. However, the practical impact will depend on the level 2 measures currently under discussion. These discussions should not overrule the previous political agreement on level 1. In this context it is important for regulators and the insurance sector to work together on level 2 and 3 measures. Another objective recognised by the European Commission is that the unnecessary regulatory burden must be reduced. This latter point is not only about Solvency II.

4. Supervisors in the EU have a strong role to play

4.1 The actual relaxation of capital requirements requires supervisors to exercise greater caution in a number of areas, in order to evenly ensure the protection and confidence of policyholders throughout the EU

A regulator explained that the nature of regulation has changed. The easing of capital requirements within Solvency II in practice meant billions of euros less capital to protect policyholders. While EIOPA advised that some easing is necessary to recognise the long-

term investment part of insurance, this has gone too far, straying into mid-term and short-term investments. Supervision has changed to consider beyond only the prudential.

Europe has created a single market for insurers, but not consumers. Inequal protection for consumers across European member states is a risk. Consumers are being asked to move money protected by a deposit guarantee scheme into an insurance product where there is generally no insurance guarantee scheme. EIOPA does not have the power to resolve every issue. The Chair observed that there is still significant work to be done on the supervisory side.

4.2 Supervisors still have to clarify certain issues and optimise the balance between customer protection, insurers' contribution to EU investment needs and EU insurance companies' competitiveness

A regulator noted that regulators seek to inform and advise, with no commercial interest. There are misconceptions, for example, about the level of investment by EU insurers in Europe. Supervisors can use their reputation to inform debate and challenge the industry. The industry must balance consumer protection with the need for investment in Europe. The retail investment strategy will be a key consideration in this regard, as will the European competitiveness debate. Supervisors view the current conversation as unbalanced. Competing elements must be brought together to provide simple products with the same protection for every European.

4.3 Developing sustainability risks require supervisors' caution

An official remarked that the insurance sector has successfully dealt with challenging situations. The robustness of the prudential framework is the cornerstone of its resilience. The prudential transition plans introduced in Solvency II will be useful tools, provided that they are made fully consistent with the Corporate Sustainability Reporting Directive (CSRD). EIOPA's work on climate-related risk and climate protection gaps is welcome, as is the 2024 stress test conducted by Autorité de Contrôle Prudentiel et de Résolution (ACPR) at the French national level, but more work is needed.

4.4 Attention is paid to balancing the regulatory framework and limiting regulatory burden

An industry representative reported that European confidence in the non-life insurance sector is strong. There is a question of whether the right balance is being struck. The fundamental goal of broader insurance at an affordable cost is sometimes forgotten and here the insurance sector can contribute to European competitiveness and the wellbeing of the European citizen. There is a positive direction of travel in the prudential field, but perhaps less so in other areas of regulation.

A regulator commented that, in practice, there is a lot of supervisors must deal with. Reducing the regulatory burden would be helpful. For example, EIOPA has reduced the datapoints required from small- and medium-sized enterprises implementing reporting

technical standards (ITS) and is reviewing the Solvency II guidelines. Revised versions have thus far reduced the number of articles by at least 20%.

A policymaker noted that Solvency II level 2 measures are under discussion, with a view to balancing competitiveness with financial stability and consumer protection. Moreover, work on the retail investment strategy would not end with matters currently before the legislature, as the retail investor must be put at the heart of the CMU. In the new political cycle, there will be a focus on implementation, enforcement and consistency, including cutting red tape and reducing duplicated reporting requirements. The question of why the insurance sector is kept away from securitisation will be reviewed.

The debate on the European Securities and Markets Authority (ESMA) might also apply to EIOPA. Centralising of supervision is a possibility, but strong political commitment will be needed to engage with the notion of an investor guarantee scheme. There is optimism that political will of this nature will develop.

4.5 Sustainability challenges also require complementary approaches and focus points

An industry representative recommended that artificial intelligence (AI) be considered an opportunity to improve productivity and understanding of risk first before it is considered a risk. The main contribution insurers can make to the green agenda is prevention of and adaptation to climate change. There is insufficient focus on liability and how the regulatory framework might foster preventative action on the part of the insured. However, the insurance sector must have the humility to admit that it cannot do everything. Collaboration is key.

The Chair concurred that the insurance sector can contribute both to the transfer of risk and to prevention, to the benefit of the policyholder and society. It is uncertain whether there are regulatory obstacles. Insurers are being asked to do more, beyond their traditional role.

An industry representative added that the reasons behind the decline in affordability must be considered. It is possible that a regulatory framework aimed at stabilising insurance companies might reduce the availability of insurance services. It remains unclear how agreement can be reached on climate risk between developing and developed nations.

5. In the EU and globally, economies are facing additional challenges – cybersecurity, climate-related threats, solvency of social security schemes, development of fintech – and both should leverage the insurance sector as these challenges might impact the risk pooling that traditionally underpins insurance

An industry representative recognised the issues at play, including climate and cyber risk. There are three key elements to consider. First is progress in medical technology, which might reverse the informational asymmetry between insurers and consumers, leading to adverse selection issues or the emergence of a group no longer requiring insurance. Second is the management of the health of individual citizens by the government as social security systems reach their limit. Third is a radical reorganisation of the financial industry, as a result of reduced transaction costs. Reliance on traditional risk pooling models will become increasingly difficult. The division of roles between the public and private sectors in terms of regulation may require review.

5.1 Addressing the negative impact of demographic shifts on the pension and health system, as well as cyber risk

The Chair highlighted the challenge of balancing different objectives. There is work to do and a role for the insurance sector play in terms of filling the demographic gap.

An industry representative supported the idea that a pensions dashboard as promoted by EIOPA is a step in the right direction to foster awareness by citizens. On health, more can be done on the public private partnership (PPP), particularly in terms of prevention and data sharing. Insurance companies can be part of the solution. The sector is engaged to contribute to bridge the pensions gap while ensuring sustainability and promotion of long-term investments in Europe, through further development of collective and individual savings and pension products. However, promoting private collective pensions will require political courage.

An industry representative noted that insurers and reinsurers are eager to develop coverage for digitalisation and cyber risks. It is a key issue covered by the Draghi report, though the precise definition of cyber warfare remains unclear. This may become problematic in the future.

5.2 Insurance digitalisation raises regulatory challenges for the sector, notably because of horizontal regulations on insurance mechanisms

The Chair observed that technological innovation creates risk but can also provide opportunities for the insurance sector to take up its ever-evolving role. An industry representative added that new technologies are likely to be the main tools by which the insurance sector can increase productivity. One use case might be the tailoring of products for clients, using client data. However, this would require specific regulation. Horizontal regulation raises some concern. Any regulation must also be tailor-made and both horizontal and specific.

The Chair suggested that digitalisation, while helping the insurance sector price better, might also limit the mutualisation principle behind insurance. An official was of the view that enhanced cyber security is the key to better balancing innovation, customer protection and sound insurance markets. France strongly supports the development and enforcement of cyber risk governance in the European financial sector. Innovation fostered through regulation must be pragmatic. The Financial

Data Access Act (FIDA), for example, aims to develop personalised products, but will also impact the economic model of European actors.

If there is no caution, data sharing might negatively impact mutualisation, the principle at the heart of the insurance sector. Indeed, generalising data sharing through FIDA might result in a much more targeted and heightened selection of risks, which would increase

financial exclusion and widen protection gaps. The Chair agreed that it is a matter of balancing different objectives.

A regulator explained that AI is already supervised under Solvency II. An AI Act is additional, has overlap with Solvency II and adds complexity. Supervisors seek to build a final, single set of regulation where the source, AI Act or Solvency II or both is irrelevant to insurers.

Insurance protection gaps

1. The natural catastrophes trend and economic affordability

1.1 Growth in losses due to extreme events

An industry representative referred to the Swiss Re sigma publications concerning natural catastrophe (nat cat) protection issues, nat cat protection gaps and nat cat losses. A new record was broken in the previous year in the global protection gap for nat cats at 385 billion. 74% of exposures were not covered. Looking at the total losses from natural catastrophes in 2023, a note particularly eventful year, only 40% were covered by insurance. In terms of resilience, positive changes have been made between 2013 and 2023. However, they are not enough to catch up with other developments in terms of losses.

Looking across regions, Europe, Middle East and Africa (EMEA) is best placed in terms of resilience, followed by North America and then Asia Pacific. The top 10 countries in terms of resilience include a few European countries, though Italy and Greece are comparatively low in the rankings. Even within EMEA and within the EU, the situation is mixed.

In terms of affordability and the evolution of losses, losses have always been higher than GDP growth in the past 30 years, which creates a challenge for the industry. The Swiss Re Institute forecasted that insured losses will increase by 5-7% in the foreseeable future, beating any GDP forecasts. There is an increase in the frequency of medium severity events. In the previous year there were more than 108 billion losses, of which around 70% were related to convective storms in the US, which is a very new phenomenon.

In the United States, the UK and Australia, the increase in premia for property insurance last year was higher than both inflation and the increase in disposable income. If the path of insured losses continues, low penetration affordability may become an issue and challenge the progress made in terms of penetration and resilience.

Annual record high protection gaps, changing weather patterns and increasingly high losses mean that for the current model to be sustainable there has to be consideration of ways to decrease exposure impacts. That can only be achieved through prevention, mitigation and adaptation, which needs everyone working together.

1.2 Frequency, severity and new regions impacted

An industry representative reported that nat cat frequency and severity in Europe are increasing. Additionally, nat cats happen in regions where they typically were not observed previously, so those regions are not prepared and have not invested in protection.

These elements lead to an increasing trend in losses.

The WEF Global Risks Report provides the opinion of 1,500 experts. According to that risk report, climate risks dominate. In only 10 years' time, the top four global risks will be environmental risks like extreme weather, the collapse of ecosystems and critical changes to earth systems. This is an urgent topic.

1.3 Limits on the speed of recovery

A regulator emphasised that the exponential growth of the protection gap presents a financial stability risk. The European Insurance and Occupational Pensions Authority (EIOPA) and the European Central Bank (ECB) produced a paper that showed the impact of nat cats on GDP. When there is no insurance cover, GDP recovery takes much longer and falls far lower. Actual insurance coverage enables immediate intervention and starting the recovery. When there is no coverage, though state help may come it might be much later.

The Chair added that there is work happening at Financial Stability Board (FSB) level around the financial stability impact of nat cat insurance protection gaps, including recognition of the spillover effects of uncovered losses in the real estate sector and what that might mean for the banking sector.

1.4 The challenge of raising awareness about the challenges posed by insurance gaps

The Chair highlighted that the global community of insurance supervisors is acutely aware of the challenges posed by insurance protection gaps and the fact that a coordinated response is needed. In November, the International Association of Insurance Supervisors (IAIS) published a report making it clear that addressing protection gaps is vital for insurance supervisors, regardless of their mandate. The IAIS presented a range of supervisory actions covering five areas: assessing insurance protection gaps, improving consumer financial literacy and risk awareness, incentivising risk prevention and the reduction of insured losses, creating an enabling environment to reduce protection gaps, and public-private partnerships. A coordinated approach is required.

An industry representative noted that the EIOPA/ECB paper was very useful for the public debate. Many in the industry have been talking about protection gaps for years, but it is something different when EIOPA, as an institution, launches something, as it leads to recommendations. There is a partnership in explaining to the public and to policymakers what is at stake.

An official sought risk awareness from the population. In Spain, cover is connected to the policies that are known by the population. Some people do not know the importance of having a private insurance policy in order to be covered.

2. Climate related threats require addressing varied challenges including prevention

2.1 Moral hazard, poor education, perfectible product design and coverage are part of root causes

A regulator stated that one reason there is not much appetite to take up insurance coverage is that there are expectations that the state will intervene. However, that expectation is sometimes not very well grounded. Even when there are state interventions, they are slow, and they impact GDP recovery.

Another reason is that the price is perceived to be unaffordable. When it is asked how much entities would pay for the coverage, the price they give is not very different from the market price, so an educational effort is needed. The simplicity of the product and clarity of the terms can be improved. Public authorities and the private sector can help, in terms of risk awareness, by making it simpler and more friendly to buy this kind of product. They could even intervene at key moments. For example, when someone buys a new house that is a key moment, as the appetite to cover the risk is higher.

EIOPA produced a nat cat risk dashboard that shows how much exposure there is. Italy and Greece are outliers. There are awareness initiatives that can still be undertaken.

2.2 Common tools and deepening insurance penetration

An official reported that, in the past decade, the frequency of extreme weather events has increased over 40% globally. Additionally, the population and the assets exposed are increasing. The approach to dealing with the challenges varies across countries. It is not easy to adapt markets that have evolved over time, depending on the specific social and economic and environmental issues, and that have different tools. Some countries have advanced early warning systems for natural disasters, while others lack the infrastructure to implement such measures effectively.

In theory the most common solutions tend to broaden the mutualisation base, which is connected with insurance penetration, and applying better models to adjust the policy prices in order to adapt to the risk in play. These prices can also be flexible depending on the risk mitigation measures. For example, some insurers offer discounts on properties that implement flood defences or fire-resistant materials. If too much information is applied to prices or premia at the property level, some properties will be uninsurable. Very large mutualisation is needed in countries. The Consorcio de Compensación de Seguros (CCS) in Spain is an example of successfully covering such losses.

2.3 Adequate insurance design requires public-private partnerships (PPPs)

A regulator indicated that to make the system more resilient in general through PPPs, each player must have the right role, starting from the primary insurer

and the people who need to put measures in place to mitigate the risk. There should be a product offer that takes account of the mitigation measures taken by the individual, then the system can be built up such that each player plays its role in mitigating. The means primary insurance, the reinsurance market, the capital market and then a last resort measure in terms of the government, because things could become unaffordable otherwise.

2.4 Risk prevention

An industry representative emphasised that risk prevention is key. There is a collective responsibility beyond just insurance, so it requires cooperation. The obvious role of insurance is to insure the risk, but, with the dynamics of climate change unfolding across Europe, the capacity of the insurance industry will be challenged at some point. Furthermore, paying a loss is only the second line of defence. The first line of defence is prevention. Insurers, reinsurers and brokers play a key role in prevention and building resilience. There are already resilience services combining risk engineering expertise with climate data scientists' expertise, in order to model and assess risks, and calculate the impact. On this basis, clients can be advised on risk improvement actions to help build resilience.

For example, Audi had a flood event that affected production. Following this event, it asked for support in building flood resilience measures. After an on-site assessment, it was decided that several measures would be taken, such as an early warning system for floods, local training with the fire brigade, and building measures. When the next flood came, it did not affect the production.

In big cities, heat is becoming an enormous problem, especially for vulnerable populations like children, the elderly or poorer people who cannot afford air conditioning. The city of Madrid and an insurer developed a blueprint for how to build the climate resilience of a city with respect of heat.

3. Roles of the different stakeholders

The Chair suggested that one consideration at the global level is whether there are things that insurance supervisors can do to either incentivise or even require insurers to include risk prevention and reduction of insured losses in how they approach the business of insurance.

3.1 Multi-stakeholder and holistic frameworks

An industry representative replied that governments can build the framework for insurance penetration and prevention measures. They can build on capital funds to cover extreme events. Policymakers and supervisors can help to enable that.

Insurance protection gaps are increasing, because losses are increasing, and natural hazards are increasing. Insurance premiums will therefore also

increase. That means affordability will become an issue. Although globally the insurance industry has significant capacity, there is still a limit, so availability will become an issue. Protection gaps in Europe are very diverse, ranging from 3% to 97%. Addressing availability, affordability and having more harmonised protection requires the collaboration of governments, European institutions, worldwide institutions and insurers.

That starts with data. Many member states do not collect data on nat cat. The EIOPA dashboard is a good starting point. It is not yet a PPP, and that should be the next stage by combining data from reinsurers, insurers and countries. Digital tools are beneficial. Austria has an insurance data base, the Natural Hazard Overview & Risk Assessment Austria (HORA). It is a risk map for natural hazards. Anyone can type in an address and immediately see how it is exposed to natural hazards. It was developed by the Austrian Insurance Association together with the government and is a very successful PPP.

The insurance industry regards the Spanish consortium as a functioning nat cat scheme. Other countries should look at it. An EU-wide solution will not be achieved in one step, but looking at the already existing solutions is worthwhile. Belgium chose the simple solution of combining nat cat insurance with fire insurance and making it mandatory. Switzerland has almost no protection gap. It has solved availability and affordability with a pool solution and aggregate reinsurance cover.

An industry representative noted that there are particular types of schemes in the US and in Europe, and there are reasons why they were set up as they were. PPPs are not needed where the private sector can step in and deliver. PPPs should exist where they are required and should be tailored to the particularities of the regions/countries.

An official emphasised that there is no one-size-fits-all solution. It depends on the market circumstances, which include the social and economic values of the society. PPP approaches vary widely. They might address specific hazards, like floods, earthquakes or terrorism, or target specific sectors like commercial or residential, or cover the entire market. They can be insurance and reinsurance schemes. They could involve private or public insurance companies. Sometimes there are public reinsurers or a concession to a private pool. The regulator's role is crucial. The key to these approaches is having a common goal for all stakeholders. Insurance supervisors should play a central role in implementing the schemes.

3.2 Supervisor contributions at macro and micro levels

A regulator suggested that supervisors can help with design, from a technical point of view, at the political level. When checking the risk management system in different supervised entities, if there is a system that really measures the risk, and there is a mitigated measure, then it is evident. That is also the job of supervisor. If it does not work properly then a better understanding of the real risk exposure of the company is asked for.

From a supervisory angle, both sides of PPPs can help with the design of the system to make it affordable and give the right incentives to each player, as well as in terms of measuring how much risk management there is in the company, what needs to be improved, the mitigation measures, or the pricing policy considering the mitigated measure.

3.3 CCS case study

An official reported that, in Spain, the CCS covers extraordinary risk. It is a state-owned company with its own assets independent of the state. This arrangement is based on PPPs. The consortium is complementary and interacts with the private insurance industry.

In the scheme, insurance companies cover predictable mass risks. However, where wind, for example, exceeds a speed of 120 kilometres per hour, the consortium enters to cover the losses. For some other phenomena, like earthquakes, volcanic eruptions, hurricanes and floods, the consortium covers the losses. The partnership is a cooperative solution to not remove any commercial opportunities from private insurers. The extension of the needed cover can be a selling point for other products.

The private market also bears some burden of natural hazards. They retain the capacity to choose risk and maintain more hazards under control. The goal of the scheme is to be a win-win solution for insurers and the insured, and so for society in general. There is a mutualisation scheme from three points of view: risk, geography and time. The risks do not usually happen at the same time. The same risk with a high probability in one place but not in another is mutualised as well. There is no dividend distribution, and all the assets of the consortium remain for future events.

3.4 Collecting data

An official added that the CCS scheme gathers a great deal of risk data from agencies, administrations and academia, which is used in risk reduction measures and initiatives, such as for where buildings are built in the context of potential floods. However, such actions take time, and then buildings can already be built on locations that could flood.

3.5 National natural catastrophe prevention and mitigation schemes

A regulator stated that the ECB and EIOPA are evaluating 12 existing schemes to extract the key features. The incentive system is key. It must have the purpose of diminishing and mitigating the risk in general. The first step should be mitigating measures at the level of individuals. The public sector can help there, because it provides more credibility to data, though there is need to evolve in terms of depth and granularity.

The system should have, as a natural last resort measure, a form of final reinsurance through the government, because matters can become unaffordable and uninsurable. There can also be help with talking to politicians about making addressing the protection gap more palatable for people, and on how to give returns to people. When people see that they are

insured, and there are no events and no catastrophes, the profits can be returned to them. For example, in one initiative a city gave back part of the profits made, year by year, by building up new gardens. There can also be help with linking between people's desires and their needs, with government selling the product. It must be sold, as otherwise it is simply a new form of tax imposed on people.

An industry representative recommended a deeper dive at the European level in already existing and functioning PPPs, to have more transparency on how they function, what does and does not function well, and what could or could not function in other countries.

3.6. Mobilisation in the global and European contexts

An industry representative recommended continuing the conversation with all parties at the table. EIOPA continuing its work is appreciated. A climate resilience dialogue paper was recently published in Brussels. There is also the new Commission.

A regulator stated that the issue is a European and global one, and for the EU it can be tackled at the European level, for which more awareness is needed. It is an issue for every area of Europe, so a European solution has to be sought.

The Chair emphasised the scale and urgency of the problem. A positive message, from the global perspective, is that there has been a perceptible shift from talking about the problem to looking at concerted, collaborative action. There are opportunities to not only go deeper on the nat cat protection gap issue and what is working, but also to bring in other types of protection gaps.

4. Dedicated approaches to address protection gap specificities

An audience member highlighted that there will be gaps in the pension market and other exposures. The experience of Covid demonstrated that there were expectations for the insurance industry to have done more. With nat cats there is also the challenge of business interruption.

An industry representative highlighted that there had been a focus on the nat cat protection gap, because discussing all protection gaps would take a very long time. The protection gap in the pension system is an increasingly important topic. Business interruption is also increasing, and there is also the supply chain problem, not only related to the pandemic but also several other worldwide crises. The problem becomes even greater with business interruption.

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Digital finance policy: key priorities

1. Digital finance trends

The Chair noted that digitalisation is leading to a constant transformation of the financial value chain. For customers, this means a shift to more dematerialised financial services, such as digital savings accounts and loans, and the launch of new financial products and solutions such as cryptocurrencies and buy now pay later services. Back-office processes are also becoming more efficient and faster with the use of automatic payments, blockchain settlements and artificial intelligence (AI) tools that facilitate fraud detection and sophisticated analytical applications.

An industry speaker highlighted that the ongoing trend of digital transformation in financial services is both well underway and inevitable. In sectors like capital markets, insurance and banking, financial institutions are increasingly moving infrastructure to the cloud. Cloud computing also acts as a foundation for the adoption of other technologies, such as AI. For financial firms, the speed at which they are embracing cloud and integrating other technologies thanks to that is becoming a key differentiator.

Financial entities are leveraging digital technology to enhance customer experience, risk management and back-office process optimisation, the industry speaker explained. In the past, discussions about technology and digitalisation were limited to IT departments, but the conversation is now shifting towards the broader benefits and value of technology for financial institutions and their customers. According to a recent survey conducted AWS, there has been a 69% reduction in unplanned IT downtime, a 40% faster time to market for new products, a 40% reduction in costs related to fraudulent transactions and a 20% decrease in customer acquisition costs thanks to technology. These wide-ranging benefits demonstrate the business value that can be derived from digitalisation.

2. Opportunities from digitalisation

2.1 Opportunities for financial market participants and the overall financial market

An industry representative noted that technology brings many opportunities for financial market players. These include faster go to market, the ability to launch tailored products and services and improved customer service, fraud detection and risk assessment. Technology also enables companies to achieve scale, which is crucial for efficiency and competitiveness. Not only can it help individual companies to become more competitive, but it can also potentially benefit the European financial market and sector as a whole. Successful digitalisation however depends on how quickly the related opportunities are seized and how effectively they are leveraged.

Another industry speaker agreed that technology enables faster implementation, time to market and the ability to scale operations quickly without the need for extensive local presence or infrastructure. From a market perspective, the digitalisation of financial services provides huge benefits in terms of competition and cooperation. The possibility to centralise services notably enhances cost effectiveness for all market players, including the more established ones, and facilitates cooperation between market participants.

A regulator stressed that beyond improving the efficiency, speed and competitiveness of the financial sector, digitalisation also allows financial companies to engage with investors and consumers in new ways. Concerning distributed ledger technology (DLT), one promising opportunity is the DLT Pilot Regime, a Commission led initiative which aims to help trading and settlement providers to leverage DLT to handle transactions more efficiently. The first use cases are emerging, showing that there are also opportunities in less visible parts of the market.

A Central Bank official confirmed that digitalisation has fostered greater efficiency for traditional financial institutions, allowing them to offer a wider range of products and expand their customer reach, thereby promoting financial inclusion. These changes will help ensure that banks remain resilient and competitive in the long term. For instance, Hungarian banks now offer online onboarding and online cash loans, enabling citizens to choose a bank based on their product offering rather than branch proximity. Over time, this should also help to reduce fragmentation in the single market.

An official argued that finance is already digital to a large extent and has reached a 'post digitalisation' stage. There has been significant progress in using technology to enhance customer experience, facilitate access and increase the efficiency of financial institutions. Many of the initiatives under the digital finance agenda are moving in the right direction, but the key issues to address are no longer only digital or technological, they relate to data use and legal and fiscal fragmentation in particular.

A public representative added that the improvements enabled by technology in the financial sector, such as greater innovation and higher competitiveness, will play a key role in supporting the Capital Markets Union (CMU) which is essential for channelling investments in the European economy.

2.2 Benefits for customers

An industry speaker remarked that the technological developments in the financial services market over the past decade have greatly benefited customers. Products that were once exclusive to high net worth individuals, such as portfolio management, are now accessible to a much wider audience. Costs are also decreasing, as digitalisation has fostered competition in the market,

allowing previously expensive products and services to become more affordable.

Another major benefit, the industry speaker added, is the increased cross border accessibility of digital financial services, providing customers with access to more competitive products and enabling financial institutions to offer services in different European countries. Additionally, the new digital platforms are more transparent, making it easier for customers to understand product offerings and to track performance without intermediaries, contributing to a more open market with less information asymmetry.

A public representative agreed that digitalisation offers significant benefits for retail customers, including more consumer choice, improved access to products and lower costs. A regulator added that, when properly implemented, digitalisation can empower retail customers to make more informed investment decisions and can enhance inclusiveness and accessibility.

2.3 Potential benefits for regulatory and supervisory activities

A public representative noted that technology offers many opportunities for supporting regulatory and supervisory activities. It notably enables policymakers to process and share the vast amounts of data available in a more effective way, allowing them to create relevant frameworks more swiftly and adapt them in a more responsive way. Secondly, the ability to process and share data in a secure way thanks to technology could make supervision much more efficient. Moreover, the use of technology can facilitate cooperation between the public and private sectors and help the public authorities increase their expertise.

A regulator confirmed that digitalisation and technological innovation present significant opportunities for supervision. For example, supervisors can harness technologies like large language models and natural language processing to improve analytical capabilities and use DLT for market surveillance. Supervisory authorities are sharing their experiences to maximise the benefits of these technologies.

The Chair highlighted that there are several areas of connection between technology and supervision. Technology can help supervisors manage and analyse the data available to them. European supervisory processes could also be optimized with the implementation of a data hub within the European Supervisory Authorities (ESAs) supported by new technologies, where data could be centralised and used by the different national competent authorities (NCAs). A further aspect is that the supervision of digital activities will become an integral part of the role of the ESAs with the implementation of the Digital Operational and Resilience Act (DORA), which tasks the ESAs with the oversight of critical third party providers (CTPPs).

An industry speaker concurred that there are many opportunities to leverage technology in supervisory activities and that the connection between technology and supervision is growing as regulation begins to encompass technology providers. In the implementation of DORA, careful consideration should be given to the

implications of the new oversight approach to CTPPs. The primary goal of supervisors and regulators in this area should remain financial stability.

A Central Bank official emphasised the importance of supervisory authorities developing technological expertise and creating standards that may facilitate digitalisation. In the implementation of Payment Services Directive 2 (PSD2), the absence of unified standards led to missed regulatory goals and inconsistent implementation, which eventually necessitated a review of the directive. Establishing clear technology standards can also help align industry efforts and reduce time to market.

3. Challenges associated with the digitalisation of financial services

3.1 Customer related challenges

A regulator emphasized the challenges that digitalisation presents from an investor perspective. While digital services make it easier to develop cross-border business operations, they also introduce questions about how financial activities can be effectively regulated and supervised on a cross-border scale. Furthermore, digitalisation is transforming the way customers engage with financial services. With easier access to complex products, the gamification of financial platforms, and the growing influence of social media, there is a need to adapt regulatory safeguards and supervisory activities to this evolving landscape.

An industry speaker pointed out that in a cross-border environment the EU authorities should play a greater role in combating fraud, in order to accelerate actions against fraudulent websites, which can take several weeks to execute.

A public representative noted that digitalisation increases the risk of fraud. The ongoing review of PSD2 is focused on fraud prevention. The innovative services linked to crypto assets also pose a new risk to customer protection due to low levels of financial literacy. On the positive side, technology can also play a crucial role in detecting and preventing fraud and making the financial ecosystem more secure and efficient.

A Central Bank official agreed that there is a growing need to manage potential fraud risks on digital channels. It is also important to understand the needs and capabilities of different demographic groups in terms of financial and technological literacy, to ensure that the digitalisation of financial services does not leave anyone behind. Targeted education programmes are needed to address these gaps.

3.2 Challenges for financial institutions

An industry representative pointed out that much of the technological development is currently taking place outside the EU, which poses a significant challenge for European financial institutions. The location where technology is developed is important, as it fosters an ecosystem that supports and drives innovation, benefiting

all stakeholders in the region. If European financial institutions are too far removed from where technologies are being developed, this could result in a lag in adopting new innovations, placing them in a reactive position and potentially weakening their competitiveness in an increasingly dynamic and fast-evolving digital landscape.

A public representative agreed that digitalisation poses a challenge to the competitiveness of Europe's traditional financial sector. Additionally, since digital finance transcends borders, overly burdensome regulation within the EU could push innovation elsewhere. This will be a key issue to address in the coming years.

A Central Bank official emphasized that a major challenge for many banks lies in their reliance on outdated legacy IT systems. These systems, which lack connectivity, require scarce specialized expertise for maintenance. This is hampering banks' ability to adapt their business models and compete effectively with fintechs, which offer more flexible and tailored services to customers. To address this issue, banks need to consider replacing their core systems, a task that is both complex and resource-intensive. Public sector support and incentives may be necessary to facilitate this significant transformation.

An official noted that the key challenges financial institutions face with digitalization are less about technology and digital regulation, and more about data management and legal and fiscal fragmentation across the EU. The first challenge lies in making better use of data and promoting data sharing. The second challenge is the fragmentation in legal and fiscal frameworks across member states, which impedes the ability of digital finance to foster cross-border services and enhance competition within the EU financial sector. For instance, differences in national tax systems add complexity and costs, while the fragmented nature of pension systems prevents the creation of large, unified capital pools in the EU. This fragmentation limits the full potential of digital finance. Therefore, the goal of any new regulation should be to make financial intermediation more cost-effective, rather than increasing costs.

An industry representative agreed that market fragmentation continues to be a challenge for the European banking sector and capital market. Europe currently struggles to compete with countries that have access to larger, more unified consumer bases. To drive investment and create better opportunities, a larger and more integrated market is essential, providing the necessary scale.

3.3 Challenges facing fintechs

An industry speaker emphasized that innovative financial companies such as fintechs, which are key drivers of digitalization, face several significant challenges that must be addressed to enhance the European market's attractiveness and prevent firms from relocating to other regions.

First, these companies need sufficient availability of talent, by attracting skilled professionals and also creating a positive and open workplace culture to retain them. In this regard, Europe's high quality of life is a notable advantage. Secondly, fintechs require adequate access to capital to fuel their growth. The CMU project

should help channel more funding to innovative companies. Encouraging retail investors to invest in pension products would further expand the capital pool available in Europe for these firms.

Thirdly, these firms need a regulatory environment conducive to business growth and cross-border expansion. Regulatory barriers, caused by the gold plating of national laws and excessive bureaucracy across Europe, must be addressed to facilitate the expansion of firms into new markets. Streamlining authorization processes and harmonizing regulations, such as a unified anti-money laundering (AML) regime, would make it easier for companies to operate across borders. Simplifying consumer protection requirements at the cross-border level is also important. Once a company meets standards in one EU country, those should be recognized across the bloc, particularly for cross-border product authorizations. The forthcoming digital wallet, expected in the next legislative period, could further support cross-border activities by simplifying customer identification processes. Lastly, the industry speaker suggested that greater efforts are needed to digitalize tax processes across Europe, as many member states still rely on inefficient, paper-based systems.

4. Policy priorities for the next political cycle

4.1 Focusing on the implementation of adopted legislations

An industry speaker emphasised the importance of focusing on the implementation of the existing set of digital policies before discussing possible reviews or additional measures. Much of the digital legislation, particularly DORA, has not yet been implemented and some issues still require adjusting. DORA seeks to harmonise the requirements for achieving digital operational resilience. However, the guidance from some national competent authorities (NCAs) contradicts some of these objectives.

A public representative concurred that the next policy cycle should focus on implementation, as many of the measures adopted during the current cycle are not yet in place. Finalising implementation before considering any amendments to the regulations will help maintain the continuity and long term stability of the European business environment. The Chair agreed that the implementation of the agreed frameworks is the priority. These measures need to be tested on the ground before considering possible adjustments or proposing new measures.

A regulator also emphasized the importance of focusing efforts in the upcoming political cycle on the implementation of legislation adopted in the previous cycle and fine-tuning the details of these legislations. Concerning DORA, much of the policy groundwork has already been completed by the European Supervisory Authorities (ESAs) and submitted to the Commission for approval. The focus of the ESAs is shifting now to supervisory aspects in cooperation with the NCAs.

Achieving convergent rules is crucial to ensuring a harmonised approach on the ground. The ESAs also have to prepare for their new oversight duties under DORA in relation to CTPPs, which will require advanced expertise, technology and new methods of operation. The implementation of the Markets in Crypto-Assets Regulation (MiCA), which is happening on the same timeline, also presents a challenge in ensuring convergent implementation and supervision across the EU.

4.2 Ensuring an appropriate balance between risk mitigation and supporting innovation

An industry representative pointed out that regulations can be too prescriptive. While it is important to set clear objectives, businesses should have flexibility in deciding how to achieve these goals. There is a lack of innovation and 'business sense' in some European digital regulations, where data is seen as something to protect rather than a driver of innovation. This contrasts with the data driven innovation cultures in Asia and the US.

The policy approach should also strike a better balance between customer protection and customer accountability, the industry speaker suggested. As digitalization accelerates, customers need to become more comfortable with digital tools and channels. The implications of this shift must be properly managed, and excessive consumer protection measures are not the solution. For instance, placing the bulk of the responsibility for fraud prevention on banks may not be sustainable. Instead, there should be a greater focus on educating customers about both the risks and opportunities of digitalised financial services, and their responsibilities in the digitalized financial value chain.

A Central Bank official emphasised the need to balance innovation and stability when setting new regulations. There is a disparity in AI development between Europe and other regions. Last year, 60% of global AI patents came from China, 20% from the US and only 2% from Europe. The EU's AI Act is highly prescriptive and compliance focused, which might contribute to producing a risk averse environment that stifles innovation and competitiveness. A more flexible approach would be preferable, involving greater supervisory dialogue and the use of regulatory sandboxes to test innovations in controlled settings.

A regulator stressed the importance of providing regulations that are adjustable and flexible to keep pace with the fast evolving market. The level 1 legislation should focus on key principles, but the technical standards should be adaptable to future market developments and technological innovations.

A public representative advocated for the use of experimental environments, such as regulatory sandboxes and enhanced supervisory cooperation, instead of relying solely on rigid regulatory frameworks. The experience with the DLT Pilot Regime has demonstrated that this approach enables regulators to work more closely with businesses, gain valuable expertise, collect data for informed policymaking, and foster a more adaptable supervisory environment. In this context, the inclusion of an EU-wide sandbox in the AI Act is a positive development.

Navigating AI and the cloud

1. AI and cloud trends and opportunities

1.1 The fast uptake of AI in finance

A regulator noted that the widespread adoption of cloud computing and artificial intelligence (AI) is leading to a growing reliance on data analysis in the financial services sector. This is evident across various financial activities such as credit scoring, financial advice, investment in securities, and risk analysis. These technologies are used by financial institutions to streamline and automate operational processes, thereby improving efficiency, and increasingly to support front office functions.

The regulator added that AI is no longer a source of hype but an integral part of daily life and business operations. AI is fast-evolving and many use cases are starting to appear. It is encouraging also that the potential of AI is starting to be recognised in society. Only three years ago, university students were prohibited from using generative AI (Gen AI) tools; now they are taught how to maximize the use of these tools. Firms and supervisors must deal with AI in a way that enhances competitiveness and efficiency while not creating harm. AI presents significant opportunities, as highlighted in the Draghi report, but there is still much to learn about managing and harnessing its potential.

An industry representative emphasised that the rapid adoption of AI in finance is unique. Firms are now using it on a daily basis. There was fear of an 'AI winter' after the initial hype, but there continues to be strong demand for taking advantage of ongoing AI developments.

Another industry speaker agreed that the pace of AI development has accelerated significantly. While some firms have been working on AI applications for more than two decades, the broader industry is also reaching a turning point. This shift is driven by the combination of secure, cost effective and scalable computing power, advanced algorithms and mathematical breakthroughs, allowing for results that seemed unimaginable just a few years ago. As the initial hype around AI begins to fade, attention is moving toward the practical implementation and real-world applications of AI tools likely to leverage the transformative potential of AI.

A public representative stressed that there needs to be a stronger emphasis on the practical implementation of AI systems in Europe, beyond the current focus on AI regulation and R&D to leverage AI's full potential in real world applications.

1.2 AI's transformative potential in finance and the wider economy

An industry speaker outlined four key benefits of AI and machine learning (ML) in the financial sector. First, AI is

significantly enhancing the fight against financial fraud. For instance, with AI tools a major payment industry company is able to detect three times more fraudulent transactions while reducing its false positive rate tenfold. Secondly, AI is accelerating analysis and decision making. Hedge funds are using AI solutions to analyse a wide variety of data from different domains to improve the quality and speed of decision making. Thirdly, insurance companies are using AI systems to aggregate different types of risk data, including geospatial, environmental, and financial risk data, to improve their risk assessments. Finally, AI is enhancing productivity and the personalisation of customer service.

Another industry representative stated AI is not the solution to a single problem; it is a technology that has the potential to bring value across organisations in a wide range of areas as diverse as cybersecurity, risk management, legal services and data rights management. AI tools can be used to drive internal efficiency and interoperability, improve customer service and interaction and enhance the quality of products by providing broader data context. For example, customer support can be enhanced by deploying AI-powered chat services, which ensure more consistent responses and better service quality.

A strategic and structured approach must therefore be taken to AI, starting with an identification of the specific problems that AI can solve for the markets and activities in which firms operate. These may include for example accessibility (AI can for instance solve language barriers); the ability to spot relationships and trends in data that traditional analytical methods miss (e.g. to detect anomalies or unusual patterns); and enhanced timelines (ensuring that the right people receive the right information at the right time).

A Central Bank official agreed that AI has transformative potential. The biggest impact might be outside the financial sector, but the sector will feel the effects. The use of AI could bring a wide range of tangible benefits and opportunities, such as better prediction of settlement failures in money markets and improved cyber defence to fight increasingly sophisticated cyber attacks, also using AI.

A public representative commented that the potential impact of AI on competitiveness must also be considered, beyond productivity and customer-related improvements. The Draghi report highlights that increased computational capacity provides a unique opportunity to lower the cost of products and services supported by AI. Europe has the necessary computing infrastructure to lead in AI, with three of the 10 largest supercomputers in the world and world class computing infrastructure in several member states. This could be a competitive advantage in the deployment of AI in the financial sector. In this regard, the European Commission's proposal to open up computing capacity to start ups, SMEs and the broader AI community is very welcome.

2. Challenges and risks related to AI implementation

2.1 Challenges in AI implementation

An industry speaker pointed out that the challenges tied to Gen AI must be tackled to avoid repeating the issues that arose with machine learning (ML) during its hype in 2017. ML models struggled to outperform traditional statistical models that had been refined over decades, leading to disappointment within the financial sector. To prevent similar outcomes with Gen AI, some key implementation challenges need to be addressed. These include concerns about data protection and the need for investment in educating people about the stochastic nature of Gen AI and how to mitigate its 'black box' risks. Moreover, Gen AI solutions should be designed to ensure explainability and to prevent misuse. Large institutions will also need to implement strong control mechanisms to manage potential risks, such as employees inadvertently sharing data outside the organization when using Gen AI systems in a private capacity. Despite these challenges, the potential of Gen AI is vast, and avoiding the technology is not an option. While there may be some eventual disappointment, this is a typical phase in any innovation cycle.

A public representative outlined six key challenges related to AI implementation. First, data security and data protection are crucial. Second, consumer trust is vital, which is linked to digital literacy. It is still difficult for most users and regulators to really understand AI and to distinguish between AI and ML systems. If citizens have insufficient digital skills, the AI strategies implemented by the industry and the regulatory efforts of the authorities will not be effective. Third, there is a need for transparency and accountability. Fourth is ensuring fairness and avoiding discriminatory patterns. Lastly, AI should supplement human expertise rather than replace it. AI is a tool, not a replacement for human experience.

2.2 Risks associated with AI use

A Central Bank official noted that the risks posed by AI can be divided into firm specific (microprudential) risks and broader systemic (macroprudential) risks. At a firm specific level, data bias and quality are key concerns, as they can lead to inaccurate or flawed outputs or 'hallucinations' if not properly managed. Other sources of firm specific risk include AI model explainability, governance, accountability and the increased reliance of financial institutions on critical third parties (CTPs) such as cloud providers. There are also major risks related to cyber attacks, market manipulation and collusion.

At a macroprudential level, there are four main areas of concern. First, there is interconnectedness risk, which occurs when multiple players are vulnerable to common

weaknesses in the same AI models. Secondly, there is incentive alignment risk, which occurs when one firm's actions encourage herding behaviour among other players, leading to increased risk exposure to common risks. Thirdly, there is 'outcome ignorance' risk, which happens when firms do not understand the broader impacts and interactions of AI driven decisions on the ecosystem, leading to unintended consequences such as correlated trading decisions. Lastly, there is 'rational exploitation' risk in which players seek to exploit imbalances in the financial sector such as arbitrage opportunities, which may potentially amplify risks or shocks across the system. These macro level risks cannot be understood simply by adding up the AI related risks of individual firms, but require a system or market-wide approach to risks.

A public representative added that AI has the potential to boost productivity and competitiveness significantly, but it will cause harm if insufficient efforts are made to develop the necessary skills to manage and understand it effectively.

3. Progress in the implementation of AI frameworks and principles

3.1 Implementation of the European AI Act

A regulator pointed out that several European regulations have been set out to govern the use of AI and govern the data that supports it: the AI Act, the Data Act, the Digital Operational Resilience Act (DORA) and the Financial Data Access (FiDA) proposal. The implementation of the AI Act, which takes a cross sectoral and risk based approach to AI use, is underway. By the end of 2024, unacceptable AI risk will be prohibited. By September 2025, codes of practice for Gen AI systems will need to be fully operational.

EIOPA is currently working on secondary legislation and guidance to implement the AI Act in the insurance sector, which will be ready for consultation in early 2025. There is also work underway on AI application guidance at the international level led by Basel. In the financial sector, the AI Act will mainly impact high risk AI systems¹. Lower risk AI systems will be covered by existing sectoral financial legislation such as Solvency II. This means that high risk systems used for life and health insurance will be covered by both the AI Act and Solvency II. The coordination of horizontal AI legislation with sector specific rules will require supervisors to produce guidance; concrete proposals on this subject are expected by early 2025.

A public representative welcomed the progress made under the AI Act and the Data Act. AI development needs to be secure, customer friendly and business friendly while fostering a robust data economy. The three main

1. Two types of AI systems are considered 'high risk' in the financial sector due to their potential impact on individuals' financial well-being and the integrity of financial markets: (i) AI systems intended to be used to evaluate the creditworthiness of natural persons or establish their credit score, with the exception of those AI systems used for the purpose of detecting financial fraud; (ii) AI systems intended to be used for risk assessment and pricing in relation to natural persons in the case of life and health insurance.

priorities for European legislation are: promoting innovation and growth through clear regulations; improving efficiency to lower costs for consumers; and, most importantly, protecting consumers.

An industry representative explained that their firm's framework of responsible AI principles is guided by the regulatory requirements as well as the firm's own internal policies and best practices. These layers were combined with principles for data management and model selection to create a framework which ensures that decisions made about AI systems and models are transparent and accountable.

3.2 AI regulatory approaches in other jurisdictions and international alignment

A Central Bank official explained that the Bank of England has been engaging closely with the industry to evaluate the UK's existing regulatory framework for AI. To facilitate collaboration and exchange of knowledge between public and private sectors, an AI Public-Private Forum was established. This forum focuses on assessing the benefits, risks, and use cases of AI within the financial services industry, as well as providing insights into regulatory needs. In addition to the forum, the Bank is considering the establishment of an AI consortium, which would bring together a broader range of industry participants and experts to conduct in-depth research, discuss emerging AI technologies, and contribute to the Bank's policy-making on AI deployment.

The UK regulatory toolkit has been deemed adequate for the current uses of AI, but the more important question is about whether it is sufficient for future applications. The current toolkit includes a critical third party (CTP) regime for systemic third party suppliers, tools such as stress tests to assess resilience to cyberattacks and a set of operational resilience requirements for banks, insurers and infrastructures including impact tolerances for outages.

An industry speaker observed that there is broad agreement across jurisdictions on the core principles to apply to AI systems in terms of fairness, transparency and human oversight and the need to develop AI safety institutions to ensure the application of safety standards before deployment.² However, jurisdictions are approaching the regulation of AI in quite different ways. In the UK, AI governance is managed under the Senior Managers and Certification Regime (SMCR), which is a framework for improving accountability and governance within financial institutions, whereas the EU AI Act bans certain applications of AI and imposes strict rules on high risk models. In the US, states have different approaches to AI principles. Colorado's regulatory framework provides a detailed definition of fairness, while California is still debating the question of accountability for AI malfunctions. There will eventually be alignment on the ban of unacceptable practices related to AI at the international level, but divergent approaches to permitted AI systems will create frictional costs for

international firms. These inconsistencies make compliance across multiple jurisdictions expensive and hinder innovation. Greater international alignment in AI regulations is needed to reduce these frictional costs and promote a more conducive environment for innovation.

4. Further questions and policy priorities for an effective implementation of AI

4.1 Possible need for more specific AI requirements

A Central Bank official stated that determining whether the current policy tools will be sufficient to address the future challenges posed by AI requires a deeper understanding of AI. The Bank of England is working with public and private sector partners to assess key channels of risk to financial stability so that any future decisions about AI policymaking are well informed, and it is contributing to discussions in international forums accordingly. Areas that are currently being assessed include: explainability issues; the systemic risks of outcome ignorance, herding, and rational arbitrage exploitation; and clarifying how the current CTP regime, which is geared towards a small group of systemic CTPs, will work for AI tools, which in many cases rely on smaller or niche CTPs. Important issues also include the implications for cyber risk of combining AI and quantum computing towards encryption code breaking; the potentially destabilising effects of deepfakes on financial markets; and accountability for AI-based decisions where the functioning of AI tools is not fully understood. Finally, authorities will have to consider whether the current technology agnostic approach to regulation can be sustained or whether AI specific rules will be needed in the future.

A regulator agreed that it is important to decide whether regulation can remain technology agnostic with the advent of AI. With the introduction of the EU's AI Act, there is a shift towards a more technology specific regulation, which is a trend that has also been seen in the international dialogue. There is also a new AI application paper, which includes rules on outsourcing and vendor models. It remains to be seen whether more specific regulations are required to address the complexities of AI systems used by financial institutions. It will also be important to determine whether financial entities using third party AI tools should simply treat them as outsourced services or be held accountable for understanding how their output is produced.

An industry speaker noted that current discussions about AI models and architecture treat AI use as a specific activity, but in reality, AI is supporting existing financial activities. AI must be integrated into existing frameworks rather than treated separately, which requires considering the interplay between existing rules and those applying

2. The establishment of the UK's AI Safety Institute (AISi) was one of the outcomes of the AI Safety Summit held at Bletchley Park in November 2023. The summit led to the signing of the Bletchley Declaration in which 28 countries, including the US and China, committed to international collaboration on AI safety. The AISi will act as a global hub for testing AI models and is intended to address safety concerns by evaluating AI systems before and after deployment.

to AI. There is a challenge around determining which AI driven tasks and use cases rely on traditional deterministic models and which ones should rely on newer data driven probabilistic models.

4.2 Responsible and risk based AI implementation

An industry speaker stated that the implementation of AI, like any new technology, is fundamentally a question of risk management and change management. AI must be used in an effective and safe way. Implementing 'responsible AI' should be the way forward, which means thinking about accuracy, fairness, security and privacy. Transparency will be key to this approach. This allows users to make informed and risk based decisions about which services to use. Traditional assurance models, such as those based on common criteria, cannot keep up with the rapid pace of AI model training because they involve analyzing a fully baked model at a given point in time, which may take up to a full year, when models evolve on a daily basis, as they are progressively trained. The companies developing AI systems also have a responsibility to customers and broader society. AI development should be aligned with international standards and AI assurance should be risk based and flexible rather than overly prescriptive. There are services that can mitigate the hallucinations and harmful content produced with AI. The goal is to make responsible AI easy to implement taking a risk-based approach.

Another industry representative emphasised the importance of adopting a risk based approach to AI use in the financial industry. Trust in AI systems must be ensured, particularly regarding the quality and source of data. The data and information that AI systems process and produce must be appropriately validated when

systems are being designed. AI systems must be designed to provide reliable outputs. The core principles put forward in regulatory frameworks such as DORA can help to ensure that there is sufficient data integrity and governance.

A public representative suggested two areas for further regulatory work. A clearer definition of customer control is needed to ensure that consumers understand how their data is used and analysed by AI. Secondly, the introduction of consent and opt out mechanisms will allow customers to make informed decisions about the use of their data. These measures are crucial for building consumer trust. A regulator agreed on the importance of ensuring that AI systems are fair and non discriminatory and that there are checks on data quality.

4.3 Maintaining critical skills and human oversight in AI

An industry representative highlighted the need to cultivate critical thinking skills alongside the use of AI. People working in the industry will not understand how the fundamental tools and processes work if they are not trained on them and do not have experience of using them manually. This level of knowledge and skills must be maintained to allow users and supervisors to understand when AI outputs are accurate or misleading and how the output is being produced.

A regulator agreed that there is a risk of losing knowledge and skills if people rely too heavily on AI tools. There is also a need to ensure that both the EU economy and citizens benefit from AI.

Unleashing data driven innovation

1. Trends and opportunities

1.1 Key trends related to data and technology use in the financial sector

An industry speaker remarked that data is considered as the 'new oil', but unlike oil, it will never run out. Data innovation is fundamentally intertwined with technological advancements. Open banking, which came before open finance, initiated the first wave of data-driven innovation in the financial sector by standardizing APIs. The widespread penetration of traditional AI, including machine learning (ML), has driven data-led innovation further with the creation of applications to manage and analyse structured and unstructured data for example in the areas of trade finance and insurance claims management. Generative AI (Gen AI) is now changing the landscape. Gen AI applies a right brain perspective to the left brain of traditional AI. It introduces context, correlation, creation and summarisation. This combination of traditional AI and Gen AI facilitates the creation of new applications that derive even more value from data. In fields like anti-money laundering (AML) and know your customer (KYC), multiple institutions can pool data to build foundational models for detecting anomalies and combating fraud. Furthermore, this technology can help develop new services that allow users to interact seamlessly using natural language. The most exciting developments are yet to come, with cross-industry data models being developed, enabling shared insights between sectors like financial services and retail distribution without the need to share actual data.

The progressive mainstream adoption of scalable AI and cloud services is facilitating a democratisation of technology due to transform the landscape further, with AI integration in personal devices and applications becoming widespread. The evolution of AI models encompasses both global large language models for enterprise applications—where privacy is a key consideration—and specialised local models tailored to specific industries. Innovations in augmented reality and hyper-personalisation are leading to disruptive scenarios like virtual relationship managers and augmented contact centres.

Beyond AI, several other technological advancements are driving the digital transformation of financial services, the industry speaker added, influencing areas like security, identity management, computing power, data analytics, and innovation. Blockchain is improving identity management, transaction security, distributed responsibilities, and digital asset management. The Internet of Things (IoT) plays a role in real-time risk management and sustainability initiatives. Quantum computing promises a paradigm shift, offering exponentially increased computational power through cloud services. Together, these trends aim to accelerate business value for financial institutions by enhancing customer experiences through personalisation and real-time insights, improving risk management with predictive analytics and fraud detection, increasing operational

efficiency via automation, and fostering new business models through open finance initiatives that encourage collaboration between traditional banks and fintech companies.

A regulator agreed that data is the 'lifblood' of financial markets. This is evident in the value investors place on data as a key asset in driving profitability and growth.

A public representative added that data is now central to all industries, including financial services. Leveraging data is a key objective in the development of open finance frameworks in particular, such as the European Commission's Financial Data Access (FiDA) proposal.

1.2 Opportunities of AI in the financial sector

An industry speaker emphasised the significant opportunities presented by data and AI in the financial sector. Banks have vast amounts of data and have been utilising AI for many years with their own data, particularly in areas such as fraud detection, obtaining good results. Integrating financial data with external sources from various sectors, such as ESG, behavioural, personal, and geographical data, will yield even more valuable insights, support decision-making and help to maximise the potential of AI, provided the data is of high quality. For example, AI can help advisors to better understand the needs and behaviours of their clients, allowing them to provide more personalised service. The use of external data will become even more crucial in the future, as banks are increasingly required to ensure that their financing aligns with ESG goals and customers' investment objectives.

A second industry speaker explained that the use of internal and external data in AI systems helps to deliver value in three main ways: first, by driving operational efficiency through intelligent operations, risk scoring and risk management, providing short term benefits; secondly, by driving business and revenue transformation notably via personalisation and the creation of new services, providing benefits in the short to medium term; and, thirdly, by enabling new business models to be created through new developments in marketplaces, aggregation and white label offerings, providing medium to long term benefits.

A third industry representative noted that AI and the leveraging of data are core strategic priorities for banks, as demonstrated by the increasing number of chief data and analytics officers appointed at the highest organisational levels. The question is not whether data and AI create opportunities, but how best to capitalise on them. There are immediate opportunities from AI driven solutions in the optimising of operations and risk management to address financial risks and also operational and compliance risks. The next step will be to leverage AI to transform the way banks interact with customers. While digital banking has increased convenience and accessibility, allowing customers to transact 24/7, it has also reduced proximity and the 'personal touch', with

customers often feeling underserved. Banks also risk losing a deeper understanding of their customers. AI could help banks regain the broader understanding of their customers by combining their internal structured data with data from other institutions and all the information gathered during customer interactions. There is a huge opportunity to make the customer experience truly personalised, which would be a game changer for the banking industry.

A regulator added that supervisors are also using AI. The FCA is using natural language processing to assist with the management of serious cases and machine learning for predictive financial data analysis in consumer finance for example.

1.3 Opportunities associated with open finance

An industry representative noted that there is support for increased data sharing in the financial sector, which is the purpose of FiDA. This should bring greater competition and ultimately benefit consumers. Banks have handled internal data for a long time, but there is now a growing volume of external data in areas such as sustainability, which can enrich financial models and decision making processes. Because financial institutions often do not have a complete view of their customers who tend to have several bank accounts, data sharing is becoming an essential tool for banks to gain deeper insights and better serve customers.

However, an ambitious cross-sectoral framework for data sharing is lacking and represents a missed opportunity, according to the industry speaker. Indeed, sectoral regulations such as the Payment Services Directive (PSD2) or FIDA only impose data sharing obligations on financial sector players and allow non-financial third parties to access such data without imposing similar obligations on their own customer data, creating an asymmetric situation.

A public representative stated that financial service firms have different expectations from open finance. Some firms will try to leverage shared data from other sectors, such as energy and automotive, to drive innovation further, while others will focus on the financial sector. The EU has adopted a strategy of establishing sector specific data spaces; these data spaces need to be interconnected to drive broader innovation. Open finance will also enable financial institutions to share data amongst themselves, which will lead to better data access and data quality, which in turn will drive innovation.

The public representative also highlighted the synergies between open finance and AI. Open finance will help generate the data necessary for the development of AI models, which in turn can support the creation of open finance services. It is hoped that the regulatory framework and also the way it is implemented will support the effective use of data in both cases without hindering innovation.

A regulator stated that the use cases of data sharing under FiDA need to be further assessed. For example, while it was hoped that FiDA could enable the creation of pension dashboards, it seems unlikely that this will be possible with the data that is available and can be shared under FiDA. EIOPA also developed a use case for an insurance comparison tool, but it remains to be seen whether there

is a business case for it. Data sharing can also be used to make targeted offers, such as offering pet insurance to customers who buy dog food, but it is not clear whether this will actually benefit consumers or make them feel that they are being watched.

2. Challenges posed by data sharing and AI use and implementation conditions

2.1 Customer related challenges and risks

A public representative noted that it is necessary to balance the opportunities created by the enhanced use of data with the potential risks. The risks need to be adequately mitigated and sufficient safeguards need to be put in place.

A regulator commented that the impact of the PSD2, which aims to improve data access and sharing, has been limited so far, largely due to trust issues. Currently, data sharing happens regularly online, but consumers do not have enough control. It is important to ensure that data sharing does not undermine consumer trust, otherwise, the goals of data-driven innovation will not be achieved. Given the risks of data sharing, it is important to define what data can be shared by financial institutions and how it can be shared with customer consent. The logic of FiDA is that a company can share data that a consumer would have shared if asked, which excludes data that has been enriched by the financial service provider. The European Supervisory Authorities (ESAs) are to determine what type of data is raw and can be shared with customer consent, and what type of data is generated by internal processes and should remain private. One issue relates to data used in conjunction with AI, and the extent to which it can be shared.

Consumers' consent should be well-informed and voluntary, stressed the regulator. Those who choose not to share data should not have to pay a higher price or be excluded from essential services, such as insurance. The function of insurance is to enable society to share risks collectively. Overly individualised risk assessments enabled by AI and data sharing could undermine this model. It will be important to strike the right balance between data granularity and consumer protection. One of the key benefits of FiDA is its potential to give consumers greater control over their data, through the mandatory provision of dashboard tools that can enable individuals to manage their consent to data sharing.

A second regulator observed that it will be hard to police whether consumers who do not share their data pay a higher price for insurance. Hyper personalised products will be developed across the financial sector and insurers will argue that the data allows them to price more accurately. Regulators will need to consider when to intervene and whether politicians should deal with such societal issues.

An industry speaker agreed that maintaining customer trust in the use of data is paramount, adding that European consumers' data must be used in a way that benefits them,

with data sovereignty principles and appropriate controls reflected in the regulations, if needed.

An official stressed that this is not just a question of regulation and supervision. Consumers should be able to use technology to protect themselves. For example, AI can already be used to check the terms of reference of products. It would be positive if consumer protection organisations developed AI tools that would allow customers to check contracts using a smartphone. For this to happen, it will be necessary to make data available and accessible. If consumers were given easier access to data held by traditional financial institutions, they could also gain a better overview of their financial situation and better identify financial opportunities and challenges.

2.2 Challenges for regulators and supervisors

A regulator remarked that financial regulators are gradually turning into data regulators. This evolution means a top to bottom change in operations, systems, skills, capability and culture. One of the key challenges for regulators is the range and pace of technological development across a variety of technologies such as DLT, AI, cloud computing, quantum computing, etc. Regulators have difficult choices to make about how to build their supervisory capacity and appropriately allocate resources and how to regulate areas that even the industry does not fully understand. It is important to be humble, open to experimentation and ready to test different approaches. This also requires a shift in the way that regulators are held accountable in the external political debate.

There is also a risk around regulatory silos, the regulator stressed. The UK has created the Digital Regulation Cooperation Forum bringing together the UK regulators of different sectors to ensure a coordinated interaction with large tech players and address common issues concerning citizens in a consistent way. It is also important to note that data sharing is even more difficult in the context of law enforcement due to the sensitivity of the data being shared. Public sector entities often underestimate the level of investment required to secure their perimeters and make full use of the available data. Finally, it is worth remembering that cultural issues can influence the approach of regulators. For example, the approach to dynamic pricing is totally different in the US and in the UK. Each country has different societal expectations that should be considered when implementing new technologies.

2.3 Conditions for the effective implementation of AI and open finance systems

An industry speaker outlined four key priorities for successfully implementing AI systems. The first priority is aligning execution with a clear strategy that integrates AI and is consistent with the institution's goals, focusing on practical application rather than mere experimentation. Financial institutions must go beyond proof of concepts (PoCs) and aim to develop scalable minimum viable products (MVPs) in collaboration with tech companies to move faster.

The second priority is leveraging high-quality data, as effective AI depends on well-structured, ingested, and

cleaned data. Organising the data estate within financial institutions is essential for deriving actionable insights. Advancements in technology, such as cloud computing and Gen AI, can help to achieve this at scale in a reasonable timeframe and also create real-time, auditable algorithms that run on the data that has been structured.

The third priority is change management, which involves acquiring specialized talent, such as data scientists and data architects, and fostering collaboration across departments. Breaking down internal silos within firms is crucial for facilitating innovation through better data sharing.

The final priority for leveraging the opportunities from AI is working on ethics, governance, and regulatory compliance, the industry speaker added. Financial institutions should proactively develop responsible AI frameworks to navigate ethical dilemmas in the use of AI and data, before regulatory intervention is required. Adopting a proactive stance towards regulation, rather than just complying at minimum and ticking boxes, will allow firms to move faster and more confidently, seizing the opportunities that AI and digital transformation offer.

The Chair observed that data helps improve knowledge and support decisions, but without control and governance, data is either useless or dangerous. To support data led innovation, there must be proper governance and an objective decision making process. In the end, the board and the directors of a company remain accountable to customers and shareholders.

3. Regulatory and supervisory priorities

3.1 Ensuring an effective implementation of EU digital regulatory frameworks

A public representative emphasised that the implementation of the existing digital regulations should be the main priority. The frameworks that have been adopted, such as the AI Act, now need to be tested in practice to identify potential loopholes and gaps. Work also needs to continue on the FiDA proposal. It is also critical for the public authorities to continue to develop their expertise to ensure an effective implementation of these regulations, given the complex supervisory mandates introduced by recent regulations. Regulators must invest in state-of-the-art technology and expertise in order to oversee the sector effectively and stay up to date with industry developments. Efforts must also be made to reduce the regulatory burden related to reporting in particular.

A regulator pointed out that questions remain regarding the regulation of high risk AI systems. In the insurance sector, these systems will be regulated by the AI Act and Solvency II, while other systems will fall under Solvency II. The dual regulation of high-risk systems needs to be streamlined into a single set of rules to avoid conflicts and inefficiencies. Requirements should also be aligned at the global level by working with international standard setters.

An industry representative highlighted the cost and complexity of implementing FiDA for the financial industry. It will require significant investment to bring together players from different parts of the industry to create the infrastructure to share data and implement open finance. Implementation should be gradual, using a market-based approach, based on strong evidence of demand for specific data sets before any commitment is made, otherwise investment could be partly lost.

Another industry speaker remarked that policy makers and regulators should conduct thorough impact assessments before digital regulations are implemented to ensure an effective implementation. There should also be a phased and pragmatic implementation of requirements to ensure that the regulations support adequate innovation.

3.2 Preserving the capacity of the EU financial services sector to innovate

An industry speaker stressed the importance of fostering innovation within the EU. Regulations should not impede companies' ability to innovate. While stringent regulations on AI and data are understandable, there is a clear trade off: the stricter the regulations, the less room to innovate. It is crucial to be mindful of the constraints imposed by regulation and the combined effect of multiple regulations. There is a real risk that Europe could face 'gridlock' in the digitalisation of its financial system due to the overwhelming number of regulations.

Market concentration among non European digital players and data localisation issues are also key challenges to consider when implementing open finance and AI solutions, the industry speaker added. Europe could become a marginal player in certain sectors, if the true holders of data and value are concentrated outside the region. A regulator agreed that there is concentration risk in the AI sector and risk in data localisation, given the small number of major AI actors.

A public representative argued that the classification of some AI applications as high risk under the AI Act is questionable. It is uncertain whether this will truly protect consumers, and it may unintentionally obstruct innovation. It is important that regulators and financial institutions work together, through sandboxing and other initiatives, to assess potential risks and implement requirements in a way that does not hinder the provision of advanced AI models in Europe. In the next phase of regulatory work, EU regulators should explore the possibility of moving towards more principles-based regulation, which will allow for more flexibility and creativity in industry practice.

A second industry representative added that clear rules are needed to support innovation. The potential overlaps in the regulatory framework for high-risk use cases need to be clarified, because without clear rules, the implementation of the AI Act could be delayed and Europe risks falling further behind China and the US. This is also important for Gen AI and large language models. The introduction of some large language models in Europe has been delayed for regulatory reasons. Given the pace of progress in Gen AI, even a delay of 6 or 12 months would represent a significant opportunity cost for European financial institutions.

3.3 The need for public private and international collaboration

Several panellists emphasised the importance of collaboration between the public and private sectors to support innovation.

A regulator observed that with the ubiquitous use of data, collaboration among regulators and between regulators and industry is becoming increasingly important. The FCA launched sandboxes and innovation hubs several years ago. Subsequently, the Global Financial Innovation Network (GFIN) was launched, bringing together approximately 90 regulators worldwide to share insights on innovation services and the use of new technologies for regulation. This kind of mutual interaction enables regulators to learn from the operational experience of other regulators and facilitates decisions when deploying new solutions.

Another regulator noted that the EU Digital Finance Platform, a collaborative space bringing together innovative financial firms and national supervisors to support innovation in the EU's financial system is operational. In this sandbox, EU companies can work with supervisors on a cross sectoral and cross border basis within the EU and cooperation mechanisms are in place between the ESAs. However the uptake is slow. This shows that what is needed now is to put technologies in place in practice rather than fine-tuning the rules and experimenting.

An official commented that cross border data sharing and processing issues have long been intertwined with trade and are embedded in the World Trade Organization (WTO) agreements, which means they should be reviewed taking trade policy into account. The UK Singapore Free Trade Agreement for example has three pages on financial services, all of which concern digital finance. In terms of regulation, Europe should update existing frameworks to adapt them to the use of AI and other new technologies and defend its approach to the regulation of digital activities in global trade agreements and digital cooperation agreements, otherwise it will end up being isolated. In the area of trade finance for example the United Nations Commission on International Trade Law (UNCITRAL) recently set out a model law on automated contracting. The UNCITRAL Commission has reviewed existing trade rules and proposed modifications related to automatic and AI contracting, which are important to consider.

The Chair commented that the transformation of the value chain with technology means that the current regulatory and supervisory perimeters might no longer be fit for purpose. Risks need to be tackled irrespective of where they arise in the value chain. A greater degree of collaboration among supervisors and with the industry is needed to achieve this. There must also be an integrated assessment of the risks, which can potentially arise outside traditional financial intermediaries or due to the interaction between different players.

Cybersecurity and digital operational resilience

1. DORA implementation progress

1.1 Overall progress made with the implementation of DORA and next steps

The Chair explained that the Digital Operational Resilience Act (DORA) aims to enhance digital operational resilience in the financial sector. It takes an ecosystem approach extending to ICT third party providers and covers a number of interlocking facets, such as risk management by financial entities, third party risk management and outsourcing, incident reporting, threat led penetration testing and the new oversight framework for critical third party providers (CTPPs). The Level 2 regulatory technical standards (RTS) are being completed. The first set of RTS was adopted by the Commission earlier in the year, and the second set is due to be adopted in the near future. Proportionality is embedded throughout the regulation. The main focus is now on implementation, given the planned start date of 17 January 2025.

A regulator stressed the need for industry players to begin preparing for the implementation of the DORA RTS, even though they are not yet fully adopted, as significant changes to them are unlikely. The first priority is to establish the information registers mandated under DORA, which are designed to ensure transparency, accountability, and facilitate oversight in the management of ICT risks within the financial sector. Once these registers are in place, they will allow for better mapping of potential contagion channels and provide a clearer understanding of how incidents involving different levels of third-party providers might impact financial entities. The second key priority for financial institutions is reviewing their contracts with ICT providers against DORA requirements. This requires developing a comprehensive plan to establish new, balanced relationships with their third-party providers. This will be a significant effort, as many existing relationships with third parties have been in place for years.

A dry run exercise was conducted during the summer to help financial institutions and regulators evaluate their readiness to implement DORA. On a voluntary and best efforts basis, 1,000 financial entities from 20 member states took part in the exercise, supported by the national competent authorities (NCAs). The preliminary results show that only 2% of entities achieved fully adequate results. Around 50% did not demonstrate an appropriate level of readiness. It is clear that further work is needed to prepare the implementation of DORA. The feedback documents of this exercise will set out the best practices and areas of improvement that were identified, together with further guidance for market participants.

An official noted that the UK has also made good progress on tackling cyber and digital operational risks, which are

considered as one of the top risks facing financial firms. The UK's operational resilience, outsourcing and third party risk management policies are due to be implemented by March 2025. Critical third party (CTP) oversight is another regulatory priority that is being addressed. These frameworks will address a broad range of risks, including new developments such as artificial intelligence (AI) and quantum computing.

1.2 Preparation of the implementation of the CTPP oversight framework

A regulator explained that the new CTPP oversight framework is an important and innovative part of DORA. A common structure will be created by the three European Supervisory Authorities (ESAs) to conduct the oversight of CTPPs and ensure their operational resilience in a consistent way across the different financial sectors. Each CTPP will have a lead supervisor, but the aim is to create consistency in the regulatory interactions with CTPPs, using the same oversight methodologies, risk assessments and tools and reporting systems. In addition, resources with adequate IT skills must be available to conduct the oversight. The ESAs have been recruiting additional staff, but two thirds of the resources will come from the NCAs.

An industry speaker explained that their firm, anticipating designation as a Critical Third-Party Provider (CTPP), established a cross-functional working group in 2022 to proactively prepare for DORA compliance and to assist customers in navigating the upcoming requirements. Cybersecurity and operational resilience are long-standing areas of focus, but it had to be ensured that internal processes for testing and resilience meet the requirements of DORA and that these requirements are embedded in internal controls and governance. Contractual agreements with customers also have to be reassessed. The structured two way dialogue that is due to be implemented between the authorities and the industry should help improve risk management and resilience further across the financial sector. In addition to the DORA implementation, there is also an ongoing discussion on the EU's voluntary cybersecurity certification scheme. ENISA's recent updates are welcome, particularly the introduction of a three-tier certification system and the removal of some sovereignty-related requirements. These changes are expected to encourage broader adoption of the scheme across Europe.

An official stated that the Bank of England, the Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) are developing a UK regime for critical third parties (CTPs), which will be similar but not identical to DORA. Due to the timing of the recent UK election, the regime will be finalised later in 2024. During the consultation process, the industry supported the objective of enhancing the resilience of the financial sector and

provided positive feedback on the proposed regime, but there were also comments on the challenging granularity of the regime.

1.3 Expected changes with DORA

An industry representative considered that DORA is a significant step forward in managing ICT risks, although it is not certain that it would prevent complex failures such as the CrowdStrike global outage in 2024, which disrupted interconnected systems worldwide. There is a need for preventative actions and a proactive approach, such as the enhanced testing and reporting obligations and CTPP oversight introduced by DORA.

The true effectiveness of DORA will however depend on its real-world application and enforcement. The impact of improved testing and reporting systems will need to be monitored over time, with a focus on how reporting can provide data that can help stop attacks, especially since current testing is performed at set intervals rather than in real time. Additionally, proportionality is key: while DORA's impact on financial institutions of different sizes is often discussed, its effects on technology companies of varying sizes must also be considered. It is hoped that the issues that smaller tech companies experienced with GDPR will not be repeated now we have the hindsight of that experience. This aspect requires further attention within DORA's framework.

A regulator commented that a situation as complex as CrowdStrike might be difficult to avoid completely, but the registers of information in DORA will help alleviate contagion risk.

A second industry speaker emphasised that the focus on testing, reporting and preventative measures is essential in light of the changing nature of cyberattacks and the increasing reliance on third parties. DORA does not introduce anything fundamentally new, but it will create a significant shift across the whole industry. Financial institutions will have to undertake more systematic third party risk management, involving more regular and real time reporting, monitoring and testing.

2. Challenges raised by the implementation of DORA

The Chair highlighted a number of challenges to overcome in the implementation of DORA. The first challenge is DORA's ecosystem approach. There will need to be rigour to get the whole ecosystem moving and ensure there is real improvement across the industry. Second, the supervisory community will need to maintain momentum to ensure that DORA is implemented in a timely manner. Firms in the ecosystem are currently at different levels of maturity in terms of cyber resilience, but they all need to move forward together to achieve a consistent level of high-quality implementation. Finally, addressing resource scarcity is a key priority in the implementation of DORA.

An industry speaker agreed that making a significant change to the entire ecosystem, which includes a great variety of players of different sizes, is challenging. Some

market participants do not have sufficient resources to make the required changes. Secondly, the adoption of new technology and change processes necessary to implement DORA will be a step change for many institutions. It will require additional resources, technical expertise and the buy in from senior management. Although all players need to progress, the nature and timescale of the evolution required might vary according to the size of the player.

A regulator considered that the main challenges to be addressed by supervisors in the implementation of DORA relate to the CTPP supervisory regime. The first challenge is capacity building. At NCAs, resources with supervisory experience will need to be redeployed and trained to conduct CTPP oversight. Secondly, the ESAs and NCAs must coordinate their actions to avoid duplication or contradiction, including with other authorities such as the ECB and ENISA. Finally, there must be greater mutual learning between authorities and third party providers to ensure that CTPPs understand what is expected from them and that authorities can implement oversight appropriately within the planned timeframe of 2025. Further policy developments are not needed in this area for the time being. The priority is to implement DORA and the other digital regulations that have been adopted. Some refinement of DORA's interactions with the existing regulations on ICT risk and operational resilience might be needed however, such as eliminating any duplication.

An official highlighted that establishing a common understanding of how the oversight regime for CTPPs will function is essential. That will represent a significant change in terms of culture, because the institutions concerned are unaccustomed to being regulated by financial services authorities.

A second industry representative noted that the implementation of DORA will require financial entities to review the existing contracts that they have with IT third party providers. Some financial institutions do not feel like they have enough power to renegotiate the right service level agreements (SLAs) with large tech companies. In this regard, proportionality is also important.

A third industry speaker agreed that the scarcity of resources with cybersecurity skills is a key challenge. A further aspect to be considered, as stated in the Draghi report, is that Europe needs to find a middle way between promoting its domestic cloud industry and ensuring that European financial entities can access the right technology to ensure the security and resilience of the EU financial sector.

3. Tackling system wide cyber risks

An official emphasised that the systemic dimension of cyber-risks must be considered, beyond the operational resilience of individual firms. As the financial sector is one of the most protected, significant cyber-risks have not yet materialised, but disruptions to other vital activities, such as hospitals, caused by cyber-attacks show the importance of preventing these risks. Concentration risk is particularly challenging in the financial sector because financial institutions often

operate homogeneously to reduce costs and use similar tools. Regulators also seek a common framework for efficiency reasons. But this uniformity increases vulnerability to cyber-attacks. Introducing some controlled inefficiencies or duplication could actually help mitigate cyber risks. The Chair remarked that the establishment of registers of information under DORA will facilitate the identification and tackling of concentration nodes.

The official also identified three changes that need to be considered by regulators in the fight against systemic cyber risks. The first is a cultural change, as traditional prudential regulation is not sufficient to address these risks, and new approaches are needed that take into account technology choices and data protection. Second, these risks need to be addressed on a system-wide basis from the outset, rather than focusing initially on individual financial institutions. Finally, the credible risk that central banks could also be targeted by cyber-attacks needs to be taken into account in the development of cyber resilience strategies.

The pan-European Systemic Cyber Incident Coordination Framework (EU-SCICF) was developed in collaboration with the Bank of England and the ESAs to mitigate the risk of a coordination failure during cyber incidents. This mechanism aims to improve the preparedness of authorities and ensure a consistent response to major cyber threats by facilitating the collection and sharing of information between authorities, allowing for better assessment and coordinated responses. The EU-SCICF is well integrated into DORA through Article 49, which establishes a coordination mechanism between supervisory authorities.

Another official stated that the priority for the UK, which is consistent with the objectives of the EU-SCICF, is to ensure that effective arrangements are in place to handle crisis situations. This means that all stakeholders need to be aware of their roles and effectively coordinated during an operational resilience incident. Cooperation during cross border incidents is critical to remediating them properly. In general, supervisors are used to thinking about risk from a micro prudential perspective and making sure that individual firms are operationally and financially resilient. With digital operational resilience comes the need to think about risk at a system wide and macro prudential level, however, which requires a better understanding of data and the interlinkages within the system. There is work underway on this subject at the Bank of England and the European Systemic Risk Board (ESRB), but this is a significant change in the mindset of the supervisory authorities. Further exploratory work is required before deciding on the policy tools, which could include the creation of additional redundancy in the system.

An industry representative stated that one key question with regard to financial stability is whether some tech companies have become 'too big to fail', for example if they operate a piece of infrastructure that poses a systemic risk. CrowdStrike is an example of the impact that a tech provider can have in the financial market and beyond. The testing performed before the roll out of the technology was clearly insufficient, but there is still a

lack of clarity on whether it is the responsibility of financial institutions to ensure that tech companies have properly tested their technologies or whether the relevant regulator should ensure that the tech company has performed adequate testing before deploying its software.

4. Further issues to consider

4.1 Cooperation at the EU and international levels

An official explained that operational resilience issues are cross border by nature and financial entities are exposed to cyber risk originating in other jurisdictions, which emphasises the need for coordination between authorities at international level. All authorities need to work together to fight cyber risk, and this approach already exists for other forms of prudential regulation. The UK authorities have bilateral arrangements with a number of authorities, participate in global colleges and also engage with international standard setting bodies and groups like the G7 Cyber Expert Group. The Chair agreed that these ecosystems are not restricted by national boundaries. While much work has been done by the FSB and other international organisations, there is much more to do on cross border cooperation.

An industry speaker highlighted the need for harmonisation and a shared vision across all authorities in the EU. It is positive that the three ESAs have formed a common structure for implementing DORA, but all European financial supervisors need to have the same understanding of the texts to ensure that the detailed guidance does not create confusion or contradict the Level 1 regulation. The 27 national transpositions of the Network and Information Security Directive (NIS2) also need to be aligned with DORA, and DORA itself needs to be aligned with other global third party frameworks, such as the UK's CTP regime. There might be a steep learning curve in the short term, but consistency should be attainable over time.

Another industry representative emphasised the importance of knowledge transfer, especially from technology companies to regulators and the IT departments of financial firms. This needs to be done properly to ensure the right skills are in place. There needs to be a more collaborative approach than is typically seen in regulation and a more transparent approach with more information sharing. These culture shifts will be a prerequisite for success.

4.2 Supply chain risks

The Chair noted that one of the aspects being discussed as the draft regulations are being finalised is how to capture the interface between financial firms and their wider supply chains and how to strike the right balance of responsibilities along the supply chain in a pragmatic and proportionate way.

An industry speaker remarked that the evolving nature of supply chains has increased the scope for attacks and is a key driver of cyber risk. This can be mitigated by using real time monitoring tools and ensuring that all players along the value chain use common frameworks in a

consistent way. In this regard, it is essential to be proactive and use predictive threat analysis. With increasing interconnection, cyber risk propagates along the value chain both downstream and upstream. Continuous monitoring and reporting is needed to fight these evolving cyber risks.

4.3 The role of AI

An industry representative stated that the huge amount of data that has to be collected and analysed to fight cyber risk requires the power of AI. Cyber-attackers are already leveraging AI technology to identify vulnerable

targets in the financial services sector and design attacks. The financial ecosystem needs to use the same tools. AI is a tool that can help stress test and model different response scenarios for the whole ecosystem, which is much more complex than for an individual entity.

Another industry speaker agreed that the impact of AI needs to be assessed in terms of how it is changing the threat landscape and how it can support cyber-security teams. While AI will not replace security teams, it will help to bridge the resource gap and support their actions.

Crypto perspectives and regulatory outlook

1. The need for regulation of the crypto sector

An industry representative stated that regulatory clarity will drive investment, growth, consumer protection and healthy competition in the crypto market. EU's leadership with the MiCA (Markets in Crypto-Assets) regulation is a significant step toward this clarity at the European and global level. It is particularly welcome for centralised crypto exchanges.

A second industry representative also expressed support for regulating the crypto sector and endorsed the approach taken with MiCA. Compliance with regulation must be embedded in market players' approaches. MiCA is probably the most comprehensive and thoughtful framework available globally at present and has served as a blueprint for much of the work of international standard setters. While crypto regulation in the US remains uncertain, MiCA provides regulatory clarity that will drive investor trust and is likely to further expand the European crypto market and economy.

An official explained that Polish consumers are open to crypto and new technologies more generally, with up to 3 million citizens investing in cryptoassets. It is therefore crucial to regulate the crypto market. The decision to regulate stablecoins is also relevant, due to their role as a natural connection between crypto markets, traditional financial institutions and retail customers. However, there is concern about the rise of fraudulent activities, with data showing that 20% of Polish crypto investors have fallen victim to some form of fraud. It is important to achieve the implementation of the MiCA framework by the end of 2024 to protect consumers and legitimate market participants whose reputation may be undermined by fraudulent companies.

An industry representative suggested that the implementation of MiCA will help 'clean up' the crypto ecosystem, with some member states expected to revoke the licenses of certain cryptoasset service providers (CASPs). This will help to promote better practices and foster a more level playing field between the crypto sector and the wider financial industry. Although full alignment of requirements between the crypto space and traditional finance has not yet been reached, progress is being made.

2. MiCA implementation

2.1 Progress on the implementation of MiCA

A regulator emphasised that the implementation of MiCA is the primary focus for the regulatory community

in the crypto space in the short term and good progress is being made. Regulators and market participants are still on a learning curve given the rapidly changing nature of the crypto sector.

ESMA has been making steady progress in delivering the required regulatory mandates through three consultation rounds. The first package of guidelines, which was completed in March 2024, focused on the authorisation of CASPs in a context in which some CASPs are already filing for authorisation with certain national competent authorities (NCAs). The second package finalised in July covered record keeping, transparency, standardised information, including white papers. The third package, now being finalized, tackles key issues such as reverse solicitation and the scope of MiCA, focusing on the distinction between cryptoassets and MiFID financial instruments to ensure legal clarity in their classification. A case-by-case assessment is needed given the evolving definition of financial instruments under MiFID.

2.2 Convergence challenges across member states and between crypto and traditional financial market rules

A regulator noted that the implementation of MiCA remains uneven across Europe, with about half of the member states yet to designate the NCAs responsible for its rollout, while some NCAs have already begun handling authorization filings. Further clarity on this issue is expected by October. For example, in Italy, where the final legislation was passed in August, CONSOB was not initially responsible for cryptoassets. The transfer of responsibilities from one authority to another has led to delays and required communication with the market.

ESMA is working to ensure a coordinated and convergent implementation of MiCA in order to avoid inconsistencies and ensure a level playing field across member states. The first objective is to establish a unified approach to authorisations through supervisory briefings and collaborative discussions among supervisors.

ESMA has been providing clarifications to the NCAs and the market about the scope of MiCA and possible circumvention risks. The opinion published in July regarding certain business models also offered guidance on what should be authorised at the European level and which activities may potentially be conducted outside the EU by third-country broker dealers.

An industry representative welcomed the efforts being made to implement MiCA in a consistent way with convergent supervision, which is essential to ensure a level playing field across the EU. The different grandfathering periods granted for CASPs already

authorised under national law¹ could however lead to confusion in the short term, particularly around whether firms are acting under reverse solicitation rules or are fully licensed.

A second industry representative was also concerned that the transition of registrations over the next 12 to 18 months could lead to divergence in the timing of application of MiCA across member states. This may be challenging, particularly in a competitive market where consolidation is naturally taking place due to market forces. When the transitioning provisions of MiCA end, platforms will need to transition existing digital asset portfolios into the new framework in a way that preserves market integrity and avoids disruption. Large platforms that service more than 250 different assets will find this transition challenging.

A third industry representative commented that, in addition to convergence among European countries in the MiCA implementation, there is a need for a level playing field between traditional financial activities and blockchain-based activities, with an alignment of regulations. This is a shared concern between the industry and regulators. Blockchain offers advantages such as transparency, immutability and instantaneity, but implementing traditional financial processes in the blockchain environment is challenging. For instance, the travel rule, which must be implemented by the end of 2024, is not natively supported by most blockchain solutions, requiring external mechanisms to ensure compliance, which adds complexity. At present, two parallel visions coexist: traditional finance, with its established rules and compliance structures, and the emerging, less regulated blockchain ecosystem. To verify the origin and destination of transactions and track payments, traditional finance rules need to be adapted for the blockchain environment.

An official highlighted that MiCA's status as a regulation, rather than a directive, will promote greater consistency in its application across member states. The official agreed however that the implementation of CASP requirements presents specific challenges, particularly due to potential differences in transitional periods between member states, which could result in temporary variations in rules across the EU.

2.3 Pending issues and challenges related to the MiCA implementation

An official explained that Poland is currently implementing the MiCA provisions, but significant work remains due to the complexity of the regulatory framework. While some provisions took effect two months ago, the full impact is difficult to assess at this stage. A recent public consultation on the implementation of MiCA has generated strong interest from market participants in Poland, providing regulators with valuable insights.

An industry representative noted that MiCA has already gone live for stablecoins. Stablecoins, often referred to as the 'oil of crypto markets', could scale very fast due to their critical role in the execution of most crypto transactions. They have huge potential for cross-border payments, with the ability to send real US dollars instantaneously and globally at almost no cost using crypto technology, which cannot be done within the traditional financial system. They can also play an important role in supporting tokenisation, as an on-chain settlement asset. However, MiCA's current approach hinders the development of euro denominated stablecoins. Although the EURC stablecoin was recently approved in France, its market capitalisation remains small compared to US stablecoins. Obstacles to further growth include high capital requirements despite limited risk, the ban on giving interest, requirements on the holding of bank accounts that are challenging for fintechs and complex rules for managing reserves. These issues limit the ability of stablecoins to compete with traditional financial instruments. A review of MiCA stablecoin requirements may be required as rules are progressively established in other jurisdictions.

Another issue concerns EU-regulated CASPs that need to have access to global liquidity. Only 10% to 12% of global crypto trading volume happens in Europe. There is a need to grow EU liquidity and also ensure access of CASPs to global markets in order to provide consumers with best execution and positive outcomes.

The industry representative also noted that the overlap between MiCA and the Payment Services Directive (PSD) results in a number of technical issues that need to be addressed in the coming six months, such as whether firms transferring e-money tokens (EMTs), which are fiat-backed stablecoins regulated under MiCA, would also need a PSD license for payment transactions. EMTs should be exempted from PSD to avoid duplicative regulations. Potential conflicts between the two frameworks include the PSD's requirement for transaction reversibility, which is incompatible with blockchain's irreversible nature.

3. International regulatory developments

3.1 International divergence

An official emphasized the current international divergence of regulatory approaches to crypto, particularly with respect to centrally issued stablecoins denominated in fiat currency and backed by traditional assets. These stablecoins, traditionally used as digital settlement assets, are now also being used for storage of value and payment purposes as payment service providers are exploring their integration into their networks. This could result in regulatory arbitrage and

1. Crypto-asset service providers that provided their services in accordance with applicable national law before 30 December 2024 may continue to do so until 1 July 2026. However, member states may derogate from that rule (by not applying this transitional regime at all or reducing its duration) if they consider that their national regulatory framework is less strict than MiCA and inform the European Commission and ESMA until 30 June 2024 about their choice.

financial stability risks if certain business models achieve rapid scalability and wider retail payment use. Existing international standards, such as the recommendations from the Financial Stability Board (FSB) on global stablecoin arrangements, provide guidance. However, only 10% of jurisdictions have comprehensive regulatory frameworks for stablecoins, aside from the widely adopted anti-money laundering (AML) and counter-terrorism financing (CFT) measures based on the Financial Action Task Force (FATF) recommendations. Financial stability and consumer protection risks remain unregulated in most jurisdictions.

A paper published by the Financial Stability Institute (FSI) in April 2024² compares established and proposed regulatory frameworks for stablecoin issuers in 11 jurisdictions. Emerging national regulatory strategies address common issues, such as the nature of issuers and reserve assets, custody and redemption requirements, governance, and risk management. Issuers are typically required to maintain reserves equivalent to the value of their circulating stablecoins, ensure segregation and custody of assets and establish clear redemption procedures. Regulations also contain prudential, governance, risk management and AML/CFT requirements, as well as disclosure obligations. Most frameworks follow two authorisation regimes for issuing stablecoins: the regime for banks and certain non-bank financial institutions under existing regimes and/or a newly established crypto-specific licence.

Inconsistencies between national regulatory regimes however exist that can prevent effective coordination across jurisdictions. For instance, the terminology used to classify stablecoins varies significantly across regulations. Notable differences also exist in restrictions on reserve assets, the treatment of redemption fees and the nature of stablecoin holders' claims. For example, an e-money stablecoin in Europe differs significantly from a fiat-backed US dollar stablecoin in New York state or other fiat-referenced stablecoins in the UK or Dubai. In most countries, users hold a claim against reserve assets, however in some jurisdictions, including Europe, the claim is against the issuer. Further regulatory convergence will be essential as the use of stablecoins grows globally and this will also facilitate enhanced supervisory cooperation. The FSB is establishing global standards for stablecoins. Data on stablecoin arrangements is also being gathered and will support the work on regulatory convergence.

An industry representative commented that the inherently global nature of crypto markets, with continuous trading and asset fungibility, makes consistent regulation across jurisdictions critical. The gaps that persist between major G10 markets in terms of timing of crypto market regulation may create problems for global market operators. The aim is to move towards responsible cross-border market access and regulatory convergence, for which global standard setters have a critical role to play.

3.2 Progress of the legislative process in the US

An industry representative stressed that in the near term, the primary focus in the policy area should remain on achieving regulatory clarity in key global jurisdictions. The current lack of regulatory clarity in the US in particular, hinders market growth, and leads to costly legal battles diverting resources. Several crypto companies are currently engaged in litigation with the US Securities and Exchange Commission (SEC). Early court rulings have aligned more closely with the industry's perspective of the nature of cryptoassets traded on secondary markets, reflecting a similar approach to MiCA.

Despite significant advancements and strong bipartisan support in both the House and Senate, final legislation has not yet been passed. The leadership shown by the EU with MiCA will likely encourage further legislative developments in the US. The upcoming elections have slowed down the political process, but a potential legislative window could open towards the end of 2024. Cryptocurrency has unexpectedly become a key issue in the US presidential election in recent months, complicating the political environment for crypto but also acting as a catalyst for progress. The current US administration has reset its approach towards the crypto industry and there are positive signs that regulation is moving towards becoming a nonpartisan issue. Ensuring consumer protection and risk management should indeed transcend party politics.

4. Future market developments

4.1 Prospects of the crypto and digital asset market

A regulator highlighted three key elements to consider in future work on crypto regulation. First, the continued strong interest in crypto from consumers, particularly younger generations, must be taken into account when shaping future regulation. Second, regulation could provide legitimacy for the sector, potentially accelerating the strong growth that has already occurred in an unregulated environment. Third, the growing interconnection and hybridisation between traditional finance and the crypto sector, could complicate the regulation and oversight of the sector.

An industry representative observed that digital assets have important implications for the EU's competitiveness. Digital assets are a next-generation, transformative technology with the potential to significantly impact financial services, payments and even the evolution of the internet with a progressive transition to Web 3.0. There are also growing synergies between blockchain and AI. While AI scales content, blockchain will scale trust. MiCA provides Europe with a unique opportunity to address some of the competitiveness gaps identified in the Draghi report by driving the adoption of digital assets within a globally unmatched regulatory framework.

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The debate on open versus closed systems will also be essential to determining the future of crypto regulation. A Bank for International Settlements (BIS) paper published in April 2024, *Finternet: the financial system for the future*, foresees a financial system based on technologies such as tokenisation and unified ledgers. This is very relevant, but the envisioned system is presented as a closed centralised system. Although such a system has merits, it is also important to allow private sector innovation on public permissionless blockchains, as closed and open systems are likely to converge and complement each other in the future. Public blockchains could, for example, help achieve some G20 goals for 2027, such as improving global financial inclusion and increasing the speed of cross-border transfers.

4.2 The implications of CBDC for crypto

An industry representative highlighted the need for a widely adopted euro-denominated digital currency to support settlement processes. Stablecoins offer a partial solution but a wholesale euro central bank digital currency (CBDC) could enhance the efficiency of blockchain-based transactions by offering a digital currency leg for settling them and could streamline operations across traditional and digital financial systems, that are likely to coexist.

Another industry representative commented that CBDCs are not expected to have significant near-term implications for the crypto market. As certain jurisdictions make progress with CBDC initiatives, other policymakers and central banks will likely be prompted to engage more deeply in the debate.

4.3 Institutionalisation of the crypto market

An industry representative emphasised that the traditional financial industry is moving fast in the area of blockchain and digital assets, offering clients the opportunity to experiment with blockchain and providing digital asset safekeeping services. At present, many clients lack knowledge about the potential uses of blockchain, so traditional financial players are providing them with opportunities and tools for experimentation. Institutional clients such as asset managers, pension funds and insurance companies are increasingly recognising blockchain's potential. This growing interest can be attributed directly to MiCA's positive impact on the market.

5. Pending regulatory questions

5.1 Addressing global stablecoin risks

An official noted that a common dilemma in international regulatory debates is determining the right moment to intervene in response to emerging risks. In the crypto world there is a need to differentiate between various use cases and assets. Future international regulatory focus should prioritise stablecoins used for payments or as stores of value in cross-border contexts, as their use is rapidly increasing, particularly in emerging markets where stablecoins offer easy access to US dollars. This growing use, which is increasing the cross-border

dimension of stablecoin business, calls for prompt regulatory action, which is why the FSB is working on standards for global stablecoins.

The market capitalisation of stablecoins is currently around \$160 billion, which is relatively small compared to the broader financial system, but the pace of growth is remarkable. For example, PayPal's USD stablecoin reached a \$1 billion market capitalisation in less than a year, growing much faster than other major stablecoins like USDC or USDT. With PayPal's 430 million global users, the potential for this stablecoin to scale rapidly is significant, further reinforcing the need for swift regulatory action.

MiCA already includes a chapter on significant stablecoins, with enhanced requirements for systemic instruments, but these requirements will likely need to be strengthened in the future. Additional controls, particularly on reserve assets, risk management, and governance, seem necessary to mitigate risks. Robust supervisory cooperation at the international level is also essential to ensure regulatory convergence. However, regulation cannot be the only policy response to stablecoin risks. The public sector must also invest in infrastructure to enable private stablecoin transactions to be settled in CBDCs, creating a safer environment, while fully leveraging the value that stablecoins can bring to the financial system.

5.2 Potential review of MiCA

A regulator commented that, while MiCA has been praised for its comprehensive scope, some areas, such as decentralized finance (DeFi), staking and non-fungible tokens (NFTs), remain outside its scope and may require further regulatory attention. MiCA was drafted before recent market events, such as the collapse of FTX, and might have been framed differently had these incidents occurred earlier. The ongoing implementation process has also revealed areas that may require adjustment in terms of proportionality and ensuring a level playing field, such as reporting standards, market supervision and access to on-chain and off-chain data. The European Commission is expected to closely monitor developments, particularly the emergence of DeFi.

An official acknowledged that there will likely be a need for future revisions and adjustments of MiCA, as is common with major financial regulations. However, no significant blind spots have yet appeared in the Polish market, notably in terms of consumer protection and countering market abuse. The scope of MiCA is appropriate for tackling the current risks associated with the crypto market. Monitoring of MiCA's implementation by public authorities will guide future revisions if needed.

The Chair concluded the panel stating that he was encouraged by the comments made regarding Europe's leading position in the global crypto landscape, which is helping to drive change in other parts of the world, including the US. Implementation is still underway, but the MiCA framework has already provided companies with the regulatory clarity needed to develop their businesses, even as significant changes driven by digital applications continue to transform financial markets.

Digital transformation of securities markets

1. State of play of the use of technologies in securities markets and future prospects

1.1 Ongoing digital transformation in securities markets

The Chair highlighted the wide-ranging impact of technologies, including Distributed Ledger Technologies (DLTs, such as the blockchain), smart contracts and artificial intelligence (AI), which are increasingly integrated in the financial sector¹. While these innovations can deliver important benefits, such as through efficiencies and productivity improvements, they also carry challenges and risks for the markets and their participants, and require responsible and safe integration in securities markets.

A Central Bank official noted that, over recent years, experimentation of blockchain, digital assets and smart contracts has significantly increased in the European securities markets, with projects led by international public institutions, national central banks and market participants. This trend is driven by three main factors: a better understanding of the technologies and their use cases, increasing experimentation with wholesale central bank digital currencies (CBDCs) worldwide and the implementation of more innovation-friendly regulatory frameworks.

Central banks in particular are playing a key role in experimenting with blockchain-based systems to support the execution of securities transactions. Several Eurosystem central banks, including the Bundesbank, Banca d'Italia and Banque de France are conducting exploratory work aimed at testing new technologies for settling wholesale transactions in central bank money. The Deutsche Bundesbank's trigger solution for example connects DLT platforms with the existing Eurosystem TARGET2 payment system, enabling the direct settlement of DLT-based financial market transactions in central bank money, without creating CBDC. There have been successful trials for such use cases as digital corporate bond issuance and digital commercial paper settlements and the trigger solution will be extended to payment versus payment (PvP)² use cases.

An industry representative stressed that tokenisation has moved beyond the pilot stage, becoming a tangible reality for the digitalisation of securities markets. Traditional financial institutions are progressing faster

than expected. Research shows that over 50% of banks are exploring tokenisation to improve efficiency and speed, with between 10% and 12% already in the commercialisation phase. Steps have also been taken to tokenise exchange-traded funds (ETFs), which is a significant milestone towards increased efficiency in the asset management sector.

A second industry representative agreed that, during the past 15 years, there has been significant change in the securities market due to the development of blockchain-based systems and services, such as crypto-asset exchanges. Such exchanges act as a bridge between traditional finance and crypto markets, facilitating the trading and custody of digital assets. A recent development in the crypto market are cryptocurrency ETFs, which track via benchmarks the value of digital assets like Bitcoin, simplifying the investment process by removing the need for investors to manage wallets or private keys. These ETFs allow investors to gain exposure to crypto without direct engagement in the ecosystem.

Crypto ETFs also represent a significant step forward in institutional adoption, facilitating the participation of traditional investment structures such as hedge funds, family offices and registered investment advisors in the digital asset market. The influx of institutional capital not only deepens market liquidity but also contributes to the overall maturation of the industry. The launch of Bitcoin ETFs in the US by major asset managers in 2023 was the most successful in history reaching \$17 billion in net inflows by August 2024 and was followed by the introduction of Ethereum ETFs in 2024.

1.2 Future prospects

A Central Bank official emphasised the importance of implementing a cash leg on the blockchain, to reap the full benefits of digital asset innovation. Innovation on the cash leg has not kept pace with progress on the asset side. Realising the long-term advantages of DLT will take time, as it requires global interconnected systems to evolve and a widespread participation of market actors across financial instruments to provide sufficient financial intermediation. Different regulatory regimes also add complexity.

Another Central Bank official observed that wholesale transaction settlement solutions being tested by Eurosystem central banks should contribute to providing a solution for the cash leg on the blockchain. In addition, significant changes are likely to happen in Europe's settlement infrastructure in the future. The concept of a

1. See for example OECD (Regulatory approaches to Artificial Intelligence in finance, September 2024), OECD (Generative artificial intelligence in finance, December 2023).

2. PvP is a settlement mechanism that ensures that the final transfer of a payment in one currency occurs only if the final transfer of a payment in another currency takes place.

European unified ledger proposed by the ECB and mentioned in several reports on the future steps of CMU could be a gamechanger. Though discussions are in their early stages and more work is needed to reach a concrete solution, a unified ledger could unlock the potential of the digital euro, wholesale CBDC and asset tokenisation and improve efficiency and innovation in European securities markets. Harmonised standards and regulatory frameworks will be essential.

A regulator recognised the transformative potential of blockchain in the securities market. The ecosystem's evolution will be gradual, and potential risks must be carefully managed during this transition. In contrast, AI is evolving in a different manner. With lowered barriers to entry, most financial institutions are already utilising AI, mainly to reduce costs. Institutions must now consider broader use cases and design comprehensive AI strategies to maximise its benefits. However, in contrast to blockchain and DLT, AI is not expected to fundamentally reshape financial markets but will instead contribute primarily to optimising processes and services.

An industry representative noted that new developments are expected in the crypto market, such as Ethereum ETFs exploring the integration of staking rewards. This would allow clients to benefit directly from staking via the infrastructure provided by centralised cryptocurrency exchanges. Decentralised finance (DeFi) should also drive innovation going forward, offering an alternative to centralised platforms.

An official observed that the pace of technological change in cryptocurrency, tokenisation and AI is rapid. These innovations could be gamechangers in the securities markets, but there must be careful consideration of both opportunities and risks.

1.3 The need to move beyond the experimentation phase

An industry representative emphasised that the industry must move beyond the experimentation phase to unlock the potential efficiency gains offered by blockchain and tokenisation, which could eventually move the entire market on-chain. Products and services must be launched to test the technology's feasibility and impact. Tokenisation should be applicable to a broad range of financial instruments and real-world assets. BIS's Project Mariana also demonstrated the technical feasibility of an automated FX market maker using smart contracts.

A Central Bank official noted the importance of building on Europe's regulatory framework for digital assets, which includes the markets in crypto-assets regulation (MiCA), the DLT pilot regime and domestic requirements like Germany's electronic securities law, to practically apply tokenisation in the market. Central banks can support the adoption of tokenisation by offering short-term solutions for the payment leg like the trigger solution, to provide a bridge between tokenised assets and existing financial systems. The opportunity of expanding such pilot solutions into production must be assessed at the European level to avoid market fragmentation.

2. Opportunities and challenges of digital transformation in securities markets

2.1 Main opportunities and benefits

The Chair noted the opportunities offered by digital transformation for both securities market participants and investors. Efficiency, as well as choice and access for investors, can be increased.

A Central Bank official highlighted the potentially transformative effects of DLT and blockchain in securities markets that may benefit all market participants. DLT can reduce back office friction through the automation of manual and sequential processes like trade reconciliation and ownership recording and broaden the range of assets available. By reducing settlement times and back office processing costs, DLT can minimise counterparty credit risk and generate savings for market participants. The absence of cash netting on blockchain-based platforms, however, might introduce new liquidity risks, necessitating more cash for settlements. This issue could be partly offset through an increase in market liquidity, facilitated by the lowering of costs and reduced barriers to entry for new market participants. Faster settlement times may also lead to the development of new use cases, such as intraday repo, which in turn could offset liquidity risk with a faster turn-around of liquidity, and impact collateral markets, enabling a wider range of assets to be used and increasing resilience. DLT also could enable more personalised transactions for end users.

Another key innovation is the shared, programmable ledger, which allows the building of pre-agreed verification rules into financial contracts. Smart contracts can be used to automatically pay coupons on bonds and their composability allows them to be combined to automate more complex chains of financial actions. For example, a smart contract paying bond coupons could be combined with another contract that automatically reinvests such payments into a designated portfolio.

A Central Bank official and an official agreed on the transformative potential of these technologies in securities markets, emphasising that asset tokenisation and blockchain may increase the efficiency and reduce the complexity of these markets.

2.2 Blockchain and digital asset challenges

The Chair noted that the introduction of innovative technology in markets also poses challenges and risks that require careful assessment by regulators, the possible introduction or adaptation of policies and regulatory frameworks, the building of new skills and coordination at the international level. The FSB, IOSCO and the OECD have been working on these issues for a number of years (e.g. crypto-assets and DeFi; tokenisation; AI).

An official emphasised the global nature of challenges from DLT, tokenisation, and cryptocurrency. IOSCO has also been working in these areas, applying a 'same activities, same risks, same regulatory outcomes' approach. Collaboration with CPMI has also been valuable, particularly on stablecoins.

The official highlighted IOSCO's 2023 recommendations on cryptocurrency and digital assets, which address risks associated with both centralised and DeFi platforms across six key areas, including conflicts of interest, cross-border custody risks, operational and cyber threats, market manipulation, insider trading and fraud. Conflicts of interest are of particular concern in vertically integrated crypto asset service providers (CASPs) that combine multiple roles. All such risks apply to both centralised and decentralised platforms, but DeFi presents some additional challenges. For instance, some DeFi platforms claiming to be decentralised may not be so and there are asset pricing challenges.

IOSCO is examining the use of tokenisation across the capital markets value chain and evaluating its potential risks. Three key challenges have been identified: legal challenges relating to the issuance and transfer of tokenised securities, operational challenges such as interoperability and cyber risks, and market functioning challenges, related to liquidity fragmentation, market manipulation and settlement. Tokenisation does not yet pose a systemic financial stability risk, but may as the market grows.

An industry representative noted that regulation is vital to ensure crypto ecosystem growth. There is more to be done in this regard on digital assets.

2.3 AI-related risks in financial markets

An official referenced IOSCO's 2021 recommendations on asset managers and market intermediaries' use of AI and machine learning (ML), which addressed potential concerns in terms of governance, oversight, algorithm development and testing, data quality and bias, transparency and explainability, outsourcing and ethics. The rise of generative AI has led IOSCO to revisit these recommendations and assess new use cases, including in customer support, operational efficiency, transaction processing and reg-sup tech for compliance and fraud detection. There are key risks to be considered in this context, including explainability and model drift risks, concentration risks due to reliance on third-party providers and pre-trained models, and also operational, cybersecurity, fraud, privacy, deepfake and hallucination risks. Herding behaviour in AI models and talent scarcity in the field could pose further challenges.

3. Opportunities and challenges from sandbox approaches

A Central Bank official stated that sandboxes play an important role in fostering innovation in securities markets. The EU and UK have developed approaches allowing both market participants and regulators to test ideas and develop supervisory approaches. The sandbox helps contain financial stability risk by imposing limits and requiring participants to meet specific standards before scaling up activity. The absence of major events during a sandbox's operation, however, does not guarantee absolute safety. Regulators will be required to make a judgment as to what can be considered 'safe at scale' without perfect information.

Traditionally, regulators have intervened when things go wrong, but with sandboxes and pilots the regulator is involved earlier in the development process. This requires a significant shift in the regulatory mindset. There is a need to identify and remove inadvertent barriers in existing rules that may hinder new technologies, while maintaining the principle of same regulatory outcome for the same risk. A key challenge is encouraging existing financial market infrastructures (FMIs) and new entrants to invest in new technology. This will require continuous dialogue with the industry to foster shared understanding. The UK sandbox will soon be operational, with the aim to offer a flexible rulebook with several stages of progression for participants and a glide path to ensure safe scalability.

An industry representative reiterated the importance of ongoing dialogue between market participants and supervisors, as regulation cannot be adjusted to fit every new development in the fast-evolving crypto ecosystem. A pragmatic approach will be essential. A Central Bank official agreed, observing that Central banks will also have a role to play in the adoption of new technologies in the securities market.

Another industry representative noted that the DLT pilot regime is in effect a regulatory sandbox that offers participants the flexibility to bypass certain EU regulations legally to foster innovation. However, the pilot has limitations and been slow to yield results. Participants must go through a lengthy and complex process to access the sandbox due to entry requirements. For larger incumbents, the volume caps are also too low to justify the necessary investment in infrastructure and there is an obligation to exit the sandbox after 5 years. Larger firms are therefore hesitant to participate, particularly given that similar technologies are already being used live in other jurisdictions.

Under the current DLT pilot regime, the EU risks falling behind in terms of technological innovation. Singapore, for example, is progressing rapidly with tokenisation through active industry engagement. The UK is advancing with its own regulatory sandbox. Rather than reviving the DLT pilot regime, the EU must begin to implement the necessary regulatory changes to existing frameworks required by tokenisation and assess the broader infrastructure implications of this evolution.

A regulator suggested adjusting the EU DLT pilot regime to reduce barriers to participation and make the scheme more accessible to smaller players.

The Chair highlighted the challenge regulators face in striking the balance between swift policy action and appropriate assessment of rapidly-evolving technologies. Sandboxes and pilots may be necessary to gain insight but could also mean that the industry struggles to keep pace with rapid market advancements.

4. Focus on implementing and adjusting existing frameworks

Answering a question from the Chair about the need for additional measures to support digital asset and crypto markets, a regulator stated that no further regulation is

currently necessary in the EU and cautioned against drafting new legislation prematurely, as the market continues to evolve rapidly. The focus should instead be on implementing and refining the regulatory technical standards (RTS) of the Markets in Crypto-Assets (MiCA) regulation, which are highly detailed. The challenge of this implementation for supervisors will be the technical complexity of crypto, requiring national competent authorities (NCAs) to recruit additional resources with technical expertise and the ability to assess risk. This is difficult for the public sector.

An active dialogue between market participants and regulators is important to take the right decisions on aspects of crypto not covered by MiCA, such as DeFi, and to fully exploit the potential of these technologies. This will help regulators to determine exactly what constitutes DeFi and, consequently, which elements need to be regulated.

A Central Bank official observed that there are some areas of securities regulation which must change, particularly with regards to accountability and settlement finality. In the EU and UK, central securities depositories regulation (CSDR) which is designed for centralised entities may need to be adapted to account for a more decentralised recording of securities ownership. An industry representative agreed that traditional frameworks and rules will need to change to align with the development of tokenisation, DLT and DeFi. The

settlement finality directive (SFD) and the markets in financial instruments directive (MiFID), in particular, need to be adapted to the changes brought by tokenisation. Achieving the potential gains in terms of speed, automation and cost reduction will also require open collaboration and shared standards and siloed working must be avoided. Tokenisation should be viewed as a tool to achieve greater efficiency and automation, rather than an end goal.

An industry representative explained that permissionless blockchains facilitate participation without permission from a central authority. This results in operational, technological, legal and regulatory challenges when using them for securities markets. Existing frameworks like MiFID and CSDR are not designed with such platforms in mind and instead support intermediated financial infrastructure. The European Commission is exploring the policy approach to address DeFi, with a report anticipated in late 2024. The European Supervisory Authorities (ESAs) and NCAs are also in an assessment phase. DeFi also has implications for centralized exchange as the latter play an important role in the trading of tokens which empower individual investors to access the DeFi ecosystems. A further consideration is the need for greater scalability and interoperability, as the sector is multi-chain and highly fragmented.

Sessions

IV

PAYMENTS AND THE DIGITAL EURO

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Retail payment priorities

1. Retail payments are complex, which has required public sector intervention

1.1. One ECB priority is to remedy the dependence on international payment companies in the EU and the inability of European solutions to have a pan-European reach

The Chair recalled that the EU market is special in view of its multi-jurisdictional nature and that in any case every payment ecosystem can end in different equilibria with strong path dependency. Public policy interest in an efficient outcome is high and can lead to regulation, or provision of infrastructure and services by central banks, such as payment systems or retail central bank digital coin (CBDC). In the last two decades cards have emerged as the dominant electronic payment solution, and e-commerce has been a fast-growing phenomenon. There has been a rise in e-money and the instant payment revolution; it is a revolution of the settlement layer, but when combined with a front end revolution it can also lead to payment instruments such as the European Payments Initiative (EPI)'s Wero.

The ECB's retail payment strategy (RPS) puts significant emphasis on the desirability of a European-governed, pan-European payment instrument at the point of interaction (POI), that could be based on instant payments as a settlement layer.

1.2. Regulation has proved essential, and innovation remains strong

A Central Bank official stated that the most important thing that happened in the EU for cards was the Interchange Fee Regulation (IFR) because it brought more competition. From a global perspective the EU is doing well when it comes to the costs of card payments, but there are new alternative ways of paying that may be more efficient. The Czech National Bank is trying to introduce the instant payments infrastructure, and in Czechia about 33% of all credit transfers are instant. Hungary has taken an unusual way of introducing instant payments, with mandatory acceptance. Czechia is the leader in contactless and has about 50% tokenisation.

The Payment Services Directive (PSD2) is also important. Strong Customer Authentication (SCA) was a success, but fraud is evolving. Eliminating fraud is a goal that is almost impossible to achieve. PSD has also led to modernisation in the backends of banks. As a result of the PSD2 application programming interfaces (APIs) Czechia received a Scandinavian style bank ID that helped to move the country forward.

An official stated that the instant payment infrastructure is a significant achievement, and European customers will be able to use it from 2025. Hungary has used it

since 2020 and has had positive experiences. From 1 February 2024 payment service providers in Hungary have been obliged to accept payment requests in that system. QR code payments have been trialled from 1 September 2024, and the QR-code-based payment using the Single Euro Payments Area (SEPA) Instant Credit Transfer Scheme (SCT Inst) will be owned by the banks, not the central bank.

The Chair noted that if the last five years have been so dynamic, it means that innovation and competition are alive in principle, which is positive.

An industry representative stated that their company is global and is a pan-European player. In some countries it has a physical presence and in others it operates on a cross-border basis. It also operates as both an issuer and an acquirer. From a regulatory perspective there has been good improvement, but more regulation is coming.

In terms of innovation Europe is leading the way in areas like open banking, new players, new models and new use cases that have been exported to other places in the world. Something similar might happen with SCA. Behavioural biometrics could be leveraged as a new means for protecting customers whilst improving the customer journey. Europe is crowded when it comes to payment institutions and banks, with around 5,000 players in the market, but the relative shares of the players has not significantly changed.

Payment institutions can now get access to banking rails for instant payments, which is a big win and a good example of fostering competition. Another aspect that their company is proposing as part of the Payment Services Regulation (PSR) is the elimination of the current limitation that payment institutions have for cross-border credit beyond 12 months.

2. Technology and Covid are among the many drivers of e-commerce and the development of electronic payments, and vulnerable citizens and fraud remain a focus

An industry representative explained that their organisation has 10 million active clients who are representative of the entire population of its country and notes that user habits have changed because of many technological innovations and Covid. Electronic payments are expected to double from the end of 2022 until the end of 2027. The use of cash is of course decreasing but remains important for vulnerable clients. Indeed, having seamless payments could be harmful for more fragile clients, because it makes it more difficult for them to closely manage their budget. There are more card payments in a number of countries,

which will accelerate in future years with more wallet payments. Wallet is clearly the future of payments, as younger people are more willing to use a wallet compared to a card.

An official noted that Hungarians frequently use the instant payment system and instant payment services. More than 40% of transactions are now outside of banking hours. Online fraud is a significant problem in Hungary, with €60 million lost due to online fraud in 2023. Hungary's main priority is to tackle online fraud and to establish a system that emphasises prevention and solving the crime as soon as possible.

An industry representative stated that fraud is a competition between fraudsters and banks. New tools like the European Digital Identity (EuDI) Regulation, fingerprints, face shape and voice prove there are a number of ways to make wallet more secure than cards. If banks want clients to trust payment systems and use them then the latter need to be given trust. Innovation without operational resilience or security for customers will not work, as there is a huge diversity of client needs.

An industry representative highlighted that caution is needed about the future with regard to fraud and cybersecurity, as AI can be used by both bad actors and good ones.

An industry representative agreed that stopping fraud has greatly improved through SCA, but the implementation cost of the payment supply chain has been significant. The speed at which fraudsters evolve is much faster than the time it takes to analyse, legislate and enforce. Outcome-based regulations for specific targets need to be considered, but there also need to be customer experience targets.

3. As a result of leveraging regulation, technology and payment ecosystems, card payments have quickly evolved in order to combine improved customer experience and security

The Chair noted that worry about fraud has been a common denominator of all panel members so far.

An industry representative observed that payment has changed more in the last five years than in the last 50 years. The contactless payment revolution went smoothly throughout Europe and the consumer user experience (UX) is the best ever in terms of face-to-face payments. Hungary is the country with the second highest saturation of contactless payments worldwide, and 99.3% of all Hungarian card transactions from the industry representative's company are contactless.

Visa is trying to use the learnings from contactless migration to implement Click to Pay in Europe, which is a continuation of the scheme-agnostic standard EMV Secure Remote Commerce (SRC). Everything is underpinned by the token revolution, as technology

helps to replace sensitive card credentials with tokens. Token is a base for Click to Pay, mobile payments, further development and acceptance. Small and medium enterprises (SMEs) across Europe are a very large part of the economy, and due to technological possibilities, they can now accept cards online and in person. The mobile phone is becoming both a payment tool and a tool of how to be paid. One billion small, nano and micro businesses around the world will imminently start card acceptance or payment acceptance.

The most important part is to have a choice, which is different in different parts of Europe. In Central and Eastern Europe (CEE) people need to be able to choose either cash or digital payments. Customers can start their digital journey with many different means of payments that are emerging in every single country, such as wallets and account-to-account payments. The most important part is to convince consumers that it is an easy and secure way to pay, but cash should still be a choice. The change that has happened has been driven by three major factors: the entire ecosystem working together to make it happen, the regulation being very well orchestrated, and technology development being in its best ever space.

4. The EU still lacks homegrown pan EU payment instrument

An industry representative stated that the EU has made significant progress on the efficiency of retail payments, SEPA and streamlined cross-border transactions. Instant payments have the potential to enhance speed and reliability. The EU also ranks well in the diversity of payment options. Account to account based technology has led to the emergence of several payment options in recent years, mostly country specific. PSD2 and SCA have helped to reduce fraud.

There is still far to go to enable more competition and choice. The EU is missing a homegrown, pan EU payment method. The lack of interoperability in a domestic payment method is fragmenting the industry, which creates lower competition. More work is needed to bring those alternatives to the right level. There are several resiliency-of-platform issues and key features for customers who want to pay with subscriptions. Logic needs to be fixed to help customers transact when they face a decline.

5. Priorities for the regulation going forward

5.1. Many regulations are already on the table which requires focus on implementation and checking mutual consistency and effectiveness

A Central Bank official stated that the Czech National Bank is also a payment services provider (PSP) and has to comply with all European payment regulations. The discussion of new regulations is tempered by the

experience with the currently implemented regulations. Many new issues are on the table, and it is time for implementation. The EU is trying to scale successful national level models through European regulation to create pan European solutions, but it did not work with PSD2, and it will not work with PSD3 or Instant Payment Regulation (IPR).

Czechia has a solution for payee verification that is much more user-friendly than the EU suggestions. If a mobile proxy payment is done, then the name of the recipient is visible. Czechia learned from Singapore, as Singapore is much better from a user perspective. What is not encouraging is that PSD3 is forcing Czech banks to implement something for domestic payments that is substandard to what they already have.

An official agreed that something needs to be done about over-regulation.

5.2. Fraud remains a challenge. Key success factors include balancing customer experience, privacy and security, and enabling attractive business models. Regulatory stability and simplicity are needed.

A Central Bank official stated that fraud is a big topic and addressing it has to be a joint effort. More stakeholders need to be involved. There is the potential to voluntarily come up with a solution, knowing that regulation could subsequently come if it does not work.

An official highlighted that online fraud is an area where intervention is needed. On 1 August 2024 Hungary modified the law to allow communication between payment service providers. If a client suspects that there is a fraudulent action they can call their bank, and by law the bank will be able to communicate with the destination bank where the money went. Once the money is located it will be frozen until the investigation is completed, and if it is proven that the transaction was fraudulent then it will be transferred back to the client. The main goal of Hungary's EU presidency is tackling online fraud, with a significant emphasis on prevention.

An official added that, regarding the PSP, Hungary is working on a comprehensive solution that will respond to the increasing volume of fraud. The solution will be a consumer-friendly, fair and justifiable solution for all parties involved in the transaction. The most important thing is to raise prevention to a robust level so fraud can be reduced to a very low level.

An industry representative highlighted that the priority for Europe and worldwide is the resilience of the entire economy and payment systems. Cooperation as an ecosystem is needed, because if fraud is simplified in a certain space, then fraudsters will move to it. The industry representative's company has invested around \$10 billion in the cybersecurity space worldwide in the last five years.

The Chair noted that multiple panellists have mentioned over-regulation as an issue.

An industry representative stated that their company is happy to work with any regulator. The first opportunity is to focus on security, but not at the expense of customer experience. If efforts are dedicated to fighting fraud

there are fewer reasons for legitimate customers to be impacted. Outcome-based regulations could be attempted, such as authentication success rates, timeouts and latency rates. Another opportunity is competition and choice. Targets can bring the right resiliency and availability metrics.

A third opportunity relates to two upcoming regulations, the digital identity wallet and the digital euro, which are going to force many customer journeys to be redesigned. Regarding the digital euro, some things can be done to maximise privacy with a self-custody wallet. The digital euro is uniquely featured to bring conditional payments, but if those points are not favoured and compromised for then it is not going to help customers' adoption. If a remuneration model is not created that incentivises parties to invest in value-added services and replicate four-party models when there are not four parties anymore then it will not work.

An industry representative highlighted the need for stability and simplification of regulation, as the focus needs to be on implementation rather than discussion. A client solution is needed that is practical, fluid and safe. It is vital to not only focus on niche clients, because banks still need to take people on board who are less familiar and less willing to use the most digital solution. A digital wallet like Wero is a very relevant solution because it is a pan-European initiative and meets both customers and merchants' expectations and new uses. Such an initiative must continue to be supported by the EU.

An industry representative noted that more time needs to be spent on the implementation of regulation that is already in place to give all players space to do it. Small players sometimes have a challenge with implementation, but large companies also have much to do such as their business goals, compliance, regulations and development. Regulation always comes first because it is an obligation. The regulator needs to understand that good, future-proof regulation is sometimes 'less is more'. Technology and development is accelerating, and it is not easy to design future-proof regulation if the ecosystem is changing very quickly. Close cooperation with the business side and partnership with the businesses inside of that ecosystem is extremely important.

The Chair highlighted the work of the Euro Retail Payments Board (ERP) on QR standards and on the SEPA Payment Account Access scheme and invited everybody to use them.

5.3. Achieving effective consistency of the rules of retail payments remains a top priority

An industry representative stated that the concept of harmonisation in Europe is very important, both in terms of cooperation between players and between regulators and supervisors. From a pan-European perspective applying the same rules in different countries sometimes means that the interpretation is not the same. Harmonisation needs to be a key objective in the upcoming regulation. A surcharge ban is happening in many countries in Europe but not all of them. Other issues could focus on open banking and the Financial Data Access (FiDA) Regulation.

6. Despite comprehensive and constant work on payments and digitalisation the EU fails to define and manage its strategic autonomy in the area of retail payments, to the detriment of market development

The Chair highlighted the ECB's RPS and added that the ECB welcomes European initiatives like the EPI, also since the market share of European solutions has seen their roles shrinking, which creates an issue of strategic autonomy.

A market expert stated that the EU has become the champion in payment regulation, but it is nowhere near being the best in strategic autonomy because it is not serious about it. Strategic autonomy in payments means European governance, technology, standards and rules. There are significant doubts about whether the EU wants to achieve sovereignty and strategic autonomy. At the recent Paris Olympics purchases could only be made with cash or Visa.

Of the EU wants instant payments to be successful then it has to finalise the sanction screening policy, and the regulation applied to them, otherwise instant payments on a cross-European basis will never be successful because the failure rate will be too high. The Commission says it is the fault of the governments, the governments say it is the fault of the G20, and the G20 says it is the fault of the working groups. The EU is applying American rules to European payments, which does not work.

There is a great deal of regulation and much of it is necessary, but things like instant payments, PSD2, PSR, anti money laundering (AML), sanctions screening, the Digital Operational Resilience Act (DORA), and the payment instruments, schemes and arrangements (PISA) framework is 'drowning' companies.

Payments in Europe is a substantial economic sector but there is no recognition of that sector in Europe. The EU does not have any policy in favour of the development of European payments, and the regulations prevent market development. The approach needs criticising, not the regulators. Central banks are trying to give good guidance and help. Interesting discussions have taken place at Commission level. Regulators are doing their best, but the EU has the wrong approach.

An industry representative agreed with the point on strategic autonomy, which should be the top priority.

A market expert stated that Europe currently has three different models to get to a pan-European reach. The first model is national solutions that try to have interoperability. The second model, which is the approach the expert's company has taken, is to join forces, come up with a solution and try to convince merchants and others. The third model is the one of the ECB, and the digital euro to come up with a new payment solution. The best idea is for the private and public sectors to truly cooperate. Merchants will not understand if there are too many standards, so one standard is needed in the future that is valid for everybody.

Global and EU cross-border payments

1. Taking stock of the G20 Roadmap for enhancing cross border payments: diagnosing the problems, defining the objectives and implementing in a complex and fast moving landscape

A Central Bank official explained that the G20 roadmap is trying to achieve at cross border level the high level of efficiency that has already been achieved at the domestic level. The objectives and timelines have been defined and the key performance indicators (KPIs) and objectives have been set.

A Central Bank official added that the three priority themes of the revised roadmap are interoperability and extension; data exchange and message standards; and progress on legal, regulatory and supervisory frameworks. The roadmap's explicit objectives on cost, speed, access and transparency are a good departure point for enhancing cross-border payments.

1.1 The integration of fast payment systems (FPSs) will drive fast, cheap and secure payments

A Central Bank official stated that the current priority is to finalise the operational details of the G20 roadmap. First, there needs to be a common language. The implementation of ISO 20022 is a key milestone in this regard. One of the major tasks of the G20 roadmap is the interconnection of FPSs. These systems enhance domestic payment efficiency, but this efficiency must extend beyond national borders. The work to achieve this objective has a legal and regulatory component and an operational component, which includes the definition and implementation of application programming interface (API) protocols.

An industry speaker noted the importance of taking stock of the framework that is currently being implemented. The payments sector has been transformed by the adoption of a digital framework, which happened largely in response to consumer expectations. Consumers want to make fast, cheap and secure payments. To do this, they have turned to new technologies. The transformation has been driven by the technological evolution and the important collaborative work between stakeholders.

An official emphasised that the G20 jurisdictions have advanced some aspects of the roadmap, with the support of the Financial Stability Board (FSB), the Committee on Payments and Market Infrastructures (CPMI) and other international organisations. The CPMI established a forum for central banks to discuss operational hours and access, while the Financial Action Task Force (FATF) continued its essential work on enhancing the wire transfer rule, which is FATF Recommendation 16.

1.2 Aligning banks and non banks

An official explained that the FSB's bank/non bank recommendations were designed to improve consistency of regulation and supervision of bank and non bank payment system providers (PSPs), using a risk-based approach. The emergence of non bank PSPs has led to a significant evolution in market structures and technology, which should bring benefits and risks. The FSB consultation on the recommendations contained specific proposals to address these risks by assessing risk management frameworks; providing clear supervisory guidance to firms; reviewing licensing requirements; and expanding data sharing among relevant authorities, as appropriate.

1.3 To define the conditions for interoperability and enable cross border data flows, it will be necessary to work with a wide range of authorities, the industry and non G20 jurisdictions

An official noted that the second important set of FSB recommendations relates to alignment and interoperability of data frameworks related to cross-border payments. For this piece of work, the FSB engaged extensively with FATF, the Organisation for Economic Cooperation and Development (OECD) and the Global Privacy Assembly (GPA) as well as industry stakeholders. The FSB's key recommendation is to establish a forum to bring together all these authorities to help address the identified frictions in data frameworks for cross border payments. Firms are worried about the difficulty of balancing the different supervisory and regulatory obligations, such as the balance between fulfilling anti money laundering (AML) obligations and data privacy. This forum would seek to bring together different types of authorities to consider these issues. The FSB's other recommendations on data frameworks are designed to promote alignment and interoperability of the implementation of data requirements and to mitigate restrictions on cross border data flows, i.e. data localisation or data mirroring, and to promote innovation. Improving the cost, transparency and speed of cross border payments should require more data to flow cross border, not less.

A Central Bank official agreed that the list of important stakeholders in payments includes the national, European and global authorities; institutions in the public sector and the private sector; and the non G20 members. For non G20 countries, progress on cross border payments is very important. On interoperability, one promising solution is the interlinking of FPSs and instant payment systems (IPSs). A specific example is the BIS Innovation Hub Project Nexus. While there are some doubts in the industry about the G20 Roadmap, its objectives are certainly worthy of support.

A Central Bank official agreed on the importance of extending FPS networks beyond G20 membership by bringing benefits to non G20 constituencies and maintaining a strong dialogue between public and private partners.

An industry representative emphasised the importance of ensuring private sector participation. The CPMI has involved the private sector in its cross border payments work, such as the payments interoperability and extension (PIE) task force.

2. Mitigating foreign exchange (FX) settlement risk in cross border transactions

An industry speaker highlighted the importance of mitigating FX settlement risk in cross border transactions. In any cross border payment, there is usually an FX leg which is subject to an exchange of currency. There is a risk that one party pays the currency which they have sold but does not receive the leg which they have bought. The payment versus payment (PvP) solution offered by CLS addresses this risk. One of the key obstacles in the G20 Roadmap is the challenge of emerging market (EM) currencies. Extending PvP solutions to EM currencies creates many different challenges, but the forthcoming initiatives should help to address these issues. There are many different legal, regulatory and geopolitical risk aspects to this problem, which chief risk officers (CROs) need to be aware of during the adoption process. In 2023, the G20 Roadmap moved into the prioritisation phase. CLS is participating in the new CPMI PIE task force, which aims to deliver concrete actions to establish and implement the cross border roadmap.

3. Other key challenges: data exchange standards, capital and currency controls, legacy infrastructure and inconsistent regulation

An industry representative noted that the FSB KPIs mandate that 75% of transactions should complete within one hour, but only 60% of transactions meet this goal. 90% of all transactions over the Swift network reach the end bank within one hour, but there are several reasons for delays that occur between the money arriving at the bank and being credited to the beneficiary's account. First, in certain countries and currency corridors there are systemic delays caused by currency controls, FX controls and mandatory regulatory processes. Secondly, some institutions are late in making payments due to batch processing, a lack of automation and legacy technology. Thirdly, the timing of payments is important. If a payment is going from west to east after the operating hours of the real time gross settlement (RTGS) system, it will take more time. In some cases, the existing instant 24/7 infrastructure can enable the last mile to be credited, but this is not possible everywhere. Policymakers need to identify the capital and currency controls that exist and consider whether anything can be done to speed up

these last mile payments. With pre validation, better insights due to ISO 20022 and richer data, the collective cost of cross border wholesale transactions is continuously decreasing.

An industry speaker stressed that the ultimate goal of the G20 Roadmap is to achieve the highest possible degree of regulatory harmonisation. It is essential to ensure that loopholes are closed and money flows across jurisdictions in a transparent and safe way. Regulatory clarity, innovation and consumer protection are central objectives in the future of cross border payments.

An industry representative (Shiyanka Hore) added that the FSB's call for consultation is a positive first step towards framing the legal pathways for data sharing. This will be fundamental to tackling fraud at an industry level through enhanced anomaly detection and improved coordination between jurisdictions.

4. Future priorities in cross-border payments

4.1 Defining the conditions for widespread adoption of PvP

An industry speaker stated that one of the preconditions to widespread PvP adoption is the need to address the challenge with EM currencies. Bilateral netting is one way of at least partially mitigating this issue by enabling better liquidity risk management, more effective transfer and timely execution of settlement. PvP solutions have to change with the evolving needs of clients, members and key stakeholders. While the move to T+1 has not brought any material changes to volume and value, it will be important to anticipate the move to shorter settlement cycles in other jurisdictions. The 2025 BIS Triennial Survey will help create an accurate view of the magnitude of the remaining settlement risk, but it is important to recognise the importance of operational resilience. Whenever the business model or the underlying technology changes, there may be additional risk. Defining and understanding this risk is essential to deliver a resilient service to the ecosystem.

4.2 Ensuring interoperability

The Chair agreed that resilience and interoperability are two of the most important priorities for any payment system. There is no interoperability without harmonisation and standardisation on messaging and data exchange.

An industry representative explained that the fragmentation in the financial ecosystem makes it necessary to use standards to ensure interoperability by design. ISO 20022 is an open standard that allows for rich data to be shared across the entire financial ecosystem. In Europe, most of the major schemes are ISO 20022 ready, such as TARGET 2, Single Euro Payments Area (SEPA), SEPA Instant Credit Transfer (SCT Inst) and One Leg Out Instant Credit Transfer (OCT Inst). Even private systems such as the EBA's EURO1 and RT1 are ISO 20022 enabled. If each market adopts its

own version of ISO 20022, there will be no interoperability. This is why it is essential for Cross border Payments and Reporting Plus (CBPR+) to be interoperable with High Value Payments Systems Plus (HVPS+)¹ and the other standards and templatised usage guidelines used by RTGSs. Today, interoperability is achieved through correspondent banking. There is interoperability between the jurisdictions where RTGSs are already interlinked. In the future, there must be interlinkages between payment systems, central bank digital currency (CBDC) rails and closed loop systems that serve tokenised assets and trade platforms. In all of these systems, the adoption of universal identifiers, such as Bank Identifier Codes (BICs), Legal Entity Identifiers (LEIs) and unique end to end transaction reference numbers is extremely important. There must be harmonised standards for reference data and regulatory reporting and a framework of harmonised policymaking. The Instant Payments Regulation (IPR) is an instructive example of this.

4.3 The benefits of proportionate and consistent regulation

A Central Bank official explained that consistent regulation and supervision ensures that there is no friction between payment systems. Any differences in views on the application of oversight and supervision will inevitably lead to complications. Across different jurisdictions, there are changing views about how to balance AML and countering the financing of terrorism (CFT) measures and data privacy, for example. These differences can cause cross border transactions to fail. It will not be straightforward to address this issue. As other parts of the financial system have shown, the journey to convergence takes time. Without convergence, there is an un level playing field. In payments, this will result in failed transactions, higher transaction costs and a lack of transparency. There has been good progress in giving non bank PSPs access to the EU's payment system. With the adjustments to the Settlement Finality Directive (SFD) and the IPR, non bank PSPs should be able to participate in the EU's payment systems by next year, which will contribute to competition and further innovation.

An industry speaker suggested that there are three key focus areas on legal and regulatory requirements. First, it is important to address the competition challenges between banks and non bank PSPs by ensuring that unwarranted de risking practices are fully eliminated. These practices lead to challenges for business continuity and ultimately mean that consumers struggle to access products and services. Account closures and restrictions limit the availability of banking services to vulnerable populations. Secondly, the regulatory requirements need to be proportionate, fit for purpose and technically feasible. The new Payment Services Regulation (PSR) aims to enhance consumer fairness and information by enhancing transparency and increasing the amount of information associated

with money transfers. However, the proposals to display FX margin will not improve consumers' ability to make an informed choice and might be confusing. For providers, it would be more useful to use independent benchmarks, as central bank reference rates may not consistently provide reference rates for all global currencies. Finally, it is essential to minimise the inconsistencies between requirements across legislative frameworks, including the rules on payment services, AML/CTF and data privacy. Duplicative and contradictory requirements create inefficiency and legal uncertainty, which penalises competitiveness. Ultimately, non bank entities need to be subject to the same regulatory requirements as banks, including on AML/CTF. The key is to ensure that the requirements are consistent and create as little confusion as possible for consumers.

The importance of international standards cannot be stressed enough. Moving forward, there will be increasing complexity in the payments space. Legacy and new payment systems will have to coexist as innovation continues and private and public innovations continue to interact. This complexity demonstrates that any new payment system must adhere to the international legal, regulatory and supervisory standards. Standards are the strongest and most proven form of interoperability. This is necessary for payment stability as well as financial stability.

5. Digital tools can contribute to the G20 cross border payments objectives

5.1 Promising experiments in the use of DLT and tokenisation

The Chair noted that in the short to medium term it will be necessary to improve the existing payment rails, but it is also important to consider the future of payments. From the outset, the G20 Roadmap sought to drive the use of new technologies to enhance cross border payments.

A Central Bank official commented that tokenisation will help the payments industry to meet the objectives of the G20 Roadmap by improving transparency and timeliness. While there are cyber and operational risks to the use of tokenisation, it also offers several advantages and features. Banque de France is trying to remediate these risks while taking an operational approach to the technology. Tokenisation and CBDC issuance on DLT could have two key benefits: improved settlement of tokenised assets and improved cross border and cross currency payments.

Banque de France's work on this subject started in 2022 with Project Mariana, which was about creating an automated market maker to be the central counterparty for FX transactions of CBDCs in different currencies.

1. Guidelines and standards such as CBPR+ and HVPS+ are closely associated with the transition to the ISO 20022 messaging standard, which is part of the broader evolution of payment systems to meet the demands of the rapidly changing financial landscape by making high value transactions more secure, reliable and efficient.

Project Rialto was an experiment which interlinked several fast payment systems. Project Mandala was another successful project about automating cross border compliance using smart contracts. Banque de France has also started Project Agorá with seven other central banks. This project seeks to establish a unified ledger for seven major currencies. The goal is to have CBDCs and tokenised deposits on the same DLT system and to conduct cross border and cross currency exchanges. The project will publish its conclusions in late 2025. The Project Agorá platform would contain both commercial bank money and central bank money in a tokenised form in many different currencies. From a Capital Markets Union (CMU) perspective, the creation of a unified European ledger would drive efficiency in terms of the settlement of assets and help to eliminate fragmentation in the market.

5.2 The guiding principles of experimentation: defined objectives, optionality and innovation

An official explained that the payments industry is in a remarkable period of innovation, as jurisdictions, international organisations and the industry are developing and experimenting with new technologies. There are several key principles that should guide these experiments. First, cross border payment solutions should be designed to achieve well defined objectives. In the retail market, there are already technologies that provide better speed to market than some new

approaches; the benefits of tokenisation on the wholesale side might justify investment, however. It is unlikely that any single technology will meet all the policy goals. Secondly, policymakers need to preserve optionality. Investment in experimentation should be balanced with investment in legacy systems. Indeed, public authorities need to remain technologically neutral. Finally, it is important to remember that the private sector has advantages with regard to innovation and to market; a main task of the public sector is to provide a level playing field.

A Central Bank official noted that it is important to moderate expectations for the initiatives on DLT and tokenisation. These experiments have been happening in the private sector for over 15 years, but real progress has been limited. The development of a unified ledger would solve many of the problems being addressed by the G20 Roadmap, but it will be difficult to create.

The Chair outlined the key points of the discussion. First, transparency and safety are key priorities. Secondly, the efforts on cross border payments should not be limited to the G20. The G20 targets are global targets which require input from non G20 jurisdictions. Thirdly, this initiative needs both the public sector and the private sector. Finally, there must be optionality in terms of technologies and legal and regulatory frameworks.

Digital Euro: features and challenges

1. Challenges of adapting central bank money to the digital age in EU retail payments

The Chair noted that, in October 2023, the European Central Bank (ECB) and the national central banks of the eurosystem successfully completed the two-year investigation phase of the digital euro project. The eurosystem is now preparing for the possible issuance of the digital euro as a digital means of payment to meet changing payment preferences among European citizens. Internationally, many central banks are considering central bank digital currency (CBDC) as a way to adapt central bank money to the digital age. The eurosystem is a pioneer in this area.

1.1 The ECB follows a step-by-step approach in order to achieve the most appropriate design for the digital euro

A Central Bank official reported that the digital euro preparation phase had begun in November 2023. This phase will focus on further developing and testing the digital euro in line with the choices made in the investigation phase. Extensive analysis, testing, experimentation and stakeholder management is being carried out to ensure that the digital euro meets the highest standards of quality, security and privacy. The governing council will be updated by the end of 2025 and will decide whether to move on to a next phase

A draft digital euro scheme rulebook has been produced and will be instrumental in ensuring a smooth implementation and payment experience throughout the euro area. Tenders have been issued to select potential providers for the parts of the digital euro ecosystem that need to be provided by the eurosystem. Design of the digital euro will include consideration of privacy and offline functionality features, but also ensure that the digital euro is accessible. In June 2023, during the investigation phase, the Commission published draft legislation. The ECB is working on the digital euro in parallel with the work of the co-legislators and supporting them on a technical level, for example by providing a technical analysis on multiple accounts.

1.2 Understanding the conditions for an effective adoption by both citizens and merchants is essential

An industry representative observed that adoption of a payment solution must be approached differently on the payer side and the merchant side. However, it is a 'chicken and egg' situation: if the consumers do not use it, the merchants will not offer it; if the merchants do not offer it, the consumers will not use it. From the perspective of the merchants, any payment method must be accepted by the majority of users for it to be a success. The payment method must be easy to integrate

with current systems and simple to use in the checkout process so that consumers feel comfortable. Cost is a key factor as merchants want the least possible cost for the payment methods that they accept.

On the consumer side, timing is crucial. Consumers need to be presented at the right time with the perfect product that meets the market demand and is state of the art in terms of trends on digitalisation. The next one to three years will be key to moving customers from plastic cards to digital wallets. Merchants will need access to a low-cost product. Any solution must be simple to install. For example, installing customer authentication on a new phone is complicated so this process must be streamlined. The more steps there are to install, the higher the dropout rate will be. The solution must be easy to use and should not result in embarrassment in a shop when the user wants to pay for something.

An official highlighted that it will be important to clarify to the public that the digital euro is not meant to replace cash, although theoretical and strategic planning must consider the possibility of a digital society with no cash. In the Nordic countries cash usage has possibly reached its lower limit and there is an indication that people still want to have a minimum level of cash. It is not yet certain what the digital euro will be a substitute for. It could replace part of the card business, insert itself into the wallet or be something else entirely. The approach should be nimble. The payment service providers (PSPs), banks and the acquisition side will all need to be engaged to achieve the necessary momentum. Common governance will need to be built in the coming months or years.

1.3 Clarification of the most appealing or sensitive features of the digital euro will be essential

A Central Bank official reported that knowledge about the digital euro outside the financial sector is extremely limited. Several individuals have asked what the exchange rate between the digital euro and the euro will be. This illustrates the current level of knowledge outside the financial sector and how people perceive the digital euro. The first task will be to explain the basics of the digital euro. Experience suggests that how this is explained will also matter greatly. Merely stating that the digital euro will be digital cash creates more confusion. The digital euro will need to be explained to the audience in an appealing way.

Individuals outside of the financial sector often ask why the digital euro is needed when other means of payment are already available. One reason is that Europe needs strategic independence. This argument resonates well with professionals, but it is less likely to encourage someone to download the app and onboard onto the app. A good go-to-market plan will be vital. The usual go-to-market plan from central banks is that they state what must be done, but this approach will not work for

the digital euro. A strong action plan will be needed to convince people to move away from their current habitual means of payment. This will be a difficult task, but it presents an opportunity.

An official commented that the compensation scheme is key not only for the active participation of the financial sector but also for merchants. Merchants need to have a positive approach towards this new means of payment, especially because they would have no choice but to accept digital euro payment transactions given its legal tender status. In Italy, convincing merchants to accept electronic means of payment, such as credit or debit cards, for paying for a coffee or a taxi was challenging, but it has been done through a mix of policy measures, even with cashback, and no one now complains any longer. From a political point of view, if merchants understand that the digital euro leads to more competition and thus reduces the cost of the merchant fees, the digital euro would be more easily accepted.

Thus, a good marketing strategy will be needed. When Libra was announced in the summer of 2019, there was a realisation at the ministry that central banks needed to consider an alternative. However, there was also an acknowledgment that the central banks might not have the same marketing capacity of Big Tech to make the product 'sexy'. Another selling point for the digital euro is that it could play an important role in financial inclusion. The G7, under the Italian presidency, is focusing on this. The CBDC handbook produced by the International Monetary Fund (IMF) also includes a chapter on CBDC and financial inclusion.

The Chair acknowledged the need for an extensive marketing plan closer to its potential issuance aimed at the wider public.

An industry representative advised that the marketing of the digital euro will need highlight its relevance. The digital euro will go deep into the European society to provide in the last mile.

1.4 The impact on the banking sector must be anticipated and clarified to enable banks to play their role as facilitators.

An official emphasised that the Italian treasury fully supports the digital euro project. The digital euro is a collective project, and the public and the private sector must collaborate to ensure its rapid take-off. Buy in will be needed from the private sector, and not just the financial sector but also the merchants. Acceptance and understanding will also be needed from the general public. The financial sector would need to act as a facilitator. In this respect, it is useful that we have gone beyond the initial reaction of the financial sector, which was that the digital euro will be disruptive and that there will be a substitution effect with bank deposits. The explanations provided by the ECB and the legislative proposal have to some extent assuaged these concerns. since we know that there will be a well calibrated individual holding limit and that the substitution effect will likely not happen. This is well known and is being addressed, so is not a big issue.

2. The digital euro is expected to help close the digital gap and will also enable the next innovation step

An industry representative commented that the digital euro project is a potential sandbox for the future European digital society. The digital euro project is happening at a moment of convergence between physical and digital and digital services and financial services. The digital euro is important for a number of reasons, the first being the digital gap. The introduction of electronic ID in Italy was initially very difficult but then developed well during the pandemic. Now everybody in Italy has a digital ID. The digital euro is a similar project. Every European citizen must be engaged. Companies are interested in a tool that is easy to develop and is helping to close the digital gap. The proposed legislation states that postal offices will deliver the service of digital euro to non-banked Europeans. 4%, or roughly 30 million, of Europeans are still not banked. The digital euro will enable companies to provide new services using wallets.

From the citizen European perspective, digital and financial education should be aligned. The population includes digital natives and digital ghosts, who are the people more advanced in age who need more basic information. However, this more basic information can also be needed by digital natives in the younger generations. Younger generations can have a an overly simplistic approach to technology, believing that they can simply go on a trading platform and become rich. The digital euro is a currency and an element in reducing societal fragmentation. Champions will be needed. There will need to be capacity for cooperation between public and private institutions. Champions need arenas in which to operate, so a sandbox must be provided where the digital euro and other new solutions can be tested. This can become an ongoing forum in which the champions can continue to work together. The Financial Stability Board secretary general has spoken about a tokenisation revolution. This will likely be the next development and will transform how financial services operate and how any kind of service is supplied to citizens.

An official remarked that new initiatives must be interoperable. A merchant that will accept European Payments Initiative (EPI) must also be able to accept a digital euro and vice versa. The same approach must be taken with other current initiatives with Bizum and others.

3. To contribute fully to Europe's strategic autonomy, the digital euro needs to be carefully positioned in the landscape of payment methods and infrastructures

The Chair noted that the digital euro will create a new European infrastructure that uses real-time processing

and provides an independent basis for payment transactions.

An official commented that the digital euro project is still at an early stage. Public private cooperation will be needed for the design and potential operational deployment of the digital euro. The place of the digital euro in the broader landscape of all the payment means and payment infrastructures must be better defined. In some segments, Europe is lacking strategic autonomy. In the card segment, the market is fragmented. Big schemes that are European but with a US base are the ones that are truly pan-European. Instant payments will likely have a smooth rollout, because the payment from account to account has been a pan-European success, with public-private cooperation and SEPA standards from the outset. This should not be forgotten. Regarding tokenisation, the threats to strategic autonomy are very real on the wholesale issue. Work on this and on retail must occur at the same pace, with the possibility that someday the two will connect.

4. The digital euro should contribute to a reduction in fragmentation at both EU and global levels

An industry representative observed that there are a variety of different payment systems and methods at the global level and at the European level. ECB documentation makes a distinction between non-systemic and systemic payment systems. At a global level, coordination and creation of a common platform or interoperability across platforms is needed. At European level, the solution should be integrated with existing platforms, especially the ones that are not necessarily located in Europe. Regulators will be key to the success of any platform. The rulebook of the digital euro will need to build a platform that is cohesive and interoperable.

A Central Bank official acknowledged that the markets in Europe are still fragmented. 13 out of 20 countries do not have a national solution and are fully based on international schemes. This limited competition has resulted in a reported increase of the average net merchant service charge from 0.27% to 0.44%. Retaining sufficient competition within the European landscape will strengthen European autonomy. The digital euro can be instrumental in this.

5. Key success factors for rolling out the digital euro

5.1 Leverage the most instructive use-cases

An official suggested that the possibility to travel across Europe and to use the digital euro for any basic need and in everyday life situation, such as to pay for the public transport in any European city, would be a powerful use case. This would clearly demonstrate to people how useful the digital euro is compared to other

private means of payment: currently, for example, you cannot use the same payment card to access every subway in Europe because the local administration might have a different private payment provider. Conversely, the digital euro will always be accepted throughout the Euro area, providing citizens with a universal and gratuitous means of payment.

A Central Bank official commented that the digital euro would be a widely accessible European electronic means of payment that would be accepted throughout the euro area, as long as the draft legislation keeps the legal tender. That is extremely important, because it means that the digital euro would be comparable to bank notes. There are differences but the characteristic of being able to pay everywhere in the eurozone would be the same.

5.2 The digital euro must be integrated with digital wallets

An industry representative reported that the industry has a clear go to market strategy in terms of how to get apps onto people's phones. This has been started with the EPI and Bizum. The ECB can benefit from this as, once apps are on people's phones, it will be possible to then add the digital euro. The industry's go-to-market strategy can be utilised as part of integrating the digital euro. This is an offer from the industry.

5.3 A harmonious integration of the necessary infrastructure and regulations should allow clear communication limited to the essentials

An industry representative stated that the entire infrastructure will be needed on day one. A clear approach to explaining the digital euro is crucial, but the less that needs to be explained the better. Cash does not need to be explained and there is no reason why the same should not be true for digital cash. The approach to rolling out a digital euro should be very simple. The rulebook is essential for every payment scheme. A eurozone-wide merchant network will solve many of the problems outlined earlier on the merchant side. The 'magic bullet' of the legal acceptance obligation will provide that network. Agreement on branding will be necessary so that it is clear and transparent for everyone that the digital euro is available and that it is possible to pay with a digital euro wherever the user chooses to.

5.4 The objective is a reassuring level of privacy adapted to each use case of the digital euro

An industry representative observed that, from a political perspective, a promise of increased privacy for the digital euro will be needed. However, an offline solution will not be necessary on day one. Privacy can be increased through political decisions and legal frameworks. There already is a sort of privacy, but there are conflicts in the legal discussions, for example regarding the Financial Action Task Force (FATF) travel rule and proximity payments at the point of sale (POS). The technical infrastructure is completely new and separate and understanding is still limited. Offline functionality is an evolution that can be considered in the next phases of the digital euro. The rulebook will be fluid and will need to be re-agreed repeatedly to be fit for purpose in the long term.

An official commented that people will need to understand that behind the digital euro there will not be any public or private 'Big Brother' and that data protection and privacy will always be ensured. Also, there is no conflict between transparency for anti-money laundering or anti-fraud purposes and the interests of the consumer and privacy. It is possible to have privacy in a system where, with very high preconditions, whenever necessary, it is possible to ex post reconstruct how money has been transferred. The possibility to differentiate the level of transparency of online and offline digital euro and/or remote or proximity payments should be discussed but relying too much on a comparison with cash is a mistake. Saying that there should be full anonymity offline because there is full anonymity in cash transactions is dangerous. Cash is a physical means whereas the digital euro is by its nature immaterial and does not have the same constraints of cash (e.g. for transportation). Different underlying means can bear different risks. Thus, the input of experts on use of money for illicit purposes would need to be sought to understand whether different technological means pose different risks. In this respect, we should not forget the experience with cash, where the €500 banknote was discontinued because the risks of illicit use were too high.

6. The novelty and complexity of the digital euro are such that setting up the legal framework for the digital euro will require in-depth debate and adaptation to the likely changes in behaviour, without creating uncertainty

An official stated that the digital euro is a brand-new project and therefore a brand new area in terms of legislation. The legal services of the Council, the parliament, the Commission and the ECB are all involved, so there will be many debates. The treaties and the primary legislation did not envisage the digital euro, so there are still some areas of uncertainty in terms of rollout, operational questions and acceptance by the public and the market, but also in terms of how to draft the legislation and how to allocate responsibilities for decisions on the digital euro. Any approach will need to evolve over time and adapt to changing behaviours.

The year spent reviewing all the aspects of the digital euro and understanding it better was particularly important for

the treasuries, which are not operational specialists in payments. The next stage will involve a more thorough investigation in terms of impact assessment and understanding the trade-offs. The ministers have asked for a design that enables 'selective privacy'. The financial stability impact will be considered by the Single Supervisory Mechanism (SSM) and the ECB.

Sufficient time should be taken to assess all aspects and ensure full understanding and engagement on the Council side. The same approach should be taken on the European Parliament side. The digital euro project concerns money and European sovereignty, so it is better to move more slowly and safely than to rush and fail. However, it is important that the digital euro project does not move too slowly and cause excessive uncertainty. At some point there will need to be clarity about the form of the digital euro, even if it still takes some years more to roll it out. Within the next 12 months, a clear message must be sent that a digital euro will be introduced, it will be interoperable, and the infrastructure will be compatible with private sector initiatives.

7. Multi-stakeholder cooperation is needed to ensure that the digital euro is properly designed, easy to market and works effectively

A Central Bank official commented that, once the industry has clarity about the design of the digital euro, the interaction between all stakeholders will be much easier.

A Central Bank official remarked that the digital euro can offer additional benefits through the digital euro rulebook and the standards that are being designed with stakeholders. All PSPs, including credit institutions and non-banks, are represented in the rulebook. The consumer and merchant organisations are also involved in the discussions about what the best standards for Europe are. Once these standards are rolled out, they will be open standards that can be used by all, reducing the implementation cost at merchants and enabling private initiatives, on the basis of the instant payment network, which provides easy access to the merchant side. The digital euro should ideally be distributed via existing payment solutions, possibly as an additional choice of payment method in an app that already exists. Sufficient time should be taken in the development of standards, but there must be enough pace to not hamper the rollout of private initiatives.

Sessions

V

EU AND GLOBAL SUSTAINABILITY AGENDA

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Challenges facing the EU sustainability approach

The Chair noted that the Corporate Sustainability Reporting Directive (CSRD) has been approved.

1. ESG goals will remain an important driver for investment. Regulation will help, provided that it is usable, factors in transition and contributes to the competitiveness of corporates and SMEs

The Chair explained that, in Belgium, around 400,000 small and medium-sized enterprises (SMEs) file their accounts, but only around 200 companies are mandated to non-financial sustainability reporting. In future, depending on the approach taken, this number will be 10 times greater. CSRD is a challenge not only for large banks or well-known providers of data, but also for many SMEs that are clients of these entities or in the value chain.

An official commented that achieving goals around sustainability remains vital not just for the planet, but also for the competitiveness of the system at macro and micro levels. Regulation will continue to play a pivotal role in driving investment towards environmental, social and governance (ESG) goals. ESG goals are a key driver of investment, but regulation also helps to shift the focus from short term to long term. An entrepreneur should not need to spend valuable hours navigating administrative requirements. According to the Draghi report, regulatory obstacles are the greatest challenge for 55% of SMEs in Europe. Regulation should be a tool for progress rather than a barrier to growth and innovation.

Focusing on the usability of the framework is an easily achievable goal in the short term. This will include addressing inconsistencies and simplifying processes. For example, overlapping definitions should be consolidated. There is no definition of transition finance in Europe, so there is still some friction in this area. Technical requirements for sectoral legislation should be streamlined so that rules apply to banks, insurance companies or investment funds. In the medium term, a competitiveness test, as proposed by Mario Draghi and others, could be embedded within the policymaking process.

There is a sense that the regulatory journey will be gradual. The level of engagement differs depending on

the company or industry. All parties have their own directions, but the debate is going beyond compliance and reporting. There is also a strong focus on what precedes reporting, such as governance arrangements, internal processes and strategy.

An industry representative observed that increasing or broadening disclosure requirements will almost always advantage larger companies. Support for smaller companies is crucial. A more inclusive definition of what private sector finance should target is needed. There are companies that are not yet able to meet the high requirements of the 'green fence', but still show promise for change. It will not be possible to transition the economy without these companies.

An industry representative highlighted that progress has been made on international alignment for sustainability disclosures to reduce fragmentation and duplication and connect them with financial statements. For some time, work has been ongoing on the International Sustainability Standards Board (ISSB), CSRD and European Sustainability Reporting Standards (ESRS), assuming that interoperability will happen and using a common language, which is vital to foster transparency and comparability. The requirements to quantify impact, risks and opportunities are clearly supporting effective integration of sustainability into management. These developments are tremendously positive. Requiring the disclosure of over 1,000 data points might not be helping managers and stakeholders. A simpler approach could be much more effective.

The landscape is currently quite uneven. Recent differences between the US and Europe have been not just in relation to the approach, but also the direction of travel. Europe remains a leader, but a lack of growth and public deficits have hindered progress in transition measures, while supervisory scrutiny of banks has increased. The goal in relation to climate is clearly net zero economies by 2050. The approach to this and goals for transition plans are not yet agreed. Transition should be approached from a global perspective and fragmentation should be avoided. The role of a transition plan as a plan and not an accurate forecast should also be clarified.

Banks' transition plans depend on customers' transition plans. For example, in relation to the mortgage sector in the UK, 28 million houses need to be retrofitted to achieve the goals. Close to 70% of UK adults do not know the energy performance certificate rating of their homes and around 70% of adults stated that they could not afford to install a heat pump. Even if the awareness gap is closed, incentives will be needed.

2. Implementing international sustainability standards is a positive challenge for the companies involved but has not yet triggered a perceptible move in the economy

2.1 EU and international sustainability standards are currently being implemented, which provides corporates with a real benefit in understanding the drivers of value for business and enabling banks to further support the greening of the economy

The Chair noted that the Draghi report warns of the danger of fatigue about climate. To avoid regulatory fatigue, the focus should be on stabilising and converging the regulatory framework.

An official reported that a significant number of companies around the world are preparing for the new type of sustainability reporting. There are currently around 30 jurisdictions that have either made decisions or are in the process of making decisions regarding using the ISSB Standards. This represents more than 55% of global GDP and illustrates the pace of adoption of the Standards around the world. Companies and investors are very supportive of having a global baseline to ensure comparability in reporting around the world.

Companies state that there is a lot to do. It is not easy, and companies need help with education and implementation. Sustainability experts need to be brought together with the financial reporting experts to produce this type of reporting to the high standards necessary and have it accompanying financial statements. That is a big change, but many companies are positive about it because it means that different people are engaged in important conversations internally. Many companies are looking beyond the compliance aspects and observing that there is real benefit in understanding the drivers of value for businesses.

The comprehensive global baseline that the ISSB is developing is designed to be policy agnostic and to enable companies to provide information that investors need to understand on sustainability-related risks and opportunities in order to make investment decisions. There is a continuing focus on ensuring that the information asked for is cost effective and proportionate for companies to provide. In addition to encouraging adoption, work will continue to maintain and build on the interoperability that has already been established. Good partnerships with other important stakeholders in the ecosystem, such as Global Reporting Initiative (GRI), Taskforce on Nature-related Financial Disclosures (TNFD), Carbon Disclosure Project (CDP) and the GHG Protocol will improve the efficiency of the system.

The Chair noted that, although the banking sector must implement many standards and regulations, it is clear that it is supportive of the green journey. The banking sector is possibly not as heavily affected as industrial concerns are in respect of implementation, but it is still a challenge.

An industry representative commented that current key

discussions are around sustainable growth and measuring, managing and reporting impact, risks and opportunities for affected communities. Companies need to be able to evidence to the market how they are creating value by integrating sustainability. The challenge is integrating sustainability in a way that creates tangible value and where competitiveness is reinforced instead of undermined. As the Draghi report states, climate policy should not be applied without an industrial plan, and this is correct. Transition should secure a competitive advantage for Europe and help it to grow faster, providing responses to stress situations and the lack of dynamism and growth.

A banker states that his bank is supporting corporate and investment banking customers in high-emitting sectors that are already deploying cutting edge technologies. Socially responsible investment offerings have been deployed. However, too much time and effort are being spent on implementing developments such as the taxonomy and CSRD. These should be enablers to facilitate action and change and should not be traps. Sustainability still too often involves additional costs and risks, while opportunities are not mainstream. Simplification is needed, as President Macron and Draghi have made clear, and that requires courage.

An example of this is in relation to the taxonomy. Europe made an important contribution when defining what 'significant contribution' means but adding European taxonomy aiming for perfection and 'do no significant harm' and minimum safeguards has increased the complexity. Banks finance the whole economy and should not be asked to check and provide evidence for the rolling noise and resistance coefficient when financing mobility solutions, for example. Instead, this should be part of the licence to operate in the transport sectors. Banks should be able to use counterparty 'do no significant harm' and minimum safeguard assessment. This is not for the benefit of the banks but instead is to embed sustainability sufficiently for it to be a source of competitiveness.

An industry representative commented that banks are facilitators and enablers of change. There are different industries and different countries, and everyone has different needs. The practicalities of helping clients, industries and governments to transition must be navigated. This requires a very granular engagement with clients on an individual basis.

The EU sustainability agenda is one of the most far-reaching in the world, but it comes with implementation challenges. An American bank in Europe has been mobilising resources and capabilities to support the objectives of the European Central Bank (ECB) and the European policy makers, in line with its own principles: \$1 trillion of sustainable finance by 2030 and achieving net zero by 2050. Current focus is more on environmental risk, including biodiversity. In response to an increased focus from the regulators, solid greenwashing principles have been established to ensure that the sustainability of products and services is clear, fair and not misleading.

CSRD will require that 50,000 companies in Europe and 10,000 non-European companies will be required to report against 12 European sustainability reporting

standards. This will be a significant change in corporate transparency. Investors are excited because ESRS will provide millions of comparable and widely available data points. This will enable the creation of richer and deeper ESG indexes and investment strategies. However, corporates are struggling with resources to carry out the reporting. Institutions are sometimes trapped in an overlap between the EU framework and other existing frameworks. In that respect, the work of the ISSB in trying to align the global and the European framework is very welcome.

2.2 Companies leading the effort to disclose sustainability data tend to be large and EU based

The Chair noted that the costs and complexity of the journey should not be underestimated.

An industry representative explained that she considers the situation from two different perspectives. An international ESG data and ratings provider is a major consumer of sustainability data disclosed by companies around the world, and it also serves global financial institutions that are incorporating that data into their investment processes. Both sides have recently asked whether there has been a reduction in the growth of sustainable investing and, if so, whether the benefits to them as seekers and providers of capital still outweigh the increasing costs.

The sector has subscribed to a theory of change that suggests that capital will flow towards the companies that are most transparent, most ambitious and progressing the fastest, and away from those who are lagging. Considering the approximately 8,500 companies that make up around 99% of the value of publicly listed markets globally, leading companies tend to be large, and EU based. Larger companies disclose emissions data at nearly twice the rate of the medium and smaller-size publicly listed companies. The percentage of EU-listed companies that are aligned or aligning with net zero is almost triple the percentage of non-EU-listed companies doing so.

2.3 Corporate disclosures on sustainability targets have not led to a significant impact on the sustainability of the economy

An industry representative stated that the global sustainable bonds issuance volumes continue to be very strong, with an increase of 4% in the current year and an issuance of \$717 billion to date. The majority comes from the European region. There are \$4.4 trillion of outstanding sustainable bonds. Around 60% of these are green bonds. 17% are social and 18% are sustainable. Only 10% to 15% of the whole euro or dollar bond issuance globally is labelled as sustainable. However, that number increases to 26% to 30% when it comes to European corporate bond issuance.

The European Commission is clear that investments need to increase by 60% to meet the 2030 target. Ensuring that the money flows from the private sector or the capital markets into these investments is a collective responsibility and pragmatism will be needed. Capital markets union and leveraging the sustainable finance framework are closely linked. Despite ongoing regulatory

activity and discussions, the target will not be achieved without capital.

An industry representative noted that, despite large companies in developed markets attracting the bulk of the sustainability focused private sector investments, there has not been a significant impact on the full market or the economy. The world's listed companies account for just under one-fifth of the world's scope one greenhouse gas (GHG) emissions. According to the MSCI net zero tracker, this figure has not changed much in recent years. Allocating capital towards the most transparent and green companies that can meet a long list of eligibility criteria is leading to a smaller investment universe that will not be very consequential in the wider context of global capital markets and does not motivate change in the parts of the economy that need it the most.

2.4 Capital is currently flowing into transition of heavy emitting sectors. Data on investment in climate focused funds by private equity, private credit and venture capital funds is scarce

An industry representative advised that the focus for the future should be on capital flows that show growth and opportunity. Currently, capital is flowing to transition and private markets investments. Most transition labelled funds were launched in the last couple of years. These are mostly in actively managed equity funds. 70% are based in the EU but it is estimated that around 70% of the companies held in these funds are based in the US. In the private equity, private credit and venture capital funds context, climate focused funds are a nascent area that is growing very quickly. Very little data about these companies is available but they are disproportionately in the heavier emitting industries. Any approach that constricts the green investment universe reduces the opportunities to make a change and to make returns.

3. Coordination and coherence are needed at national, EU and global levels

3.1 Cooperation between the private and public sectors is needed to solve real-life ESG problems and engage SMEs of all sizes

An official observed that, if a regulation becomes a box-ticking exercise, the benefit will be limited. A cooperative approach between policymakers and market players are crucial. The Italian Ministry of Economy and Finance has recently produced a plain language 50-page document providing definitions, formulas and converting factors to assist companies in assessing and managing ESG impacts. The guidance document is targeted at non-listed SMEs and micro enterprises with fewer than 10 employees. These companies are not affected by mandatory rules but are crucial for the overall process. Improving accessibility to ESG information is critical. Sometimes information is already within the company, but the entrepreneur is not aware of it. More often, the company needs to rely on external data sets.

Technology must be leveraged to streamline not just the

collection but also the use of this information. Leveraging technology could include creating a single point of entry so companies and the financial sector can access information in a streamlined way or by using an artificial intelligence solution to calculate metrics required by banks in a more efficient way.

3.2 Political cooperation on whether to define net zero targets, tax incentives and disclosure standards for sustainable development, considering a global economic and political perspective, is also necessary

A regulator commented that the Draghi report is very informative and interesting from a Japanese perspective. There are differing positions on many issues, for example when to achieve net zero. Advanced economies are aiming for 2050, while some of the major emerging economies are aiming for 2060 or 2070. There is a difference in the interpretation of common but differentiated responsibilities. When discussing disclosures or transition to net zero at a corporate level, the metrics used are actually a global standard. Corporates will try to adjust in line with the global standards, but nationally determined contributions could vary. The fundamental challenge going forward is the inconsistency between what the countries do and what the corporates do.

Japan is a strong supporter of the ISSB, particularly of the inaugural ISSB Standards, IFRS S1 and IFRS S2, that have been issued in June 2023. The Japanese standard setters have published an exposure draft that we believe provides a functionally aligned outcome with the ISSB Standards. The engagement with the ISSB has been very constructive. A public consultation has been carried out and is being finalised. It is crucial that the standard itself is not undermined. This is particularly important from a market capitalisation basis. At the same time, we need to carefully consider the need of scalability and phase-in approach, for example, allowing preparation time for reporting. These points will be important in the actual application of the standards, in particular in the context of emerging market economies and SMEs.

When considering the disclosure standards and transitioning, a whole of the economy, as well as whole of the government approach must be taken. Finance plays a pivotal role and can provide encouragement in our efforts. However, governments need to consider not only finance but also incentives such as tax breaks, subsidies and carbon pricing as tools to enable the transition to net zero. In addition, while climate change, or decarbonisation, remains to be one of the highest priority issues, we must carefully consider its implications from a macroeconomic perspective, including competitiveness and geopolitical risks.

An industry representative commented that people often refer to different things when discussing fragmentation. In sustainable investing there is sometimes some confusion between jurisdictional fragmentation and definitions and traditional market segmentation. Regardless of region, there have always been investors who have a very financials-first approach, considering ESG factors, and investors who are very impact focused. The difference now is that investors with fiduciary constraints in many markets need to become clearer and

more consistent about which objective they are targeting. The data and analytics have always existed in a modular way that enable investment institutions to construct strategies and products that meet different investment objectives or their own objectives. This clear segmentation is a healthy development for the market and should not be regarded as fragmentation.

In relation to jurisdictional differences around what words can be used to describe a sustainable strategy and what activities are allowed, the field is going through a somewhat painful adjustment period. There is a deglobalisation in how sustainable investing is being practised and labelled. Institutions and investors across all regions have indicated that there is very little appetite to accept someone else's definition for a certain word or activity. There has been a move from a world where an institution could have the same laundry detergent with the same brand in different jurisdictions to one in which there is the same detergent but different brands or formulations for different regions. The rules must be sufficiently clear and, most importantly, stable, so that it is possible to manage which formulations of which brands go in which markets.

An official noted that many people have requested that standard setters do everything they can to reduce complexity. It is difficult for companies to adhere to the different and fragmented regulations and reporting requirements around the world. This illustrates the need for the ISSB's work. The ESRS-ISSB Standards interoperability Guidance, produced in collaboration, has been very well received in the market. The guidance has signalled that it is possible to present disclosures in a way that reduces the risk of duplication in reporting and meets both the European and the ISSB requirements.

Companies often highlight the importance of retaining a high degree of good interoperability with Europe. Jurisdictions should be encouraged to use the ISSB Standards without modification to prevent the introduction of friction into the system and reduce fragmentation. The IFRS Foundation has taken responsibility for the Transition Plan Taskforce's disclosure requirements and will encourage alignment with the ISSB's work in this area to eliminate another potential source of fragmentation. The aim is to make the process as efficient as possible, so that the focus is on managing sustainability risks and opportunities rather than on reporting.

A regulator reported that the Brazilian G20 presidency is particularly focused on promoting sustainable finance, including disclosure standards, in emerging economies and SMEs. The Sustainable Finance Working Group has highlighted four considerations. First is to consider reasonable adjustments. Second is to consider using digital technologies. Third is to promote activities and initiatives that build skills and technical capacity. Fourth is to seek interoperability and harmonisation. These points will continue to be relevant in the international context.

Simplifying the EU sustainability framework

The Chair opened the discussion by citing page 318 of the Draghi report, which says, 'The EU's sustainability reporting and due diligence framework is a major source of regulatory burden, magnified by a lack of guidance to facilitate the application of complex rules and to clarify the interaction between various pieces of legislation'.

1. The challenges of the current EU sustainability framework

A regulator emphasised that the introduction of the framework in 2018 and 2019 has accelerated the progress on the 2030 and 2050 climate goals. The legislation to create several frameworks was passed in record time: the Sustainable Finance Disclosure Regulation (SFDR), the taxonomy, the benchmark regulation, the European Sustainability Reporting Standards (ESRS) prepared by the European Financial Reporting Advisory Group (EFRAG) and the Corporate Sustainability Reporting Directive (CSRD). One of the main issues with the sustainability framework is its complexity. There are uncertainties and inconsistencies between the many different pieces of legislation. Secondly, the high cost of implementation makes EU firms less competitive than international firms. Finally, there is a risk of greenwashing. One additional key issue is the inadequate quality of sustainability data. The European Securities and Markets Authority (ESMA) has been trying to identify greenwashing by analysing a variety of datasets. When ESMA compared the estimated data from data providers with the actual data, it found significant discrepancies.

An industry speaker stated that it was important to praise the EU for its ambition and commitment to tackling climate change. One of the key challenges in the sustainability framework is the implementation of CSRD in the ESRS. The ESRS mandates a complex set of disclosures and contains over 1,000 data points. There are clear benefits to standardisation, but the ESRS standards are excessive. This is arguably mitigated by the materiality statement, which places a filter on the reporting. However, companies are required to prove whether each data point is material or not, which takes a significant amount of time and money. This creates a competitive drag for EU firms. The introduction of sector specific reporting standards will be more meaningful, but these standards will not remove the drag created by the current cross sectoral requirements.

An industry representative remarked that the Draghi report captured that the EU's sustainability and due diligence regulations are a major burden for companies, which was already well known. However, it is important to remember that sustainability is a significant policy

objective. The purpose of these regulations is to help to redirect capital to prevent catastrophic climate change and biodiversity extinction; the burden on the economy is likely to be significant. The question is not whether it is too great a burden but whether it is the right burden. The real problem is that policymakers went very far very fast because there was a need and a willingness to solve the problem. Mario Draghi noted in his report that the lack of clear guidance in the regulatory framework is causing a magnification effect. It is not clear whether it is necessary to implement everything or only some aspects of the materiality assessment.

Despite the high degree of complexity, it is important to keep making progress. The financial industry is 'in the middle of the river', but there is a better world on the other side. The trap to avoid is a cycle of paper compliance that solves nothing and has little real world impact. The current framework should be stabilised and calibrated and the burdens should be reduced through simplification, but it is impossible to return to a world in which information on sustainability is not shared.

There is some good news, however. From 2013 to 2023, the top 15 utilities rated by S&P have doubled their investment from €50 billion to €90 billion while decreasing scope 1 and scope 2 emissions by almost 40%. Despite a significant outlay of capital, the credit rating implications have been limited. On average, S&P's ratings have fallen by one notch over that period. Firms are doubling their investment, but credit quality has not been affected significantly. S&P's look forward research indicates that the 2030 decarbonisation targets for the private sector are manageable from credit and operational perspectives. The outlook is relatively benign, which means that now is the time to transition. Some sectors will only have two or three cycles of investment before 2050. For many CFOs, 2030 is 'tomorrow'. There are also some challenges. The data is not yet good enough, and this will take time to improve. S&P's studies suggest that reliable access to data and disclosure and the application of screening mechanisms will go hand in hand. The SFDR, the Paris Aligned Benchmark (PAB), the Climate Transition Benchmarks Regulation (CTBR), the CSRD and the taxonomy must all work together. Of the 2,000 companies that were assessed for the taxonomy last year, only 31% of non financial corporates made any taxonomy disclosures. This dropped to 25% in the financial markets. Utility companies are doing well at 42%, but only 17% of energy companies made any disclosures. There is a need for significant progress in these hard to abate sectors.

An industry representative agreed that the volume of regulation and the speed of its rollout act as a drag on the efficiency of the regime. Over the last few years, financial firms have been asked to implement level 1 legislation before seeing the final level 2 texts. After implementing

level 1 measures, firms often discover that other parts of the legislation need amendment. Even after the supplementing regulations are in place, helpful clarifications are provided in the supervisory guidance. This is an important tool for communicating the thinking of regulators, but it can border on rule making, which adds to uncertainty and the need to make changes continuously. This significantly increases cost. As well as financial cost, there is a strain on the important internal resources needed to operate a well functioning bank. The legislators and regulators often underestimate the complexity of financial IT systems, and the lead time required to make substantial changes. The limited resources in bank IT departments are needed to keep banks operational and to implement all these regulatory changes.

2. Implementing the sustainability framework: perspectives and challenges

An official stated that the objective of the framework is not to overburden firms. While the Draghi report suggests that the burden is undue, there is a difference between justified burdens and unjustified ones. The EU has reached a critical moment in the journey to standardise corporate reporting. The first wave of companies is currently preparing sustainability statements in accordance with the CSRD and the Sustainability Reporting Standards (SRS) in advance of publication in early 2025. The situation prior to the CSRD and the SRS was unsatisfactory. It was fragmented, uncoordinated, insufficiently qualitative and prone to greenwashing. The purpose of standardisation is not to burden; it is to increase quality and simplify. In EFRAG's view, simplification happens via standardisation. Good standard setting reduces cost in other systems. Without standardisation, data providers might only provide lower quality data because the data itself is neither free of charge nor standardised. The introduction of the International Financial Reporting Standards (IFRS) was a challenge of similar difficulty. It was a success because it introduced a common language, although many people considered it impossible at the time.

EFRAG recognises the challenges and the corresponding priorities. First, in a liberal economy, transparency is key. Quality data must be the starting point, and there will need to be coordination and consistency in the regulations. Secondly, there must be global consistency. There should be no duplication or replication of reporting. EFRAG has achieved a degree of interoperability with the International Sustainability Standards Board (ISSB), the Global Reporting Initiative (GRI) and the Taskforce on Nature related Financial Disclosures (TNFD) and it is working hard on the greenhouse gas protocol. Thirdly, implementation must be supported. EFRAG dedicates significant resources to its Q&A platform and issuing implementation guidance. Fourthly, there must be good standard setting. The standard setters have a responsibility to move at the right pace and not to make too many changes. There cannot be any 'stop and go' in the process of regulation.

The political authorities can set the pace, but EFRAG must produce the technical material. Finally, SMEs should not be unnecessarily burdened by the framework. The creation of a voluntary SME standard with fewer than 30 indicators will enable SMEs to participate in the transition via their accountant or legal advisor. The standard setters can and will do better. When crossing a river, it is better to focus on reaching the other side than judging the efficiency of the journey.

The Chair commented that the introduction of IFRS is an example of another stormy river crossing. It is useful to think about the current challenges with the benefit of this experience.

An official agreed that the sustainability framework is a moving target. The first reports from the CSRD will soon be published. It is important to remember that the framework is about digitalisation as well as sustainability. EFRAG has recently published its XBRL standard. The data in XBRL format will have to be audited, and this audit will have to be done on a limited assurance basis before it can be done on a reasonable assurance basis. Ultimately, this data will go to the European Single Access Point (ESAP), which is an ESMA data platform. The ESAP will be an extremely broad platform. It will have research functions that are truly database like. It will be possible to filter the data according to country, business size and sector. The Corporate Sustainability Due Diligence Directive (CSDDD) is an interesting piece of legislation that will change the approach entirely. It is not about transparency; it is about civil liability, sanctions and competent authorities. The sustainability framework is not perfect, but when the data becomes available, it will make clear whether firms are green and whether they comply with the taxonomy. However, the speed at which the framework is being implemented is problematic. Everything is happening at once, which is extremely difficult to manage.

3. European companies need to be helped to implement the framework

A consumer representative emphasised the importance of the objective of the sustainability agenda. Transparency is being blamed for the additional burden on companies, but it is a precondition to the next set of actions on sustainability. It will be important to help companies implement the framework, however. EU companies need to be allowed to focus on what is essential. Transparency is not an end in itself. Helping companies with implementation is more important than trying to eliminate parts of the regulatory framework. Other sectoral legislation and actions beyond transparency, such as actions on risk management or fostering real economy transformation, are much more difficult, especially in the financial services industry. If other actions were effectively being taken, reporting on those would be simpler.

It is important to bear in mind the complexity of information chains on sustainability issues and the complexity of the financial system itself. There are other environmental objectives alongside climate objectives.

There are smaller and simpler firms, but there are also companies that offer complex structured products alongside traditional lending. The process of reporting will be complex as long as complex products form part of the ecosystem. Ultimately, it is important to focus on real economic activity and ensure that reporting remains connected to real world objectives.

4. Improving the EU sustainability framework

An official observed that there is considerable room for improvement in the framework, but every attempt to simplify it seems to introduce more reporting obligations. Regarding SFDR, the use of labels would make products more understandable to retail investors. There is also scope for improvement on transition finance. The transition needs to be financed, and this should be defined in level 1. It is very difficult to keep up with the plethora of papers, explanations and FAQs published by the European institutions. It would also be extremely useful for the transition pathways to be defined at European level. It makes no sense for these pathways to exist only in a subset of countries.

A consumer representative noted that the parallel development of many different legislative initiatives has led to duplications, inconsistencies so that there are areas for streamlining. The two main goals should be coherence and clarity. This will require the alignment of many different pieces of legislation such as SFDR, CSRD, PRIIPS and definition of sustainability preferences per MiFID and IDD. Consistent definitions and a sufficient level of transparency for retail investors are especially important because retail investors are increasingly being called upon to salvage the capital markets union (CMU) project. It is important to use the same definitions across different pieces of legislation. Unless such clarity is achieved, it will not be possible to achieve the ultimate objectives of the sustainable finance framework. People talk about the growth in sustainable investment, but there is not yet a single definition of a sustainable or a transition product. There are other issues to address, such as overlapping requirements in CSRD and entity level disclosures in SFDR, but clarity and common baselines, including on sectoral pathways and scenarios, are the most fundamental need.

An industry speaker stated that EFRAG should revisit the ESRS. Streamlining these requirements would create the right foundations for sector specific standards and transition plans. Regulators and supervisors need to have the political and institutional courage to revisit the ESRS in order to establish a stronger foundation on which to make progress.

An industry representative noted that there is a significant mismatch in the use of the SFDR requirements for corporate disclosure. There is insufficient data on some of the mandatory indicators in the principal adverse impacts (PAIs). There is 100% coverage on some of these indicators and 0% coverage on others. There could be greater alignment if the PAIs measured less but measured it better. ESMA recently proposed the development of a

single common reference of sustainability. As currently constituted, the taxonomy will struggle to provide this kind of clarity. There is a middle ground to find here. For example, the use of SFDR labels could enable a distinction to be made between the taxonomy definition of sustainability and the sustainability that is needed in practice for transition.

An industry speaker commented that it is important to understand the issue at a technical level. The lack of consistency and harmonisation across various rules, is an issue that must be dealt with. As an example, the transition planning expectations in the CSRD also appear in the CSDDD guidelines, but transition activities are not covered by the EU taxonomy. There are also issues related to scoping. In some areas, the CRD IV requires transition planning work at European subsidiary level, while the CSDDD imposes requirements at both entity and group level. It would be more productive to focus on the elements of the framework that can help EU banks to create credible transition plans and strategies to support clients around the world. As a starting point, the EU banking sector needs to be able to quantify climate related and environmental (C&E) risk. The sector has produced materiality assessments which are currently being integrated into stress testing frameworks. If banks understand these risks, they will be able to support their clients through the transition. Taking an outcome based approach is the key to making progress in the real economy, which is the ultimate aim of the framework. Sustainability reporting should not be a compliance exercise. The focus should be on helping and financing clients on the journey to net zero and using these frameworks to improve transparency, which will assist in the creation of better benchmarks and drive consistency in global standards.

It is also important to consider the need for proportionality. In large groups with many smaller local entities, actions at group level often have a greater impact than actions at local entity level. Increasing the proportionality in the framework would allow larger groups to make greater progress. The development of bank transition plans should be guided by significant client engagement. This kind of disclosure should not be a compliance exercise. It should be based on an understanding of how financial services firms can support their clients. On balance, the existing framework does not need a complete overhaul, but some recalibration will be necessary. The key components of this recalibration will be consistency and proportionality. An industry representative noted that, while there are amendments that the industry would like to make to the framework, it is preferable to have a period of calmness and predictability.

5. Conclusion: balancing the competing priorities for change

A regulator stated that the main priority should be to simplify disclosure, which includes creating a product categorisation system for sustainable and transitional investments, and to improve data quality.

An official emphasised the importance of digitalisation and transition pathways.

Another official remarked that it is important to reduce reporting for SMEs, but there is no alternative to EFRAG's Voluntary Reporting Standard for SMEs (VSME).

A consumer representative noted that the two key priorities are to align the different aspects of the legislative framework and to clarify the requirements for transition plans by producing guidance on sectoral and geographical pathways and scenarios.

An industry speaker stated that the key priorities are to converge on global standards for transition scenarios, which will ensure international delivery, and to review the EU regulatory process itself. The forthcoming report entitled 'Less is More' should be considered alongside the Draghi report.

An industry representative highlighted the importance of fixing SFDR, defining sustainable finance and creating a robust framework for a definition of 'do no significant

harm' in order to avoid the trap of greenwashing. The key priority is to focus on the transition. Theoretical definitions of sustainable finance that might apply in 2050 are less useful than definitions that apply to the transition plans that will be implemented over the next five years.

An industry speaker agreed that sectoral pathways will be an important part of the future development of these frameworks. The use of this approach in Japan has helped to ensure that the private sector and the public sector share the same set of assumptions about the path to net zero. These pathways would also provide banks with better benchmarks for assessing whether their clients' plans are credible or not as well as providing support with respect to reputational risks.

An industry representative stated that there should be a clear acknowledgement from the European supervisors that the CSRD will not work without accurate and reliable data from the real economy.

SFDR review

1. The merits of SFDR and the difficulties of its implementation

An industry representative stated that SFDR has some good building blocks as starting points. Firstly, it is focused on disclosures and transparency. There is increased demand in the EU single market for environment, social and governance (ESG) investments, and more than 50% of investment funds in Europe are Article 8. For that, the regulation's core objective of transparency through accurate, consistent and robust disclosures is more relevant than ever. There is also the issue of materiality, allowing investors to make informed decisions aligned to their own sustainability preferences. One of the key pillars of the regulation is ensuring that investors understand the underlying investment strategy and the sustainability risks.

However, just having a very divergent and extensive list of requirements does not necessarily mean that someone is well-informed. Moreover, having irrelevant information could lead to people being misled or confused. What serves transparency and informed decisions is the appropriate set of information. In addition, many of the requirements for disclosures are not matched for the time being by solid data from corporates, which means many of the disclosures are based on estimates.

Moreover, it is important to keep in mind that the information with value for investors is linked to the features of a specific product in which they are considering investing. To the contrary, having aggregated information across many and different investment strategies offered by an asset manager does not say much to an investor. In terms of the merits such information can have from a public perspective, this is already addressed via the Corporate Sustainability Reporting Directive (CSRD). Having therefore aggregate entity-level references under SFDR is duplicative and potentially also misleading.

The majority of those implementing struggle with the meanings of 'sustainable investments' and 'do no significant harm' (DNSH). When internal definitions are communicated to clients, they might not align with other corporates' or regulators' definitions.

An industry representative emphasised that SFDR was a significant step forward for the industry. As with anything new, it has to be learned from. The framework has helped a great deal, although there are challenges. There are almost €8 trillion of assets under the management that are Article 8 and Article 9. There was a 28% increase in assets under management for Article 8, although some of that is due to overall exposure to the market. Article 9 is struggling somewhat. 'Sustainable investment' should have a strict definition, and not everything should be sustainable.

There is significant investor demand. There has been increased consideration of where data comes from, but data is lacking. Quality and coverage have been looked at, and there has been a realisation that coverage is not everything. There can be an estimate of everything, but the question is what something says if it is not a good representation. There is a great deal of innovation at the product and engagement levels.

SFDR should be efficient. There has been a great deal of confusion about the definition and the application of the definition. There remains confusion around applying the taxonomy DNSH for SFDR purposes. Such confusion can probably not be completely eradicated, but it can be reduced. There are also recommendations about being more prescriptive. It is hoped that CSRD will solve some of the data gaps. Some of the principal adverse impacts (PAIs) have very low coverage. There are comparability issues with estimates. For Article 4 PAI disclosure entity level, there are very different numbers for large asset managers and comparably sized global portfolios, which is concerning. With the underlying data, even for scope one emissions normalised by enterprise value including cash (EVIC) there are differences when similar numbers would be expected for large managers.

Europe has had challenges with regulatory alignment and there should be more clarity there. The way in which the European Securities and Markets Authority (ESMA) fund naming guidelines interoperate or link back to SFDR should be clarified. Different regulators apply the same rule set differently. The naming in itself is undesirable. The main objectives are quality and usability, and not just coverage.

The definition of 'sustainable investment' is effectively principle based. It involves looking at objectives, DNSH, minimum social safeguards assessments or good governance. Moving to a label regime similar to the UK Sustainability Disclosure Requirements makes sense. Most of the market already views Articles 8 and 9 as labels, so there is some disconnect there. There is a significant net flow into transition-labelled funds, so that area also needs clearer definitions.

An industry representative emphasised that SFDR is for disclosures for financial products, and CSRD is for disclosures of corporates. The sustainability preferences of customers in France, for example, are disappointing in that few want taxonomy-aligned products or sustainable investment products because they do not understand them or the definitions. Financial advisors are puzzled by the complexity of the regulation. There is also limited demand from retail customers.

Life insurance companies provide multi-option products (MOPs) that are not just funds but are also savings products with multiple funds and options. BlackRock and Amundi have different definitions of sustainable investment, for example, so disclosing sustainable investment shares at the MOP level makes no sense.

An industry representative highlighted that there are some first mover disadvantages. There is a gap in the regulation that supports transition finance, which is important due to the alignment with the objective of the Green Deal. Transition products are buried in Article 8, which is very broad compared to Article 9, which is very narrow. Labelling is sought as a way to promote transition finance. Directing capital in this way serves to de-risk the economy and society. One correction is dedicated labelling across sustainable products, with particular recognition of transition finance.

A regulator stated that SFDR's weaknesses have implications on how financial market participants implement the regulation and how supervisors supervise the implementation. The weaknesses are even more important when they touch upon the foundational concepts of SFDR, like the definitions of sustainable investment or DNSH, or the interlinkages between the taxonomy regulation and sustainable finance framework. The disclosure requirements might be too complex for retail investors, and there is a lack of guidance on how to complete the templates, which has led to diverging practices. ESG data remains scarce and lacks reliability.

The lack of clarity makes supervision difficult and complex and impairs investor protection. Clarifications have so far mostly been made through FAQs. When they are not clearly noted in level 1 or level 2 texts, there is legal uncertainty in the market and an impact on the enforcement powers of national competent authorities (NCAs).

2. The results of the consultation on SFDR

A regulator stated that the consultation is an acknowledgement that there are shortfalls that need to be fixed. It covers a broad range of topics, which will allow the European Commission to conduct an in-depth and comprehensive assessment of the framework. More work has been done at the European level in coordination with NCAs, which needs to feed into the consultation, including the joint European Supervisory Authorities' (ESAs') opinions on SFDR, the opinion issued by the ESMA Sustainability Standing Committee, and the Common Supervisory Action on sustainability risk, which is being finalised by NCAs. The replies to the consultation demonstrate major differences, but also clearly show how important SFDR has become in the ESG landscape. It is important to coordinate efforts to bring the relevant revisions, so the regime can be effective.

A policymaker confirmed that the number of replies in the consultation had been satisfactory. SFDR is contributing to making a difference, but there are weaknesses. Implementing the sustainable finance agenda has involved a significant legislative activity within a short amount of time. The whole framework will have to be looked at with some distance in order to ensure that it works.

One issue is the misinterpretation of Articles 8 and 9. These were meant to be disclosure articles, but they are

being used as labelling schemes. That was not the intention of the original proposal or the legislator. That needs to be fixed. The current structure of disclosures at product or entity level leaves room for streamlining and simplification. Consistency across sustainable finance files as well as quality in transparency could be improved. Different regulators have different views about what is needed. Some are hungrier in terms of information and want to know 'everything'. Even if they do not use the information, they feel comfortable having it just in case. Others would like more filtered information. There are also comments from the consultation on definitions and the way they are interpreted and used.

There are many ways in which these problems could be addressed, as shown in the feedback statement. However, a majority of respondents seem to support the establishment of a voluntary categorisation system. The basis for choosing the criteria, how that would have to be defined and how it would work is another matter. There is not a great deal of input on this, so bilateral and multilateral discussions will likely be needed.

An official highlighted that key areas in the consultation questionnaire included current sustainable finance disclosure regulation, interactions between other sustainable finance regulation, the subject of potential changes to regulation, and a new approach to categorisation for green and dark green sustainable financial products. These demonstrate the desire for a holistic and comprehensive review. There were 324 respondents. Taking into account the number of financial market participants and advisors there are in the European market, that number is not overly impressive. It might be that the respondents did not have any sources for a proper evaluation of the regulation, or they might not have seen the sense of the consultation. However, it is the role of the public sector to encourage each interested person to take part in the consultation, as every voice counts. Consumers and the financial market should be encouraged to take part in the consultation.

The whole process has identified major weaknesses and vulnerabilities. However, responders support the main goals of the regulation. There is divided opinion about how to reach those goals, but everybody agrees that, for example, the regulation needs clarification, simplification, fewer gaps and fewer overlaps. The most challenging issue is around Articles 8 and 9, but there can be a good solution. The transition project is also important. Most responders' comments were that the regulation should have an international dimension, which is important given the international dimension of sustainable finance.

3. Recommendations to the Commission

An industry representative emphasised that the importance of transition finances, the deficiencies, and the unintended consequences of Article 8 and Article 9 are understood, and consultation presents an

opportunity to make corrections. Investors are interested in financing transition. It can be seen from the ESMA data that flows into transition funds are up versus ultra-green strategies. The introduction of a labelling regime would be appreciated, including a range from ESG integrated to high impact, with the provision for transition finance.

Labelling should be harmonised across jurisdictions. Provisions for flexibility can create a fear of greenwashing, but it is preferable to have a very large, scaled-up market that finances sustainability with pockets of greenwashing and inefficiency, rather than a very small market that is perfect and has high barriers to entry. Some flexibility is sought, but with accountability in reporting. This is necessarily a qualitative process.

An industry representative highlighted that, given the consensus about transparency, the next stage will be to ask what type of transparency is most meaningful. Very targeted, meaningful information needs to be provided to investors to keep them informed and to avoid confusion. There should be a more limited set of core metrics, which could be human rights, climate and metrics that can be substantiated with existing data. As long as that is the minimum across all types of funds, then it can be built upon depending on the underlying strategy or the sustainability preferences of the investors.

The starting point should be rationalising the types of disclosures and underlying data points. There should also be rationalisation for entity-level disclosures. Unlike 2019, when SFDR entered into force, today CSRD is also in force and becomes applicable imminently for , all entities, including financial entities capturing thus sustainability considerations at entity level. In addition, SFDR can foresee a narrative on how the asset manager is looking at sustainability risks, which will be much more effective and less duplicative compared to the PAI entity-level reporting.

Caution should be taken with regard to SFDR and the current state of play in the market; moving too fast away from current categories may also have countereffects.

Although there was a first mover effort, there are now efforts across other regimes as well. Building categories that are too narrow can be very detrimental, especially in an existing market. It is already very difficult to define concepts such as Sustainable Investments and DNSH and we should seek in further clarifying them. There is also significant potential for better defining the transition path, because transitioning companies present important opportunities and are considered an important investment area for clients. Clarity is needed on how different investment strategies look into transitioning companies.

If there are voluntary categories, they need to give sufficient flexibility, simplicity and clarity. There should not be an overly rapid move using completely new categories and we should caution against replacing existing confusion with a new one.

An industry representative suggested that a two-pager would be sufficient to provide enough information to

retail customers. The SFDR pre-contractual disclosure is expensive for entities to produce each year. It can be made simpler and more understandable for retail customers, and less costly for financial market players.

The definition needs to be fixed, and a good balance found between a taxonomy, with 800 pages of regulatory technical standards (RTS), and a sustainable investment that has one paragraph. The taxonomy is not applicable to sovereign bonds. It is unclear whether sustainable investment can be applied to a government bond. Life insurance companies are disadvantaged as result because much of their asset allocation is dedicated to sovereign bonds. When customers want a sustainable product, they do not know what to say.

Sometimes a unit link is offered, which is a listed equity or a listed bond from a corporate. This listed equity is not a financial product listed and subject to a SFDR, so it is not known what kind of information has to be provided to customers. There are other examples, like euro medium-term notes (EMTNs) and portfolio management. There are some loopholes in the regulations to be fixed.

A regulator recommended clarity, simplicity and a focus on investor needs. SFDR is a disclosure regulation for building the bridge between investors looking for green investment opportunities and the real economy financing need. Investor needs should be at the heart of this regulation. SFDR should give assurance to investors that they have at their disposal the necessary information for the investments they are considering.

Disclosure requirements need to be clear. The sustainability performance of investments, need to be measured against clear and objective criteria, because the responsibility of investment due diligence cannot be left to investors, as is mostly the case under the current SFDR regime. The requirements need to be simplified, focus on the essential information and be further standardised to allow for comparability. They need to provide the necessary information to allow investors to make informed judgment of the contemplated investments. They need to cater for transition finance strategies. The right balance between qualitative and quantitative disclosures needs to be found. Europe does not operate in vacuum, so easing interoperability with other sustainable finance frameworks at the international level is essential. It is also important for the various pieces of legislation to fall into place and to be sufficiently robust.

The ESMA guidelines on fund names still lack clarity on key concepts like what a meaningful investment in sustainable investments is, the list of terms that triggers the application of the guidelines, the fact that the guidelines will apply to close-ended funds, or the rules applicable to green bonds. Applying the Guidelines in the current form without more clarification could exacerbate market divergences and fragmentation. There can only be a regime that eases transition if it builds and maintains investor trust.

An industry representative emphasised that the key concepts need to be clarified more than just with Article 217.

The European Sustainability Reporting Standards (ESRS) will help with the gaps. There should not be

further delays in the ESRS sector specific implementation and guidance. The materiality and sector specific aspects are missing in the PAI disclosures. Investors are not just sourcing the data for reporting; reporting informs the outside world, but much of the data is being used for downstream alpha generation or investment decisions. Fewer metrics with more quality and better coverage could have more impact.

The links with ESRS and CSRD are important. For any PAI recommendations, there are the draft RTSs, including new social metrics, all of which should be covered by mandatory reporting from ESRS.

There should be clarity about application. The cost of change is large. Although system updates are costly, legal updates or prospectus updates are far more costly. The industry wants to help the economy to finance the transition and give the best available data. Product categorisation will help. There is also room to better define what transition, sustainable and impact are. Global interoperability is genuinely important. All partners are needed in this journey, so having a level playing field and similar types of definition approaches makes sense.

Some sectors, like utilities, have very high numbers of reported taxonomy data. The situation is improving and with CSRD it will only improve further. There is a role for e-taxonomy to play in sustainable investments, which should be clarified.

An official emphasised that a complete change of the current framework would be inefficient. Financial market participants and advisors, as well as consumers and investors, have become used to the current framework.

A policymaker stated that the timeline for a potential future review is not yet known. There is a need to correct the weaknesses, there are many good suggestions and some emerging trends. Although there are some commonalities, there are also nuances. The new Commission will try to focus on implementation and avoid putting forward too much legislation.

The direction, in terms of the substance, is more or less known. Suggestions to improve EU legislation usually imply simplification. The complexity of the legislation is often linked to the complexity and uniqueness of the EU construction. For the College of Commissioners there are 27 different opinions, 27 different nationalities and several different political parties. The result of that first discussion then gets into the hands of the Council and the Parliament, and what was planned always becomes more complex, because everyone puts in what is important for them. Nonetheless, in the next mandate we should see more convergence of views towards simplicity and flexibility.

Priorities for developing transition finance

1. The promotion of transition finance is necessary

The Chair suggested that complete sustainability requires a pragmatic approach and a gradual shift from high carbon to greener activities. In this context, the sector must develop priorities for and a greater understanding of transition finance. Transition finance can help to reduce greenhouse gas emissions and rising temperatures.

An official noted that the Spanish Treasury has a team dedicated to green finance and clear targets it seeks to achieve. The climate transition is both a necessity and an opportunity to improve competitiveness through the building of new, sustainable, productive models and to achieve strategic, European energy autonomy. Corporates should view the transition not as a burden imposed by public authorities, but as a demand from consumers. The transition should be driven by demand. Some sectors will not be able to become fully compliant overnight and will require time to develop the necessary technologies and business models and to reduce cost. Nevertheless, green transition is an optimal economic policy.

A regulator observed that the role of supervisors is to protect consumers and, in doing so, they must ensure that insurance is affordable and accessible. In the U.S., insurance availability in some regions is limited because of recent catastrophic losses and other stressors. As such, increasing premiums is no longer the answer and supervisors must seek new solutions, especially reinforcing and strengthening resilience efforts.

Forcing insurers to eliminate either coverage or investments in coal, gas, oil and other “brown” industries is short-sighted as it could have adverse effects on the economy at large, especially as the need for those fuels remains while transitioning to a carbon neutral economy. While fossil fuel and other high-risk industry participants are voicing their struggles in seeking financing and insurance, newer green technology firms are also lacking coverage as insurers consider them “too new,” and potentially exposed to tail liability.

As insurers and supervisors consider a new transition they should consider green technology firms as a new customer base for the insurance sector. Pragmatism will be key to ensure that there is no domino effect on transportation, healthcare, education or food security.

In terms of the Japanese viewpoint, an industry representative highlighted that, in pursuit of decarbonisation, there must be a balance struck between transition and green technology. Funds should be provided through public and private sector collaboration. The Kishida administration in Japan issued basic guidelines on climate transition finance, clarifying sector-based roadmaps with a science-based disclosure framework while recommending how nine specific industries should transition.

¥20 trillion of climate transition bonds are to be issued in the coming 10 years. Public sector investment of this kind will induce private sector involvement. Immediate transfer from brown to green energy is not possible. There is no clear path between the two and there will be challenges ahead. Transition finance will therefore be key.

2. The challenges of transition finance and the ways forward

An official observed that the green transition is to take place in a context of increasing uncertainty. More equity financing and new sources of financing are required. Companies' transition plans must represent a change in their corporate culture, not solely be a check-box exercise. Support for small and medium-sized enterprises (SMEs) will be key, as the challenges of transition finance are compounded in such cases. The transition also imposes upon SMEs additional competitive pressures, because they must be able to integrate into the value chains of larger corporates.

Transition finance presents challenges for both business and finance actors to address. Finance providers will increasingly be required to ask SMEs for the information needed for climate reporting. SMEs will require capacity building and access to finance. Banks can play a role in accompanying their clients. The Chair added that we need to acknowledge that significant progress has been made so far, yet challenges remain in terms of the development of climate and sustainability-related financial instruments to support the transition. Such challenges must be identified and recognised before they can be addressed.

A regulator agreed that there is no clear path from brown to green energy, making the transition period all the more important. As a supervisor, the Austrian Financial Market Authority's first consideration is the Corporate Sustainability Reporting Directive (CSRD). Transition plans are a vital tool through which financial information can be collected for publication and disclosure. Regulators, usually accustomed to overseeing and challenging such information, will be required to consider transition plans and ensure their consistency with financial reporting as a whole. A transition plan must be credible in its climate objectives. The European Securities and Markets Authority (ESMA) has useful guidelines on enforcement, but more practical approaches are necessary.

Another consideration is the Capital Requirements Directive (CRD). EBA's consultation demonstrated the difference between prudential transition plans and those plans included with financial statements. The former represent a powerful tool for supervisors. The supervisory approach to challenging key performance indicators (KPIs) will develop over time, with some

preferring to see one plan with various additions. In terms of insurance, the solvency sustainability plan is included in the revised Solvency II framework. The International Organization of Securities Commissions (IOSCO) is working on transition plans in the interest of consumer protection and the Austrian Financial Market Authority is preparing its own complementary guidance in support of institutions' transition planning.

An official noted that there is a lack of consensus on the definition of transition finance. It may also include sustainable finance or focus only on the highest-polluting sectors. Transition plans must be aligned at both the corporate and sovereign level. Data standardisation will allow investors and lenders to operate on a level playing field. Many yet-to-be-transitioned assets sit on corporate balance sheets, while others sit on government balance sheets or represent contingent liabilities. These are the potential issuers of debt.

Issuers and lenders must understand what they are financing, for how long and the disclosures required. Beyond debt financing, there is the matter of equity financing. Given that investors are not providing capital for free, returns must be discussed. Such returns can be reduced only if risk is reduced. Transparency, disclosure and clarity of definition all play an important role in risk reduction and, without these factors, lenders will be reticent to be involved. Uncertainty must be resolved in a timely manner. Rating agencies and banks have roles to play in this regard.

An industry representative shared that, in Japan, around ¥150 trillion of both public and private sector investment is needed to achieve the green transition in the next 10 years. There must be a clear pathway to encourage private sector involvement and the guidelines compiled by the Japanese government are a step in the right direction. For instance, Kyushu Electric Power recently issued a transition-linked loan, targeting capex investment and utilising the interest rate subsidising mechanism issued by the government for the sector. Such initiatives are vital to ensure that transition projects are funded and that the inherent technology, development, reputational and political risks are overcome.

An official concurred that policies by which corporates' access to finance can be improved are crucial. The single market, banking union, capital markets union, equity and new financial instruments all have a role to play. The EU exports 2.5% of its GDP annually. The public sector can contribute by disseminating and promoting best practice. The Spanish administration, for example, intends to launch a green book on sustainable finance, focused on the promotion of transition finance within SMEs. A green sandbox will foster dialogue with supervisors.

The Spanish administration also plans to create a sustainable finance board, made up of relevant stakeholders, to facilitate the development of sectoral guidelines. The private sector is more aware of the technology available to support transition planning, and such awareness must be transferred to the public sector. There will furthermore be a role for the Spanish

Treasury in issuing green bonds. An official noted that Hungary has been an issuer of green bonds since 2020 under the International Capital Markets Association (ICMA), though alternatives, such as sustainability-linked bonds, were considered. Governments have contingent liability towards yet to be transitioned assets and it is therefore natural for them to be involved in financing, without crowding out the private sector.

National and corporate level transition plans must align. In Hungary, the issuance of green bonds has enhanced alignment of internal processes within governmental infrastructure. There are differing political views on the topic, but transition financing would ensure that government action is institutionalised irrespective of the party in power. It is the government's task to determine how supranational development banks might play a role in transition finance, provided that there is clarity and the appropriate data.

3. Possible changes to the European sustainability framework

An industry representative stated that, though the sustainable finance framework has its merits and is relatively comprehensive, there should be a change in approach. The framework is not perfect and never will be, despite widespread awareness and continuing implementation of Articles 8 and 9. The underlying issue is highly technical and constantly changing. These factors must be taken into account in the design of regulation, with more emphasis placed on testing and learning from practitioners. Enhanced flexibility will improve the utility of regulation.

Additionally, the CSRD requires targets to be set as absolute figures, even when they are centred on intensity. Banks engaged in the Net-Zero Banking Alliance (NZBA) have intensity-based targets, which are therefore somewhat at odds with the CSRD. It is critical that sectoral guidance, such as that included in the CSRD, provides clarification and enhances utility. The CSRD is built around the double materiality assessment, a subjective process that can lead to a variety of results within the same company. Biodiversity and nature, for example, can fall under both the material and non-material classifications. Such classification determines the necessity of transition planning. There must be a discussion as to how the European framework can be adjusted.

Cross-jurisdictional consistency is needed

A regulator noted that cross-jurisdictional consistency remains a key concern for US state insurance supervisors. Any framework developed to match such a diverse market must be a living framework that can be changed and adapted as new situations arise. The National Association of Insurance Commissioners' (NAIC) has 56 member jurisdictions, each with its own challenges. So, there is no one-size-fits-all approach. The most beneficial path forward for US insurance supervisors is a broad, non-prescriptive framework that facilitates consistent but independent rulemaking in each jurisdiction. This

goes hand-in-hand with information sharing and other coordination across borders.

The NAIC provides the necessary tools for that communication, online resources, dashboards, and training for its members and other interested parties. Also, the NAIC collects data across sectors to identify, monitor, and address challenges to the industry. Recently, state insurance supervisors launched a data collection effort across property markets to better understand each states' markets. That has yielded close to an 80% response rate, and once analysed, the data will provide insights into closing protection gaps (unique to each state's market) and strengthening the market as a whole.

4. How can greenwashing be addressed?

The Chair recommended that the panel consider how to address the issue of greenwashing, in order to enhance the credibility of transition planning. An industry representative agreed that certainty, transparency and credibility are essential.

A recent Association Europe Finances Régulations (AEFR) debate paper comments on the credibility of transition plans and makes 11 recommendations. The first is that there must be clear public policy upon which transition plans can be built, as per the Japanese example. Secondly, there should be one internationally consistent transition plan and transition planning guidelines. The CSRD is a positive starting point, but there are also prudential elements to consider.

Occasionally, the need for action is forgotten in favour of a focus on disclosure. Implementation must be made central, through scenario development and planning and identification and monitoring of external factors. It is not possible, nor is it useful to disclose every detail of the transition plan. Public guidelines in this space could help supervisors be certain that the planning process is sound.

A regulator added that a report produced by the three European supervisory agencies (ESA) provides a clear definition of and a starting point on greenwashing. ESMA recently published guidelines on fund names,

covering both environmental, social and governance (ESG) concerns and the green transition. If a fund has 'transition' in the name, quantitative minimum requirements of 80% apply. Despite these developments, there remains no clear definition of transition finance. The three ESAs' report and the recent ESMA opinion on the SFDR underscore the need for such a definition. In the past, there was also no formalised definition of greenwashing. Another, similar initiative led by the three ESAs might provide a solution. It is vital for the elimination of greenwashing that the use of transition finance be clarified, and this is of particular importance to investors.

In terms of how national and European authorities might contribute, an official emphasised the role that the public sector should play in the setting of clear transition targets. Clarity on this should encourage investment. There must be a taxonomy defined and a common understanding reached to facilitate the creation of a reliable, credible framework.

Recent progress on reporting standards in Europe has been promising, reducing transaction costs and enhancing credibility. There are more specific policies facilitating public sector intervention, but the limited fiscal space means that such interventions must be well designed, carefully targeted and focused on the additive power of the private sector, building on its capacity to create a broader ecosystem.

5. Conclusion

The Chair noted that it is evident that clear policies, appropriate regulatory guidance and credible transition plans will be key elements in the scaling up of transition finance. There is an initial sustainable finance framework in place and Europe is playing a leading role, but there is more to be done. There are steps that need to be taken by regulators, policymakers and the financial sector and collaboration between these parties, as well as with relevant stakeholders, will be essential, both within and across borders. Where there is a will, there is a way.

Sessions

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Capital Markets Union: future steps

1. Progress made with the CMU initiative

1.1. Progress of the regulatory framework but limited impacts in the market

The panellists acknowledged the significant work that has been done on the capital markets regulatory framework since the launch of the CMU initiative in 2015, but several speakers highlighted the lack of progress in terms of effective market growth and competitiveness of EU capital markets.

A policy-maker stated that the overall direction of the CMU is positive. Much has been done since the launch of the CMU 10 years ago with the adoption of three comprehensive action plans. Several promising measures have been passed, notably in the 2020 action plan, including the MiFIR review and the Listing Act.

An official agreed that much has been done on the regulatory front, leading to an improvement of the single rulebook. There is however a sense of frustration with CMU, as little progress has been made in terms of effective market development and integration. Stock market capitalisation in the EU still represents 62% of GDP compared with over 150% in the US. Financial markets remain fragmented along national lines. This is the case in particular in the post-trading space, where a great number of central securities depositories (CSDs) subsist and where processes are not yet sufficiently efficient. In addition, supervision is not yet sufficiently unified. It must be recognised however that preparing and implementing regulations takes time with the current EU legislative process, so the effects of CMU cannot be short term.

A regulator stressed that several key initiatives, such as consolidated tape and the European Single Access Point (ESAP), still need to be fully implemented to realise their benefits. In addition, regulatory measures alone will not be sufficient for achieving the broader objectives of significantly developing and integrating European capital markets.

An industry representative agreed that a great deal has been achieved in terms of regulation and that a lot of political effort has been made, but that this did not result in the desired effects on the markets. All key proxies continue to illustrate this. The EU accounts for only about 10% of global IPOs and much less if you exclude Sweden, the EU's IPO machine. Market capitalisation in the EU is around 50% of GDP, compared with around 190% in the US. And a growing number of companies no longer see the EU as an attractive place to do business, with many moving abroad or not coming to the EU at all. In addition, there is significant fragmentation of trading venues across the EU and even within member states, with more than 500 venues active in Europe.

There are also challenges on the demand side. According to recent data, EU citizens demonstrate a strong preference

for investing in international securities, with only about 25% of equity investments allocated to EU ISINs. The rest of the flow goes abroad. In contrast, in the US and Asia around 80% of investors invest within their own jurisdictions. There is an urgent need to act given the negative spiral created between weak growth, fiscal and monetary policy.

A second industry representative stated that there are three fundamental points to consider in assessing the effective progress made with CMU: whether dependency on bank debt has been reduced, whether supply of public and private equity has increased, and whether the supply of equity has been better distributed across Europe.

Efforts made on CMU have not delivered a satisfactory result so far on the supply or demand side. While there have been improvements in some countries, such as Sweden or France, there is no benefit at the aggregate EU level. In addition, the progress observed in these countries is not due to the CMU but rather to domestic strategies or the role of legacy institutions, such as Bpifrance in France. Public markets have declined and progress in private markets is concentrated in a limited number of markets. There is a lack of financial capacity and money going into European markets and also a lack of operational capacity. There is a shortage of adequate vehicles through which pension funds and retail investors can invest, as well as a general absence of a risk culture, both from investors and companies. A great deal of effort has been put into regulation, particularly on the supply side, but action must be more focused on the increase of equity financing of enterprises going forward.

A third industry representative agreed that there has been real progress in the capital market regulatory framework, although the legislative process has been too slow. The reviews of the Alternative Investment Fund Managers Directive (AIFMD) and European Long Term Investment Funds (ELTIF) frameworks were positive, as well as the measures adopted in the context of the MiFIR review, such as the implementation of consolidated tapes, which should contribute to increase market transparency and liquidity. This will be beneficial for the ETF market in particular. More efficiency must be gained in the broader ecosystem however, with the development of wider and deeper liquidity pools. Primary and secondary markets in Europe are still much smaller, in comparison to the US, when considering the market capitalisation of long-term financial assets compared to GDP.

There is a cultural element in the lack of development of European capital markets, but culture can change with market innovations, especially with changes in distribution, the industry speaker suggested. Rapidly growing neo brokers and digital wealth platforms in Germany for example have attracted many first-time and younger investors. Sweden and Denmark also offer positive examples in Europe where capital has been put to more productive use.

A fourth industry representative emphasised that progress has been made in the consolidation of the post-trading market over the last few years, with three major groups now representing roughly 90% of the volume. However, the advantages of this consolidation have not yet fully materialised due to persistent legal and fiscal barriers and differing market practices. Further integration is achievable, but it requires time and appropriate regulatory conditions. The US market went through consolidation efforts in a more harmonised environment that eventually led to a single CSD. Europe is on a similar journey that needs pursuing. The European financial market infrastructure has always been robust, helping to maintain safe and competitive capital markets.

1.2. A new political momentum around CMU

The panellists welcomed the current political momentum around CMU as a new political cycle is about to begin in Europe.

An official considered that the current political momentum is cause for optimism on CMU. The Draghi, Letta and Noyer reports on CMU, and contributions from the ECB and ESMA, make a clear description of the situation of capital markets in Europe and set out key elements on which progress can be made. These opportunities must now be seized to build a clear agenda for further action.

An official agreed that there is reason to be positive on the future potential of CMU. The Draghi report in particular gives a clear indication of what can be done. The current CMU action plans also provide a strong basis on which further actions can be built, with measures such as ESAP and the Listing Act.

An industry representative also noted the positive political momentum around CMU following the publication of the Eurogroup statement and the Draghi and Letta reports. It is now time to create a concrete action plan based on the proposals made to move towards a real savings and investment union.

An industry representative observed that, beyond the willingness and political momentum demonstrated in the reports recently published on CMU, there must also be a greater sense of urgency.

2. Approach for the next steps of CMU

2.1. Focusing more on tangible action than regulation

An industry representative pointed out the excessive focus on regulation of the CMU initiative so far. More tangible action is needed now, driven by investor and issuer demand. The key challenge is how to generate more public and private market equity and distribute it effectively across Europe.

Europe however needs a different approach from the US style venture capital model, which is largely focused on leveraging, controlling and selling companies. In Europe the focus should rather be on long-term patient capital, minority equity stakes, and forming genuine partnerships with venture capital institutions. It is

unrealistic to expect a surge in retail investment in SMEs, and pension funds lack the vehicles to invest in smaller European companies. Banks should therefore play a central role in filling this gap. The UK's Business Growth Fund (BGF) model which has been replicated in Canada, Australia, and Ireland, is a good example of how this can be achieved. Banks, which hold the savings, should be encouraged to collectively invest these funds in companies, in a way that creates scale, efficiency, and impact. Such an approach is preferable to further regulatory changes, as meaningful CMU progress depends on the financial industry mobilising to meet the challenges rather than on additional regulatory measures.

Another industry representative suggested that time must be given for the initiatives adopted in the context of the CMU action plans to settle and deliver their full effect before considering any further regulation. A more investor centric approach is needed in the next steps of the project to bring savers on board and encourage them to invest in the capital markets. Tax measures to incentivise retail investment are important to consider for example. The industry also has a role to play in achieving the objectives of CMU. Securitisation can help banks to play a more active role in the funding of firms by freeing up their balance sheets. Asset managers have an equally important role to play in attracting investors to the capital market and mobilise their savings in a more effective way, building on well-regulated, attractive vehicles, such as UCITS and the recently reviewed ELTIFs. Pension funds and a reshaped PEPP could also contribute to developing capital markets.

A regulator emphasised that regulatory reform alone will not create a robust capital market. The supply and demand for capital must improve. This requires a more conducive ecosystem for listed companies and a greater emphasis on incentivising investors and boosting capital flows.

A policy-maker agreed that, while regulation is a key part of the solution for further developing and integrating capital markets in Europe, it cannot fix everything. Markets must also be driven by the industry as well as evolutions of society, such as enhancing financial literacy.

2.2. Completing European initiatives with actions at member state level

A regulator stated there should be combined efforts at European and member state level. The Commission should work on common policy issues likely to drive CMU forward and member states should step up their efforts to develop their national markets in a way that is consistent with the CMU objectives.

A policy-maker stressed that while member states can take measures for the development of their own capital markets, it is necessary to identify the areas where convergence can be beneficial at the European level. In addition, a European approach is needed for cross-border issues. An industry speaker agreed that the measures taken by member states to step up their capital markets should be consistent with the actions taken at European level.

Answering a question from the Chair about the possibility of using enhanced cooperation mechanisms among a group of member states for measures where EU-level agreement is not possible, an official stated that such an approach would not be relevant in this case. The process is

too long, taking up to three years and is quite complex. For promoting a new savings product for example, it would be better to build a coalition of the willing from the start with the member states that would be interested and agree on a set of common key features. Involving the private sector is also essential, since, ultimately, the product will need to be widely adopted and promoted by the private sector to create a new pool of liquidity for the new asset class. The experience with the PEPP initiative, which did not deliver what was expected, should not be reproduced. Although there was a properly crafted political compromise at EU level, it did not work in real life.

An official suggested that the political feasibility of policy proposals should also be better taken into account when proposing EU reforms.

2.3. Streamlining regulation and improving the legislative process

An official considered that European capital markets are suffering from overregulation. A key priority is to reduce the regulatory burden where possible. The starting point should be to identify the complexities created by existing rules and the impacts this may have in terms of disincentives to investment, diversion of resources and hampering of innovation. The relevance of financial frameworks in an increasingly digital environment also needs considering.

An industry representative suggested that the approach to regulation must be reformed to enhance the competitiveness of EU capital markets. Level 1 texts must be streamlined, and supervisors must have more freedom to adjust Level 2 and 3 standards. This would require a review of the Meroni doctrine as well as measures to enhance the agility of rule-making in the EU, in line with the approaches that exist in the US and UK where market competitiveness is part of the authorities' mandates..

A regulator agreed that there is a need to move towards a more efficient regulatory approach in financial markets in Europe that can adapt more quickly to market changes. The Level 1 framework should remain at a high level, rather than including an excessive amount of detailed rules.

The Chair echoed the comments made on the current legislative process. Co-decision is too exhaustive and slow. Many unresolved issues are passed to the European supervisory authorities, creating a system that becomes overloaded with mandates and tasks. This results in a clogged, sluggish system. The Lamfalussy process, originally designed to work as a set of principles to ensure regulatory efficiency, is no longer being applied effectively in some cases.

2.4. Work on the labelling of the CMU and the underlying economic rationale

An official noted that it is not always easy to explain the purpose and need for CMU to national politicians. This contributes to creating a gap between European policy-makers and member states on CMU.

Another official agreed that the narrative around the project is important. The way CMU has been presented is perhaps too technical and insufficiently aspirational. The

proposal to change the name of CMU to a savings and investment union makes sense, but what is needed now is primarily taking action in the key areas highlighted by the recent reports on CMU. Answering a question from the Chair about the need to demonstrate more clearly the economic rationale for CMU, the official suggested that the focus should now be on achieving tangible and convincing deliverables rather than spending time on demonstrating the economic rationale of CMU, which is quite a complex task.

An industry representative noted that the competitiveness of the European economy is a key driver of CMU. If Europe is not an attractive investment destination, investors will not invest their capital in Europe. The two are closely connected. There cannot be strong capital markets without a competitive economy and an economy cannot be competitive without vibrant capital markets.

Another industry representative observed that CMU and mobilising private capital are particularly important considering Europe's very challenging economic position, with recession looming in Germany and Eurozone growth at only 25-30% of the rate of the US economy. Fiscal and monetary policy instruments are no longer as effective as they used to be and large number of member states have unsustainable public finances at present.

3. Key areas of focus for future CMU work

3.1. Policy priorities for the next steps of CMU

A regulator emphasised that there are three perspectives to consider for CMU going forward. First are the sources of capital that firms and the economy need; secondly, there are issues on the demand side, where household savings are not being used productively or delivering sufficient benefits for investors. Thirdly, there needs to be greater regulatory and supervisory harmony across the EU to break down legal barriers and tackle fragmentation. European rules must also be applied and supervised in a common way.

A policy-maker stated that further work is needed in the next political cycle to address the structural challenges that prevent deep and liquid capital markets in the EU. There are persistent legal divergencies mostly stemming from areas that are beyond the remit of financial services, such as company, securities and insolvency laws. How to further integrate financial market infrastructures without necessarily fully harmonising these laws and rules needs to be further assessed, as well as how to improve supervisory convergence.

On the investment side of the CMU, there are also a number of issues to be considered, such as securitisation, on which a consultation will be conducted; how to develop venture capital in Europe; and how to make better use of retail savings, beyond the measures proposed in the Retail Investment Strategy (RIS). Tax incentives are an important aspect of encouraging retail investment, which is the responsibility of Member States. Opportunities for convergence in this area need to be explored. Improving

retail investment products and accounts should also be further examined, as should the development of occupational and personal pensions.

An official observed that the way the CMU project is structured is important. As proposed in the Noyer report on CMU from April 2024¹, it seems appropriate to focus on a limited number of more visible proposals that may be easier for ministers to endorse and monitor than the comprehensive approach taken so far. These proposals include creating an EU-level investment product label, promoting integrated supervision, reviving the securitisation market in Europe and working on post-trade integration. While there are other issues to be addressed, such as the fragmentation of insolvency law, it is important to focus on a limited number of initiatives.

Securitisation is an area where it should be possible to move forward quickly because all the elements are on the table, the official pointed out. A consultation needs to be launched very soon to assess the prudential and regulatory aspects and also concrete solutions to promote securitisation, such as the type of platform that is needed drawing on the US experience.

An industry representative observed that, while securitisation is useful for increasing the financing capacity of the banking sector, it remains focused on debt rather than equity.

A second industry representative highlighted two key priorities for the CMU's future steps. The first is to improve the supply of capital to the economy. This is not only a question of attracting capital flows from outside Europe but is also about mobilising savings in bank accounts for more productive use, by providing appropriate investment solutions for retail savers and developing pre-funded private pensions, building on existing best practices. IFIs operating in Europe, such as the EIB and the EIF, should also be strengthened and better used to finance scale-ups and support IPOs. Second, the depth and liquidity of European capital markets must be increased to make them more attractive to investors and issuers. This requires an improvement in market structure. The European trading space needs to be further rationalised, with additional rules on dark trading and a simplification of MiFID and MiFIR exemptions that are too complex to apply.

A third industry representative considered that the recent reports on CMU provide appropriate analysis and guidance on Europe's challenges and priorities. The focus should be on creating demand and supply for capital, turning savings into investments and attracting and retaining more companies in Europe.

Efforts to further integrate the EU post-trading space also need to be pursued. Some consolidation has taken place at the post-trading infrastructure level, but it is important to further reduce costs through additional synergies. Efforts by infrastructures covering multiple markets in Europe to build common IT platforms and operations to achieve synergies need to be continued. It is also important to take advantage of available opportunities for integration at the European level. There

are interesting examples, such as Ireland's decision not to have a national CSD and to enable CSD services to be provided by an entity in another Member State. Another example is the Eurobond market. Created some 60 years ago, it is the third largest fixed income market in the world at around €13 trillion and attracts many non-European issuers. It is also very important to maintain a level playing field in the European post-trading market, supporting fair competition between providers.

A fourth industry representative added that providing fund depositaries with a European passport is another integration opportunity worth considering. This could facilitate a further integration of asset custody activities, which are fundamental to the functioning of the asset management market. The investor perspective should also be at the forefront of the CMU's future steps, in particular ensuring that investors have access to the right products and that these products are adequately distributed.

3.2. The prospects of a more unified supervision

An official suggested that progress should be made towards more integrated supervision. There should not be a complete shift from national supervision to fully integrated supervision, but there needs to be a sense of momentum with concrete steps towards more integration.

A regulator considered that there is value in coordinating supervision at European level where it makes sense and where there are clear benefits. This is the case for some cross-border activities, but supervision of most national and smaller players at the European level does not seem necessary.

An official noted that particular caution must be exercised when considering the extension of unified supervision. Financial market supervision must be carried out at the appropriate level. While some activities can be supervised at EU level, it is important to maintain the supervision of domestic products and services at the member state level.

The Chair agreed that caution is needed when considering changes at the supervisory level but observed that some redistribution of responsibilities would be appropriate. For instance, systemic or cross-border activities could be more effectively managed at the EU level, while domestic players should remain supervised at national level.

Conclusion

The Chair summarised that the start of the new political cycle is a crucial moment for CMU. Much has been done since the launch of the initiative, and many new ideas have been set out. There is now a strong political momentum around CMU and a new sense of urgency. However, without a high-level political agreement at Council, Commission and Parliament levels on the direction of travel and the timeframe of the CMU, there is a risk of slipping back into a complex process that does not deliver on the key regulatory issues.

1. Proposals for a Savings and Investments Union – Developing European capital markets to finance the future – Report drafted by a committee of experts chaired by Christian Noyer April 2024.

CMU: bottom-up or top-down approach?

1. Progress made with the CMU initiative

The Chair noted that the beginning of a new political cycle in the EU is an appropriate time to review what has been achieved on the CMU and what actions need to be taken going forward. There is appetite to do more. There is a need to identify what more needs to be done and how future steps in the CMU initiative will be taken. The Commission is likely to prepare a strategy on the CMU for the next political cycle, possibly under the new label of a savings and investment union.

1.1 Effectiveness of top-down actions for achieving the objectives of CMU

An official considered that the CMU initiatives to improve the functioning of capital markets have been quite effective. Much has been done to strengthen and harmonise the regulatory framework. However, differing national implementation of these rules must be avoided to facilitate the common design and distribution of products across the EU. There are very effective common rules for investment funds with the UCITS and AIFM directives and the recently reviewed ELTIF regulation. Consistent customer information rules have been developed with the PRIIPs regulation. The capital market framework has also been strengthened with the significant work conducted on MiFID, MiFIR and CSDR. Europe has robust infrastructures and two international central securities depositories (ICSDs). Trading is also quite efficient, although a significant amount of equity trading takes place in systematic internalisers (SIs) and banks.

A second official remarked that a great deal of progress has been made on the European capital market regulatory framework. Top-down regulations that have been adopted at the European level address many important areas including for example investor protection, information provision to investors and the listing of smaller companies.

An industry representative stated that the CMU top-down actions implemented so far in the securities markets have had a mixed effect. The evolution has been positive on the clearing side. EMIR introduced open access and interoperability rules and has reduced costs. In equities clearing, five central counterparties (CCPs) concentrate 80% of securities clearing and costs have reduced by 60%. However, some major CMU initiatives have been quite unsuccessful, with significant unintended consequences for the market. MiFID and the first version of MiFIR have not worked as expected. The aim was to increase competition and lower trading costs, but these legislations mainly led to liquidity fragmentation with a huge number of OTC trading venues. This also impacts initial public offerings (IPOs), as the liquidity of the secondary market is an important factor when deciding where to list. The measures taken in the settlement layer with the CSDR have not been effective either, with 27

CSDs still operating in Europe compared to one in the US and the persistence of different withholding taxes and insolvency laws across Europe fragmenting the market.

A third official highlighted that MiFID has resulted in numerous trading venues for securities, raising questions about their necessity. Currently, only 35-40% of equity trading occurs on exchanges, with the remainder happening on SIs or in dark pools. Whether this development is beneficial should be further assessed.

A fourth official noted that after 10 years of work on CMU, there is now a greater sense of urgency to make decisive progress. However, there is currently a lack of conviction in a number of EU member states about CMU. Too much time has been spent thinking about how to develop capital markets in Europe and not enough thought has been given to how CMU will benefit the EU's smaller capital markets. The CEE (central and eastern Europe) countries in particular, except Poland, have much smaller and less liquid capital markets than the rest of the EU. Savings primarily go through banks and to government securities, which represent the bulk of the capital markets in the region and most of the funding of companies is bank financing. In a more integrated European capital market liquidity and trading will tend to gravitate to the largest financial centres because investors prefer to concentrate their trading for simplification. Countries with underdeveloped markets do not trust that flows will eventually trickle back down to them if the trading ecosystem concentrates on the large economies. Similar situations have arisen previously in the banking sector. For example, it was said that the presence of western European banks in the CEE countries would insulate them from a crisis, while in reality it accelerated the transmission of the global financial crisis into those countries.

An industry representative suggested that, as a result of the political focus of CMU being centred in Brussels, the tools used to advance the CMU agenda have largely consisted of regulatory and harmonisation efforts. Although progress has been made with the regulatory framework, the EU's capital markets have not yet expanded to a scale in proportion with the EU's gross domestic product (GDP). Public policy can support the drive towards deeper and more competitive capital markets in the EU, but markets cannot be regulated or supervised into existence.

At present there is too large a gap between the goals of CMU and what is possible within the current political conditions. Closing this gap could be transformative and could accelerate the pace of the positive change already observed. The EU's trading landscape compares very favourably with that of the US, because it has many competing channels, but the EU post-trading landscape is complex and expensive. Market participants have to build separate connectivity into each domestic infrastructure to trade, which creates frictions and costs and fragments liquidity.

1.2 Actions implemented at member state level to develop national capital markets

An industry representative observed that national governments can act to develop their capital markets in cooperation with regulators and the financial industry. The Nordics and Baltics are good examples of this. The success of the Swedish market is a result of local financial market infrastructures working with the government, industry and pension funds to help improve financial literacy and an ecosystem that allows innovation to flourish. The Baltics have collaborated on joint regulation and have been able to consolidate three CSDs into one. This can be done on a regional level provided it makes commercial sense.

An official noted that significant action has been taken at the national level in some member states to develop financial literacy and ensure that investors can make informed decisions. In the Czech Republic for example, financial education has been a mandatory part of the school curriculum for more than a decade, which has been successful. To help citizens select the investment products that are most relevant for them, a Corporate Bond Scorecard tool has also been developed, classifying corporate bonds according to criteria that are relevant for retail investors.

2. Combining top-down and bottom-up approaches in the future steps of CMU

The Chair observed that the President of the European Central Bank (ECB) has suggested that a more top-down approach to CMU is needed at least in certain areas. Mario Draghi has shared a similar view on supervision in particular.

An official stated that top-down and bottom-up approaches will both be needed in the next steps of CMU with an appropriate balance between the two. Top-down actions can be perceived as controversial by member states but are needed to drive coherent actions at EU level and can also indirectly support the development of national markets. Investor protection, investor and issuer financial literacy, which are essential for encouraging more investment and funding through the capital markets are areas where joint action makes sense, although attention must also be paid to national specificities. The same is true for revitalising the securitisation market, which can be an adequate method to increase bank funding. Market fragmentation is a more controversial issue. Consolidation of post-trading market infrastructures can be worrying for countries with a smaller capital market. However, there are significant opportunities to reduce the current fragmentation of venues in the trading space, which would be a less politically sensitive question.

A second official agreed that both top-down and bottom-up approaches will be needed to achieve the overall goals of CMU. A number of aspects must also be determined by demand and supply with no intervention from the public authorities, such as the pricing of

securities. A top-down approach is needed to assist member states in growing and deepening their national capital markets. The work conducted at the EU level in particular by the Financial Services Committee (FSC) and the Eurogroup on CMU should help ministers to agree a common work plan with deliveries in the short and mid-term and identify the main messages to convey. The European institutions also have a role to play in fostering the exchange of best practices between member states and market players and ensuring that there is effective cooperation at EU level. Achieving the desired CMU outcomes will take time. Sweden, which now has a vibrant capital market, launched the first initiatives aimed at developing its capital markets in the late 1970s.

Bottom-up approaches conducted at member state level could include tax incentives to attract investors to the capital markets. This has worked in many countries, such as Sweden, the US, the UK or the Netherlands. But this incentive needs to be implemented at the national level because taxation is and needs to stay a national competence. In the Czech Republic, the same tax treatment is applied to all types of long-term saving and investment products that aim to prepare for retirement. National-level measures are also needed to inform SMEs about the benefits of capital markets and provide guidance on how to obtain funding. A guide for SMEs has been introduced in the Czech Republic with explanations about the capital markets, how to approach them and the importance of diversifying financing sources.

A third official emphasised that, while financial regulation should be harmonised as much as possible at the European level to build the internal market and simplify requirements for cross-border players, member states must improve the functioning of their local markets. Some parts of the market will remain mostly domestic such as SME markets. SME bonds tend to be distributed to local investors, because investors in other member states do not know the companies issuing them.

A fourth official also suggested that both top-down and bottom-up approaches are needed. Those looking at CMU from a bottom-up perspective are usually more concerned with having sufficient access to funding, whereas those looking at CMU top-down want to improve market liquidity and efficiency. Action at the European level is necessary to remove the barriers that hinder cross-border business within the EU, such as insolvency law and withholding tax, but much can also be done at the national and private sector levels to grow the markets. Business is quintessentially bottom-up. Businesses operate within the existing rules to decide where to list and where to get money from, which can be within or outside the EU. Trust-building is critical for business and requires an appropriate alignment of the bottom-up and top-down perspectives.

An industry representative highlighted the need for adequate alignment and synergy between the actions undertaken at the EU and member state levels. Achieving a seismic change in capital markets is about scale and enhancing a number of dimensions such as liquidity. This requires clear direction and a credible agenda. The UK and EU both have insufficient exposure of retail money to capital markets due to regulatory

hurdles and tax treatment issues. Stamp duty for example perversely incentivises investment outside the union, typically into the US. Increased retail investment will not have a significant short-term impact on market liquidity but is essential for meeting the political conditions needed for capital markets to develop in Europe. European governments and citizens must be convinced that capital markets are beneficial for European savers and firms, especially given the lack of growth in most European economies.

Another industry representative considered that increased participation of households can have a decisive impact on the growth of European capital markets. If retail participation was comparable to that in the US, approximately €4 trillion of savings could be unlocked for the European capital market. This is achievable with sufficient political will. National governments can build effective pension systems over time, as demonstrated by the examples of Sweden, Denmark and the Netherlands, and can incentivise investment in the capital markets with tax incentives.

The conditions must also be created for companies to remain in Europe and find adequate risk capital. Risk capital will be brought into the market if companies are productive, profitable and innovative and if it is more attractive for savers to invest in the capital markets than to leave the money in savings accounts. As detailed in the Draghi report, there are many sectors in which the EU is still a world leader, such as industrial technology, clean tech, biotech and pharmaceuticals. These sectors must be nurtured and financed. This can be done at private sector level. Actions are however needed to make it cheaper and easier for companies to list, trade and access risk capital in Europe.

3. A top-down approach to simplifying EU regulation

An official emphasised that over-regulation and the excessively complex regulation is a major issue in the financial sector, including for capital markets, as it increases costs and creates inefficiencies. A top-down approach will be needed to reduce this over-regulation, for example simplifying reporting and alleviating administrative burdens. An active participation of member states can be expected to achieve this, as this is not a politically controversial issue.

A second official agreed that the first priority for top-down action should be a rationalisation of the current European capital market regulatory framework, starting with a holistic analysis of the overall framework and the identification of the overlaps and inconsistencies between the legislations composing it. Capital market professionals, issuers and investors need a transparent regulatory framework that is easy to apply and to comply with.

A third official acknowledged that the European framework could be further streamlined. The different layers of regulation with Level 2 and 3 requirements in addition to the Level 1 text result in complexity. As stated by Ursula von der Leyen, a key topic for the new legislative cycle is to

reduce costs and make the European framework easier to use. This is highly relevant to the CMU discussion.

The Chair noted that certain recent regulations, such as the Listing Act, aim to provide simplification and improve consistency between various pieces of legislation pertaining to SME listings.

4. Focusing on key priorities in terms of impact and feasibility

An industry representative suggested that thoroughly addressing a smaller number of important aspects in the CMU would be preferable to trying to solve all the problems identified. This will result in a clearer and more credible agenda that will be more effective in attracting investment. Policy should focus on key measures that will provide funding and investment opportunities for the European economy and citizens and remove the obstacles to achieving this.

An official considered that rather than trying to solve every problem, the focus should be on the actions that will have the largest impact and are the least politically controversial and thus easier to implement. A thorough analysis of the improvements needed is necessary before taking action. There are two types of action to be taken in the capital markets area: long-term actions aimed at laying a sustainable foundation for future growth and stability, and short-term actions focusing on "low-hanging fruit" aimed at addressing immediate challenges and strengthening Europe's competitive position. Priority should be given to the second type of action, given the importance of enhancing the competitiveness of the European economy and the significant role that capital markets can potentially play in achieving this objective.

A second official suggested that top-down actions should focus on a limited number of priorities that are likely to have short term impact and are relatively easy to deliver, so that member state politicians and citizens perceive the benefits. Considering the three elements of CMU in turn, capital is already available in the form of abundant household savings that need to be used in a more active way. The focus should now be on developing and deepening the markets, following which there will be a natural demand for further integration. At that point, a union can be created, but this stage has not yet been reached. At present, SMEs and retail investors remain focused on their national market.

The discussion on centralisation of supervision and further consolidation of infrastructure should be postponed, as there is currently no broad consensus on these issues and therefore a high probability that the discussions will not reach a conclusion. This has happened before, for example in the case of the European Deposit Insurance Scheme (EDIS), where the discussion was blocked because there was no initial consensus. Instead, priority should be given to areas where there is broad agreement.

A third official stated that the focus should be on the key issues that are hindering demand and supply of capital. On the demand side, it must be easier for retail customers

to invest in capital markets rather than leaving their money in deposit accounts. On the supply side, the funding of firms on the capital markets must be facilitated. A top-down approach is preferable to achieve these objectives, but there should be a focus on simplification. On the demand side, UCITS are a good example of the benefit that a European approach to investment products can bring to facilitate cross-border investment. Further harmonising insolvency law is another priority, but rather than harmonising the whole area, only the elements that are specific to capital markets and those that concern the settlement finality directive, which plays a critical role in protecting financial markets during insolvencies, need to be addressed. The same targeted approach could be applied to other Giovannini barriers that hinder post-trading integration and cross-border transactions. On the supply side, SME listing is a first priority. It should be as easy as possible for SMEs to list on public markets. An additional area that needs to be simplified is reporting. In Germany, a consultation has been launched to assess how reporting requirements could be simplified.

A fourth official highlighted two priorities that the CMU should focus on. Further consolidation of infrastructures is a first priority, as it will help to reduce transaction costs and facilitate cross border transactions. The Baltic countries all wanted to retain a domestic stock exchange, so the CSDs were consolidated. Rationalising the post-trade infrastructure is an urgent project that does not require public sector intervention. Work is ongoing with eight stock exchanges in central, eastern and southeastern Europe (CESEE) to create a common infrastructure, that will allow investors to invest in any security in that region through a single point of entry.

Attracting savings to the capital markets is a second priority. This will first require an adequate offering of investment products and pension funds to intermediate investments, because most savers will not want or do not have time to invest directly in the capital market. These products are lacking in the CESEE region. The EU level can assist here, providing common product frameworks. Secondly, financial education is needed to build investor trust and also to convince other stakeholders that capital markets development is a key driver of competitiveness. Once this is understood, regulatory convergence can be built. The Baltics are again a good example of this. The Baltics converged their regulations to the extent that they were considered as a single market by index

providers such as MSCI. The Baltics then moved from being frontier markets to emerging markets, which was very successful for attracting capital. In addition, adequate insolvency laws and efficient taxation rules are needed to encourage investment in the capital markets.

5. Enhancing the governance of the CMU project

The Chair asked whether improvements are needed in terms of the governance of the CMU project. At present several entities are involved in the governance of the CMU, including the ECOFIN council, the Eurogroup, the Commission and the FSC.

An industry representative commented that, instead of creating new bodies or possibly a super body to run the CMU, the roles and mandates of the existing bodies must be clearly defined to ensure that the right competence and expertise are in place for decision making.

An official emphasised that a European super agency is not needed to steer the CMU. Top-down support from Brussels in response to bottom-up political will from different countries built on a clear competitiveness agenda is a type of governance that could support the development of capital markets going forward. Private-sector money will then come in.

Wrap-up

The Chair summarised that panellists agree that a combination of top-down and bottom-up measures are needed. The nature of the specific actions should dictate whether the process chosen is either top down or bottom up. Panellists also advised further simplification of European rules and maybe also of national rules. Great importance should be attached to developing national markets in a consistent way, with interconnection between local markets where appropriate so as not to contradict the aim of developing integrated, deep and liquid markets at a European level.

Attractiveness of EU capital markets for issuers and investors

1. Challenges that hinder Europe's capital markets attractiveness

1.1 Inadequate funding of growing companies in the EU

An industry representative stated that Europe has a relatively high number of successful and innovative private companies in different sectors, which are very important for addressing the key challenges ahead, such as the energy transition and healthcare challenges. To support their growth, they need to be adequately capitalised at key stages of their lifecycle, possibly leading to an initial public offering (IPO).

Currently, many home-grown European companies look outside the EU, and in particular to the US, for this capital and for a listing. There is a perception that higher IPO valuations can be achieved in the US than in Europe. Companies also look for a broad and deep investor base, combining institutional and retail investors, which is more readily available in US markets, where retail participation is higher than in the EU. High-growth companies also seek financing at various stages before going public, which requires a well-developed and vibrant ecosystem of venture capital, private equity firms and institutional investors. Further action is needed to strengthen Europe's financing ecosystem to retain growing companies.

1.2 Fragmentation issues along the capital markets value chain

An industry representative suggested that inefficiencies, particularly in terms of fragmentation, prevent capital markets in Europe from fully playing their role of optimising the allocation of capital to the real economy and delivering the best possible returns to investors. Further integration would add value for investors and issuers by improving the flow of capital across the EU and increasing choice and competition.

It is important to identify, across capital market activities and asset classes, where inefficiencies due to fragmentation exist and where more choice and competition would be beneficial. This does not require full integration and centralisation of markets, but specific fragmentation issues and inefficiencies need to be addressed. At the trading level, there is generally a benefit to having venue competition. At present, however, there is probably too much dispersion of trading venues in Europe. In equity markets, while pan-European multilateral trading facilities (MTFs) compete with regulated markets, the latter do not really compete with each other for listings or secondary trading in a given listing. Unlocking more competition in this area would likely lead to more consolidation, which would be beneficial.

Market data provision also needs to be further unified at the European level. Historically, it has been highly fragmented, but steps have been taken in the MiFID II review to introduce a consolidated tape and to improve the transparency framework, notably in terms of deferrals and consistency. For clearing and settlement, at least on the equities side, there are opportunities to reduce fragmentation and redundancy in the infrastructure, as identified in the Draghi report and other reports on CMU. There is merit in exploring further consolidation of equity clearing and settlement infrastructures. Margin and haircut regimes will be further harmonised. For cleared instruments, they are set by clearing houses in a fairly standardised way, and efforts have been made in OTC derivatives markets to create more standardised margin models.

Another industry representative added that fragmentation in European markets has a real cost for end-investors and market participants. There is fragmentation in terms of the range of products available. For example, different Exchange Traded Funds (ETFs) are offered in different Member States, which are largely identical products with identical underlyings. This limits corresponding liquidity pools and reduces the attractiveness of these ETFs, as investors are looking for very liquid and highly traded products with high turnover.

A second area where fragmentation increases costs is in trading venues and post-trading. Providing liquidity across many venues in the European equity landscape is costly for market makers because they need to connect their systems to all the venues to provide adequate price information. This affects the price and bid-ask spread displayed to investors. Post-trade fragmentation also affects this bid-ask spread. The fragmentation of liquidity across venues, which leads to thinner trading volumes and higher costs, also drives down the valuations that companies can achieve.

The fragmentation of secondary markets affects primary markets as well. When companies are in the pre-IPO phase and deciding where to list, they consider factors such as secondary market trading volumes, potential valuations, and the investor base they can tap into. Due to Europe's fragmented landscape, many companies opt to list in regions with more liquid markets. This is a missed opportunity for Europe, as higher liquidity drives better valuations and attracts more listings, creating a self-reinforcing cycle.

1.3 Insufficient retail participation

A regulator noted that ESMA statistics show that EU equity markets are in decline, with a market capitalisation to GDP ratio of 11%, down from 16% 10 years ago and compared to 45% in the US. One of the main reasons for the underdevelopment of EU capital markets is low household participation due to tax issues, cultural

aspects such as risk aversion and domestic policies that support the acquisition of real estate. This hampers liquidity and reduces the attractiveness of the market for issuers, with knock-on effects for the whole ecosystem. A more integrated and deeper capital market would also support liquidity and contribute to more efficient European capital markets.

An industry representative stressed the need for the EU to channel savings into productive risk capital. According to the Draghi report, the EU has a savings rate four times higher than the US, but lower overall household wealth in financial assets. Over the last 14 years, the net increase in household wealth in the US has been 151% compared to only 50% in the euro area, largely due to lower investment returns. Savings that are not properly invested also deprive the real economy of productive risk capital that could fuel more innovation and growth. Expanding pension provision and encouraging more self-directed retail investment is essential for the further development of capital markets in Europe.

1.4 Levels of remuneration in the EU

An industry representative highlighted the lower remunerations in the European financial sector compared to other regions, which make it more difficult for European firms to compete with other jurisdictions or other sectors in terms of attracting and retaining talent. This balance needs to be adjusted to encourage innovation in the capital markets.

2. Expected impact of adopted CMU actions

The Chair noted that increasing the attractiveness of European capital markets has long been a goal in the EU. Some progress has been made, but more needs to be done to meet Europe's significant financing needs. There are reasons to be optimistic about the change in political tone on CMU. The need to further develop capital markets is now widely shared across Europe. There is also a shared sense of urgency, as evidenced by the Letta report, the Eurogroup conclusions and the recommendations of the Draghi report.

An industry representative concurred that much has already been done by the European Commission, regulators and market stakeholders to create integrated capital markets, notably in the context of the CMU initiative, but more is needed.

Another industry representative agreed that, on the regulatory side, there have been many positive changes in recent years, but different parts of the ecosystem, such as post trade, trading and listing, have been looked at in isolation rather than together. The impacts that changes in one part of the ecosystem can have on other parts have not been sufficiently considered. One example is the application of bank-centric regulation to investment firms that provide liquidity. The prudential regime for investment firms has led liquidity providers to either reduce their activities in Europe or relocate to other jurisdictions, thereby reducing market liquidity.

An official highlighted that several initiatives at the EU level have contributed to strengthening European capital markets, but more needs to be done to further integrate European capital markets and increase firms' access to productive capital and funding for innovation. Measures to improve access to finance have mainly been taken by individual member states and capital markets have evolved very differently across the EU. Further regulatory efforts should aim at ensuring a well-functioning interplay between national and European measures, where market integration does not come at the expense of well-functioning local markets.

The Swedish example illustrates that structural national measures beyond regulatory and supervisory adjustments are needed to achieve well-functioning and deep capital markets. Sweden has well-developed capital markets. There is a great deal of IPO activity, and Swedish households have a high degree of exposure to equity and risk capital. This has been encouraged for decades by national measures. The introduction of tax-incentivised mutual funds took place in the late 70s, and major pension reforms were undertaken in the 90s with a development of occupational pensions and a diversification of investment options in the state pensions. The *Investeringssparkonto* (ISK) investment account was moreover introduced in 2012, with the aim of making it easier for retail investors to invest in capital market instruments, with simple taxation and limited reporting requirements, and it has proven to be very attractive. 4 out of 10 Swedes hold an ISK account. The official summarised that providing retail investors with a choice of investments is important, as is nudging them to take well-informed decisions. Low fees and building trust in capital markets are also key.

3. Approach for enhancing the attractiveness of EU capital markets

A regulator suggested that the development of capital markets is less about financial regulation or supervision than about incentives to ensure that sufficient capital is invested in European markets. Sweden, which has the most vibrant capital market in Europe, with the same supervisory structure and European regulation as other Member States, is proof of this. Financial regulation and supervision can have an impact on improving the functioning of the existing market, but are less effective in attracting larger volumes of investment and savings and increasing liquidity.

The next Commission and Parliament should address the underlying issues that explain why investment and capital market financing, particularly for the more innovative companies, are insufficient in Europe, leading to weak balance sheet structures. One challenge is that many of the issues to be addressed relate to tax incentives for investors and issuers, financial literacy and investment culture, and are either outside direct European competence or politically challenging. For example, the proposal for a debt-equity bias reduction allowance (DEBRA) to address the current asymmetry between debt and equity financing for companies has unfortunately been shelved for the time being.

Another regulator emphasised that developing European capital markets should not be viewed as an end in itself; instead, efforts should be directed toward specific improvements within the EU market that serve Europe's needs. The aim is not to mirror the US financial system, nor to simply reduce reliance on bank financing or expand capital markets. Instead, the focus should be on more specific objectives such as enhancing the appeal of public capital markets and expanding equity financing, especially for late-stage and pre-IPO companies that are critical to fostering growth and innovation. Additionally, increasing retail investment in capital markets should primarily aim to offer investors better long-term returns on their savings, rather than improving the financing structure or lowering costs for European companies.

An industry representative stressed the need for capital markets to grow in Europe to complement bank financing and provide additional sources of risk capital to fuel business growth and innovation. However, banks must continue to play their current role. It is also important to improve the efficiency of bond markets as an important source of financing for companies, alongside equity markets. In the US, the amount of capital raised so far in 2024 is 10 times higher in bonds than in equity: \$1.3 trillion in bond issuance compared to \$130 billion in primary and secondary equity issuance.

4. Key areas of focus for enhancing the attractiveness of EU capital markets

4.1 Further harmonising capital markets regulation

An industry representative suggested that the strong political momentum around CMU should be taken advantage of to address the divergence in the application of regulation across member states. This divergence has a tangible impact on competitiveness as it translates into barriers for both issuers and investors and is the starting point for any further discussion on greater integration or consolidation. Divergence in the application of regulation affects issuers' listing and reporting processes by adding cost and complexity. As a result, they either decide not to list because it becomes too complicated, or they continue to seek financing from other sources, or they list elsewhere. On the investor side, barriers such as different tax regimes in different Member States discourage cross-border investment and create a competitive disadvantage for European markets.

4.2 Increasing supervisory convergence and coordination

An official emphasised the importance of creating conditions for more efficient supervision within the EU. In some areas, EU-level supervision could bring efficiency gains, cost savings and a more comprehensive view of risks. However, moving supervisory responsibility to the EU level should not be an objective in itself, and should be done in areas where this is likely to strengthen EU markets.

An industry representative noted that more unified supervision is often presented as a solution to problems

of regulatory divergence, but unified supervision in itself is not sufficient. In addition, it will not make supervision easier, and could even make it more difficult, as it will not necessarily have all the capacities that local national competent authorities (NCAs) have in terms of expertise and knowledge of local markets.

A regulator noted that some recent reports including the Draghi report, propose moving towards a single supervisor, but the implications of this must be further assessed. More supervisory convergence is necessary, but it is not a sufficient condition for further integrating markets. There has been single supervision for large banks for a decade, but the level of cross-border lending is lower than when the Single Supervisory Mechanism (SSM) was implemented. Central supervision however makes sense in certain areas. For large, systemic cross-border infrastructures, there is a case for moving towards supervision at the EU level. That should probably come with a change in governance at ESMA and more legal powers in certain respects.

One aspect that needs improving is to allow ESMA to make changes to regulation in a more agile way. Currently, many changes require a Level 1 discussion, which is a very cumbersome process that only takes place every 5 to 10 years. In other jurisdictions, regulators have more leeway to make agile changes, for example by using no-action letter powers to temporarily suspend the application of regulation if necessary. In the UK, the Financial Conduct Authority (FCA) controls the level of dark trading. Another aspect to consider is that the roles of the three European Supervisory Authorities (ESAs) do not need to be fully aligned, as securities market supervision and regulation at EU level is at a different stage than banking or insurance.

Another regulator stated that more unified supervision would help to improve the European rulebook. As supervision is fragmented, Level 1 rules are excessively detailed to avoid differing interpretations and loopholes, making the rulebook very complex. The industry also complains that the European rulebook is not flexible enough and suggests that Level 1 texts should be more principle-based, leaving the possibility for Level 2 requirements to be more continuously adapted to market developments. However, this will only be possible with a more unified supervisory structure in the EU. Improving the supervisory architecture is a long-term project that needs to be implemented step by step. In addition, unified supervision may not be necessary for all areas of the market and all aspects of regulation. For example, retail markets are very local and require strong national supervisors.

The Banking Union serves as a warning, but it is not a counter-example. The institutions of the Banking Union were created primarily to improve financial stability. No progress has been made in further integrating the European banking sector, but that was not the main objective of the Banking Union. This shows the need to clarify the objectives of a possible further integration of capital market supervision.

An industry representative emphasised that targeted changes are needed to the supervisory structure, rather than a move to centralised supervision. The aim is to

remove significant friction points in areas where this can bring tangible benefits. National gold-plating of rules makes it difficult to operate cross border. This happens more often with directives but is also seen with national interpretations of regulations. More coordinated supervision would help to alleviate these issues. That does not mean suppressing the NCAs, but ensuring that firms that operate across multiple countries are asked to comply with exactly the same rules.

The industry speaker agreed that Level 1 legislation is too detailed. The details hardwired into Level 1 legislation make the rulebook less dynamic. Waiting 5 to 10 years for a regulatory review to make changes hinders innovation and growth.

4.3 Improving investor and issuer financial literacy

An official emphasised the importance of educating and nudging retail investors to encourage them to participate more in the capital markets. Policies need to create incentives, so that retail investors move part of their capital from their deposits into simple capital market products likely to provide a higher yield over the long term. Developing pension capital is also essential to foster a deeper capital market. At present three member states (Sweden, Denmark and the Netherlands) represent more than 60% of funded pension capital in Europe.

An industry representative added that financial literacy is the cornerstone of investor protection, because investors who understand the functioning of capital markets and the related risks are much better equipped to make appropriate decisions. Investor protection must, however, be embedded in regulation to ensure an improvement of the overall investment landscape. Financial literacy efforts should also be extended to issuers. Many SMEs struggle to understand the implications of listing from a regulatory, governance and economic standpoint. The lack of investment culture of issuers can also lead to conflicts of interest from financial players. For example, for a bank, it is easier to lend money via a loan than to support an issuer's IPO. There is a widespread belief that the US market is more attractive, but that is not true for all issuers. European issuers need to be educated about how the EU can provide a more tailored and nuanced framework that can allow them to grow in their own region.

4.4 Further integration and consolidation in the European capital market ecosystem

An industry representative highlighted that although further integration is needed, that does not mean full consolidation. On the secondary market side, reducing

the number of venues and infrastructures makes sense. On the primary listing side, different aspects need to be considered. Smaller companies need a first port of call in their country, such as an SME growth market. However, more concentrated mid and large-cap venues offering greater liquidity are needed to meet the funding needs of larger companies, so that they can reach higher valuations.

A regulator noted that while some reports on CMU and the Draghi report recommend further consolidation of European infrastructure, it is up to the private sector to achieve this. However, European competition policy has been an obstacle to consolidation in the past and may need to be reviewed in some respects.

A second industry representative stated that progress has been made in developing a vibrant ecosystem for growth companies in Europe, consisting of venture capitalists, private equity firms and pension funds, but this ecosystem is mainly organised at national level. For European markets to compete with other regions, larger pools of capital need to be available, which requires the ecosystem to operate at a European level, otherwise the match between supply and demand of capital for growth companies will not be efficient enough.

Conclusion

The Chair summarised that there are many challenges to improving the attractiveness of EU capital markets. Action is required from all parties: European institutions, Member States and the financial industry. EU markets need to be more competitive, as companies looking to raise funds to finance their growth are turning to global markets. This requires fostering a virtuous circle that attracts both investors and issuers, with a strong focus on equity financing and innovation. Among the challenging issues that need to be addressed are better incentives for retail participation, pension reforms to create the necessary liquidity pools, and improved supervision. In addition, tackling regulatory fragmentation and aligning interpretations of EU rules are essential steps to reduce market friction and support greater integration where it adds value.

Priorities for the asset management sector

1. Trends and opportunities in the European asset management sector

An industry representative stated that the European investment fund sector has many strengths and successful frameworks to capitalise on. The Undertakings for Collective Investment in Transferable Securities (UCITS) framework is a global gold standard that has attracted confidence around the world. Exchange traded funds (ETFs) which trade on stock exchanges like stocks represent a significant opportunity. ETFs can be very effective in getting citizens more involved in investing in capital markets, including in line with the objectives of the EU's Retail Investment Strategy (RIS). They are widely recognised as a new vehicle in Europe and many of them are structured as UCITS. Active ETFs are also a new and fast-growing part of the market. The relaunch of European long-term investment funds (ELTIFs) with a reviewed framework, which are designed to foster long-term investment in the EU's real economy by channelling capital towards infrastructure, SMEs and other real assets, should provide additional investment opportunities for retail customers in particular.

A second industry representative added that both institutional and retail clients are reorienting from active to passive strategies using ETFs and hybrid products such as active ETFs. A second important trend is that institutional investors are looking to consolidate their partnerships with fewer asset managers who can provide a broad spectrum of investment capabilities. This will lead to consolidation with larger and more diverse asset managers. A third trend is investments in private markets, especially in private credit loans. Finally, de-accumulation strategies that provide stable income for retirement, while allowing people to continue to achieve capital growth with a more flexible approach during retirement, are another important focus.

A third industry representative noted that the asset management sector in Europe is still a growing market. There has been a significant increase in assets under management in the last 10 years and European asset managers are also leaders in sustainable finance. There is a tendency now towards consolidation and, because fees are constantly decreasing, there is pressure on margins.

2. Fragmentation and competitiveness challenges

An official emphasised that the main challenge facing the European asset management sector is fragmentation. One issue is the insufficient size of the EU players on average. Another issue is the level of fixed costs in the sector, which are higher than in other regions and needs to be reduced. Consolidation, which started after a tough year for the sector in 2022, is part of the solution, but

consideration needs to be given to what can be done beyond this to address the high fixed costs. There is also a need for public authorities to think broadly about how to increase the efficiency of the European capital markets, notably by encouraging the industry to move to ambitious projects such as a T+1 settlement cycle.

An industry representative stressed that near-constant regulatory change, as well as regulatory fragmentation across the EU, are a major challenge for the European asset management sector. An industry representative agreed that fragmentation across the European asset management market needs to be reduced. Actions such as avoiding gold-plating and ensuring that there is more supervisory convergence are necessary. It is also important to ensure that the regulatory proposals currently being discussed such as the RIS are not overly complex and treat products in a consistent way. The simplicity and consistency of requirements across the EU have a significant impact on the competitiveness of the European fund sector, which is decreasing. There is only one European asset manager among the top 10 globally. The market share of US asset managers in Europe has increased from 20% 10 years ago to 40%, while the share of European asset managers in the US remains below 2%. It is vital to foster the competitiveness of European actors with further integration at the EU level and ensure a more level playing field at the international level. Europe is one of the most open markets in the world, but this is not the case for many other jurisdictions.

Another industry representative considered that the issue is not the origin of investment managers but how to increase investment in EU firms and EU assets. Both US-led and EU-led managers have been tilting towards the US recently because of the higher returns. Money flows according to offer and demand for capital and can only be directed to certain areas temporarily. The EU has valuable industries and companies, but to attract investment these companies must remain competitive and have the ability to grow, without being burdened by over-regulation.

A policy-maker observed that, despite the declining market share of European asset managers, there is a strong foundation in place with UCITS and the Alternative Investment Fund Managers Directive (AIFMD) directives to drive the sector forward. Other developments and challenges ahead include the shortening of the settlement cycle to T+1 and the need to stay internationally competitive. An industry speaker stressed that any potential reforms to UCITS should be assessed very cautiously to preserve UCITS' status as a gold standard in the asset management sector.

A regulator stated that, in terms of further harmonisation of rules and supervisory coordination, there are already effective mechanisms in place in Europe, such as common supervisory actions and peer reviews. These have worked well during recent crises and have allowed European regulators and supervisors to react quickly and in a coordinated way.

3. Policy priorities for the next political cycle

3.1. Leveraging the role of asset management to finance the European economy

Several panellists highlighted the role of asset management in the Capital Markets Union (CMU) initiative and the potential of the European asset management industry to increase investment in EU capital markets and support the EU's long-term financing needs.

A policy-maker stated that the main objectives of the CMU are to turn savings into productive investment while ensuring that retail investors get adequate returns from their investments and that companies can access the capital they need to grow. Asset managers have a significant role to play in achieving these objectives, however the sector must remain competitive. Following the review of the AIFMD and ELTIF frameworks and the introduction of rules for loan origination funds, the Commission is planning to review the European venture capital funds framework. There is also a need to reflect on broader measures to improve access to market-based funding for innovative companies in the EU, which face too many obstacles to raise capital for their future growth compared to US peers.

An official suggested that the CMU may be close to a turning point. Much progress has been made in improving the capital markets framework, with a number of key reforms such as the AIFMD, UCITS, ELTIF and MiFIR reviews now in the implementation phase. There is strong political momentum around the CMU, following the publication of a series of reports on the future steps of the CMU and the Letta and Draghi reports. The Eurogroup, the European Finance Committee (EFC), the Financial Services Committee (FSC) and ESMA have also been working on proposals to strengthen the CMU. Building trust between policymakers, regulators, industry and investors is also essential to encourage more investment in capital markets and to achieve the objectives of the CMU, as long-standing habits need to be changed.

An industry representative agreed that the CMU might be at an inflection point, given the strong momentum surrounding the project. The MiFIR review, in particular, which seeks to enhance transparency in European capital markets, is expected to have a substantial impact by facilitating best execution and reinforcing investor confidence in European markets.

3.2. Encouraging European households to engage in the capital markets

An industry representative stated that European citizens have too much of their savings in low-yielding savings accounts. Encouraging more retail investment into the capital markets must be a key objective of future policy work at the European level. A policy-maker agreed that a greater proportion of the savings of European citizens

needs to be invested in the real economy and noted that the Commission is reflecting on further measures to boost retail participation in EU capital markets.

An official concurred that there is a significant reservoir of household savings to be tapped in order to develop capital markets, but this requires changing the current habits of savers. To encourage investors to become more involved in the capital markets, it is necessary to increase financial literacy and also to help savers gain practical experience in investing. One of the proposals put forward in the recent report from Christian Noyer on the CMU¹, namely the creation of a product label based on common criteria at European level, could contribute to this. This label would identify investment products within existing ranges that are likely to support long-term retail investment and invest predominantly in European assets, in return for favourable tax treatment in their home country. This type of instrument could encourage retail investors to invest more in capital markets and gain investor experience. In the current fragmented policy landscape, a common approach to tax incentives, building on existing product offerings, seems more likely to be adopted. It could also be more sustainable over time, which would also help to attract retail investors.

A second industry representative suggested that moving more savings towards investment in the capital markets requires a cultural shift as well as education. People must get more comfortable and knowledgeable about investing. Ease of access to investing is also important for retail investors. ETFs can play a significant role in this regard, as they are a simpler product. This is the way the market is evolving in the US, where passive products have now overtaken active ones, and Europe is also starting to follow that trend. Increasing the access of retail investors to private markets and implementing auto-enrolment strategies, in particular for Pillar 2 pension schemes, are further opportunities to consider. Retail investors also need to have confidence in the market. That starts with investor protection, which is not necessarily about having more rules but about having clear and consistent rules. There is also the need for fair and orderly markets across the EU, which the MiFIR review measures should contribute to achieve.

A third industry representative stated that around €700 billion of additional investment is required each year to finance the green and digital transitions in Europe. The growing trend of passive investment with ETFs has positive aspects but also has some downsides, notably as regards the allocation of savings towards the financing of the European economy. For instance, it is important to realise that the MSCI World Index is investing more than 70% of portfolios in US equities, which is higher than the share of the US stock market in terms of global market capitalisation, which is around 40%. This is why the French Finance Ministry's report on the future steps of CMU proposes a harmonised European product label that includes tax incentives for products investing predominantly in European assets.

1. Proposals for a Savings and Investments Union – Developing European capital markets to finance the future – Report drafted by a committee of experts chaired by Christian Noyer April 2024.

3.3. Enhancing supervision at the EU level

An official observed that in several reports published on the future steps of CMU, and also in the Letta and Draghi reports, the enhancement of EU-level supervision is considered as a key priority to further integrate the EU capital market, promote a single rulebook and increase efficiency. The present supervisory set up is quite costly for global and European players operating across the EU, and also consumes a great deal of time, money and resources on the supervisory side.

An industry representative stated that moving towards pan-European single supervision must not be seen as a solution to all CMU problems. The result might be a single supervisor with multiple supervisors below, and the persistence of fragmented regulations, if there is insufficient power at the European level and ability to align regulations and supervisory approaches. To make this change, a shared understanding among European stakeholders of the goals that are aimed for and sufficient trust that they may be achieved are needed.

3.4. Focus on value for customer rather than costs

An industry representative recommended that in the context of the RIS, European policymakers think in terms of value for investors and not just price or costs. In the UK there have been some policy missteps. A charge cap was imposed on defined contribution pension plans. This immediately priced all future defined contribution master trusts to the cheapest, which is not necessarily what brings most value to customers. The active managers that continue to grow in Europe are those that provide investors with sufficient value. It is also important to be aware of the unintended consequences of regulation. In the UK, the retail distribution review (RDR), which was implemented in December 2012, aiming to set new standards in the distribution of retail financial services products and clarify the advice market, has led to roughly 85% of UK citizens getting no financial advice at all. Access to advice must be preserved, as it is essential to encourage savers to invest and help them meet their long-term financial goals.

Another industry representative agreed that the RIS approach should not put at risk the ability for retail investors to continue to benefit from appropriate advice. Some reports on CMU have suggested promoting simpler products or creating a new EU label for simple products. However, the most valuable and appropriate products for customers are not necessarily the simplest. It would be better for them to be advised on the best products to invest in. Price controls should also be avoided in the value for money measures of the RIS. Competition and transparency are more effective tools for achieving this objective. Tax incentives should also be improved to encourage European savers, who are generally risk averse, to invest more in capital market products.

A policy-maker commented that it would have been good if active management and advice, as it is currently provided, had widely resulted in high net returns and value for money for EU consumers, but evidence of this is limited. It is important that customers are offered a wide range of products, including simple and less simple ones.

3.5. Prioritising the implementation of the measures adopted

An official stressed that as a new political cycle is about to begin in Europe, it is important for policy makers, regulators, market participants and other stakeholders to reflect on what has been achieved and to fine-tune the measures adopted before new policy proposals are made.

An industry representative agreed that it is important not to overburden the industry with many new regulations without first implementing those that have already been adopted. It is necessary to reflect and absorb what has been done and possibly improve existing rules before proposing new ones, in order to make steady progress without confusing market participants.

4. Addressing financial stability risks

An official stated that the EU fund sector has held up reasonably well in recent crises, but some new issues may emerge that need to be grappled with. Before developing new tools to mitigate risks, it is necessary to ensure that existing ones, which are already quite extensive, are used to the fullest extent. The efficiency of supervisory processes also matters. The Central Bank of Ireland, for example, has been quite proactive in this area and has intervened when needed, using tools such as article 25 of AIFMD to establish a specific macroprudential framework for property funds. Actions have also been led in combination with ESMA and some NCAs in the area of sterling denominated liability-driven investment (LDI). It is also important to avoid applying a one-size-fits-all approach to the non-bank financial institution (NBFI) sector, because that label covers many different products such as UCITS, money market funds and hedge funds that pose different risks and are regulated in different ways.

A regulator agreed that the primary focus should be on using existing tools in the most effective way. Access to liquidity management tools (LMTs) has been extended in the context of the AIFMD review. These tools have been used in the market for 20 years, but the CCSF has published in a recent paper on macroprudential measures that further guidance is needed for their use in terms of selection, notification, calibration and timing, and how to put them into operation. The main responsibility for activating these tools, as a general rule, should lie with the investment manager, and not with national or European-level supervisors. There could be instances during a systemic crisis where a different approach might be needed, but that should remain exceptional.

As part of the current review of the eligible assets directive, the regulator suggested a systematic review of liquidity at the asset level and to avoid a presumption of liquidity for some assets. It is also important to enhance the data on leverage. Ensuring effective data reporting at the right frequency with adequate reporting templates that are consistent across the EU is also essential.

A policy-maker emphasized that while there is a strong focus on competitiveness, financial stability is essential

for a viable and trustworthy market. To support stability, the LMT toolbox has been enhanced and harmonised across the EU, and supervisory reporting has been strengthened.

Ongoing discussions focus on effectively identifying emerging vulnerabilities, monitoring systemic risks, and evaluating the adequacy of the macroprudential framework for NBFIs, which includes investment funds. A targeted consultation on this topic is currently underway. The objective is not to revisit areas recently reviewed by co-legislators, as regulatory stability is important, but rather to pinpoint potential fragilities. Some specific areas demand attention. One is money market funds (MMFs), where significant work has been undertaken at the international level and key reforms have taken place in some non-EU markets. Another area are short-term asset markets that MMFs invest in, which may require targeted adjustments, although they are functioning relatively well.

5. Addressing the impacts of digitalisation and tokenisation

An industry representative noted that technology such as blockchain and AI present significant opportunities for the asset management sector. Industry must embrace technology to engage with customers more effectively, and digital solutions can help customers to understand the products they are investing in, the related risks and consumer protection measures. Technology can also support regulatory and supervisory approaches.

A regulator observed that tokenisation is progressing in the fund sector. Some firms are now tokenising assets

and funds in order to reduce costs and add value for clients. From a regulatory perspective, tokenisation of funds is essentially the use of different technologies to perform the same activity. Regulators regulate activities, not the underlying technology, and act in a technology-neutral manner, so the same rules should apply regardless of how the activity is performed. However, a number of laws on blockchain and distributed ledger technology (DLT) have been enacted in Luxembourg to provide a regulatory and legal basis for the use of blockchain for financial activities. Guidance has also been provided by the CSSF, via a dedicated white paper, to help stakeholders identify risks associated with the use of blockchain and implement mitigation measures.

Digitalisation efforts should be industry-led, rather than driven by regulation, although regulators and supervisors can act in terms of risk mitigation and data standardisation. The Digital Operational Resilience Act (DORA), which is currently being implemented, addresses information and communication technology (ICT) risks. It requires ICT risks to be mapped and mandates ICT risk management and governance measures. Further regulation in this area does not appear necessary at this stage. In terms of standardisation, reporting is an area where improvements can be made to move towards common standards at the European level. Technology will also change the way supervision is conducted. It is becoming increasingly data-driven and supervisors need to keep pace with technological developments in this area.

An official agreed that technology regulation should be neutral and activity-based. It is, however, important to ensure that the regulation is also future-proof and can adapt to evolutions of the underlying technology.

Retail Investment Strategy next steps

1. Objectives of the Retail Investment Strategy proposal and progress made

1.1 A key component of the CMU

The Chair noted that the Retail Investment Strategy (RIS) is a key proposal of the Capital Markets Union (CMU) initiative, but it is also quite controversial in some respects and has led to heated debates.

A public representative stated that with the start of the new political cycle in Europe we are in a 'make or break' moment to develop the EU's CMU. The end goal is to make European capital markets more attractive for citizens and companies to address the EU's huge financing needs. This work started in 2015, but there is now a significant political momentum around the CMU project, which has to be taken advantage of. Europe needs €800 billion per year to fund its objectives such as the green and digital transitions and defence. Since public financing capacity is limited, retail savings must be put at better use to support these financing needs, which is one of the objectives of the RIS. Making the CMU a reality would better channel the more than €35 trillion household savings into the EU economy.

An investor representative considered that the objectives of the RIS proposal to create an attractive environment for retail investment in the EU are relevant. As underlined in the Letta report, the EU is home to €35 trillion of private savings, mainly held in currency and deposits, while also facing the challenge of the pension gap and of providing the necessary financing for the digital and green transition. To encourage citizens to invest, they need to receive decent real returns on their investments and value for money.

1.2 Objectives of the RIS proposal and progress made

The Chair noted that, after the adoption of positions by the European Parliament and the Council on the RIS proposal, the trilogues are ongoing and will be pursued in the coming months.

A public representative stressed that the trilogues must ensure that the RIS proposals remain in line with and support the CMU objectives, which are to support a drive towards a stronger, greener, more digital and more autonomous Europe. Retail savings must be channelled in an inclusive way into the investment needed for Europe. The negotiating positions that have been achieved by the Parliament and the Council go in the same direction and trilogues will be an opportunity to improve the text, by addressing the question of simplification for example. Taking a holistic approach, the Parliament did not ban inducements but strengthened value for money (VfM) requirements. In addition, other priorities were addressed. Financial literacy actions, which are essential for the success of the RIS, were

reinforced with more ambitious proposals. Tools are also provided to protect consumers from 'finfluencers' in a context of increasing digitalisation and to help supervisors act more efficiently.

There is however still a significant amount of work ahead to turn the RIS into a reality. The Commission, the Council and the Parliament will have a key role to play in maintaining momentum during the implementation phase of RIS and ensure that all stakeholders are on board.

An official stated that the RIS must be assessed in the context of its primary objective, which is to encourage European citizens to move more of their bank savings into the capital markets. To achieve this, it is critical to boost investor confidence while simultaneously protecting them from potential pitfalls and ensuring they receive high-quality advice. The Council has sought to strike this balance in its approach to the RIS.

An industry representative expressed strong support for the objectives of the RIS, but noted that there is a discrepancy between the CMU's objective of channelling more savings to the capital markets to finance the green and digital transformation and being very cautious about the risks taken by retail investors, with strict investor protection measures. Moreover, the primary focus of RIS should be on ensuring that citizens can save for their retirement, rather than on channelling retail investment into projects aimed at transforming the European economy.

1.3 Conditions for a successful implementation of the RIS

An investor representative observed that the Letta Report has rightly pointed out that tangible progress on the CMU and the further integration of EU capital markets will only be possible if it is clear that the integration does not just serve the finance sector. The problem is that the current status quo and the current positions of the Council and Parliament on RIS are more in favour of the financial sector than of retail investors. There are positive elements in both texts, but neither is a game-changer for retail investors.

The initial RIS proposal set out by the Commission had the potential to introduce positive changes into the market, the most important elements being value for money and a move towards high quality independent financial advice. The Council position acknowledges these issues and proposes principles to be respected, such as treating third-party and in-house products equally, or putting in place a mechanism for reclaiming inducements in case client interests have been harmed. However, the European Parliament has chosen to delete the proposals made by the Commission on inducements in the report it adopted, which does not go in the direction of high quality independent financial advice.

A further question concerns the enforceability of the principles proposed and whether the RIS measures can

be appropriately implemented. For example, the proposed rules on inducements indicate that inducements accepted and retained must not directly benefit the recipient firm, its shareholders or employees without tangible benefit to the client, but the question is who determines what benefits are tangible and how they should be measured.

An industry representative was concerned about the complexity and stringency of the measures proposed in the RIS, which could deter customers from investing in capital markets. The current investment process, which involves filling in many documents with a strong emphasis on investment risks, is already quite cumbersome and time-consuming, which goes against current trends, supported by digitalisation, to simplify access to financial services. RIS should not further complicate the investment process, as this may deter retail investors. In Germany, many people prefer a 3% return on their savings account to a potentially higher return on the capital market because it is easier to manage and savers are not always aware of the impact of inflation on interest rates.

Another industry representative stated that the EU Parliament's position on RIS is a step in the right direction and has good intentions, although some details need to be fine-tuned. Ensuring that there is sufficient investor protection and that retail investors receive sufficient value for money and quality advice are valid objectives. It is important to build on the current system in Europe, which works well. Effective investment products are available, many customers buy them and take investment advice, and financial institutions do their best to engage with their customers. But more needs to be done to ensure that regulation is effective and balanced. The RIS is about consumer protection but it is also about enabling consumers to access better investment opportunities. If investor protection rules are too strict, the second objective may not be achieved.

An official pointed out that regulation can help to improve the consistency of the framework for retail investment across the EU market, notably in terms of transparency, but agreed that over-regulation such as potential price controls in the context of the value for money proposals should be avoided.

1.4 The case for a more principles-based approach to the RIS

An industry representative stated that the objectives of RIS are in line with the MiFID and IDD directives. The need to revisit the same issues after 10 years shows the complexity of the issue, but may also indicate that the regulatory approach used so far needs to be reconsidered.

A more principles-based and less rigid approach to the RIS would be more effective, allowing financial institutions to focus on high impact areas. Such an approach, which focuses on achieving outcomes rather than implementing prescriptive rules, would allow financial institutions to better tailor their implementation strategy to their specific contexts and business models, taking into account cultural differences across Europe. Small and medium-sized financial institutions in particular, would be able to use their more limited

resources more efficiently to find new solutions to serve retail investors. This would promote a culture of compliance where business objectives are aligned with customer needs and would encourage innovation by allowing banks to explore different solutions, such as investing in fintechs and digital platforms, to meet regulatory requirements and enhance their service offering. Principles can also provide a robust framework for risk management by emphasising the importance of sound judgement and ethical decision-making, allowing financial actors to tailor their risk management practices to their unique risk profiles and business environments.

A principles-based approach can also help foster the trust that is essential to encourage retail participation in capital markets by focusing financial institutions on achieving high standards of conduct and customer-centric service under the supervision of national competent authorities (NCAs). This approach will also help to strengthen customer relationships and loyalty. For example, a strong know-your-customer (KYC) approach is much more effective than a long, standardised questionnaire.

2. Inducement rules: pending issues and next steps

A public representative stated that the Commission's initial proposals on inducements only focused on tackling conflicts of interest and did not take sufficient account of other aspects, such as the potential impact of a ban on inducements on access to advice and inclusiveness of investment. A ban on inducements would reduce access to investment for most average savers by making advice too expensive. After the Netherlands introduced its ban on inducements in 2013, the percentage of customers receiving advice fell from 21% to 5% between 2013 and 2021, providing a cautionary example of the potential negative impact of a ban. Enhancing financial literacy is also essential. Ambitious proposals were made by the Parliament that will hopefully be taken up in the final text.

An official agreed that many retail investors rely on advice and it is difficult to provide advice in an accessible way without inducements. The focus on reducing costs and ensuring value for money must be maintained to address potential conflicts of interest. Alternative approaches aiming to maintain the availability of objective and high-quality advice have been explored by the Council. The forthcoming trilogue discussions will determine in particular whether the inducement test proposed by the Council can provide clarification. Further measures are also needed to enhance financial literacy.

An industry speaker believed that an inducement ban would prevent most people from obtaining proper advice. This would be problematic, as self-guided investors generally do not take enough advantage of the possibilities offered by capital markets. They tend to have insufficient diversification and excessive concentration in certain risky assets, which do not correspond to a long term investment strategy for retirement.

An investor representative disagreed that people who have enough savings to invest in capital markets cannot afford independent advice. They should be willing to pay for independent advice that can provide better long term outcomes. A case study conducted on the French market showed that one off independent advice is cheaper than non independent advice with recurring trading commissions. Customers who cannot afford independent advice are usually those who do not need it and would rather need broader financial guidance for example about the risks of indebtedness.

It is also important not to overestimate the impact of financial education, which cannot be considered as a substitute to independent advice. A study conducted by the Central Bank of Ireland shows that people with very high financial literacy are not much more effective than average savers in taking care of their own financial future and pension. EU citizens should be able to benefit from independent financial advice, and there should be more nudging to increase their participation in capital markets.

In addition, while financial education is essential for achieving the objectives of the RIS, it is challenging to implement and this will take time. Financial education should be part of the school curriculum, but it is a long-term project that will not yield significant results until 10 or 20 years later. It is also very difficult to bring adults back to the classroom. Financial education for adults should mainly happen at the point of sale, but this is currently not happening there because advisors are mostly sales representatives of in-house products trained to sell those products and incentivised for their sale. Developing independent advice is vital, as it would allow consumers to get access to and information on the products that are best for them. That has to be combined with efforts to improve financial literacy over time.

A second industry representative agreed that both advice and financial literacy are needed. Advice is sometimes presented as a palliative for insufficient financial literacy, but it is essential, even if consumers are more literate. Improved financial literacy can help customers better understand the different products proposed and ask the right questions when they discuss investment options with an advisor, but it does not enable them to be fully autonomous in most cases, because investment is a complex subject.

A third industry representative emphasised that financial advisors play a key role in building trust. Banks strive to recruit experienced financial advisors and invest in training their staff. Certification programmes should be expanded to ensure that all advisors have the right level of skills. KYC is also very important, because if advisors know their clients well, they are more likely to recommend relevant products. If this is not the case, customers, especially the most affluent ones, will move to another bank. However, investing in staff training to achieve high quality advice comes at a cost, which in one way or another must be passed on to the client.

The Chair noted that an interesting question is whether it is preferable for customers to pay knowingly and specifically for advice, or if it is better to embed it in the overall cost of the service or product.

3. Value for money requirements: pending issues and next steps

An official highlighted that the main objective of the value for money (VfM) measures of the RIS is to eliminate outlier products that are excessively costly. VfM measures introduced in France for unit-linked insurance products and also in Denmark and the UK have shown positive results. These measures can be effective if they are flexible and avoid unnecessary complexity. However, the financial industry has expressed concerns that the RIS's VfM provisions could create additional regulatory burdens at both the national and European levels. How they can be simplified while preserving their effectiveness will be discussed during the trilogue negotiations.

An investor representative stated that the Commission's VfM proposal was not perfect, but it required firms to list and quantify all costs and it required manufacturers and distributors to compare the cost/benefit balance of products. Producers should be able to say how much it costs them to make a product and it should be possible to analyse the market to evaluate the competitiveness of different producers. The pricing process remains a VfM assessment in the Council text, which maintains the requirement to identify and quantify costs, as well as the other benefits of products.

The benchmark proposals to evaluate VfM referred to peer group comparisons. This is useful for identifying outliers, but will not work if the whole market for a particular type of product consists of expensive, underperforming products. A comparison with the performance of the underlying assets in which the products invest would be useful, but is not mentioned in any of the current proposals on RIS. The Council's proposal that supervisory VfM benchmarks should be made public is welcome, as is the fact that these benchmarks should be conducted at European level. National benchmarks should be limited to cases where they have already been implemented before July 2024, as RIS should promote a single market for capital in line with the CMU.

An industry speaker commented that VfM should be about getting value for the money spent and not only about costs because low cost products are not always adequate and do not necessarily provide the best return. Including an insurance component in an investment solution has a cost for example. In addition, VfM measures should not lead to an obligation to disclose profit margins, because it might be misleading and is not required in any other industry. Disclosing fees and charges can be helpful, but profit margins require complex aspects to be taken into account such as the cost of capital associated with protections and guarantees.

If the VfM benchmarking concept is applied in an overly restrictive and complex manner, it could reduce consumer choice and ultimately drive some investors away. Product diversity is valuable, and it is important to avoid a system that forces all offerings toward a limited, one-size-fits-all benchmark. This could lead companies to focus only on aspects directly measured by the benchmarks, limiting innovation and excluding

potentially valuable features. The result would be fewer options for customers and diminished competition among products.

The Chair questioned whether achieving VfM requires regulatory measures or if it should be the result of effective competition. The reasons to introduce specific VfM regulatory measures could be that complexity makes it difficult for consumers to compare products, that integrated distribution channels prevalent in Europe mean that consumers do not look beyond the bank where they have their account, or that retail investors lack the knowledge and experience to compare products.

An investor representative agreed that VfM is not necessarily a question of regulation. Effective competition should normally lead to well performing products and cost-efficient intermediation. However, assessing the degree of competition in financial services markets is complex. Open finance and digitalisation could help to enhance competition.

An industry speaker suggested that competitive market forces should be the main driver to improve the product offering and drive inefficient products out of the market. The current VfM proposals are not moving in the right direction and should rather focus on improving transparency. There is already a significant degree of transparency in the investment product market, but reporting by product providers could be made more systematic, consistent and independent. In Germany, for example, customers can access a database that compares current account costs, to which all providers must contribute. This would be a more pragmatic and simpler way to compare products without interfering with pricing decisions, which should remain the responsibility of the firms providing the products. In addition, competition is not lacking in the market; there

is strong competition from digital players and fintechs leading to increasing demand for low cost securities accounts and zero fee trades.

4. Further aspects to consider for developing retail investment beyond the RIS proposals

An industry speaker considered that taxation and Pillar 2 and 3 private pensions are key drivers to encourage retail investors to invest in the capital markets. The open finance framework can also be helpful to facilitate innovation and competition.

An official highlighted that digital tools could help to improve the transparency, simplicity and affordability of investment solutions, but potential concerns need to be addressed. Digital tools and improved analytics could lead to overly individualised risk assessment. This could limit the possibility of offering insurance, which is by nature mutualised across customers. In addition, while increased data sharing can facilitate the development of more appropriate products and services, it should not go so far as to require incumbents to share proprietary models or data resulting from internal assessments with new entrants, potentially giving them an unfair advantage.

A public representative agreed that further work is needed on digitalisation, which is reaching a tipping point in the market. Other proposals made in some reports on the future steps of CMU also need considering, such as the creation of new European long-term savings products.

Developing long-term retail investment

1. Main challenges and issues to address

An official stated that Europe is facing major challenges. First is the need for significant investment in the dual green and digital transitions in the coming years, with the European Commission suggesting that between €700 billion and €800 billion per year will be required. The growth gap between Europe and the rest of the world, particularly the US, has also widened over the past 15 years, a key underlying element of which is the productivity deficit due to chronic underinvestment.

The second challenge is that European citizens have too much of their savings, which are quite substantial at EUR 35 trillion, in liquid and low-risk products. This is partly due to the overwhelming supply of such products in the EU. Around one third of savings are placed in bank deposits. This figure rises to almost 50% if low-risk life insurance investments are taken into account. As a result, they receive lower long-term returns than savers of many other developed countries, and this also results in inadequate financing of long-term, more risky investments needed for the twin transitions or to increase productivity. A significant part of European savings is also exported to other regions.

Another official noted a key takeaway from the recent report chaired by Christian Noyer on CMU¹. The money that a majority of Europeans put into low-yielding, highly liquid products is then channelled by intermediaries into the US market, where bonds are purchased and the proceeds used to buy equity in European companies. Changing this nonsensical process will be challenging, because it would require reforming the functioning of pensions in Europe, which in most member states are pay-as-you-go Pillar 1 and fostering more pre-funded private pension products as in the US.

The objectives of channelling investments into specific areas of the European economy and providing savers with adequate long-term returns might also be contradictory, as the latter requires sufficient diversification. Effective long-term retail products must primarily satisfy investors' needs. Otherwise, the results will be counterproductive. In Austria, for example, a private pension product that aimed to channel investments into Austrian listed companies turned out to be disastrous for savers in terms of risk diversification.

A regulator stressed the importance of establishing a strong link between retail investors and capital markets. Savings must play a key role in providing long-term financing to the real economy, and capital markets must provide investors with adequate returns

commensurate with the risk taken. Both roles are necessary to ensure an effective and mutually beneficial system. While more investment in the European economy is needed, European savers' investments should not be restricted to Europe however. Risk diversification is essential and investment opportunities outside Europe could also support Europe's long-term development. A strategy of global diversification should be favoured, as it will bring greater benefits to both savers and the wider economy than concentrating investment in the European market.

An industry representative highlighted that an investment product should always be designed in a way that prioritises the clients' interests. Access to well-diversified portfolios that secure clients' financial future is key, as opposed to pushing investments in a particular direction. A client-centric approach is needed to encourage individuals to invest in capital markets, instead of leaving their money in savings accounts.

An official acknowledged the importance of flexibility and diversification in portfolio management, but warned against the common misconception of global indices, which tend to allocate around 85% to US markets and only 10 to 15% to Europe. Such indices are weighted by market capitalisation rather than by factors such as GDP share or geographical distribution. Many European products that receive tax incentives, including pension products, actually invest a majority of their assets into the US. Instead, a reasonable proportion of the assets of these products - around 50% to 75% - should be invested into Europe. Otherwise, European public money is being used to finance foreign economies through tax incentives.

2. Improving the product offering and relaunching PEPP

An official suggested that improving the long-term savings products offering in Europe will contribute to the development of a larger and longer-term investor base, in turn deepening and integrating capital markets. The pan-European personal pension product (PEPP) was a first attempt at creating the equivalent of the successful US 401(k), directing funds into equities and long-term investments and providing the holder with adequate returns. However, the complexity of the PEPP, worsened by disparate tax regimes across Europe, has hampered its success. In addition, the intermediaries' remuneration cap is not realistic. Competition, rather than price controls or price regulation, is the best approach to lowering cost in the financial sector.

1. Proposals for a Savings and Investments Union – Developing European capital markets to finance the future – Report drafted by a committee of experts chaired by Christian Noyer April 2024.

For relaunching the PEPP, the first priority should be to apply common taxation principles across the EU, such as deductions from taxable income for investments in PEPP products and taxation of PEPP income after retirement at the individual's place of residence. This would enhance the functioning of PEPPs in a more consistent way across the continent. Another option, proposed in the French Ministry of Finance's April 2024 report on future steps for CMU, would be to develop common criteria at European level to identify existing domestic products that best support long-term retail investment and guide the development of new products and related tax incentives.

A regulator agreed that a focus is needed on improving the quality of product offerings and simplifying products to ensure real value for savers. Eurobarometer analysis shows that 50% of Europeans lack confidence in insurance and pension products. This hinders long-term retail investment and favours the use of liquid savings accounts. To encourage investment, products need to be simple, user-friendly and tailored to different customer needs.

A new product category is not necessary, the regulator felt. The fundamentals of the PEPP remain valid, although its first version was unsuccessful. The product should be simplified and refined to be focused more on consumer needs. There is room for improvement and development of PEPP, as shown in the recent recommendations published by EIOPA. For example, the requirement to have sub-accounts in different jurisdictions could be made voluntary, to facilitate cross-border distribution and reduce administrative burden. Tax incentives should be easier to implement also with clearer rules.

A further issue is the cap on costs at 1% of accumulated capital, which, in the view of the industry, is a barrier to the launch of PEPPs. The cap should be replaced by the value for money concept proposed in the retail investment strategy (RIS). EIOPA has been working on this concept for several years, following the realisation that many long-term insurance and pension products offer insufficient value to investors, creating mistrust in the sector.

Another official considered that PEPP's lack of success stems primarily from the lack of harmonised tax treatment across member states. Instead of introducing new products that could lead to further market fragmentation, efforts should focus on enhancing existing European products like PEPP and European long-term investment funds (ELTIFs). Market fragmentation is an issue to be considered at both the European and member state level. PEPP was not adopted in Austria for example, because several domestic, subsidised retirement products and insurance-based investment products (IBIPs) benefitting from tax breaks, were already available. The fact that the PEPP cannot benefit from a European-level tax break puts the product at a disadvantage. However, while domestic products can support capital accumulation at the national level, that is suboptimal compared to a European solution.

An industry speaker concurred that the introduction of new products could confuse consumers, who already

have multiple investment options, and could increase the regulatory burden for market participants. The focus should be on scaling up existing European products such as UCITS, a well-established brand, or the recently enhanced ELTIFs. These products can be fully utilised to drive EU investment and economic growth. Tax incentives could further encourage the adoption of ELTIFs, as recommended in the Letta report.

A convergent labelling approach at the EU level, with common criteria, could also be beneficial, but any new regime must be introduced cautiously to ensure it adds value without causing confusion. National labels should be avoided, as they can add complexity and may promote a form of protectionism, creating challenges for both end users and pan-European players. An industry representative also cautioned against the use of national-level investment labels, which could cause market fragmentation due to their inconsistent requirements. The focus should be on a unified European approach and initiatives that help citizens take their first steps into investment.

A regulator advised that the market should not be driven to create new products. Ultimately, it is the industry's prerogative to introduce new products that meet investors' needs and respect the existing regulatory framework. A focus on reducing complexity for investors and market participants and facilitating investor access to investment solutions would be more beneficial.

3. Additional measures for fostering more long-term retail investment

3.1 Simplifying and facilitating access to investment solutions

An industry representative noted that the results of investor surveys show that while European consumers recognise the importance of saving, they often find the investment process too complex. There is therefore a need to improve access to investment solutions and simplify the investment process. This would increase the confidence of European investors and help to create a stronger investment culture over time. One way of doing this would be to develop flexible and simple investment accounts that can be progressively invested in to meet both medium-term and long-term goals, thus complementing existing pension schemes. Fractional share dealing is another practical solution likely to reduce barriers to investment, allowing individuals to invest smaller amounts and diversify their portfolios. This would make investment in European companies more accessible to a wider audience.

Such accessible investment solutions are already available at scale in Europe. For example, German fintechs have successfully rolled out ETF savings plans that attract younger investors through ease of use and transparency, resulting in 7.5 million trades each month. France's plan d'épargne retraite (PER) has gathered over €100 billion in assets across 10 million

accounts due to straightforward life-cycle investment strategies and flexibility across both individual and workplace schemes. Sweden's *Investeringsparkonto* (ISK) is another illustrative example. Europe moreover has a comprehensive range of funds such as UCITS and ELTIFs, that can be used to build long-term investment portfolios.

These successful examples, along with EIOPA's recent insights, offer valuable guidance for scaling up the PEPP. Users' investment journey regarding PEPP must be streamlined, with minimal steps required to open an account. Time-consuming individual suitability questions should be removed, particularly for small, regular investments, and replaced with life-cycle strategies, which protect investors through key suitability factors like time horizon, risk allocation and portfolio diversification that automatically adjust over the individual's lifetime. Embedding suitability into product design in such a way reduces cost, benefits investors and providers and also makes it easier for employers to offer such plans in the workplace. The PER example illustrates that the approach can boost participation rates. Offering an improved PEPP as a default scheme with auto-enrolment across the EU could have significant impact.

Another industry representative agreed that simplification and ease of access are the key factors in fostering more long-term retail investment. The younger generation favour digital means of accessing investment solutions. Traditional financial institutions should further develop digital channels to get investors more actively involved in capital markets, particularly younger customers. Digitalisation can also streamline often lengthy onboarding processes, enabling advisors to spend more time providing financial advice and less on administrative tasks.

A regulator referred to Adam Smith's definition of the cost of a product as the 'toil and trouble' involved in acquiring it. Although the price of a product is the most visible part for consumers, the 'trouble' of acquiring it plays a critical role in their decision to buy it. In order to increase the attractiveness of regulated, supervised and value-generating financial products, it is essential to improve accessibility for investors and to make products easier to manage for financial intermediaries. Regulators and supervisors must contribute to this objective by adapting existing rules where necessary. Technology also has a fundamental role to play.

An official agreed with the potential of digital tools and online brokerage accounts to attract younger investors. However, their interest should be directed towards equity investments rather than investments in bitcoin.

3.2 Developing private pensions

An official suggested that further developing pre-funded private pensions in Europe could be a game-changer in encouraging retail savers to invest more in the capital markets. However, this is a challenging political task, requiring broader reforms of pension provision and social welfare systems. These are areas in which the EU has no direct competency. Pensions are also beyond the remit of financial services regulation. Increased political momen-

tum and broader commitment beyond the financial sphere will be needed to address these issues.

Incremental progress can nevertheless be made without fundamentally changing existing pension systems in the EU. Pillar 3 private pension products can be promoted effectively at the national level with tax incentives, but attention must also be paid to product design and objectives in terms of portfolio diversification and capital guarantees. For example, in Austria, some private pension products offering a capital guarantee against losses resulted in low yields, with the tax breaks absorbed to pay for expensive guarantees.

A regulator concurred that pensions have an important role to play in the development of long-term retail investment in the EU. Social and labour laws also have an impact. There is a wider audience to be addressed beyond the financial services authorities, including pension authorities, which may have a different type of mandate. Progress is possible however if there is a convincing narrative and common benefits for European citizens.

One aspect on which progress is being made at the European level and that should be given priority, is the implementation of pension tracking systems. Such systems leverage digital technology and aim to provide citizens with a clear view of their potential revenues at retirement, increasing awareness of the need to invest for the long term. At present, these systems are available only in some member states and their use must be expanded across the EU, with a coverage of all three pension pillars. An official added that employee savings schemes can also play an important role, encouraging individuals to save early in their career.

3.3 Enhancing financial literacy and investor experience

A regulator highlighted the importance of enhancing financial literacy among the European population for fostering long-term retail investment. Financial literacy refers not only to financial education and consumer knowledge of capital markets, but also to practical investment experience. Hands-on investment experience can boost consumers' understanding of products, their confidence and their motivation to invest.

An industry representative agreed that financial literacy is a way to overcome the ingrained cultural aversion to risk, which leads many Europeans to favour low-yield bank savings. Visualisation and simulation tools, allowing a comparison of the long-term impacts of investing in capital market instruments as opposed to keeping money in deposit accounts, also have an important role to play in educating savers about the importance of long-term investment and enhancing their confidence. Such tools are already in use in the wealth management sector. Digitalisation is essential in the development of effective simulation tools. They should be leveraged by both the public and private sector to educate European citizens.

Another industry representative observed that any approach to consumer financial literacy must vary by generation and gender. Investor surveys demonstrate that female and male investors, for example, have different requirements and approaches. Addressing the

shortfall in retirement savings for women across Europe should be a priority.

Public-private cooperation to roll out financial health checks would also be valuable. More emphasis should be placed on developing guided advice under MiFID rules, which could serve as a bridge between execution-only services and full portfolio advice. Combining this with a framework supporting the provision of financial planning tools could provide retail investors with more accessible options, through which they can make their initial steps into investment.

4. Conclusion

The Chair summarised that there is more to do to develop long-term retail investment across the EU. It is also clear that action beyond financial services regulation is required. Many aspects need to be considered including savings for pensions, regulation, tax, product design, digitalisation and financial literacy. One of the key themes is the need to increase European consumers' trust in long-term retail investment and facilitate access to effective investment solutions. The new political cycle and discussions on the CMU will likely have a significant impact in this area.

T+1 and other post trading priorities

1. The US experience of moving to T+1 and ongoing processes in the EU and UK

1.1 Lessons learned from the shift to T+1 in the US

An official stated that moving to T+1 was a priority in the US in order to reduce risk and margin requirements and enhance liquidity in the securities market. The US transition to T+1 went well. A key lesson from this experience is that preparation, coordination and cooperation are essential. The preparation and implementation of the change was a collective effort involving an enormous number of participants across the US private and public sectors. There were also significant interactions with foreign regulatory counterparts and key international industry players. Much time was spent in the final weeks before the deadline to ensure that the new process would work smoothly.

Other jurisdictions wishing to move to T+1 should also consider a forcing mechanism, as collective action is required and there is always a valid reason for delay if change is not mandatory. It is important to set a firm target date and then consider how to bring all stakeholders together to meet that deadline.

An industry representative agreed that the transition to T+1 in the US had gone very smoothly. This was the result of more than three years of collective effort and cooperation within the industry and between the industry and the SEC. The starting point was a clear regulatory mandate, a clear deadline and clarity for the market on the rules and expectations, which allowed the industry to come together efficiently. The goals were very specific, requiring same-day confirmation, allocation and affirmation, with a 9:00 a.m. cut-off by DTCC. Investment in automation and efforts to drive efficiencies in post-trade processing were also essential elements in supporting the move to T+1.

Metrics shared with the SEC and the industry demonstrate the success of the transition. Same-day affirmation rates rose to 95% from 65% a year ago, exceeding rates under T+2 settlement, while failures remained in line with T+2 levels. Three months after the introduction of T+1 settlement, the US clearing fund has fallen by 28%, representing a margin saving of \$3.2 billion.

1.2 Ongoing assessments in the EU

A regulator noted that the EU moved to T+2 10 years ago, but the opportunity of moving to T+1 now needs to be assessed. ESMA has been mandated to examine the costs and benefits of this change and the impact on market participants' operations, and has been asked to outline a potential roadmap, taking into account the impact of ongoing changes in other jurisdictions. Accelerating the settlement cycle is a project that requires deep understanding and coordination on all

fronts of the securities market. The settlement cycle must work for all market participants, as it affects all parts of the securities markets. ESMA launched a Call for Evidence to gather evidence on the impact of T+1 settlement on the EU market and published a feedback statement in March 2024.

ESMA continues to engage with market participants and industry to ensure that the issues and solutions are clearly identified. A final report on T+1 is due no later than January 2025. The European post-trade landscape is complex and T+1 is expected to be more challenging to implement than in the US. It will be important to leverage the results of the ongoing industry task forces and political guidance will be needed on the timeline.

1.3 Preparations in the UK

An official stated that the UK had taken on board the lessons of the US experience about the importance of preparation and collaboration. There is a great deal of energy in the UK around the project of moving to T+1 and significant progress is being made. An Accelerated Settlement Taskforce on T+1 reported to government in early 2024, and its recommendations on timing have been accepted. The aim is to implement T+1 in the UK by the end of 2027. A technical group has been set up in the UK to bring the industry together to analyse the technical issues needed to make T+1 a success. Nearly 500 firms are involved. It is essential to manage the process with all stakeholders.

Another important consideration is that the UK's move to T+1 should ideally be aligned with the EU and Switzerland in order to reap the full benefits of this change, with close coordination between authorities on the preparation process and timing. It is important to move together if possible because trading venues and market infrastructures operate across these different jurisdictions, for example some instruments are traded in the UK but cleared or settled in the EU.

2. Moving to T+1 in the EU: benefits and challenges

The Chair noted that the European post-trade landscape is more complex than in other major financial jurisdictions. Initially, the relevance of a move to T+1 for the EU seemed uncertain, but with the recent implementation of T+1 in the US and Canada, and other jurisdictions considering the same change, the discussion has moved forward. The question now is when and how to make the move in the EU without compromising settlement efficiency and increasing settlement risk. A broader question is to what extent shortening the settlement cycle would support the Capital Markets Union (CMU) and what other measures are needed to enhance the efficiency, integration and resilience of the EU securities post-trading landscape.

2.1 Expected benefits

A regulator stated that the feedback received in the ESMA call for evidence showed that T+1 can reduce risks and costs. Significant investments are required but they should be outweighed by the benefits. Shorter settlement means less time to cover, leading to margin savings of approximately €3 billion, which is significant and consistent with what has been observed in the US. These cost reductions can only be achieved however, if there is alignment with other jurisdictions, as the current misalignment with the US creates friction for some European participants and for firms listed in both markets.

An official stressed that T+1 will improve the functioning of the securities market and will help to provide the incentive, attention and direction for back-office optimisation, which will bring many additional improvements. The issue is more complicated for the EU than for the US, but the move to T+1 will likely bring huge improvements for investors and market participants.

2.2 Implications of T+1 for the CMU

An industry representative noted that whether T+1 will help achieve the CMU's objectives is uncertain, but in the longer term, not moving to T+1 would be an obstacle for the CMU. In the short term the investment is quite significant and could divert the attention of the ecosystem for some time from the CMU. Another issue is that the costs of such a project are specific to each firm and the benefits are general to the markets, which could create tensions within the industry. It has been suggested that T+1 could encourage consolidation in the market, with some asset managers no longer able to operate in the market due to the investment and costs associated with moving to T+1, but this remains to be proven. Although there may be benefits in the post-trading area, these will not be major, as T+1 will not help to reduce fragmentation.

Another industry representative stated that T+1 is not going to shift the CMU in a significant way, but it will bring attention to the need to improve operational efficiency and back-office operations in European post trading and will build a foundation that can help drive standardisation and efficiency further, notably at the central securities depository (CSD) level. That is a huge opportunity for both the UK and Europe when it comes to optimising the process flows.

Efficient post-trade processes and automation are vital to achieving accelerated settlement. Trade-level matching is a critical part of the post-trade lifecycle that allows counterparties to identify exceptions that may cause the transaction to fail. By completing the allocation, confirmation and trade-matching processes on the trade date, firms can increase the time available to address errors, thereby reducing the risk of settlement fails. Straight-through processing must also be a priority in the EU since there are more intermediaries and messages in the settlement process than in the US. Same-day processes should be implemented ahead of T+1 implementation to ensure preparedness.

Several issues need to be addressed that hamper upstream efficiency, including bilateral securities transactions that are executed prior to hitting a CSD,

firms that still use faxes to complete transactions, and the significant over-the-counter (OTC) bilateral volume that continue to flow through the CSDs. Downstream problems at the CSD and central counterparty (CCP) level need to be addressed in parallel.

A regulator agreed that T+1 is not going to solve all the problems in the European capital markets, but it should help to increase their attractiveness. This is essential for the CMU since large amounts of funding need to be attracted to European capital markets to support innovation and sustainable projects. Fragmentation issues will remain in the settlement space, but T+1 can help in providing a push for more automation and standardisation. This will lead to a progressive harmonisation of markets and greater operational efficiency, which in turn can lead to more integrated and more attractive markets.

Another regulator concurred that the work on T+1 could be a catalyst to improve the overall efficiency of securities markets and enhance the post-trading landscape, thus supporting the CMU, because T+1 requires an improvement of processes and interconnectivity.

2.3 Implementation challenges

A regulator highlighted that the market feedback received in the Call for Evidence that concluded in March 2024 is that T+1 is feasible, but views were mixed about how and when T+1 should be implemented. The main message was to avoid sequencing the implementation and to implement T+1 for all asset classes at the same time. A number of challenges were identified related to corporate events and corporate actions. In the fund space some issues were raised around exchange traded funds (ETFs), and there was also a clear call to try to align changes in Europe with the UK and Switzerland. The market also warned against going directly to T+0, which would be too significant a change.

The debate has evolved following the successful implementation of T+1 in the US. There is now a broader consensus in Europe that T+1 can work; discussions are now focusing more on how and when to implement T+1 and how to minimise costs. It is important to pursue the assessment of the issues raised by this change in order to address them in a timely manner.

An industry representative commented that providing a cost estimate of the T+1 project at industry level has been very difficult because how it will be implemented has not yet been precisely defined. The scope of the project in terms of products, technical specificities and whether the ultimate goal is T+1 or T+0 need to be clarified. Moving to T+1 will be costly because European markets are complex and fragmented, and it is also difficult to identify a comparable project in the past. TARGET2 Securities (T2S) could be taken as a benchmark, but T+1 is more impactful than T2S because it will affect trading, clearing, settlement and custody. Europe also does not have a common market infrastructure such as DTCC in the US that can help to coordinate the project.

Defining the appropriate timing is also critical. Moving to T+1 could be a catalyst for other improvements in the

market, but a rushed transition to T+1 would be detrimental for the competitiveness of the European market, given the magnitude of the project and the specificity of the European market structure. In addition, although a coordinated approach with other jurisdictions such as the UK and Switzerland seems preferable to avoid frictions, a strict alignment may not be necessary. The impact of a misalignment needs to be assessed more precisely, taking into account factors such as the volume of cross-border transactions and interdependencies between jurisdictions. It will also be necessary to determine how the approach could be implemented in the EU to decide on a timetable. The UK and Switzerland have already indicated that they are flexible in their timelines, which should be used as an opportunity to define the optimal timing for the three jurisdictions.

Another industry representative stressed that caution is needed to limit the negative implications of a move to T+1 for EU financial markets. The project must be defined and timed in such a way that it is practicable for the European post-trading industry. The potential upstream impacts on financial markets must be clarified in particular. In the bond market for example, liquidity is not spontaneous. Market makers take on risk to provide investors with immediate liquidity. When a client seeks to buy a bond, the market maker prices the bond based on factors such as the yield curve, spread and cost of sourcing liquidity. After striking a deal the market maker attempts to find a counterparty within the market to offset the position, though they often end up short and must resort to a lending and borrowing desk to source liquidity with asset owners through a borrowing transaction. The EU borrowing market currently operates with a deferred timeline, typically starting at T+1, making it compatible with a T+2 settlement environment. However, in a T+1 world this timeline would create problems for the cash leg, as the borrowing desk would not be able to secure liquidity quickly enough to settle on time. For the transition to T+1 to be successful the repo market would need to evolve into an overnight market, allowing liquidity to be immediately sourced.

Such a shift in the repo market cannot be mandated by regulation and would need to be driven by market dynamics. Asset owners would need to assess whether the benefits of lending their positions in an overnight market outweigh the costs. If the costs exceed the benefits, then some lenders may withdraw from lending altogether, while others could raise their fees. This could lead to increased costs for sourcing liquidity, which in turn would widen spreads in bond trading. These post-trade aspects need to be carefully considered in the design of the project to avoid unintended consequences for the market.

A regulator acknowledged that although an evolution towards T+1 is inevitable, possible challenges and practicalities on the industry side have to be further assessed and solved before drastic changes are made. These challenges must be addressed quickly, as other changes are coming up in the post-trading environment such as the implementation of distributed ledger technology (DLT).

An official added that while the practical consequences and the technical issues related to the shift to T+1 need to be worked through, a lesson from the US is that the official sector needs to give a clear direction to the private sector to indicate what is expected. The appropriate investments and changes then need to be implemented by the private sector.

The Chair summarised that it is clear that collective action is needed from the regulatory and private sector sides to move towards T+1 settlement in an effective way, with coordination and preparation at the forefront. One question is how long the preparation phase has to be. The project is a major one for both regulators and the private sector, and investments are high.

3. Further improvements in the post-trading space to support CMU

3.1 The prospects of further consolidation and integration in the settlement area

An industry representative highlighted that the need to address the fragmentation of post-trading has received new attention in recent reports. The Draghi report notably calls for the creation of a single CSD in the EU. This idea is conceptually appealing, as it could generate significant economies of scale and would be a decisive step in terms of integration, but it is unrealistic. It would face significant political obstacles, particularly from member states that may resist relinquishing control over their national settlement systems. Consolidation has to be a market driven process; CSDs are not isolated entities and operate within complex ecosystems involving issuers, investors and a variety of stakeholders, all of whom would need to move in unison for any consolidation efforts to succeed.

It is also important to consider that while the CSD landscape in Europe remains fragmented in terms of the number of entities, significant progress has been made in the concentration of activity. The top five domestic CSDs in the EU currently account for 80% of assets and 90% of settlements. The two international CSDs (ICSDs) also play an important role in the processing of international trades. Eurosystem initiatives such as T2S have also contributed to greater efficiency.

In the current legal, regulatory, and tax environment the potential for a further reduction of fragmentation of settlement activities seems limited. Further harmonisation of national securities laws that govern asset custody and protection is difficult and has failed in the past, but it could be tried again in a more focused way. Improvements can also be made at industry level. Issuers and investors can change CSDs, which has happened in the fixed income market. This can allow CSDs that operate under the most adequate securities laws to grow, while others may lose out, possibly leading to a further concentration of flows. More drastic measures can be considered, such as the approach Ireland took after Brexit to discontinue its national CSD and to move to an ICSD and adopt Belgian securities law.

Over the last 15 years all the attention has been focused on enhancing settlement processes with the implementation of T2S and the work on settlement efficiency and settlement penalties in the context of the CSDR. Limited progress has been made in terms of further integration, because the EU market is complex, and the custody and location of assets are fragmented. A change of focus is needed to reduce fragmentation, acknowledging the complexity of European settlement due to the inherent complexity of the EU market and focusing instead on attempting to bring the custody pools together.

A second industry representative agreed that the idea to move towards a unique CSD is aspirational but it will not be seen anytime soon, although the current situation with 16 CCPs and 30+ CSDs in Europe is far from optimal. CSDs are often seen as a tool of sovereignty by member states, which hinders any attempts to merge CSDs. Further harmonising securities law would also be a complex task. A more realistic option could be the extension of T2S, both in geographical and functional terms.

A third industry representative stated that the fragmentation of the EU post-trading market across many market infrastructures needs to be reduced in order to increase the EU's attractiveness to global investors, but that this should be done gradually. T+1 could be a catalyst, but it is only one measure. The aim should be to achieve greater convergence of insolvency and tax regimes across the EU. To take this forward, the Commission could set up a dedicated task force of public and private sector experts to identify the practical steps needed to improve the coherence of these laws in order to enhance the competitive environment of European post-trading.

A regulator noted that improving the integration of European securities markets is essential to drive the CMU forward and enhance the attractiveness of European capital markets, as was highlighted in ESMA's May 2024 position paper on the CMU. Collaborative work between the different stakeholders concerned including the Commission, the European Central Bank

(ECB), and market participants could help to identify the areas where connectivity needs improving and where obstacles need lifting. Further integration is not needed in all areas of the market; in some areas it is preferable to have multiple players to support healthy competition, while in others further consolidation or integration is beneficial.

The Chair summarised that the fragmentation of post-trading must be addressed for progressing the CMU. It is uncertain whether the vision of having only one CSD or one CCP is realistic, but a long-term perspective on these issues is needed.

3.2 Enhancing the attractiveness of EU clearing

A regulator stated that improvements are also needed in the clearing space to enhance the attractiveness of EU securities markets. EMIR 3.0 which has recently been adopted, aims to make clearing in the EU more attractive and to encourage market participants to clear at EU-based CCPs, in addition to the objective of reducing the dependency of the EU on UK-based clearing by setting a minimum amount of derivatives transactions that must be cleared through an EU CCP. This is a question of attracting liquidity to the EU. Most of the liquidity for the clearing of interest rate swaps is in the UK, and liquidity attracts more liquidity.

3.3 Further integration of supervision

A regulator highlighted that moving towards a more integrated and consistent supervision of capital markets is also a potential catalyst for a more attractive and robust CMU. This proposal was made in several reports on the future steps of CMU and in the Draghi report. This is a challenging objective, but progressive evolution is possible. A first step could be to centralise reporting and capital markets data at EU level.

An official noted that adequate supervisory arrangements are needed in the EU to deal with cross-border post-trade market infrastructures located in other jurisdictions that Europe relies on.

Clearing: EMIR3 and further priorities

1. EMIR 3.0 objectives and implementation

1.1 Current state of clearing in Europe

An industry representative observed that, despite the prolonged periods of market stress due to Covid, the Ukraine war and incidents such as the yen carry trade turbulence during the summer of 2024, taxpayers' money has not been used in recent years and public bailouts could be prevented. This has been a major achievement of the regulatory reform agenda over the past 15 years since the great financial crisis and the G20 Pittsburgh reforms. It is also symbolic of the positive result of the progress made on clearing regulation in particular with EMIR and the CCP recovery and resolution framework in the EU, which have fostered financial stability. The EU has demonstrated strong leadership in the regulation of clearing activities at the global level and can be considered to set the gold standard.

While the need for further efforts around the attractiveness of the EU clearing ecosystem, including with EMIR 3.0, are very much appreciated, it is also important to recognise that the EU has strong clearing capacities and an effective ecosystem in certain areas, for example on exchange-traded derivatives (ETD). Therefore, a targeted approach to those areas where further progress is needed to ensure global competitiveness is important.

Another industry representative observed that there has been limited change in the clearing landscape in continental Europe in recent years in terms of integration and costs. Processes are very efficient for liquid instruments such as long-term interest rate derivatives, but clearing costs are quite high for more illiquid asset classes, such as small and medium caps, particularly for retail investors. Responding to the point on prices, an industry representative stated that clearing prices are competitive at EU CCPs, particularly when considering the financial stability and efficiency gains that can be achieved.

1.2 Key objectives of EMIR 3.0 and implementation timetable

The Chair commented that, although the adoption of the EMIR 3.0 Level 1 text in February 2024 is a major milestone, it is still not formally in force and its publication in the official journal is awaited. There is a mandate for ESMA to deliver a set of 28 regulatory technical standards (RTS) and guidelines for the implementation of EMIR 3.0 between 6 and 18 months after it comes into force. This will require prioritisation. Focus will initially be on the Active Account Requirements (AAR) and streamlining approval procedures for minor extensions of services and risk model changes, before revising requirements for CCPs in a second stage. While there has been much emphasis

on the first two items in the debates prior to the adoption of EMIR 3.0, it is the combination of the different measures proposed in EMIR 3.0 that will improve the competitiveness and resilience of the EU clearing ecosystem.

EMIR 3.0 provides ESMA with a stronger coordination role for EU CCPs, in particular in emergency situations, and aims to enhance supervisory convergence between National Competent Authorities (NCAs), with for example the co-chairing with ESMA of the CCP supervisory colleges. The creation of the joint monitoring mechanism that will monitor risks across CCPs is also important from a financial stability perspective. The activities of this new body will add an important element that is currently missing in the supervisory space.

The implementation of EMIR 3.0 will require a collaborative effort from all players in the ecosystem. Industry engagement and preparation will be vital. Preparatory work can begin regarding the elements set out in the Level 1 text. ESMA is aware of the deadline and will issue consultative papers on the RTS as soon as possible, which will provide additional indications of the steps to undertake for implementing EMIR 3.0.

A policymaker explained that the EMIR 3.0 clearing package aims to support competitive and attractive clearing markets in the EU, while ensuring financial stability. The strengthened supervisory framework for EU CCPs will help to better mitigate risks. The package also promotes a reduction of overreliance on UK CCPs and improves the rules for non-financial corporates that clear derivatives. EMIR 3.0 moreover aims to enhance the competitiveness of EU clearing markets with measures including streamlined approval procedures for CCP risk model changes and product extensions deemed to be minor. In addition, the new package will increase the transparency of margin models so that all market participants can better prepare for margin calls, in parallel with work being done at the international level to improve the provision of margin. The focus is now on implementation, where ESMA will play a key role. Two aspects are of particular importance in the short term. First, active account requirements (AAR) must be properly implemented. Second, market participants need to take full advantage of the measures to enhance the competitiveness of EU CCPs.

An official observed that the implementation of EMIR 3.0 is still at an early stage and there is time to ensure that the necessary conditions are in place, including the engagement of all stakeholders. CCPs must recognise that the market is competitive and rapidly evolving and that significant investment in innovation will be necessary to remain competitive and expand into new markets. In terms of supervision, the new mechanisms for enhanced cooperation between ESMA and the national competent authorities (NCAs) including the co-chairmanship of supervisory colleges, as well as the

new Joint Monitoring Mechanism, must be efficiently operationalised. They will strengthen collaboration and lead to more uniform supervisory practices.

Another official stated that the RTS will be a key part of the effectiveness of EMIR 3.0. The planned 18-month review will be an important milestone to assess the effectiveness of the measures.

2. EMIR 3.0: key measures

2.1 Active account requirements (AAR)

A policymaker highlighted the conditions for an effective implementation of the AAR, which aim to reduce the EU's excessive reliance on third-country CCPs with the introduction of a requirement for EU market participants to hold an active account at EU CCPs. Market participants need to start preparing for the implementation of the AAR immediately, as accounts with EU CCPs will have to be opened within six months of the entry into force of EMIR 3.0. RTS need to be clear for market participants but also sufficiently ambitious within the boundaries of the Level 1 text with meaningful targets, in order to change the current market dynamics. An appropriate reporting framework is also needed to enable the authorities at national and European level to monitor the functioning of the AAR. ESMA and the Commission will assess the possible need for additional measures based on the observed effectiveness of the AAR.

An industry representative agreed that the implementation of the AAR must start now. Although the negotiations on the AAR have been tough, a balanced outcome has been achieved that reflects the range of different interests. The approach is proportionate, with carve-outs for small entities, global client business and non-euro currencies (except zloty dimension).

An official stated that EMIR 3.0 should help to address the EU's current overreliance on systemic or super-systemic offshore CCPs and the related financial stability risks. However, it will not be possible to assess the effectiveness of the framework until it is fully implemented. Since 2022, the amount of IRS cleared in the UK has increased by 40%, driven by significant changes in interest rates and volatility movements. This was not the expected evolution. In this context, it is important that the EMIR 3.0 Level 2 measures make the framework as effective as possible. It is hoped that the AAR will quickly trigger a significant migration of positions into the EU. This should include not only flows but also holdings, and not only short-term but also long-term positions, which are the most important in terms of risk mitigation. EU CCPs must also become a real back-up in case of disruption of an offshore CCP.

An industry representative considered that although the AAR are a positive development, they are unlikely to significantly change the clearing landscape in continental Europe. The clearing of interest rate swaps (IRS) is likely to remain predominantly located in London. The situation will likely be the same for Euribor futures, which are less systemic and could have been more easily shifted to the continent.

2.2 Streamlining of authorisation procedures

A policymaker stated that the Level 2 RTS on streamlined authorisation procedures need to identify in a clear and predictable way the offers and changes that can be authorised quickly and those that require more extensive procedures due to higher risks. These requirements need to be implemented consistently across the EU. Public and private stakeholders will need to work closely together in the coming months to take advantage of the new opportunities offered by the reformed regulatory framework.

An official emphasised that clarity and consistency will be essential when applying the measures for streamlining the regulatory approval process. CCPs must understand which criteria to apply and what documentation is required. Clearly defined rules will enable faster regulatory approvals and a more efficient release of services in the market.

An industry representative stressed the importance of streamlining approvals to speed up time to market. In the past, there have been concerns that allowing CCPs to launch new products and services and to review risk models more quickly could create new risks, but speeding up these processes is actually in the interest of financial stability, as it is safer to adapt risk models quickly in response to market events.

Another industry representative agreed that the EMIR 3.0 measures to streamline authorisation processes for new products and model changes will be beneficial. Launching new products can currently take up to two to three years in the European market, which is too slow for a fast-moving industry such as clearing. Allowing faster changes to live models or products, without having to restart a lengthy full approval process, could greatly improve market efficiency. Getting real-time feedback from users is also essential for the clearing industry. Some clearing houses already have mechanisms in place to gather input from risk committees composed of representatives of authorities and users. This feedback loop could be extended more widely across the market to accelerate and facilitate product improvements and their adaptation to user needs.

3. Priorities in the clearing space beyond EMIR 3.0

The Chair noted that, beyond the scope of EMIR 3.0, there are further issues to be considered in the clearing area. Some relate to the further improvements needed in terms of competitiveness and integration of EU clearing activities to support the future steps of the CMU initiative. Others relate to the scope and modalities of central clearing activities to further enhance financial stability.

3.1 Enhancing the competitiveness and integration of European clearing activities

An industry representative noted that the objective of enhancing the competitiveness of EU clearing has been mentioned in several recent reports, including the Draghi and Letta reports and the Noyer report on CMU.

Proposed measures include reducing the fragmentation of the clearing landscape in continental Europe and moving towards a unified supervision of central counterparties at EU level. There is political momentum behind these two measures, but discussions on these issues have been going on for a long time. Pragmatic action is needed for progress to be made.

A policymaker considered that a move to more European level supervision will be politically challenging to implement but could have significant implications in the clearing space. A further evolution to consider is the move to T+1 settlement. An assessment of the potential impact on clearing of this change is needed. Shortening the settlement cycle could bring significant benefits in terms of efficiency gains and margin savings, as has been seen in the US, but it is uncertain whether the US experience can be fully replicated in the EU.

A second industry representative emphasised that enhancing the competitiveness and agility of EU CCPs should be the key focus of further measures in the EU clearing area alongside maintaining financial stability. More competitive CCPs will support the strategic autonomy of the EU and its broader competitiveness, including the international role of the euro.

A third industry representative suggested that, beyond strategic autonomy and control over central clearing, the EU should aim for more scalable power in this area. While the EU has led the regulatory agenda on clearing, the focus should now shift to leading the global market by enhancing competitiveness, which requires speed and scale.

Speed is needed to optimise clearing processes and to innovate. CCPs need to be able to adapt quickly to market changes, but the excessive level of detail in regulatory texts and overly prescriptive rules, in particular to promote harmonisation, are a challenge in this respect. This hampers the ability of CCPs to exercise judgement and perform outcome-based analysis. More European-level oversight, with broader reference points than domestic CCPs, should also support innovation in the clearing space.

Scale is also important to increase the attractiveness of the EU clearing market. The EU has a competitive advantage over smaller jurisdictions due to its large population of 450 million people and the potential size of its addressable market. However, a more unified market with common rules and fewer competitors per asset class is needed to attract non-European players. The aim should be the emergence of several European champions to help channel savings from outside the Union into EU investment programmes. For example, Japanese, Australian, and Canadian banks participate in the repo clearing business for Next Generation EU bonds, meaning that these foreign jurisdictions are effectively financing the EU economy. However, not all CCPs in the EU should be treated equally in terms of integration and interoperability measures. The larger, multi-asset, pan-European entities will require different solutions than the more focused entities.

3.2 Digitalisation to enhance post-trading processes

An industry representative stated that technological innovation, notably tokenisation and blockchain solutions

combined with the use of central bank digital currencies (CBDC) should help to improve the efficiency of post-trading processes. Efforts are being made by central banks and the industry to experiment with these new technologies, but greater resources must be invested in these developments to avoid lagging behind the significant advances being made in the US and UK. Otherwise business might shift outside continental Europe.

An official observed that the use of digital assets could lead to new post-trading models, the development of which needs to be closely monitored. The digital euro and other CBDCs have an important role to play in this context as settlement assets, in order to promote sound financial innovation and ensure that settlement risk continues to be properly managed.

Another official commented that the use of asset tokenisation and digital assets in the post-trading space is being widely experimented by central banks and industry in Europe, which is at the forefront of these new developments. A challenge however is being able to scale up these experiments in a way that does not complexify post-trading business models and does not create new risks. Achieving this will require the collective effort of the public authorities and the industry.

An industry speaker agreed that safety should remain a priority. Innovation and the implementation of new technology must not impair the ability of CCPs to mitigate risks and prevent contagion. A key element of safe innovation is the full segregation of asset classes, with dedicated resources for each asset class all the way to the default fund. This ensures that any failures in one asset class do not affect others and that the risks posed by each asset class are clearly identified.

3.3 Extending the scope of central clearing and clearing capacity

A policymaker observed that the scope of products to be centrally cleared beyond derivatives is part of ongoing discussions at the international level. Central clearing can improve market functioning, enhance transparency and offer netting opportunities to dealers. Some jurisdictions, such as the US, are imposing clearing mandates for government bonds, while some are reflecting on ways to enhance the clearing of repo transactions, which was one of the Financial Stability Board (FSB) recommendations after the great financial crisis. Repo markets have demonstrated resilience in stress situations, which can make them a source of liquidity for entities needing to meet margin calls.

An official added that CCPs are already considering the clearing of digital and crypto assets, such as futures and options on Bitcoin. Crypto raises a number of challenges, including the limited availability of historical data, high price volatility and a lack of harmonisation of regulatory approaches. This leads to legal and operational risk and could create difficulties in the application of risk management tools.

An industry representative noted that the impact of central clearing should not be viewed in isolation, as it can relieve pressure on the bilateral market. The ever-growing flow of debt issued by European member states is currently intermediated by the same group of banks,

which have balance sheet constraints and limited intermediation capacity, leading to an imbalance between supply and demand. Clearing can help to reduce this pressure on banks by bringing the non-banking financial institutions (NBFIs), which are the clients of banks, into repo clearing in a way that allows bank intermediation to consume less balance sheet capacity. There are different membership models available that could address this. This could help to release bank balance sheet capacity to support bilateral markets.

Another industry representative agreed that further reflection is needed on the benefit of central clearing, taking into account the total cost of clearing (non-fee related) for customers compared to the benefits in terms of netting and resilience. EU-based CCPs would typically have significantly higher margin requirements due to regulatory realities, including higher MPOR, APC measures, and CCP recovery and resolution which are not comparable in other jurisdictions. In addition, EU CCPs are obliged to hold a banking license to access central bank facilities, adding Bank Recovery and Resolution Directive (BRRD) requirements. Moreover, key capital standards for Clearing Members and customers differ – where other jurisdictions e.g. deviated from the Basel standards in a different way. The EU should therefore holistically reflect further on how to make EU clearing more attractive from an implicit capital cost perspective, nurturing growth and competitiveness.

3.4 Access to central bank liquidity

An official remarked that CCP access to central bank facilities is an important question that requires further investigation. EMIR 3.0 mandates the European

Commission to report to the European Parliament and Council on this topic. Current arrangements vary across central banks and depend on whether CCPs have a banking licence. Access to central bank facilities by all CCPs should be further assessed, taking into account level playing field and financial stability considerations. CCPs should nevertheless continue to manage their own liquidity risk and provide adequate safeguards in terms of risk management.

An industry representative commented that central bank liquidity access has been discussed frequently in recent years. There are currently different approaches to this across jurisdictions that need to be further assessed. Especially the overnight dimension is critical to get right in the EU.

3.5 Data quality

An official noted that a great deal of data is generated under EMIR, but its volume and heterogeneity, due to poor reporting quality, make it difficult to use. Improving the quality of the data is necessary to support risk mitigation and facilitate initiatives such as the transition to T+1 settlement. Currently, many individual players clean up their own data but the process is slow and fragmented. Establishing joint teams with adequate expertise and using AI tools could speed up this process and enhance its reliability. Workshops and knowledge-sharing initiatives should be set up to initiate this process.

The Chair agreed that data is a core issue and that further work is needed on data quality, usability and reporting.

Relaunching securitisation in the EU

1. The high stakes benefits of securitisation

A market expert opined that the value that securitisation can bring is extremely high. One of Europe's main challenges is the struggle to finance the digital and green transitions and the enhancement of euro area growth. The securitisation market can create significant additional funding capacity, but any changes to the regulatory framework need to be implemented in the right way.

An industry speaker agreed that securitisation will bring many opportunities. It will boost economic growth, help to bridge the pension protection gap and support economic growth. Given the need to finance both the digital and green transitions and increased defence expenditure, it makes perfect sense to use the benefits of securitisation to channel Europe's capital towards economic growth.

1.1 Easier access to credit, efficient risk allocation and improved transparency

An industry representative explained that the US mortgage backed securities (MBS) market funds 70% of mortgages, which frees up originators' balance sheets. These originators are then free to find new borrowers and expand access to credit. This funds more housing, which has knock on benefits on construction and household demand. Taking another example, collateralised loan obligations (CLOs) are securitisations of corporate loans which fund lending to small and medium sized enterprises (SMEs).

Secondly, securitised products help market functioning by helping to allocate risk. In a well functioning securitised products market, the different parts of the capital structure are allocated to the most appropriate pockets of risk. The senior tranches go to banks or pension funds; assets further down the capital structure are allocated to insurance companies; below investment grade, assets go to hedge funds and private equity. Securitised products also help market functioning through the transfer of risk. It is difficult to transfer assets when all banks want to be asset light, but this can be done using securitisation. Portfolios of assets can be transferred to banks for securitisation and transmission throughout the financial system.

Finally, securitisation increases the transparency in the economy. In a thriving securitisation market, there is monthly reporting on consumer loans, commercial property and SMEs, which would not exist if these assets were simply sitting on balance sheets. The trade in these assets also increases price transparency. The existence of a large number of participants thinking and talking about the drivers and pricing of credit risk is a significant benefit to regulators.

1.2 Securitisation is an essential tool for managing banks' funding needs and balance sheets

A regulator added that the ability to tranche liquid standardised assets decreases banks' cost of funding. In the German market, banks retain approximately 40% of their securitised positions for funding purposes. Secondly, securitisation frees up capital from the balance sheet. If 40% of a position is retained on the balance sheet, this effect is not significant. This effect is linked to supply and demand in the credit market, however. As the credit market is suffering from low demand and the banks are well capitalised, there is not currently a strong need to free up capital.

2. The main objective is to scale up the EU securitisation market

An industry representative explained that many financial institutions do not invest in the EU securitisation market because it is too small and too fragmented. Ultimately, the market needs to grow. One reason for the small market size is the onerous reporting requirements and loan level transparency. Transparency is welcome, but some of the templates used in the reporting process are excessively complex. There has to be a recalibration of the requirements. Currently, the requirements add cost and deter issuers from the market. The smaller investors' struggle to comply with the due diligence requirements makes them even less likely to invest in the EU. In the US, the insurers are substantial players in the securitisation market. Structured products comprise over 20% of insurers' balance sheets. In some private equity backed insurance companies, this number is even higher. However, the figure for EU insurers is less than 5% due to the higher capital requirements. For covered bonds the capital requirement is 5% to 7%; for non simple, transparent and standardised (STS) securitisations, it is 100%.

The regulatory framework is channelling the investment into covered bonds over securitisations. The EU should want structured products to be considered a top tier asset class. This does not happen due to stigma and the limited size of the market. In the US, market participants can allocate to anywhere in the world; in the EU, they can only allocate to assets that comply with EU regulations. This means the market is too small to drive investment, which means the required yield is significantly higher, which makes the market unattractive for investors. Frankly, US issuers do not comply with EU disclosure requirements because they do not have to. Allowing EU investors to invest in asset classes and structures that are approved in other jurisdictions will create a healthier market.

3. The main impediments to the proper functioning and development of the securitisation market

3.1 Information asymmetries have led to the stigmatisation of securitisation risk in the EU and a corresponding miscalibration of the regulatory framework

A regulator emphasised that securitisation is a very powerful and therefore very successful financial innovation, but it does pose some risks. These risks are typically linked to problems with the quality of underlying assets. Essentially, the principal issues are information asymmetry and incentivisation.

An industry speaker explained that there is still a stigma against securitisation. The issue with securitisation is really about the assets that are being securitised. The same applies to banks' balance sheets. If a balance sheet only contains poor quality loans, it will contribute to systemic risk. The EU securitisation market remains depressed for several reasons. First, two parts of the capital surcharge are incorrectly calibrated. The first is the p factor, which is designed to cover the additional risk created by the securitisation structure, such as model risk. The current weighting of the p factor is too high. Even though it was reduced in Capital Requirements Regulations 3 (CRR3), especially for STS output floor calculations, it should be reduced further. The second incorrectly calibrated element of the capital surcharge is the floors that are applied, especially on senior tranches.

The second key bottleneck is liquidity. Today, only AAA senior tranches of securitisations are eligible for the liquidity coverage ratio (LCR). They are treated as 2B high quality liquid assets (HQLA), which is less favourable than covered bonds, for instance. Finally, it is vital to bring investors back. Today, the insurers are experiencing punitive capital charges. This needs to be addressed to bring back investment.

An industry representative emphasised that the stigma of securitisation is only an issue in Europe. It is time for Europe to go beyond political statements and ideological convictions and look at the data. The data on securitisation in the EU does not suggest any reason for this stigma, barring a few products which no longer exist. Secondly, the excessive capital charges are a significant issue for banks as well as insurers. In academic terms, this issue is called non neutrality. The capital for securitisation is higher than the capital for the underlying, which does not make sense. Thirdly, the investor base is limited due to the non neutrality of regulatory capital and quirks in the European regulatory framework, which are preventing different parts of the market from participating in it. Europe introduced STS on the recommendation of the Basel Committee on Banking Supervision (BCBS), but the capital requirements are excessive.

The real market in Europe is very small. If volume is small, there is not enough frequency and continuous issuance for investors to justify the cost of setting up the business. The high barriers to entry for issuers and investors lead to complications with liquidity. Bank of America's research

indicates that there is almost no difference in secondary market liquidity between STS ABS and prime benchmark covered bonds, although their regulatory treatment is materially different. Finally, there are unjustified discrepancies in the treatment of cash and synthetic securitisations. For unknown reasons, the reporting on synthetic securitisation does not show how many transactions are happening. There are also quirks in who is able to invest in what. For example, under the emergency legislation during Covid, insurance companies were prohibited from making unfunded investments in STS synthetics.

A market expert summarised that, although the EU has the safest and most highly regulated market in the world, some forms of securitisation are still being penalised. Not a single penny has been lost on a AAA tranche in 40 years, but these products are still not viewed as AAA instruments.

3.2 Inconsistencies in bank funding tools

A regulator explained that the German covered bond market is highly standardised and successful. The strength of this market means there is little room for securitised mortgages. A market expert remarked that, from the point of view of lending capacity, the difference between covered bonds and securitised products is that securitised products leave the balance sheet and thereby create room. A regulator commented that German banks consider covered bonds to be more attractive, which indicates that there is not a level playing field.

3.3 Fixing the regulatory framework, taking a risk based approach and monitoring macro risk

An official agreed that securitisation is an essential tool for allocating risk and an efficient capital market requires a broad variety of instruments. The regulation of securities is not perfect, however. The disclosure and due diligence requirements are excessively burdensome; there is the issue of liquidity; and the capital requirements in Solvency II and the Capital Requirements Regulation (CRR) are not correctly calibrated. There needs to be a risk based approach to securities regulation. The level of risk should determine the capital requirements that apply. It is also important to consider consumer protection and the macro risk that is associated with securitisation. If the whole framework is being recalibrated on a broad scale, the regulatory and supervisory community will need to monitor the market. Ultimately, the way forward is clear: the European regulatory authorities need to do more to free up the securitisation market.

A regulator stated that artificial incentivisation should not be used to make securitisation more attractive. In the end, capital and liquidity should still reflect economic risk. Any reduction in the requirements should not act as a subsidy. In some markets, there is not an exact substitution between covered bonds and securitisation. A market expert agreed that there should be no artificial incentives. The question for EU policymakers and industry participants is whether the regulatory framework is excessively strict.

An official added that there should be a holistic and horizontal approach to regulation. The capital requirements should reflect the risk of securitised assets, which currently is not always the case. Allowing investment

funds regulated under the Alternative Investment Fund Managers Directive (AIFMD) to sponsor is one way to introduce more competition into the market. The due diligence requirements should be targeted and proportionate. Sophisticated investors should not be burdened or double burdened by the requirements. A specific way to make securitisation more attractive is the current proposal on the third party effects of assignment of claims conflict of law. This proposal clarifies what assignment of claims would apply, which would make the legal perspective much clearer.

3.4 The rules on disclosure must be simplified

A regulator emphasised that it is possible to make the regulatory framework more efficient. Regulation has generally become too complex, and this is also true for securitisation. The disclosure rules and some of the practical aspects around due diligence are extremely complex. Reducing this complexity would lower transaction costs and make securitisation more attractive without increasing risk.

A market expert agreed on the need to simplify templates and remove excessive administrative burdens. The European Central Bank (ECB) uses a template for banks that want to use securitised products in refinancing operations, yet ESMA requires banks to use a much more complicated template. Many market participants find this discrepancy somewhat strange.

An industry speaker agreed that some of the disclosure requirements are triggering significant additional cost. Simplifying the features of the originated loan will enable these instruments to be understood more easily, which should support a lower capital charge. The capital charge should be calibrated according to the tail risks. In the US, the market is much deeper because loan features are harmonised and there are state support mechanisms, such as Freddie Mac and Fannie Mae. There is investor appetite for securitised products if the risk return is appropriate.

3.5 Bringing stakeholders together will help to create an effective EU securitisation ecosystem

An industry speaker stated that the originating banks, the regulators and the investors need to work together to tackle these issues. An official noted that regulation is not able to build a market, but it can provide the ecosystem to enhance a market or even hinder the development of a growing market. From an academic perspective, the securitisation regulation has been an impediment to the market.

4. Success factors for an EU platform for safe securitisation assets

4.1 Determining the objectives and the business model

A regulator noted that greater standardisation and securitisation would also help to create deeper and

more liquid markets, which is essential for capital markets union (CMU). In Germany there are some helpful market driven initiatives such as True Sale, but the creation of an EU platform would increase standardisation even further.

An industry representative commented that any platform similar to Fannie Mae and Freddie Mac would need to have a defined objective and be designed to provide safe assets.

A market expert agreed on the importance of establishing the objectives of any future platform. The small banks do not have the internal capacity to conduct tranching and selling. An EU platform could conduct these operations for smaller institutions. The difference of risk is another interesting benefit of such a platform. It could allow an institution to buy an instrument at a value that incorporates the risk, which may differ between countries, sell the lower tranches to the appropriate investors and then keep the AAA tranche on the balance sheet and resell its own securities.

An official (emphasised that public guarantees are not free money. There is risk being taken with taxpayers' money. Any public guarantee is highly likely to constitute a form of state aid, which means it will have to meet the public interest test. To pass this test, the guarantee will have to have a specific purpose, such as freeing up capital in SMEs, which will significantly limit the horizon of possibilities for the scheme. European state aid law will also limit the profits of the investors, the sponsors and the platform because the benefit of the guarantee must go to the SMEs. There are also significant fiscal challenges across Europe. The use of guarantees might increase debt levels and deficits, and guarantees are always a difficult issue in ratings negotiations. It might appear easier to work with the European Investment Fund (EIF) and European Investment Bank (EIB) on this endeavour, instead of national governments, but their funding is common debt. There will be a way forward, but it will not be an easy journey.

A market expert agreed that the way forward will not be easy. However, the governments in the US, Canada and Japan have never lost any money on their guarantees; on the contrary, these guarantees are a source of significant revenue.

An industry speaker agreed on the importance of defining the economic model for a theoretical European platform. It could be a public guarantee, or a mutual guarantee financed by fees. The selected option will have consequences on the economic model and who ultimately pays for it. The idea of a European platform appears to be a longer term project. Tackling the challenges in the securitisation market will require both regulatory reform and the development of a platform. These initiatives should be launched in parallel.

A market expert agreed that it is important to review the regulatory framework while also launching the platform initiative. The creation of an EU platform will require a state guarantee, which is a difficult political question. This is the biggest difference between the US and EU markets. In the US, there are entities sponsored by the federal government.

4.2 Solving the issues posed by the diversity of underlying assets

An industry representative explained that the platforms in Canada, Japan and the US work because there is a common product and a common legal framework. The EU countries have different legal frameworks and use many different products. It will be difficult to combine these into a common platform. It should be possible to address the issues with credit risk and loss sharing, perhaps using a form of insurance or fee, but the lack of cashflow predictability in the pools will likely lead to a significant demand for data, unless there is a bullet structure or guaranteed liquidity. It will not be impossible, but it is important to figure out the objectives and then determine how to achieve them. Another alternative would be to allow smaller banks and originators, possibly including non banks, to access

country level platforms. This would reduce the barriers to entry and the cost of doing business. To deal with the issues with due diligence requirements and templates, the pre existing platforms for bank networks and national platforms and formats for SMEs should be exploited and leveraged.

4.3 Involving the EIF and EIB to leverage private capital

An industry representative stated that the remit of the EIF and EIB could be expanded to capture consumer and mortgage products. The establishment of a public private partnership (PPP), with the co participation of the EIB and EIF, could facilitate the use of private capital to magnify the effect of the risk transfer and liquidity and cash placement.

Sessions

VII

FINANCIAL STABILITY AND CLIMATE RISKS

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Financial stability in Europe

Introduction

The Chair explained that the discussion would focus on the main risks posed by radical uncertainty and non-bank financial intermediation (NBFi). The radical uncertainty in European public life, influenced by an interplay of both internal and external factors, makes it very difficult to price certain risks, such as global terrorism or a global pandemic. Nevertheless, the EU financial system has been generally stable. After a long period of very low interest rates, there has been a sharp tightening of financial conditions in different segments of the market. Although there is always a need to work on the "unknown unknowns", regulators and supervisors should feel confident: they have been able to cope with all the challenges so far.

1. The regulatory response to radical uncertainty

1.1 The fiscal situation around the world is worrying

An official explained that the debt-to-GDP ratio has risen significantly around the world and in some EU countries, but there are few plans for fiscal consolidation. Demographic trends, increased defence spending and the fight against climate change are placing increasing demands on governments. These developments are worrying because high levels of public debt can affect financial markets. As debt increases, interest rates become more sensitive to policy rates as risk premia rise, which could test the financial intermediation capacity of markets. Financial markets could also become more volatile. Government bonds are used as benchmarks for pricing other assets and as collateral. Any sharp movement in government bonds spreads very quickly, generating further volatility and exacerbating existing vulnerabilities. This was evident in the sovereign bank doom loops in the euro area debt crisis (2020-2012) and the US gilt stress in September 2022. So far, markets have been complacent, benign or sanguine about these fiscal developments, but markets do not usually behave in a linear fashion. As Rudi Dornbusch said, crises take a long time to materialise and then they materialise very quickly.

1.2 Addressing geopolitical and political uncertainty

1.2.1 Geopolitical and political uncertainties can affect the private sector in many different ways

A regulator emphasised that geopolitical and political uncertainties can destabilise financial markets and act as a catalyst for existing vulnerabilities. In the aftermath of the 2022 Russian invasion of Ukraine, the volatility in the nickel market was exacerbated by large positions which were spread across several clearing members,

meaning that counterparties were unable to see the full size of the concentration. Pre-existing vulnerabilities were exacerbated by the dash for cash, the collapse of Archegos, the nickel crisis and the liability driven investing (LDI) crisis.

1.2.2 The resilience of the banking sector

A Central Bank official agreed that Europe is going through a decade of uncertainty. In any period of uncertainty there is always a search for stability. The banking system is stable and part of the credit for that should go to the supervisors. Capital and liquidity levels in the banking sector are good. The level of non-performing loans (NPLs) is historically low. Before Covid and the war in Ukraine, it was unthinkable that NPLs would be between 2% and 3%. Banks need to have enough capital to pay dividends, meet their regulatory requirements and lend. Capital should not be a bottleneck to improving the economy through lending. In the longer term, any new initiatives should take into account the need for the banking sector to remain sound in times of uncertainty.

1.2.3 Stress testing can help supervisors and firms understand the complexity of geopolitical risk

A Central Bank official stressed that the regulation and management of geopolitical risk is highly complex. Many regulators have sought to improve the way regulated entities incorporate geopolitical risk into their models. In one of its Financial Stability Reviews, the European Central Bank (ECB) stated that banks should take a "proactive approach" to managing geopolitical risks, using a range of risk management and diversification techniques. It is not easy to create a good toolkit for this type of risk, as it manifests itself in many different ways. Given the high level of uncertainty, stress testing can be very useful. When a crisis or period of turbulence looms on the horizon, automated stress testing models can enable market participants and supervisors to understand and anticipate the potential impact. The Central Bank of Hungary is automating its stress testing model to speed up its understanding of the impact of crises; it is important for banks and other financial institutions to do the same.

1.2.4 High quality securities should be eligible as collateral to cover variation margin calls by central counterparties (CCPs)

An industry representative agreed that geopolitical shocks can have a significant impact on markets, particularly derivatives markets. During some of the shocks of the last decade, there was a so-called "dash for cash". One aspect of this dash for cash could be mitigated by adjusting the regulatory approach to variation margin requirements in centrally cleared markets. In centrally cleared derivatives markets, many CCPs only accept cash to meet variation margin calls. This creates a pro-cyclical situation as market participants seek cash to meet variation margin calls,

which by definition spike during a crisis. Allowing high quality securities, such as government bonds, to cover variation margin calls would reduce the procyclicality of the market in times of crisis.

1.3 Preparing for anything

1.3.1 Operational risk management is a key priority

An industry speaker explained that responding to the risk of cyber-attacks and disinformation campaigns is a question of operational resilience. Indeed, it is important to be prepared for anything. This risk cannot be mitigated by additional capital requirements. Banks and other financial institutions can deal with traditional risks, but these new risks cannot be modelled and can bring banks to a standstill. They can only be addressed by good risk management. The challenge for Europe is to simplify and coordinate its regulatory framework rather than introduce additional capital requirements. Passing on the cost of capital to customers hampers growth, and the lack of uniformity in global requirements creates an uneven playing field. The Chairman noted that it is not clear whether cyber risk could ever be fully insurable, as the full extent of potential operational disruption from cyber risk is notoriously difficult to quantify. If it is not insurable, cyber risk will change significantly.

One industry speaker emphasised that the core of the issue is risk management. It is about supervision rather than regulation, and it is microprudential rather than macroprudential. The ECB has done well to push for strong risk management frameworks, but it is also important to consider the resilience of the business model. There can be unanticipated changes in customer behaviour, as seen in the Silicon Valley Bank (SVB) crisis and the role of social media in that crisis.

1.3.2 The behaviour of asset managers in the face of risk and uncertainty

An industry representative explained that asset managers have to comply with fiduciary duties and regulatory obligations to monitor their investments, ensure the diversity of their portfolios and manage risks. Risk management is critical for any regulated asset management firm. This has been reinforced by the recent review of the Alternative Investment Fund Managers Directive (AIFMD) and the Undertakings for Collective Investment in Transferable Securities Directive (UCITS). The two cornerstones of asset management are portfolio diversification and risk management.

1.3.3 Diligence, planning and optionality in facing the 'unknown unknowns'

One industry representative noted that dealing with uncertainty is a matter of basic risk management. It is about due diligence, planning and optionality. The large global investors try to factor in geopolitical risk and sectoral change. The hardest part is dealing with the unknown unknowns that cause financial crises. Financial institutions need to make robust assessments of these hard-to-measure risks in terms of due diligence, scenario planning, global conflicts and crises. Global investors need to mitigate their own risk and identify

those markets and institutions with unmitigated risk. Financial markets and the global regulatory environment are more interconnected than ever, but the volatile political environment in many jurisdictions is a recipe for uncertainty.

1.3.4 Transparency increases the resilience in the economy

One industry representative stressed the need for identifying what additional transparency is actually needed in financial markets. The work of the stability supervisors has been commendable in developing a common language for analysing systemic risk. However, there is still no universal definition of basic things like leverage, which would help to structurally mitigate risk. One of the key principles of risk management is that having more of one type of risk limits the ability to manage that risk. In the US, the diversity between private markets, public markets and banks provides diversification if one type of business model has a problem. In this respect, private markets play a very important role.

2. NBFIs: strengths, systemic risks and regulatory challenges

The NBFIs sector has grown significantly since the Global Financial Crisis (GFC). It currently accounts for around 55% of total financial assets, up from 45% immediately after the GFC. The importance of NBFIs in the financial system is increasing. In the euro area, NBFIs assets have more than doubled since the GFC and NBFIs institutions are estimated to provide 20% of all debt funding provided by all financial institutions (banks and NBFIs). The growth of the sector has brought many benefits, but also new risks. While the sector is heterogeneous and comprises a wide range of different types of entities, it is useful to classify vulnerabilities according to key categories such as liquidity and maturity mismatch, leverage and interconnectedness. In particular, the interconnectedness of the NBFIs sector – although facilitates risk sharing in the financial system – is a key risk transmission channel. Despite considerable progress in recent years, much more needs to be done to implement an appropriate policy response.

2.1 The role of NBFIs institutions and potential vulnerabilities in the sector

2.1.1 The growing importance of NBFIs

A Central Bank official stressed that the high level of attention to NBFIs is required because NBFIs entities now play an important role in financial intermediation. Broadly, financial intermediation has three characteristics: liquidity intermediation, risk transfer and the provision of payment instruments. Necessarily, financial intermediation involves a liquidity gap, a maturity gap and interconnectedness between transactions. Historically, these functions have been performed by banks. Thanks to innovation on various fronts, NBFIs institutions now play an important role in the global market.

2.1.2 The level of systemic vulnerability is contingent on market conditions

A central bank official noted that the market conditions, i.e. the level or direction of interest rates, market volatility, and the creditworthiness of firms, could amplify the systemic impact of NBFIs. In August 2024, the market experienced significant volatility due to the large unwinding of yen carry trade positions and positions related to equity derivatives by hedge funds. The market recovered quickly, partly because long-term investors such as pension funds and asset managers bought these shares at a lower price.

2.1.3 The NBFIs sector is not monolithic

A central bank official emphasised that the NBFIs sector is extremely heterogeneous. The risk profile of their business models varies across the segment and between individual firms. The sector includes insurers, pension companies, asset management companies, money market funds (MMFs), hedge funds, special purpose vehicles (SPVs), private equity funds or even family businesses. This heterogeneity is important when assessing the vulnerability of NBFIs. To fill this data gap and identify hidden leverage, supervisors and regulators need to have a strong dialogue with each segment of NBFIs.

One supervisor commented that securities regulators need to be involved in any discussion of the financial stability risks posed by NBFIs. As John Schindler explained in an earlier speech at the conference, the NBFIs sector is not a cohesive or monolithic group of entities. When discussing the implications for financial stability, three main issues are usually considered: the size of the sector, the risk of liquidity mismatches, and the use of leverage. In order to understand whether there is a build-up of risk in the sector, it is important to ensure that methods are in place to detect concentration and interconnectedness.

2.2 Balancing the strengths of NBFIs entities and the risks posed by their activities

An industry representative stressed the importance of diversification of funding. In the EU, 67% of non-government debt is held within the banking system, compared to 41% in the US. In the insurance industry, the figure is 13% in the US against 6% in the EU. This effectively doubles the amount of real economy credit provision in the US insurance industry. As everyone knows, banks borrow short and lend long. Insurance companies can borrow long and lend long. With long dated and forecasted liabilities, they are ideally suited to hold long dated assets that finance the needs of the real economy. Insurance companies provide senior financing to the US economy in a way that de-risks the system given stable liabilities. This type of financing also facilitates capital formation. If life insurers do not fund this part of the investment grade market, the equity market will have to be funded at a much higher cost as an alternative to the banking system. Finally, it is important to recognise that public markets are no longer able to provide the returns that insurance companies and other institutional investors require. Public markets are struggling in a number of ways. There is much greater concentration and fewer issuers.

The real economy needs to be financed in a safe and stable way, mainly by private actors.

An industry speaker explained that some NBFIs players are disintermediating the lending activities of banks. This poses a risk to financial stability as these entities are highly leveraged and concentrated and much less diversified than large banks. Banks provide liquidity facilities to these players, but they do not take equity type risks. This suggests that there should be some regulation of NBFIs entities and a greater degree of transparency in the sector.

A central bank official stressed that the global economy is at a turning point in terms of inflation, monetary policy and geopolitical risks. If this leads to higher market volatility, it will structurally change the landscape. In Japan, the transition from a deflationary to a moderately inflationary economy will allow Japanese companies to reposition their business portfolios. Private equity and credit funds and asset management companies could play an important role in supporting this transformation, especially in channelling savings into investment. NBFIs will further activate financial intermediation by complementing banks' capital constraints. As half of the 2,000 trillion yen of Japanese households' financial assets are in the form of bank deposits, there may be room for NBFIs institutions to offer new products and services. While there are financial stability concerns regarding non-banks, there are also opportunities for these firms to create real value.

2.3 Interconnectedness as a key vulnerability

A regulator observed that the non bank sector is an important source of liquidity and can absorb risk as well as amplify it. The evolution of NBFIs is positive for the global financial system because it provides alternative sources of financing, promotes diversification and avoids overreliance on the banking system. However, it can also be a transmission mechanism for risk. Given the level of concentration risk, this interconnectedness will likely be a feature of the system for some time.

2.3.1 The NBFIs sector is tightly connected to the banking sector

An industry speaker noted that the NBFIs sector is closely linked to banks via the MMF market. Many MMFs are invested in sovereign wealth funds. EU MMFs hold both EU and non EU government debt and are used as short term funding vehicles for banks. Banks also provide credit lines to NBFIs institutions. The average private equity or debt fund will have a large bank credit line. Therefore, if there is a deterioration in credit quality or a shock to the private markets, the bank will also be affected and could face significant liquidity needs through these credit lines. In Europe, banks often own investment funds directly. If a bank-related fund gets into trouble, the bank may feel obliged to provide support beyond its contractual obligations.

Data on banks' exposures to NBFIs institutions are scarce. At a minimum, better data are needed to assess these linkages and vulnerabilities. NBFIs are

increasingly acting as counterparties to banks in cross-border activities. Banks' cross-border assets and liabilities to NBFIs have grown substantially in recent years, and this may also be an amplification channel. These examples only scratch the surface. More generally, it should be recognised that banks and NBFIs are no longer separate sectors. The current perception is that banking exposures are passed on to the NBF sector, but the situation is much more complex. Exposures flow back to the banking sector in a variety of ways. In the case of insurance, exposures can be arranged across institutions and borders. Supervision, monitoring and regulation need to take a holistic approach, looking at the financial system as a whole and recognising that it is constantly adapting to new regulations.

2.3.2 The risk of interconnectedness underlines the need for international cooperation.

One supervisor stressed the importance of coordinated international work. The FSB is currently working on the visibility of non-bank leverage risks and possible mechanisms to address them. This could involve private or public disclosure, but the risks should be foreseeable before they materialise in practice.

An industry speaker noted that the insurance sector manages USD 35 trillion of assets worldwide. During the period of low interest rates, insurers started to invest more in riskier and less liquid private markets and alternative asset markets. Private equity firms have played an important role in this development, as many of them have acquired, taken stakes in or provided services to insurers. He noted that the complex web of interconnections between insurers and the rest of the financial system makes it difficult to predict the dynamics of a common shock to the insurance industry. This shows why international cooperation is crucial. The financial market is global, and it is impossible to look at financial conditions or activities on a jurisdiction-by-jurisdiction basis. A central bank official agreed that policy coordination among relevant stakeholders is key to realising the opportunities presented by the NBF sector.

2.4 Regulatory challenges

2.4.1 NBF data is key for enhanced risk monitoring

A central bank official stated that the fear of cross-contamination indicates the need to collect data on NBF institutions. In Hungary, non-banks need a licence to lend. It would be useful to bring all types of supervised entities under one integrated authority. In case of a

crisis in any part of the market, it would be clear whether this activity was financed by a bank. If the same authority collects all the relevant data, there will be less cross-contamination. To this end, cross-border cooperation between supervisors should be strengthened. Cross-border data sharing will benefit the supervision of firms in all Member States.

2.4.2 Monitoring counterparty risk in NBF players and banks

An industry representative mentioned that banks currently have to comply with counterparty risk rules, in particular due diligence, to ensure that their counterparties (including non-regulated NBFs) do not contaminate their banking counterparties, as was the case in the Archegos crisis. Banking supervision should also be strengthened to ensure that banks carry out adequate due diligence on their counterparties, in particular non-regulated NBFs. Proposing new guidelines for counterparty risk management may be reasonable (as currently proposed by the BCBS), but effective supervision of the existing counterparty risk assessment (including due diligence) banking rules is also crucial.

2.4.3 Extending the scope of regulation to non-regulated players and enhancing market surveillance

An industry representative commented that there are both regulated and non-regulated entities in the NBF space. As such, being a regulated entity, such as a regulated Asset Management Company, means it is directly known by regulators, which is not the case for non-regulated NBFs. It should be a priority for legislators to extend the scope of regulation to the currently non-regulated players, such as family offices. Regulation facilitates direct knowledge and information by regulators regarding those entities. This is the surest way to anticipate and reduce systemic risk. In addition, the tools currently used by securities regulators to conduct their market surveillance legal mission should also be systematically enhanced, perhaps using AI, to improve the screening and detection of systemic actors, including non-regulated NBFs.

Sustainability risks in the banking sector

The Chair stated that operational challenges have been on the agenda for a significant period. There is a broad consensus that it is urgent and that many initiatives are necessary. Financial intermediaries are key in the transition that is needed to help European economies manage. Financial intermediaries provide the funding, but by their very nature, they are there to reduce asymmetries of information, to ensure delegated monitoring and to provide liquidity.

1. Context, stakes, and challenges to address in the banking sector in order to translate macro-level sustainability visions into the micro-level

1.1 Multiple factors are at play

A Central Bank official stated that the sustainability issue is very important from three points of view. Natural disasters are taking place year after year and the risk is becoming more imminent. There are still many challenges to face, such as the data gap, uncertainty on government policies, technologies, and the market and public perceptions and geopolitical risks. It is vital to move forward, especially considering that the risk is becoming more imminent. Practicality and pragmatism are required.

A Central Bank official explained that policy coordination is needed for the aforementioned to happen. Climate related or sustainability issues are an external matter, so there needs to be policy coordination between the government and the private sector. Policy coordination among governments and private sectors or global governments might be also important. The second aspect is engagement by the government, financial sectors, financial authorities and top corporate management to the greenhouse gas intensive industry. The third aspect is transition, including the transition in finance. Good benchmarking and best practice need to be set up. Regarding regulation and supervision, a Pillar 3 approach is preferable to Pillar 1 and Pillar 2.

1.2 Uneven macro-level sustainability visions and goals

A Central Bank official noted that macro-level sustainability visions and goals sometimes differ from country to country, and sometimes even within a country between different decision makers. Nuclear power can be considered green and not green. When thinking about an international bank or a pan European bank, one country pushes it to finance nuclear power plants or nuclear energy, and another does not. Translating macro visions to micro-level decisions can also be difficult because the global needs are not necessarily the needs of the local

community. Banking products can also be a challenge, such as mortgages or commercial building loans. Agriculture is a very complex sector that was excluded from the EU taxonomy, but agriculture finance is a significant part of a universal bank.

A Central Bank official added that the regulatory requirements and tools should adjust to challenges. Supervisors and regulators do not want to put unnecessary burdens on banks. Discussion is taking place about how to enhance and facilitate competitiveness, and it is almost certain that will not happen if extra administration is put on them.

1.3 The excessive focus on climate change obscures the multiple sources of risk that are unfolding; banks are expected to drive the economy, but they should only be supporting it.

The Chair agreed that the macro issue itself is an issue. There are many variations across countries at a macro level and the immediate objectives may not be the same.

An industry representative stated that the largest operational challenge is the disproportionate attention that is attached to climate change. When thinking about risk management and when focusing on the area of credit risk, when assessing the creditworthiness of borrowers, banks should be looking at them one by one. If there is a technological shift or any type of structural shift within the economy, there will be winners and losers within sectors. Thus, labelling sectors for risk management purposes is inappropriate. No data from the past is sufficient to make that assessment, so banks will have to come up with their own qualitative assessment based on their intelligence gathering.

An industry representative noted that the largest risk might not be climate change, so geopolitical risk and other risks must be kept in perspective. The excessive emphasis on climate change is problematic, as it is causing many expectations from many people. People have expectations about who should be doing what by 2030 or by 2050, but individual borrowers might not be moving in that exact way. A one size-fits-all approach is not beneficial. Banks can support the real economy as they transition but cannot drive transition.

An industry representative highlighted that he is a member of the task force on nature related financial disclosures (TNFD), which is the nature version of the task force on climate related financial disclosures (TCFD). The disproportionate attention given to climate change means there is insufficient attention given to nature, which is a problem. The best solution is to start from the risk management and supervisory review components of Pillar 2 (not the capital add-on component), and not Pillar 3.

The Chair agreed that the financial sector is there to support those who are trying to move the economy. Expectation management is essential; different types of risk drivers will affect sensors.

1.4 The transition is driven by economic players in the various economic zones around the world; it is essential to understand underlying trends and resulting risks

An industry representative stated that climate change is important, but from a banking perspective, the physical risk of climate change is the lesser of the issues that need to be worried about. Physical risk from climate change will not manifest itself in a chronic way but in an acute one. Transition risk is the area that banks need to examine. Many banks have historically conceived of transition risk as the risk that a government might come along with a new regulation and say that things need to be done in a specific way on account of climate change. The assumption has been that the transition to a low-carbon economy will be policy driven rather than commercially led, but in the real economy the transition to a low-carbon economy is commercially driven and will happen much more swiftly than any policy-led models might imagine.

An industry representative noted that the world is past the tipping point on many technologies such as zero emission vehicles (ZEVs) and precision fermentation. Solar power is the cheapest power that has ever been known. Sinopec believes that China has passed peak oil, but the stock market valuations of many major oil companies around the world assume fairly constant cash flow over the next 20 to 30 years. The production capacity of the Chinese economy for solar panels in 2025 will reach two terawatts. If all of that year's production of solar panels is installed around the world and operates at 15% efficiency it will displace 9% of global power requirements.

An industry representative added that there will be a geography to the transition risk. Energy intensive industries will move their businesses to where power is cheapest, which will be where solar power exists. What needs to be done is to disentangle climate risk from transition risk and to look at the transition risk irrespective of the climate debate.

2. The accuracy of sustainability risk assessment and pricing in the banking sector and on financial markets remain areas of concern

2.1 In the green asset ratio (GAR) green mortgages are the predominant form of green assets, but a great deal of the data is unavailable for existing loans. The situation is worse for corporates

An industry representative stated that Deloitte recently did a benchmarking of the GAR and found that the average GAR in European banks is 2.6%, which is very low. Some Dutch banks have as high as 20%, but in central Europe the number is as low as 0.1%. Only 50% of the 66% of the balance sheet that is exempt is currently covered by the EU taxonomy. Green mortgages are the predominant form of green assets and 25% of large European banks do not have any reporting on them. The average GAR is 7% for the 75% of banks that reported green mortgages. When examining Dutch or Norwegian banks that have very high

GAR the green proportion of those mortgages tends to be above 20%.

An industry representative added that data is needed, but a great deal of the data is unavailable for existing loans. Only 20% of banks reported any green assets in corporate, with the ratio around 6%. The Corporate Sustainability Reporting Directive (CSRD) will help. The energy and automotive sectors are very strong, but transport, real estate and cement are lagging, and breakthrough technologies are needed. Data is needed, especially energy performance certificate (EPC) data.

The Chair agreed that there are limitations in the GAR, but the EBA believes there is value in the way it can help understand the differentiation across types of banks, geographies and portfolios.

2.2 It will take time to improve the information and data and refine the models, which suggests partnering with experts and developing risk mitigation approaches involving the public sector

An industry representative explained that they primarily work with banks in the Central European region. The root cause of the operational challenges is that the risk and reward profiles are unclear. The pricing of green assets is based on market conventions. There are many sophisticated models in the background and stress testing scenarios, but when it comes to business there is a convention on how many basis points the green premium is worth and it is not related to the more sophisticated approaches. The banks do not tend to have sizable green funding pools. Many banks have issued green bonds and received funding, but it is quite limited.

An industry representative highlighted that it is likely that the risk management departments in banks are wrong. There are sophisticated calculations, but they are dependent on many inputs and assumptions, and if they are slightly changed then there is a completely different answer. The solution is getting the business side roughly right, as nobody knows where the transition risk is going. More data and disclosure to refine sophisticated models is useful, but it is going to take too long. The public sector needs to intervene and help, because pricing is imperfect. Subsidised lending and blended finance are needed.

A Central Bank official stated that understanding the climate and nature risk requires knowledge from many areas of science. Since 2022, the Hungarian Central Bank has been working on an environmental, social and governance (ESG) questionnaire recommendation for banks regarding the integration of ESG risk into credit risk and modelling. Dozens of meetings have taken place with external partners such as the World Wildlife Fund (WWF), Greenpeace, universities and experts.

2.3 Some supervisors try to leverage the attractive risk profile of green long-term investments; the starting point should be enabling internal rating systems to account for environmental risks

A Central Bank official observed that supervisors tend to prefer using the stick rather than the carrot for regulatory capital. By adopting a risk-based approach, supervisors might favour entrepreneurs who focus on long-term green financing because there is a positive

correlation observed between that and the improved probability of default (PD) and loss given default (LGD). The Hungarian Central Bank has initiated a capital relief program on Pillar 2 requirements and banks have responded positively.

An industry representative stated that Pillar 2 has four principles: risk management, supervisory review, capital add on, and supervisory intervention. The starting point should be how the bank's internal rating system deals with environmental risks. The current downgrades purely due to environmental risks may be relatively few based on a company-by-company assessment. Although there may be an expectation that there should be many downgrades, the few downgrades might be appropriate given that the risk management time horizon is typically 1-2 years. As a means to cover a longer time horizon, the use of scenario analysis is useful, which can also be considered as a component of Pillar 2.

3. The challenge is to effectively integrate climate and environmental (C&E) risks into the economy beyond the banking sector

3.1 Bank managers need to familiarise themselves with the risks and opportunities associated with decarbonisation technologies and sustainability risks

A Central Bank official stated that decarbonisation technologies are an area of opportunity for institutions. In oil and gas there is the financing of renewable energy and low-carbon projects. In power generation there is carbon capture, dedicated finance for it, special purpose loans for conversion and supporting institutions in the transition towards renewables. In the automotive area there is funding investments in electric vehicles. In steel there is the financing of hydrogen electrolysis technologies. In cement there is supporting carbon capture and in aviation there are sustainable fuel components.

3.2 The role of the SSM

A Central Bank official stated that the SSM started the work in 2019 with an objective to be clear and predictable. The process has been very interactive with the institutions. In 2019 only 25% of Europe's banks had demonstrably reflected the upcoming physical risks and credit risks from climate in their supervision. The SSM published a guide in 2020. In 2021 it asked the banks to do a self assessment, and in 2022 it had conducted a thematic review and a stress test. The first milestone was for banks to have adequate materiality assessments by March 2023. The second was to integrate the climate and environmental (C&E) risks into the governance strategy and the risk management practices by the end of 2023. The third was that by the end of 2024 banks should address the risks in full alignment with the ECB's expectations. There needed to be binding decisions issued for 22 banks, which enabled assessment of periodic penalties in the case the banks did not undertake the work.

A Central Bank official added that the SSM is assessing the second interim deadline that it gave to banks to integrate the C&E risks. 2024 is a crucial year, because by the end of the year the full alignment expectation will be in place. All the tools in the supervisory toolkit will be used to move the industry in the direction of risk, primarily operational risk and credit risk. The objective is that institutions have adequate risk management in place. A standing working group is in place with the European Banking Federation to allow for a continued dialogue with the industry.

3.3 The risk assessment must be comprehensive and forward-looking

A Central Bank official agreed that there should be a focus on the transition risk, as the policy changes require management from banks. One of the main robust approaches that has been seen is an alignment assessment, which compares the projected production volumes in key economic sectors with the required rate of change to meet the climate change pathway objectives.

A Central Bank official noted that the ECB had published best practices for alignment assessments in its report called Risks from Misalignment of Banks Financing with the EU Climate Objectives. The first is that scenarios are representative, and science based. This means that they are consistent with policy objectives and pathways, especially from the Paris Agreement. The second is that they are internally consistent and that the scenarios are incorporated into the strategic process, governance process and risk management process. The third is that they are re baselined and up to date. The fourth is that they are geographically relevant and aligned with the portfolio. The fifth is that they are annually updated. Transition planning must be the cornerstone in the standard risk management practices by institutions.

An industry representative stated that supervisors should be challenging banks. The Network for Greening the Financial System (NGFS) has been helpful in coming up with a climate scenario, and the hope is that it will come up with a similar scenario for nature. There is a role for supervisors to provide banks with a benchmark in carrying out the analysis of what might happen in the future, so that that could inform banks in their assessment of the credit risk for the shorter term.

An industry representative noted that assessments need to focus on the future. Banks need to ensure they are talking to the right people and that they have the right people in their organisations. If gas and industry teams are speaking to established players like the International Energy Agency (IEA) for their projections of solar uptake, then they are going to be wrong. Risk models have to reflect that what will happen will be very different than what has been predicted.

An industry representative added that banks also need to stay abreast of business innovation. The value in the next phase of the transition to the low-carbon economy will come from the software that governs how solar panels and renewable energy are integrated into an energy grid. An understanding is needed around what innovation is taking place and what is happening behind

the meter. Banks also need to stay abreast of the interactions between sectors. 40% to 45% of global shipping is shipping hydrocarbons, and if the hydrocarbon sector is eroded by electrification, then that is going to have a knock-on effect on the shipping sector. Integration will take place.

3.4 Forward-looking holistic approaches require adequate disclosures and a structured cooperation between the public and private sectors

A Central Bank official explained that in terms of public-private partnership in Japan, the Ministry of the Environment, the Ministry of Economic Trade and Industry, the Ministry of Finance, the Japan Financial Services Authority (JFSA), the BOJ and the Japan Business Federation are working together on improving the issue, particularly on how to utilise the risk to improve productivity or potential growth. Japan is trying to improve its economy and its energy mix, utilising nuclear stations, renewables, and trying to use hydrogen to manufacture steel. Around 1,500 Japanese companies are complying with TCFD disclosures.

A Central Bank official noted that major banks and plenty of regional banks are making a clear commitment to support the sustainability finance; they established a designated function and unit led by the senior executives in charge and established a strategy to reduce greenhouse emission vis-à-vis greenhouse intensive industries. The BOJ is providing the sustainability finance operation in the market and is back financing

green sustainability lending conducted by financial institutions. The Japanese government recently started issuing the transition government bond, and the BOJ and the JFSA are working on the scenario analysis with respect to activities around the sustainability risks that started in 2021.

A Central Bank official highlighted that due to the possible negative externalities of market failures, some regulation and supervision might be necessary. A Pillar 3 approach is needed, because it is very challenging to quantify the risk of sustainability in an accountable and transparent manner, both in terms of physical risk and transition risk. Pillar 3 might be useful, but in Japan many projects are being worked on under a hybrid of the Pillar 2 and Pillar 3 approaches. In the medium to long term, it might be useful to set up some benchmarks to show a useful way to address this risk. Cooperation among the private sector and public sectors could be essential.

The Chair agreed that staying abreast of developments and being innovative is an opportunity. There are going to be coordination aspects, and it will be complicated. Tools are being used that should be flexible to combine the carrot and the stick approach. Expertise is needed. Horizons and patterns are evolving. It is also encouraging to see that data is coming in. Data can be used, but the traditional backward looking regulatory approach will not work.

AML: key success factors

1. Regulatory, supervisory and coordination conditions to be met for AMLA to address the EU Money Laundering and Terrorism Financing objectives

The Chair stated that the 2021 anti money laundering (AML) package entered into force in the summer and will create a new AML universe with a single AML rulebook for all obliged entities and with the European Authority for Anti Money Laundering and Countering the Financing of Terrorism (AMLA). AMLA will be a standard setter and will coordinate national competent authorities (NCAs). It will directly supervise selected obliged entities and will be an exchange platform for financial intelligence units (FIUs). It will not become fully operational before 2028.

1.1 The Commission is focused on the operational set up of AMLA

The Commission has set up a task force and is working on the operational setup of AMLA by recruiting staff and preparing an IT infrastructure, but there is a great deal of work to be done on the substance before AMLA becomes operational. Around 70 regulatory technical standards (RTS) need to be drafted in the next three years. AMLA needs an effective launch and close cooperation with national supervisors and FIUs. AMLA also needs to work closely with law enforcement agencies like the European Public Prosecutor's Office (EPPO) and Eurojust and needs close cooperation with prudential supervisors at an EU level.

New AML regulation also allows information sharing partnerships among obliged entities, supervisors and FIUs. AI will help increase efficiency and prevention of money laundering but must not come at the expense of data protection and privacy. AI has also the potential to improve transaction monitoring systems and enable financial institutions to identify suspicious activities more accurately.

A regulator noted that the Commission has also requested the European Banking Authority (EBA) and the NCAs to do some preparatory work on the regulatory side. 70 products need to be delivered in a short time, which is the core of AML regulation supervision. Risk analysis and customer due diligence (CDD) requirements need to be put in place and specified as a foundation for the future system. The objective is to build something high quality, based on broad participation of stakeholders, and to evolve as it progresses.

1.2 Providing the AMLA with the agility to define and adapt its strategic approach

A regulator highlighted that AMLA is going to be a new authority so there needs to be strategic thinking about

how to proceed with anti-money laundering and counter-terrorist financing (AML CFT) regulation and supervision. Thought is also needed about having more of a principles-based approach rather than a rules-based approach, combined with more effective supervision and more regular supervisory engagement. It is about having supervisory engagement that is not only risk-based, but also based on compliance outcomes and having a measure of effectiveness of supervision. AMLA is a new authority and needs to build its reputation. AMLA needs to build its relations with the European authorities and the NCAs, but also with international standard setters and third country agencies that have similar roles.

1.3 State-of-the-art technological equipment is also required

A regulator stated that technology is very important. As a starting point a report should be commissioned on how technology can be used for the purpose of meeting AMLA's objectives, including how AI can be better applied for the role that AMLA needs to fulfil. Stakeholder management is also vital.

2. Operationalising AMLA raises high managerial and human challenges across the board

A regulator stated that AMLA needs to employ approximately 430 people within a period of three years who need to have a proper skillset in the field of AML, financial supervision, enforcement, rulemaking and policymaking. Those types of professionals are not widely available, so a setup is needed that allows continuous professional development and the ability to recruit people of a certain standard. AMLA needs to set up its own financial crime compliance academy in order to ensure that it recruits and can also keep its staff up to date with trends such as AML and financial crime. AMLA could also support NCAs in building or retaining their own capacity in the field of AML.

Thought is needed about how to create a common AML CFT supervisory culture, which has already started through the EBA. The European authorities currently all have their own committees that bring supervisors together. The European Securities and Markets Authority (ESMA) has its own Senior Supervisors Forum (SSF), which brings senior supervisors together from all the European authorities. Those structures could be well placed in AMLA in order to ensure that supervisors meet, exchange best practices and ideas, and build a relationship, which is very important for cooperation.

The Chair agreed that an academy is needed. It is important to look at coordination, IT and getting the right staff, but there are 27 different cultures and

mindsets to deal with. A new common mindset is needed.

A Central Bank official stated that work needs to be done on the 70 RTSs and Implementing Technical Standards (ITSs) so that the articulation of the framework is made in a complete way. The day to day implementation of that will happen at national level. The key ingredient in AMLA and at the NCAs will be risk culture. It is about progressing in a converged way to deliver the outcomes that are needed, directly delivered in the AMLA construct through direct supervision, but also in the board of supervisors and through the structures that AMLA will adopt.

2.1 The transformation of NCAs will be deep; their involvement and buy-in are vital

A regulator highlighted that there is much work to do but resources are currently limited, particularly on AMLA's side. Cooperation is needed, and there is a need to prepare at the NCA side. It is different compared to the Single Supervisory Mechanism (SSM) or the EBA, because it combines regulatory and supervisory work. The work is much more at the national level but in a more integrated way, as currently the SSM and the ECB oversee around 75% of the balance sheet of European banks. The bulk of AML will be at national level. Integration and cooperation will be key.

Work is needed around internal organisation, as well as looking externally to what other authorities are doing. It is about governance, processes and systems. A forum has been created at the EBA level for supervisors in order to exchange, define common priorities and see where everyone is challenged. Data has been exchanged. The AMLA General Board is composed of supervisors across the EU from both the financial and the non-financial sectors, which forces AMLA to organise itself domestically in a national context to speak with one voice. Data is key, as if the information is not being interlinked then the whole purpose of AMLA being the main host of an EU-wide database will fail.

A Central Bank official stated that the NCAs must be at the centre of the approach in standard setting and the regulatory approach. The entire AML framework was predicated on the fact that the EU27 have to adopt a more holistic and collective approach in order to be more effective at fighting financial crime. That can only be done if the EU collective delivers a coordinated approach. The vast majority of the resources will reside at national level, and once AMLA is incepted the vast majority of the responsibility for supervision of the obliged entities will remain at national level. In the SSM most of the systemic risk sits in its direct oversight; although there will be around 40 entities selected for direct supervision by AMLA, the vast majority of the entities will still be supervised at national level.

The EBA has a small team that is doing an excellent job on the Standing Committee on Anti-Money Laundering and Countering Terrorist Financing (AMLSC). Adding NCA experience will drive high standards for everyone, as it will harness the AML risk culture that needs to be seen in a pan-European way. The hope is for the General Board to incept it at the end of 2024.

Two of the key four first pieces of work that are being done on the package are about risk methodologies, both in selecting the directly supervised entities and how risk assessments are conducted for all of entities. That is supervisory work, meaning that even if it could be resourced differently it should not be.

The Chair agreed that it is not only about a new authority but also a new system of cooperation between AMLA and the national competent authorities. The motto is 'five Cs': convergence, common culture, cooperation and coordination.

2.2 Work is ongoing to make national FIUs vital contributors in the new EU AML network

A Central Bank official outlined that FIUs are doing a significant amount of work to prepare for AMLA. The EU FIUs Platform is a working group and committee chaired by the European Commission, which will come up with ideas and preliminary work on the numerous mandates that AMLA will have to fulfil in the initial years of its activities. The platform has set up an ambitious work plan, with more than 25 projects in five thematic areas, and work has commenced on a number of those projects. The platform is working intensively in uncharted territory, which is the information content and template for suspicious transaction reporting (STR). The EU has 27 different approaches to STR contents and formats, with significant differences across the FIUs. Convergence is needed. A one-size-fits-all approach to STRs would not be appropriate, but basic commonality is necessary.

Work is ongoing on common information formats for STRs, but also for transactional information that accompanies STRs when they are reported and when the FIU reverts to the reporting entities to acquire additional information. The work will impact reporting entities and has an overlap with the work that the EBA is currently conducting in the Supervisors' Forum on the information that must be collected for CDD purposes. CDD information and STR information must link to each other to simplify working procedures and information flows within reporting entities and FIUs.

Work has also been completed on common formats for FIU-to-FIU exchanges. Templates can be used to cover the whole cycle of FIU-to-FIU cooperation, which is a complicated framework and ranges from initial requests to responses to feedback, to follow-ups. Intensive work is ongoing on the common approach to joint analysis. Joint analysis will be crucial for AMLA as the FIU's mechanism. The work will complement what FIUs can do at the national level, which has not been enough in the past. The joint analysis teams will have to set up a common approach and a common culture to analysis. Analysis is an open question at the EU level, which is being answered by setting up a common methodology that AMLA should be prepared to endorse in the future. AMLA will not have a deadline to begin joint analysis, meaning that it will be effective as of 2025 when the FIU's mechanism becomes operational.

Another challenge is to set up an IT infrastructure for AMLA and for FIUs working with AMLA. FIU.net is already available, which is a very effective network that

serves the purpose of assisting FIU-to-FIU exchanges. Building on FIU.net, AMLA will have to be able to set up its own IT system in support of joint analysis and all internal procedures in support of the FIU's mechanism. Costs are involved and the complexities are relevant, but it is an additional more reason for FIUs to collectively work with the Commission to come up with a proposal for the new system.

2.3 Financial institutions and their clients are also preparing on data, culture and organisation

An industry representative stated that clients need to be ready and need to get the basics right. Clients need a good governance organisation and clear reporting lines. Management needs to lead by example in having a good compliance and AML culture, and regular staff training also needs to be provided to ensure that the culture is widespread among the organisations. A clear and exhaustive set of data is vital to allow for audit trails. Companies also need an in-depth and exhaustive knowledge of their client base, including good client segmentation, appropriate due diligence, and regular reviews of that due diligence.

A regulator noted that broad industry participation is vital. It will be important to engage early on with the industry to see their pain points when it comes to setting up the regulatory and the supervisory framework. The result should be much more regulation with more effective supervision. Once policy and methodologies are conceived it is also very important to think about the actual implementation. A risk assessment methodology cannot be created without thinking about the data points.

3. The high number of transactions means that AI, machine learning and data science are needed to detect suspicious transactions, meaning the industry needs to create a complete data ecosystem

A regulator highlighted that the competition is not on AI software anymore it is the chip making. AI depends on the quality of the hardware and those who are not involved in AI. AI, machine learning, robotics and reading can help to detect money laundering and suspicious transactions. The amount and size of transactions is so large that nothing else can help to detect what is going on aside from AI, machine learning and data science. It is also important that financial institutions implement AI and machine learning as much as possible to detect and prevent transactions. Banks and other financial institutions are spending billions of euros on investing in machine learning and new technologies for their everyday business, but they need to be forced to implement algorithms and models that will detect money laundering and suspicious transactions.

Data is important for AI, as the model is only as good as the data it receives. The entire ecosystem is created on

the way that the data can be used. Without implementing machine learning and AI it will be very hard to prevent money laundering and the financing of terrorism.

The Chair agreed that it is advisable for supervisors to encourage its industry to implement AI and digital technology for making their systems more effective as long as this is in line with the law.

An industry representative stated that there is a significant opportunity around AML and financial crime. The annual Forrester survey estimates that financial institutions spend \$200 billion a year on financial crime, compliance and monitoring. \$85 billion of that is in Europe and 70% of it is people cost. Every financial crime decision needs to go to a human for review, so compliance teams do a very large amount of manual work. There are a huge amount of false positives, and those false positives have a cost. The application of AI has great potential in helping address those problems.

3.1 In many cases AI can outperform the usual approaches that are taken

The Chair commented that a money laundering case could be compared to a puzzle with a thousand pieces; a team that only has few pieces will hardly be able to find the whole picture, but an AI might be capable of doing so.

An industry representative added that AI can identify links much quicker than a team can, and it can also look across borders.

An industry representative noted that AI will bring considerable productivity gains through the holistic consolidation of internal information and the use of external database and unstructured information. AI can improve the knowledge of clients at a low cost. An intelligent chatbot could enhance physical networks to complete "Know Your Customer" (KYC) processes and analyse the links between people and legal entities. Fraudulent documents could be unmasked by cross-referencing external or internal data. Companies can also enrich their customer knowledge with external data collected in an unstructured information on the internet.

3.2 AI is cost effective and analyses unstructured data and generates reports, enabling a focus on understanding the telling outcomes

An industry representative stated that AI is a huge opportunity and will help banks to have much better and more efficient risk assessment. The priorities are speed, accuracy, scalability and being proactive; the main characteristic of AI is its capacity to analyse a huge amount of data in a very short time, which is vital for AML prevention. A clean dataset is very important, but AI can also analyse unstructured data. Natural language processing means that AI can examine news articles and link to another dataset, enabling identification of suspicious patterns and abnormal behaviours. Machine learning can be used to do more proactive analysis.

AI can also generate reports, which leaves time for teams to look at the outcomes and to have a proper analysis of what comes out of it. In the last years banks

have spent a significant amount of money to build teams to be able to spot suspicious transactions. There is always a problem, because 100% of all transactions cannot be checked and specific patterns need to be relied on. AI will help to go through the transactions and information in a quick and efficient way, which will help the team to use their time to better analyse transactions.

An industry representative highlighted that AI can extract relevant information from unstructured texts to assess matches and maximise the effectiveness of investigations and can also identify false positives more quickly. AI can also automatically generate reports and can improve the accuracy of STR through a dynamic approach between large amount of internal and external data, which can also capture the evolving patterns of money laundering.

3.3. Mature data processes, good data governance and responsible AI approaches are needed for AI

The Chair agreed that AI cannot work in a lawless space and highlighted the ethical concerns about biases and fairness.

An industry representative noted that in 2023 their company conducted a survey of around 500 compliance professionals around the world that looked at where they were in the adoption of AI. Only 10% of respondents were using any AI in production, but the two things they had in common were mature data processes and good data governance. The role of data cannot be underplayed, as any bias is largely the fault of the data that is used for training and processing. The company has also externally published its position on responsible AI and its principles around transparency, accountability and fairness.

4. Key success factors for the launch of AMLA

Panelists were asked to give their 'must do' and 'must not do' for the next three years, particularly with the launch of AMLA.

A regulator commented that the 'must do' is cooperation and the 'must not do' is to forget about implementation.

A regulator stated that the 'must do' is capacity building and the 'must not do' is to create another single rulebook which becomes unmanageable.

A Central Bank official highlighted that the first task is for AMLA to set itself up as quickly as possible. Clear indications are needed on the FIU's delegates, what the FIU standing committee is and what its role should be. FIUs also must receive indications on relations with external stakeholders such as EPPO, the European Anti-Fraud Office (OLAF) and Europol, and how information would flow from AMLA and FIUs to and from those bodies. The priority for FIUs is to not be complacent with AMLA, and to engage AMLA and fill it with information and working procedures capable of integrating joint analysis.

A regulator explained that the 'must do' is to force banks and financial institutions to implement machine learning as much as possible, which will implement rules and procedures for AML. The 'must not do' is to forget about the data flow and data quality.

An industry representative highlighted that the 'must do' is to keep up with what is happening in technology, and the 'must not do' is to ignore the data.

An industry representative stated that the 'must do' is to keep open-minded, because AI will also bring new criminality. The 'must not do' is to forget current in house IT systems that need to evolve to support future AI solutions.

A Central Bank official commented that the 'must do' is to focus on outcomes and to continue to focus on fighting financial crime. The 'must not do' is to fall into the trap of a race to the bottom in terms of the lowest common denominator because of a need for speed to implement.

An industry representative observed that the 'must do' is for companies and organisations to anticipate, clean their data and clean their system. The 'must not do' is to wait for the regulatory request.

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Mindaugas Liutvinskis - Vice-Minister, Ministry of Finance, Lithuania

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Strengthening the EMU: economic priorities for the EU and member states

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Marketta Henriksson – Director for EU Affairs, Ministry of Finance, Finland

Jacques de Larosière – Honorary President, Eurofi

Harald Waiglein

Thank you very much for joining us. This panel is trying to take a longer-term view of the challenges of EMU and how we should address them in the next legislative cycle. Let me set the scene against which we discuss what should happen over the next five years. The situation is very different from what it was just before the last legislature, because now we have a more pressing concern about the competitiveness gap with the US and other major global powers. It is widening. Europe is falling behind. We have concerns in some countries that old business models based on cheap Russian gas are probably no longer viable, or maybe they are. I do not know. It is up for debate, but it is certainly an issue. We have the high debt and structural problems in other parts of Europe that we are trying to address with new rules. We now have the challenge of making those new rules work and implementing them in a way that actually tackles the problem.

We have the very pressing problem of the incomplete single market, particularly in financial services. That is what we are trying to address with a Capital Markets Union (CMU) and a Banking Union. We are having a fairly new discussion because 15 years ago the consensus was that we would not interfere with market mechanisms, but now we are talking again about state intervention, subsidies and industrial policy. Can that be the solution? Should we discuss this or should we go back to where we were 15 years ago? We have the geopolitical situation, with the ongoing war in Ukraine, which is unlikely to end before the beginning of next year.

Marketta Henriksson

I think your diagnosis is correct. Europe is indeed experiencing slower GDP growth than that's my first point. I'll make three, as is our custom in Finland. The slowdown in growth is not the only problem facing the EU (my second point), and so far the EU's response has not been ideal (my third one).

Going back to the first point, there is a lack of investment in Europe, particularly in high tech and R&D. The Draghi report picked up on the fact that the EU's innovation activities are mainly concentrated in sectors with low R&D intensity, such as automobiles, whereas in the US there has already been a shift to software and hardware sectors and further to the digital sector, where the US is clearly more advanced than the EU.

Turning to other challenges, in addition to growth and productivity, there is the long-term challenge of ageing. At the same time, we need to digitise and decarbonise the economy. We are still grappling with the problems that started with Chechnya, Russia's war of aggression and the other global conflicts. These have also required significant responses from the EU. Then there is the internal issue of the EU, where we are not always very fast in taking decisions and making progress, even on important issues like the CMU. Another issue where we are perhaps too good is the development of new regulation. I have noticed that the future President of the Commission has made this one of her main points, where she wants to reduce regulation and simplify things. On the other hand, I have noticed that in her first 100 days she is more or less adding regulation. This will be a priority for the next Commission.

The EU's response to all this has perhaps not been ideal. We have new instruments, relaxation of state aid rules, new tariffs and then the call for industrial policy. Starting with the new instruments, the main ones are the Next Generation EU (NGEU) and the Recovery and Resilience Plans (RRP). It is perhaps a bit early to say whether the RRP's have been a great success or just a small one. It is often said that there is not a lot of money going from the EU to the member states, and this has been taken as a sign that things are not progressing, but from the member state side, we have spent all the money. We are just waiting to get it back from the EU, so the measures are ongoing. We are now in a phase where - coming from Finland, which is one of the countries that wanted this - we have all these checks and very tight control over the money that it is well spent. I wonder a little bit if we have gone too far on that front and maybe we could have done it with less bureaucracy. We need to do a post-mortem on the RRP and how it worked before we start another one or anything like it. There is probably something we can learn and something we do not want to repeat.

Then, in terms of the solution and what needs to be done, we need to address the challenge of the productivity gap. That is quite clear, but it has to be done in the most efficient way. We need the most effective technological solutions for digitalisation and decarbonisation. Here I wonder how much public intervention is optimal. The public sector is not always very good at picking winners, because politics tends to get in the way, both at national and EU level, so we need to be careful here, especially when we choose things like disruptive innovation, which was mentioned in the Draghi report. We still need a level playing field to encourage competition, so we need to allow growth-oriented small and medium-sized enterprises to compete with the big ones.

We need to keep CMU on track. I think Mindaugas will talk a lot about this, so I will more or less leave it at that, but this is a key answer. Rather than focusing on financing investment through common EU debt instruments, which my government is not in favour of but which has been suggested again this week in the Draghi report, the priority should be to ensure that our capital markets function as efficiently as possible.

Finally, my third point on the solution side is the limited role of government. For the single market to work, the role of the state must be limited, and market forces must be allowed to drive economic activity. We should limit government intervention to correcting obvious market failures. That is all from my side. I think I have avoided mentioning the word "fiscal" once, so I can congratulate myself on that.

Harald Waiglein

This is going to trigger a question for me because I noticed this. We both come from frugal countries. I am not going to go into the details of all the reports we have received. There are very good things in them. There are things in them that probably need to be discussed more, but what I found very lacking was a lot of focus on the potential risks of having very high debt in the current interest rate environment. It is not there

at all. Are we wrong now? Is it no longer an issue? What are your thoughts? I will ask Paula the same question afterwards.

Marketta Henriksson

Coming from a frugal country and chairing a committee that wants to keep debt levels low, and on a personal basis as well, I would see it as a problem. I do not know why it is not in the reports, but I noticed in the Draghi report that there were a couple of things where fiscal rules were mentioned. One was having a common debt and then, in contrast to that, having tighter rules for member states, the rules that we have just reformed very painfully and probably do not want to reopen anytime soon. That was one place where that came up, but I also noticed that the European Semester in the future should only be about fiscal policy.

Harald Waiglein

Paula, what do you think about the challenges? You heard my question on fiscal and debt issues. We have seen the agreement on the revision of the Stability and Growth Pact under the Spanish Presidency, with contributions from you, so I was wondering what you think of the progress made so far. You can answer the general question first.

Paula Conthe Calvo

We have been fortunate to have a very good diagnosis in all the reports. I agree with some of the points made by Marketta, but perhaps not so much with those relating to the Recovery Plan, which I think has been a very good experience and has had a very positive impact on many countries. The main priority that could sum it all up, looking forward to the next five years, is really to look at everything from a European perspective. In particular, when we look at the investment gap, it is very much related to fiscal policy. Obviously, national fiscal space is limited, but we have a huge investment gap that we have to finance.

Many of the investments that need to be made to improve competitiveness in Europe are things that are really European public goods. This is true for defence, innovation, research, energy and many of the things that have been mentioned. Investment at national level would not be the most efficient solution. It would be much better to have a common action that would be efficient and take advantage of the economies of scale of a market of 450 million people.

For that to happen, there has to be funding, and a lot of that is private funding. When Mindaugas goes to the CMU, I am sure we will very much agree on the need to make strong progress there with very concrete proposals. There is also a very strong case for joint public investment. We may agree or disagree with some aspects of the various reports, but as we enter this new legislative cycle, we have the opportunity to have an open discussion about this common public investment and how to finance it. Perhaps one of the options, especially given the limited fiscal space and the high debt of certain countries, if we want the most efficient solution, would be a common debt. We now have the opportunity to actually discuss this in our groups. I look

forward to doing that in the next few months, hopefully not too many.

Harald Waiglein

I mentioned the fiscal rules earlier, and you rightly mentioned the huge needs for investment and other spending. At the same time, if you look at recent developments in at least two very large countries, it looks like we are going to have a default under the new rules very soon. Are you not worried that we will lose all credibility when we talk about the big investment needs if at the same time, we cannot get fiscal policy on track, or do you think that the new rules will bite and we will actually see good results?

Paula Conthe Calvo

I have every confidence that the new rules will indeed create a framework that will allow fiscal responsibility to go hand in hand with the growth and investment that Europe needs to regain its competitiveness and become a global player that can compete with other players right now. Right now we are in a situation where there is a significant competitiveness gap - I think we all agree on that - and that needs to be addressed. The fiscal rules provide the space to combine fiscal responsibility with this investment. At the same time, I hope that if we approach joint public investment in those elements that we absolutely need in terms of innovation, energy, high technology and many other aspects, we can have a very constructive dynamic for Europe in the coming years.

Harald Waiglein

I will move to Mindaugas. We are also in a very similar situation. Sometimes, when you look at European challenges, you have a different view if you come from a small open economy than if you are a big country. I know that we agree on many things with Lithuania when we discuss issues. I was wondering what your view is on these big challenges that we rarely discuss as broadly as we have the opportunity to do here.

Mindaugas Liutvinskis

Let me start where you started. Five years ago, the buzzword was Green Deal. Now I think the buzzword is competitiveness in the new cycle. As with the Green Deal, over time we have understood the complexity of the issue and the different policy tracks. I expect that in the next five years we will have a lot of debates on competitiveness. We will see where it goes.

The diagnosis you put on the table when we started is pretty much right. It is also well reflected in the Draghi report that we have all read. It is big, but it is good. It is a good basis for future policy steps. We are behind, yes, and there are challenges, but we are not in a desperate situation that we cannot get out of. We just need political action, political will, and coordination at the European level.

I will not go into the data on where we are compared to the United States because of the time constraints, but I will focus on what could be done and offer a few ideas from my side, although this is a very broad subject.

The first is the economic governance framework. We have focused on getting the reform done, so now we

have the new fiscal rules. It has built-in incentives, as we know, for structural reforms and countries are now preparing their medium term fiscal structural plans (FSPs). What we have to do together, in the Council and the Commission, is to make sure that the plans are of high quality and that if there are reform commitments followed by extended fiscal adjustment paths, they are implemented. We have to have ownership and enforcement. We have to make fiscal rules work.

As far as private funding is concerned, CMU is obviously a major item on the agenda. I see it as a core element whenever we talk about competitiveness. We must not shy away from this issue, and we must actually have some momentum. What we did in the Eurogroup with the declaration is a good basis and a good starting point. I hope that in the near future we will be able to move on to concrete legislative issues, because progress in this area is closely linked to total factor productivity growth in economic terms. We need more funding for innovative, high-growth companies, which is not fully available at the moment. That is why many promising companies seek funding in other jurisdictions, such as the United States. We need to reduce this fragmentation.

Private funding is a big part of the puzzle we are trying to solve, but I agree that it is probably not enough, and we need to talk about what we can do with public funding. We have to be pragmatic and realistic. We have to recognise where we are at the political table and what kind of different views and positions we have in different capitals. There is one thing we should and could pragmatically focus on. The one real fiscal instrument that we have at the European level is the common budget, the multiannual financial framework (MFF). At some point, I think in the second half of next year, the Commission will propose the draft MFF for 2028-2034. This will be a big thing. It will be the blueprint of how the new Commission plans to financially implement its strategic objectives, so we need to focus on that.

From the Lithuanian perspective, we would be open to discussing ways to give the common budget more capacity and more financial muscle. This may involve some reordering of priorities, but we would also be open to discussing the possibility of having a bigger budget to deal with the new challenges that we are putting on the table as politicians, from competitiveness to defence policy and other issues, including the same Green Deal that is still on the table. I think there will be a debate on public finance, but I would urge that it should not just be reduced to 'single borrowing, common borrowing, yes or no'. Then we will probably get nowhere. Let us try to be pragmatic and see where we can go.

Of course, I must also mention the geopolitical environment and defence policy. Coming from the Baltics, this is a very big issue for us. We have been very focused on increasing our security and defence spending. We feel that with the change in the security environment, this needs to become a real European issue. It is indeed welcome that the President of the Commission has announced that there will be a Commissioner for Defence, so we are moving in the right direction. I think that the priority of defence policy and increased coordination needs to be reflected in the next

EU budget in a more thoughtful way than it is now. We need to focus on increased coordination of the defence industry, how we can make it more competitive at the European level and how we can improve its access to funding. There is a lot of work to be done in this respect and I think it is existential at this point.

My very last element that I wanted to mention - you also referred to it at the beginning, Harald, and it appears in the Draghi report - is the debate on industrial trade policy. I think we are moving into a period, internationally or geopolitically, where foreign policy and trade are more closely linked, or the security and geopolitical dilemmas are linked to economic policies and issues. We would be open to considering targeted industrial policies at the European level, especially in those segments of the economy where it is critical, such as critical raw materials and defence industries, things where we have the common European public good, and it is not just about fragmenting the single market, but rather creating some kind of added value at the Union level.

Finally, on foreign economic policy - it is a bit of a new term - in the political sense, it is on the table again. We need to recognise it, discuss it and think about what it needs, from foreign direct investment to supply chains to trade agreements with other blocs. Geopolitics is here at the ECOFIN table, at the EFC table, and it is here to stay.

Harald Waiglein

There are very interesting debates ahead when I imagine discussing this in the EFC. I have one thought on what you said, because I agree with you completely on the budget. We recognise how much the situation has changed, and it has probably changed even more in the last, let us say, 20 or 30 years, but the priorities of the EU budget have remained largely the same, as if nothing had changed, and we do not have that discussion. We are discussing 'let's leave everything as it is and fill the gap with joint debt'. That is our particular problem in this debate, but I do not want to go into it too much. Our position is well known. It is something we really need to think about.

Now we have somebody who actually has the experience of having been a finance minister and now working in an international financial institution dealing with stability, so his advice is probably twice as good as ours. Pierre, how do you see this?

Pierre Gramegna

Thank you for the kind words and the introduction. I hope I will not disappoint you in five minutes on such a broad subject. Let me start with the three megatrends that are affecting Europe and perhaps the world. One is the geopolitical landscape, another is demographic trends and the third is increasing climate risks. Let us leave aside climate risks, not because they are not important and growing, but because they affect the whole planet.

With regard to the other two issues, the impact on Europe is greater than on other parts of the world. Why is that? The geopolitical landscape has reduced the prospect of continued growth in world trade. Europe is the world champion in world trade. We cannot expect

world trade to be the engine of growth that it has been in the past, and that will affect Europe more. The second is the cost of energy. Also because of geopolitics, we have lost access to cheap resources. That will affect us more than others. On demographics, everyone knows that we are one of the regions of the world where this issue is becoming more critical.

We have a competitiveness problem and a lack of investment that is even worse than perhaps five years ago. In that sense, the Draghi report and the Letta report, which partly cover similar issues, are timely. There are a lot of common themes. My conclusion from both reports - and this will not surprise you, because I am who I am and I have spent my life trying to strengthen Europe - is that the answer is more Europe, not less Europe. Let us not forget what is happening in all the Member States. You have many parties that are - let us put it this way - nationalist. They do not believe that the solution lies in Europe. That has not been mentioned here, but we have to keep that in mind. The IFIs have to convince people, politicians and stakeholders that we can only solve these megatrends and the lack of competitiveness together.

A key point of both the Letta and Draghi reports is how we are going to finance this €800 billion of public and private investment per year, which is three times the size of the Marshall Plan. Obviously, most of it will have to come from the private sector. In the private sector, we are talking about Banking Union and Capital Markets Union. On Banking Union, we have unfinished business there, on the one hand the lack of a backstop for the single resolution fund, but on the other hand a common deposit insurance scheme. There is unfinished business.

In Capital Markets Union, we should really switch to the name that Letta suggests. It is an investment and savings union. That tells you why we need it. Talking about capital speaks only to enterprises and some public servants, but 'investment and savings' union talks to the people. The common ground here, also compared with the banking union, is that we have to move all the topics in this area in parallel. There cannot be winners and losers in this investment and savings union. This is key to understand.

Let me then turn to public risk-sharing and say a word about the new economic governance we have. The new Stability and Growth Pact provides the right framework for more investment. That is good news. The key now is to implement it in a credible way. That will not be easy, despite the room for manoeuvre in the new system. If we can have a credible implementation, I think it will encourage countries to go further in solidarity and perhaps have more public investment or more solidarity in public investment. We have to build trust.

Let me conclude by saying that I see a lot of good things happening. First, the NGEU. Who would have thought that we could agree on that? It is not finished yet, but I am convinced that the post-mortem will be positive, because it is not just a distribution of money. It comes with programmes. Let us look at the great work that the European Investment Bank (EIB) has done in the past. Its size has increased. Its leverage has increased. Let us look at the European Stability Mechanism (ESM). The

ESM is also a way of leveraging public money to help the private sector and our private economies.

I will end with the idea of Letta, who suggests that the ESM could eventually be made accountable by offering a precautionary line for defence spending. Again, you see that defence is something that is in everyone's interest. It is a public responsibility, but ultimately it is also a private investment. How can we leverage private investment? There is an idea that in the EIB and in the ESM there should be a kind of paid-in capital, as you can call it, or a part of the public money, but then the rest has to be done by the private sector.

Harald Waiglein

That was quite pragmatic. Maybe just a word on the Marshall Plan, because the Marshall Plan has often been quoted and compared to the NGEU. It is interesting, if you look at the history of the Marshall Plan, that the success story was in the countries that had no choice in implementing it. That was Germany and Austria, whereas in other countries, some of the victors who had more say and more responsibility, such as Britain and France, it was much less successful. This is just food for thought for the ownership debate. Here is someone who has decades of experience of financial crises, debt, industrial policy and where it all went wrong. I will now hand over to Jacques de Larosière, who has also published his new book. Jacques, how do you see this in the grand scheme of things?

Jacques de Larosière

I feel a bit on the sidelines of this discussion, because when I look at my own country, France, I see that there is a lack of investment and that growth is lagging behind, and I look at the causes of this. In a very objective analysis that I have made, I come to a number of observations.

The first observation is that French companies have lost much of their competitiveness because of the excessive weight of taxation. This excessive tax burden is the result of a very zealous policy of increasing public spending in the budget. This has been to the detriment of the private sector and of companies, which have had to bear the consequences of this excessive taxation. I am sorry to say that nothing in the reports that you have mentioned in the discussion will help companies in France to regain their competitiveness unless there is a very strong action to reduce excessive spending. This is a very important point, and it shows that fiscal policy in a country like France is at the heart of regaining competitiveness.

A second thing I wanted to say is that if we want French companies to invest more, we must have a sufficient number of companies that are able to invest. What I see is that France's industrial capacity has been reduced by a good third over the last 20 years. We have fewer companies and groups able to invest. If, in France, we take a share of the 800 billion euros that are presented to us in these reports, but we have fewer and fewer companies that can digest this money - and I can promise you that this is the case in my country - because the money cannot just be used for investment and has to be digested by a company that invests, it will not help.

We need to go back to basics. Fiscal policy needs to be more normal in a case like ours, and the number of companies able to invest needs to increase. It is not so much a question of money. We have a lot of savings in France, but these savings are not directed towards long-term investments. They are channelled into very short-term investments that do not benefit the real productive economy. The reason why there has been this shift of private savings from longer-term investments to very short-term liquid placements is that monetary policy has not helped the investment climate. If you want to invest your money in a long-term project - let us say 20 years - in an industrial technology - let us say energy improvements and ecological research - if you ask 'what will I get out of it', the answer is that you will get nothing in real terms.

Then the liquidity trap that Keynes described so well comes into play. The liquidity trap is what we are suffering from. I have done some studies on this which are absolutely convincing. It is that, instead of long-term projects, people prefer to finance or buy apartments that already exist, which do not add any value to the economy, or to participate in financial placements that are very speculative and where you really make money, because the values increase on the market, but it is only the financial value that increases. It is not the real increase in the economy.

I am sorry to say this, but I do not think that grabbing a little bit of €800 billion is the problem. The problem is that we do not have enough projects, and we do not have enough companies able to invest, and the reason why we do not have them is twofold. The fiscal position is completely overstretched and is too much of a burden on the corporate sector. The second is that monetary policy has not been conducive to long-term investment. Very low interest rates have encouraged the flight of this money into the dollar area. I have calculated that, at European level, the problem of the liquidity trap, the fact that long-term investment has not earned money in real terms because of the zero-interest rate issue, which forces savings into very immediate liquid placements and does not favour longer-term investment, has cost 800 billion euros a year. It is an irony of history that we ourselves have contributed to the flight of €800 billion a year and now we say: 'Ah, we have to borrow another €800 billion to make up for this flight of which we are the authors'. Yes, use the reports. They are excellent but let us look at the basics. Fundamental things will force us to be a little more normal in terms of the fiscal policy that we pursue and a little more normal also in terms of offering returns to people who accept to put their money in long-term companies.

Harald Waiglein

I will definitely take that to heart. It is never a bad idea to focus on the simple, basic things. We should do that more often. My second takeaway is actually in line with the International Monetary Fund (IMF). The focus should be on the corporate sector, regardless of what we think about public debt, but the corporate sector is where the productivity problem is. Thank you for listening.



Conversation with Mark Jopling

Mark Jopling - Head of Global Financial Services, Europe Middle East & Asia (EMEA) & Asia-Pacific Japan (APJ), Amazon Web Services (AWS)

David Wright - President, EUROFI

David Wright

Ladies and gentlemen, I have the pleasure of having with me here Mark Jopling. Mark joined Amazon Web Services in January 2020 as the Director for Global Financial Services for EMEA and APJ.

A very warm welcome to Mark, and we thank you most sincerely for your support of Eurofi. I did a bit of research looking at some of your numbers, and to be honest, I was quite staggered by them. Just in the second quarter of 2024, net sales were up 19% to \$26.3 billion according to *The Financial Times*, which is our bible here. There are impressive figures on return on equity (ROE) and so forth.

First, why are we seeing this apparent huge growth? Where is it? Is it global? How do you see the perspectives economically for AWS here?

Mark Jopling

Good evening, everyone and thank you for that introduction David I am now a regular at Eurofi and it is one of the highlights of my calendar.

To answer your question about Amazon's recent results – AWS, the division I represent, is a technology provider of cloud services. Our revenue, as you said, was just over \$26 billion and grew 19% year over year. The question is, given the audience we have here today, what does that mean in the broader context of financial services in Europe? I'm going to use a word that I heard quite a lot in that last session, which is 'competitiveness'. I have an external reference here. A report by Gartner, one of the leading consultants in the technology sector, states that cloud computing, the business of AWS, 'will move from being a technology disruptor to a necessary component of business competitiveness'.

What we have seen is that companies have benefitted from the early adoption of cloud in financial services, early adoption in test and development environments

not initially in production environments. Cloud services are robust and secure, and customers, including financial services customers, are expanding adoption of the cloud for a variety of reasons. They are adopting the cloud for the cost savings, the agility it gives them, the fact that you can spin up services instantly, and the operational resiliency and security. Over time, customers have learned how to use the cloud it is proving to be more resilient than legacy technologies. I will come to some specific data in a moment. Cloud is no longer a new technology platform; we launched this service over 18 years ago.

To back up these words with some specific data, we recently commissioned a financial services-specific survey from the Gerson Lehrman Group (GLG). In terms of operational resilience - an issue in our industry with the Digital Operational Resilience Act (DORA) just around the corner - this survey of 100 customers measured a 69% reduction in unplanned downtime for applications using our services compared to their previous legacy environments.

GLG found a cost saving in moving from an on-premises infrastructure that requires a large capital investment to a flexible pay-as-you-go cloud service. This is not just about a cost saving at the point of migrations. Our approach to customers is that once they have moved, we will continue to optimise and help reduce those costs once their applications are running in our cloud.

Sustainability is also a big driver. Again, our data centres, running in highly efficient cloud services, reduce the carbon footprint on average by more than 85-88% compared to a traditional on-premises data centre.

Last is business agility. We talk a lot about the business value that the cloud enables and this idea of competitiveness. The cloud enables businesses to innovate faster and to deploy technology instantly. What that means for business owners, in terms of moving

from being a technology buyer to being a business user of these services, is for example a 29% reduction in the time it takes to make an underwriting decision, a 33% increase in new customer conversion rates and a 39% reduction in time to market. In other words, you can produce and sell new products faster.

One European bank, a customer I have worked with very closely, has moved its product releases in its investment bank from twice a year to every two weeks because it has been able to innovate much more quickly using the cloud. When we talk about competitiveness and business value, there are many business drivers enabled by the technology benefits.

David Wright

Are you seeing this growth all over the world, Mark? Is it more focused on the US or Europe? Are financial services the biggest customers when you look at the sector alternatives?

Mark Jopling

Financial services represent a large sector for us, as you would expect given its role in the economy. We are a global business. The services we stand up in our regions, which are our clusters of data centres, are globally agnostic. The service we stand up in São Paulo, Singapore, Stockholm, Dublin or Sydney is the same service that you are consuming, and that is certainly an attractive feature to global organisations. We are also expanding to meet customer demand. In the area I am responsible for – APJ and EMEA – we have added regions in the Middle East and South Africa. This builds on our existing regions across Europe, Asia, North and Latin America as well.

David Wright

Are you expecting this growth to keep going?

Mark Jopling

'Expect' would be the wrong word. We pride ourselves on being a customer-obsessed organisation and thinking about the long-term strategic priorities of our customers. The independent analysts that look at the technology market would certainly observe that the penetration of cloud technologies is still below 10% of its addressable market. If we continue to build services that our customers are excited about, then the cloud "share of wallet" will grow. Within that, we have competition, and we have to be good at delighting our customers. If we achieve that, then I suspect our revenues will continue to grow.

David Wright

Here we are in Eastern Europe. We have rules in Europe, including DORA and so forth. How do you see these rules? Are they fit for purpose from your perspective and your customers' perspective, or do you think they need profound revision?

Mark Jopling

I would not say 'profound revision'. We are in the process of preparing for DORA and have been actively engaged in discussions with policymakers and stakeholders as DORA has been developed. We are

now looking at what we need to do to implement DORA as well as helping our customers in their preparations for DORA. We welcome the consistency it delivers and the harmonisation of requirements across the EU. As I said, many customers are multi-national corporation, so it is a benefit to our customers to have a consistent approach to regulation in order to gain those competitive advantages that I talked about.

As mentioned, the focus now is on implementation. Obviously, we are going live in January and there will be a period where, as with any change, we will need to ensure that both us and our customers, meet the requirements. As someone who is responsible for customer relationships, we have built up a team of compliance, security and operational resilience experts who will provide advice to our customers. Ultimately, it is up to customers to choose how to use our services and the services of any technology provider, but we are ready for DORA to be implemented.

David Wright

Are you worried about inconsistent implementation here? Are you worried about other holes in the rules as technology advances so quickly? Are there bits and pieces that are missing?

Mark Jopling

I do not think that there are holes in the rules. The point you make about technology advancing means that it is not static. We have spent the last two days talking about rules for technologies like artificial intelligence (AI). The beauty of innovation is that we don't know what hasn't been invented yet, so of course regulation has to keep pace.

To answer your question about whether there are holes in the regulation we have, I would not say that. The consultation process has been thorough. We have had our opportunity to submit remarks, as have other technology companies and all of the regulated financial entities. We have a period of implementation. I have no doubt that there will be reviews, as you would expect, but we have focussed on building an operationally resilient business regardless of regulation and we support measures that deliver an operational resilient financial services sector

David Wright

I am a big European. I like to be ahead of the game. We like the first mover advantage in Europe, regulatory and otherwise. Can I say that we have good regulatory first mover advantage, or do you prefer what is going on in the US?

Mark Jopling

I would not call it out as one region against another. What is helpful is harmonisation. DORA is obviously driving consistency within the EU, and it is helpful to have other regulators driving as much commonality as possible, both for us as technology providers delivering a single service across the world, and for companies operating across the world.

As I said, we at AWS build operational resilience and security as a first principle for the services we provide. In response to the regulatory agenda

in Europe and elsewhere, we provide a series of education and points of view for our customers, and we train our engineering staff that are available to advise customers on how to use our services to best effect. That best effect includes operational resilience, building new applications for security and any other priority the customer may have.

David Wright

Another theme we have been having here is over-regulation hampering competitiveness. Do you feel that in this area?

Mark Jopling

I started by focusing on competitiveness as a priority and demonstrating how the adoption of cloud technology has helped our customers to be more competitive. We believe that the services we provide enable customers and entire industries to reinvent themselves and transform their operations. Going back to your original question about why AWS and the cloud services market is growing as a share of technology spending, it is because we are helping our customers become more competitive that we are seeing much broader adoption.

I can quote this example because it is a public reference. An EU-based bank, Danske Bank, announced its partnership with us in March. It was a very broad partnership across their business, all types of legacy infrastructure and modernisation, and they cited several business benefits, including customer experience and the ability to do risk modelling. What we are seeing is that the leaders in every sector are adopting cloud services to improve their competitiveness. If we provide services that enable our customers to do that, then we are delivering on our promise to be customer obsessed.

David Wright

The growth of your business is impressive enough, but European regulation is not holding it back.

Mark Jopling

I will not use those words. As I said in response to your question about DORA, we recognise that the operational resilience of the financial services industry is as important as financial resilience. As European consumers, we have all benefited from financial stability since 2008/2009. As someone with a credit card in my pocket and a mobile application for my bank on my phone, I expect services to be resilient, reliable and always on. We provide services that enable our customers to deliver these end services to their customers. Covid has taught us that customer expectations are getting higher and higher. Industries are going digital, and our job is to build services that enable our customers to ultimately delight their customers.

David Wright

I will ask you the usual question. What keeps you up at night in terms of risk? Is it concentration risk or cyber risk? Are we missing risks here and do you worry about that?

Mark Jopling

Cyber is a good example because it is a benefit of cloud technology that we have not talked about. We mentioned operational resilience in the sense of availability of services, and security is deep "in our DNA" in the way we build our services. Security is our number one priority at AWS in terms of providing security for the infrastructure services we build for our customers, we also advise our customers on how to build secure applications that run on our infrastructure.

David Wright

Talking to you is fascinating. Finally, when you look forward, what companies like yours will be doing, five or 10 years hence, are we going to see dramatically new technologies even replacing the cloud, or are we going to see profound development of the cloud? Will there be a complete quantum leap in technology? It is a very unfair question, but you are an engineer, and I am not.

Mark Jopling

We take a long-term view of our customer needs. We build 90% plus of our services in direct feedback to what our customers want. We seek to be a very customer-centric company. By the nature of the infrastructure we are building, these are long-term investments. For example, in June 2024 we announced with the German Chancellor an €8.8 billion investment in Germany. Earlier this week we did the same with the UK Chancellor of the Exchequer in terms of a commitment to increase our infrastructure investment in the UK by £8B. We have done this around the world in countries where we are already present and we have expanded the number of countries where we are present.

When you are building data centre infrastructure, the core of what we run, they are not short-term investments but long-term commitments to every country and society that we operate in. Your wider question of what technologies may come along and be popular and transformational in the way that generative AI is now, is something that we probably need to ask the universities around, because that is a guessing game. We are investing in technologies like quantum computing. There could well be a great idea out there that someone else is working on and our philosophy as a company is to be customer obsessed at all times and to maintain what we call a "day one" mentality. Even though we are the size that you observed in your opening question, our challenge as a company is to be customer focused and to maintain that "day one" entrepreneurial view, so that we are not overtaken by technologies that we might miss.

David Wright

Thank you, Mark. It was not a trap to keep you here for the next five years but thank you very much and thank you for your support of Eurofi.

Mark Jopling

I am delighted to be here.



Conversation with Paul Donofrio

Paul Donofrio - Vice Chair, Bank of America

David Wright - President, EUROFI

David Wright

I have the pleasure of being with Paul Donofrio, who is the Vice Chair of Bank of America. We have spoken before and I am looking forward to hearing him tell us about the progress they have made in sustainable finance. He has been with Bank of America since 1999 and has held many key positions in the company, including Chief Financial Officer. Now you are leading Bank of America's work on sustainable finance, and that is what we are going to talk about.

I know that this is a big, big business and important business for you. When we spoke last time, you said you were optimistic about this framework and momentum building on sustainable finance. Has that momentum continued? Is it the same all over the world? I sometimes get the sense that there is a sort of push-back.

Paul Donofrio

Hello David, and hello everybody. It is great to be here. The short answer to that question is, 'Yes, we are still optimistic. We still see momentum.' Let us talk a little bit about why Bank of America is optimistic because the transition is creating opportunities for companies that are huge and hard for them to resist. We are optimistic because we can actually see that activity and momentum building among our clients. We all know that just about everything we produce, use and do puts greenhouse gases into the environment, and you do not have to believe that we are going to get there by 2050, but just trying to get there is probably going to have more impact on the economy than the Industrial Revolution.

It is a giant challenge, but we are focused on the huge opportunity it creates, and companies are focused on that as well. The largest companies in the world are all advancing towards transition plans. We can talk a little bit about that. The smaller companies are the key

to those large companies achieving their goals, and they are going to reap the benefits as well. If you look at estimates from experts, they are all over the place, but McKinsey thinks we are going to have to spend \$275 trillion or \$9 trillion a year, which is almost double what we are spending in a normal year. You have to think about all the jobs, the innovation and the socio-economic progress that will come with a \$275 trillion investment.

The important thing to remember is that, when the government invests that money, or when a company invests that money, it is just another company's revenue. The revenue growth opportunity for companies is huge

David Wright

Turning to Europe, Paul, if I may, the Commission has been clear about its objective to make it easier for business to deploy capital and resources towards sustainable projects. This is a big theme now and includes reducing burdens, simplifying the rules for the sustainability framework, less red tape and so forth. Are you seeing that? Are your clients telling you that it is getting easier, or are they saying to you, 'Hold on, Paul. It is getting more complicated'?

Paul Donofrio

I think our clients have certain things that they would like to see get done that are not getting done. Maybe I can check through a few of those that we think people need to focus more on and let me end with one item that I think would really accelerate the transition that we do not spend enough time talking about.

The first one is that we need more effective carbon markets, and particularly a reliable carbon price, so that everybody knows the true cost of fossil fuels and can better plan and invest.

We need to create demand signals for the scale-up of sustainable energy. This is what business is looking for.

We need governments and companies to put firm orders in for things like sustainable aviation fuel years down the road so that banks and the capital markets can use those firm orders to finance the development of manufacturing and supply.

We have done a great deal of good work around creating incentives for early-stage investment, but we need more of that. We need governments to do even more around nuclear fusion, carbon capture, green hydrogen and technologies that have not even been invented yet. If it is a climate emergency, we should be doubling down on that, and the Inflation Reduction Act (IRA) is a good start. There have been several things here in Europe, but more is needed. The banking industry certainly, and I think the private sector, would like to see some advancement in the way that multinational development banks operate so that their activities encourage the private sector to help finance the Global South.

Lastly, again, we have made progress here, but it is really important to have sustainability disclosures that are harmonised across all regions and countries, that focus on material issues and, most importantly, that are trustworthy.

There is one other thing that I want to talk about that I alluded to earlier and would really accelerate the transition. We need a better partnership between some of the key players in the economy, particularly in relation to the supply chains of large global companies. While we are working at that partnership, I want to suggest to everybody that the current focus on banks as a wedge to drive the transition is totally understandable, but probably overemphasised. While banks have a very important role to play, ultimately, it will not be banks that drive the clean energy transition. It will be the activities of companies, large and small, in every sector, as they realise the opportunity to grow revenues, gain market share and invest in new technologies.

It takes a partnership to help them do that; it takes a partnership of governments, non-profit organisations, financial institutions and large companies. We should be careful about too sharp a focus on any one of those elements. I would argue that it is far from certain that our current focus on banks will achieve the objective that we all share. I would offer as proof of that the current pushback that we are seeing in the United States and other regions around the world that you alluded to earlier, including right here in Europe. The more fundamental reason is that banks are just transmission mechanisms for the economic objectives of other economic players, namely governments, companies and consumers. Ultimately, by 'consumers', I mean voters in democratic societies.

As highly regulated entities, banks ultimately serve the public interest in each of the countries in which they operate, and what people want in one country versus another country, or even in one state versus another state in the same country, can vary greatly and change quickly. This is why it is hard for banks to be the wedge that some want us to be. I would argue that, the next time we are all feeling a little bit insecure about what we need to do and whether we are making enough

progress, we should focus a little less on banks and financial institutions and a little more on developing market forces to drive and accelerate the transition. I would say the good news is that those forces already exist.

As I said earlier, the largest companies all have transition plans. The smaller companies are all in their supply chain. That connection between large companies and supply chain is where this partnership can really accelerate the transition because, if we focus on the supply chain, then it becomes a business imperative to develop and execute a transition plan. It becomes a business imperative.

David Wright

You talked about convergence of regulation and convergence of standards and so forth. Do you see that, or do you see dispersion?

Paul Donofrio

I definitely see that a lot of progress has been made on disclosures. I want to give a shout out to the International Sustainability Standards Board (ISSB) for all the work they have done. There are still regions and countries that want to develop their own, and it is not just about inefficiencies that companies experience because they have to report different things in different places. What is much more important is the fact that, if it is too different all over the place, people lose confidence in the disclosures. It is very important to have global interoperable sustainability standards. Again, I applaud the ISSB for playing its part in this.

David Wright

Do you want to add anything more on your own transitional plans here?

Paul Donofrio

Sure. For a long time, we had various internal and external documents that helped us advance towards a more secure, sustainable and affordable energy future. Those were important documents, but they were developed piecemeal by different parts of our company. A few years ago, we started to consolidate those documents, and then, this year, we have gone to a transition plan. The important thing here is that we develop our transition plan in the way we develop our strategic plan. In fact, we integrated it into the strategic planning process, and it was written by leaders in our line of business and in our support group like risk, HR and finance. It was not written by some silo in the centre. Because of the way that we did that, the value of doing it that way, but even the value of a transition plan, is the engagement and ownership it creates within the company.

Our leaders now own this plan. It is the plan of the people who run our lines of business and our support groups, and they are embedding it into the existing processes of the company. It is not like we are going to pick up this plan and then flick to page 37 and say, 'We should be following this thing.' What is valuable about this, again, is the creation of it, the engagement, the ownership, the reporting to each other and discussing

it with the Board and creating that engagement and ownership across the whole company.

David Wright

Finally, Paul, I understand, if I am well informed, that your recently issued green bond was issued at around €1 billion. How are your clients using these types of bonds and sustainability themed bonds? Are they using them to advance their goals in sustainability and transition or do you think this is a market that will trundle along? Do you expect big growth here?

Paul Donofrio

Let me say two things about them. Firstly, you asked earlier about whether we see progress continuing. We can see it because we talk to our clients and we can see what they are doing, but it is hard for other people to see the progress. Most of what companies are doing is not finance with a green bond; most of what companies are doing is financing through their own operations, so it is hard to see the activity.

If you look at the issuance of sustainability themed bonds, you can use that issuance as a proxy for whether companies are doing more or doing less. If you just look at the year-on-year, for example, 20% of all bonds issued in Europe Middle East and Africa (EMEA) were sustainability themed bonds, and issuance was up 12% year-over-year. We are doing more, not less. In the US, activity is up 35% this year. People are worried that companies are not doing stuff. If you want to look at sustainability bonds as a proxy for their activity, it is up 35% in the US. That is not at 20% of all issuance, but the IRA is just getting started. That is one point I would make about the activity.

The second point I would make about these bonds is that it is interesting to hear people talk about them. They were not developed because companies needed them to finance the transition; they were developed because institutional investors wanted to own them in their portfolios. They want to own them because they think they are better investments. They want to own them because it is a regulatory requirement, and they want to support the transition. Unlike in some corners of finance, they are not needed by companies to finance the transition because companies can just as easily finance the transition with a normal bond or a normal loan or their own cash flow, which is how they normally finance a transition.

It is not that they are not important to companies. They are important signalling events that sustainability is important to the directors, the company and the employees. It is because they are important to companies, and because they are very important to our institutional clients, we have worked hard to be a leader here.

That bond is just one example. We have issued \$15 billion for ourselves to deploy, but way more important than the \$15 billion is the fact that we have raised well over \$1 trillion of sustainable-linked bonds for corporations all around the world. We are a leader in the US in terms of financing renewable energy through tax equity. We have a \$14 billion portfolio that is roughly

equivalent to helping 16% of the wind and solar get financed in the US. The IRA has created huge demand for tax credits, and we are developing the capabilities to originate and distribute them, because there is so much supply that they are going to have to be distributed more broadly. We are working very hard with multinational development banks to help to finance the Global South. A lot more work needs to be done there. We are clearly a leader globally in that field, if not the leader in the US in terms of sustainability.

David Wright

Is the market bigger in the US for these bonds than in the European Union (EU)?

Paul Donofrio

The market is bigger in the EU, but it is growing faster in the US.

David Wright

Paul, it was a pleasure to be with you again. Thank you for your support of Eurofi over many years, which is greatly appreciated. We will have to take a stocktake in Warsaw and Copenhagen next year if you are available. I hope you are.

Paul Donofrio

I look forward to it.

David Wright

Thank you very much.

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Mihály Varga

Minister of Finance, Hungary

Opening Remarks

Mr. President and Mr. Secretary General, thank you for the kind words regarding the capital city of Hungary and, of course, the hospitality regarding my colleagues. Dear guests, ladies and gentlemen, welcome to the Eurofi 2024 financial forum here in Budapest. It is a great pleasure for us that, this year, Eurofi holds its annual grand meeting in Budapest.

The themes in the programme suggest that there will be a series of in-depth and to-the-point lectures and discussions here in the forthcoming days. Even on the first day, such questions will be covered as the process of digitalisation, the future of cryptocurrencies, the opportunities and challenges related to artificial intelligence, and cyber security – current topics that are all strongly related to competitiveness.

Ladies and gentlemen, we are in Hungary, which is the country that currently holds the presidency of the EU. The working programme of this presidency meets many of the topics to be discussed in the Eurofi financial forum. Today, the main problem of the EU is facing a backlog in the world economy. The most important goal of the Hungarian presidency is therefore to reinforce European competitiveness. According to the data available today, growth in the EU currently falls between 0.5% and 1%, whereas that in the United States (US) is 2-3%. Growth in China last year – and probably this year too – is about 5%. This

translates to five-fold quicker growth in the US and 10 fold in China compared to the EU. Europe is ailing, whereas the world still has growth potential today and, as we can see, competitors are able to make use of this potential.

The problem did not start yesterday, and it is not only the Hungarian presidency that considers it a priority. This is the subject of the so-called Letta report published in April, which will also be discussed here tomorrow. The Draghi report, published a few days ago, also urges measures to be taken in the interest of improving the competitiveness of the European Union economy, whatever it takes. Hungary has pinned such a theme to the flag of the presidency, the weight of which can be felt by the whole community of the EU.

Ladies and gentlemen, when starting, it is always useful to step back a little first. Likewise, it is useful for us to take stock of the lessons that can be learned not only from the crisis of the past years but also from how we handle them. Today's competitiveness data clearly show that asking certain questions cannot be postponed any longer. Taking the problem as an opportunity, we can, instead, say that, today, we have new information available for making our goals more accurate. Although such clarification is, basically, a political task, we all know that the economy and technology are becoming more and more related to political decision-making,

which renders the dialogue between the economy and politics more and more important.

As its name suggests, the Eurofi forum directs its focus to Europe, which is the continent that has been considered, throughout thousands of years, as the centre of the world and has been, in fact, the cradle of what we call the world economy today. This is the continent that is stagnating today.

Of course, there are certain reasons for this that are beyond our control. First and foremost, I should mention the war between Russia and Ukraine. Still, the fundamental problem is not making use of the opportunities available. It is high time to examine the relations between various themes and questions that fundamentally affect, positively or negatively, the economy of Europe. Perhaps the successive crises of the recent years are also responsible for the fact that we try to handle various issues separately. This practice has led to controversial questions and answers in many fields. Let me give you a few examples.

In order to mitigate the economic damage caused by the Covid pandemic, the EU created a Recovery and Resilience Facility. However, this support arrived in certain countries with huge delays or has not yet arrived at all. This raises questions about the bureaucratic operation of the EU. Due to excessive administration, there is a tendency today for companies to choose other continents due to more favourable

conditions. As the Draghi report has also drawn attention to, this problem also needs to be addressed.

Let us take the case of the nuclear power plants. After the closure of such plants in Germany, the lost energy could be replaced, amidst other measures, only by the reopening of coal-fired power plants, which are much more polluting and more expensive. It is legitimate to ask how such measures relate to the objectives of the green transition. Similarly, we can also ask whether it is logical to talk about the future with electric cars and about phasing out combustion engines while in the meantime re-increasing the level of air pollution with these coal-fired power plants.

On the one hand, we spend close to one-third – between 31% and 32% – of the EU budget on our common agrarian policy to help our European farmers to survive. On the other hand, we are destroying the market of the same farmers by letting in Ukrainian grain. Should we call that good practice? Is it reasonable, without control and calculations, to bring masses of undereducated people into Europe who will live on governmental aid. Is it reasonable to do so instead of directing the focus to our own families, who should be considered as the fundamental pillar of European demography and societies? We should instead take care of families of locally born people, where the workforce of the future will be born, who understand and live in accordance with

European heritage. It is practical to bring problems to Europe through promoting migration and, in fact, even escalate these problems. Should we do that instead of bringing solutions to the original place of the problems?

We should remember that these are countries whose economic difficulties were at least partly caused by Europe during centuries of colonisation. Is it reasonable for Europe to impose such kinds of sanctions that fundamentally cause problems for ourselves, whereas the sanctioned country might even benefit from them? We have all come across those analyses that discuss the successful bypassing of sanctions. Even if we do not talk about it, in many cases, the energy carriers, in various tanker vessels, even arriving from the opposite direction, and in pipelines or containers, are fundamentally of Russian origin or are replaced in another country of origin, like India, with Russian supplies.

All these examples show that the economic, professional and ideological objectives are today mixed in the decision-making process. Hungary is of the opinion that the economic power of Europe should not be sacrificed for ideologically motivated objectives. At this point, we have to define the real economic interest of Europe, and we have to gear our goals and measures to that. This is why we support economic neutrality and a pragmatic policy of connectivity instead of blocking and decoupling.

Ladies and gentlemen, let me shortly present you the offer of the Hungarian presidency in the field of strengthening competitiveness in the EU. It is a top priority for Hungary to adopt our new pact on European competitiveness. This concept relies on such instruments as the deepening of the internal market, priority support for small and medium-sized enterprises, and the promotion of the green and digital transitions in partnership with stakeholders of the European economy and with European citizens.

European defence policy is another target area that can support competitiveness along the security challenges that we experience today. The main directions of this policy are defined in the Strategic Compass, which has already been adopted by member states. In addition to implementing this strategy, we intend to place special emphasis on and reinforce the industrial and technological basis of the defence industry and on related research and development (R&D) activities.

A consistent and merit-based enlargement policy is another potential instrument in increasing competitiveness, first of all, concerning western Balkan countries. The accession of new member states can bring new energy and momentum to the EU. Hungary is of the opinion that, even in the medium term, illegal migration affects the future of Europe in a fundamental way. After 10 years, we seem to have arrived at this medium term. The protection of European citizens

requires us to reinforce the external borders of the EU from central sources at the level of the whole community.

Results from elections in the past period and figures from various public opinion surveys tell us that the Hungarian position is in accordance with the opinion of huge masses of European voters. We are convinced that migration is unable to solve the workforce problems of Europe, whereas it imports a large series of other problems.

At this point, we reach the topic of demography, as the competitiveness of a certain geographic area is, obviously, strongly related to its demographic characteristics. Aging is an increasing problem in Europe that threatens the social welfare system as well as the labour market balance. In our opinion, the future of Europe stems from the use of Europe itself. For this end, we consider that it is of the utmost importance to apply the demographic instruments of the Commission published in October 2023 and to enhance this set of instruments.

The main area connected to demography is the elimination of our internal regional differences. Let me remind you that, today, according to the ninth cohesion report, more than a quarter of EU citizens live in regions whose level of development does not reach 75% of the European average. This means that local economies must be reinforced in these regions. This is expected to improve competitiveness and to lead

to a more balanced operation of the internal market.

I have left agriculture until last, although it is the most fundamental of all fields in terms of food safety. In this area, in recent years, in addition to climate change, international trade and armed conflicts have also generated new challenges. The establishment of EU agricultural policy rules after 2027 is already underway. It is important to provide solutions to these challenges within this framework. We must protect the internal market by enforcing the same production standards for incoming goods as for products produced in the EU. In addition, we must move towards more sustainable production, ensuring a reasonable balance between the strategic objectives of the European Green Deal and a decent livelihood for farmers.

Ladies and gentlemen, what we are advocating at the EU level we have already tried for the most part under domestic conditions. Over the past 15 years in Hungary, we have developed a work based economy which relies on connectivity and has withstood the test even during crises. The Hungarian tax environment and capital attractiveness, as well as the family support system, are all among the best in Europe. Hungarian economic growth is now above the EU average again, which also lays the foundation for our positive vision, even though the end of the war is a pivotal point in terms of prospects.

We believe that Europe has the opportunity to strengthen its competitiveness, but to this end, it must provide its own answers to today's challenges in accordance with its own interests. When we say 'own', we also say 'local'. Europe needs strong local economies in order to find its own answers, and it needs cooperation between these strong economies. In addition to all of this, we need peace and a negotiated settlement of the armed conflict as soon as possible. These are the goals that Hungary intends to emphasise during the European presidency.

Ladies and gentlemen, I sincerely hope that the forum can play an effective role in strengthening Europe's competitiveness. To this end, I wish much perseverance and strength to all participants. I wish you a good meeting in Budapest. Thank you for your attention.



Marton Nagy

Minister for National Economy, Hungary

Gala Dinner Keynote Speech

First of all I would like to welcome you in Budapest, and also let me thank the organisers of EUROFI. The large number of esteemed guests shows the importance of this conference, which enables the consultation between stakeholders and regulators.

Personally I believe in consultation with the industry, which sometimes can even lead to self-regulation, and - in my view - can be more effective than a regulation.

In order to foster an efficient industry, it is essential to minimise the administrative burden and to approach regulations in a pragmatic manner.

The EU faces challenges in global competitiveness, the pandemic and the Russian-Ukrainian war have amplified the long standing competitiveness struggles of Europe. This we can see in EU's share in global GDP, the limited numbers of EU companies in the list of big global corporations, and EU has only 3 significant financial centres.

The competitiveness issues can be identified in the financial sector too. This is evidenced by the disparate trends in market capitalisation observed between US and EU banks. Furthermore, EU banks demonstrate a proclivity for allocating funds in a more costly and less efficient manner.

Consequently, one of the main priorities of the Hungarian Presidency is to encourage competitiveness. We are working on the new competitiveness

deal, which will be presented in October. We would like to emphasise holistic facilitation of sustainable and inclusive growth, supporting small and medium sized companies, while promoting green and digital transition.

At our last ministerial meeting in July I have already presented some issues linked to the need to speed up the spread of electromobility and the use of artificial intelligence.

Concerning AI we just had our usual annual summit in the beginning of this week. Clearly, AI is one of the keys to competitiveness. It is an important element of digital transition, which improves effectiveness. In the EU the AI act has just entered into force, and Hungary will soon adopt a new AI strategy.

All of our above-mentioned ambitions are certainly reflected in Mr. Mario Draghi's report on the future of European competitiveness, which has been published this Monday. The report urges to significantly cut administrative burden in the EU, to support key industry sectors such as the automotive, to have the European Industry Strategy reviewed by the Commission with regard to the needs of the European Industry, and to have a horizontal and sectoral approach on how European competitiveness should be boosted. These are all part of the Hungarian Presidency's agenda too.

Our overall aim is to relaunch economic growth, in a sustainable

and inclusive way, with a focus on SMEs, which are the engines of the economy.

You all know how important catalyst is the financial sector in this. The sector has demonstrated resilience in the context of the COVID pandemic, with Member States able to implement measures to protect their citizens from significant economic impacts, but presently it is high time to relaunch our economies.

The single financial market of the EU is a valuable asset, which ensures resilience and can address strategic dependencies, but we should provide clear responses to the present challenges.

The competitiveness aspects should apply holistically to all policies, taking into account the different characteristics of Member States, respecting national competencies.

We have identified five priorities to move forward the single financial market:

1. To determine the future of Capital Markets Union.
2. To improve the resilience of the financial sector.
3. To address the challenges and opportunities of digitalization.
4. To promote sustainable finance.
5. To increase consumer protection.

In the implementation of these priorities we should span the

regulatory gaps that often hinders consistent application across the Member States. A harmonized approach can effectively support innovation and address the changing demands, while respecting national practices.

To keep up with our global competitors, we need to integrate these considerations into adaptive regulatory frameworks that requires the openness and cooperation of Member States and the European Institutions as well.

The implementation of the Strategic Agenda 2024–2029 should lay a sustainable foundation for future growth and stability, addressing immediate challenges to reinforce the EU's position in the global economic area.

Hungary has always supported Banking Union and Capital Market Union. We believe that the EU has to make progress in both sectors for a well-functioning single market, as these are complementary aspects of more resilience and competitiveness. Clearly the 2 sectors need different approaches, but there are synergies, for example in the market confidence.

The way forward on the Banking union and Capital Market Union could be to focus on the common issues which are less controversial, and deal with the challenges that Member States face. Therefore we welcome that the EU institutions work on identifying national and regional practices, and weight the needed steps and possible impacts.

As an example financial literacy can boost confidence, and in this respect fight against fraud is also an important aspect of consumer protection.

Concerning digital transition one aspect is retail payment, where we need safe and efficient payment solutions for the users.

Electronic retail payments are increasingly being transformed from bank-based payment services, to commercialised payment solutions. The rise in the use of digital payments has also been spurred by the COVID pandemic, with the continuing shift to cashless payments.

While the European payments market's openness to global competition is crucial for fostering efficiency and innovation, an overdependence on a small number of non-European payment solutions and technologies is undesirable.

We believe the focus of the next legislative cycle should be to strengthen the competitiveness, and to find ways how this financial sector can help further the real economy.

The key to this is to put less burden on companies, with smart regulations, which focuses on the results, and on the goals of sustainable and inclusive growth, to serve well our citizens.

We should also monitor the impacts of the regulations and as I said, consultation is vital.

The recently published Draghi report explored a number of new

and long-standing ideas. Many of these elements are supportable, such as transparent securitisation, but we advise to be cautious about the reduction of prudential rules for banks, which is a stability issue and would have a cumulative negative impact on systemically important institutions.

In this vein I would once again thank you for the EUROFI conference, which is one of the most important forums dedicated to the consultation between regulators and industry.



Barnabás Virág

Deputy Governor - The Central Bank of Hungary

Monetary policy in the thunderous 2020s: navigating in a continuously evolving global economy to win the decade

Dear Chairman Wright,
Ladies and Gentlemen,
Distinguished Guests,

The previous Hungarian EU Presidency took place in 2011, when the global economy was emerging from a period of crisis – much like it is today as we try to find our way back to a sustainable growth path.

After a successful period in the second half of the 2010s, came a challenging decade. Our days are defined by a multicrisis, but our future depends on what we have learned in the past and in the present. **What was the past that shaped our present?**

The aftermath of the Great Financial Crisis determined the 2010s globally; however, years of the Great Moderation had continued bringing stable growth and low inflation. In these years, the CEE region had a successful catching-up story.

- **The CEE region showed a significant catching up to the Western European countries.** The average growth rate during the 2010s in the CEE country group was nearly double that of the EU as a whole at 2.9 percent in contrast with the EU's growth rate of 1.6 percent. Over the decade, CEE countries were the growth engines of Europe, generating around 20-25 percent of the EU's growth. Strong economic performance came hand in hand with low interest rate conditions,

decreasing debt-to-GDP ratios, as well as low and stable inflation near or even below target levels, averaging 1.8 percent over the decade (while average inflation in the EU was only slightly lower at 1.5 percent in the same period).

- **In Hungary, we had to deal not just with the global and European challenges, but with our internal vulnerability problems too. The 2010s began with restoring balance in the economy.** A coordinated fiscal and monetary policy response was needed to address systemic risks in the banking system, as in the case of phasing out foreign currency loans in the household sector. For this, we had to implement many targeted reforms and turnarounds, which successfully paved the path of catching up with Europe.

What is the present like, which now defines our world and the years ahead? The 2020s has a completely different character than the 2010s. The Great Moderation has been replaced by the era of the Great Tension – although I prefer the term Great Transitions which includes opportunities as well as challenges. The first three years of the current decade have been dominated by unprecedented shocks, namely the coronavirus pandemic and the related economic consequences, the terrible Russia-Ukraine war, the energy crisis and other tectonic shifts in the geopolitical

landscape. This multicrisis has left its mark on the regional developments.

- **The lessons of the previous years laid the foundation for a successful crisis management.** The resilience, or the immune system of the economies was stronger when the coronavirus pandemic hit the economies than it was at the outbreak of the GFC. The prompt, well-coordinated fiscal and monetary policies helped the quick recovery and enabled us to weather the storm with a strong labour market, resilient bank balance sheets, growing real wages and sound economic fundamentals, keeping the main pillars of growth intact.
- **After re-opening the economies, the age-old enemy of central banks, inflation re-appeared and rose to double-digit levels in several countries.**
- **The inflationary shockwave was a major challenge for the world, an even greater one for Europe, and greater still for the CEE region. Gravity works in the economy as well: countries closer to the conflict zone in Ukraine were hit harder by the war's economic ripple effects.** The CEE region was particularly affected due to high energy intensity and the jump in risk premium because of the geographical proximity to terrible war in Ukraine. Average CEE CDS spread

compared to EU more than doubled, while between June 2021 and January 2024, the accumulated inflation in the CEE region was nearly double than in the Western-European countries (28.2 and 15 percent, respectively).

- ***It was clear that we had to avoid the outcomes of stubbornly high inflation like in the 1970s.*** If there is one takeaway from the inflationary episodes of the 1970s, it is that if central banks do not stay disciplined and maintain positive real interest rates for an extended period, inflation will keep coming back.

- ***The CEE region was the frontrunner in monetary tightening as a response to rapidly growing inflation. It was obligated to be fast and decisive, because we recognised the inflationary patterns of the 1970's.*** The decisiveness and the targeted approach of the central banks paid off: the national central bank's actions played a key role in taming inflation. As a result of central banks' swift response to the inflation surge and their commitment to tight monetary policy we are now approaching price stability both globally and in the CEE region, including Hungary.

- **This decade has redealt the cards also in terms of economic growth.** Increasing geopolitical tensions and the world becoming more divided have led to fragmentation

in global value chains and shocks in energy prices. After prospering years, Central Europe¹ has shown significant slowdown: until now, average growth dynamic in the 2020s has been by 1.5 percentage points lower than in the 2010s. Although the growth rate of the CEE region has slowed down considerably, it still exceeds the growth of the Euro Area, therefore the catch-up continues.

- **Compared to the decade of 2010, banking systems of the 2020s are significantly more stable and resilient, both globally and regionally.** European banks significantly improved their profitability. In the 2010s the average RoE in the EU was 2.4 percent, while in the 2020s it was 9.1 per cent in the EU member states. In the 2010s the average ratio of NPLs was 8.6 per cent in the EU, meanwhile, average NPL ratios fell to 3.2 per cent in the EU member states in the 2020s. Nowadays, European banking systems are characterised by healthier loan portfolios, and sounder balance sheets. This is partly due to the implementation of macroprudential rules and the favourable labour market developments. Our decade is full of challenges; however, European banks have so far proved shock resilient, and are also better prepared for the upcoming challenges than they were a decade ago.

- **The main goal of dynamic catching up remains the same as before.** To achieve this, policies must be tailored to the character of the decade. Key terms include competitiveness, efficiency and productivity, the focus should be placed on these areas.

What does the future hold?

However central banks have performed successfully globally in the thunderous first years of this decade, inflation casts a long shadow. Legacy of high inflation still leaves a mark on economic performance. Our mission, the sustainable achievement of price stability, remains unchanged. The constantly evolving global economy with high degree of uncertainty will probably stay with us in the following years. Let me now briefly introduce the **four** most important lessons that shall guide us in the current era of challenges.

1) Remain committed

- The appropriate monetary tightening can prevent inflation from transitioning to a high-inflation regime. The decisiveness and the targeted approach of the central banks will pay off: the national central bank's actions play a key role in curbing inflation.
- Central banks must react immediately and decisively to surging inflation. The lesson of history is that price stability is a precondition for a sustainable economic growth, so restoring and maintaining it is crucial.

2) Prepare for the unexpected

- We must build buffers for unexpected situations. In turbulent times ensuring financial market stability is also key, and for this, we need room for manoeuvre. In a volatile environment, financial market stability is also necessary to achieving and maintaining the primary objective of price stability. Maintaining sovereignty in the energy sector, in finances and having adequate level of foreign reserves also strengthens the immune system of our economies, which in turn becomes more resilient against future shocks.

3) Be credible with clear communication

- Role of central bank communication has strongly increased. In times of more frequent supply shocks, the role of shaping expectations is more important than ever because effective anchoring inflation expectations can prevent second-round inflationary effects.
- In this decade, credibility has become the principal capital of central banks. Clear communication are playing a crucial role in anchoring inflation expectations. Economic performance can be restored only if there is confidence and belief in the future return of stability.
- Central banks can mostly contribute to stronger

credibility by achieving and maintaining price stability and proving their strong commitments to this mandate.

4) The future is green and digital: be proactive

- Central banks can and must facilitate a faster and smoother green transition – and thereby can contribute the transition period being shorter. The MNB also undertook a pioneering role in supporting the green transition of the economy with several instruments, e.g. the legal mandate of the MNB includes the promotion of environmental sustainability since 2021.
- Moreover, digitalisation can open a new era in the history of money, e.g., through central bank digital currency (CBDC). This topic is actively researched nowadays by central banks around the world. According to the BIS survey on central bank digital currencies, 80 central banks from the 86 asked were engaged in CBDC work in 2023.
- Remaining at the topic of digitalisation: as cybercrime threatens digitalisation, we must fight for a protected cyberspace because trust can only be founded on safety.

Finally, I cannot emphasize enough the importance of our primary mandate. Despite a constantly evolving global economy, our principal mandate remains the same, to achieve price stability in a sustainable

manner. In response to the decade of challenges, resilience is key, and central banks must remain innovative. The main takeaway of the 2020s is that in our highly volatile environment, there is no trade-off between growth and inflation: without price stability, there is no sustainable growth. Restoring a low and stable inflation environment is crucial in order to continue catching up.

We have to stay committed to our core principles of stability and sustainability while supporting sovereignty, competitiveness and cooperation. But also keep in mind that the future will be "green" and "digital". The green transition and digitalisation also support the competitiveness of the economy through improvement of energy efficiency. As a result, we have every chance to emerge victorious from the current decade of challenges.

1. Central European countries: Czech Republic, Hungary, Poland, Slovakia



Valdis Dombrovskis

Executive Vice-President for an Economy that Works for People, with responsibility for Trade
- European Commission

Objectives of the next European Commission

Ladies and gentlemen, thank you for inviting me to address this flagship conference. Today's world is very different from the one that we knew just a few years ago. We have withstood a series of major shocks – the pandemic, Russia's war against Ukraine – and these have particularly affected the EU economy.

We now need to look ahead and tackle longstanding challenges related to our productivity, growth and competitiveness. In this mandate, the Commission has acted to help European Union (EU) industry to stay competitive during the green and digital transitions, speed up the rollout of renewables, increase our economy's open strategic autonomy, and diversify supply chains.

The next Commission intends to go further still. As President von der Leyen has indicated, the aim will be to boost the EU's sustainable competitiveness and prosperity. Above all, it means more work to strengthen and complete the single market. The involves helping our companies – especially small and medium-sized enterprises (SMEs) – to scale up and grow. Doing business in Europe should become easier and faster, with legal certainty underpinned by simple, smart and targeted regulation, and with a reduction in administrative burden.

The challenges ahead in energy, digital and defence, among others, will require a great deal of financing, dovetailing both

public and private investment. On the public side, reforms and investments such as those supported by the Recovery and Resilience Facility are paramount, both now and in the years ahead. The EU's revised fiscal rules also have a major part to play. Apart from strengthening member states' debt sustainability, the new fiscal setup is designed to promote sustainable and inclusive growth, also through reforms and investments.

However, as we know, an important share of investment will have to come from the private sector. It will take a lot of risk capital to stimulate the innovation required to maintain competitiveness and boost growth. This is why we need deeper and more integrated capital markets. Without large and developed capital markets, our investment and growth will be limited at best. If our capital markets remain fragmented and limited in the capital that they can provide, we run the risk of seeing young, innovative companies move outside Europe to find the financing that they need to grow. This is something that we certainly need to avoid.

The next Commission will build on many capital markets union (CMU) initiatives already approved since 2015. It is encouraging to see political momentum and convergence emerging in areas such as securitisation, supervisory convergence, retail participation and market consultation. However, we must go significantly

further with this vital project. For example, we should leverage more on the enormous wealth held in Europeans' private savings. Today, most of these are held in low-yielding bank deposits, but they could be put to more rewarding use via the EU's capital markets. This would help to sustain our growth and competitiveness while also driving forward the green and digital transitions.

It is for these reasons that President von der Leyen announced the proposal of the European savings and investment union. It will require strong banks and financial market operators working across borders to provide services vital for creating a genuine integrated European capital market. In turn, this will require more convergence of national rulebooks, including tax and insolvency rules.

Turning briefly to financial stability, I have just a couple of observations. Firstly, on the prudential side. Completing the Basel III reforms remains a major achievement for the EU. It makes sure that EU banks respect the most advanced set of globally agreed prudential requirements. We are maintaining 1 January 2025 for implementing the bulk of the Basel III standards, but, as you know, postponing application of the market risk rules in the EU by one year. This will ensure equal conditions for internationally active European banks that compete with other global players.

Secondly, on the review of the crisis management and deposit

insurance (CMDI) framework, we need successful CMDI reform to give authorities the right tools to deal with failing banks of any size and business model. This includes smaller and mid-sized banks. However, current member state positions would make things more complex and less effective. Their stance would not improve depositor protection and financial stability. It could even increase the risk of using taxpayers' money to handle failing banks. While interinstitutional negotiations on CMDI should start as soon as possible, I would like to see more ambition as we work towards a final political agreement.

Ladies and gentlemen, it has been a pleasure to address you again. As we enter a busy autumn, especially with the institutional changeover, Europe continues to face a complex economic and political landscape. And, as always, the financial sector has a vital role to play. Thank you.

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Verena Ross

Chair - European Securities and Markets Authority (ESMA)

Putting investors and companies at the heart of effective and attractive EU capital markets

Ladies and gentlemen, good morning,

I would like to extend my sincere thanks to Eurofi for giving me the opportunity to speak to you this morning. It is a particular pleasure to do so here in Budapest. Twenty years ago, Hungary joined the European Union. The addition of ten new member states marked a true milestone in the history of the EU. With over 74 million¹ new EU citizens and potential consumers, the EU became the world's largest single markets. This led the new member states into an era of rapid economic growth through their connections with the rest of Europe.

Together we have made this bigger single market a success!

What is true for trade is also true for capital. Hungary's development serves as a strong argument for continued integration efforts. A more integrated and effective capital market will benefit companies and investors, and ultimately help to drive growth and the dual transition, in the whole of the European Union and in each Member State.

The topic of a Capital Markets Union (or a European Savings and Investment Union), features in several of today's panel sessions. I welcome the opportunity to lead you into this part of the conference with a few thoughts from the ESMA perspective.

Some of you will be aware that we recently published a

Position Paper setting out 20 recommendations for deepening the EU's capital markets. These recommendations are based on the experience of the 27 national authorities who make up the ESMA Board. They represent what we agree is needed to push forward more effective and attractive capital markets in Europe. Most of the recommendations require collective efforts, not just from us as market supervisors in the ESMA family, but also from Member States, the EU co-legislators, the financial industry, and (importantly) from the European Commission. I believe that we have a real opportunity to unlock the full potential of our capital markets - ensuring they are effective and attractive - and putting the needs of investors and companies at the heart of our actions.

Capital Markets are built on Confidence.

EU capital markets have performed quite well, and their resilience has considerably improved over the past years. Still, they are not efficient and attractive enough. By making necessary adjustments to the functioning of our capital markets we can change that. Yes, we need more Confidence (in our financial markets). Yes, our companies need better access to market financing. And yes, our investors need the trust and confidence that their money can do more for them (and, ultimately, for the European economy).

Before I move on to discussing how we can address those needs, I would like to shine a light on

what makes the European market so unique: The European Union represents one of the world's largest economies, offering a vast internal market with more than 450 million consumers. It constitutes the largest single market in the world, generating 25% of the EU's gross domestic product. When the single market was first conceived, it was considerably smaller and less complex. Tremendous growth and transformation have taken place over the past few decades, and combined with the structural shifts we are seeing in the global economic system, there are new challenges for our single market, as Enrico Letta sets out in his report "Much more than a market".

Despite many significant and unexpected external events in recent years, our financial markets have proven remarkably resilient to various shocks. We should never forget that it was our collective efforts that allowed us to steer European financial markets through (these) stormy waters. We should also not forget that, through the CMU action plan, some progress has been made towards developing European capital markets further. As a side note, I want to mention that as part of this, we at ESMA are busy working on establishing the European Single Access

Point and on launching the consolidated tapes. We are also getting ready to launch the first consultations under the Listing Act and to take on some further supervisory tasks.

Unwelcome barriers to cross-border financing and investing however still impede genuine pan-European market integration. Earlier this week, Mario Draghi in his report on European Competitiveness said that 'a key reason for less efficient financial intermediation in Europe is that capital markets remain fragmented and flows of savings into capital markets are lower'. I fully agree that now is the time to further stimulate investment and help companies and investors in any member state tap into the vast pool of European savings. To lay the foundation for this, we need to continue to, and perhaps do so a little more emphatically, invest in capital markets that are genuinely pan-EU - built on European standards, harmonised regulation, and seamless supervision. Bringing our markets from where they are today – functioning and resilient – to where we need them tomorrow – deeper, more liquid, more attractive and more closely integrated – requires strong commitment and new energy from all of us. We might not be able to see the whole road ahead, but we have to meet the needs of European companies and investors. And our confidence - in what EU markets can still achieve for them - will be our guide.

Capital Markets for citizens and investors.

Investors are at the core of the effective capital markets debate (and the reason why more recently we are talking about the Savings and Investment Union). Earlier, I said we need to inspire (confidence and) trust in our

markets. Inspiring trust in capital markets is about inspiring trust in investments. And in the end, trust is built by increasing knowledge and understanding. Did you know that despite notable differences across Member States, recent Eurobarometer results illustrate that a staggering 64% of EU citizens score rather poorly on measures of financial knowledge? We need to do better. And we can only do so by equipping European citizens with the knowledge they need to access and navigate capital markets safely.

Cost and fees remain a critical component when evaluating the benefits of an investment. As is complexity. We believe that in general, European investors need simpler investment products. Rather than putting ever more complex and costly products on the market, which might cater to a small minority of investors, we should create a voluntary EU-label for "basic" investment products. Such a label could be used by certain financial instruments, such as for example a sub-set of UCITS funds or a plain vanilla corporate bond. Simple advice that meets basic investment needs should go hand in hand with that. Such 'simplified' advice (which could be based on streamlined suitability assessments) would be a step that could also benefit firms by reducing compliance costs.

With a new label and simplified advice, we propose to pave the way for easy-to-access and cost-efficient products. This will empower European retail investors

to make informed decisions - based on simple, accurate and reliable information and support. At the same time, Member States should review their pension systems – effective ways to save for retirement would also help to strengthen EU capital markets.

Investors provide the fuel for the engine of capital markets. To build efficient EU markets, we therefore need to put investors at the core of our efforts. ESMA stands ready to continue this important work.

Capital Markets must serve Companies.

The ability of companies to access capital efficiently and effectively is the lifeblood of economic growth and innovation. It is what allows businesses to expand, create jobs, and compete at a global scale. Small and Medium-sized enterprises are the backbone of the European economy. In the past five years, they have created around 85% of new jobs and provided two-thirds of the total private sector employment in the EU². Yet, these companies often face the greatest challenges when it comes to raising capital, especially in an environment as diverse and complex as the EU. Market fragmentation is undermining a true flow of capital across national borders and making it difficult for European companies to identify and secure the financing they need at different stages of their development.

We need to connect European investors with European companies, and in particular with SMEs, creating

an eco-system to the benefit of all. By developing effective pan-European markets we can create sufficiently large and liquid market segments dedicated to specialised and critical industries, and with that providing alternatives to bank and debt financing. In our recent ESMA Position paper, we also emphasise the need to strengthen Europe's equity culture by promoting public markets (as well as funding through venture capital, private equity, and crowdfunding).

One way to do this would be for the European Commission and the financial sector to mobilise institutional and retail equity capital through dedicated funds, including public-private partnerships. The focus should be on partnerships that mobilise resources to provide financing and guarantees, bridging the gap between private investors and small businesses.

We need to revitalise our financial markets in a way that allows capital to flow freely from Dublin to Ljubljana, from Lisbon to Warsaw. Only this way can we be sure that European businesses secure the financial means to grow, innovate, and compete on a global scale. More deeply integrated financial markets are the best investment in our companies, and ultimately, in our economic growth and global competitiveness.

Capital Markets require convergent supervision.

Strong and effective supervision of capital markets is an important factor in building the confidence that encourages retail investors

to invest and EU companies to operate beyond national borders. I am the first to agree that reforming the structure of supervision alone will not deepen our capital market. Rather, I believe we should think of it as one necessary element in building a seamless and consistent capital market ecosystem.

From the early days, our focus at ESMA as the European supervisor has revolved around convergence: ensuring consistency across the EU's national supervisors, the NCAs. ESMA's supervisory convergence framework has evolved towards an increasingly common risk-based and outcome-focused approach. We have also expanded the toolkit we use to drive this greater supervisory convergence. Our Founding Regulation was revised in 2019 to include for example the new tool of Union Strategic Supervisory Priorities. Less formally, together with the NCAs, we actively use 'Common Supervisory Actions', to undertake coordinated supervisory activity across all European markets on a commonly faced risk or problem. We have also established voluntary supervisory colleges for some large asset managers and investment firms in the EU.

Overall, these measures have proven to be effective, but there is more we can and should do to genuinely improve the collective efficiency and effectiveness of our supervision in the EU. In this context, let me highlight one of the recommendations from

the Position Paper: The need for more joint supervisory work (and potential for ESMA to centralise certain supporting tasks).

An example could be to collect and analyse EU-wide data and build common risk indicators, based on data flowing to ESMA centrally (instead of being collected and analysed through 27 different IT systems). Such risk indicators would then be used by the NCAs to direct their supervisory efforts, focusing on the highest risk firms or products.

We are often asked if we advocate more direct ESMA-level supervision. ESMA's Board did ponder this question and made one specific recommendation. Crucially, the question should not be if we advocate such a move, but under what circumstances EU-level supervision would benefit our capital markets.

Let me be very clear, our existing supervisory framework in the EU is not fundamentally broken. It generally functions well enough, particularly when it comes to supervising national markets and national market players. The EU financial markets – as fragmented as they are – are home to a large variety of entities, many of them small and operating only at national level. In cases where market entities serve local markets, national supervision is likely to continue to be the most effective form of supervision.

However, we should not forget that EU financial markets are not what they used to be when the

single market was first created over 30 years ago: Large, pan-European entities, operating cross-border, provide critical services to today's companies and investors. This poses new risks, that are difficult to supervise in a fragmented framework, where each national supervisor first and foremost focuses on his domestic business. This can lead to regulatory and supervisory arbitrage and ultimately make our markets less efficient. When different EU supervisors are called to the scene, we see inconsistent approaches, which give rise to an unlevel playing field. And companies themselves do not stand to gain either, with the added administrative burden of doing business across the EU which leads to significant inefficiencies.

We at ESMA have accumulated significant experience from the different (and evolving) direct supervisory tasks we have been entrusted with over the past 13 years. Based on that experience, we consider (as outlined in our Position Paper) that pan-European market infrastructures would benefit the most from direct EU-level supervision, simply because of their critical role in the European financial system. Furthermore, we think that for services that are vital to the functioning of EU capital markets AND are provided by entities based outside the EU, ESMA should act as the gatekeeper.

An urgent and thorough evaluation of direct supervision

at the EU level is called for. I think that ESMA has built up experience in direct supervision and expertise in relation to pan-European market infrastructures, which would allow us to support a more effective EU supervisory framework for such entities. I firmly believe that more EU-level supervision is an important step towards more effective, fully integrated capital markets. Accordingly, I invite the European Commission and the co-legislators to be open minded and conduct a serious assessment of where a strengthened role for the EU financial markets supervisor would make sense.

Closing

Ladies and gentlemen, allow me to conclude my reflections by stating the obvious. It is time to chart a better path towards deeper and more effective EU capital markets. I appreciate that many of the proposed initiatives will require additional measures beyond our ESMA remit, such as fiscal incentives and pension reforms at the national level. It may be challenging to make improvements in all these areas in the short term, but I believe we need to step up our ambition. As Isaac Newton famously said: "When two forces unite, their efficiency doubles." We are stronger together.

I welcome the growing awareness among policymakers that it is paramount to build a more effective and attractive EU capital market. Only then will we be able as Europe, to fund the

dual transition and to remain competitive in an increasingly complicated world. Many recent reports have supported this ultimate goal and have made proposals on how to set it in motion. Strong commitment is an important first step to guide us on this journey. But real action needs to follow. And for that, I call on all of you in this room – whether you represent a member state government, a supervisor or an industry player – let's work together to build an ambitious agenda for a truly single, efficient and attractive EU capital market.

Thank you.

1. Source: European Commission

2. Source: EUROFOUND: <https://www.eurofound.europa.eu/en/topic/small-and-medium-sized-enterprises#:~:text=SMEs%20are%20the%20backbone%20of,sector%20employment%20in%20the%20EU>



Claudia Buch

Chair, Supervisory Board – European Central Bank

Building a resilient future: how Europe's financial stability fosters growth and competitiveness

Sustainable growth and the competitiveness of European firms are high on the European policy agenda. Over the coming years, growth in the euro area is projected to remain below 2% and thus lower than in the United States.¹ This divergence in growth is not a new phenomenon.² Increasing the productivity of European firms, while mastering the energy transition, and revamping crucial parts of the (digital) infrastructure are key challenges. And all this is happening in an environment characterised by heightened geopolitical risk. What Europe needs is long-term investment and firms that successfully innovate.

In Europe, more so than in other markets, banks play a particularly relevant role in funding the real economy, managing risks and safeguarding deposits. A stable and well-functioning banking system is thus a prerequisite for economic growth in Europe. Banks are regulated and supervised so that they can perform their roles without taking undue risks or threatening financial stability.

In the current debate, the question has been raised as to whether regulation and supervision have become too conservative to the point that they may constrain growth. Does the European approach to regulation and supervision prevent European banks from becoming more efficient, from providing better services to their clients and from successfully competing on a

global scale? Would deregulation and lighter-touch banking supervision release more funding and promote sustainable growth?

In my view, the suggestions being put forward to relax banking regulation and supervision to promote growth are misguided and could have negative side effects.

The establishment of the banking union, ten years ago, was a significant achievement that has served European citizens well. European leaders responded to the global financial crisis and the European sovereign debt crisis by centralising supervision and resolution, by building new, strong institutions. The creation of European banking supervision in 2014 has had a positive impact on the stability of banks and market confidence. The banking union authorities apply harmonised prudential standards in an integrated banking market.

Strong banking regulation and supervision ensure that banks are resilient and manage risks well. By acting within their mandate, supervisors and regulators also contribute to growth and competitiveness. One key focus of good supervision is that banks have sustainable business models to deal with an evolving competitive landscape in financial services. More resilient and better capitalised banks are better equipped to take risks, to compete, and to lend to the real economy, including during economic downturns. The reforms that have been implemented since the

global financial crisis have made the banking sector more resilient and improved banks' ability to fund the real economy. Banking deregulation or more lenient supervision would compromise these achievements.

A European policy agenda that promotes growth needs to tackle the root causes of low productivity. Ultimately, growth is driven by innovation. Policies to promote innovation and the Single Market are thus important levers. We need further progress to complete the banking union and towards a capital markets union (CMU). Supervision and regulation contribute to the proper functioning of financial markets by enhancing transparency and efficiency, streamlining reporting requirements and reducing complexity, but without compromising on resilience.

Competition in banking, risk taking and the role of supervision

Good supervision ensures that individual banks remain safe and sound, that they can manage risks well and that they have sustainable business models. This allows banks to better compete in the market. But should supervisors directly focus their efforts on banks' ability to compete?

As supervisors, we are in principle neutral about competition between banks. Our focus is on banks' risk management and resilience, which are key drivers of their ability to finance investment and innovation. The

degree of competition and market concentration matters, but not in a clear-cut way – just as risk taking can be more pronounced in competitive markets, a high degree of market concentration can be a source of risk if banks become too systemic.

So how has competition changed, how does it affect risk, and what role does supervision play?

Over the past decades, competition in financial services has become more intense. Global cross-border financial assets and liabilities increased from around 120% of GDP in 1990 to over 450% in 2021.³ The market share of non-bank financial intermediaries has also risen, particularly since the global financial crisis. Today, almost 50% of global financial assets are held by non-bank intermediaries, compared with 43% in 2008.⁴ This can promote a better allocation of risks in the system, but it also requires risks in the non-bank financial sector to be adequately regulated. And new digital providers of financial services are entering the market, threatening to disintermediate the traditional value chains of banks.

At the same time, market structures in national banking markets are relatively persistent. Many banks provide retail banking services at the national level, and cross-border market entry has often been limited. Within the banking sector, there have been shifts in market shares away from weaker banks to stronger banks, which benefits growth and stability.

Competition between internationally active investment banks is an area where national borders matter less. In investment banking, the market shares of European banks have declined relative to their global competitors.⁵ In the Asia-Pacific region, Chinese investment banks have increased their market shares over the past decade, overtaking both US and European banks. As regards corporates' access to finance, the market has adapted with more efficient banks stepping in, potentially improving the quality and availability of financial services.

For supervisors, it is not competition per se that matters but its impact on risk taking and resilience. Greater competition has many positive effects for welfare, but it can also have a dampening effect on profit margins and franchise values with the potential to incentivise adverse outcomes. To compensate, banks may search for riskier investments with higher returns.

Empirically, the link between banks' risks and the competitive structure of banking markets is not universal.⁶ There are studies confirming that more intense competition increases risks.⁷ Due to smaller margins, the benefits from obtaining information are smaller in more competitive markets, which can lead to an underinvestment in information and, in turn, increase fragility. Crises are more likely in less concentrated banking sectors; banks' risk exposure increases when their market power is limited. But a high degree of market concentration can bring risks of its own and have negative implications for welfare. The costs of financial services tend to be higher in more concentrated markets. Larger banks may become too big to fail, and they may perform critical functions which are difficult to replace.

Good regulation and supervision can curb such potential negative side effects.⁸ The creation of European banking supervision in 2014 had a positive impact on banks' financial conditions, market confidence, bank performance and market integration.⁹ Generally, banks that are subject to more intense supervisory scrutiny tend to be safer, without showing signs of lower profitability. More intense supervision reduces banks' risk taking and improves their stability, with little or no impact on bank performance. And more frequent supervisory examinations of banks are associated with reduced loan losses and delinquencies and thus higher profitability.

Concerns I sometimes hear that European supervision and regulation would be too conservative and would lead to losses of market shares are not

supported by the evidence. In fact, current capital standards in Europe are not higher than in other jurisdictions, in particular the United States. ECB internal analysis asked the question: would European banks face lower requirements under the current US prudential framework? We found that, under the US framework, the requirements for European global systemically important banks (G-SIBs) would be higher than their actual requirements today. Requirements would be lower for most smaller and medium-sized European banks in the sample.¹⁰

Moreover, the forthcoming application of Basel III rules in the EU will impact European banks' capital requirements by less than if the standards had been applied without any Europe-specific modifications. The implementation of CRR III would halve the increase in capital requirements from 18.0%, which would be fully compliant with the Basel standards, to 8.6%.¹¹ And this estimate is an upper bound as it assumes a static balance sheet. It does not factor in how banks would react to the new rules. Banks would certainly adjust their activities to reduce the impact of the final Basel III rules. In this case, the impact would be lower. Anecdotal evidence suggests that banks' internal estimates of the impact of the reform are lower than official estimates.

Long transition periods further mitigate the impact of Basel III. Banks have until the year 2032 to fully comply with the new rules – 25 years after the global financial crisis and 15 years after the international agreement on Basel III in 2017.

So let me sum up: changing patterns in competition between banks, between banks and non-bank providers of financial services and across borders can affect risks in banking. This is an effect that supervisors need to carefully consider within their mandate – making sure that risks are managed well and that banks are resilient. There is no evidence that the European approach to supervision and

regulation has gone too far or that it limits European banks' ability to compete. Giving supervisors additional objectives related to growth or competition could in fact have negative repercussions for their existing mandate to ensure the safety and soundness of the banking sector.¹²

The impact of regulation and supervision on the real economy

How about the real economy? Have the banking reforms that have been implemented over the past decade and the changing patterns of competition affected the way in which services are provided to households and firms? Let's look at how the efficiency of the provision of financial services and lending to the real economy have evolved.

In banking, like other sectors of the economy, the potential benefits of competition are well known. Competition enhances efficiency, lowers prices, favours innovation and provides consumers with a wider range and higher quality of products. This benefits the real economy by lowering funding costs, enhancing risk sharing and providing better saving opportunities. Increased competition has been accompanied by efficiency gains in banking. Driven by technological advancements, banks' operating costs have declined.

However, benefits in terms of lower financial intermediation costs are more elusive.¹³ While the volume of financial services provided has increased, financial intermediation costs have remained largely flat on both sides of the Atlantic. For the United States, these trends can be tracked over a long period of around 130 years. Time series for Europe start in the 1950s and show a similar pattern.

In recent years, total factor productivity (TFP) in the euro area banking sector has actually decreased from over 2.0% in 2007 to 0.8% in 2017.¹⁴ This decline is primarily due to slowed technological progress and persistent structural inefficiencies within the sector. Banks' digitalisation strategies can be an important driver of future productivity gains, but associated

risks also have to be managed. That's why European banking supervision has made digitalisation one of its core supervisory priorities.

European banks have maintained a strong role in funding the real economy.¹⁵ In 2022 euro area banking assets measured 290% of GDP, which is higher than in 2002 (240%). In Europe, around 67% of debt funding for the corporate sector is provided by banks. Bank funding is much less relevant in the United States, where banking assets relative to GDP stood at around 110% in 2023.

In particular, banks are a key funding source for small and medium-sized enterprises (SMEs) that cannot easily access the capital market. If more intense competition reduces the incentives to acquire information about borrowers, this may reduce the provision of credit, particularly to smaller and newer firms, and shift it towards riskier borrowers.¹⁶ Good supervision can mitigate these effects by ensuring that sound lending standards and risk assessment procedures are maintained across all banks. Impact assessments do in fact show that the post-GFC financial sector reforms have not come at the expense of lending to SMEs.¹⁷ Generally speaking, strong supervision and regulation have positive implications for the real economy by bolstering trust and market confidence. Good supervision supports the resilience of the overall financial system, ensuring that the real economy has access to finance. It promotes trust in the business environment, which ultimately benefits economic growth.

But, as with any kind of regulation, bank regulation and supervision may have unintended side effects.

Monitoring the effects of supervision and regulation is therefore a key element of accountability and transparency.¹⁸ The Basel Committee on Banking Supervision (BCBS) and the Financial Stability Board (FSB) have evaluated the post-crisis reform agenda. The European Banking Authority (EBA) monitors

the impact of EU transitional deviations that were introduced with the CRR III. European banking supervision is currently developing a framework to better assess supervisory effectiveness.

In general, impact assessments find that better capitalised banks are better able to provide funding to the real economy. In the short term, banks already struggling to meet supervisory requirements may have to reduce their activity if regulations are tightened. This could indeed be an intended effect, by shifting market share away from weaker banks toward stronger ones. In the medium to long term, the positive effects of tighter regulations on aggregate lending and growth prevail.¹⁹ As regards the Basel reforms, impact assessments show that the transitory economic costs are outweighed by the permanent, long-run benefits, including an increase in economic resilience.

Hence, there is little to suggest that higher resilience has come at the expense of the provision of financial services to the real economy and economic growth. In this sense, relaxing regulations and supervision would do more harm than good: such a move would weaken resilience and ultimately impair the ability of banks to provide financial services in a sustainable way.

Reforming supervision and reducing complexity

Overall, there is no indication that the European supervisory and regulatory approach might stand in the way of higher growth. At the same time, we can always improve in terms of making supervision more effective, more efficient and less complex.

The European banking supervision approach is currently undergoing reform to make it more efficient and effective but also more intrusive. Enhancements to the Supervisory Review and Evaluation Process (SREP) are a prime example of the changes being made. The enhanced SREP has six main objectives: conducting more focused risk assessments, improving the integrated planning of the different types of

supervisory activities, using the full supervisory toolkit, enhancing communication with banks, making methodologies more stable, and making better use of IT systems and analytics.²⁰

We are building on previous work to enhance transparency and accountability. Over the past years, we have made significant strides to enhance the transparency of supervisory practices and methodologies to become more predictable.

Reducing unnecessary complexity can complement enhanced transparency and efficiency. The current regulatory framework is complex, reflecting the complexity of modern banking as well as input received during consultations. National regulations and the use of national options add to this complexity. This effect could be mitigated through direct regulation rather than directives.

One example of the complexity inherent in banking regulation is the capital framework. This framework includes minimum requirements and buffers, parallel risk-based and leverage requirements, and distinct components of going-concern and gone-concern capital.

The framework's structure is multidimensional by design. It recognises that the diverse risks banks face cannot be captured by a single metric. However, complexity also stems from industry concerns raised during the calibration phase about the costs of capital.

Indeed, banks have their own role to play to reduce complexity. For instance, simplifying the landscape of internal risk models would make it possible to better focus on banks' actual risks while freeing up resources. The number of model-related weaknesses and subsequent findings would decrease, which would reduce the resources needed for remediation.

To assist banks in their deployment of internal models, European banking supervision has made its interpretation very transparent. The standardised

approach should be favoured if the available data do not meet the requirements to produce high-quality internal models. We recently updated our guide to internal models.²¹ The guide will be maintained and updated regularly to align with the modifications of the upcoming CRR III, which offers banks an opportunity to further streamline their internal model landscape.

But let me be very clear: Any steps towards reducing complexity cannot come at the expense of resilience in the system. Reducing resilience by weakening capital requirements or risk controls would impair growth and stability in Europe.

We do not control the external risks that banks face. Geopolitical, climate and environmental-related risks, and risks arising from the digital transformation, are certainly heightened. This needs to be reflected in microprudential capital requirements. Similarly, macroprudential requirements need to be adjusted when there are increased levels of financial stability risk. Our primary responsibility is to ensure the stability of the financial system, which requires adjustments based on real-time risk assessments.

If banking deregulation and more lenient supervision is not the solution to Europe's growth conundrum, then what is?

A European policy agenda to promote growth needs to tackle the root causes of low productivity. Ultimately, growth is driven by innovation.

Many relevant policies promoting innovation will benefit the financial sector and the real economy. Take, for example, regulation of the provision of digital services, which are integral to banking. Effective regulation of these services ensures a secure and efficient digital infrastructure, which supports innovation of banks and firms. Another example is a stable political and institutional framework for the energy transition. Investments to finance the energy transition are subject to a high degree

of uncertainty and are made over a long time horizon. They require equity capital alongside debt financing. A stable policy framework provides the clarity needed to invest in sustainable ventures and adequately manage the related risks.

The capital markets union can promote the integration of markets, equity markets in particular, improve private sector risk sharing, and enhance the willingness to take risks.

Focus should be placed on the core elements of the CMU, including harmonising regulation, reducing national discretion and centralising supervision as needed to address systemic risks beyond banking. Of no less importance, tax systems that favour debt over equity finance should be reviewed.

In addition, ways to promote securitisation are currently being discussed.

From a prudential perspective, the right balance needs to be struck between the risks and benefits of securitisation. Securitisation can have positive effects if it enhances market liquidity through standardisation and if it transfers risk to investors that have the comparative advantage to bear such risk. However, securitisation can also impair financial stability if it weakens the incentives to monitor risks or if it shifts risks to unregulated, highly leveraged parts of the financial system, with potential spillover risks to the banking sector in times of stress.

Post-GFC regulatory reforms related to securitisation have served us well. An international discussion at the Basel Committee, informed by an impact assessment, would be needed before discussing any change to bank capital charges applicable to securitisation in Europe.

At the same time, securitised products can be highly complex and differentiated. European banking supervision therefore cooperates closely with the banking industry to simplify the approval process for a given risk transfer. Ultimately, however, it is up to the industry to agree and

commit to a level of simplification in line with supervisory requirements.

Concluding remarks

Over the past decade, Europe has built a strong, reliable and recognised supervisory and regulatory framework. This joint response to the financial crisis serves Europe well in promoting stability while not hampering growth or competitiveness. There is no evidence of excessive conservatism in terms of resilience.

Supervisors and regulators can best contribute to growth and competitiveness by ensuring that banks and the financial system remain sound and stable. Becoming more lenient or adding other policy objectives to their mandates would weaken financial stability. Instead, policies are needed to tackle the root causes of low productivity, promote innovation and foster the Single Market. Completing the banking union and introducing a capital markets union are key elements.

A resilient future for Europe requires a stable international institutional order. The Basel framework contributes to that by setting globally agreed standards to strengthen banks' ability to better withstand future stresses. We should not allow the memory of the global financial crisis to fade in the rear-view mirror. Its lessons are as relevant today as they were then, and applying those lessons will be key to securing a stable, resilient financial system that supports sustainable growth for the future.

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Klaas Knot

President - De Nederlandsche Bank (DNB) & Chair - FSB

On flood management and financial stability

It is a pleasure to be back at the Eurofi Financial Forum. This time in beautiful Budapest, near that stunning Parliament Building.

I find cities that are built on riverbanks especially appealing. There is something about water that is soothing and energizing at the same time. But there is also something about it that keeps you on your toes. Something dangerous.

Those of you who live here, in Budapest, will surely remember the high tides of the Danube last winter. Eventually the river breached its banks, right here around the corner, and flooded the otherwise bustling streets. Luckily, without too much damage.

In the Netherlands, we know the dangers of rising water levels all too well. One disaster in particular has become a core part of our collective memory.

During the night and early morning of February 1st 1953, the combination of high spring tide and a severe windstorm led to 'a storm tide'. This storm tide eventually breached the Dutch dikes and flooded the land beyond. Almost 2.000 people died and another 72.000 became displaced and homeless. And the damage to houses, streets and fields was unimaginable.

After this disaster, known as the North Sea Flood, it didn't take the Dutch Government long to take action. Within a year, work began on an elaborate flood defense system of dikes, dams and coastal storm surge barriers: the Delta Works. And the Delta Works have defended

the Netherlands from such a catastrophe happening again ever since.

Remarkably, the reason the Dutch government could take action so quickly, was because concerns already existed about the resilience of the Dutch dikes before that disastrous early morning in 1953. Indeed, the plans for the Delta Works were already on the table. But due to a lack of funding and other priorities, they were not yet implemented when that deadly combination of water and wind hit the coast.

Now, I wouldn't be telling you this story if I didn't see a parallel with our fields of expertise – and the dikes and defenses we try to build to safeguard these fields from flooding.

Going back to 2008, I think it is fair to say that very few saw the Global Financial Crisis (GFC) coming. The devastation of the Great Depression had faded from people's memories, as well as the kind of deregulated finance that had caused it. Instead, markets were widely believed, once again, to be able to regulate themselves.

This time, even though the international regulatory community was caught off guard when the GFC struck, they were determined to ensure this would not happen again.

And so, the global financial system underwent a much-needed reform. You could say the international regulatory community effectively constructed its own version of the Delta Works for the worldwide banking system.

Beyond banking, however, the story is somewhat different.

Even though banks were at the epicenter of the GFC, non-bank financial intermediation (NBFi) played an important role in that very crisis. And, already a decade before, in 1998, the failure of the 'Long-Term Capital Management' hedge fund had alerted us to the systemic risks that non-bank financial institutions could pose.

Reforms, however, have been modest. The complete Delta Works for NBFi is still being designed. And that design is not yet implemented.

This is worrying, especially since NBFi – the investment fund sector in particular – has continued to generate systemic risk in recent years.

For instance:

- In March 2020, we witnessed the market turmoil and 'dash for cash'.
- In 2021, the collapse of the hedge fund Archegos followed.
- And in 2022, we saw the strains in commodity markets, and the UK gilts crisis.

These events were threatening enough to market functioning and financial stability that central banks and public authorities were forced to come up with immediate and extraordinary policy responses.

We now know very well that the NBFi sector faces structural vulnerabilities, including structural liquidity mismatch in open-ended funds, leverage that can create financial stability risks, and

inadequate margin preparedness. And, the NBF sector is highly interconnected with the rest of the financial system.

As we have seen, these vulnerabilities can, in the event of an external shock, amplify market stress and propagate through the broader financial system. This happens mainly via a sudden or large rise in demand for liquidity, typically brought about by rapid selling of assets to meet redemptions, the need to deleverage, or to meet margin calls.

When similar financial entities – particularly investment funds – with similar investment strategies, sell similar assets, with a similar timing, asset prices may fall and a vicious downward spiral of further falling prices and forced selling may ensue. Subsequently, stress may spill over to other parts of the financial system, either directly to counterparties, for example when leverage is involved, or indirectly through mark-to-market losses on common asset exposures.

Of course, market-based finance will not necessarily result in threats to financial stability. On the contrary – especially in Europe – the real economy, the financial sector, and investors could benefit from more diverse funding channels and investment opportunities. As such, I wholeheartedly support the EU's Capital Markets Union policy agenda.

However, if we want to harness the benefits of market-based finance, we also need to put in place appropriate safeguards to protect financial stability. In this

regard, I consider the recent stress episodes in NBF to be clear signs of rising water and swelling winds – signs that underscore the urgency for constructing a Delta Works equivalent for the NBF sector, and to do so before an even bigger storm hits.

To this end, global standard setting bodies (SSBs) and national authorities are doing a great deal of analytical and policy-oriented work. Let me briefly mention a few initiatives.

- After the events of March 2020, the FSB published several policy proposals to enhance money market fund resilience.
- In 2023, working closely with IOSCO, the FSB revised its policy recommendations on addressing vulnerabilities stemming from structural liquidity mismatch in open-ended funds, while IOSCO issued new guidance on anti-dilution liquidity management tools.
- Earlier, the BCBS-CPMI-IOCO reviewed margining practices in centrally and non-centrally cleared markets. In a follow-up to this review, later this year the FSB will publish its final recommendations to enhance the liquidity preparedness of market participants for margin and collateral calls.
- Currently, the FSB is working on policies to address NBF leverage-related financial stability risks.
- In connection with this, the Basel Committee on Banking Supervision (BCBS) has recently

consulted on guidelines for counterparty credit risk management, also in relation to non-bank entities.

The main concern of SSBs is systemic risk in NBF. To this end, their policy proposals aim to reduce liquidity demand spikes, or at least mitigate the impact on financial stability. Otherwise, they aim to improve the resilience of liquidity supply in stressed market conditions. Additionally, the SSBs encourage authorities and market participants to increase their risk monitoring frameworks and use this information in their resilience planning.

Drawing up these policy recommendations, however, is not enough to stem systemic risk in NBF. In the end, the success or failure of these policies depends on their swift and proper implementation by member jurisdictions.

The NBF sector is global in nature. As such, implementation needs to happen at the same time and with a sufficient degree of consistency across all major jurisdictions – to avoid cross-border fragmentation and regulatory arbitrage.

Safeguarding financial stability also relies on effective cross-border cooperation and adequate data sharing arrangements. All jurisdictions need to strengthen their part of the common dike against rising water. A breach in one part of the dike may have consequences well beyond a single jurisdiction.

We did this for the banking sector after a severe crisis. I am convinced the regulatory community will

manage to do this for the NBFi sector too – but this time before a new major crisis hits.

The European Union is an important player in this regard. We are in a unique position to lead-by-example when it comes to the implementation of globally agreed standards.

I believe that the recent review of the European regulatory framework for investment funds will bring about important changes, once it is transposed into national law – changes that will include, for example, additional requirements for liquidity management tools to address liquidity mismatch in open-ended funds.

But more work remains to be done. As such, the ongoing Consultation on the Macroprudential Framework for NBFi by the European Commission provides a great opportunity to set out a clear path for the future.

Let me briefly address five areas where progress could and should be made, and where I believe the incoming European Commission will have its NBFi work cut out for it.

First, regarding liquidity mismatch in open-ended funds: to fully comply with the 2023 revised FSB recommendations and the accompanying IOSCO guidance, more actions are needed beyond the recent amendments to the main European investment fund regulations. For instance, the incoming Commission should consider regulatory guidance and, possibly, further legislative

amendments to encourage consistent use of anti-dilution liquidity management tools under both normal and stressed conditions. And efforts must be made to implement the FSB's recommendation to classify funds by their liquidity profile, and adapt redemption terms and conditions to the liquidity of the fund's asset portfolios.

Second, the new European Commission should take action to implement the FSB's 2021 policy proposals for money market funds. While the previous Commission recently decided not to review the MMFR anymore, other jurisdictions have either raised the liquidity requirement for MMFs, like the US, or proposed to do so, like the UK. The 2024 FSB's thematic peer review on money market fund reforms highlighted that there is significant variation between jurisdictions on minimum liquidity requirements. Europe should follow suit to close this regulatory gap and improve the resilience of EU MMFs.

Third, the FSB is preparing policy recommendations on enhancing margin preparedness of market participants for margin and collateral calls. Once finalised, the European Commission should work on the implementation of these recommendations. Doing so will also help reduce liquidity pressures for money market funds.

Fourth, to address leverage-related risks, the European Commission should aim to implement the FSB's minimum haircut framework for securities financing transactions. Additionally, the Commission

should consider further reforms based on ongoing work by the FSB on NBFi leverage.

And last but not least, as FSB Secretary General John Schindler mentioned in his contribution here at Eurofi yesterday, having high-quality data is of crucial importance. It is therefore necessary to keep a close eye on any initiatives to solve data-related challenges. And European authorities should take a supportive role on the global stage to make progress, especially in sharing data.

Let me wrap up.

In Amsterdam, I live in a neighborhood close to the river Amstel. In an area that lies five meters below sea level. But I don't have a fear of floods. Because I know that measures have been taken to safeguard the city and the people living in it.

Unfortunately, I don't feel the same level of reassurance yet when I speak about NBFi. For that to happen, we need much more implementation of global standards. Much more cross-border cooperation. Much more consistency across jurisdictions.

And so, I urge everyone involved to implement the 'Delta Works for the NBFi sector' – just like we did for the banking sector after the Global Financial Crisis. But this time, let's not wait for the water to rise and the winds to swell. This time, let's get ahead of it.

Thank you.



François Villeroy de Galhau

Governor - Banque de France

Two insights concerning the latest developments in price stability and financial stability

Ladies and Gentlemen,

I first want to thank warmly David Wright and Didier Cahen for organising once more this impressive Eurofi event, this time in the wonderful city of Budapest, and for exceptionally allowing me to speak remotely. I would like to share with you briefly some insights into two current developments: our monetary policy decision yesterday, and the latest US revision on Basel 3.

I. An obvious but important monetary policy decision

We decided yesterday a second rate cut. Our Governing Council led by Christine Lagarde took a unanimous decision, because the economic evidence was strong. Inflation evolves according to our forecast, which we didn't change in any decimal (the first time since almost 20 quarters): we are at 2.2 % in August, and we should reach a lasting 2% by the second half of next year. Furthermore, market expectations on inflation – be it on fixing or in the options market – are at present significantly below our own forecast, but time will tell.

On activity, the latest data have been somewhat disappointing, with growth stemming mainly from net exports and government consumption, while private domestic demand weakened. High uncertainty and low confidence still foster savings, rather than households' consumption and firms' investment. By the way, Banque de France will publish its forecast for France on September

17th, and beyond the one-off stimulus of the successful Olympic games, it will be consistent with this view of a very gradual recovery.

Hence, our decision also proceeds from a sound risk management. Unlike the US, we don't have a dual mandate (prices / employment), but we have clearly a symmetric mandate around our 2% target: we must be attentive to the risk of undershooting our target as much as to the risk of overshooting it.

It was not our first rate cut, and it will not be the last one. Hence the frequent question: what will come next? Well, we said clearly that we will decide meeting by meeting, and be data-driven – beyond the possible volatility of the next monthly figures and including leading indicators. To put it in other words: the direction of the journey is clear – we should continue to reduce gradually and as appropriate the degree of restriction of our monetary policy. But the pace has to be highly pragmatic: we are not pre-committing to any particular rate path, and we keep our full optionality for our next meetings. Be assured anyway of our firm determination, and even commitment, to bring inflation sustainably back to 2% during next year. Let me add one thing: Europeans shouldn't rely exclusively on monetary policy to address their serious growth challenge : hence our clear call yesterday not to bury Mario Draghi's and Enrico Letta'

s reports and their proposals of badly needed supply side reforms – which are not fiscally costly for many of them.

II. On Basel 3, a gradual US clarification

Let me first welcome the clarifications brought earlier this week by Fed's Vice Chair M. Barr regarding the US revised Basel endgame proposal and, more importantly, their restated commitment to implementing the Basel 3 package. It is a good omen for financial stability.

Nevertheless, we don't have yet the precise content, as it remains to be adopted by the three federal agencies. The initial US proposal, published in July 2023, contained indeed some provisions that were gold plating the Basel rules. These provisions are expected to be largely and legitimately eliminated in this new version. That being said, the Basel Committee will be paying careful attention to the precise rules to come. On certain areas of risks, especially on market and operational risks, and some of the directions recently announced as a "preview" of the final reform, it will have to be looked at whether they might possibly deviate from the Basel standards. The scope of application of the revised rules could be an additional focus, in particular for medium-sized banks with balance sheets of between USD 100 and 250 billion.

Finally, the timeline must be clarified quickly, to reduce as much as possible the time gap

between major jurisdictions: this also regards the UK. As you all know, in the European Union, the rules stemming from Basel 3 will start to apply as of January 2025, but with one important and warranted adaptation: the Commission's proposal to postpone to January 2026 the implementation of the FRTB (Fundamental Review of the Trading Book) on market risks.

The two topics I just dealt with have some links, indeed: our duty as central banks is to restore price stability while preserving financial stability. Achieving these two objectives together was not expected to be easy, remember the fears till early 2023; but we have been successful so far, and not by chance as banks are now safer thanks to Basel. European banks are also very sensitive to competitiveness, and rightly so: but safety and competitiveness are not at odds, on the contrary. Be sure we will now be more and more attentive to ensure their compatibility. Thank you for your attention.

Explore the "**Current Topics**" section of the Eurofi website to access the latest Eurofi policy notes and contributions from public and private sector representatives on key economic and financial policy issues.



Economic and stability challenges



Capital market regulation



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Jean-Paul Servais

Chair of the Board - International Organization of Securities Commissions (IOSCO)

A new era of international collaboration

The views expressed in these remarks are those of the speaker in his role as FSB Secretary General and do not necessarily reflect those of the FSB or its members. Ladies and Gentlemen, it is an honour to address you today.

The Friday programme at Eurofi is traditionally focused on monetary policy and banking regulation. But given the growing importance of non-bank finance and its ramifications within the financial systems, it is perhaps timely to invite me today to speak on behalf of IOSCO that stands for the community of financial markets regulators.

We live in a time when the global financial landscape is more interconnected than ever before. The international regulatory agenda after the 2008 financial crisis rightly focused on how to strengthen resilience and reduce risks in the banking system. But over the past decade, non-bank finance has grown significantly across all continents to 43% of global financial assets, and is creating new challenges that securities regulators are facing head-on.

IOSCO is uniquely placed to coordinate and bring forward collaborative solutions to global developments such as sustainable finance and developments arising from financial innovations such as crypto-assets, tokenisation or artificial intelligence that have global roots and present challenges that must be

confronted cohesively. These global outcomes strongly inform the EU agenda.

The power of collective efforts

As a global standard-setting body, IOSCO has always championed international collaboration. But it is fair to say that our efforts have reached new heights in recent years.

In a complex and fast-changing financial environment, no single jurisdiction can tackle challenges alone.

1. Whether we talk about tackling liquidity or leverage risks arising from the growth of non-bank financial intermediation;
2. Whether we talk about new forms of risk arising from new technologies, or
3. Whether we talk about enhancing consistency, reliability and comparability of sustainability information in the interest of investors and issuers ...

it is clear that the issues we face are global, and that they require a coordinated response.

With a membership which regulates more than 95% of the world's securities markets in some 130 jurisdictions, IOSCO is well placed to provide such a response.

The endorsement of the International Sustainability Standards Board (ISSB) standards is a powerful example of IOSCO's ability to deliver such a coordinated response. This

endorsement has driven more than 20 jurisdictions to take steps to integrate these standards in their regulatory regimes in just one year! Together, these jurisdictions represent over 40 % of global market capitalisation.

Days after IOSCO endorsed the ISSB standards, the European Commission adopted its European Sustainability Reporting Standards (ESRS), in which they made significant strides to integrate the ISSB disclosure requirements, bringing all 27 Member States of the European Union into the global wave of support for the ISSB standards around the world.

This rapid and widespread progress illustrates the importance of global cooperation in addressing the urgent need for transparency in sustainability reporting. It highlights what we can achieve when we work together towards a common goal.

In another area of sustainable finance, IOSCO's principles on ESG ratings are informing reforms in key jurisdictions. Under the Belgian Presidency, the EU became one of the first regions to introduce binding requirements taking into account these IOSCO principles.

Addressing cross-border risks IOSCO's ability to bring together regulators, policymakers, and industry leaders from around the world allows us to develop solutions that are globally consistent and locally relevant.

Take, for example, our work on

crypto-assets. The rapid growth of these assets has brought new challenges for regulators. Without a coordinated international approach, there is a risk of creating regulatory arbitrage. Different rules in different jurisdictions could significantly harm both retail and non-retail investors.

We continue to monitor areas of risks of market fragmentation and we benefit from the invaluable insights of our affiliate members, including industry associations and stakeholders. These reports highlight how market fragmentation can undermine financial stability and efficiency, orderly functioning of markets and investor protection. This kind of input from our broader community is unique to IOSCO and is instrumental as we seek to develop policies that promote a more integrated and resilient global financial system.

Bringing convergence in the regulatory treatment of crypto-assets across our 130 members has also been a priority and our publication of recommendations for the regulation of crypto- and digital assets was only the first step. An important step, yes, but it is not enough. Implementation, where appropriate according to national regulatory decisions, is the next key step.

Moreover, we are working closely with other international bodies, such as the Financial Stability Board (FSB), the World Bank, and the IMF, to ensure that our recommendations are recognised as the gold standard, and that other global bodies support their adoption by jurisdictions, where necessary. This collaboration is essential to ensure that we have a coherent and comprehensive framework to address the risks posed by these new financial instruments and intermediaries. I believe that when the EU decides to review MICA, it should look to the IOSCO standards for inspiration.

Identifying and addressing emerging risks

IOSCO takes a structural approach to identify vulnerabilities and risks

within the global financial system within its remit. We draw on input from our regional committees to ensure the diverse perspectives from our 130 members are taken into account. The findings of this risk outlook will shape our next work programme, guiding IOSCO's efforts to address the most pressing challenges facing global financial markets.

One can naturally expect Artificial Intelligence to become a major point of attention, and many jurisdictions such as the EU have already begun to consider the risks and opportunities attached to the use of Artificial Intelligence in financial services. I have no doubt that they will be looking to IOSCO as they consider how to best approach these issues.

A new era of collaboration

We are now entering a new era of collaboration, not only across IOSCO's membership but also with other global standard-setting bodies. Our enhanced cooperation with the FSB, the International Monetary Fund (IMF), the World Bank, the Organisation for Economic Cooperation and Development (OECD) and others, has strengthened IOSCO's role in the international financial regulatory system. Our work as IOSCO, but also with the FSB, directly contributes to the G20, as evidenced by the FSB Chair's regular letters to the G20 Leaders.

This collaboration is crucial. It allows us to leverage each other's strengths and expertise, leading to more robust and effective regulatory outcomes.

IOSCO's standards are recognised as key pillars in the architecture of global financial regulation. They enhance trust in the financial system. They provide jurisdictions with the tools they need to develop their financial ecosystems in a resilient and inclusive way.

Guidance for the European debate

For those involved in the European debate around the Capital Markets Union (CMU), I encourage you to closely monitor IOSCO's regulatory initiatives. Our work can provide valuable insights and

solutions to help shape the future of capital markets. One area where IOSCO is leading important work, is in retail investor protection. This is crucial to the success of any financial system. IOSCO's initiatives could serve as a source of inspiration as Europe continues to develop its capital markets.

The CMU aims to deepen and integrate the capital markets of the European Union. It seeks to make it easier for companies to raise funds and for investors to access diverse opportunities. As Europe moves towards this goal, the lessons learned from IOSCO's initiatives, particularly in investor protection, can provide valuable guidance.

Conclusion: global solutions for global challenges

In conclusion, IOSCO's commitment to international cooperation has never been stronger.

As we navigate this new era of global finance, we must continue to join forces and leverage IOSCO's convening power. The challenges we face are global in nature, and so, too, must be our solutions.

I encourage you all to stay engaged with IOSCO's work. Consider how our initiatives can inform and inspire your own efforts. Together, we can build a more resilient, transparent and inclusive financial system that serves the needs of all.

Thank you.



Shigeru Ariizumi

Vice Minister for International Affairs, Financial Services Agency, Japan (J-FSA)

Remarks on green transition

Good evening, everyone, and it is my great pleasure to be here today. I would like to thank David Wright and the Eurofi team for inviting me to this financial forum in this historic and beautiful city of Budapest.

I would like to touch upon what the key messages will be for today. First of all, I think it will be important in terms of green transition to have the three following points. The first is that we need to have an inclusive and comprehensive approach. The second would be that we need a whole-of-economy, whole-of-government approach. Third is that, while we need to be ambitious in our aspiration, we must be practical in our approaches. I hope you do not leave now, as you have heard the key messages already.

Climate change is undoubtedly affecting everyone, and it is becoming more profound in various ways, particularly in recent years. It is a huge challenge that requires inclusive and comprehensive efforts, where all stakeholders need to work together. Today, I would like to share with you my thoughts and perspectives on the role of the financial authorities in our challenging journey.

Today's theme is green transition, and firstly let me emphasize that a green transition cannot be achieved solely by the financial sector. It requires a whole-of-economy approach. While I fully understand and acknowledge the important role that the financial sector can play, every sector has its own respective ways to contribute. Such a comprehensive approach will enable all stakeholders to share the common goal, the common understanding and the benefits of a

green transition. Under a market-driven economy, there are a variety of ways to push for a green transition. For example, regulations, incentives such as subsidies and tax breaks and carbon pricing. The view within the Japanese government is that collaboration among stakeholders provides a useful basis for a sustainable path towards achieving net zero. Our government has published a green transformation promotion strategy and sectoral roadmaps, thereby providing national benchmark transition pathways for industries. It not only outlines future transition plans, but also includes necessary public support for easier transition planning, even for SMEs.

The Financial Services Agency (FSA) has issued guidance encouraging financial firms to engage with clients to better support them in achieving their climate goals. These multi-faceted, on-the-ground, practical approaches will help create the fusion of formal transition policies and market-driven transition approaches. I will refer to this later.

Next, let me turn to what financial authorities are doing to encourage our green transition. First is sustainability disclosure. As you are aware, various jurisdictions including the EU are taking steps to promote disclosure in sustainability. Promoting the disclosure of sustainability information, which could present not only risks but also opportunities to corporate finance, and enhancing constructive dialogue among key stakeholders such as investors, financial institutions and companies, can serve as leverage to encourage investment in

sustainability. In light of the global nature of climate issues, priority should be given to introducing consistent, comparable, reliable, and interoperable disclosure standards in each jurisdiction, with the International Sustainability Standards Board (ISSB) standards as a global baseline.

Currently, the Sustainable Standards Board of Japan (SSBJ) is developing domestic standards which we believe would provide a functionally aligned outcome to the S1 and S2 standards finalised by the ISSB. They are currently under discussion, towards finalisation by March next year. While the SSBJ is working to ensure that domestic standards are functionally aligned to ISSB standards, the government is currently exploring how to apply the new standards. For example, we are discussing applying the standards gradually from companies with large market capitalisations, and setting an appropriate preparation time for disclosure and provision of assurances. We have also been mainly discussing the safe harbour rules and the scope and level of assurance. Here I think what is important is that we maintain the high quality of the standards while being mindful of the scalability aspect. This is not just about the size of the corporates, but the same applies for emerging economies as well.

Our government has been encouraging and supporting the private sector in starting sustainability disclosure. For me, the most important point is 'regulate but support'. This means we should take a whole-of-government approach. For example, in Japan

we have provided a platform in which companies can use tools to calculate their greenhouse gas (GHG) emissions, in light of Scope 3 emissions. If you want to collect Scope 3 data, you need your clients, even the smaller ones, to be able to calculate that. Another thing we have been working on this platform is to be able to obtain emission intensity data of each product category, and also enable firms to see what the good practices are, so there is information sharing on the platform. This will make it easier for corporates, particularly the smaller ones, to be able to push their efforts towards net zero. In the private sector, some players are aiming to launch a mechanism to identify emissions throughout the supply chain – so it is not just about the single firm, but also about the overall supply chain – and to come up with a voluntary disclosure framework that SMEs can refer to when financial institutions and investors collect emission data from SMEs.

In this way, we believe that rather than seeking everything to be perfect from the beginning, taking steady steps reflecting our present can push up the number of companies that respond to sustainability disclosure, and as a result improve the quality and quantity of information for investors in the longer term. The volume of sustainability investment is on the rise. If you look at what it was globally between 2016 and 2022, 2016 was \$22.8 trillion. In 2022, it was \$30.3 trillion. Looking to Japan, we find it was \$0.5 trillion in 2016, and \$4.3 trillion in 2022, so it has increased by eight times. We can see from this trend that investor interest in sustainability is growing. Simply put, we need to be ambitious in our aspiration, but practical in our approaches. The key to success in promoting green transition is how to respond practically while upholding high ideals.

Next, I would like to talk briefly about transition finance. In our pursuit to net zero, steady decarbonisation will be critical, particularly in high emission industries such as electric power, steel and chemical. While we need to focus our attention to encourage these sectors from a whole-of-economy perspective, the reality is that not all industries can decarbonise

very quickly. The government has published sector-by-sector roadmaps for high emission industries, encompassing future technologies and pathways that will help decarbonisation efforts. For the financial sector, the FSA has published guidance emphasizing the importance and identifying the ways in which financial institutions could engage with their clients to encourage them to move towards net zero. It is also clear that green transition requires huge global investment which neither the public sector nor the private sector alone can sufficiently provide. Japan has been advocating the importance of transition finance from the very beginning at the G20. However, its operationalisation remains a challenge, and I think that is also true for Europe.

Given that Asia accounts for a large share of global emissions, the accumulation of projects in Asia can contribute to its total reduction. The FSA has kicked off the Asia GX consortium – GX stands for 'green transformation' – with ASEAN countries, gathering high level participants from both the private and public sectors. Such regional approaches can help to consider public/private partnerships, including through identifying useful actual cases, hopefully leading to a consensus on best practices.

Last but not least, let me talk about transition plans. For real economy corporations, transition plans are often strategic documents. When we talk about transition plans, it can mean aspirations to do better towards net zero. On the other hand, from a financial institution perspective, we are much more interested in the risks that it poses to clients, so there are differences of views on what transition plans should look like.

As I mentioned, while transition plans are used for various purposes, at least for financial institutions, ensuring the implementations of credible transition plans by clients may also lead to the management of climate related risks, and this will not only reduce immediate transition and physical risks in their portfolios, but also ultimately bring down risks for the whole system, which is why financial authorities are interested in transition plans.

One of the candidates for financial institutions' transition plan metrics is financed emissions. From Japan's perspective, given its backward-looking characteristics because financed emission is historical data, we need to supplement this with a set of forward-looking metrics that can measure how financial activities ranging from the provision of finance to engagement with clients contribute to emissions reduction alignment of client transition plans with net zero goals.

For example, there could be a temporary increase in financed emissions if you support high emissions sector but usually that comes with disposition of legacy assets later on, which will eventually reduce the financed emissions in the longer term. That is a forward-looking metric, and we need to be mindful of such aspects moving forward. Building on the above-mentioned guidance, the FSA aims to develop an effective monitoring framework for climate related risks. This framework will emphasize the dialogue with financial institutions, to identify the progress on how they manage climate related risks through supporting client alignment of transition plans, ultimately reducing climate related risk for the full financial system.

Let me finish by saying, as I mentioned at the outset, that we need to be inclusive. You may know that Japan does not take a taxonomy approach, because we think that all sectors should move towards net zero regardless of their characteristics, so we think an inclusive approach, a comprehensive approach, will be very important. Taking a holistic approach, such as the whole-of-economy, the whole-of-government approach will be quite important as well, and we also need to be practical in our approach. Under the whole-of-economy approach, we need to be mindful of the impact of our green transition on our macroeconomic policy management, competitiveness, and geopolitical tensions. By leveraging these approaches, we can avoid sustainability fatigue, but at the same time make steady and important progress towards green transition, which should remain as one of our top policy priorities. Thank you very much for your attention.



John Schindler

Secretary General - Financial Stability Board

Building bridges: the case for better data and coordination for the non-bank sector

The views expressed in these remarks are those of the speaker in his role as FSB Secretary General and do not necessarily reflect those of the FSB or its members.

Thank you for having me here today. This is my first visit to Eurofi and my first trip to Budapest. I want to speak to you today about a topic of increasing importance to financial authorities on both sides of the Atlantic, and indeed around the world: Non-Bank Financial Intermediation (or NBFi or what I will call the non-bank sector).

The 2008 global financial crisis exposed severe vulnerabilities in the global financial system, and it prompted an awareness that we needed to be more vigilant to financial stability considerations.

The global financial regulatory community embarked on an ambitious reform agenda, scrutinising the entire financial system — banks and non-banks alike — to build resilience. In the banking sector, Basel III was developed to enhance capital requirements and liquidity management and to reduce leverage. A parallel focus was placed on what was then commonly referred to as 'shadow banking', but that focus matured into a holistic approach to what we now refer to as non-bank financial intermediation.

Fifteen years later, we face a different financial system. The system has evolved because of our regulatory interventions, innovation, and shifts in global economic and financial conditions. One of the most notable changes has been the increasing importance of the non-bank sector.

Today, I want to make three points as I focus on this critical part of our financial system:

First, the non-bank sector is increasingly critical to the global financial system, and that criticality has been highlighted by the role the sector has played in recent periods of market turmoil.

Second, calling it the non-bank sector may have been appropriate for a while, but the time has come to stop referring to it as if it is monolithic.

And finally, we need more and better data from this critical area.

The non-bank sector is increasingly critical to the global financial system

The non-bank sector has grown in size, complexity, and importance since the GFC, with global assets reaching approximately \$220 trillion in 2022. But the core issue, which can't be encapsulated in any single number, is where risk is building up within the financial system. Over the last decade, again and again, we see parts of the non-bank sector playing a central role in amplifying shocks across the financial system during periods of stress.

The changing role of the non-bank sector has been driven by several factors.

First, regulatory shifts. Stricter regulations on banks have led to the migration of certain activities to the non-bank sector. For example, non-bank lenders and other entities now play a more prominent role in credit intermediation and in critical

activities such as the provision of market liquidity.

Second, the search for yield. The prolonged low-interest-rate environment that followed the Global Financial Crisis drove investors to seek higher returns in alternative asset classes, to seek larger maturity and liquidity mismatches, and to use more leverage.

Finally, technological innovation. The rise of fintech and online lending platforms has introduced new forms of financial intermediation, often operating outside the traditional regulatory framework.

While this has brought benefits, including increased access to credit, it has also introduced new kinds of risk. In recent years, we have witnessed several episodes of market turmoil in which the non-bank sector played a significant role.

The onset of the COVID-19 pandemic was a sharp and sudden shock to global financial markets. Investment funds and money market funds, faced significant liquidity pressures, as investors sought to redeem their holdings amid the heightened uncertainty.¹

In the commodity market turmoil following the Russian invasion of Ukraine, commodity prices and volatility spiked. Non-bank entities, especially commodity trading firms and some investment funds, experienced substantial stress. Weak liquidity management practices and interconnectedness led to contagion.²

Those two examples followed external, nonfinancial shocks. The implosion of FTX and the collapse of Archegos did not. Those two events were stark reminders of the risks associated with leverage and concentrated exposures within the non-bank sector. Archegos, in particular, led to significant losses for investors and counterparties, and raised concerns about the adequacy of risk management practices among prime brokers.

Finally, there was the turmoil in the UK gilt market. A sharp rise in gilt yields led to severe liquidity challenges because of the investment strategies of some pension funds. The liquidity issues led to contagion that necessitated central bank intervention.

These examples highlight the importance and the interconnectedness of the non-bank sector and the existence of vulnerabilities in the sector that can spread to the broader financial system.

Historically, the regulation of the non-bank sector has focused more on investor protection or market integrity or other similar mandates. However, these mandates do not fully capture the systemic nature of risks that the sector can pose to the global financial system. The negative externalities that can arise from non-bank activities during times of stress suggest that a financial stability perspective is necessary. This perspective requires us to consider not just the risks to individual investors or markets, but also the potential for systemic risks – risks that can have far-

reaching implications for the global financial system and the global economy.

The FSB has argued that we must adopt a financial stability perspective when regulating and supervising the non-bank sector. This is not a case of treating this sector differently or failing to acknowledge how important this sector is. Just the opposite. It is precisely because of how important this sector is to the functioning of the global financial system that we should bring and enhance the financial stability perspective to the regulation and supervision of this sector.

This also doesn't mean treating non-bank institutions and activities the same way as banks. The two sectors have different business models and risk profiles. Indeed, there are many business models in the non-bank sector.

Bringing a financial stability perspective to the non-bank sector means acknowledging the centrality of the non-bank sector to the proper functioning of the global financial system and the way the non-bank sector can amplify shocks to the financial system. Therefore, regulatory frameworks should be in place to mitigate the risks that non-bank institutions or activities can pose to financial stability.

For example, following the turmoil that surrounded the onset of the COVID pandemic, the FSB emphasised the need to enhance the resilience of non-banks to market stress by addressing mismatches in liquidity that can amplify crises. That has underpinned our work on money

market funds and open-ended funds in recent years. Currently, the FSB is considering actions that might be useful to mitigate the risks of leverage in the non-bank sector and recommendations to ensure market participants are better prepared for margin and collateral calls.³

Dissecting the non-bank financial sector into its constituent parts

Turning to my second point on referring to this critical sector as the non-bank sector. For many years, NBFIs have been referred to as if it were a monolithic entity. That approach was useful for a time as we tried to identify the broad contours of this vastly diverse set of institutions and activities. However, this approach is no longer sufficient. We have reached a point where broad studies of the non-bank sector are not as useful. We need to drill down into the gallimaufry of non-bank entities and activities.

The FSB has already started to do this, as I alluded to in some of my earlier examples. We have been looking at specific entities and activities where vulnerabilities are more pronounced and where these can create financial stability risks. We seek to understand the unique challenges associated with each and consider the possible interactions among these entities and activities, especially during stress. In our ongoing work on NBFIs leverage, we first delved into non-bank leverage broadly, and then we started doing more in-depth work in specific areas where risks to financial stability may be more prominent. Going forward, this more targeted approach would suggest focusing on markets

or entities that are known to be potential amplifiers of shocks.

By dissecting the non-bank financial sector into its constituent parts and looking at the behavior of those parts during stress, we can better identify potential threats to financial stability and develop policies that are appropriately calibrated to the specific risks involved.

We need more – and better – data on NBF

This brings me to my final point: We need more and better data, particularly on those parts of the non-bank sector which are least regulated.

Over the past fifteen years, we have become much better at assessing vulnerabilities to the financial system as a whole and to the banking sector in particular. Our assessments have become more systematic – looking at things like the valuation of assets, use of leverage, maturity and liquidity mismatches, interconnectedness, and complexity. Making such assessments requires enormous amounts of data. In many cases, such data are publicly reported, or measures of vulnerabilities can be calculated from publicly reported data sources. In other cases, such assessments lean on supervisory data. Our ability to assess vulnerabilities and to develop policies to mitigate those vulnerabilities is only as good as the data we have.

There is a reason why the non-bank sector was formerly called “shadow banking”. The sector has traditionally been characterised by a

lack of transparency, meaning there are data gaps that hinder its effective oversight. Those gaps mean that often we can't identify vulnerabilities until periods of market stress reveal them, sometimes with painful consequences.

The FSB has had some success in improving the availability and quality of data for this sector. The FSB's Global Monitoring Report on NBF provides insights into the size, composition, and main trends and risks in the sector. However, challenges remain related to data availability, quality, and use.

On availability, in some jurisdictions there are no legal requirements for some non-bank financial entities to report data that are critical for financial stability assessments. This creates gaps in our understanding of the sector's activities and exposures.

On quality, even when data are available, they may not be fit for the purpose of assessing financial stability risks. For example, data collected for investor protection or market conduct purposes may not capture the systemic risks associated with leverage, liquidity mismatches, or interconnectedness.

Finally, in some cases, data are collected but not used effectively or are not shared with those who need them for financial stability purposes. This can be due to legal or operational barriers that prevent data-sharing among regulators, both domestically and internationally.

The quality and timeliness of non-bank data is essential to the identification and assessment of

vulnerabilities and to the design and calibration of effective policies. We must address these data challenges, because we cannot rely on periods of market stress to reveal vulnerabilities in the sector

Conclusion

The financial system is constantly evolving, and so too must our approach to safeguarding it. This requires a concerted effort to improve data collection, reporting, and sharing practices across the sector. It also requires greater cooperation and coordination among national and international regulators and with the non-bank sector.

Just as the Chain Bridge here in Budapest connects Buda and Pest, we have to bridge the gaps in data and cooperation that exist between the regulatory community and non-bank practitioners. By working together – across sectors, jurisdictions, and borders – we can ensure that the non-bank sector remains a source of strength, rather than vulnerability, for the global financial system.

Thank you.

1. See the FSB's Holistic Review of the March 2020 Market Turmoil.

2. The FSB report on The Financial Stability Aspects of Commodities Markets provides further detail.

3. See the FSB's latest progress report on its NBF work programme for further details.



Péter Csányi

Deputy Chief Executive Officer, OTP Bank

CEE – Is Europe's growth engine in need of repair or just maintenance?

Let me start by saying that I believe that this conference is a great opportunity for the Central and Eastern European (CEE) economy and also for the financial sector, because there are relatively few forums where we can openly discuss the real issues that are facing the European economy and the real challenges that we have to face. It is also a good opportunity for me to introduce OTP Group, the success story of OTP, why I think it is one of the biggest success stories, and why it has become the largest and fastest-growing banking group in the region. Finally, I would also like to raise a few issues that I believe need to be addressed at the regulatory level.

A lot has been said so far this morning about the CEE economy. To outsiders, bankers probably seem to be very much numbers people, but we have heard from the different viewpoints today that it is not just about the numbers; it is about the history. It is about understanding the region's culture. It is about understanding how we got to the place we are today. I am pleased that I can share a few of my thoughts about this because I believe that things are a little bit nuanced and not exactly as the media, politicians and regulators put it. This is not just true for the CEE region, but also Hungary. The perception of Hungary was probably better two, three or four years ago than it is today, but believe me when I say we could talk about this at length as well.

Let us just look at some of the numbers for the CEE region. The population is roughly 100 million. It consists of about 10-12% of the total EU GDP, and it has some positives. The GDP of the region, besides being a significant part of the overall EU GDP, still has a lot of potential. Unemployment is typically lower in this region than in the EU. It usually averages between 4-6% compared to 6-7% in the European Union. The government debt ratio is also lower than the EU average. It usually ranges between 30-70% depending on the country, whereas the EU average is more 80-90%. However, inflation is higher, not least because of the recent Hungarian spike. On average, in 2023, it was above 10% in the CEE region while the EU average was 6.4%. The level of development is obviously lower. GDP per capita ranges between 70-75% of that of the EU average.

Looking at these ranges, the CEE region is not a homogenous region, but in some aspects, I believe that it is worthwhile looking at it or trying to imagine it as one economic area. First of all, the lower level of development in terms of GDP per capita provides a lower base from which we can grow. Thereby, it can provide faster economic growth in the medium to long term than the EU average. Foreign direct investment, EU convergence funds in many countries, rising industrial production, and innovation and technological developments provide a good backbone to this future growth.

In some areas, CEE is actually a leader. I will just give you a few examples. Contactless card acceptance has been one of the fastest developing areas in CEE. In Hungary, before the crisis, more than 90-95% of the issued credit and debit cards were already contactless, as were all the terminals. I do not want to insult anybody or take it as a disadvantage, but I was in Austria for a biking trip this summer, and there was an ATM machine on the mountain. In the restaurant, they said 'cash only', so I had to go to an ATM machine and bring out the cash. That is how I could pay for a coffee.

The instant payment scheme in Hungary has been one of the first to be introduced in the region. Just recently, we have introduced NFC and QR payment as well. In some areas, I believe that not just Hungary, but CEE is ahead of the trend. Other areas that provide a good basis for CEE include lower labour costs and relatively good educational levels. It also provides a stable environment for businesses. Even before the Covid crisis, the CEE supply chains were even more integrated into the European supply chains. Hungary, for example, has particularly significant automotive bases within the EU. Lastly, what is worth mentioning is the geographical location. CEE is a key logistical connection for East-West trade in the world.

I believe this convergence in CEE economies is also visible in the numbers. If you look back, GDP

growth has been at least 1% higher than the EU average over the last year. In 2025, GDP growth is expected to range between 2.8-3.8% for the CEE economies, while it is only expected to range between 1.4-1.6% for the EU economies.

The CEE economy has good mid to long-term prospects, but I am a banker, so I would also like to talk a little bit about the banking market. The banking market in the CEE region really started developing after the economic transition about three decades ago after the fall of the iron curtain. The local banks in the countries were sold mainly to strategic and financial investors. Only very few have been sold through IPO via the stock exchange. OTP is one example, and some of the Polish banks are also examples of that, but the majority of the banking sector is owned by strategic investors, mainly EU-based banks. The banking penetration is still significantly lower than Western European levels both in the retail and corporate sectors. Household debt in the region is only 20% of GDP on average, while it is 46% in the Eurozone and as high as 90% in Denmark and Sweden, so there is a huge gap to fill.

The fragmentation of the market also needs to be mentioned. We still have a lot of banks in the CEE markets. The market share of the top three banks is below 50% in Serbia and Poland and around 60% on average overall in the CEE without the Baltic states, whereas if you look at the Netherlands

and Sweden, for example, it is 88-89%. There is still room for consolidation, which I believe is key in order to reach economies of scale in this market, not just on an individual country level, but already on a regional level.

While OTP Bank is probably less well known than some of our western competitors like Raiffeisen or Erste, if you look closely enough, it is an interesting success story. The bank is 75 years old, and as I mentioned earlier, it was privatised through the Hungarian Stock Exchange in 1995. It now has a very diversified institutional shareholding structure and no state ownership. After the privatisation in the early 1990s, which was years ahead of the competition, it invested a lot in digital developments. In 2000, it started an international expansion.

How have we reached such a success story? I would like to tell it from three angles: growth, stability and profitability. How did we grow? We started our international expansion in the 2000s. We have acquired 25 banks in 13 different countries in the region. The last acquisition was in Central Asia. We were the first of the competition to enter that region when we bought a bank in Uzbekistan. Besides acquisitions, we have also been able to demonstrate very strong organic growth. Since 2016, 60% of our growth has come organically. Today, we are an international banking group with over €100 billion in total assets. This growth

during the last 30 years has been achieved by always maintaining a conservative business model on risk provisioning, capital management and liquidity management. We have always made sure that we are comfortably above the required regulatory minimums. Even in the 2008 crisis, OTP did not require any capital injection from the state, whereas most of our European counterparts needed some help.

Last year, we proved to be the fourth most stable bank in the stress test conducted by the European Banking Authority (EBA). By growing fast, we put a lot of emphasis on stability. What has the result been? Our return on equity has been around 20% every year since 2017. Last year, we achieved a return on equity of 25%. The combination of the three – growth, stability and profitability – is probably pretty enviable to a lot of bankers in Europe because you may have two of the three but you rarely have all three. I am proud to say that, for the first time in its history, The Banker magazine ranked OTP as the largest bank in the CEE. Based on a complex but objective financial comparison, Standard & Poor's global market intelligence unit ranked OTP as the best performing bank among the largest 50 banks in Europe last year, so I believe we have demonstrated that we have a good track record in managing strong growth.

Obviously, this does not mean that

we face no significant challenges. There is political turmoil, a war raging next door, climate change, inflation – I could go on – that we do not have a direct influence upon. However, I would like to highlight three issues which I think should and can be addressed through joint effort by us in this room. Firstly – and I think there has been quite a bit of discussion about this today already – the regulatory arbitrage between the different countries in Europe, which is especially present in the cross-border financial services. The emergence of fintechs and bigtechs on the European stage, which are gaining a significant market share in a relatively short period of time, is probably not only the result of their superior customer experience. In many cases, they do not need to adhere to the same regulations or pay the same tax burdens in the different countries as local players. To a certain extent, they have to manage different data requirement laws as well.

Even the European Bank of Settlements highlighted this in its 2019 annual report in which it called on the importance of closing these regulatory gaps and enforcing the so-called ‘same activity, same regulation’ principle to create a level playing field with the incumbents. It is no wonder that some of the fintechs – I will not mention the names – relatively quickly managed to gain 25 million to 30 million customers within the European Union.

The second issue that I would

like to highlight is less of a CEE specific issue, but more of an issue in the context of the EU and US playing field. It is capital requirement. The EU’s approach is that determining the capital requirement is relatively complex. We have also heard that opinion today. The EU prescribes uniform rules for all member states in some aspects – for example, risk weighted asset calculation methodologies – but it also grants decision making rights to EU bodies, and also to national supervisors, where national supervisors have a flexibility in determining different buffer levels, or the ICAAP and SREP examinations, and so on.

This duality is more complicated and less transparent, which encourages EU-based banks to naturally hold a higher level of buffer than what perhaps is necessary for their US counterparts. We also see the cost of equity difference between EU and US banks. The cost of equity difference is not just big, but it is also increasing over time. A lot has been said about single supervision. This is an area where European banks are losing ground to US counterparts.

The third issue I would like to highlight – as a Chief Digital Officer, I must talk about this – is the importance of technology and technological adaptation. Cloud, AI and quantum computing are all coming our way, and they are all technologies that are crucial for us to implement quickly in order to have a cost-

effective operational structure. All of us, and not just regulators, need to educate ourselves on cloud technology because the adaptation of cloud technology in financial services is significantly more cumbersome than in other sectors. I do not want to say which country, but in one of our foreign subsidiaries, we introduced a piece of group lending origination software, and it took us six months to convince the local regulator to allow us to use it in the cloud. With the Digital Operational Resilience Act regulations coming into force next year, if we decide to change a software then we will have to repeat the same process. This time lag to introduce new services and new technologies is much too long.

These are the three main issues that I would like to highlight: the regulatory arbitrage, the difference in the capital requirements between the EU and the US and trying to adopt technology at a quicker pace in financial services. As I said, I believe that CEE is in a good position over the medium and long term. The banking sector has a lot of potential in terms of increasing the penetration of financing in not just the household sector but also the corporate sector. I am very happy that this conference is taking place today and we can discuss it more in one-to-one or more informal conversations. Thank you very much for your attention.

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