

# VIEWS

## THE EUROFI MAGAZINE

FEBRUARY 2024

### VINCENT VAN PETEGHEM

Deputy Prime Minister and  
Minister of Finance, Belgium

Belgian views on how  
to finance the EU  
competitiveness agenda



#### P. WUNSCH

Too good to be true?  
Financial stability and the great  
reversal in interest rates



#### M. MCGUINNESS

Keeping Europe's financial  
sector competitive



#### J-P. SERVAIS

IOSCO delivers on key  
priorities and will continue  
its leading role in 2024



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**EUROFI REGULATORY UPDATE**

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**EUROFI VIEWS MAGAZINE**

# THE EUROFI VIEWS MAGAZINE

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FEBRUARY 2024

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This bi-annual Views Magazine comprises contributions from a wide range of public and private sector and civil society representatives on the macro-economic challenges Europe is facing and their implications for finance, on-going industry trends such as digitalisation and sustainable finance, pending financial stability and environmental risks and the main policy initiatives underway in the banking, insurance and capital market sectors to address these evolutions and risks.

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DIDIER CAHEN



MARC TRUCHET



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This new edition of the Eurofi Views Magazine is published on the occasion of the High Level Seminar organized by Eurofi in Ghent in association with the Belgian EU Council Presidency.

The macro-economic challenges facing Europe and the main regulatory and supervisory developments in the financial sector at the European and global levels will be discussed during this Seminar, as well as key industry trends such as the use of new technologies in finance and the development of sustainable finance and the related policy implications. As a new political cycle is approaching, we are also initiating during this Seminar a discussion about the priorities for the incoming European Commission in the financial area, which will be pursued by Eurofi throughout this year.

In the following pages, you will find more than 230 contributions and articles drafted by the public and private sector and civil society representatives participating in this event on the themes that will be addressed during the Ghent Seminar. We are very grateful to the contributors for this significant input, which provides a comprehensive overview of the latest thinking on trends and issues affecting the financial sector and the policy actions needed to address them. We are sure that you will read their thoughts and proposals with great interest.

The Eurofi Secretariat has also published several papers on these topics in the latest edition of the Eurofi Regulatory Update, which we invite you to read. The Eurofi macro-economic and monetary scoreboards have also been updated, providing a detailed perspective on the European macro environment.



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## DAVID WRIGHT

President, EUROFI

A warm welcome to EUROFI, Ghent, our 37<sup>th</sup> edition which is taking place at a particularly important moment in the history of Europe. The EU is facing formidable challenges - the war in Ukraine, its own security, pressures to enlarge, its underperforming economy and environmental degradation....

On behalf of all the members of EUROFI and all participants, I thank most sincerely the Belgian Presidency of the European Union and the Central Bank of Belgium for their considerable support to enable this major event to take place.

Since EUROFI, Santiago De Compostela, the European Union has lost one of its great statesman and leaders, Jacques Delors. His contribution to the process of European integration was in every sense immense. He shifted the European integration dial, from a long period of stasis and sclerosis to a period of dynamic activity and growth in the late 1980's and 90's. He created self-belief and optimism in the European project and its future through the delivery of the massive Single Market Programme and by laying the foundations for the single currency. He was intellectually rigorous - serious, cartesian, determined, a visionary but also practical and realistic - supported by a brilliant cabinet, headed by Pascal Lamy.

In one of his great speeches on Europe he posed two fundamental questions:

- *Quels sont nos intérêts communs?*
- *Quel est le niveau de notre ambition...?*

Two questions that are as relevant today as they were in his time. We should, as Europeans, continually ask ourselves these questions and try harder, by working together, with respect, constructively, cooperatively, to define very clear answers particularly now as this European political cycle is ending and a new one will begin in the autumn of this year. This focus I think will be the dominant theme of EUROFI, Ghent.

Our European common interest in the economic and financial spheres, which underpin all other policy areas, is to make the European economy stronger and more competitive -

with more robust, faster, sustainable growth, with greater resilience, diversity and depth- a more innovative economy, with the fullest employment and with manageable public debt. A democratic, law abiding and inclusive EU that offers peace, prosperity and opportunity to all its citizens. A European Union that is indeed a model and an example to the rest of the world.

### What is the level of our ambition?

It should be very high, visionary, inspiring - to cement the essentials of European integration and security where it makes evident sense to do so at European level in full respect of the subsidiarity and proportionality principles of the Treaty. Our ambition should be derived from unimpeachable economic and social evidence that European integration in certain key policy areas is the best formula for all Member States of the European Union.

The level of our ambition means to lead, to shape, not lag. To have vision and clear goals as Jacques Delors demonstrated so effectively with the clear 1992 timeframe to deliver the core aspects of the Single Market.

The regrettable reality today is that economically and financially the EU is lagging - falling further behind year after year.

Compared to the U.S, we have lower growth and have had for many years, far smaller fragmented capital markets, no banking union and very few global scale financial, IT or industrial companies. The overall quality and productivity of EU and MS public spending is far from efficient, aggravated by spiralling public and private debt. Whilst global warming is causing more and more damage, it seems fewer European economic actors believe that pursuing a sustainable economic model can be a winning suit.

Our ambition is being further curtailed by over-complex EU decision-making that is too slow and cumbersome for the digital world we live in. An EU that is simply not innovative enough; that is not developing its best pioneering SMEs into

world beating companies located inside the Union - in fact more and more are deciding to list in the U.S.

In spite of the evolving and important €800 billion NGEU programme whose absorption needs to accelerate in the Member States, overall, the EU is underinvesting in its future - too fragmented, punching far below its collective economic, trading and geo-strategic weight. And even worse, on its doorstep, Europe is facing 2 ferocious, ugly and dangerous wars.

More positively however, we have the means within our collective compass to change these trends. Our European destiny is in our hands.

We can start by deploying “la méthode Delors” to define our collective interests and our ambition for the next European political cycle for economic and financial integration. This means more ambition, more political drive and more focus on delivery. It also requires taking account, case by case, the different economic and cultural characteristics of the Member States. I see 6 key issues if the EU is to make the quantum leap needed to ramp up the EU’s long-term economic and financial performance:

1. **Capital markets union, banking union and enhancing pan-European competitiveness cannot be delivered without much stronger, hands-on political support at the highest level by all the key EU institutions.** Today these key policy areas remain undelivered. The European institutions in almost all cases have not been sufficiently supportive of these projects in order to drive forward timely agreements. There are indeed no delivery timetables, nor agreed monitoring mechanisms. The few highest level political declarations there have been, unfortunately, have been weak and far too general to have had any galvanising effect and the sum of them have not increased political momentum.

As I have suggested for many years the new European Commission, the European Council and the European Parliament, supported by the ECB, EIB and the ESAs should draw up as a top priority a Tripartite political agreement to deliver these vital projects in the next cycle - with an agreed, politically binding timetable and a strict monitoring mechanism. This alone will create momentum and trigger market and international investor interest.

2. **The Commission should coordinate, now, a Financial Cecchini report i.e carrying out a set of in-depth, rigorous, unimpeachable, empirical economic and social studies covering all the Member States to demonstrate the benefits of**
  - lowering the cost of capital in the EU;
  - deepening the liquidity and depth of EU capital markets;
  - enlarging the supply and range of different financing instruments;
  - increasing cross-border banking activity and competition with a genuine Banking Union.
3. **Encouraging significant EU capital market integrating moves through major cross-border infrastructural mergers in the stock market, clearing and settlement**

**domains to create pan-European scale and so trigger the logic of the “European dimension”.** International investors and players will sit up and take notice that the EU is really moving forward.

4. **Governance. If we desire European capital and banking markets we need to apply that logic to regulation and supervision by the EU’s institutions.** This does not mean for example transferring all supervisory competences to the ESA level. 40 000 German broker dealers should not be supervised by ESMA. But major financial institutions that trade cross-border and that are potentially systemic at the European level should be supervised at the European level with the ESAs delegated sufficient additional disciplinary and sanctioning powers and a full tool box to ensure there is one prevailing European rulebook, not 27.

Also under the label of governance, the ESAs own governance arrangements should be changed. Their governing Boards should be replaced by an ECB type governance model, with their leaders and small number of Executive Board members elected directly by the Council and European Parliament on the basis of European Commission proposals. Their mandates must be European, not de minimis national compromises.

5. **Defining a smaller number of legislative and regulatory priorities for the next cycle and rigorously delivering them. Such as...**

Sensible securitization; making private pan-EU pensions work, so upgrading the PEPP; delivering withholding tax simplification and harmonisation; securing necessary insolvency convergence; completing the banking union...

6. **Setting ambitious technology targets for the next cycle, eg:**

- T+1 and eventually T+0 for EU clearing and settlement;
- Ensuring AI and DLT benefit European financial consumers and market integration;
- Using technological means to support retail consumers (eg by supervisor approved robo-advice models and through more widely disseminated lifecycle financial education)...
- Improving the transparency and the velocity of data reporting to regulators, inter-alia to help reduce system risks.

I believe acting on these 6 themes will mean the EU’s economic and financial integration will move forward very quickly.

I look forward to seeing you all in Ghent and listening to the discussions. There will be more than 1200 top rank delegates from all across the EU and from around the world present to debate where we are today and what our priorities should be for the next European political cycle.

Let us define our common European interests, let us be ambitious.

Inspired by the work of Jacques Delors, a truly great European leader.



Q&A

VINCENT VAN PETEGHEM

Deputy Prime Minister and  
Minister of Finance, Belgium

**Belgian views on how to finance the EU competitiveness agenda**

**What are the main priorities of the Belgian EU Presidency in the economic and financial areas?**

This 13th Belgian Presidency clearly is a special Presidency. With the European elections on the 9th of June, and the dissolution of the European Parliament in April, the Presidency will be divided in two parts with a different outlook. The European legislative train will keep on running at high speed in the first months, while in the second part of the Presidency we will mainly focus on the strategic agenda of the next European Commission.

The economic and financial challenges that we face as a Union are mounting. The main overarching challenges for the Belgian Presidency in the economic and financial sphere are enhancing our EU competitiveness in a world of growing geopolitical uncertainty, and regaining our strategic autonomy. Shaping a resilient and predictable economic environment will be key. Significant challenges equal significant investments.

Specifically, as chair of the Ecofin Council, I see two main underlying political priorities. Firstly, we need to work on protecting our taxpayers, and strengthening their purchasing power. Taxpayers should feel respected. They should be confident that they will receive protection in return for their contributions to our society. Good healthcare, robust pensions, top education: those are key elements of our European welfare states. When confidence in that welfare state is under pressure, societies are under pressure too.

Secondly, we need to work on strengthening trust between citizens and financial institutions. Today, however, we see cracks emerging in citizen's trust in our financial institutions. In recent months we have seen various Member States resort to a wide array of different measures to restore confidence. I am convinced that it is time to make a strong stance together. Because trust is crucial for the stability of our economic and financial system, and by extension our Union.

Around these two ambitions we are finalizing the legislative agenda of this European Parliament's tenure. Which will be

the finalization of the review of our economic governance review, the completion of the Banking Union with of course the Crisis Management and Deposit Insurance package, and the deepening of our Capital Markets Union where we still have some files to finish before the end of this mandate. Moreover, a topic that remains high on the agenda is the current situation in Ukraine and its financing needs. The Belgian Presidency is fully committed to keep providing the necessary support for Ukraine.

**What are the priorities to improve the competitiveness of the European economy vis-à-vis the United States and China?**

As we are preparing the work program of the next Commission, clearly one of the main challenges will be enhancing our overall competitiveness. We can fairly state that the European regulatory burden is heavier compared to the United States. By showcasing solid, clear and coherent legislative frameworks, we can tackle the problem of the European red tape, notwithstanding that the single market must operate within clear guidelines that support the main strategic goals of the Union.

At the moment, many economic players consider the European Union as too rigid, too bureaucratic. The Commission's strategy on long-term competitiveness sets out the goal of reducing burdens associated with reporting requirements by 25%, without undermining the policy objectives of the concerned initiatives. As Belgian Presidency, we fully endorse this objective.

We cannot deny the economic and financial firepower the United States and China showed in the last years. President Biden's Inflation Reduction Act and the state subsidy schemes driven by Beijing are difficult to match. However, the answer will need to be European. Member states could foster competitiveness at a national level, but a team of 450 million

Europeans stands much stronger. When developing a reaction, we should avoid fragmentation. In my view, more investment equals more integration. This will require a fully-fledged European capital market, and a strong European state aid framework. We cannot have Member States creating a subsidy race amongst themselves. We need to protect our European interests, and cannot allow to create market fragmentation.

An integrated response could come from a revision of our European industrial policy framework. We should mobilize investments both in the public and private sphere. On the public side, after the revision of our budgetary rules taking into account investments and reforms, we should start looking at a possible follow-up of our Recovery Fund. Moreover, we should review the European Investment Bank as the biggest multilateral investment bank in the world. On the private side, we need to further strengthen the Banking Union to ensure stable banks and stable financing for companies. At the same time, we need to further deepen and create a true European Capital Market.

### In which areas are common policy responses needed to the economic competitiveness challenges facing Europe and what should be the way forward?

Clearly, national policy measures require more and better coordination. Even though the current economic landscape is marked by resilience, we are often faced with numerous challenges and crisis situations posed by geopolitical uncertainties. For example, when we are all faced with an energy- and supply chain crisis, and subsequent general price hikes, we need to coordinate our policy responses. The implementation of certain national subsidy schemes or tax incentives do have an impact on other Member States, therefore require clear coordination.

When it comes to European responses, on multiple occasions I have stated that we should look into 'NGEU 2.0', a new central fiscal capacity. However, before discussing the potential establishment of a new fiscal capacity, it is essential to evaluate the current Recovery Fund. That is precisely why we will conduct a mid-term review the Recovery and Resilience Facility during our Presidency. The historical European crisis response worked, but we should stay critical. The disbursement rate is too low. The process is too rigid, too sticky. There could be various reasons for this, which we will discuss during the review.

Moreover, in any potential follow-up of the current recovery instrument, trans-European investment project should play a more significant role. Amongst others, here I am thinking about major investments in European mobility, such as HST-lines, trans-European energy distribution grids or EU-level defense projects.

### How to strengthen the Banking Union and deepen the Capital Markets Union? What impact can be expected from these initiatives?

The further strengthening of the Banking Union and deepening of the European Capital Market are two top priorities of the Belgian Presidency. Of course, public sector investments will need to materialize too, but given the amounts at stake the financial sector has a major role to play.

Both the banking sector and financial markets are essential players. As far as the banking sector is concerned, the reforms undertaken in recent years in the wake of the financial and sovereign debt crises have made it more stable and resilient. It is therefore in a position to continue financing the real economy by granting credit to businesses and individuals. Of course, we should not rest on our laurels. Our financial stability remains a key priority. We should at all cost avoid taxpayers having to come in when banks would get into problems. But on the other hand, we also need a banking union that allows citizens and companies to find the necessary financing to support our economy.

As for financial markets, they clearly must play a greater role. There are some important legislative files to be finalized under the current CMU package, such as the Listings Act. Apart from the low-hanging fruit that needs to be finalized, we also need to start thinking about the Commission's next Work Programme. What should the Capital Markets Union look like in 2030?

We of course have set some small steps forward during this mandate, but we are still acting too fragmented when it comes to leveraging the necessary private capital. And here I am not only talking about institutional private capital but also citizen's savings. The informal Ecofin meeting in Ghent will be an important moment of debate, where we will have particular attention for financial literacy of our citizens. According to an OECD survey of adult financial literacy from 2020, about half of the EU adult population does not have a good enough understanding of basic financial concepts. This topic of financial literacy, and especially the lack of financial literacy that we see within our households, was also one of the observations that emerged from the issuance of our Belgian State Bond at the end of last year.

We all know that a stable financial system is built on trust. Therefore, we need to work on strengthening trust between citizens and financial institutions. This requires both stronger institutions and better financial literacy of our citizens. I am convinced that it is time to take a stance together and to work on both fronts. Because trust is crucial for the stability of our financial system, and by extension our Union.



Q&amp;A

PIERRE WUNSCH

Governor - National Bank of Belgium

## Too good to be true? Financial stability and the great reversal in interest rates

What a ride it has been for interest rates! After the Global Financial Crisis and the euro area sovereign debt crisis, interest rates across all maturities and for all borrowers were lowered to record-low levels. As from mid-2022, however, we have witnessed a spectacular reversal of this trend. To wit, the ECB's main policy rate has stood at 4% since September 2023.

The past decade has held many surprises. In the period of ultra-accommodative monetary policy, inflation persistently surprised on the downside. This situation reflected the diminishing returns of monetary policy at rock-bottom interest rates, as spending became less responsive to ever-lower borrowing costs. At the same time, concerns arose about the side effects and risks that years of negative rates could generate. High on my mind were over-investment in non-productive assets, the belief that budget constraints were outmoded, an overly enthusiastic search for yield, and rising leverage. In particular, a sharp reversal in interest rates risked exposing certain accrued vulnerabilities.

During and after the pandemic, an unseen combination of shocks related to both supply (e.g. strains in global supply chains and energy price spikes) and demand (e.g. the resumption of spending, fiscal policy support and the maintenance of low interest rates) caused substantial and persistent underpredictions of inflation. As a response, the ECB embarked on a steep rate-hiking cycle.

It is perhaps also surprising that this abrupt turnaround in monetary policy has not, at least so far, led to financial stability issues in the euro area. Banking problems have been confined to the US and Switzerland, and corporate and sovereign spreads have remained contained. House prices have declined in many countries, but in an orderly fashion, and sovereign debt ratios have also come down in many - but not all - euro area countries.

The comparative resilience of the euro area banking sector can be explained in large part by the strong capital and liquidity buffers to which EU banks are subject under the Basel rules, which were significantly beefed up following the Global Financial Crisis. These buffers helped to avoid an undue tightening of credit conditions and contributed to an orderly downturn in the financial, credit and real estate cycles.

In addition, the absence of financial stress could also indicate a degree of fundamental uncertainty for central banks regarding the stance and transmission of monetary policy at the current juncture. One possibility is that the rise in nominal interest rates seen thus far has been only a mild monetary tightening. After all, real interest rates are barely positive and domestic inflation remains high and helped to inflate debt away. Nonetheless, the financial markets are pricing in a swift return to price stability: inflation expectations remain anchored and long-term interest rates are down again as investors expect central banks to start easing soon after an immaculate disinflation. That being said, it may be too early to get our hopes up. Wage pressures continue to be high, labour markets remain tight and bond markets can change course quickly, as the late summer sell-off illustrated. Therefore, I believe one should not discard a scenario in which monetary policy stays tight for longer than currently expected, one that would also be associated with more pronounced risks to financial stability.

A second possibility is that the tightening has yet to be fully transmitted to the real economy. Although interest rates have risen rapidly, economic agents' decisions may be less affected by the current turnaround in rates than in past tightening episodes. Many borrowers, including sovereigns, lengthened the maturities of their borrowings when financing conditions were more attractive. This now affords them some protection against higher rates, at least for a certain period of time. The large cash buffers built up by firms and households over the last few years also provide temporary relief from higher borrowing costs. To the extent more pronounced pressures in the monetary policy transmission pipeline are relevant, central banks should be mindful of the fact that these could put a strain on financial stability down the road and, in general, factor such lags in when setting the policy stance.



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**the Belgian Presidency of the EU Council**



Q&A

**VALDIS DOMBROVSKIS**

Executive Vice-President for an Economy that Works for People, with responsibility for Trade - European Commission

## Looking back, looking ahead: strengthening the EU's competitiveness and economy

**What are the priorities for improving the competitiveness of the European economy and what actions are being undertaken by the EU?**

Europe's main and longstanding bottleneck to economic growth relates to its low growth in productivity. However, this is now compounded by new challenges related to disruptions in global supply chains, the energy crisis and heightened geopolitical tensions.

They have further exposed our economic vulnerabilities and dependence in several areas, especially in technologies vital to the green and digital transitions.

To address these issues, we have proposed a strategy identifying nine key areas where we need to focus to maintain the EU's competitiveness: from investment and financing to open trade and skills, along with smarter regulation.

To start with, the EU is reinforcing its open strategic autonomy and economic security, and de-risking its supply chains. We need to maximise the benefits of trade openness, while minimising our strategic vulnerabilities.

For example, we are diversifying by developing mutually beneficial strategic partnerships with reliable partners, such as in critical raw materials.

A strong single market is key, reinforced by a well-functioning Banking Union and more integrated and deeper capital markets.

So we need to make more progress with building a genuine Capital Markets Union: it is the most cost-effective way to drive capital towards long-term investments.

The single market plays a key role in building a resilient economic base that will keep us competitive in the long term. We are taking action to strengthen it, leveraging its internal and external dimensions and resilience.

For example, the Single Market Emergency Instrument will ensure greater transparency and coordination when a critical situation emerges. This will help to mitigate harmful impacts on the single market, protect the free movement of persons, goods and services and maximise the availability of products needed in the crisis response.

Lastly, we are working to create an attractive EU business environment - with skilled workers, a smart regulatory environment with reduced administrative burdens for companies. The Commission has set a target of reducing burdens associated with reporting requirements by 25%.

**How is the EU addressing public debt sustainability issues and the related fiscal challenges? How to make the new rules sufficiently credible?**

The weaknesses of the EU's current fiscal rules are well known. They relate to a lack of ownership and enforcement; they are too complex; they have not been able to reduce public debt where it is too high.

The Commission's proposals include several features that should help to overcome these problems.

First, the new rules entail moving to a more risk-based surveillance system that puts public debt sustainability at its core, and also promotes sustainable and inclusive growth.

Second, the trajectory to reduce deficits and debt should respect common criteria and safeguards. It can be more gradual if a Member State commits to specific reforms and investments that comply with specific and transparent criteria.

Then, while the rules would give Member States more control over designing their medium-term plans, there would be closer monitoring via a control account and stricter enforcement regime. For the new rules to be credible, enforcement is key.



Finally, using net expenditure growth as - effectively - the sole operational indicator for fiscal surveillance would simplify the implementation.

At this stage, interinstitutional negotiations on the new rules are moving ahead.

Co-legislators are working hard to conclude the legislative process before the European Parliament's recess.

While there are likely to be some differences compared with the Commission's proposals, it is vital that the key elements of our proposed approach are retained.

In the meantime, coordination of fiscal policies takes place on the basis of the current rules. In particular, Member States have been recommended to move to more prudent fiscal policies, with quantified net expenditure limits for this year. And, as already announced, the Commission will propose that the Council open deficit-based excessive deficit procedures in spring 2024 based on the basis of 2023 outturn data. While the new EU fiscal rules could be in force by then, the deficit-based EDP is expected to remain unchanged.

## What are the expected impacts of NGEU and is it up to the challenges facing the European economy? What further actions are needed to boost productive investment in Europe?

---

We are now halfway through implementing the Recovery and Resilience Facility (RRF), the centrepiece instrument of NextGenerationEU.

To date, more than €221 billion has been paid out to Member States after they fulfilled specific milestones and targets for putting agreed reforms and investments into effect.

Last year, Member States revised their national plans to speed up the energy transition and decouple from Russian energy imports. Since then, RRF implementation has accelerated.

The RRF has directly supported companies, including many SMEs. It is supporting strategic investments in green and digital industries and also improved funding conditions for corporates - thanks to loan, equity and hybrid instruments.

The type and intensity of support varies by Member State depending on its priorities.

Overall, the RRF is helping to develop a more friendly business environment. For example, most Member States are simplifying administrative and planning procedures, along with many other structural reforms.

We have never seen EU countries carry out such a wide-ranging set of national reforms. They address long-standing recommendations within the European Semester, such as reforming labour markets and addressing aggressive tax planning.

I am also confident that we will see more positive effects from the RRF in the years ahead.

Since investments often involve a longer timeframe, implementation should pick up further towards the later years of the RRF, in 2025 and 2026.

The EU will continue to provide incentives, funding and the appropriate legal environment to drive investments towards green technologies.

Although coordinating tax incentives and subsidies at the EU level could help to harmonise policies across Member States, reducing discrepancies and creating a more level playing field for businesses and households operating within the EU single market, the EU has limited power to coordinate tax incentives or subsidies for households and businesses. Tax policies are the responsibility of Member States.

From the Commission's side, we are ready to facilitate dialogue among Member States - if there is political will - ensuring compliance with EU rules, including state aid regulations.

Striking the right balance between the benefits of harmonisation and the desire for national sovereignty and flexibility is a complex task. It calls for careful consideration of the economic, political and social implications - for all Member States.

## Are the Banking Union and the Capital Markets Union making sufficient progress and what are the priorities ahead? What impact can be expected from these initiatives?

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We have made a great deal of progress over the years with these two flagship projects: the Banking Union and Capital Markets Union. Both are essential for the EU's long-term growth and competitiveness. But there is still work to be done.

The first two pillars of the Banking Union are in place: supervision and resolution.

Its third pillar, the European deposit insurance scheme (EDIS) is still missing.

This remains a priority for the Commission, whose proposal is still on the table.

At present, we are focusing on our proposal to strengthen the EU's existing system for bank crisis management and deposit insurance. This aims to make sure that all failing banks can be handled more effectively and coherently should the need arise.

On the Capital Markets Union: we have made significant advances since the first action plan in 2015. But this is a long-term project. It cannot be completed with a single measure. And it cannot generate benefits overnight.

To date, the Commission has completed - or is on track to complete - all the initiatives in the 2020 action plan. Several proposals are being negotiated by the European Parliament and Council: for example, the Listing Act and Retail Investment Strategy.

We now have to finalise these negotiations and focus on areas for the next mandate, potentially considering areas such as securitisation, pensions and venture capital.

Completing these two projects will boost the EU's competitiveness. We need our banks and capital markets to be strong and resilient. They help the EU to tackle the big global challenges, finance the green transition and the digital transformations.



Q&A

**JEAN-PAUL SERVAIS**

President - Financial Services and Markets Authority, Belgium (FSMA) & Chair of the Board - International Organization of Securities Commissions (IOSCO)

**IOSCO delivers on key priorities and will continue its leading role in 2024**

**Sustainable finance, crypto and NBFi risks: what were IOSCO’s main achievements in 2023 and what are the priorities for 2024 in these areas?**

Since my election as IOSCO Board Chair, I have stressed the importance of speed to maximise the impact of our work on sustainable finance, crypto-assets, and non-bank financial intermediation (NBFi). I am proud to say that in 2023, we have delivered on these priorities, in line with IOSCO’s work programme.

First and foremost, we have achieved significant progress on the sustainable finance agenda. This includes the historic endorsement by IOSCO of the first sustainability disclosure standards of the International Sustainability Standards Board (ISSB). This decision to endorse the inaugural framework marks a major step towards consistent, comparable and reliable sustainability information. This endorsement is in line with IOSCO’s objective to provide a comprehensive toolkit for both sustainability-related disclosure and related assurance standards that should be available to jurisdictions and issuers for the 2024 accounts. As such, IOSCO is looking forward to the forthcoming ISSB Adoption Guide, which will set out pathways for the implementation of the ISSB Standards. IOSCO is committed to collaborating with the ISSB and other global stakeholders to deliver a sound capacity building program to support the wider roll-out of sustainability disclosures.

Besides the disclosures themselves, IOSCO has stressed the importance of building trust. It is our view that trust in disclosures will be enhanced when they receive external assurance based upon globally accepted technical and ethical standards, and also around independence of assurance providers. This is why IOSCO welcomed the consultation by the International Auditing and Assurance Standards Board (IAASB) on the proposed International Standard on Sustainability Assurance (ISSA) 5000 and why we are looking forward to the publication of the International Ethics Accounting Standards Board’s Exposure Draft for sustainability reporting and assurance.

At COP28, IOSCO was represented by a strong delegation. During the conference, IOSCO published a consultation report on Voluntary Carbon Markets (VCM). The report outlines a set of Good Practices to promote the financial integrity and orderly functioning of the Voluntary Carbon Markets (VCMs). This represents an important step toward a proposal which will contribute to Good Practices to promote financial integrity in these markets.

The second priority was about crypto-assets regulation. The cross-border nature of crypto markets poses inherent risks of regulatory arbitrage and of harm for retail investors. One of the primary goals of IOSCO has been to promote greater consistency in how its members approach the regulation and oversight of crypto-asset activities. In 2023, IOSCO fulfilled its commitment to deliver a globally consistent set of policy standards, as envisioned by the G20, to protect investors and safeguard market integrity. In accordance with IOSCO’s Crypto-Asset Roadmap, IOSCO published 2 sets of recommendations. These recommendations are designed to support consistency in the way crypto-asset markets and activities are regulated, in accordance with the principle of “same activities, same risks, same regulatory outcomes”.

After the delivery of these recommendations, IOSCO must now focus its efforts on promoting, supporting, monitoring and assessing adoption and implementation of effective regulatory regimes for crypto-assets across IOSCO member jurisdictions. The efforts will be coordinated with other international organizations such as the FSB.

Concerning the third priority, IOSCO has also redoubled its efforts to address structural vulnerabilities in non-bank financial intermediation (NBFi), in partnership with the FSB. At the end of 2023, IOSCO and the FSB jointly published reports on liquidity risk and its management in open-ended funds (OEFs). The joint publication underscores the excellent partnership between them and their joint commitment to significantly strengthen financial stability. It also concludes a period of in-depth work at the international level, emanating from the March 2020 stress episode, to better understand the vulnerabilities of liquidity

mismatch in OEFs, to assess the extent to which existing recommendations have been implemented and have been effective, and to develop appropriate policies to further enhance the resilience of OEFs. IOSCO's guidance on anti-dilution liquidity management tools (LMTs) and the revised FSB recommendations achieve a significant strengthening of liquidity management by OEF managers, as compared to current practices. This will lead to improved investor protection and will support financial stability. IOSCO will further operationalize the revised FSB recommendations in 2024 (and beyond) through amendments to the 2018 IOSCO recommendations on liquidity risk management and supporting good practices, as necessary.

We look forward to continuing this successful cooperation with the FSB in 2024, by addressing financial stability risks from leverage in NBF1, to which a new workstream has been devoted by the FSB.

Indeed, the time is ripe to undertake policy work to improve our ability to identify, monitor and contain systemic risk arising from leverage in NBF1. This work will be co-led by a member of the IOSCO ecosystem, alongside a representative from a central bank, to ensure the views and expertise of securities regulators are well accounted for.

Addressing risks stemming from leverage is about identifying the common denominator between the relics of 2022 Gilt crisis and the fall of Archegos.

### How important is cross-border cooperation between authorities at the global level and is it improving?

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Cross-border cooperation and collaboration between financial regulatory authorities has been a constant and continuing theme for IOSCO. Although there are some risks of fragmentation due to current geopolitical tensions, global trends within our remit such as crypto-assets or sustainable finance will benefit from IOSCO's contributions to globally coordinated policies. We develop, implement and promote adherence to internationally recognized standards for capital markets.

Let me remind you that IOSCO's membership is composed of securities supervisors who regulate more than 95% of the world's financial markets across 130 jurisdictions, including more than 90 members from Growth and Emerging Markets. This feature makes IOSCO unique amongst other financial standard setters in its ability to reach jurisdictions. IOSCO recommendations also benefit from the input of its wide membership thanks to the great work done by its regional committees. This explains IOSCO's excellent record in ensuring the timely and fair implementation of its standards and recommendations across the world.

One of the key initiatives aimed at promoting supervisory cooperation is the IOSCO Multilateral Memorandum of Understanding (MMoU), which enhances the ability of securities regulators to cooperate on enforcement matters and share information. As of 2023, over 129 jurisdictions are signatories to the MMoU, demonstrating the global recognition of its importance.

### What are the main areas in which IOSCO is currently working to develop standards?

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IOSCO has an important role to play in enhancing international consistency by developing standards and by supporting their due and timely implementation. We recognise that global standards are only as good as their implementation.

We work closely and inclusively with our members to ensure that all 130 member jurisdictions embark on the journey. IOSCO's process of policy development and implementation benefits from the expertise of the Regional Committees and of the Growth and Emerging Markets Committee, and is based on a comprehensive and thorough bi-annual risk outlook. As mentioned before, these committees play an instrumental role in building capacity across the members, which explains IOSCO's excellent track record of implementing its standards throughout its membership.

As regards the sustainable finance agenda, IOSCO insisted on the importance of ISSB standards being interoperable and comparable across jurisdictional regimes. This is key to avoiding double reporting, but also to ensuring the global comparability of disclosures. We need to learn to speak the same language. This is why we are rolling out capacity building programs for regulators and issuers, in order to ensure that the necessary skills are passed on to the right people in a globally consistent manner.

On the digital finance front, we have also supplemented our policy recommendations by an extensive program to monitor and implement the crypto asset recommendations. This will be rolled out in the next few years, and will include collaboration with international organizations such as the FATF and the FSB. I cannot emphasize enough the importance of this coordination at global level, including with other standard setters.

Next to this, we have seen rapid developments of artificial intelligence (AI) technology in the field of financial services and financial markets, which pose new forms of risks and challenges. This global phenomenon should be understood and addressed globally, and IOSCO has a role to play.

IOSCO has a strong convening power, and we are leveraging it to promote adherence to our standards and recommendations.



Q&A

**MAIREAD MCGUINNESS**

Commissioner for Financial Services,  
Financial Stability and Capital Markets  
Union - European Commission

**Keeping Europe’s financial sector competitive**

What has already been achieved to reduce the administrative burden of existing regulation (Listing Act, non-financial disclosures...) in order to enhance competitiveness and what remains to be done by the end of 2024?

Reporting is important in financial services. Companies disclose information about their finances and activities, so that investors have clarity about what they are investing in. Transparency is important to attract financing. Financial institutions disclose information to supervisors, which is important to maintain financial stability and market integrity. But of course there is a balance to be struck, and we are committed to reducing unnecessary burdens.

In October 2023, the Commission made proposals to rationalise reporting and reduce administrative burden for companies. In financial services, the Commission proposed reducing the scope of the EU benchmark regulation, foster sharing supervisory data among national and EU financial supervisors to avoid duplicative requirements, delay sector-specific sustainability reporting rules by two years, and increase the size thresholds defining the various types of companies under the Accounting Directive. The latter has already started to apply, which should reduce financial and sustainability requirements for more than a million companies.

These are significant proposals and complement earlier efforts to rationalise reporting in EU financial services legislation. For example, as part of our strategy on supervisory data, in the recent reviews of rules for banks, insurers and fund managers, the Commission cut or streamlined reporting to supervisors and instructed the European Supervisory Authorities (ESAs) to work on integrating reporting in their sectors. In the Listing Act proposal, which was recently agreed by the European Parliament and Council, we simplified the process of listing on EU stock markets.

We have also taken significant measures to simplify sustainability reporting and address implementation challenges reported by stakeholders, and this remains a key area for the Commission. Another way to lower costs is to help companies to comply, for example through capacity building and practical support. We have to strike the right balance. In the long term, companies have to be sustainable to be competitive – and sustainability reporting can help them manage their transition. Sustainability disclosures are also vital if we want private investors to have the information they need to invest in the green transition.

The Commission is now working closely with the Parliament and Council so that our tabled proposals are agreed in a timely manner. We’re also working with the ESAs so that upcoming technical standards minimise reporting to the extent possible. Work on implementing the supervisory data strategy will also continue, and we’ll explore other opportunities to rationalise reporting requirements without undermining the very purpose of the rules.

**What are the synergies between the Banking Union and Capital Markets Union initiatives and how can these be taken advantage of?**

The Banking Union and the Capital Markets Union (CMU) are complementary projects to address fragmentation in the single market for financial services in different parts of the financial market. A strong and resilient banking sector would help the CMU by reducing systemic risk in the financial system and allowing investors and banks to allocate capital more efficiently. Meanwhile strong capital markets would make the EU economy less reliant on bank funding and help finance innovation. Banks can benefit from CMU: more active markets for securitisation would allow banks to offload risks from their balance sheet more effectively and strong fixed income capital markets allow banks to efficiently raise funds from bonds.

We've made some progress on both projects during this mandate, but work remains to be done. The Capital Markets Union and the Banking Union will continue to be priorities for the Commission in the next mandate.

### What overall assessment can be made of the CMU initiative so far? When can effective impact be expected in terms of growth and integration of the EU capital markets?

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The CMU project is as fundamental as ever for the EU's economic policy objectives and EU competitiveness: it boosts access to finance for EU companies, supports the transition towards a digital and sustainable economy and strengthens the EU's open strategic autonomy in an increasingly complex global economic context. For this reason, it's vital for Member States, private stakeholders and the EU institutions to keep working together on the CMU.

Almost all the legislative measures in the latest CMU action plan have recently been agreed or are being negotiated by the EU institutions. They will have a positive impact on the growth of EU capital markets, improve access to market-based sources of funding for EU companies and make it easier and more attractive for investors to invest in EU companies.

The CMU won't happen overnight. Its effects will take time to become visible. Until then, external factors – notably the macroeconomic and geopolitical environment – will continue to dominate capital market indicators and sentiment.

### What are the main impediments to the take-off of the securitisation market in the EU? What are the main priorities for further developing these activities and the expected benefits?

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Greater use of securitisation can let banks and other lenders free up their balance sheets – giving them the ability to finance the real economy more broadly and more efficiently.

Since 2019, the EU securitisation framework has brought welcome transparency and standardisation of markets, but there is widespread consensus that the EU securitisation market is not used to its full potential. In addition, the investor base of the EU securitisation market remains highly concentrated within banks, when one of the benefits of securitisation is its ability to transfer risk out of the banking system.

The Commission remains fully committed to creating a solid framework for a thriving and stable EU securitisation

market. The impact of certain aspects of the securitisation framework on the EU securitisation market and the breadth of its investor base merit further analysis. That could include transparency requirements, due diligence requirements, supervisory processes, including the assessment of significant risk transfer, capital and liquidity treatment of securitisations in the Basel framework compared to other similar instruments like covered bonds, and non-regulatory factors that might prevent non-bank investors from entering the market. We may need to assess whether measures beyond regulation could also contribute to reviving sound securitisation markets.

### How to make European interests and expected benefits from EU financial integration prevail over national interests and discords among Member States? What are the expected impacts?

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During a crisis, the EU has the ability to come together and act decisively. You can see that in the response to the Covid pandemic and to the Russian invasion of Ukraine. The EU has also shown its ability to respond to big challenges like climate change – for example, putting in place a comprehensive sustainable finance framework to help provide private finance to complement public investment.

But elsewhere, progress can be slow. Take Banking Union, where the European Deposit Insurance Scheme proposal has been with the Parliament and Council for 8 years now, with no meaningful political or legislative progress. Banks have weathered recent crises well; this can lure some people into thinking that difficult reforms may not be needed after all. But we need to be ready for a future crisis.

Beyond readiness, there's a lot of discussion of competitiveness and how we can best help European companies to prosper in good times and bad. It's clear that Banking Union and Capital Markets Union would support the competitiveness of EU countries. Politicians need to take the long view: instead of prioritising short-term national interests, they should look to the benefits to every Member State of integrating EU financial markets.

The costs of not having done this yet are clear. Before the global financial crisis, EU and US GDP were roughly equivalent, and China was about 25 percent of that. Today the US and China represent 150 percent and 109 percent of EU GDP respectively. The euro/dollar exchange rates explains part, but not all of these developments. We can talk endlessly about harnessing the benefits of the single market, but when will we have the courage to actually take meaningful measures to complete the single market for capital? We can act decisively – as we see in the EU's unified response to recent crises – but we need to have the political will to realise our ambitions.



Q&amp;A

**SHIGERU ARIIZUMI**Vice Minister for International Affairs -  
Financial Services Agency, Japan (J-FSA)

## Changing dynamics – How should regulators respond to new challenges

Is regulatory fragmentation increasing at the global level? Are on-going initiatives at the international level sufficient to address market fragmentation issues?

Japan, during its presidency of the G20 in 2019, identified ‘addressing market fragmentation’ as one of its top priorities, and has continued to lead discussions at the FSB and elsewhere. Since the global financial crisis, financial regulators as well as the FSB and SSBs have striven to make the global financial system more resilient and to maintain an open and integrated structure. When introducing new regulations to this end, there have been efforts to minimize market fragmentation, including through continuous jurisdictional coordination and cooperation.

However, we may be witnessing a new surge of fragmentation against the background of emerging technologies and challenges in the financial sector. For example, for crypto-assets and stablecoins, there are significant differences in regulatory and supervisory responses among jurisdictions. To address such issues, the FSB and IOSCO have issued high-level recommendations. To avoid market fragmentation, however, we need to engage non-FSB jurisdictions, given the cross-border nature and rapid innovation of digital assets. Turning to sustainability, we welcome ISSB and others’ efforts to provide for a global framework with interoperability, but the journey has just begun. We must be mindful to avoid market fragmentation in the implementation of the standards while recognizing jurisdictional differences. Another example is in insurance, with the finalization of the Insurance Capital Standard (ICS) for Internationally Active Insurance Groups (IAIGs) planned by the end of 2024. The adoption and consistent implementation of the ICS will greatly contribute to minimizing market fragmentation in the sector. The IAIS is now in the process of assessing whether the Aggregation Method (AM) being developed by the United States as group capital calculation provides comparable outcomes to the ICS. If so, it will be considered an outcome-equivalent implementation of the ICS. Finalizing the ICS and the assessment of the comparability of the AM to the ICS will be among my initial priorities as Chair of the IAIS Executive Committee.

How can regulatory fragmentation issues be effectively tackled and can they be prevented?

Robust international standards and international coordination and cooperation are important to prevent fragmentation. This requires ingenuity in both the process of introducing new regulations and its implementation. For example, in the process of rule-making, we tend to be ambitious in our approach to fully pursue our respective mandates. While being ambitious is completely understandable and needed, we should also consider whether such regulations could be effectively implemented in respective jurisdictions. The FSB and SSBs have been mindful of these aspects, introducing impact assessments and conducting public consultations. During these multilateral efforts, each jurisdiction should consider, if certain standards are agreed, whether they can put such regulations in place. In such consideration, it would be helpful to thoroughly discuss these standards with various domestic stakeholders, making a strong case for credible standards. While this process could be resource-consuming, it can help avoid market fragmentation, such as delay in implementation or partial implementation. Japan may sometimes seem overly cautious in the discussions on international standard setting, but once we agree to one, we have generally been successful in full domestic implementation. This could be attributed to close communication with various stakeholders in the course of impact assessments and public consultations. We fully understand that this is not an easy path and may not be applicable to all jurisdictions, but it would be useful to explore ways to ensure the full implementation of any agreed standards.

It is also true that domestic regulations and supervisory frameworks need not be identical across jurisdictions, but could be tailored, due to the uniqueness of respective jurisdictions and domestic considerations. These differences could be acceptable, but even in such cases, we need to continuously assess whether such differences are aligned with international standards. Peer reviews and the implementation assessment frameworks conducted by the FSB and SSBs will help assist with such alignment. As highlighted by the FSB Report in 2019, we also

need to leverage our supervisory cooperation frameworks and mutual recognition among jurisdictions, which aim at ensuring consistency at the outcome level in the application of regulations.

### Is enough being done to address NBFi risks and potential interactions between the NBFi and banking sectors?

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With NBFi accounting for approximately half of global financial assets, there is increasing concern about the risks that NBFi may pose to financial stability. Some players in NBFi are highly leveraged and interconnected with banks. One example is the case of Archegos, which exposed the vulnerabilities in the NBFi sector, with negative spillovers to the banking sector. Recent episodes have fortified the notion that the NBFi sector may lack regulatory and supervisory oversight compared to the banking sector.

Against this background, FSB, in collaboration with SSBs, has been accelerating its effort to address risks associated with NBFi. MMFs policy proposals and OEFs recommendations have demonstrated the determination to strengthen the resilience of the NBFi sector. Work is still ongoing at the FSB, particularly focusing on leverage in NBFi. In our discussions, it has become clear that comprehensive data collection is critical to fully assess the vulnerabilities in NBFi. Given the diverse entities and activities in the NBFi sector, this is a significant challenge, as regulators currently have access to limited data, including from public data, national statistics, and supervisory data. In addition to a data gap, differences in the extent and granularity of the available data among jurisdictions pose challenges in exploring the optimal regulatory response in the NBFi sector.

While there is no easy answer, FSB and SSBs will continue to work in strengthening data collections and metric building on stocktakes of existing regulations, while assessing the costs of data collection and the resources constraints of authorities.

Having said that, we must remain mindful of the risks and vulnerabilities in the banking sector as seen in the turmoil last March, with some negative spillovers in the NBFi space. Japan's experience in the 1990's was highlighted by a vicious negative feedback loop between banks' NPL problem and equity market

downturn. Fiscal and monetary policy management can also present challenges as seen in the consequences of LDI strategies. Prudent banking regulation and supervision and sound macroeconomic policies remains at the core of financial stability. As an integrated regulator, the FSA is committed to contributing to global stability efforts, including through providing a holistic perspective across the financial sector.

### How important is addressing climate-related risks in the banking and insurance sectors and what are the related policy priorities?

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Given the inevitable transformation that climate change brings to the wider economy and financial system, addressing climate-related risks in the banking and insurance sectors remains our key focus. Climate-related risks are unique in that they are not adequately captured by conventional metrics owing to their high degree of uncertainty and longer time horizons. Due to limited data availability, methodologies for calculating emissions are still in the process of development. Therefore, we do not believe that requiring immediate capital strengthening is an appropriate response to climate-related risks. It is important for banks and insurance companies to assess how climate-related risks affect risks in each category such as credit risk, market risk, liquidity risk and operational risk over the medium to long term and to respond to such risks.

The road to net-zero is a transition encompassing the whole of the economy and requiring long-term efforts. Taking an inclusive approach, engaging with and encouraging all sectors towards our common goal is needed. Japan has been a longtime advocate of 'transition finance,' now a widely recognized concept. In providing transition finance, if banks, for example, can support their clients in proactively managing their climate risk and leveraging new business opportunities, this will be favorable for their risk management through better earnings for their clients. It can also help reduce their Scope 3 emissions.

Operationalizing the concept of transition finance, including through a credible transition plan, is an urgent priority. The FSA's Chief Sustainable Finance Officer, Satoshi Ikeda, is chairing the Transition Plan Working Group at the FSB, and we are firmly committed to advancing this important work.



Q&A

JACQUES DE LAROSIÈRE

Honorary President - EUROFI

## Reflexions on financial Europe

One of the important pillars of the reforms proposed in your 2009 report was to couple more integrated microprudential supervision with a European set up for macroprudential policy. Do you think that we have the right framework in place for addressing systemic risk at the European level?

It is good to note that European banks have weathered the recent turbulence caused by rising interest rates without difficulty, Europe having implemented the Basel rules unlike the United States. But we have to be careful not to be too complacent because there are still headwinds: weak economic growth and increasing defaults.

In my view, there are still several weaknesses at the supervisory level:

- The macro supervision implemented to protect the world from systemic risks has been insufficient. The crisis of 2008, that of 2010 and the resurgence of inflation in the spring of 2021 were neither foreseen as they should have been nor preceded by recourse to macro-prudential supervision.
- I believe that the system we designed in 2009 (ESRB) has not lived up to expectations and that it needs to be reviewed, as I have stressed on several occasions to the Commission. In my opinion, we should have a macroprudential Council separate from the ECB, broader than the existing one, made up of academics and technicians and endowed with real independence.
- Finally, the development of non-banks in recent years continues to concern me; their role in financing the European economy has doubled since 2008. It's a highly leveraged sector that deserves to be closely monitored. Admittedly, some form of regulation - particularly in Europe - has been put in place, but the repercussions of defaults, even if only on the banking sector that supplies these non-banks with liquidity, could pose a problem.

How do you see the future of the eurozone?

I have said a lot on this subject, and you know my answer. In my view, it is problematic for a monetary union to prosper without a minimum level of economic policy coordination, which does not exist today, which undermines the future.

As Europe is not a single nation but a confederation of national states, we have to accept that the EU seeks compromises that optimize national objectives. But a monetary union can only function if a minimum of fiscal discipline is ensured by all States which has not been the case for 25 years. We have a conflicting zone fed by 20 different approaches to economic and fiscal matters. The specificity of the euro currency is that it is not an overwhelming symbol of unity but rather a permanent source of issues to negotiate for the Member States of the euro zone.

The ECB has maintained until July 2022 a questionable negative interest rate policy in real terms, which made public deficits easily financeable: it has reduced the financial difficulties caused by the emergence of spreads. Yet, such an accommodating monetary policy has encouraged general indebtedness and financial instability. It has disincentivized Member States to undertake necessary structural reforms (especially in France and Italy). Overall, this has been accompanied by a decline of growth and of corporate competitiveness in over-indebted countries.

The current intensity of fiscal and economic divergences between EU countries makes it more difficult to define in Europe a common interest, encourages a current policy of "every man for himself", creates a climate of mistrust between Member States which hinders progress in terms of public and private risk sharking and weakens the eurozone.

This overview is not optimistic.

If fiscal, inflationary and economic drift continues in the eurozone, the "virtuous" countries will end up paying for it. This would be the definition of an uncooperative game, where



most players try to evade their obligations by passing on the cost to those who respect them. We must therefore take the Union's destiny into our own hands and not let it drift. If this is to be the case, the logical outcome could well be a new and inevitable eurozone crisis.

### What do you think of the compromise reached by the Ecofin Council in December on the revision of the Stability and Growth Pact?

Public debt levels are at records and fiscal deficits remain way too large in large EU member States (France, Italy, Spain in particular). The fact that money has been thrown at the problems for years has worked against supply-side policy which are essential to raise potential growth, and which have been the orphans of the EMU story.

On 21 December 2023 the Ecofin Council achieved an agreement on the reform of fiscal rules which paved the way for negotiations with the EU Parliament on the preventive arm regulation.

Although the case-by-case framework – which is a specific technical dialogue between the EU Commission and each member State regarding their differentiated multi-year budget trajectory - has been introduced, which is positive, the goal of simplification of the rules has regrettably not been achieved. What is even more worrying is that the Commission's proposal demands from the most indebted countries the smallest effort, which should perpetuate the decline of these economies.

#### There are several areas of concern:

- Countries that are subject to an excessive deficit procedure (total public deficit over 3% of GDP) are exempt from the rule requiring them to reduce their public debt by an average of 1% a year until their deficit falls back below 3%. These countries will only be subject to the procedure once their public deficit has fallen back below the 3%. This is not the best way to encourage the worst performers to reduce their debt to GDP ratio! It's as if the worst performers in a class were exempt from extra effort and sanctions as long as their results remain mediocre.

The quality of public spending and composition on public finances must be given more importance than its quantity. But if countries that are subject to an excessive deficit procedure are not required to reduce their public debt by an average of 1% a year, they will have no incentive to do so. This is an incentive to remain above a 3% deficit for as long as possible. When the level of public debt is at the limit of what can be tolerated, the trade-off in public spending is generally in favour of the most current and unproductive expenditure in order to cope with the next day, instead of giving priority to research, training and well-chosen public infrastructure investment.

- Adjustment implementation horizons seem very long: 4 to 7 years to reduce the public deficit below 3% (the annual adjustment of the structural primary deficit must be 0.5%). Such horizons also extend beyond typical political cycles, and experts deem the Commission unlikely to force a government elected with different priorities in the middle of the seven-year cycle to implement policies agreed by its predecessor.

### How do you explain this lack of ambition in the reform of the Pact?

The postponement of the of budgetary adjustment for countries subject to an excessive deficit procedure is based on two erroneous prejudices:

- The reduction in the public debt ratio is based on a return to very low medium and long-term interest rates, which is likely to prevent budgetary efforts (i.e. cuts in public spending). This is the “easy money” paradigm: an accommodating monetary policy (permanently low interest rates) avoids budgetary efforts.
- Any budgetary adjustment is “by nature” recessionary because economic growth is based primarily on domestic demand.

These two assumptions should lead European countries with excessive debt to continue their economic decline. There are several explanations:

- Recent monetary history (2014-2021) puts the emphasis on the paradigm of easy money which leads to excessive debt that does not stimulate economic growth. Persistent low (or even negative) interest rates over this period have not led to an increase in productive investment but has on the contrary encouraged savers to keep their financial assets in liquid instruments (see Eurofi Scoreboards) and not to channel them in securities geared to long-term investments<sup>1</sup>. Furthermore, persistent low interest rates encourage indebtedness and the proliferation of asset bubbles, increase wealth inequalities and favor a misallocation of resources (e.g. development of zombie firms).

Given the headwinds we face, it would be very unwise to cut interest rates too soon and give in to the desire of the markets. It would be prudent not to rule out the possibility of high interest rates for longer than we think.

- Excessive deficits and debt jeopardize economic growth. They require an increasing tax pressure, which deteriorates further the competitiveness of companies in these countries. Stimulating demand does not translate into increased production but leads to a widening of trade deficit if a country does not have an efficient production system. On the contrary, what is needed to increase potential growth and achieve a better allocation of resources is:
  - To return to primary surpluses as soon as possible,
  - To rationalize of public spending – qualitative public spending must be an absolute priority – in countries where the public spending-to-GDP ratio exceeds the European average,
  - To steer supply side-oriented reforms that enhance productivity gains.

1. *Long-term investments do not produce returns consistent with the risks involved in such projects. So, savers act rationally and prefer to keep liquid banking accounts that are easily mobilizable. This is the “liquidity trap” feared by Keynes which is particularly severe in European countries that do not have the risk appetite for equity that characterizes US markets.*

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Q&amp;A

## PHILIPP LOTTER

Managing Director - Head of Global Ratings  
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### Euro area credit outlook: navigating growth and challenges in an election year

#### What's your outlook for the euro area economy this year?

We expect real GDP growth will remain slightly below potential, at 1.1%, because of the effects of past monetary policy tightening and softer external demand.

Still, there's better news ahead as a strong labour market and lower inflation will support sustained consumer spending. The EU's NextGen EU (NGEU) funds will continue to boost investment, helping growth to return towards potential, around 1.3-1.4%, from 2025.

It's important to understand how these trends will affect households – since this will shape policies and outcomes in this bumper election year. For most people in the euro area, this level of growth should be enough to maintain living standards. But governments will have little headroom to tackle inequalities – so social risks and demands remain high. This will be a key credit theme this year and beyond.

#### Why has Europe's economy fallen behind its global rivals and how do you think it could become more competitive, especially against the US and China?

Over the past 20 years, Europe's comparatively weaker labour markets, lower capital formation and less efficient use of capital and labour mean growth has been slower than in the US.

We all know that population growth in the US is set to rise faster than in the euro area, but the US economy also benefits from higher employment rates, longer working lives and a more flexible labour market.

Europe's employment situation has improved over the past decade as labour market reforms introduced greater flexibility,

particularly in countries such as Portugal and Greece that were significantly hit by the euro area sovereign debt crisis of the early 2010s. Reforms in France in recent years have also improved employment rates. And furlough schemes introduced during the pandemic helped avoid labour market scarring and preserve previous gains. But while these measures have increased participation rates they are not enough to fully offset Europe's demographic disadvantage.

Europe's shortcomings in capital and productivity are partly caused by its less diverse and less flexible environment for investment financing. Non-bank financial sectors, including fixed income markets, aren't as deep as they are in the US and investors in the region are less open to early-stage riskier investments.

The EU's productivity growth gap also reflects lower spending on research and development – at only 1.5% of GDP in 2020, compared with 2.6% in the US. And the US also invests more in sectors with higher productivity growth such as information and communication technologies (ICT) – partly because in the EU there is limited access to financing for riskier investments.

What can be done? The EU and individual Member States continue to explore a range of regulations and policies to encourage companies to invest and innovate, while taking into account related social risks – especially potential job losses – and costs. While governments seek to balance these against related risks, there is no coordinated strategy to fundamentally improve competitiveness in these areas.

**So far, EU plans to boost productive investment have failed, despite increased public spending by France and Germany, the rollout of New Generation EU funds in 2020 and Europe's response to the US Inflation Reduction Act in 2022. Looking ahead, do you see any grounds for optimism?**

The implementation of the EU's Green Deal Industrial Plan (GDIP) has so far delivered far less than the US Inflation Reduction Act (IRA).

While EU-level funding for the green transition is similar in size to the IRA, the EU's structure of financial incentives is more complex. Under the IRA, US companies can directly apply for a tax credit, which is a relatively simpler and quicker process. The US financing structure is also straightforward for grants and loan guarantees, and direct funding to the private sector encourages a faster take-up.

The EU's action plan marks a significant change in mobilising substantial financial resources, identifying priority areas, such as green and digital technologies, and improving conditions for the disbursements of EU financing. We expect these measures to contribute to higher growth over the next few years. In particular, Cyprus, Greece and Portugal are likely to see substantial gains, which we reflected in our sovereign rating upgrades for these countries last year.

### EU banking and capital markets remain fragmented 10 years after the creation of the Single Supervisory Mechanism and nine years after the first CMU action plan. How do you think the situation could be improved?

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Capital markets in the EU could be more effective at fostering growth in the region by offering a more diverse range of funding options and providing additional capacity and access to investors with appetite for higher risk and longer duration. Also, the EU has an excess of savings over investment, meaning that facilitating flows between member countries is crucial for growth.

The continued development of a CMU could help these developments to happen – but it isn't the only path to deeper and more diverse capital markets in Europe.

The EU's financial markets are limited by smaller, privately funded pension pools and constraints on securitization. Together with a CMU, a more complete banking union would reduce fragmentation and facilitate cross-border operations between banks.

Two of the three key pillars of a banking union - namely the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM) - are already active and mostly effective, helping to anchor financial stability in the euro area. While the SSM is fully operational, the resolution framework under the SRM still lacks a reliable liquidity backstop when it comes to large bank resolutions.

Progress towards a European Deposit Insurance Scheme (EDIS) has also been slow due to political and financial constraints. The EDIS would require power to be transferred to a central authority, as well as the pooling of national resources. This makes it challenging to reach a deal, although the Crisis Management Deposit Insurance (CMDI) project is a first step towards more harmonization between countries.

But even if all three pillars are successfully implemented it still wouldn't be enough to create a level playing field across the euro area, because many other obstacles to a true banking union would remain.

Not least of these are the major differences in product regulation and local practices. For example, mortgage features vary considerably between countries, reducing the benefits of creating cross-border banks.

So, addressing the fragmentation in the EU's banking markets is a crucial step to further develop the CMU.



## Q&amp;A

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**PROF. DR. AXEL WEBER**

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## Banking Union now: a call for action!

**What have been the consequences of lasting zero interest rates (2014 - June 2022) in the euro area for productive investment, indebtedness, leverage of the financial system and more generally on financial stability? What lessons can we learned from this long period of low rates for the future?**

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The zero interest rate policy was aimed at stimulating economic activity and preventing perceived deflationary risks in the euro area. While it achieved some of its objectives by supporting investment and economic growth, outright deflation - as opposed to below target inflation - in the Eurozone was never a real threat in my view. And the long-run costs of this prolonged ultra-loose monetary policy are materialising as vulnerabilities and distortions in the financial system and the economy are starting to emerge.

Lower borrowing costs typically encourage consumers to spend and companies to invest more. However, the risk is that the zero rates environment has led to a severe misallocation of capital, with investments flowing into less productive or riskier ventures because the cost of borrowing was artificially low. To maintain yield, many investors and financial institutions have increased their risk exposure, including leveraging up to invest in higher-yielding assets. This behaviour has build up systemic risks within the financial system and could lead to lower productivity growth over the long term. The low cost of borrowing has also encouraged both the private and the public sector to increase their leverage. With higher level of debt, the economy is now more vulnerable to interest rate increases, putting pressure on central banks to keep rates low.

First signs of financial stress have emerged in credit and banking markets. Lower for longer interest rates have spurred an increase in household debt, particularly in mortgage debt, which has now become a cause of concern, especially with economic and credit conditions deteriorating. Ultra-loose monetary policy injected massive liquidity into markets. Central bank's asset purchases in combination with the zero rates environment has been a

key driver of rising asset prices, including real estate and stock markets, as investors searched for yield. While this benefited asset holders, it has raised concerns about the sustainability of these valuations, making the economy more vulnerable to financial shocks. In addition, it had adverse distributional impacts, benefiting asset owners whilst disadvantaging savers and potentially widening inequality.

A key lesson for monetary policy from this recent experience of lower for longer interest rates has been that the effectiveness of traditional monetary policy tools diminishes as interest rates approach zero or turn negative. But relying on unconventional monetary policy tools, such as quantitative easing and forward guidance, also comes with risks. The failure of these policy tools to prevent the massive recent reflationary shock and a cost of living crisis suggest that a more humble approach to monetary policy is required, recognising the limitations of unconventional monetary policy and acknowledging their long-term risks.

**Is the new EU fiscal framework proposed by the EU ambitious and effective enough to address the budgetary vulnerabilities of over-indebted EU countries and avoid a possible euro crisis?**

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It is simply to early to say what consequences the new EU fiscal framework will have. A key aspect of the reform debate has to be the right balance between flexibility and fiscal discipline, which is needed for ensuring long-term fiscal sustainability and the anchoring public expenditure. More tailored fiscal paths and reform commitments may help if they effectively address the structural weaknesses of over-indebted countries by promoting growth and reducing debt vulnerabilities. But the risk is that too many public expenditure items will in the future be classified as productive investments when really they are unproductive subsidies or status-quo preserving fiscal expenditure, which undermine growth and competitiveness instead of enhancing them.

## What are the synergies between the Banking Union and Capital Markets Union initiatives? To what extent do the economic and fiscal divergences between the largest Member States affect progress on these initiatives?

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Completing the Banking Union and advancing towards a Capital Markets Union would significantly improve financial stability and provide more diversified financing sources for consumers and businesses across the eurozone. A more stable banking sector complements the CMU's objectives of making capital markets more attractive to investors, providing greater confidence in the financial system's stability. In addition, CMU seeks to diversify financing sources for businesses, reducing their reliance on banks. This diversification would be greatly facilitated by a more integrated banking sector, where banks are more resilient and can support capital markets through EU-wide activities like market making and securities underwriting. Both the Banking Union and the CMU are designed to facilitate cross-border financial services within the EU. The Banking Union does this by creating a unified regulatory and supervisory framework for banks, while the CMU focuses on removing barriers to cross-border investments. Together, they enhance the single market for financial services by making it easier for capital to flow across intra-EU borders, fostering deeper financial integration.

Economic and fiscal divergences between the largest Member States of the European Union (EU) have had a significant impact on member states' perspectives on financial integration and risk-sharing mechanisms. Core countries with strong economic fundamentals fear that banking union could lead to sharing the financial burdens of less stable economies without adequate safeguards. Conversely, countries with higher public debt are more inclined towards mechanisms that facilitate risk sharing, hoping for potential fiscal relief or stability benefits. In contrast, countries with healthier fiscal positions prioritise risk reduction over risk sharing, fearing that integration could expose them to the fiscal irresponsibilities of others. More concretely, proposals that imply mutualising debt or risks (e.g., through a common deposit insurance scheme as part of the Banking Union) face resistance from countries wary of underwriting the risks of others without stringent controls. This has been a stumbling block for any political agreement to pursue deeper integration in banking and capital markets. I'm convinced that only a regulatory Big Bang can create a proper single European capital market and a EU-wide financial service sector. A bold approach is needed to support the efforts of the Eurogroup to relaunch the CMU and to promote EU competitiveness.

## How to better align European and national interests and overcome the current deadlock on the Banking Union and CMU?

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To align European and national interests and overcome the deadlock on the Banking Union and the CMU, we need a fully-fledged EU banking framework for cross-border banking groups, whilst allowing for broad-ranging exceptions for purely domestic or regional banking entities. It is time to recognise that the current one-size-fits-all approach of European regulators and law-makers prevents progress and perpetuates an undesirable status quo.

A truly pan-European banking framework would rest on five key pillars.

- Cross-border banks would be subject to EU rather than national law, including for their contracts. This would allow EU banks to exploit significant economies of scale and operate much more efficiently using a single platform. Today, that is hampered by many differences in national regulations.
- EU-wide lenders would only be supervised by the EU Single Supervisory Mechanism, rather than national watchdogs. This would free cross-border banks from differing prudential rules, allowing a free flow of capital and liquidity within banking groups. Harmonised regulation will also make it easier to harness new technologies, such as digital identity measures, which are key to the fight against financial crime.
- Cross-border banks should be able to provide a full suite of banking services across all 27 countries using a single International Bank Account Number code. Today, some consumers and businesses cannot transfer money across national lines because of discrimination against foreign IBAN codes. This has paralysed competition and innovation in cross-border payments. In addition, innovative services, such as mobile wallets, are primarily offered nationally.
- Pan-European banking group must be subject to a single EU bankruptcy framework, leading to more consistency in dealing with bank failures. These changes would alleviate most remaining concerns about risk sharing, paving the way towards a common EU deposit guarantee scheme.
- A single common deposit insurance would strengthen and supplement the credibility of national deposit insurance schemes and help reduce the national bank-sovereign vicious circles.

The recent episodes of deposit runs in the US and Switzerland should not lead to a false sense of security that EU banks is immune to such challenges. It rather suggests that the EU needs to act now and before such problems emerge. A Banking Union with an EU-wide single common deposit insurance would provide an additional safeguard and will make sure that customers from different member states benefit from the same level of protection.

## STRENGTHENING THE EMU



### IRENE TINAGLI

Chair & MEP, Committee on Economic and Monetary Affairs - European Parliament

### Three lessons from the last decade

The debate over the economic governance is ongoing for long, and the analyses have shifted the judgement pendulum in the direction of a growing anachronism of the existing fiscal rules and the unfeasibility of the restoration of the pre-pandemic status quo. This is not the first time that a debate on the fiscal rules takes place. The first time occurred about almost 20 years ago, because some Member States, as soon as they were under pressure, did not feel bound to common rules or European recommendations. The second time was about 10 years ago, right after the crisis, when we realized that rules failed as substitute for explicit policy coordination because they were designed to control for the negative spillovers of fiscal profligacy, but not for those of fiscal austerity. This is why the recession after the last economic crisis has been deeper and longer in the Union than elsewhere.

It would be not fair to say that nothing has been done in recent years to address this problem. European institutions acknowledged the limits of macroeconomic governance by issuing the well-known Communication of 2015. The effects of this innovation was positive and important. More growth-friendly consolidation has been favored, and this has not been at the expense of the structural reforms that countries have continued to push forward. We must now capitalize on this experience in this review.

Three lessons from the last decade might be useful in defining a new set of rules.

- The first lesson is that an entirely rules-based approach is ineffective because rules are statics and cannot be updated quickly when unforeseen circumstances arise. Rules that apply only in fair weather conditions end up producing uncertainty. In the end, rather than generating stability, they would generate instability, including by destabilizing expectations.
- The second lesson is that drawing up rules capable of taking into account of all potential future events is impossible. Increasing the number of contingencies leads to highly complex rules which are difficult to apply and easier to manipulate and even circumvent.
- The third lesson is that delegating fiscal policy entirely to Member States constrained only by a set of rules which ignore macroeconomic externalities is no longer possible. The era of “do your homework alone” is over. Member States’ budgetary policies must be more effectively controlled and - at the same time - coordinated and harmonized to maintain an appropriate Euro area fiscal stance in order to minimize negative spillovers from national budgetary policies onto other Member States.

The Commission’s legislative proposals put forward last April seems to move in the right direction. There are many positive elements, but two of them are particularly important. The first is that the focus has shifted from annual budget to medium-term public debt sustainability assessment. This could potentially amend the anti-investment bias embedded in the current economic governance. The second is that the medium-term public debt sustainability assessment and debt-reduction paths should be country specific, therefore eliminating reference to fixed targets valid for all without distinctions. This will allow to better assessing the future evolution of debt, taking into account of the specific features of each Member States with references to growth, population dynamics, interest rates trend, but also current and future budgetary policies. While conducted at the single Member State level, the debt sustainability analysis should also need to pay attention to the cross-country spillovers and the resulting aggregate fiscal stance of the Union as a whole.

### DSA should pay attention to cross-country spillovers and the aggregate fiscal stance of the Union.

Debt sustainability risks should be balanced against the cost of adjustment in terms of production, with the explicit goal of averting a debt crisis for the individual Member State and the European Monetary Union as a whole. If we returned to fixed parameters that were the same for everyone - perhaps calling “safeguard” what instead represents an actual “constraint” - then this important innovation proposed by the Commission would inevitably be lost.

New rules must be complemented by a system of safeguards to protect the Union’s integrity in the event of systemic shocks. This task cannot be delegated again entirely to the ECB, but must be a commitment of the Union as a whole. If the political will for this tool is not there yet, I am afraid that the new rules, in order to be credible and able to work also with unfair weather conditions, will need again to include enough flexibility.

If we do not have the courage to accept this element as an essential part of our future governance, our efforts in recent weeks risk becoming useless.





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## BERTRAND DUMONT

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### A new fiscal framework strengthening EU's debt sustainability and economic resilience

Over the last decade, the successive crises have led to a substantial rise of public debt in the European Union, fuelled by fiscal policy decisions to mitigate the socioeconomic impact of these crises, but also by subdued growth. This rise has created a potential vulnerability for the sustainability of public finance and the stability of our economies. In the meantime, it has highlighted the inability of the Stability and Growth Pact to provide Europe with a fiscal framework adapted to the 21st century. The uniform stringent rules attached to the SGP, such as the 1/20th debt reduction rule, and its procyclical bias have indeed played an important part in depressing economic growth in Europe in the 2010s: while EU and US growth rates were similar at the beginning of the century (1,7 % for the EU between 2000 and 2009 vs. 1,9 % for the US), the gap widened from 2010 (1,7 % for the EU between 2010 and 2019 vs. 2,3 % for the US).

In this context, the starting point of the reform was to find the right balance between 3 objectives: ensuring fiscal sustainability and supporting growth, addressing the shortcomings of the previous fiscal framework, and taking into account the massive investments needs of the European Union facing the twin transitions.

The political agreement reached by the Council of the European Union on December 20th aims to fulfil these multiple objectives: rebuilding fiscal buffers and reducing public debt, together with tackling our massive investments needs, especially towards climate change, strengthening our defence capabilities, and enhancing our strategic autonomy.

How can the new fiscal framework achieve these objectives?

With the aim of strengthening EU's debt sustainability and economic resilience, the reform is based on three main principles supported by France from the beginning of the discussions, that ensure that these fiscal rules are more credible, adapted to our current economic environment and enforceable.

**First, the new rules are based on differentiation.** The fiscal trajectories will be designed with comprehensive debt sustainability analyses (DSA) that take into account the specific economic situation of each Member State and reflect ambitious goals regarding the reduction of excessive debts and deficits. Minimum standards in terms of budgetary effort are guaranteed by numerical benchmarks on both debt and deficit reductions. These two elements will ensure economic relevance and credibility for fiscal trajectories, while avoiding the procyclical bias of the previous framework.

**Second, the rules take into account the major investment needs that the European Union is currently facing.** The successive crises have underlined how critical it is to accelerate the ecological and digital transitions. Russia's war of aggression against Ukraine has been a wakeup call to step up our energy independence and strengthen our defence capabilities at both national and EU

levels. By allowing Member States to adjust their consolidation pace when they commit to investments and reforms, the new framework incentivizes the realisation of investments that will shape our potential growth and autonomy for the next century, and thus strengthen the EU resilience.

**Third, national ownership is at the heart of EGR.** Member States will be responsible for the design of their multiannual fiscal trajectories and their investments and reforms commitments, leading to more political accountability. Furthermore, the rules will be more enforceable because they are economically sounder and already take into account the necessity to finance forward-looking investments, making them more credible.

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**The economic governance review of the European Union is based on three core principles: national ownership, rules adapted to different fiscal challenges and effective enforcement.**

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Those principles improve substantially the European fiscal rules and will yield better results in terms of fiscal sustainability and economic resilience. Although not necessarily simpler, the new framework has the advantage of being driven by economic logic instead of a one-size-fits-all approach and being forward-looking. In the end, it is not the fiscal framework by itself that will determine the sustainability of public finances in the future, but the willingness of each Member State to abide by its rules and act accordingly. In this respect, reaching a compromise at the Council level in a timely manner has stressed the Member States' willingness to better coordinate their policies, improve the functioning of the monetary union and reach our common strategic goals. Negotiations with the European Parliament are now underway, with the aim to conclude a final agreement ahead of the June 2024 elections.

To conclude, it is important to remind that fiscal rules are only one piece of the toolkit to improve the functioning of the European Union. France's view is that more work is required to reflect on additional EU-level instruments to foster the double transition and ensure the transformation of European economies. NextGenerationEU and its main instrument, the Recovery and Resilience Facility, has been a key milestone in this regard. The EU has now the relevant scale to play a key role in coordinating and stimulating productive investments, which must be combined with ambitious strategies to further deepen the single market, to boost economic growth and reap the full benefits of European integration.

## IMPROVING EU'S GLOBAL ECONOMIC COMPETITIVENESS



### ROLF STRAUCH

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### Enhancing competitiveness in Europe: old and new challenges

Improving Europe's competitiveness has been a long-standing challenge. Since 2010, the euro area's economic growth underperformed its global competitors, particularly the US.<sup>1</sup> One third of this difference in growth can be explained by less favourable demographics in Europe, but two-thirds is due to weaker productivity of labour and capital. The productivity gap between Europe and the US has been widening because of differences in technological progress, market efficiency and institutional framework. Europe's underinvestment in innovation constraints technological progress, while market failures and excessive administrative burden keep the economy away from its full potential.

Prior to the pandemic, a favourable global environment masked Europe's relative underperformance, but this will not be longer the case. Dynamic external demand and low import costs helped the euro area to keep its

positions in global trade markets. However, after the pandemic and the energy crisis, the global situation has changed dramatically: increasing geopolitical fragmentation and uncertainty expose Europe's dependence on external energy supplies and vulnerabilities to swings on global energy markets, which raise production costs and amplify the risk of resource misallocation. Additionally, the ageing of the population is another challenge. It can aggravate labour shortages, lead to higher wages, and divert financial resources from investment, further hindering competitiveness.

In the face of increased geopolitical uncertainty and mounting global challenges, Europe needs determined action to strengthen its resilience to external shocks and maintain its international standing. Remaining competitive in this context requires not only addressing long-lasting productivity challenges, but also building up resilience to external shocks. To achieve these goals, policy priorities should focus on:

- First, accelerate structural reforms to ensure that resources move to sectors with more sustainable and higher growth potential. Reforms prioritising flexible labour markets foster a dynamic workforce. Educational reforms must align curricula with evolving industry needs, digitalisation and the greening of our economies. Innovation policies, including incentives for research and development, are crucial in cultivating a culture driving technological advancement. Businesses should be encouraged to embrace digital technologies.
- Second, deeper economic and financial integration is imperative for a more robust and resilient Europe. Facilitating workers' movement across borders within Europe is crucial for labour market integration. This involves addressing barriers to labour mobility, recognising qualifications across countries, and fostering a more flexible labour market that allows skilled workers to contribute to the economies of different member states. Completing banking union and further progress towards a Capital Markets Union are also vital to avoid financial fragmentation, unlock funding and boost investment.
- Third, green investment and trade policies play a pivotal role in boosting productivity and limiting Europe's dependence on energy imports. Investments in renewable energy

and energy efficiency strengthen Europe's technological infrastructure while reducing its exposure to external shocks to energy supply. By reducing trade barriers, harmonising regulations, and creating an investor-friendly environment, Europe can attract greener, more productive investments to foster innovation.

**Addressing Europe's competitiveness challenges require not only enhancing its growth potential but also strengthening resilience to a more volatile global environment.**

- Finally, advancing in Europe's "open strategic autonomy" can also foster competitiveness to ensure a more resilient business environment. As a large open economy, Europe is more dependent on imports of energy and several strategic raw materials than the US and China, making it more vulnerable to geopolitically induced supply shocks. Progress towards an "open strategic autonomy" (reducing dependencies while remaining an open economy), can achieve more predictable input costs. This can help firms' long-term planning, foster investments, and facilitate more efficient resource allocation.

In conclusion, addressing Europe's competitiveness challenges is now more urgent than ever and requires a comprehensive approach. A comparison with the US underscores the importance of addressing technological factors and inefficiencies across various economic dimensions. Action is essential to rising geoeconomic challenges, higher energy costs, and demographic shifts. Structural reforms and deeper economic integration are vital in ensuring resilience and prosperity in the future.

1. In the last fifteen years, potential growth in the euro area has been on average 1pps lower than in the US.



## ALFRED KAMMER

Director - European  
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### Europe has fallen behind - but more integration promises higher growth

Europe's income levels are behind the global frontier. Per capita income levels in the European Union (EU) are on average around one-third lower than in the U.S. after correcting for price and exchange rate changes that do not reflect changes in living standards. This is an eye-catching difference, and it is not just driven by less-rich European countries, such as Bulgaria and Greece which have per capita incomes of less than half of the U.S. With the exception of Luxembourg and Ireland, per capita incomes in all advanced EU economies are lower than in the U.S. This gap is driven by shortfalls in capital stocks, choices in working fewer hours and retiring earlier, and productivity.

Catching up to the frontier requires higher growth—and that just hasn't been happening. While over the period from 2010 through 2022, on a per capita basis the EU has grown at the same average annual pace of around 1.4 percent as the U.S., if one adjusts for Europe's shorter work hours the EU has grown by 1 percent on average—faster than the

U.S.' 0.7 percent. Still, with this narrow edge it would take the EU 80 years to catch up with U.S. income levels. Also, Europe is aging faster than the U.S., and the resulting fiscal costs are increasing with the size of the older population—here growth per capita matters more than growth per hour worked.

Convergence as an engine of growth has also been stuttering within Europe. Larger income differences within the EU than in the US, should make the EU grow faster given the growth opportunities lower-income countries offer. The poorest U.S. state has a per capita income level of around 80 percent of the U.S. average. In the EU alone, there are no fewer than eight countries with income levels below 80 percent of the EU average. Yet, growth in the EU's lower-income countries has been insufficient to make progress on income convergence. For example, the growth slowdown between the early and late 2010s in Central and Eastern European economies implies that its convergence to average euro area living standards would be achieved half a century later, beyond the year 2100.

Looking ahead, Europe risks falling further behind due to scars from the crises and looming structural changes. In many countries, hours worked per worker are on a declining trend, private investment is weaker than pre-crisis, and the fiscal space for growth-enhancing public investment has shrunk. In addition, geoeconomic fragmentation, and how the EU responds to it, can have a large bearing on productivity via supply chains, energy security, and access to technology.

The good news is that Europe has the tools to respond to these challenges—and the single market is the place to start. Working together, EU countries could substantially lift per capita incomes by addressing remaining internal barriers. As a rough guide of the still-untapped potential from the single market, we have estimated that a reform package that combined were to reduce within-EU barriers by 10 percent could permanently lift real incomes by more than 7 percent. Such reforms include completing the banking and capital markets unions, for example, through greater harmonization of national rules on taxes and subsidies, improving insolvency regimes, and reducing administrative burdens. Efforts at the EU-level should be complemented with domestic policies to address old and new challenges, including governance and business environment. Such reforms would spur investment rates, improve business dynamism, and incentivize labor force participation. For instance, our research shows that closing the

gap between involuntary and desired working hours alone would increase EU labor supply by about 1.3 percent.

Deepening the single market is also the right response to geoeconomic fragmentation. There are often legitimate economic security concerns around the overreliance of supply from other countries or economic specialization. Here Europe has an advantage. In contrast to China and the U.S., China specialized in manufacturing and the U.S. in innovation, Europe spans both manufacturing and innovation centers. This makes Europe's single market a formidable answer to these concerns allowing factors of production, goods and services to flow freely across borders. European countries should avoid responding to fragmentation with blanket industry support unless they address well-targeted market failures.

**Europe has the tools  
to respond to growth  
challenges - and the  
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place to start.**

As an illustration, we have estimated that the continent's per capita incomes would shrink permanently by around half a percentage point in a scenario where the EU mimics a U.S. subsidy for inward multinational production that reduces relocation costs by 20 percent. This is because the less efficient allocation of resources leads to losses in some European countries and sectors that more than offset the benefits to subsidized firms.

Strengthening the single market—the EU's unique growth engine—policymakers can foster resilience to global shocks and deliver faster convergence and higher living standards.



## TIBOR TÓTH

State Secretary - Ministry of Finance, Hungary

### Europe at crossroads: how to strengthen the foundations of the European economy

*As Europe faces a decline in her global economic standing and encounters increasing challenges, the EU needs to strengthen its economic foundations and its productivity; from regional disparities and geopolitical vulnerability to strategic investments in technology, energy and human capital for sustainable competitiveness and strategic autonomy.*

Following the US, the EU is the second largest economy in the world, but such an economy should also secure its own autonomy in many aspects. Wealth without the ability to safeguard the economy and society is a dangerous combination.

EU's global economic importance and its competitiveness have been gradually decreasing since 2000's. There is a significant gap with the US in terms of GDP per capita, and emerging Asian countries are also increasingly challenging the EU in regard of competitiveness. Recent years have particularly highlighted the importance of the urgency to strengthen EU's productivity to maintain our competitive edge and achievements in sustainability, social inclusion, and high living standards.

While making considerable efforts towards convergence, the EU remains highly fragmented. The war in Ukraine and the energy crisis caused by the imposed sanctions against Russia affected EU countries very negatively, while other global regions, like North America, did not have to face energy price explosion, leaving the European industry at a significant competitive disadvantage.

NGEU is a good, but a very bureaucratic instrument in many areas for potentially supporting economic recovery. However, it puts some member countries at a significant competitive disadvantage when the resources are withheld, they are entitled to, by this undermining common competitiveness ambitions. Approaching rigid deadlines also suggest serious problems in delivering ambitious goals.

Regarding SGP, EU budgetary rules may prove to be too strict in the current geopolitical situation, which hinder economic recovery, worsening EU's competitiveness by potentially forcing a cut-back of public and climate friendly investments.

Rising cost of capital highlights Europe's lower returns and investment gaps. Europe has consistently lagged behind the United States in net investment. Europe needs more risk-seeking capital to bolster sustainability and competitiveness.

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**EU must invest in tech, energy, human capital for sustainable competitiveness amid global decline.**

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Competitiveness needs strategic autonomous economic foundations, such as accessible and affordable energy, critical raw materials, human capital and state-of-the-arts technology. Europe has to diversify and develop its own energy sources to secure sufficient supply at much lower cost. We need to heal the wounds in a way that is consistent with climate objectives but tailored to Member States. For instance, where geographical conditions limit the efficiency of certain renewables, additional carbon neutral capacity is needed, like nuclear plants. Once nuclear is not supported appropriately in policy terms, private investments, research and technology development will not take place to further improve the nuclear energy's operational safety, efficiency and the recycling of nuclear waste.

With the rise of electromobility, Europe's dependency is increasing on critical raw materials. The establishment of EU owned battery factories and chip producing facilities should be encouraged, as much as research in new technologies, sustainable energy storage systems based on abundant and non-critical raw materials, such as Na-ion batteries.

R&D expenditures play a key role in overcoming current challenges, especially in improving productivity. There is a significant, widening gap in R&D&I expenditures between the US and EU. It would be essential to at least double Europe's corporate R&D budget to lay the foundations for future growth.

The competitive edge now increasingly originates from the application of frontier technologies, but Europe is lagging behind in areas such as microchips, AI or quantum computing. The US invests much more capital and private equity into AI than Europe, which will further deepen competitiveness gaps, unless the human capital and the financial capacity are able to turn things around. Asia is also very active and dynamic in this area.

Although Europe has skilled human capital, there are already serious shortages in many of the professions that should ensure future growth. The decline in educational standards, coupled with an aging population and diminishing educational achievements, may place Europe at a considerable competitive disadvantage. Addressing this challenge requires a strategic focus on acquiring new skills that are currently lacking in the European landscape and preventing the absorption of such skills by the US. Moreover, the urgency of the demographic turnaround is critical for the labour market. To this end, more support is needed for families, which contributes to increasing the number of births and the fertility rate all over Europe.



## DECLAN COSTELLO

Deputy Director General,  
DG for Economic and Financial  
Affairs - European Commission

### Sustainable competitiveness in the EU: challenges and opportunities

In recent years, the EU successfully responded to the COVID-19 pandemic and tackled the fallout from Russia's aggression against Ukraine, including an unprecedented surge in energy prices. The strong and coordinated response was a sign of remarkable resilience and solidarity across the EU. Now is the time to look beyond the short-term crisis management and confront long-standing challenges of competitiveness, to build and secure prosperity for EU citizens over the long run.

While the EU's overall performance as measured by trade indicators and price and cost competitiveness has been relatively stable over the past years, indicators on productivity and innovation point to weaknesses. Compared to the US, the EU's starting position is less favourable. The slowdown in labour productivity since the 2000s has been more pronounced in the EU, with substantial heterogeneity across Member States. Sluggish investment dynamics, lower R&D spending, and a lack of diffusion of new technologies are driving these differences. There are also challenges related to access to finance,

including venture capital, the regulatory framework, public administration, and investments in infrastructure and education and skills.

Against the background of these long-standing challenges, a number of new challenges have emerged, notably the need to accelerate the green and digital transitions and to adapt to a more uncertain geopolitical environment. As energy prices in the EU are likely to remain structurally higher than in the recent past, there is a risk of competitiveness losses and slower productivity growth as firms must shift to less energy intensive production processes.

Considering these challenges, Europe cannot afford to stand still. Fostering the EU's sustainable competitiveness will require continued policy action, and policymakers will face several key trade-offs going forward.

First, the EU will need to find the right balance between managing an effective industrial policy and preserving market incentives. While temporary changes to the framework for state aid allowed for a targeted response during the crisis, one must be mindful that a massive surge in subsidies would risk fragmentation of the single market, given very different starting positions and fiscal space across Member States. Moving away from providing firm-specific support to supporting structural reforms and improvements to framework conditions would help foster investment and productivity while preserving competition.

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**The EU faces key trade-offs when deciding on the right policies to preserve its competitiveness.**

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Secondly, addressing the challenges requires an upfront increase in public and private investment. At the same time, one needs to recognise that fiscal sustainability risks have risen due to the impact of the pandemic and the surge in energy prices. Whilst the recent high inflation has lowered debt-to GDP-ratios, fiscal challenges will become more apparent, as pressure on public sector spending appears with a lag, the impact of ageing populations takes hold, security and defence needs are mounting and the period of ultra-low interest rates has ended. Policymakers therefore need to effectively prioritise public investment projects in the context of medium-term fiscal adjustment efforts.

A reform of the EU fiscal rules with the right incentives to protect investment will be key to put public finances on a credible path towards sustainable budgetary positions. In addition, support from the NextGenerationEU instrument will help keep up public investment levels without overburdening national budgets. Moreover, the private sector will have to play its role in closing the investment gap to foster the green and digital transition, which requires further progress in developing the Capital Markets Union.

Thirdly, recent disruptive geopolitical events have highlighted the risks to supply chains and a lack of diversification. Going forward, the EU will need to find the right balance between reaping the benefits from trade and de-risking supply in strategically important sectors. With the objective of open strategic autonomy, the EU is committed to open trade while also asserting itself against unfair practices. In addition, further unleashing the potential of the single market and leveraging the size of the European economy can help mitigate vulnerabilities of international supply chains.

Finally, the EU is determined to foster the digital transition and allow European firms to benefit from efficiency gains through digitalisation. However, many key players are located outside Europe, which raises questions of strategic dependence. In addition, digital leaders benefit from significant increasing market power, which could hamper innovation and knowledge diffusion. The widespread use of artificial intelligence could amplify these challenges.

Hence, the EU needs to enable companies and citizens to fully embrace the digital transition and to compete at a global level, while setting the right framework to preserve competition and address important risks related to the use of AI.



## MARIO NAVA

Director General, DG for  
Structural Reform Support -  
European Commission

### The ComPAct: enhancing quality public administration to ensure competitiveness

The competitiveness of Member States is significantly influenced by the quality of their public administrations. Disparities in institutional quality contribute to variations in income per capita, while countries with robust institutions can specialize in high-value sectors, relying on innovation to generate more fiscal revenues and effectively implement reforms and investment projects. Such countries are better equipped to provide social safety nets and implement tailored strategies for regional development, playing a key role also in carrying out the Capital Markets Union action plan.

Improving the implementation of EU policies and enhancing administrative performance holds the potential to generate substantial annual savings. Member States could save billions annually by optimizing their administrative performance. For example, business establishment procedures could be simplified and made more efficient in many countries.

Identifying underperforming areas can inform the design of structural

reforms, leading to cost savings and improved services for citizens and businesses. The complexities of starting a company within the EU vary but on average, the labour costs for new companies to fulfil formal requirements amount to about EUR 3,000. Furthermore, businesses can potentially save billions annually by reducing the time required for tax preparation, filing, and payment.

DG REFORM offers support to Member States in improving regulation, reducing administrative burdens, and simplifying the business environment. Through the Technical Support Instrument (TSI) DG REFORM has facilitated initiatives such as ensuring data-driven decision-making approach in PAs, establishing institutions for early consultations on regulatory issues, enhancing public sector capacity for assessing impacts on businesses – with particular attention to SMEs - reducing tax compliance costs, improving justice systems, and promoting digitalization. In 2024, the specific actions will include development of data analytics to optimise workloads, efficiency and competitiveness.

Actions that from now on can rely on a strong commitment: in late 2023, the European Commission presented its Communication on public administration, entitled “Enhancing the European Administrative Space (ComPAct) with a set of actions aiming to support administrative modernisation in the Member States and ensure their efficiency and competitiveness.

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**Member States could  
save billions annually  
by optimizing their  
administrative  
performance.**

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The ComPAct responds to the imperative of enhancing administrative performance and ensuring public administrations that are collaborative, effective, strategically oriented and providing high-quality public services. The Communication outlines 25 actions to modernize PAs, focusing on three core areas: improving the skills of civil servants, digitizing PA, and transitioning to a more environmentally sustainable model.

Among the actions there is the new Public Administration Cooperation and Exchange (PACE) flagship, aimed

at encouraging peer learning and the exchange of best practices among civil servants across the EU. In 2024, there will be 31 exchanges for 12 Member States.

The European Year of Skills in 2023 has heightened awareness on the need for a paradigm-shift in the job market and ComPAct is actively addressing this matter for the public administration through a targeted set of initiatives, falling into the so-called “Agenda for Public Administration Skills”. The agenda comprises actions such as

- (a) the establishment of a passport of core competences,
- (b) the creation of a European network of centers of excellence for training,
- (c) a new joint leadership training program for senior management, called the “EU Public Administration Leadership Program.”

Another pillar of ComPAct focuses on ensuring the administrative capabilities to attain the Digital Decade goals, aiming for 100% online accessibility of key public services. This entails updating regulations, embracing AI, and enhancing cross-border interoperability. The third ComPAct pillar centres on the green transition, in line with the EU’s climate neutrality goal by 2050, recognizing PAs’ role in environmental efficiency, efforts involve implementing eco-friendly measures and limiting ecological footprints.

This marks the starting point to shape the future of PA in response to technological progress, demographic shifts, and the demands of green transformation.



## FERNANDO VICARIO

Chief Executive Officer and  
Country Head for Ireland -  
Bank of America Europe DAC

### Improving the EU's global economic competitiveness may require bold choices

The economic growth model of the European Union (EU) is centred on fair competition, economic security, strong regulatory requirements, while promoting a sustainable and digital transition of economies. This has provided prosperity in the past and remains the approach for the future, as it was evidenced by the adoption of the Next Generation EU package back in 2020. In an unprecedented effort, the EU Member States decided to invest €806.9 billion with the intention to transform the EU economy and make it more resilient, green and digital.

However, since the 2010s, Europe's consumption and investment levels have struggled to keep pace with those on the other side of the Atlantic. The EU's policy choices play a part in improving aggregate consumer demand. Over the past decade, European fiscal policy, in response to large shocks, has been markedly different from that seen in the United States. The same applies to the level of resources mobilised to address long term challenges in the

region. If we add to that a more growth and productivity friendly business environment, a different demographic profile, and as of late, the different energy mix and dependence from abroad, we can explain the underperformance relative to the US in recent years.

Thinking ahead, various evolutions to the European structure present an opportunity to nurture Europe's economic performance and further increase its global footprint. Enabling at the EU level a common fiscal capacity for common public goods, such as defence, energy transition and independence, and health would strengthen the European voice, both within the region and globally. This is no easy matter from a political perspective, and would have to be supported by strong governance principles.

The recent reforms to the Stability and Growth Pact (SGP) support this view. It is not yet clear whether the agreement reached in late 2023 will allow fiscal policy to act through the cycle, while leaving enough room at the country level to invest in the key priorities for the near future. A common fiscal policy in coordination with strict fiscal rules offers a potential solution. It would allow for investments to take place, with governments still able to deliver a credible medium term consolidation path. Perhaps the question we should ask is not whether the new SGP is strict enough, but rather, how the SGP can be leveraged to foster the convergence of objectives at both the EU and country level.

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**The greatest challenge  
arguably remains  
the creation of a  
European safe asset.**

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Long standing commitments to complete the Capital Markets Union (CMU) and the Banking Union should also be a priority. The European Commission's plans for the CMU would ideally be complemented by a genuine harmonisation of national legal, insolvency and tax frameworks. The potential consolidation of stock exchanges under a single regulator, as recently called for by European Central Bank President, Christine Lagarde, would contribute to a more unified European capital market, too. Finally, improving the regulatory framework to develop and deepen a European securitisation market would deliver benefits and support a broader disintermediation trend.

Nevertheless, the greatest challenge arguably remains the creation of a European safe asset, which could serve as the ultimate risk free benchmark in the single market. A European safe asset may also address the sovereign bank nexus, and in turn, help provide the political basis to complete the Banking Union.

A completed Banking Union would bring scale and efficiency benefits which are now lacking. Currently, national competent authorities require significant banks in their countries, to maintain the structure of independent banks – boards, capital, risk management. Hence, Euro area banks that made cross-border moves have not been able to unlock their full potential to scale.

Why does this matter? Wholesale and investment banking are scale businesses. While banks with large retail and commercial banking operations can balance the risks needed to deliver good returns in wholesale and investment banking with other earnings, banks with structurally smaller retail and commercial banking franchises cannot.

Finally, changes to the EU state aid regime should be considered to respond to subsidies put in place in other regions and to finance the bloc's climate transition. The EU should consider an approach that supports all EU national economies, not just the largest, and ensure the cohesion of the single market.

While Europe's "to do list" is by no means easy, we must continue to push ahead, both in the public and private sector, to further improve and secure Europe's competitiveness, especially in the current volatile geopolitical environment.



## JOSÉ ANTONIO ÁLVAREZ

Vice Chair of the Board of  
Directors - Santander

### EU Comp: actions speak louder than words do

A new year begins, but the feeling is the beginning of a new geopolitical era – the world continues to evolve at dazzling speed. In this regard, Europe faces an urgent challenge to change its trajectory: we need to fix the state of the EU's competitiveness. I am delighted EU leaders recognize the importance of the task at hand and that this cannot be business as usual.

If we look at where we are now, plenty of examples appear. Take the list of the global top 20 companies by market cap, we hardly find any European champions. In terms of market size, the US equity markets are the largest in the world and continue to be among the deepest, most liquid and most efficient, representing 42.9% of the \$106tn global equity market cap in 2023. This is 4.1x the next largest market, China, followed by Europe.

So, how do we push the power button?

First, looking at the distribution of power between European institutions and Member States. We need to be more ambitious about the EU's political and economic integration if we really want to advance towards a Single Market. Member States should cede competences to the EU institutions in areas such as defense, migration, energy or mobility

infrastructure. All that is needed to ensure the free movement of goods and persons. We have reached a point where not advancing in integration is leaving the EU behind other more integrated areas that can take full advantage of their economies of scale. If we renounce to scale EU solutions, we are renouncing to be on the race.

Second, changing our fiscal policy. As long as we do not have some kind of fiscal union, we will continue having a fragmented euro in our pockets with asymmetric fiscal policies. The response to the European shared challenges ahead (climate, digitization or security) will be suboptimal in the absence of some common fiscal policy, in a period where great strategic view and investment are needed.

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### Europe faces an urgent challenge, we need to fix the state of the EU's competitiveness.

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Third, changes needed in the regulatory framework towards the completion of the Single Market:

- To complete the Capital Markets Union. Starting by boosting the EU securitization market and explore ways to enable banks to free up capital and liquidity for the express purpose of providing additional funding to EU businesses. This should include an immediate review of the EU securitization framework.
- Need to finalise the Banking Union by establishing a common risk sharing mechanism: the European Deposit Insurance Scheme (EDIS). Without it, there is not a level playing field for cross-border offering of retail financial services. If we want to build a real Single Market, depositors should feel that they are equally protected in all countries across Europe.
- We need to work on harmonizing the regulatory framework. Although the single rulebook is a fundamental piece, the most common regulatory tool still are Directives and still national rules play a key role – there are many examples: insolvency frameworks, consumer protection rules, etc. The existence of different regulatory frameworks is the main barrier to European consolidation, due to the number of resources needed to understand and implement the different national regulatory frameworks.

- This takes us to the lack of potential synergies that could be achieved in a merger. If regulatory frameworks are different, merged banks would still need different teams to deal with the different national frameworks, different products, different procedures to attend customers, different IT systems which are designed to give response to the specific regulatory framework in each country. Mortgages are different, payment commissions are different. There are limited cost synergies and economies of scale.

- We need to improve the resolution framework. It is key to facilitate an acquisition regime for failed entities. Making the acquirer responsible for the conduct of management of the acquired entity before resolution is normally unjustified. This cannot be easily prevented through due diligence, bearing in mind the rapid reaction needed in this process. So, the responsibility regime should be reviewed. Lessons can also be taken from the US. Banks do not acquire the legal entity, but specific assets and liabilities.

- Finally, competitiveness is not only about the Single Market, but about supporting EU business operating in third countries. International companies are crucial to the competitiveness of the European industry and the EU's strategic autonomy. A top priority for the next Commission should be to ensure that the EU regulatory framework does not penalize highly diversified businesses operating in third countries and that duly recognizes banks that operate in those countries.

The current Regulatory framework is excessively biased towards the protection of financial stability. If we want to realize Europe's potential, and increase European growth, we will need to rebalance our attitudes to risk as well as to recalibrate the size and complexity of our regulatory framework to favor growth. This, I think, would be a major shift.





## ANNA DUNN

Chief Financial Officer,  
EMEA - JP Morgan

### EU Competitiveness in banking

Looking at the global economy versus Europe over the past decade, I'd characterize global growth as driven by technological change involving a large scale shift in labour market deployment. To reference the European economist Schumpeter, capitalism is a process of creative destruction. European markets over the past decade have inclined more to preservation than destruction.

The challenge for Europe: how does it want to compete in the financial sector? Given their focus on deriving value, activist investors provide a blueprint for what this involves including increasing efficiency with reduced employment, competing for global talent with competitive pay packages, investing in the best technology to automate manual efforts, and creating scale that allows for standardization away from local specificities. The European approach to regulation treats the financial sector as more a part of the broader social policy agenda, such as looking at double materiality assessments under CSRD or bonus caps. Is the ideal European bank a social utility providing community service and financing for political objectives? Or is it a streamlined interface providing access to competitive international financial market pricing for consumers and companies, with personalized financial advice earning market competitive rates? They are two very different banking models with very different

investor returns. One accelerates public policy whilst the other accelerates the economy.

Regardless of the financial sector model that Europe chooses to pursue, I'd flag two consequences of the current regulatory approach which may merit revisiting.

First, the ECB actively discourages – to the point of prohibition – dual hatting of executives in international firms' subsidiaries in Europe. The objective of this policy is to ensure that European subsidiary management has local focus. The result of this policy is an ongoing European brain drain within international firms. Top European talent that are ambitious for global roles move to international financial centres such as London or New York that welcome having global executives based in their jurisdictions. The EU is an international outlier in not wanting global executives involved in running its entities, and it undermines its competitiveness by suggesting that European bankers in international firms cannot gain valuable international experience if they remain based in the EU. Having global executives involved in the running of European subsidiaries would attract the expertise and investment that follows senior talent.

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**The EU is an  
international outlier  
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The second point is that reducing investors' returns in unexpected ways not linked with risk reduces the European financial sector investor universe and demand, which then weighs on European bank stock prices. Examples of this include the restricting of dividends during Covid, and more recently the ad hoc taxes assessed due to banks' earnings on net interest income as the European rate environment normalized. If profits from deposit beta as a core element of banking are viewed as windfall gains, European banks will struggle to have a price to earnings ratio comparable with jurisdictions in which banks return profits to investors via dividends.

A political risk premia is assessed by the market over time when political decisions disrupt the flow of profits to investors. Although some policymakers may view this as acceptable collateral damage, I would note that depressed share prices

in the financial sector can restrict capital market access and ultimately harm financial market stability.

These two items do not speak to the parliamentary agenda, and indeed in many areas I would suggest that less rather than more regulation may aid competitiveness. In situation where permitting and contracting in the EU takes significantly longer than in the US, the return on investment projections over the lifespan of the project completely changes. Looking at the European financial sector in particular, I would encourage legislative focus on the securitization market. One reason why the US banking sector has been such a powerful engine for the US economy is that it is able to recycle risk and financial resources, rather than relying on warehousing traditional credit products on balance sheet.

Financial market participation increases with securitization, banks are able to use their financial resources more efficiently with securitization, and there is greater availability of credit into the real economy.

In closing I would say that despite the challenges there are many reasons to be optimistic about the European economy going forward. The renewed European focus on enhancing competitiveness should further improve economic outcomes, whilst European banks are already forecast by financial analysts to outperform American banks in 2024.

I'd encourage Europe to take this opportunity to further develop securitization markets, and carefully weigh their regulatory and political interventions in the financial sector.



## PIERRE PALMIERI

Deputy Chief Executive  
Officer - Société Générale

### Sustainability is at the heart of long-term competitiveness

The recent energy crisis in Europe underscores the pivotal role of the ecological transition linked to economic and energy security frameworks, directly influencing the competitiveness of European companies. Being competitive involves positioning firms strategically in an ecosystem increasingly focused on long-term sustainability and where climate, environmental and social risks become more tangible. Companies that build up credible and realistic sustainability pathways into their business models are not only contributing to a greener future but are also gaining a competitive edge.

We are entering a new industrial revolution – a major economic upheaval to transition away from an economy traditionally leading to heavy GHG emissions. Further enabled by digital innovation, this is now subject to rapid change. Transformations in all sectors are already under way and innovative companies, developing breakthrough technologies or new business models, are looking for new financial services. This transformation is on a global scale, and the EU's share alone is estimated to require EUR 620 bn per year (estimation of the European Commission to

meet the objectives of the Green Deal and RePowerEU). Achieving the sustainability transition will inevitably depend on securing sufficient and swift funding through the combination of public and private financing, the latter essentially provided by banks in the EU.

Today, the EU is probably the region where the financial industry's commitment to ecological responsibility most directly supports regulators' vision of a resilient and future-proof economy.

In recent years, the EU's leadership has been amply demonstrated – from its first climate stress testing to its comprehensive consideration of ESG risks as part of banks' prudential package. EU companies, Société Générale among them, increasingly deploy vast resources to support the low-carbon reindustrialization. But we need the support of legislators and regulators to go beyond, because EU companies face increasingly intense international competition, progressing thanks to State-sponsored incentives on green investment and growth.

How can legislation support these investment flows?

First, the EU Net-Zero Industry and the Critical Raw Materials acts should be applauded. It is essential that the EU strengthens its manufacturing capacity in net-zero technologies and guarantees access to basic industrial resources.

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**Competitiveness is now  
about our adaptability  
to embrace a new  
industrial revolution.**

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But we need to move one step further: the immaturity of some disruptive technologies, the uncertainty around the commercial viability of new business models and a regulatory framework that is still in flux do not encourage the transition of industrial players. In fact, it is only once the projects have been identified and deemed financially viable (i.e., with an acceptable risk-reward) that private financing resources can be fully mobilized. Regulation should bring visibility and be ready-to-implement to allow for prompt decision making in order to stay at the forefront of innovation and remain competitive.

Another avenue is to bring more and clearer fiscal or tax incentives for our clients, and risk-sharing mechanisms between public and private funds. Although the US and EU sustainable

funds are of similar aggregate size, fragmentation between funds and administrative bottlenecks hamper EU companies compared to their US peers.

Furthermore, to enable EU financial actors and companies to further extend their reach internationally, EU authorities should ensure that norms and standards are interoperable, do not overlap and remain comparable. With national and international initiatives growing fast, the question of how the EU's legislation will interact with measures introduced outside its borders is more relevant than ever. For example, ESG indicators influence a firm's ability to secure capital and maintain its level of financing. Hence, an excessively restrictive approach may impact the attractiveness of EU companies and in turn their ability to finance their transition. Similarly, in a context where reliable and comparable ESG data is still lacking, ESG rating agencies and ESG data providers should also be subject to a best-in-class global regulatory framework.

Finally, EU authorities should ensure that EU regulation allows banks to support hard-to-abate sectors in their transformation towards decarbonization. Contingent upon these companies demonstrating genuine commitment, it is with these companies that the impacts will be the highest. It is for them that the acceleration of private and public investment is also most urgently needed, both in capital and in the know-how to manage this transition.

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We thank **the partner institutions**  
for their support to the organisation  
of this Seminar

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## OPEN STRATEGIC AUTONOMY IN THE ECONOMIC AND FINANCIAL AREAS



### MARKUS FERBER

MEP, Committee on Economic and Monetary Affairs - European Parliament

### We need bigger capital markets to match our ambition

Relative to the size of its economy, EU capital markets are small, in particular when compared to other developed economies, most notably the United States. As a consequence, equity financing for European companies is a lot more difficult than it is in other jurisdictions. Unsurprisingly, the European corporate financing model is clearly lopsided towards bank financing. This poses a particular challenge for younger and smaller companies that still need a considerable runway before becoming profitable. That becomes even more of an issue as bank financing (measured as a percentage of GDP) still remains below the levels it had reached before the Great Financial Crisis.

With scarce financing possibilities in Europe, innovative European companies often gravitate towards finding

financing in jurisdictions outside the EU. That is a concerning trend. We should be worried if the EU cannot provide financing for its companies. On the one hand, that means that non-EU actors are strengthened at the expense of European financial services players. Viewed from a “strategic autonomy” standpoint, arguably that outcome needs to be avoided.

At the same time, European companies seeking financing elsewhere, be it venture capital or an initial public offering, goes also to the detriment of European investors. Most retail investors still have a noticeable home bias in their portfolio composition and only or mostly invest in the markets they think to know best. If the most innovative and most value creating companies list elsewhere, European retail investors miss out. Missing out on excess returns, however, becomes a particular problem in light of strained public pension systems and an increased need for individuals to take care of their old-age provisioning.

Therefore, we need to think hard about how to change this unsatisfactory status quo and make sure that growing European companies stay in Europe, both for their operations and for their financing. The European Commission’s Capital Markets Union initiative has aptly identified the problems at hand. Yet, the action plan is almost ten years old by now and not enough has happened. One could even argue that with Brexit, European capital markets haven’t taken another hit as the City of London has moved from being an integrated part of European financial markets towards being a competitor - and one that is a lot closer to home than the United States. That raises the stakes even more.

When focussing on public markets, getting listing rules right, is key. The current listing provisions combined with strict and sometimes even unreasonable provisions to prevent market abuse, have made going public in Europe a costly and complex endeavour, that is not very attractive for many companies. Another aspect that bothers many owner- or family-led companies is the fear of relinquishing control of the business when going public. A clever way to circumvent this problem is to issue multiple-vote shares that combine the financial upside of a public listing with the element of maintaining control that would only be possible if the company

stayed private. That is essentially the financing model chosen by many highly innovative silicon valley companies.

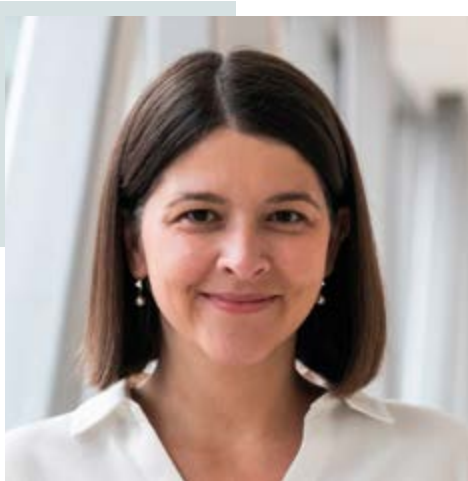
Both aspects, cutting down on red tape and making listing more flexible, are addressed in the Listing Act proposal that has the potential to simplify the listing process within the European Union thus giving a boost to European capital markets. This file therefore has to be a priority to complete before the end of the European Parliament’s current mandate.

**If we want to boost the Capital Markets Union, we need to look at both sides of the equation.**

If we want to boost the Capital Markets Union, we need to look at both sides of the equation, though. Another weak point of the European ecosystem is clearly investor engagement - and retail investor engagement in particular. Over the years, we have built a very sophisticated, but also very complicated investor protection framework for financial services in the EU. Too often, this very sophisticated investor protection framework does not do what it is supposed to, but rather poses an obstacle for retail investors to get engaged in EU capital markets by creating unnecessary complexity. This, in turn, limits the available liquidity for businesses to tap into.

Unfortunately, the European Commission’s Retail Investment Strategy does not address the existing shortcomings in an adequate manner. Instead of reducing excessive paperwork and limiting administrative burdens for retail investors and intermediaries, the Commission proposal adds a new layer of complexity that is unlikely to incentivise retail investors to get involved in European capital markets in the first place. That is why the Commission proposal needs a comprehensive redraft in the legislative process.

After all, the last thing we need is making access to EU financial markets even more difficult.



## GINTARĖ SKAISTĖ

Minister of Finance of the  
Republic of Lithuania

### The three pillars of OSA - Competitiveness, resilience, and security

Open Strategic Autonomy (OSA) embodies the EU's pursuit of self-reliance in key strategic areas, within the broader multilateral economic and financial system. The concept has evolved in response to large-scale shocks – from the pandemic to Russia's war in Ukraine – and a changing geopolitical environment that exposed the EU's structural weaknesses. Over time, OSA has become a broad-based horizontal issue covering many policy dimensions, including defence, technology, economy, and finance. Thus, achieving strategic autonomy requires a multi-pronged approach, which, in my view, should be based on three core pillars – competitiveness, resilience, and security.

#### Competitiveness

Without a doubt, the biggest economic strength of the EU is the Single Market. It brings substantial benefits for Member States and makes the EU one of the major economic blocks globally. Yet there is still vast untapped potential to deepen the Single Market. While goods in the EU move across borders relatively freely, the services market, including the

digital space, still faces various obstacles that need to be addressed.

Particular importance must be attributed to the creation of a genuine Capital Market Union. Currently, European capital markets remain largely fragmented along national borders, requiring strong and persistent EU-level efforts to advance the CMU. Future progress must deliver a tangible impact on the real economy by providing more accessible financing options for businesses, ranging from start-ups to large corporations, and it should offer households a broader set of instruments to employ their savings for productive use. Overall, the CMU plays a central role in financing the digital and green transitions, improving competitiveness, and the resilience of EU economies.

The EU also needs to invest more in physical and human capital, as well as R&D to foster innovation and technology. Such measures are crucial for ensuring future economic growth and competitiveness. Certain industrial policies, e.g., related to the green transition, are indeed needed. Yet they should focus exclusively on key strategic sectors, ensuring minimal distortion of the Single Market. Additionally, the EU should strive for fair and balanced economic and trade relations with third countries. If necessary, the EU should not hesitate to utilize the available toolkit, from the Anti-Coercion Instrument to Foreign Subsidies Regulation, to enforce the level playing field.

#### Resilience

The pandemic revealed EU vulnerabilities due to overreliance on global supply chains and complex production networks for critical goods like semiconductors. Rising geopolitical tensions also exposed potentially harmful dependencies, particularly for critical raw materials. In this regard, it is key to seek diversification and increase resilience of our supply chains. Of course, a balanced approach is necessary to limit the side-effects of global economic and trade fragmentation.

Russia's war against Ukraine underscored the importance of energy independence and added a geopolitical aspect to the urgency of the green transition. The exposed fragilities in the EU's energy security forced to accelerate investments in renewables and domestic energy production capacity to diversify energy sources, mitigate external risks and boost overall resilience. The war was a painful lesson about the risks associated with economic dependence on autocratic countries that the EU must avoid in the future.

Additionally, a notable concern is the EU's dependence in the financial sector, particularly the overreliance on third-country payments and clearing services, which may create vulnerabilities in the core architecture of the European financial system. The digital euro project is an important step towards greater resilience in this area, which could also contribute to fostering the international role of the euro.

**The EU should not  
hesitate to utilize  
the available toolkit  
to enforce the level  
playing field.**

#### Security

Russia's war against Ukraine has profoundly altered the security situation in the region. It prompted a rethink of defence strategies, necessitating a long-term substantial increase in defence spending. The war has underscored the importance of military capabilities to ensure peace and stability, which are essential public goods and the foundation of economic prosperity. In this regard, it is welcome that the new fiscal rules will treat the strengthening of defence as a common EU priority.

Overall, achieving strategic autonomy requires significant reform efforts internally to unlock the full potential of the EU Single Market, in terms of truly free movement of goods, services, and capital. Externally, the primary goal is to improve resilience through diversification and capacity building, particularly in critical areas, such as energy and raw materials, as well as defence.

Finally, while striving for greater resilience, the EU must stay open within its strategic autonomy objectives and should foster cooperation, especially among like-minded democratic countries, to counterbalance the rise of autocratic powers.



## HARALD WAIGLEIN

Director General for Economic Policy, Financial Markets and Customs Duties - Federal Ministry of Finance, Austria

### The Capital Market Union – Europe must keep pace

The EU's competitiveness and its role as a financial and business hub will largely depend on our ability to channel funds to the capital market. The green and digital transformation of our economy cannot rely solely on government expenditure but will require a substantial amount of private capital. Not only the market conditions in times of multiple crises, but also the EU's objective of defragmentation of its capital markets, of independence and strategic autonomy require further steps.

Since its launch in 2015, the Capital Market Union (CMU) has made significant progress while also facing various challenges along the way. The CMU's main goal was to create a single, well-functioning, and efficient capital market across all Member States. The reasoning behind the ambitious initiative was aimed at further integrating the EU's capital markets and addressing the fact that corporate finance heavily relies on debt, especially bank loans.

Therefore, the CMU's primary objective is to unlock new sources of funding for businesses, particularly for small and medium-sized enterprises (SMEs). By

eliminating the existing fragmentation and barriers within the EU's capital market, the initiative aims to provide easier access to finance, promote cross-border investments, and bolster economic growth and job creation.

Ensuring a level playing field for all market participants is another key aspect of the CMU. Currently, certain Member States have more developed capital markets and enjoy better access to financing compared to others. This imbalance poses a hindrance to SMEs' growth and competitiveness, limiting their ability to innovate and expand. The CMU seeks to remedy this. It promotes equal opportunities for all EU businesses.

The significance of the concept of "strategic autonomy" is not only closely linked to the CMU's objectives, but also a direct consequence of the economic, geopolitical and market conditions in recent years. "Strategic autonomy" in this regard refers to the idea that the EU needs to develop its own financial resources and capabilities in order to reduce its dependence on external actors and to mitigate potential risks to its financial stability. In practical terms, this means strengthening the EU's financial sector, enhancing its competitiveness, and reducing reliance on non-European financial centres.

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**To remain a serious competitor on the global stage, the EU needs to accelerate its efforts.**

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A crucial aspect of open strategic autonomy is the need to develop and support European champions. The EU should aim to create an environment that is conducive to the growth of large corporations capable of competing on a global stage. This includes facilitating access to capital markets, encouraging innovation, and promoting entrepreneurship. By establishing a robust CMU, the EU can strengthen its financial ecosystem, enabling its businesses to flourish and achieve financial resilience.

While the CMU has made significant progress, challenges remain in its implementation. One major stumbling block is the need to harmonise regulations and remove legal and administrative barriers. The diversity of financial systems across Member States poses challenges in creating a common regulatory framework. However, efforts

are underway to simplify and streamline rules and to enhance cross-border cooperation while maintaining high standards of investor protection.

Another challenge lies in building investor confidence and trust in the CMU. Investors need to feel secure and have confidence in the transparency and accountability of the capital market. From my point of view, transparency, satisfactory returns and value for money are more likely to boost retail investors' trust in the capital market than more interventionist measures such as a ban on inducements.

Progress has been made in terms of the availability of comparable data for investors during this Commission's mandate. The European Single Access Point will facilitate access to financial and sustainability-related information on EU companies and investment products. The consolidated tape will significantly increase the visibility of listed companies. In this respect and also from a strategic autonomy perspective, I welcome the initiative of the European stock exchanges to participate in the legal tender for the provider of the consolidated tape.

Both the development of the Capital Market Union and the objective of strategic autonomy are closely linked to and essential for the EU's economic growth and stability. Many efforts of the co-legislators to further develop the CMU have been successful. At the same time, many of the steps taken during this Commission's mandate cannot be assessed yet. Their impact will become clear only at a later stage. To remain a serious competitor on the global stage, the EU needs to accelerate its efforts to strengthen its Capital Market.



## PHILIPPE BORDENAVE

Senior Executive Advisor -  
BNP Paribas

### Mobilizing European savings: time to shift priorities

As we all know, meeting Europe's strategic priorities will require financing very significant investments: in June 2023 the European Commission estimated that the EU Green Deal and RepowerEU will require additional investments of €620 billion/year until 2030. It is important to note that this figure comes on top of the steady investment flows necessary to keep European economic players competitive and strategically autonomous. Moreover, this excess funding is needed in a complex and adverse context for the European economy: geopolitical tensions, inflation, low economic growth, and public sector deficits.

European savings are large enough though. Europe has an important capacity of household savings. In fact, the level of households gross savings rate in the EU runs at 14% of their disposable income and the excess over current investments amounts to around 500 bn€/year, not too far from the 620 bn€ needed.

However, a significant part of these savings is invested outside of Europe, or in liquid, short term assets. So the question is, how to direct a bigger part of these savings towards the huge long term funding needs of the European economy?

Currently, the European economy is reliant on bank financing (75% of total financing in the EU vs only 25% in the US) Could banks lend more? It is also key to continue the efforts to develop capital markets, where institutional investors can find opportunities to directly finance investments by using financial products meeting their demands. Could banks be more active in originating and distributing such products, with all the ingredients ensuring the required liquidity of the markets: warehousing, market making, derivatives, securities lending and borrowing? Like the big US banks do in the US?

The answer is yes: the European banks are able to and would be delighted to take part in this economic activity. But they face a number of capital and supervisory constraints hampering them.

Hence we are back to a controversial issue: what is the optimal level of bank capital?

Everything else being equal, growing capital requirements are increasing the level of financial security, but reducing banks' ability to lend and to deal in capital markets. Up to a certain point, there is more to gain by reducing the frequency of banks crises than to lose by hampering the day-to-day economic growth. But like in any economic mechanism, once low hanging fruits have been harvested, the marginal return of additional progress is declining: there is an optimal level beyond which the toll paid every year in the form of lower funding -hence lower economic growth- becomes higher than the additional benefit for financial stability.

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#### Does EU want to let banks use EU savings to finance the huge needs of the transitioning EU economy?

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In 2008, managing these two conflicting purposes was a no brainer, and CET1 requirements were sharply increased on both sides of the Atlantic from around 7% in average to around 12% in 2014. At the time, a BIS study concluded that the theoretical optimum was indeed in the region of 10%. Since then, be it by design or by coincidence, the average CET1 of US banks has stabilized and even slightly declined to close to 11%. In Europe, to the contrary, the average CET1 of banks has increased from 12% to 17% since 2014.

This is due to the ever-growing pressure put by the Single Supervisory

Mechanism. Bank supervisors in Europe keep tightening the screw in many ways: the "finalization of Basel 3" without adjusting down pillar 2 (reminder: pillar 2 is a pure European addition to Basel); climate stress tests with a view of finding a new opportunity for additional capital requirements, the return of countercyclical buffers, and more.

Since 2014, the US economic growth has significantly outpaced the EU by 15 full points...

As demonstrated in the EBA 2023 stress test exercise, European banks are resilient. This has been said and reiterated on numerous occasions by all EU regulators and supervisors, following the bank failures in US and Switzerland in spring 2023. EU banks are well above the safe and optimal capital levels.

Therefore, the question the E.U. needs to ask itself is as follows: does it still want to force EU banks to keep increasing their capital, in order to further maximise financial stability, above and beyond the existing satisfactory level? This will come at the expense of their ability to lend and to develop capital markets in Europe, i.e., ultimately at the expense of EU growth prospects and its green transformation.

Or does it instead want to let banks use EU savings to finance the huge needs of the transitioning EU economy, which they are perfectly willing and capable to do? In this case, governments and the Commission should express a clear political signal to EU banking supervisors as, up to now, the latter only have the mandate to keep increasing banks capital requirements progressively, without any limit nor any consideration for the general economic situation.



**LIEVE  
MOSTREY**

Chief Executive Officer -  
Euroclear S.A.

**Supporting  
financial stability,  
integration and  
competitiveness –  
A necessary balance  
in the current  
environment**

The world economy is recovering from a historic period of turbulence. Financial markets remain exposed to geopolitical pressures and an uncertain political landscape with countries making up over 50% of global GDP undergoing elections in 2024.

The fragile macro-economic context is set to remain for some time as the ECB and other central banks seek a normalisation of inflation levels.

Meanwhile, the year 2023 was confirmed as the warmest on record. The global challenge of mobilising financing in support of the green transition remains as pressing as ever and must be pursued alongside other priorities requiring capital resources.

The combined challenges have further underscored the importance of a strong and resilient financial system that is able to support the European economy across a range of conditions.

The promotion of open strategic autonomy is likely to acquire a renewed emphasis in the current environment.

The concept should be considered in the context of complex global trade flows and highly dynamic and interconnected global markets, shaped by competition, collaboration, security considerations and resource dependencies.

How should this translate into future policymaking in the financial sector? I believe that efforts should focus on fostering three sets of priorities.

Firstly, the continued expansion and integration of the EU's capital markets capacity – anchored around the Capital Markets Union (CMU) project – should remain a cornerstone of the single market's evolution and our economic strategy.

A key challenge for Europe is the need to improve the capacity to channel retail savings towards capital markets instruments and long-term investment products. This remains a fundamental priority of the CMU project as the availability of deep pools of investable capital drives the development of an attractive and liquid market ecosystem. Member States such as Sweden have demonstrated that it is possible to encourage high rates of household participation through tax incentives and a supportive regulatory environment. This has driven the development of a vibrant ecosystem benefiting not only households but also companies seeking finance. Achieving similar results on an EU-wide scale – through a combination of local and European-wide measures – would be a true game changer for the CMU and the global standing of EU financial markets.

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**Attracting international  
companies and  
supporting EU players  
is important to  
strategic autonomy.**

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Secondly, the attractiveness of European capital markets and the global competitiveness of businesses should be increasingly prioritised in the policy agenda. Being able to attract international companies and support those headquartered in the EU in critical sectors is also an important component of promoting strategic autonomy and economic security.

Companies across Europe need to be able to leverage the scale of the

single market and the benefits of well-regulated, open markets to compete on the global stage. This requires effective regulation that takes due consideration of the competitiveness challenge and the need to adapt to rapidly changing market conditions.

The third priority is the continued support of financial stability and systemic resilience, which must always remain at the forefront of all policy considerations.

The geopolitical developments of the last two years have posed numerous challenges to market participants, including financial market infrastructures intermediating activity across global markets. The management of heightened risks and market stresses, as well as the implementation of unprecedented sanctions policies, continue to be resource-intensive processes, resulting in major operational complexities that have been managed successfully.

Financial market infrastructures and the CSD sector have continued to demonstrate their resilience and value to the financial system during this testing period. Going forward, it is important that the measures undertaken by governments and regulators continue to be underpinned by robust legal frameworks and the appropriate consideration of risks, ensuring that the latter can be adequately covered in all scenarios.

I am confident that our financial ecosystem remains robust and well-equipped to navigate the current global landscape and the challenges ahead. As we reflect on the future European policy agenda, it is clear that the financial sector's continued resilience, capacity to support investors and issuers and compete on the global stage will be crucial for Europe's long-term prosperity and strategic autonomy objectives.





## VITTORIO GRILLI

Chairman of Italy & CIB  
EMEA - J.P. Morgan

### Balancing EU interests while keeping open and international financial markets

In 2024, over 2 billion people will be heading to the polling stations – including key regional and national elections such as the US, the UK or India; and in the EU, the European Parliament elections will kick start a new key political cycle. In such environment, political changes are inevitable, which together with a gradual increase of trade tensions, could encourage calls within the EU for more economic security / sovereignty.

We understand EU's ambitions of de-risking key strategic sectors and ensuring resilience in sensitive industries. However, there should be a differentiation between an open strategic autonomy that allows the EU to act in the international arena with a unified and harmonized voice, and an agenda that prevents the EU from strengthening alliances with trusted partners. Whilst the first maintains the EU as an important geopolitical player, the second has the potential of weakening everything the EU has worked to achieve.

That is why we support the EU's ambition to build financial markets

capabilities and achieve further market integration, and agree that EU's financial resilience is best achieved through the Capital Markets Union (CMU) and Banking Union projects. Deepening CMU through new regulatory proposals and continuing the work to finalizing the Banking Union should therefore be considered a top priority for the next political cycle.

We would however be concerned if other policy ideas under the “open strategic autonomy” umbrella showed risk of potentially weakening – or rather not strengthening – Europe's open and international financial markets. The participation of global firms in the EU system brings added competition and market depth, to the benefit of EU clients, and specifically the involvement of US financial institutions in EU capital markets supports the EU's aspirations of ensuring a more diversified source of funding for the EU economy.

As we look forward to the next Commission, a fundamental securitisation reform should be a key part of these efforts to reduce pressure on banks and open up lending to help support the economy.

Re-launching and scaling up securitisation is an essential component of the CMU, a bridge between the Banking Union and the CMU and can bring considerable benefits to the European financial system, including by reducing over-reliance on bank funding while encouraging cross border investments. When developed in such a way as to be responsible, prudentially sound and transparent, securitisation seemed to us to be an important vehicle to increase the capacity of banks to lend and also for investors to have access to European credit products.

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**Financial markets  
increase their  
resilience and quality  
through the strength  
of their network.**

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If I can give a more specific example, we believe there should be a clearer role for Competent Authorities in Significant Risk Transfer assessments. For the sake of a global level playing field, the EU prudential rulebook and the Basel framework should be amended when it comes to recalibrating capital charges for senior securitisation tranches (both for banking and insurance) and when reassessing criteria under the Liquidity Coverage Ratio (LCR).

It would also be important for the next Commission to facilitate disclosure and due diligence requirements, both in the context of public and private securitisation and also third country securitisation to ensure a more proportionate approach to disclosure requirements.

The traditional transatlantic nature of financial markets should therefore be considered as a sign of strength, and it should be protected regardless of the 2024 election outcomes on both sides. The private sector has a pivotal role to play in helping to achieve a normalization of the relationships, with the added value that non-EU firms bring to financial markets by increasing diversification in case of economic disruption affecting the EU.

By their nature, banking and financial markets increase their resilience and quality through the strength and breadth of their network. Recent geopolitical events and banking turmoil have shown how more diversified sources of financing in the EU and relatively less dependence on bank funding increased resilience, and allowed the EU to effectively address any financial instability concerns.

We know this is not an impossible task. The EU has proven the benefits of a deeply integrated single market for goods, and a similar process should follow in the single market for services, particularly financial services. CMU and Banking Union are the fundamental drivers that will allow a significant increase of financial resilience in the EU. The next Commission will be a great opportunity to continue the work, balancing the open strategic autonomy while increasing EU's financial resilience and allowing for cross-border market financing.



## ODILE RENAUD-BASSO

President - European Bank  
for Reconstruction and  
Development (EBRD)

### Capital market development – A work in progress, not an overnight sensation

Creating more developed capital markets in Europe is a long-term project and a priority of the European Bank for Reconstruction and Development (EBRD) with the worthy goals of increasing the financial wellbeing and security of the continent's millions of citizens, providing better finance innovation and delivering the transition to net zero. Diversity of financing sources supports economic resilience and can result in a quicker recovery from downturns.

And yet Europe clearly lags behind markets in the United States and Asia in terms of capital market development. In the last 15 years, the weight of the European capital market to global capital markets has almost halved (from 18 per cent in 2006 to 10 per cent in 2022). The same trend is also seen in the venture capital and private equity segments, where the lack of a sizeable pool of capital available for early-stage investments means that Europe cannot support and scale up its financing of innovative growth companies.

Strong reliance on bank lending and bank instruments is still a cultural issue in Europe. Companies raise 80 per cent of their financing through bank lending, compared to capital market instruments, whilst one third of European savers' assets are in bank deposits. To address this structural imbalance there is a clear need for a more defined comprehensive long-term strategy.

Through capital markets union (CMU) action plans and regulatory alignment, the European Union has generally made the capital markets more accessible for small, mid-size and larger companies. However, more active support is needed with financial incentives (tax regimes) on both the supply and the demand sides, mobilising new investments through collective schemes and direct retail participation, as well as programs of education for both companies and investors.

Insufficient long-term capital is also a critical issue. The average size of pension assets to GDP in Europe is 32 per cent while in the US it is 173 per cent. This average is further distorted by the concentration of 62 per cent of all EU pension assets in only three countries (The Netherlands, Denmark and Sweden). Systemic development of funded pension systems in the EU countries is a prerequisite for capital market development.

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**The consolidation of  
the Baltic market,  
supported by the  
EBRD, might provide  
a template for CMU.**

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Market fragmentation remains an obvious barrier in Europe, where there are 22 stock exchange groups operating in 35 listing venues, 41 stock exchanges for trading and nearly 18 Central Clearing Counterparties (CCP) and 22 the Clearing Settlement and Depositories (CSD) (2021 figures). Creating a bigger liquidity pool increases the chances of a successful share placement – liquidity attracts liquidity.

The fragmentation of trading venues is relatively easy to address with technical connectivity solutions. The real problem lies in the post-trading architecture where the interoperability of CCPs and linking up of the CSDs makes cross-border trading costs prohibitive, especially in those jurisdictions that are out of the eurozone and using local currencies. It is no surprise that

the US market has one single CCP and CSD but multiple trading venues. The competition of the trading venues means competitive trade pricing, while the centralised post-trading services create efficiencies from economies of scale in terms of processing volumes.

The optimal outcome of CMU is unlikely to be one single pan-European stock exchange but a strong network of the connected local ecosystems that also encourage cross-border investments and reduce the fragmentation of market liquidity.

The consolidation of the Baltic market, supported by the EBRD, might provide a template for CMU, following the decision of MSCI (Morgan Stanley Capital International) to classify the markets of Lithuania, Latvia and Estonia under a single index in 2023. This decision required much more than evidence of a single CSD and interconnected trading venues. As well as the support of market participants and operators, it also demonstrated the value of strong cooperation between the Governments to better align taxation, market regulation, and green taxonomy that was integral to the success of this initiative.

One of the EBRD's key priorities continues to be to support capital market consolidation and interlink markets. The Bank has supported the consolidation of smaller exchanges in the region and the creation of the SEE Link (the innovative platform linking Bulgarian, Croatian and Macedonian exchanges), and we continue to work with all the Central European markets to create a single marketplace in central and southeastern Europe.

# Seminar organised with the contribution of the Eurofi members



## FOSTERING LONG TERM PRODUCTIVE INVESTMENT



### MARIO NAVA

Director General - DG for Structural Reform Support - European Commission

## Reforms, public financial management, tax compliance and sustainable investments

EU Member States are grappling with substantial long-term pressures on their public finances. The EU's Multiannual Financial Framework (MFF), complemented by the NextGenerationEU (NGEU), forms the largest stimulus package ever financed in Europe. With over €2 trillion, this package is aiding in the reconstruction of a post-COVID-19 Europe through ambitious reforms and investments that will elevate productivity and growth. Public financial management reforms together with reforms addressing tax avoidance and compliance are also key to increase investment opportunities and reduce administrative burden for all businesses.

With taxation being a Member State prerogative, EU tax policy focuses on eliminating corporate tax avoidance

and aggressive tax planning (ATP) and enhancing cooperation between tax administrations. The EC communication on Business Taxation for the 21st Century<sup>1</sup> notes that corporate tax avoidance costs EU Member States 35-70 billion euros annually<sup>2</sup>. The Commission has drawn attention to ATP risks in the context of European Semester country specific recommendations (CSRs) and Recovery and Resilience Plans (RRPs)<sup>3</sup>.

The Technical Support Instrument (TSI) has gone further and been instrumental in assisting Member States in overhauling their tax policies and revenue administrations to collect taxes fairly, sustainably, and efficiently. It has also extended support to EU Member States in modernizing their public financial management and expenditure policies to achieve an efficient utilization of public funds.

Specifically to combat corporate tax avoidance, tax fraud, and tax evasion, the TSI has backed 17 reforms in 11 Member States to implement the OECD Transfer Pricing Guidelines (OECD TPG), ensuring compliance with international standards and better preparation for the Minimum Tax Directive and the proposed Transfer Pricing Directive, both stemming from the OECD/G20 global approach to curbing corporate tax avoidance by large international corporations. Thanks to the significant reduction of complexity of rules and increased tax certainty, uniform application of the Transfer Pricing brings significant benefits for all businesses that operate internationally.

Furthermore, TSI has supported 7 reforms in 5 Member States introducing Cooperative Tax Compliance Programs (CTCPs) for large taxpayers. CTCPs enable revenue authorities to promote voluntary tax compliance while building trust and legal certainty. This leads to higher budget revenues, closing existing tax gaps and expands fiscal space for investments and, at the same time reduces administrative burden of tax compliance for large businesses, by increasing communication and cooperation between companies and tax administrations.

One of the central goals of the recently revised Stability and Growth Pact is to achieve sustainable consolidation of public finances while safeguarding investments and structural reforms. Modernizing public financial management is crucial to achieving this objective, and

the Technical Support Instrument (TSI) has played a pivotal role by supporting 25 reforms across 24 Member States aimed at enhancing the national budgetary performance of public funds. Several Member States have revamped their medium-term and performance-oriented budgeting frameworks, enabling more value-oriented public spending and investments.

Good management of public funds transfers to more stable sovereign debt markets, thus reduces the risks of crisis and increases the resilience of the financial sector and economy at large. 23 Member States are actively engaged in improving their green budgeting frameworks, as a means to steer public spending towards areas that align with green transition objectives.

### Reforming public financial management and tax compliance increase sustainable investments.

Additionally, DG REFORM has supported 28 spending review reforms in 15 Member States. Consequently, Member States have enhanced their ability to reallocate public spending thanks to evidence-based assessments of where value for money is being generated. Aligning public budgets and investments with the objectives of the EU's green transition gives an important signal to the business community. Public and private finance need to work together.

As a result of the EU financial stimulus package and the reforms supported by the European Commission via the TSI, the scope for sustainable investments expands, enabling our economies to transition towards greater sustainability.

1. [https://taxation-customs.ec.europa.eu/system/files/2021-05/communication\\_on\\_business\\_taxation\\_for\\_the\\_21st\\_century.pdf](https://taxation-customs.ec.europa.eu/system/files/2021-05/communication_on_business_taxation_for_the_21st_century.pdf)
2. Dover, R., Ferrett, B., Gravino, D., Jones, E., & Merler, S. (2015) *Bringing transparency, coordination and convergence to corporate tax policies in the European Union*, European Parliamentary Research Service, PE 558.773.
3. [https://www.europarl.europa.eu/RegData/etudes/BRIE/2023/745704/EPRS\\_BRI\(2023\)745704\\_EN.pdf](https://www.europarl.europa.eu/RegData/etudes/BRIE/2023/745704/EPRS_BRI(2023)745704_EN.pdf)



## HARALD WAIGLEIN

Director General for Economic Policy, Financial Markets and Customs Duties - Federal Ministry of Finance, Austria

### The private sector dimension in the green transition

In the Sept. 2022 edition of this journal, I argued that the success of NGEU depends on its capacity to crowd in private investment. I also argued that reform agendas are key to this, more than investment projects. And I regretted that only few Member States specified a path towards green taxation in their Recovery and Resilience Plans (RRPs). With this in mind, I am not particularly surprised that productive investment in the EU has not caught up despite the pay-out of one quarter of RRF funds.

Private investment is typically multiple times greater than public investment. The private investment gap that undermined growth in the EU during the past decade cannot be compensated by public money, however big the funding pot. EU economic policy since the pandemic has devoted too little attention to private investment and too much to public investment and subsidies. Policy makers seem to remain traumatised by the low-growth era following the GFC, which according to the stylised fact was caused by public investment cuts necessitated by the EU's fiscal rules. And yet since 2020, when we suspended the fiscal rules and allowed

unprecedented borrowing by the EU, the multiplier from public investment turns out to be smaller than assumed.

Removing obstacles to private investment is key to advancing the green and digital transition. In the EIB's annual survey, availability of skills has been the most important long-term barrier to investment since 2016. Yet RRP's devote only around € 55bn to policies for the next generation. Arguably, investment in skills takes years to generate economic returns. But had we reacted to the EIB's warnings earlier, we would already see the positive effects.

Second on the EIB's list of investment barriers is the cost of energy – a more recent development, triggered by the 2022 price shock. The policy answer is less straightforward. On the one hand, higher prices for fossil fuels encourage energy savings and investment in renewables, thus supporting EU objectives. On the other hand, in some sectors and at certain times, the alternatives to fossil fuels are scarce and expensive, potentially affecting the competitiveness of EU firms. Also, there is a risk of replacing dependency on Russian oil and gas by dependency on Chinese batteries and solar panels. Finding the right balance between the green, strategic autonomy and competitiveness objectives will be one of the main challenges of the next few years.

#### The distortion of price signals and competition in the EU energy market discourages investment.

The price of energy is, however, only part of the story. Equally important is the uncertainty around the future evolution of prices for renewables vs. fossil fuels, combined with the ambiguity created by Russia still delivering gas to some corners of the EU. The EIB Survey shows that uncertainty around future returns is a major obstacle to green investment. The uncertainty is reinforced by subsidisation schemes, which blur the relation between costs and returns and undermine the level playing field in the Single Market. The distortion of price signals and competition in the EU energy market is a key obstacle to private investment, but policy makers' attention focusses more on the US and the IRA.

In addressing the fallouts from the pandemic and advancing the green transition, the EU has fallen victim to the erroneous belief that public spending can undo structural deficiencies. When

RRP's were rushed through the Council, reform efforts in the area of the green transition appeared disappointing overall. Many of the so-called "RRF reforms" are in fact preparatory laws for investments. The positive assessment of RRP's has rubberstamped that "all or a significant subset of country-specific recommendations" are being implemented, killing pressure by the Commission and Member States to go beyond RRF reform agendas.

Public investment has long lead times. The RRF could not undo this fundamental problem. It might be even worse, given that the layers of control increase when EU funds are involved, due to accountability towards the European Parliament and EU citizens. The performance-based model provides financing quicker than in the past, but bottlenecks arise when the projects are implemented on the ground. Public investment is like a tanker ship. Private investment could be the speed boat, if the wind was blowing in the right direction and the anchor lifted.

Crowding in private investment requires coordinated action at EU and national level. First, CO<sub>2</sub> reduction paths have to be substantiated by comprehensive taxation of emissions in all Member States. Second, the subsidy spree and the hollowing out of competition policy has to end. New impetus should be given to the Single Market, by levelling the playing field in the area of energy. Third, productive investment should be given appropriate attention in the EU's economic surveillance. It is not yet too late to safeguard the green transition, if we acknowledge that public investment alone won't do the job.



## GERASSIMOS THOMAS

Director General - DG Taxation and Customs Union - European Commission

### Carbon pricing and CBAM support long-term investment needed for green transition

Through interdependent regulatory, market-based and taxation measures, the EU's trajectory to climate neutrality by 2050 is well underway. In the coming years, Member States will continue to fine-tune and implement these changes, while doubling down on complementary climate adaptation efforts.

A central pillar of our internal EU strategy and our international cooperation, carbon pricing is not only an effective instrument to curb emissions – it's also the most efficient way to drive the transition to net zero. The success of the internal EU Emissions Trading System (EU ETS) since its introduction in 2005 led to a 37% reduction in power and industrial emissions to 2021. EU GDP grew by more than 50% in the same period despite major external shocks to the economy. Its recent reinforcement should lead to a 62% reduction by 2030.

The Carbon Border Adjustment Mechanism (CBAM), now in force in its transitional phase, ensures an equivalent carbon price for certain

imports to the EU compared to that paid by EU industry under the ETS - combatting the risk of carbon leakage which will be more pronounced as 'free allowances' afforded to EU industry under the ETS dry up.

We are fully aware of the need to ensure balance: our ambitious climate initiatives must preserve and promote international trade and competitiveness, including between the EU and the rest of the world. We are contributing to international initiatives such as at the WTO, the UN, the G7 Climate Club and the OECD's Inclusive Forum on Carbon Mitigation Approaches (IFCMA) to achieve just that. And it is my view that the EU CBAM achieves this balance in three ways.

First, the EU CBAM will help develop a more level-playing field on EU markets and open up investment opportunities for EU industry in the covered sectors who will no longer be undercut by imports that may have been produced under lower green standards. Overall EU production across the four biggest sectors amounts to over 350 million tonnes and employs almost 2 million people. Nevertheless, the EU is a net importer of CBAM goods: in 2022, the EU imported a total of 115 million tons of iron and steel, aluminium, cement and fertilisers products in the scope of CBAM. Most are from close partners, including in our direct neighbourhood. For example, nearly 20% of iron and steel comes from Ukraine and Türkiye combined and 11% from Canada, while 41% of cement comes from Türkiye and 15% from Algeria. While Russia was a major provider, EU sanctions and trade disruptions mean that other producers of CBAM goods will increasingly export to the EU.

As first-movers in decarbonisation, EU companies are therefore future-proofing their business models in a world where environmental provenance matters to downstream buyers and consumers. Separately, we continue to support industry in their greening efforts such as through the €40 billion EU Innovation Fund, which has already awarded €3.3 billion to 34 projects in CBAM sectors.

Second, any effective carbon price or tax paid abroad can be deducted from the price paid on import under the CBAM, kickstarting conversations in countries and regions worldwide. There are now 73 carbon pricing schemes in nearly 50 countries covering a quarter of emissions – double that in place when the Paris Agreement was signed in 2015. Several countries such as Türkiye, Ukraine, Morocco, India and Brazil, are preparing to introduce carbon pricing

or energy taxation measures. Apart from their contribution to climate change mitigation, these measures will also produce significant revenues that can help accelerate those countries' own green transitions. But, as pointed out by Commission President von der Leyen, to get emissions on track the global price of carbon will need to reach an average of \$85 a tonne by 2030, compared with just \$5 today.

Third, CBAM represents a powerful incentive for non-EU companies and EU companies present abroad and their subsidiaries to invest in more sustainable technologies and processes. As producers align with more stringent carbon standards, they become more attractive to the EU and other markets while contributing to a more sustainable global economy.

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**Global cooperation on carbon pricing is necessary to fully exploit this proven mitigation tool.**

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Not all countries and businesses have the same starting points. EU importers will have to familiarise themselves with the new CBAM to comply with their reporting obligations. To that end, the Commission has made available considerable guidance and simplifications to support them. We are engaging with non-EU countries to explain the CBAM's purpose and added value for their climate plans and businesses. And we continue to support international partners in their decarbonisation efforts through e.g. the Global Gateway and the Green Team Europe initiatives.

Regional and national carbon pricing regimes are just the start. Global cooperation is clearly necessary to fully exploit this proven tool. The EU will continue to share its unique perspective with all partners to spur global progress that delivers clarity and certainty while driving decarbonisation.



## MARKUS FERBER

MEP, Committee on Economic  
and Monetary Affairs -  
European Parliament

### Boosting competitiveness - But not at the expense of fiscal sustainability

The United States' Inflation Reduction Act was probably the biggest industrial policy initiative launched in the past decades and it has put the European Union in hot water. However, this is only partially bad news. After all, the Inflation Reduction Act was also a wake-up call for the European Commission to revisit a topic that has been neglected for quite some time: the issue of competitiveness.

Once upon a time, in its 2000 "Lisbon Strategy" to be precise, the European Union has set itself the goal to become "the most competitive and dynamic knowledge-based economy in the world". More than 20 years later, it has become clear that the European Union has not achieved this lofty objective. On the contrary, the idea of making the European Union a great place to do business has been an afterthought at best for many years. Consequently, the competitiveness of many European Member States has decreased rather than increased over the past couple of years.

Not all of this decline can be blamed on the European level. After all, there are many levers a Member State can pull to either increase or decrease its competitiveness. Nonetheless, it is fair to say that the barrage of new substantive provisions and reporting requirements that have been introduced over the past couple of years via European legislation has certainly not helped in making European businesses more competitive.

Over the past couple of months and under the impressions of the impressive Inflation Reduction Act, the European Commission has attempted to correct course. Yet, it remains unclear if the new course the Commission has charted is indeed the correct one. One pillar of the EU's response to the Inflation Reduction Act seems to be to simply throw money at the problem. That, however, is both dangerous and misguided.

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**The right tool to restore  
competitiveness is  
supply-side economics,  
not fiscal policy.**

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It is dangerous as Europe will simply not be able to outspend the US in a subsidy race. This, however, seems to be precisely the rationale behind the "Temporary Crisis Framework" that allows Member States to hand out state aid in copious amounts. The framework even comes with a so called "matching clause", that is in essence an open invitation for companies to play off Member States and third countries against each other to maximise taxpayers' contribution to their investments. Such a spending-based approach is also dangerous as it heavily favours those Member States that are in a strong fiscal position and could thereby create a rift within the EU.

Throwing money at the problem is a misguided strategy as well since it comes with a hefty price tag, yet is unlikely to convincingly solve the problem. Few businesses are that short-sighted that they make their investment decisions for a new production capacities merely on the basis of a single one-off subsidy. Instead, what matters is the bigger picture and the general question of whether a location is a good place to do business. Things like a modern infrastructure (physical and digital), a skilled workforce, a favourable tax environment and a benign regulatory environment matter a lot more in the long run than a time-limited subsidy regime. That is why the right tool to restore competitiveness is supply-side economics, not fiscal policy.

This conclusion also implies that we do not need any new budgetary tools such as a European sovereignty fund that is demanded by some policymakers. We have already seen with the Recovery and Resilience Facility, that there is indeed no lack of available funds would hold new investments back. On the contrary, often the available money is not even fully spent - a similar observation holds true with regards to other co-financed EU projects, for example in the area of cohesion policy. Often, there is simply a lack of administrative capacity to implement high-quality projects, which would have the potential to boost growth and competitiveness.

That also proves that the public sector and public money should not be overstretched, when the actual objective is to boost investments and ultimately competitiveness. In the end, the private sector is a much better and much more efficient allocator of capital than the public sector could ever be. The role of policymakers is not to pick winners, but to create the conditions for market participants to do well and to become and remain competitive in an international context.

The European Commission seems to have received the message and the SME relief package and the Commission President's promise to cut reporting obligations by a quarter are some first steps into the right direction. However, more needs to be done and supply-side economics should feature prominently on the Commission's working agenda for the next political mandate.



## MARIA TERESA FÁBREGAS

Director - Recovery & Resilience Task Force - European Commission

### Recovery and Resilience Facility: more than the EU green and digital transitions

The Recovery and Resilience Facility (RRF) is at the heart of Next Generation EU: an unprecedented solidarity exercise at European level designed for Member States to emerge stronger from the coronavirus pandemic, prevent creating further divergences within the Union and support a Union's growth strategy towards a greener, more digital and just economy, where no one is left behind. With up to EUR 648 billion in grants and loans, the RRF has introduced an unprecedented volume of funding to relaunch Europe.

Each Member State has established a country plan with reforms and investments to make its economy and society more sustainable, resilient and prepared for the green and digital transitions, in line with the Union's priorities. The national plans address long-lasting socio-economic national challenges identified in country-specific recommendations under the European Semester framework of economic and social policy coordination.

In 2022, Russia's aggression against Ukraine has put us in a new context, a new crisis needed to be addressed. The REPowerEU initiative, with additional EUR 20 billion in grants in the RRF has allowed Member States to add new reforms and investments in their plans to accelerate the energy transition, reduce our dependence on Russian fossil fuels, diversify energy supply, accelerate the deployment of renewable energy and improve energy efficiency in key economic sectors (transport, industry, public buildings, housing). The revision of the plans in 2023 has been an opportunity to increase the level of ambition where new challenges require stronger responses, or where reforms in existing plans did not address all known challenges, and to take into consideration the impacts of the war such as very high inflation, supply-chain disruptions, etc.

Member States receive disbursements upon taking steps in the implementation of reforms and investments, through the fulfilment of milestones and targets. This is the performance-based nature of the RRF. So far, the Commission has received in total 55 payment requests by 24 Member States. The total amount of disbursements under the Facility has exceeded EUR 220 billion. The end of 2023 saw a peak in payment requests (for around an additional EUR 39 billion).

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**The recovery and resilience plans are already making a real and lasting difference on the ground.**

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These disbursements have been made possible by the adoption of transformative reforms and launch of important investments by Member States, the positive impact of which are already beginning to be observed. Transformative structural reforms related to labour markets, taxation, spending reviews, pensions, judicial systems, simplification of public administrations, removal of administrative bottlenecks, education, healthcare etc, have been adopted. More important reforms are to come in several Member States. These reforms can substantially increase growth further in the longer run and facilitate the delivery of RRF supported investments on our common priorities, as well as private and public investment more generally.

Member States are well on track to deploy RRF funded investments in key

areas of strategic importance for the Union's resilience, competitiveness and sovereignty. We want to highlight the use of financial instruments in some national plans that will help crowd in private investments to these key areas.

We see that public administrations, at national, regional and local level, are investing significantly in the steady delivery of the Recovery and Resilience Plans by mid-2026. Businesses will be able to turn the excellent opportunity offered by the Recovery and Resilience Facility for Europe into concrete achievements that improve the Union's competitiveness, its ability to compete in global value chains and progress in social welfare, in line with the Single Market rules.

The Recovery and Resilience Facility was created to recover from the pandemic and make the European Union better prepared for future challenges such as the green and digital transitions. But not only. The Recovery and Resilience Facility will also play a key role in strengthening the Union's resilience with strong social action contributing to the delivery of the European Pillar of Social Rights across Member States. The Recovery and Resilience Facility is well on track. The Commission continues to support Member States to deliver its steadfast implementation.

The investments and reforms identified in each plan are already making a real and lasting difference on the ground. The aim is for future European generations to live in modern, prosperous, inclusive, sustainable, resilient and better prepared economies and societies for new challenges and opportunities. We can only achieve this goal by working together, in close cooperation between administrations, businesses, workers and civil society.





## CYRIL ROUX

Deputy Chief Executive  
Officer - Groupama

### Financing growth in Europe: challenges and roadblocks

The European Union is a single market of 450 million citizens of advanced economies, buttressed by the rule of law, well enforced property rights and reasonable prospects of democratic stability. Yet for decades now its economic growth has been financed in a lopsided way, relying too much on credit, while its high savings rate helps finance domestic governments and firms outside Europe, in particular in the United States. European citizens are risk-averse investors, in the main, so the fraction of their savings going to risk capital is limited. To make matters worse, the share of their savings they do allocate to risk capital is in good part allocated abroad. The aggregate market capitalization of EU firms is not in keeping with the size of EU's economy as measured by GDP, and a significant fraction is in non-European hands.

Several key structural elements are at play to explain the low equity stake of EU citizens in their domestic firms. First, the way individual savings are funneled in Europe leads to underinvestment in equity. This underinvestment comes in several ways. The pay-as-you-go pension systems common in much of Europe rob EU firms of a major source of funds, while in the US individual pension savings such as 401(k) or Erisa accounts provide equity funding to the domestic economy. Where pension funds are set

up in Europe, prudential constraints that weigh upon them skew their asset allocation away from risky assets.

The recent introduction of the pan European pension plans has been ineffectual. In France, the situation is aggravated by the use of with-profits life insurance products as all-purpose investments and savings vehicles: their capital guarantees and the Solvency 2 prudential requirements ensure that a very large fraction of the monies invested through these contracts go to sovereign credit and bank refinancing instruments, rather than equities.

On top of this, the preferred alternative financial investments vehicles offered to French investors are regulated savings products with fixed returns used by their government to finance dirigiste social policies. In Italy, the investment return, reduced taxation and ease of subscription make domestic sovereign debt the financial vehicle of choice.

The Retail Investment Strategy advanced by the EU Commission has been touted as a way to foster the inclusion of new swathes of citizen-investors and the development of European capital markets. However, its naivety or ignorance of the actual dynamics of retail distribution and inaffordability of investment advice that would ensue, should it be adopted as written today, bodes ill for its stated aims and so for the retail financing of European economic growth and of its multiple transitions.

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**When labor force  
shrinks and norms  
stifle economic growth,  
finance cannot be the  
only game in town.**

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There's only so much to be done about market financing by addressing the design inefficiencies of investment products and the supposed inefficiencies that mar the structures of distribution channels. At the end of the day, finance will flow to firms and projects that have the best prospects of turning sustainable profits; in the aggregate, private funds will flock to the economies best positioned to harness the promise of the coming transformation of our world. In this regard, Europe has a number of issues to address.

Demographic malaise, manifest for a long time in low birth rates, below natural replacement, has turned into a contracting labor force in several

countries and possibly in the European Union as a whole in the near future. Labor productivity growth is sluggish in Europe, with education attainment as measured by PISA on the wrong track in several countries. There is little succor on these fronts to expect from indiscriminate migration of ill-equipped populations coming from failed states alien or opposed to European values of gender equality, freedom of speech, rule of man-made laws over faith-based ones and preeminence of science and reason over tradition.

Beyond labor force issues, investment in Europe is hampered by our collective preference for an ever-expanding set of norms to tackle the future. It is telling that AI firms are shaping up outside Europe, but that European legislators were the first to come up with an AI regulation. Likewise, a well-meaning approach to durability has given rise to the development of the double materiality approach, unique to the European Union, and as such a drain to its economic dynamism. The carbon border adjustment mechanism exemplifies the new Fortress Europe: our internal regulations lead to the interdiction of foreign products or services, or the imposition of custom duties to level the competitive playing field, while the same regulations limit the production of goods and services and hampers their export.

When qualified working age population shrinks and norms stifle economic growth, finance cannot be the only game in town.



**ROLAND CHAI**  
 President European Market  
 Services, Executive Vice  
 President - Nasdaq

## Investments for the green and digital transition can come from Capital Markets

In an era of unprecedented technological and climate change, European economies and corporations face fundamental challenges adapting to the green and digital transition. McKinsey predicts that reaching net-zero targets will require spending \$9.2 trillion a year on physical assets up until 2050. It's evident that neither states nor traditional banking systems can single-handedly provide the necessary financial backing. Equally the changes herald opportunities for new industries, and sectors. In Nasdaq Europe we have helped 255 technology companies in sectors such as BioTech and MedTech come to the market since 2017.

To address the scale of investment required, a broad spectrum of investment channels across public and private have to be activated. Participation from all investments sectors is crucial, from institutional to retail investors, pension funds, sovereign and private equity. Capital markets are fundamental as the cornerstone in this scenario, providing both equity and debt financing and the ability to price and distribute risk across a democratized investor pool in full

transparency. New economic sectors with uncertain return profiles need support by financial markets to allow the best price formation and risk transfer. Nasdaq's First North has been enabling micro caps in emerging sectors to access and find investment support resulting in 130 companies making the transition to the main market since 2006.

The EU needs to deliver on its capital market objectives to increase competitiveness and facilitate cross-border business and trading in the Union. Strong local markets channelling investments to corporates is crucial to successful EU Capital Markets. Local markets provide an important nexus with local investors that generates a deeply vested connection to companies. As Nasdaq Europe's 7 exchanges has demonstrated cross-fertilization by sharing knowledge and best practice to better contribute, individually and regionally, to increase investments and strengthen EU's position in the global market.

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**Strong local markets channelling investments to corporates is crucial to successful EU Capital Markets.**

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The Nordic and Swedish markets are success stories for the technology and sustainable sectors that have thrived on the capital raised, exemplifying the potential for growth in pioneering sectors. Looking at the numbers, the Swedish startup and scaleup sector have grown from employing just over 100k people in 2019 to over 270k in 2024 and, in the same period, almost doubled their enterprise values.

In order to support broad investment in new climate sectors, Financial Market Infrastructures and regulators must create frameworks to both understand sustainability and incentivize the financing of sustainability. Nasdaq actively supports companies on their sustainability journey. Nasdaq's initiatives, including the Green Equity designation and sustainable bonds, educating institutional and public investors to allocate capital to environmentally conscious companies and projects.

Through Nasdaq's ESG offerings, a suite of products for ESG reporting has been developed to align with CSRD, taxonomy, and international reporting frameworks. This commitment extends to promoting technologies that actively remove carbon

from the atmosphere, contributing to a more sustainable future.

In pursuit of the net-zero policy vision, Nasdaq has invested in Puro.earth, the world's leading crediting platform for engineered carbon removal. This strategic partnership connects industrial carbon removal, based on the Puro Standard, with buyers seeking to implement sustainability goals by removing carbon dioxide from the atmosphere.

A thriving capital market ecosystem that is both inclusive and diverse is essential for delivering on investment for new digital and green sectors, this includes:

- Fostering an environment of transparency.
- Cultivating a society that values innovation.
- Supporting IPOs, especially for smaller companies fostering economic development.
- Encouraging institutional investors and pension funds to invest in SMEs.
- Lowering entry barriers for retail investors with robust financial literacy.
- Market Structure and Supervisory Authorities complementing legislation.
- Incentivizing investments towards sustainable and digital sectors.

While the development of such an ecosystem takes time and collaboration across policy makers, regulators and private sector, sustained focus and strategic measures can pave the way for a flourishing capital market.

Nasdaq's comprehensive approach underscores the pivotal role of capital markets in propelling Europe toward economic progress while championing sustainability and innovation. The CMU serves as a beacon, guiding member states toward a unified and robust capital market framework.



## JEAN-JACQUES BONNAUD

Treasurer - EUROFI

### Elaborating a genuine European industrial policy to face common challenges

NGEU is an unprecedented joint response to the COVID-19 crisis, making over €800bn available to Member States to stimulate economic recovery by investing primarily in the green and digital transitions. However, at this stage, unlike the IRA in the US, NGEU and EU Funds have not been able to boost productive investment, particularly in the countries that benefit most from this European aid (Italy, Spain).

A recent study by Trendeo, Fives, McKinsey & Company shows that despite its major efforts, the EU is struggling to convince investors to invest in its territory. According to this study, investment in the United States increased by 4% over the period from July 2022 to June 2023 compared with the period June 2021-June 2022, amounting to 309 billion dollars. This is undoubtedly mainly due to the Inflation Reduction Act (IRA). By contrast, investments recorded by Europe between July 2022 and June 2023 stood at -25% (compared with the period June 2021-June 2022); this figure even reached -38% in the European Union, which questions the performance of NGEU and the effectiveness of Member States' public spendings.

When qualitatively comparing NGEU and the American IRA, one thing is striking: the American funds are easily and quickly accessible and work as an incentive to achieve the fixed objectives, whereas national and European bureaucracies make the progress of spending NGEU funds cumbersome and relies heavily on prohibitive rules.

The speed of deployment of the IRA and the whopping number of companies that have announced investments on the American soil illustrates the success and the simplicity of the IRA one year on. However, the deployment of NGEU is slower as it is impeded by the lack of skilled workforce and the burden of bureaucracy.

Considering this situation, what should be done?

#### 1. Rewarding risk taking and long-term investment

Long-term investments incur a risk – especially linked to technological and regulatory updates, as well as uncertainty – and demands the immobilization of resources in the long run. Therefore, risk-taking must be rewarded, otherwise private savings will remain liquid and will not be directed towards long-term productive investments in the EU. This has not been the case over the past 15 years as real interest rates have remained close to – and even under – zero.

#### 2. Giving certainty to transition pathway in the EU

EU Member States should give all economic agents clear and complete national transition scenarios (sectoral priorities, timetables, risk edging mechanisms) and guidelines so that citizens, companies and public authorities make coordinated progress.

#### 3. Getting public finances back in order

The sooner we get public finances back in order, the sooner states will regain the leeway they need to invest. In addition, over-indebted Member States must also revise the composition of public spending to accentuate the efforts in the fields at the heart of the transitions – i.e. R&D and carry out supply-side-oriented reforms to reinforce their production system and rekindle their industrial power.

#### 4. Elaborating a genuine European industrial policy to face common challenges

To avoid lagging behind the US and China, the EU needs to adopt a genuine industrial policy. To do so, it is urgent that fiscally undisciplined Member States reduce their public debt and

deficits, and that they shift their public spending toward productive investment. Furthermore, the EU needs appropriate competition policy to boost its industry and to accelerate the single market while re-establishing a community preference. The IMF estimates that further integration of the single market would enable the EU to gain up to 7pp of GDP.

#### 5. Balancing national and common interests in the EU

There is an urgent need to find the right balance between national and common interests in the EU economic, financial and industrial areas. Recent events seem to show that industrial and economic nationalism is rising in Member States, which further thwarts the efforts towards more integration in the industrial field. Even if it is understandable that each Member State wants to keep their sovereignty, they cannot have it both ways. There is an urgent need to find the right balance between national and common interests.

The EU is struggling to convince investors to invest in its territory.

#### 6. Developing European projects financed by European companies

What the EU needs now is to finance common European projects led by European companies. Europe should finance common European projects, hence the necessity to implement a genuine industrial policy, especially in strategic sectors such as digital, energy, cleantech, defense and space.

The multiplication of Important Projects of Common European Interest (IPCEIs) and collaborative projects between Member States is undeniably a way forward, given that they align their objectives, they identify qualifying and profitable projects and that they find adequate funding. This would facilitate and foster the emergence of competitive European companies, champions and SMEs, as they would benefit from economies of scale in the single market.

## GLOBAL FINANCIAL AND REGULATORY FRAGMENTATION

### RICHARD KNOX

Director, Financial Services – HM Treasury

### CHRISTOPH KÖNIG

Deputy State Secretary, State Secretariat for International Finance SIF - Swiss Federal Department of Finance (FDZ)

## The Berne Financial Services Agreement – A new way to enhance Swiss-UK cooperation

In the final month of last year, we attended the signing of the Berne Financial Services Agreement (BFSA) by Chancellor Jeremy Hunt and the Federal Councillor Karin Keller-Sutter. This concluded our negotiations of a transformative mutual recognition agreement designed to create more efficient and globally competitive conditions for cross-border financial services trade.

The journey toward this landmark treaty has been a meticulous exercise between our two countries, but one coloured by openness and willingness to explore new ideas. We have balanced shared goals of ambition and effective risk management to deliver an agreement which provides the basis for the recognition of regulatory and supervisory frameworks and greater cooperation in financial services, covering the vast majority of wholesale financial services (i.e., services to professional or sophisticated counterparties), and supported by a comprehensive governance framework.

Whilst not all concepts used in the BFSA are inherently new, the way they have

been drawn together and applied in an international treaty is unprecedented and demonstrates the ability of both our economies to innovate. When it comes to cross-border trade in an area as highly regulated as financial services, this has been a historically difficult feat.

Based on a thorough assessment of each other's regulatory and supervisory frameworks, the agreement provides for mutual recognition where they achieve comparable outcomes. In some cases, where the wholesale UK and Swiss markets are already open, the agreement affirms existing access. In others, we are not only confirming existing access, but are also delivering genuinely new opportunities for cross border business. We have done this using the principle of 'deference'. This means firms in sectors such as insurance and investment services will largely be able to supply cross-border services whilst relying on the familiar rules and supervision of their home jurisdiction.

We have taken the strengths of established processes for international recognition of equivalence by supplementing these with stability-enhancing commitments in our governance framework and appropriate safeguard mechanism, meaning the new access businesses will enjoy under this agreement will be placed on a more stable footing, allowing them to plan for the long term.

One of the most challenging aspects of this agreement was delivering this ambitious cross-border package while preserving our respective sovereign

ability to manage domestic financial stability and market integrity risks with no compromise. Under the BFSA we have developed a layered approach to risk management that overcomes this challenge. At the heart of this is a process for enhanced supervisory cooperation that makes sure there is suitable access to information on both sides to effectively manage risks to our markets.

Signing the BFSA marks the beginning of an exciting new chapter in Swiss-UK relations. This agreement not only expresses our shared commitment to fostering open and resilient financial markets but also demonstrates our readiness to lead and innovate in the global arena. As we look to the future, we are confident that the BFSA can serve as an illustration for cooperation between like-minded nations committed to open markets.

We extend our gratitude to the teams of negotiators, industry experts, and stakeholders who have contributed their knowledge and expertise throughout this journey. Their efforts have established a new standard for conducting cross-border financial business. The agreement includes mechanisms to enable its coverage to expand over time and we look forward working through its framework to deepen our relationship in the years to come.



*In Berne, signature of the agreement on mutual recognition in financial services, the Berne Financial Services Agreement. Federal Councillor Karin Keller-Sutter (left-side) and the UK Chancellor of the Exchequer, Jeremy Hunt (right-side).*



## MARKUS RONNER

Group Chief Compliance  
and Governance Officer -  
UBS Group AG

### March 2023 highlighted that international collaboration and consistency are key

The events of March 2023 again highlighted how the interconnected and global nature of financial markets requires supervisory cooperation, coordinated policymaking and consistent standard setting by international bodies including the G20, the Financial Stability Board (FSB) and the Basel Committee on Banking Supervision (BCBS). While the regulatory framework worked and proved its soundness, we must not be complacent.

In many respects, the response to the crisis showed the value of global regulatory frameworks and the progress made since the Global Financial Crisis. The wider financial system demonstrated resilience in March 2023, with the crisis contained to a small number of firms. Strong international supervisory coordination established over many years meant action could be taken quickly based on established standards, approaches and structures such as crisis management colleges.

As recently emphasised by the BCBS and FSB, the March 2023 events suggest that targeted, internationally coordinated adjustments to the existing prudential and resolution framework should be considered. These include addressing legal uncertainties over executing a cross-border bail in of eligible securities. The case of Credit Suisse, for example, showed the need for effective public liquidity backstops across jurisdictions. And while a single point of entry resolution strategy must continue to be the base case, creating optionality is key.

The execution of a rescue transaction, where feasible, can be a superior option, as in the Credit Suisse case, while sale of business or asset transfer might also be considered, complemented by appropriate preparation for the operationalization of such tools (eg. establishment of data rooms, valuation of certain portfolios). Developments in the US and Switzerland in spring 2023 show the importance of effective supervision and international cooperation, which is equally important as a strongly-aligned policy framework.

Beyond these immediate points of focus, there is still work to be done to avoid fragmentation in the wider framework, in line with the longstanding G20 commitment.

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**While the regulatory  
framework worked and  
proved its soundness, we  
must not be complacent.**

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One example is implementation of final elements of Basel III. While the failure of some US regional banks last year reaffirms the need for comprehensive and consistent implementation of the Basel rules, we continue to observe inconsistencies in implementation, such as approaches to risk weighting unrated corporates. Overall, this results in an unlevel playing field and decreased comparability of capital ratios across banks, to the detriment of investors, while increasing operational cost and complexity for international banks. Ultimately, fragmentation can negatively impact the banking system's overall resilience, whether because certain risks are unaddressed, as with the US regional banks, or due to harmful regulatory arbitrage, including where jurisdictions decide to go over and above international standards.

Sustainability regulation in general and reporting requirements in particular is another important area where

the regulatory approach is highly fragmented, chiefly because a number of key jurisdictions implemented their own, divergent frameworks in advance of agreement on an international standard. This has reduced the positive impact of ESG frameworks, as financial markets are less efficient at pricing climate related risks and opportunities, while firms operating globally face significant complexities and costs. It is thus important that the reporting standards now approved by the International Sustainability Standards Board are applied consistently in order to reduce fragmentation in ESG reporting and drive comparability in climate-related data to enable investors to support the net zero transition as effectively as possible.

Global regulatory standards have also been agreed for digital and crypto assets, but also after regulatory frameworks had already been defined in some jurisdictions. As a result, this is another area where we see regional divergence. To avoid the risk of increased regulatory arbitrage, we need alignment on the definitions and scope set out in the FSB and IOSCO crypto and digital assets standards.

Cross-border regulatory co-operation is equally important in the non-bank financial intermediation (NBFII) sector. This market is global and regulatory approaches must also be global to ensure effective risk management. We strongly welcome FSB-led work to conduct a mapping exercise on the interconnectedness of the sector, identify risks and develop appropriate policy recommendations.

As the NBFII work evolves, we are seeing efforts to promote convergence of policy and supervisory approaches, for example in addressing liquidity mismatch in open-ended fund structures. This is encouraging both in terms of addressing identified vulnerabilities as well as the signal it sends about the ability of international standard-setting bodies to deliver solutions to complex issues. However, we would welcome a greater sense of urgency to avoid the need for another crisis before regulation is introduced.

Promoting greater regulatory coherence at the global level should deliver more efficient financial markets, allow better risk management and, ultimately, lower risks to financial stability.



## SADIA RICKE

Group Chief Risk Officer -  
Standard Chartered Bank

### Regulatory divergence: competition, coordination and challenge

Regulatory divergence is the result of many factors: different contexts for national financial system, distinct policy choices made by governments, and diverse supervisory approaches taken by competent authorities in their local jurisdictions. Some regulatory divergence is inevitable and, arguably, even desirable given specific local conditions. No two countries or markets are the same.

While the risks (and benefits) around regulatory-driven fragmentation across jurisdictions are well known. The fundamental question is: where is fragmentation inevitable and where does it need to be minimised?

As a global bank operating in more than fifty markets, at Standard Chartered, we work with a certain degree of regulatory divergence. Across our markets, we continue to experience diverging local regimes as well as varied supervisory practices.

*Unwarranted* cross-border regulatory divergence remains a key concern. In fact, such policy differences can create financial and operational inefficiencies through duplicative or even conflicting

requirements and expectations. This in turn can lead to the inhibition of cross-border capital flows, unnecessary additional costs for consumers, and even potential financial stability concerns as diverging rules might impact the ability of international firms to move resources during times of stress. These negative implications ultimately weigh on the ability of multi-jurisdiction financial firms to provide efficient financial services to the real economy.

International standard setters and the industry have focused on addressing fragmentation for a number of years. Yet, despite initiatives at various levels – including the extensive work that the FSB puts into building consensus on common minimum standards and facilitating regulatory alignment – the fragmentation trend has continued.

In the current complex geopolitical environment, there is an additional concern that this trend could accelerate due to competition between financial centres, resulting in conflicting standards.

This is evident in the areas of sustainability and new technologies where policymakers are regulating apace without the coordination seen in previous policy discussions, such as cross-border payments and banking resilience. In fact, despite some initiatives by global standard setters, the policy areas lack common structuring frameworks.

In the area of sustainability this becomes problematic as overlapping and contradictory requirements across jurisdictions risks hamper the rapid scaling of sustainable investment and the channelling of capital to where it is most needed. In addition, the increasing reliance in certain jurisdictions on extraterritorial clauses also creates potential conflict of rules, particularly when local standards are designed without considering the specificities of other regions.

Similarly, in the area of new technologies, there have been a proliferation of different regimes. These differ by taxonomy, by focus of regulation, and by timing – for example, the EU's one-time approach versus the UK's phased strategy. This does not make for a level-playing field and increases the potential for regulatory arbitrage. In parallel, there has been the emergence of uncoordinated national restrictions on the cross-border flow of data risk. This impacts the capacity of regulated firms to deliver consistent digital services across many areas of the ever-growing digital economy, thereby potentially inhibiting the creation of an open environment that can fuel innovation. Against this backdrop, we encourage regulators to

strengthen international cooperation to develop common frameworks, particularly when addressing emerging areas of regulatory concern. In this context, we welcomed the FSB's 2023 global regulatory framework for crypto-asset activities, which was based on the principle of 'same activity, same risk, same regulation' and attempted to provide a regulatory base line.

We also encourage regulators to continuously take into consideration the broader impacts of their regimes, and to ensure that local requirements are consistent and interoperable with global initiatives, where these exist. In this context, we support current efforts to ensure the interoperability of local sustainability standards with the ISSB's global baseline.

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**A focus by policymakers on addressing regulatory fragmentation is now more important than ever.**

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From climate change to new technologies and financial stability, today's major regulatory challenges are global and interconnected. No single jurisdiction can address them alone. Against this background, it is evident that a focus by policymakers on addressing regulatory fragmentation is now more important than ever.

The good news is that regulators have all a shared interest in a sound and competitive financial system and are now used to work across borders more closely than before.

At Standard Chartered, we remain fully committed to engage with policymakers and standard setters as they grapple with how to address these fast-moving policy questions in an internationally consistent fashion.



## HIDEO KAWAFUNE

Chief Executive Officer -  
SMBC Bank International plc  
Managing Executive  
Officer & Head of EMEA  
Division - SMBC Group  
Chair, Supervisory Board -  
SMBC Bank EU AG

### How does financial fragmentation impact global banks?

In its report on the 2023 banking turmoil, the Basel Committee determined that the shock felt by the global financial system highlighted the importance of prudent regulatory standards and noted that the Basel III reforms implemented to date had helped shield the banking system from a more severe crisis.<sup>1</sup>

These shocks have reminded all in the sector of the interconnectedness of the financial system, but also that significant improvements in financial stability have been achieved through regulatory cooperation since the Global Financial Crisis. However, after many years of increasing globalisation of the financial system, in recent years financial fragmentation has increased, in part driven by geopolitical events and the Global Pandemic. Fragmentation is being seen in many areas, including in

prudential regulation, the approach to sustainable finance and the impact on the diversity of business models in the banking sector.

#### Prudential regulation

Progress towards alignment on financial regulation through the Basel Committee has helped to set a global standard. The implementation of the Basel III standards across different jurisdictions globally has however resulted in different implementation timelines between major jurisdictions and divergences in transitional arrangements; this is an unfortunate outcome for global banks such as SMBC, particularly as Japanese-headquartered institutions will be implementing the standards ahead of other banks in 2024.

As well as adding cost and complexity for international banks, the impact of fragmentation can be felt in the real economy, the clients of financial institutions. For example, diverging rules on risk weights for trade finance products has the potential to make some services unprofitable for large international banks, reducing the choice and lending capacity for corporates.

**Financial fragmentation leads to increased costs, ultimately affecting the lending capacity of banks and the pricing for customers.**

#### Approach to sustainable finance

In 2023, record breaking high temperatures have alarmed the scientific community and have reminded us of the urgency that is required of all players in the financial sector to support the transition to a decarbonised society. Decarbonisation is a key sustainability strategic priority for SMBC Group. In 2021 we pledged to achieve Net Zero in our global financed emissions by 2050, and later that year, we joined the UN-convened Net Zero Banking Alliance. SMBC Group is a global leader in financing renewable energy projects, and in 2023 we increased our commitment to providing sustainable financing to JPY 50 trillion by financial year end 2029. Greenhouse gas emissions know no national borders and co-ordinated action is imperative if we are to meet the targets set in the Paris Agreement. Improving the availability, quality, and consistency of data measured and reported is the

first step toward decarbonising the economy and cooperation between different jurisdictions is essential to achieve a consistent framework for reporting ESG metrics.

Encouraging progress has been made to achieve a global baseline in climate reporting standards through the development of the ISSB standards, which are being adopted by major financial centres, including Japan and the UK. In the EU, the development of the European Sustainability Reporting Standards (ESRS) has provided banks with a robust framework to report on their environmental exposures, which will improve the quality and consistency of data reported in the EU. For international banks headquartered outside of the EU, it is important to achieve interoperability between standards, both in the EU and globally, to avoid fragmentation, achieve greater consistency, and to focus resources on financing the transition.

#### Diversity of business models

The great strength of the EU banking sector is its diversity. The EU's financial system has benefitted from having banks with differing and complementary business models and third-country banks have benefitted from the EU's openness to foreign direct investment. This has created a competitive environment in the EU which helps to improve choice and pricing for customers. The EU and Japan share a very positive and constructive relationship, and at SMBC we see the EU market as an important driver of growth; many of our largest customers are EU-based corporates and financial institutions.

However, financial fragmentation leads to increased costs, ultimately affecting the lending capacity of banks and the pricing for customers. International banks have absorbed large costs in recent years due to the impact of Brexit and more recently the Global Pandemic. The recent EU Banking Package and the third-country branch regulations will lead to further organisational changes for international banks and will require time and resources for both banks and regulators to implement.

Fragmentation is unavoidable in certain areas; international banks are complex organisations operating across different continents with differing laws and customs. However, the real economy relies on a well-functioning financial system, and therefore it is important that fragmentation is minimised.

1. *Report on the 2023 banking turmoil (bis.org)*



## MICHAEL JEFFERSON

Head of UK Financial Services  
Public Policy - Amazon  
Web Services (AWS)

### Delivering interoperability in regulations for third-party risk management

Regulation can help enable businesses, support customers and protect societies. However, ensuring regulations strike the right balance and meet the objectives of all stakeholders is crucial, especially in highly regulated industries like financial services. For third-party risk management and outsourcing in financial services there is the opportunity to deliver on these objectives and develop regimes that promote international interoperability and alignment.

Jurisdictions around the world are continuing to review and update their laws and regulations to address increased adoption of third-party technology and services, including cloud services, among financial services firms. The benefits driving this adoption include increased security, flexibility, operational resilience, rapid scalability and reliability.

The US Bank Service Company Act (BSCA), the EU Digital Operational Resilience Act (DORA), the UK's critical third parties (CTPs) to the

financial sector, and Singapore's Notice and Guidelines on Outsourcing are examples of measures which have either already been adopted or will come into effect before the next EUROFI High Level Seminar in spring 2025. Despite origination in a number of jurisdictions, the goals of many of these regulations are consistent and this provides the opportunity for harmonisation that can help support the consistent adoption of third-party services that benefits the financial services ecosystem.

Many third-party services, such as cloud computing, are provided on an industry- and location-agnostic basis. Delivering interoperability in regulations will be crucial to ensure that the goals of policymakers, customers and the industry can be met while financial institutions continue to benefit from the advantages of third-party services and outsourcing.

The establishment of an internationally consistent, proportionate and risk-based approach for third-party risk management and outsourcing supports digital transformation of the sector. It means that jurisdictions can ensure regulations meet their needs, but are also interoperable with other jurisdictions to ensure firms can utilise services on a cross-border basis consistently. With the rapid level of technological innovation in financial services, flexibility to ensure any measures can handle increasingly dynamic complexities in the financial and technology spaces is also crucial. Therefore, it is important that the interoperability between jurisdictions and industries is front of mind as regulations are finalised.

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**Harmonisation can support consistent adoption that benefits the financial services ecosystem.**

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Supranational bodies will have an important role to play and it is good to see they are already prioritising the areas that can help deliver an interoperability that works. The Financial Stability Board (FSB) published its *Enhancing Third-Party Risk Management and Oversight: A toolkit for financial institutions and financial authorities* in June 2023, the Basel Committee for Banking Standards (BCBS) is reviewing its *Guidelines for Outsourcing in Financial Services* originally published in February 2005, and the International Association of Insurance Supervisors has its Operational Resilience Task Force

(ORTF) are examples of key bodies looking at the issues.

AWS continues to engage with these bodies and to advocate for:

- enhanced coordination between financial authorities based on proven standards (for example ISO and NIST standards), and risk-based, outcome-driven regulation to limit fragmentation and redundancies;
- dialogue between financial authorities and their regulated entities, which enable practical guidance on interpreting regulations; and
- skill-development programs within financial authorities focused on new technologies.

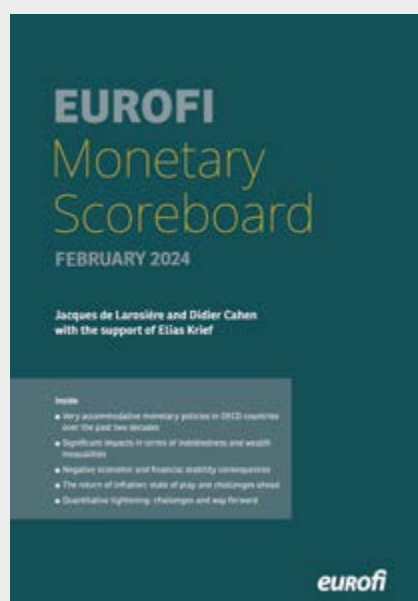
As jurisdictions look at how they treat the issue of third-party risk management and outsourcing in financial services alignment, interoperability with principles agreed within international organisations provides a real opportunity to drive the financial services industry forward for future prosperity through digitalisation. This approach will help deliver effective forward-looking regulation and also adapt thinking so regulations are ready for the next wave of innovation.



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Q&amp;A

**JEAN LEMIERRE**

Chairman - BNP Paribas

## Competitiveness: the essential component needed to achieve Europe's strategic objectives

The recent and ongoing crises and geopolitical challenges have highlighted the need for Europe to strengthen its competitive position in an increasingly fragmented and regionalized world. Indeed, Europe needs an economy that is competitive and that can fully leverage its strong advantages to drive growth and innovation and compete in the world stage.

Europe's competitiveness will be key to enhancing Europe's position in the world and to ensuring the continued well-being of its citizens and the sustainable growth of the European economy.

Bold political decisions and sustained action will be essential to achieving these goals. A consensus on this imperative is emerging among Europe's leaders, and indeed, it is very positive that the recent summit of heads of state has given the EU the mandate of achieving strategic autonomy in a number of key sectors such as defense, energy, and health. A new EU energy policy able to deliver competitive energy prices and re-industrialization will be essential for achieving the objectives. In addition to that, I do believe that a strong and competitive financial sector is also crucial to meet the targets.

Regulations implemented since the 2008 financial crisis have succeeded in building resilience and soundness in the European banking and insurance sectors. The upcoming implementation of Basel III will be the last brick of the framework. But, at the same time, it will cap banks' capacities to finance the European economy at a time when meeting Europe's strategic priorities will also require very significant investments. In fact, the Commission estimates that the green transition will require an additional investment of € 620 billion/year to meet the 2030 Green Deal objectives, and a further € 125 billion/year for the digital transition. Europe will also have to finance the investments needed to develop its industrial and defense capacities, easily bringing the total to more than € 1 trillion per year.

Europe's banks, insurers, and its capital markets have an essential role to play in meeting the challenge to finance all these needs.

Enabling them to do so will require implementing holistic reforms to the existing securitization framework in a pragmatic and fact-based approach to free up European banks' balance sheets. It will also require, after a decade of timid progress, making a decisive push to accelerate and see through the further development and integration of European capital markets to make an efficient allocation of the existing long-term savings of Europe.

The next EU legislative cycle will also need to take decisive measures to ensure the competitiveness of the European financial sector and the level playing field with global actors, within the Single Market but importantly with non-EU countries as well.

A more pragmatic approach to regulation is therefore needed, one that recognizes that the competitiveness of the financial sector is indispensable to achieving a competitive European economy and Europe's strategic autonomy as well as to protecting depositors, taxpayers and clients by a safe system. This means striving for regulatory efficiency and simplicity wherever possible and justified. To that end, undertaking an assessment of the impact of any new legislative or regulatory initiative on the competitiveness of European financial sector vs its non-EU peers would be an essential policy towards achieving this objective. This is particularly important because other jurisdictions such as the US and the UK have instituted such systematic assessments, and rightly so. Europe needs to follow suit.

There will be indeed no strategic autonomy without a competitive European economy, and there will be no competitive economy without fostering the competitiveness of European banks, asset managers, and insurers.

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**April 2025**

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## BASEL III IMPLEMENTATION



### DAVID BAILEY

Executive Director of UK Banks - Bank of England

### Basel III - Finishing the job

The 2007-08 global financial crisis revealed significant shortcomings in the regulatory framework for banks. According to the Basel Committee on Banking Supervision (BCBS), there was a 'worrying degree of variability' in the calculation of risk-weighted assets (RWAs) during the peak of the crisis<sup>1</sup>, undermining the consistency and comparability of firms' capital ratios. Ultimately, investors lost confidence in the credibility of capital ratios, exacerbating the crisis with devastating consequences.

In response, the BCBS developed the Basel III standards to improve the resilience of banks. Initial phases, globally implemented, increased the quantity and quality of regulatory capital held by banks and introduced new requirements for leverage and liquidity. The final phase, which we call 'Basel 3.1' in the UK, addresses weaknesses in the calculation of RWAs, the denominator of banks' capital ratios. Its implementation is vital to fully realise the benefits of earlier phases.

Since the BCBS published its standards in 2017, the PRA has become an independent 'rule-maker' as a result of the UK leaving the EU. It is in this context that we developed Basel 3.1.

The PRA has a primary objective to support the safety and soundness of the firms it regulates. The PRA also has a secondary objective of facilitating competition and a new secondary objective to facilitate, subject to alignment with international standards, the international competitiveness and growth of the UK's economy.

Although the implementation of Basel 3.1 is conducted under a legal framework where this objective of competitiveness and growth does not strictly apply, it has informed it. By maintaining confidence in our banks, the Basel 3.1 reforms promote stable and reliable financing to the UK real economy, thereby supporting UK growth. And by aligning with internationally-agreed standards, our finalised proposals will advance competitiveness by promoting confidence in the UK as a global financial centre. A clear and robust prudential framework is therefore an important contributor to maintaining the UK's status, reputation, and competitiveness.

So where are we in the UK's implementation process of Basel 3.1? We issued proposals in November 2022 and in December 2023 published the first set of final rules, covering market risk, credit valuation adjustment risk and operational risk. The remaining policy proposals are scheduled for Q2 2024, with the whole package then coming into effect from 1 July 2025.

Other jurisdictions around the world have also been on a multi-year journey to implement the new standards. As we get closer to implementation, we have seen a number of differences in approaches across jurisdictions. Some are temporary (e.g. implementation timelines or transitional provisions), but others are not.

Some of the more material differences that we have had to consider when developing the UK package include: the treatment of small and medium-sized enterprise and infrastructure lending, the treatment of lending to unrated corporates, and permitting the use of internal models across the capital framework.

### We support the call for a timely and full implementation of the Basel standards.

Some differences between jurisdictions are to be expected as regulators seek to reflect the specificities of their domestic markets and banking systems where the evidence supports it, as the PRA has done in the UK. What is important, however, is that the core resilience that underpins the Basel 3.1 standards is not damaged. If there are significant differences in implementation across jurisdictions, we risk undermining the credibility and comparability of banks' capital ratios, or risking a 'race to the bottom', ultimately undermining the rationale for Basel III.

Capital ratios and minimum capital requirements are a core element of ensuring banking systems are resilient to shocks. When implemented consistently, they help avoid the build-up of systemic vulnerabilities and mitigate the risk of costly bank failures. The recent failures of international banks like Silicon Valley Bank and Credit Suisse remind us of the importance of robust global financial regulation. With this in mind, the Governors and Heads of Supervision (GHOS), the Basel Committee's oversight body, have expressed their expectation of implementing all aspects of the Basel III framework in full, consistently, and as soon as possible<sup>2</sup>. We support the call for a timely and full implementation of the Basel standards and look forward to finishing the job!

1. *Basel III: Finalising post-crisis reforms (bis.org).*
2. *Press release: Governors and Heads of Supervision endorse initiatives in response to the banking turmoil and reaffirm priority to implement Basel III (bis.org).*



## PAULINA DEJMEK-HACK

Director for General Affairs, DG for Financial Stability, Financial Services and Capital Markets Union - European Commission

### Finalising Basel III: the international state of play

Basel finalisation is not about urban planning for the Swiss city, but about bank regulation. The 'Basel Framework' is a set of global standards, developed over the years by the Basel Committee of Banking Supervision (BCBS). This Committee started its work in 1974. Whilst the BCBS had developed several earlier sets of standards, its most ambitious reforms to date were those initiated after the 2007-2008 Great Financial Crisis, dubbed 'Basel III'. The first part of these reforms, already implemented in the EU and in most other jurisdictions, imposed more and higher quality capital, less leverage and stricter liquidity requirements. Jurisdictions around the globe are now moving towards implementing the second and final part of Basel III. These standards focus on how banks measure risks and, for banks using their own internal models, they provide minimum rules, based on a standardised measure, the so-called 'Output Floor'.

The Basel III standards were designed and approved by the BCBS, which brings together supervisors from 28 countries, from across the world. A consistent implementation of standards across jurisdictions is necessary, not only to deal with potentially systemic issues in a globally interconnected banking sector, but also to ensure a level playing field. The merits of a global prudential framework were clear during the banking turmoil of Spring 2023, as highlighted by a recent Basel Committee report.

The EU has implemented all Basel standards. In summer 2023, the European Parliament and the Council reached an important milestone by finding an agreement on the EU implementation of the last Basel III elements. Recently, two of the EU's important international partners, the US and the UK, have put forward draft rules as well, for finalisation in 2024. It is at this stage difficult to compare rules between jurisdictions, as the UK has published only part of its final rules. The US authorities have finished their stakeholder consultation process and is facing significant resistance from US banks. In terms of the application date, the EU will start phasing in the new regime from 1 January 2025. The US and UK have announced their intention to start applying the new rules from mid-2025.

However, as mentioned, regulatory discussions are still ongoing in these two countries. In terms of the scope of application, i.e. to which banks the rules are applied, the EU made the choice several years ago to apply the Basel rules to all its approximately 4,500 banks, including to smaller banks with mostly domestic activities. This approach provides an important and additional layer of resilience in the banking system. Following the banking turmoil in March 2023, the US regulators are proposing to enlarge the US scope of application from the current 9 international banks to close to 40 banking groups, while keeping a different set of rules for smaller

banks. In the UK, which still has the same approach as the EU, reflections are ongoing on a potential separate regime for smaller banks. In terms of jurisdictional specificities, national choices often reflect the characteristics of the local banking systems and their role for the economy.

In the EU, existing specificities have been maintained, notably the supporting factor for small and medium enterprises (SME), which are an important part of the EU economy. For the final elements of Basel III, the EU has introduced a limited number of permanent specificities. Instead, the co-legislators agreed on transitional arrangements phasing in the reforms overtime. This applies, e.g. to the use of models for exposures to low-risk residential mortgages and to non-rated corporate borrowers. In these areas, EU banks are important providers of long-term financing. In this way, banks and their clients get more time to adapt to the new rules. The US has proposed to abolish the use of internal models for credit risk, retaining such models only for market risk. To ensure a domestic level playing field between large and smaller banks, the US regulators have also proposed several parallel sets of requirements – likely resulting in the Basel Output Floor becoming less relevant in practice.

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**As in any journey, the last stretch is important. A continued effort is needed to reach the finish.**

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As regards the UK, it is too early to comment on national specificities, including the potential specific regime for smaller banks. One area where differences could have an impact beyond local banking systems are market risk rules. These affect the capital markets business of global banks, for which an international level playing field is essential. The EU rules empower the Commission to adjust or postpone the market risk rules, if necessary given developments in other jurisdictions.

To conclude, we are reaching the last stretch of a long journey. We have come far, but there is still some way to go.[1]

As in any journey, the last stretch is important. A continued international effort is necessary to reach the finish.

1. See a recent post by the European Commission with details on the Basel III implementation in the EU.



## DANIELA STOFFEL

State Secretary for International Finance -  
Federal Department of Finance, Switzerland (FDF)

### Why Switzerland implements the final Basel III standards in 2025

Switzerland is consistently implementing the final Basel III standards. At the end of 2023, the Swiss government (Federal Council) adopted the new Capital Adequacy Ordinance for banks. This bill transposes the final Basel III standards adopted by the international Basel Committee on Banking Supervision (BCBS) into Swiss law. The amended ordinance will enter into force on 1 January 2025. We are committed to the internationally agreed rules and are implementing them within the planned timeframe. We expect and are confident that the world's major financial centres will also adopt the final Basel III standards into national law within the planned timeframe. This will strengthen financial stability globally.

The global financial crisis has undermined confidence in banks' published risk-weighted capital ratios. Empirical analysis by the BCBS revealed excessive variability in the calculation of variability in the calculation of risk-weighted assets (RWA) across banks. One of the main objectives of Basel III final is therefore to reduce the excessive, unwarranted variability in risk-weighted assets that affects banks' published risk-weighted capital ratios. Basel III final should now result in sufficiently transparent and comparable risk-weighted capital ratios to enable the market to assess risks effectively. With Basel III final, the BCBS aims to strike an appropriate balance between simplicity, comparability and risk sensitivity, while avoiding excessive model optimisation. The objectives of the BCBS also make sense for Switzerland, by strengthening the financial system and financial stability.

For the internationally oriented Swiss financial centre, an implementation of the global BCBS standard and a corresponding assessment by the BCBS is sensible and important. Accordingly, we are sure that the amendments to the ordinance will be positively assessed within the framework of a Regulatory Consistency Assessment Programme (RCAP) conducted by the BCBS. This high degree of consistency with the Basel minimum standard allows a certain amount of leeway.

The Swiss implementation aims to make sure that the greatest possible benefit and the lowest possible implementation costs are achieved for the Swiss financial centre and the financial market law objectives of systemic and creditor protection are not compromised.

Basel III final and its implementation in Switzerland are intended to reduce and internalise the external costs that banks impose on society. However, direct benefits are also expected for the banks: Conformity of the domestic market with the Basel standard may facilitate access to foreign markets. In addition, the signalling effect associated with compliance with the standard and better international comparability may facilitate banks' access to international

sources of funding. A high level of confidence in the Swiss financial centre is also important for the Swiss financial centre is also important for the international wealth management business.

The national implementation of the final Basel III standards centres on the fact that higher-risk areas of the banking business must be backed by more capital, and lower-risk areas by less capital. No significant change in the total capital requirements is expected for the Swiss banking sector on average. However, the capital requirements for UBS in particular are likely to increase. In addition, the amendment to the ordinance will limit the scope for internal models to determine capital requirements and achieve a transparent and internationally comparable calculation of capital.

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#### Switzerland is consistently implementing the final Basel III standards.

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The BCBS adopted the finalised framework in December 2017 and completed it with a revised minimum standard for market risks in February 2019. The national implementation of the Basel III final standards began long before the takeover of Credit Suisse by UBS in March 2023. This crisis emphasised their necessity even more and their implementation will further strengthen the stability of the Swiss financial centre and the foundation for Swiss banks' international business.

An evaluation of the too-big-to-fail regulations for systemically important banks is currently being carried out as part of the Federal Council's report, which should be available in spring 2024.





## MAKOTO MINEGISHI

Deputy Director-General, Financial System and Bank Examination Department - Bank of Japan

### No benefit from inconsistent implementation of global minimum standards

In the mid-19th century, U.S. Admiral Perry arrived off the coast of Tokyo, demanding Japan to abandon its 200-year policy of national seclusion. His fleet of “black” warships was truly frightening. The fear was then engraved so deeply in the mind-set of the Japanese that, even today, any unknown factor from abroad that could have a major impact at home is often labelled as “an arrival of black ships”. Indeed, since Basel I, international discussion around prudential rules has tended to be regarded as such, as we sit at negotiating tables to have Japanese specificities reflected in global minimum standards.

Against this background, similar to our predecessors who worked hard to convince domestic stakeholders that “black ships” presented an opportunity to modernise Japan, we have made conscious efforts to enhance understanding and support from a range of domestic stakeholders, making a case to defy temptation to dilute already-agreed elements, and highlighting merits of globally operating under a single rule-book. I am reasonably confident about our success, though with caution, because scepticism could easily re-emerge at an indication of non-uniform international implementation.

We need to be aware of a negative spill-over of inconsistent implementation of the internationally agreed minimum. A jurisdiction may be induced to deviate, so as to gain support from its own constituencies. A failure of full, timely and/or consistent implementation in a jurisdiction, particularly a large one, tends to ignite level playing field concerns in others, thereby further weakening support for the international framework. There is an embedded danger of a vicious cycle leading to the race to the bottom.

This is a serious concern for jurisdictions that faithfully move to domestic implementation. Japan has kept a good record in implementing international agreements. Our regulatory body, the Financial Services Agency, has finalised the rules and all elements of Basel III are already in the implementation phase. The past assessments under the Regulatory Consistency Assessment Programme (RCAP) by the Basel Committee on Banking Supervision have found a high degree of conformance of Japanese rules to international agreements.

No simple solution exists to prevent an obviously worse-off situation for everyone through each jurisdiction’s rule-making process, except for tenaciously calling supports from stakeholders, so as to minimise an incentive, in the first place, to deviate. Akin to the famous quote by Jean Monnet on how crises have forged Europe, episodes of financial stress should serve as a good opportunity to reflect on the merits of international agreements. For example, Covid-19 has served as a reminder of the importance of the resilient banking system, which the implemented Basel III standards have helped to ensure. Analytical reports from the Basel Committee and the

Financial Stability Board that evaluate effects of the post-crisis reform initiatives have provided evidence that stronger capital bases have generally facilitated banks to provide credit to the economy, contrary to prevalent fear that enhanced regulation would be simply a burden. These evaluation reports have also allowed us to reach out to a wider range of stakeholders beyond traditional close-watchers in financial industry, including academics and civil societies at large. The recent banking turmoil has also been an opportunity to reaffirm the critical importance of implementing Basel III framework in full, consistently and as soon as possible.

In the future policy discussion, the key is to internalise concerns from all stakeholders in international negotiation. A two-step process, where international agreement is first reached, and then domestic negotiation starts would not be optimal. A case can be made for using the consultation process by international standard setting bodies more strategically and effectively. Equally important is to avoid a coordination failure though international cooperation. Much can be done at the international level.

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**The key is to internalise concerns from all stakeholders in international negotiation.**

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I believe coordinated communication at the Basel Committee has convinced stakeholders that the Basel III will be implemented by all Basel jurisdictions, alleviating concerns of earlier adopters. At the same time, communication that none of the new initiatives should interrupt the imperative of implementing Basel III allowed both authorities and banks to focus on the implementation of any remaining part of the international agreements.

Back in 2019, under the Japanese Presidency, G20 addressed the issues of market fragmentation that would arise due to discrepancy of implementation of international agreements. The thrust of the message under this agenda is still valid. Consistent implementation remains at the core of the international agenda, as the questions extend into emerging areas, such as crypto assets. Authorities continue to work hard, together with stakeholders, both domestically and internationally, to avoid creating a fragmented world.



## THILO SCHWEIZER

Head of Public Affairs -  
Commerzbank AG

### Ensure an international level playing field - Keep an eye on future challenges

For more than five years, the EU has been diligently working on its implementation of the latest Basel standard (“Basel 3.1”). This process is now drawing to a close. In December 2023, a final compromise agreement on the Banking Package has been endorsed by Parliament and Council.

While work on the final text versions of CRR III and CRD VI by the EU’s lawyer-linguists continues in the background, the EU has almost completed a process that is still ongoing in many other major jurisdictions. Discussions in the U.S. have recently reached the level of Senate banking committee hearings. With industry consultations closed just weeks ago, the FED is currently reviewing their proposal. In the UK, the PRA intends to publish the final set of applicable rules until May 2024. Notably, both jurisdictions have declared their intention to delay the date of application by six months until July 2025. The EU’s legislators decided not to align with this date despite severe industry concerns. It is fair to state that this will somewhat hamper a level playing field. For banks operating around the globe, however, an international level playing field is of the essence – in particular with regards to the implementation of the Fundamental Review of the Trading Book (FRTB). In the Asia Pacific region, divergent implementation deadlines are creating additional complexities for banks.

Going forward, a key challenge for banks will consist in carrying out the internal implementation of the new rules and regulations: To be ready for application of the new Basel rules once they enter into force – and once respective reporting obligations kick in. In the EU, we expect that banks will only have about eight months for the transition. This is in strong contrast to previous Basel implementations, where banks were given a 24-month implementation period. Therefore, we advocate for swift adoption and publication of the EU’s final Level I texts.

That being said, a lot of relevant Level 2 work in the EU still remains to be performed by EBA. They will have the challenging task to complete all 140 mandates that are referenced in CRR III in time, including reports, guidelines and technical standards. This work will be essential to render CRR III and its reporting obligations practically applicable. This obviously implies additional regulatory uncertainty for the banking industry. We call on EBA to ensure a timely delivery on the outstanding mandates, as set out in their ambitious roadmap.

Yet, discussions about the implications of the Basel III finalization will not end with its entry into force. In the EU, regulators have prudently decided to phase-in certain requirements until 2032, particularly those in relation to the Output Floor, with the recognition of certain “*European specificities*”. It is obvious that an international standard cannot account for specific regional considerations. I welcome these

compromises, which adapt the Basel standard to the realities of banking in Europe. Of course, such adaptations should not run counter to an international level playing field. The EU has done a good job calibrating these accordingly. Interestingly, the current political debate in the U.S. is also focusing on issues like the treatment of unrated corporates, residential mortgages, or operational risk. It will be exciting to observe in how far the “landing zones” will finally be comparable.

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**A key challenge for banks will consist in carrying out the internal implementation of the new rules.**

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Nevertheless, let me emphasize the following: In order to maintain the long-term competitiveness of the European banking sector, long-term solutions for the remaining challenges will have to be established. In particular, this applies to the treatment of unrated corporates. Should there not be a significant uptake in rating coverage for corporates over the coming years, we will have to discuss creative solutions in the EU before the deadline comes closer. An international benchmark analysis that considers the approaches and solutions of different jurisdictions should inform this conversation.

Finally, – after Basel is before Basel, to slightly adapt a famous German saying. The steady integration of ESG and climate risks into prudential regulation will be a major task going forward. We are calling for a careful and diligent assessment – and we agree with the EBA’s view that such rules should only be implemented on the basis of a broad international consensus. Consequently, the Basel Committee’s work will continue to be of great importance in the coming years. Against this backdrop, I look forward to a lasting dialogue between supervisors, legislators, and industry and to our discussions here at EUROFI.



## HENNING DANKENBRING

Head of ECB Office - KPMG in Germany

### Basel 4 – Harnessing the transitional period to achieve convergence

There has been much debate on the extent to which the EU interpretation of Basel 4 deviates from the standards set out by the Basel Committee for Banking Supervision. EU banks contend that specificities in the market require additional consideration to maintain a level playing field. Regulators, on the other hand, are concerned that all jurisdictions target a full, faithful and timely implementation.

At this stage, timeliness is something of a moot point. Finalisation of the rules and the journey to implementation have been a long time coming, and there is now consensus that it needs to get done. On the more complex subject of EU application of the standards, it seems unlikely that there will be an outcome to the debate that satisfies everyone.

Should the EU do whatever is needed to comply fully with Basel rules now? Not necessarily – and instead of continuing to focus on whether the EU's stance is appropriate, perhaps the better questions to ask are what should happen next and what can the EU banking sector do to create an environment that supports future compliance?

For European banks, at the very least the final Basel reforms will impact profitability, influence the design and pricing of individual products, and require a major overhaul of IT and reporting solutions. For banks with a high percentage of RWAs calculated using internal models, and significant exposures to both retail mortgages and unrated corporates with low probability of default, these impacts may be particularly material.

The European Commission has committed to a holistic, fair and balanced assessment of the state of the banking system and applicable regulatory and supervisory frameworks in the Single Market, stating<sup>1</sup> that 'where possible, adjustments to the international standards should be applied on a transitional basis'. Such adjustments include arrangements for the impacts of the output floor on low-risk residential mortgages and unrated corporate lending exposures.

In the past, investors have been keen to understand banks' fully loaded capital ratios post any transitional rules. Should this apply again, the response time for banks will clearly be reduced unless, for example, management actions are included as a counterweight for the phase-in of the output floor. However, given the flexibilities and potential extensions of transitional periods for different aspects of the banking package, we believe there might be more breathing space than in previous CRR and CRD changes.

So, what are the key actions that European banks and other stakeholders could take now and during the transitional period to mitigate the business implications of full compliance with the Basel accord?

First, and to state the obvious, any advancements of the Capital Markets Union that would allow for real economy financing without involving banks' balance sheets would clearly reduce the overall impact of the banking package.

Second, an action within banks' own control, is to identify business areas where originate-to-sell, rather than being easier said than done, as has often been the case, is actually achievable. Given the significant increase in regulatory capital for the same assets, any opportunity to reduce RWAs with limited implications on return to capital should be embraced. The transitional period can provide the time for banks to review their portfolios with this goal in mind and identify potential buyers. Pension or special opportunity funds might seize the opportunity to invest in appropriately risk-return-profiled assets, enabling the banking package to contribute to the development of capital markets in Europe.

Third, banks need to re-assess individual products thoroughly in the context of the new regulatory capital charges which may change their risk-return profiles. Certain businesses or products (for example, those that involve low-risk and low RWA density under an IRBA-approach but proportionally higher risk weights under a standardized approach) may no longer be viable and sustainable. Unless, as described above, originate-to-sell opportunities arise, these may need to be discontinued. Businesses or products where the standardized approach, and ultimately the output floor, result in the same or lower RWAs than the internal model approach might offer new opportunities.

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#### What can the EU banking sector do to create an environment that supports future compliance?

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In short, EU banks are unlikely to be in full compliance with the final Basel standards from 2025. This does not mean that they have any less work to do – indeed, there will be a very significant and challenging workplan to get through in the coming months and years to implement the revised CRR requirements.

There is potential for convergence, but it is some way off. Although there will likely always be some differences, if used well, the transitional period can ultimately move the EU closer to global standards.

1. CRR consolidated trilogue text, December 2023

## BANKING UNION



### GIUSEPPE SIANI

Director General for  
Financial Supervision and  
Regulation - Banca d'Italia

## The CMDI review: an opportunity to make progress on the path of integration

Many steps have been undertaken to increase convergence and harmonization in the fields of banking supervision and crisis management, until the set-up of a single European banking supervision system and a single European resolution mechanism, as a response to the great financial crisis of 2008.

In principle, the current negotiations on revising our crisis management framework will not be a conclusive step for EU integration. More critical factors like convergence in the management of public finances, market integration, and deposit guarantee mutualisation are influential. However, we should look at the crisis management review as an opportunity to move in the right direction, not only by promoting higher harmonization, and therefore by confirming the will of Member States to progress on the path of integration, but also by fostering a better understanding of national frameworks and specificities,

thus facilitating cross-fertilization between different frameworks, and ultimately building mutual trust.

In particular, this objective can be pursued along three main lines: gaining a deeper comprehension of the most efficient methods for managing banking crises; recognizing the presence of different types of banks within the EU banking system, and therefore the need for proportionality; addressing the protection needs of the most sensitive bank liabilities. i.e. deposits. While finding a compromise on these issues will not immediately resolve the current deadlock, it could promote the transition to the finalization of the banking union.

Indeed, an improved CMDI framework - where a wider access to the DGS can ensure an orderly exit from the market of small and mid-sized banks and facilitate the access to the SRF without inducing destabilizing effects - can strengthen confidence in its functioning and could overcome the resistance of some countries to mutualise losses. This, in turn, would facilitate the creation of the EDIS and a truly integrated single market, fostering the free flow of capital and liquidity across borders.

Considering the three main factors, there seems to be an increasing international consensus favoring transfer strategies over piecemeal liquidation, despite some countries being unfamiliar with these strategies involving DGS intervention. This is very clear at least from two perspectives: first, they ensure the continuity of access to deposits, which in a digital era - where banks runs are faster - is key to reassure depositors and avoid widespread contagion; secondly, they preserve value as selling the business as a whole is the most efficient way to realize the assets of the failed bank: the franchise value is maintained and the overall cost of the crisis reduced.

Additionally, recognizing the diversity among banks, especially smaller ones lacking access to wholesale capital markets for issuing MREL, is of paramount importance if we truly want to preserve a European banking system where different types of banks coexist, with benefits for financial stability and financial inclusion. For many small and medium-sized EU banks adopting resolution would not be proportionate; yet, as widely recognized, public policy concerns may arise when they fail.

Tailoring crisis management options to the business model of small and medium-sized banks is key and consistent with increasing degrees of proportionality during going-concern scenarios in the field of prudential regulation. To this end, the expected moderate expansion of resolution should be complemented by a wider use of the DGS alternative measures across the EU to support transfer strategies also outside resolution, mirroring the crisis management strategy successfully adopted in the US.

### A compromise on CMDI could promote the transition to the finalization of the Banking Union.

Finally, establishing a common understanding that a wider policy toolkit is needed for more sensitive liabilities, i.e. those deposits that could lead to higher contagion risk, can lead to a more robust crisis management framework, alleviating fears of banks run, reducing potential ring fencing, and supporting future integration efforts. The banking turmoil of March 2023 reminds us that the perceived risk of bearing losses can lead uncovered depositors to run on banks that are - or seem to be - similar to the failing one. To avoid imposing losses on depositors when there is contagion risk, wider access to the industry safety-nets is of essence; it would also prevent a substantial amount of resources, as those collected in the Single Resolution Fund, from remaining 'frozen' and actually unavailable.

The current negotiations should draw inspiration by one man whom Europe owes a lot, Jacques Delors. Throughout his entire career, he consistently urged to set aside our inactive national habits in favor of an enthusiastic pursuit of compromise to not lose the accomplishments reached so far.



## CHRISTOPHE BORIES

Head of Service for the Financial Sector - Ministry of the Economy, Finance and Industrial and Digital Sovereignty, France

### Banking Union: strengthening trust and creating a new sense of purpose

The euro debt crisis laid bare the vulnerabilities of the European banking system and made clear that further integration in this area would help restore trust and buttress resilience at national and euro area levels. Since then, France has supported all the previous steps of the Banking union agenda, even where they meant significant transfers of sovereignty and financial resources to the Banking union level, with the vision that this would eventually make our banking system safer and more resilient to future shocks, and better able to finance our economy in any weather. We are confident that this was the same vision that motivated fellow Member States to support this agenda at the time, and that it was the main driver of all the progress that took place.

By definition our achievements are not easy to measure. But when we look at the series of shocks that hit us in the last 3 years, with the COVID pandemic, the Russian war of aggression against Ukraine, the paradigm shift on rates, and the March 2023 market turmoil ignited by the bank failures in the US and Switzerland, we can

note that the robustness of our banking system was never put into question. This robustness and also its credibility show that we have come a long way in reaching the initial goals of the Banking union agenda. It doesn't mean that this agenda is now complete, especially if you look at its third pillar ("EDIS") is yet to be put in place, but we can all agree that we are way more than halfway through our objective of a safer banking system.

Nevertheless, we can only recognize that this positive achievement has not created sufficient momentum and confidence to enable taking additional ambitious steps on this agenda in the past couple of years.

It seems mostly due to the fact that the sense of purpose has been lost, now that many consider that most of the job is already. At the same time, we face an apparent paradox where objective reasons for trust and confidence in the Banking Union are higher than ever, but it does not translate into momentum for further progress on integration.

Thus, we need to find a new sense of purpose justifying new bold decisions in terms of transfer of sovereignty and pooling of resources. We also need to find out how to build sufficient trust to allow such progress. In that perspective, our agenda should be built on two main legs.

The first one would be to fill the remaining gaps in our risk management to get to the needed level of trust.

In the short term, we should focus on reaching compromises on the reform of the crisis management and depositor protection framework (CMDI). They should achieve a balance between expanding the toolbox to be able to deal with the failure of midsize and small banks in a way that is as harmonized and credible as possible, while not increasing moral hazard and systematic transfers of resources between national sectors, to avoid reducing chances of later agreements to more risk sharing. Here, our view is that the Commission proposal needs to be complemented by further "safeguards" that would include robust minimum level and quality of eligible liabilities and own funds (MREL) buffers for all banks, as well as a more balanced division of labor between the DGS and SRF interventions.

Ultimately, a good result on the CMDI review would provide new momentum and more trust that would help us move forward with the rest of the agenda. But it might not be enough.

Indeed, one aspect of the insufficient level of trust among supervisory authorities at the moment has to do with the limited formal solidarity within banking groups,

between the legal entities that operate in different Member States. There has been progress on that front with the recent reviews of the so-called "daisy chains" that improve the functioning of the loss transfer and recapitalization mechanisms within groups. But we should explore whether we could go further by introducing a new regime for intra-group financial solidarity that would replicate for subsidiaries the same level of support that exists for branches that are not separate legal entities. This could be discussed within the CMDI negotiation.

The second leg of our agenda, focusing on creating a new sense of purpose, should be to improve significantly the productivity of our banking system. At a time when the relative competitiveness of Europe and its banks is eroding against the US, and as large amounts of financing will need to be mobilized to deliver the green and digital transitions, increasing productivity should be a much more prominent goal in our agenda than it has been in the past. Identifying the regulatory levers and action plans that could contribute to that objective should be the key priority for the next Commission. Interestingly, this could also be a way to connect the Banking union agenda with deliverables of the Capital markets union agenda, where the focus should also be on how to scale up our financial system.

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**We need to find a new sense of purpose justifying new bold decisions in terms of transfer of sovereignty and pooling of resources.**

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In any case, this is a policy discussion that is taking place in Europe for many industries and there is no reason why we should not have this discussion for the banking industry. That is where a new sense of purpose can be found: scaling up the capacity and effectiveness of our banking and financial system so that they can help deliver on the promise that Europe will lead the way in transitions.

To conclude, for good or bad reasons, the past years have shown that EDIS as a unique policy objective is insufficient to move the banking union forward. We need another engine, and we should focus on delivering a productivity shock to our banking system, which together with EDIS could propel us again towards the completion of this agenda. The CMDI review gives us the opportunity to build the level of trust that we need to succeed in that endeavor.



## PETER PALUS

Member of the EFC/EWG  
& Head of Financial Unit -  
Permanent Representation  
of the Slovak Republic to EU

### Completing the Banking Union: how to escape the prison of success

The development of the Banking Union project can so far be considered a fairly success story. A decade since its inception, the EU banking sector is more resilient, banks have stronger capital positions, a macroprudential level of supervision has been established together with an EU resolution framework. The robustness of the system was tested and proofed during the US banking turmoil last March, when the EU regulatory framework and stringent Basel requirements proved to be the difference.

The Banking Union safeguards public finances, as the need to use national budgets to rescue banks is diminished. It benefits citizens and businesses, since their funds are better protected and it supports the EU economy in general, as banks can fulfil their core role of financing the economic activity.

Paradoxically, the success the Banking Union has achieved so far is diminishing the pressure to take further steps towards its completion. To be sure, the potential of the Banking Union is far from being achieved, particularly when it comes to potential benefits

for the banks themselves. The EU banking sector has so far avoided the necessary consolidation, which would lead to greater efficiency and boost its competitiveness on the global stage, where the European banks are still falling behind.

Furthermore, we are yet to adequately address the risk of negative spill-overs from the real economy to the banking sector, which is perhaps one of the key lessons learnt from the Great Financial Crisis. It also explains the continued connection between economic strength of a Member State and deposit protection. This leaves our banking sector vulnerable and insufficiently prepared for the challenges ahead of us, especially in the area of EU open strategic autonomy, increasing global competitiveness and addressing the needs of the twin transition.

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**The success the Banking  
Union has achieved  
so far is diminishing  
the pressure to take  
further steps.**

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We should no longer rely on Monnet's famous statement, that "Europe will be forged in crisis, and will be the sum of the solutions adopted for those crises". This time, failure to timely and properly address the challenges we are currently facing might have irreversible adverse effects on the EU.

How can such a scenario be avoided? How can the Banking Union escape the prison of its own success? I consider the following five principles to be the key:

1. **Highlight the political significance of the Banking Union:** it is necessary to realise, that in view of the current geopolitical challenges the EU is facing, the Banking Union is a key economic as well as political project.
2. **Overcome home bias:** What appears to be urgent at the EU level may not always appear urgent at the national level, especially as Member States are constantly looking for competitive advantage. Crucially however, working together will benefit both Member States and the EU as a whole.
3. **Overcome the prisoners' dilemma:** We are faced with a lack of trust between Member States, banks, regulators, and EU institutions. Our underlying target must be Europeanization of banks and institutions.
4. **Develop the capital markets:** The Capital Markets Union must be seen as complementary to the Banking Union. A fully-fledged CMU cannot be achieved without a well-functioning banking sector, which plays the crucial role of an important liquidity provider. The BU cannot be completed without achieving progress in the CMU, especially when it comes to macrofinancial stability. Not to mention the need to enhance the area of securitisation, which would free up banks' balance sheets for further funding of the economy.
5. **Follow a holistic approach:** The current discussion is dominated by particular interests, not by effort to achieve optimal functioning of the banking sector. Some see priority in prevention of negative spill-overs, others in removal of cross-border barriers and take full advantage of the internal market, protection of specific banking models or ensure the financial stability at the national level. Yet, all these goals are equally important and cannot be politically achieved separately.



## RUI MIGUEL CORREIA PINTO

Member of the Board of  
Directors - Banco de Portugal

### The CMDI review is a step in the right direction but more is needed...

Supervision and Resolution in Europe have come a long way throughout the last decade and although operating in different lanes (as they should) they act as two faces of the same coin, with a clear alignment and ultimate common goals. A healthy and robust banking market cannot do without both a strong supervision and a strong resolution function. And they are inextricably linked, which means that good communication and healthy interaction are a requirement, not a “nice to have”.

European supervision and regulation work together and do carry out their missions in an environment of mutual trust. Past experience is a testament to this statement as many and fruitful interactions and discussions take place between the SSM and SRB in a business-as-usual mode. While respecting the division of competences entrusted to one another, the close cooperation and sharing of information between supervisors and resolution authorities is set up for crisis situations and stable times as well. This allows both supervisory and resolution authorities to take swift and coordinated actions. And it should be evident that agility

and quickness of response is a critical success factor when dealing with a crisis.

Despite all these achievements, there is, however, meaningful work still to be done.

First, we must not lose sight of the original project for the Banking Union. While an agreement was found more than a decade ago on the set up of the supervision and resolution pillars, the Banking Union still requires the third pillar to be completed. Whereas the framework is now in place to allow banks to be truly European in life, national frontiers are still standing when it comes to their demise.

The second task to be delivered relates to the regulatory landscape. The legal framework that supports the first two pillars of the Banking Union is entering its second decade this year. Concerning specifically to the crisis management framework, the lessons learned over the past years have led both Member States – pursuant the Eurogroup statement issued in the Summer of 2022 – and the European Commission to conclude that an important review is still necessary.

The current framework, as it stands, is still not prepared to deal with the failure of every bank, regardless of their size, when considered necessary to safeguard financial stability, ensure continuity of critical functions provided to the economy and protect depositors.

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### The current framework, as it stands, is still not prepared to deal with the failure of every bank.

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The Commission’s proposed review of the Crisis Management and Deposit Insurance Framework of April 2023 is a step forward in addressing the issue, by proposing to broaden the scope of resolution and presenting an idea of “resolution for all and not just for the few”, namely through the enhancement of internal and external funding of such banks.

Firstly, by introducing a degree of proportionality through additional criteria to calibrate MREL for banks whose resolution strategy envisages an exit from the market, as they usually correspond to small and medium-sized banks. This is about internal funding and the build-up of adequate and proportionate loss absorption capacity by a larger number of institutions.

Secondly, by enhancing the role of industry funded safety nets, such as Deposit Guarantee Scheme (DGSs), overcoming the existing limitations to the access and use of the resolution financing arrangements.

While DGSs may be called to intervene more in resolution, they are, at the same time, being spared from the expensive pay-out events and the inefficient and very lengthy insolvency proceedings they entail.

As the failure of medium-sized and smaller banks can also be a threat to financial stability, solutions that strengthen the regulatory framework and prevent leaving the task of addressing such possible failures to national regimes alone are welcome.

Looking back on everything that has been achieved, there are good reasons for being optimistic that Member States can agree on some fundamental changes to the regime, so we are able to fulfil the promises that underpinned the creation of the Banking Union: one single supervision and one single resolution as well as one Deposit Guarantee Scheme.

These three pillars would support a truly integrated banking market operating under a single rulebook and in a framework that provides a set of tools which guarantees flexibility and proportionality of treatment in the system. This allows to deal with banks in their going concern mode and to deal with banks in a crisis mode. Simultaneously preserving the provision of critical functions and depositor’s confidence but also protecting taxpayers.



## TANATE PHUTRAKUL

Chief Financial Officer -  
ING Group

### Banking Union – As urgent as ever

With 2024 announcing itself as an agenda-setting election year, EU institutions and member states rightfully want to focus on making Europe more competitive in an increasingly fragmenting world. A competitive Europe will ensure the continent remains relevant in a transitioning global economy and will ensure Europeans' standards of life will continue to improve.

While primarily meant to address financial stability concerns, the European Banking Union can also be a strategic enabler for the EU's competitiveness objectives. It will complement other priorities including improving the single market and further enhancing the EU's capital markets.

After having successfully implemented single supervision and single resolution, the next five years provide a good window to finish the job.

#### What positive changes would Banking Union bring?

Beyond financial stability considerations, Banking Union is necessary because banks remain fundamentally unable to leverage the single market to the benefit of their clients. This has negative consequences for the economy: competition for savings remains largely national, opportunities to deploy capital

where it can create the most growth are constraint, and lack of scale means European banks cannot compete in all aspects of global finance.

The promise of Banking Union for the European economy is that it will allow bank lending – by far Europe's leading source of financing – to be offered in a real single market, by strong cross-border banks that deploy the scale and diversity of the EU to the benefit of the European economy.

And as opposed to many current economic policies, a successful Banking Union does not require fiscal stimuli. On the contrary, it helps protect governments from further fiscal constraints, and allow public means to be used where they are most useful like for the green transition.

This can bring concrete benefits. Better deployment of capital and liquidity will allow Europe's accumulated wealth to be used to finance new ideas and growth. In a Banking Union, European business and consumers would enjoy a more competitive and nimble banking industry deploying resources in the places where they make a difference. It may even stimulate stronger capital markets because banks remain important intermediaries in these markets.

Banking Union will also help European banks close the valuation gap with global competitors, meaning they will be better able to use their own profits for investing in their services, and be able to participate in cross-border banking consolidation.

Stronger European banks will help Europe finance its ambitions. They are amongst the most committed to global and European climate and environmental goals. This is because Europe is deeply committed to reaching these goals, which brings welcome policy clarity for those banks predominantly active in Europe.

#### Top 5 to do list for policy-makers

**Allow cross-border deployment of capital and liquidity** - today, bank subsidiaries in different Banking Union countries have to maintain separate balance sheets and apply prudential requirements that come with it (capital, liquidity, MREL, leverage limits, etc). Allowing banks to manage balance sheets centrally, rather than country-by-country, would be a gamechanger for efficient deployment of capital and liquidity. This can be done by allowing banks to apply the prudential rulebook at group level only.

**Pursue a single macro-prudential policy** - European banks are not treated equally because their macro-prudential buffers

are not set in a harmonised way. In a Banking Union, it should not matter where a company's headquarters are located inside it. The Banking Union's macroprudential policy should be made centrally.

**EDIS** - The absence of a European Deposit Guarantee Scheme creates the perception that not all depositors are equal. In absence of EDIS, banks should be able to transfer their paid-in contributions between national DGSs in case of mergers or changes to corporate structures.

**End sovereign-bank doom loop risk** - banks should diversify and limit concentration risk to sovereign bonds. This will not only make banks more resilient, but also take away a major source of distrust between European countries.

**Ensure credible liquidity backstop for resolvable banks** - Even when banks are fully resolvable and have sufficient MREL, market reaction could lead to severe liquidity problems in resolution. The currently liquidity tools (such as the Eurosystem's Emergency Liquidity Assistance) are not designed for supporting failing banks that can be orderly resolved.

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### Banking Union can also be a strategic enabler for the EU's competitiveness objectives.

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In addition, policymakers need to be aware of other roadblocks for cross-border M&A. For example, accounting rules may mean paper losses lead to excessive capitalisation requirements in case of a cross-border M&A. Even with a perfect Banking Union, this type of roadblocks can prevent meaningful consolidation.

To stay relevant, Europe needs more bold action. Banking Union is a necessary and urgent step.





## CHRISTIAN CASTRO

Head of Public Affairs -  
CaixaBank

### Banking Union and windfall taxes

The benefits of the European Banking Union have been widely commented. What's more, recent history provides a number of objective reasons to strive for such a policy objective at the EU level. These include the acute consequences—including economic and financial crises—that can be triggered or amplified by: self-reinforcing linkages between sovereigns and banks due to financial fragmentation; divergences in regulatory and supervisory approaches due to the absence of common rules and practices; lack of a credible and usable crisis management framework for banks; and finally, disturbances to the smooth transmission of monetary policy through the bank-credit channel.

Those policy measures, necessary to prevent such a kind of issues, have also been extensively discussed. In fact, important achievements have been made mainly on a common set of regulatory rules, a unified supervision, and different pieces to enhance banks' resolution. All this seeks to ensure integrated and well-functioning EU financial markets.

However, there is a significant source of undue financial fragmentation that stubbornly remains: ad-hoc taxes to the banking sector. This has been a problem from the beginning and an increasingly growing on as result of the recent

normalisation in interest rates giving rise to the so-called 'windfall taxes' to banks. At present, there are around six European countries with a windfall tax already in place. Four countries are in adoption process. And five countries have discussed the possibility to implement this type of tax. This is more than half of the member states in the EU-27. So, no doubt this is a quite material issue at stake.

The motivation, design and expected duration (theoretical and actual one) of the levies vary significantly among member states. They range from levies to tax 'extraordinary' profits from banks due to the hike in interest rates (eg: Croatia, Czech Republic, Hungary, Italy, Lithuania, and Spain) and/or to contribute to specific goals (eg: support reconstruction after severe floods in Slovenia). Further, their design (eg: completely new tax, a surcharge on an existing one), scope (eg: all banks, some banks) and discretions (eg: option to increase capital in Italy) are also significantly heterogeneous. All this constitutes a major source of financial fragmentation, misalignment with internal market practices, and unlevelled playing field for European banks. A potential stigmatization of the banking sector can also lessen a fair competition for funding in stock markets.

The European Central Bank has emphasised the negative consequences of windfall taxes. On the Spanish tax, the ECB warns about its effect on banks' resilience, capital and credit provision, as well as on market competition and level playing field. These last two aspects are particularly relevant for the Spanish tax since the levy only applies to certain Spanish credit institutions, not to all banks with activity in Spain. In addition, the tax is calculated on the basis of the interest income plus net fees (income based) rather than on profits. So, the tax is not based on the allegedly excess profits and does not capture the effect of inflation on expenses.

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**There is a need for a  
fundamental rethinking  
of policy regarding  
windfall taxes to banks.**

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One should also bear in mind that banks, as any company, are subject not only to tailwinds but also headwinds, sometimes stiff ones. The pandemic and the zero-interest rate environment were poignant examples of such headwinds. The increasing profits in the sector are part of the gradual normalisation in

interest rates following such an extreme scenario in monetary policy and the global economy.

In addition, ad-hoc taxes to the banking sector amplify uncertainty and impair investment decisions, ultimately affecting economic growth and monetary policy transmission. As said before, this a problem for the whole European Union since it undermines the normal functioning of financial markets within the country and across the whole Banking Union.

This all suggests the need for a fundamental rethinking of policy regarding windfall taxes to banks. Key aspects to consider include: the need to eliminate or minimise distortions to normal banking activity; or at least to retain the temporary nature of these taxes; and to avoid unfair competition and/or discrimination across entities, economic sectors and jurisdictions. Further, due consideration should be given to those features that may help to preserve resilience (eg: using tax revenues to support most vulnerable segments of population) and to support economic development (eg: factoring in sector contributions to key policy goals). Some coordination and guidance at the EU level on this matter could also be thought.

All this is necessary to avoid affecting the normal functioning of financial markets in the EU, an essential condition to ensure a fair, healthy and competitive Banking Union.



## RIINA SALPAKARI

Head of Public Affairs,  
Finland - Nordea

### Completing the Banking Union - Risk mutualisation or harmonisation?

Several steps have been taken since the financial crisis to ensure a strong and stable European financial system. The convergence of supervisory practices brought on by the Single Supervisory Mechanism (SSM) has been a positive development. Through increased transparency and predictability of supervision such as the coordinated and decisive approach to treating non-performing loans (NPLs) has had positive effects in times increasing interest rates. The drastic drop in NPLs across the Banking Union, with the remaining exposures duly capitalised, has been paramount to maintaining confidence in EU banks and in incentivise further lending.

Looking to the new Commission's term, the EU is currently facing severe economic, environmental, and security threats which require ample financing to overcome. Given these large financing needs in the coming years to finance, it is pivotal to ensure that the European financial industry can contribute to financing innovation and to resolving EU's challenges.

In order to ramp up further financing, the EU needs a better functioning internal

market for financial services. This would increase competitiveness in the sector and could improve its efficiency.

We have seen consolidation in many industries both on EU and global level. Banking seems to lag behind especially in Europe, and consolidation has happened mostly within jurisdictions. Digitalisation could drive cross-border banking services given that one platform can be leveraged across several Member States. However, complex regulation coupled with a lack of harmonisation creates obstacles, making it difficult for a bank to contribute to the economy and/or expand abroad as a full service player.

Policy makers should rapidly shift their focus to further enabling banks and other providers of funding to finance the real economy. Areas remain where harmonisation is lacking and where existing regulation has not lead to sufficient regulatory convergence or a level playing field.

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#### The EU needs a better functioning internal market for financial services.

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First, same risk carries a differing capital requirement depending on where a bank is domiciled within the EU, and this is mostly driven by the macroprudential requirements. The EU needs to revise the macroprudential landscape to further harmonise conditions under which macroprudential buffers are set and to strengthen processes that ensure no overlaps with microprudential requirements or other capital buffers. There should be further entity level oversight of the aggregate capital requirements to ensure that the aggregate buffers reflect the risks of each institution, rather than relying on assessments at Member State level.

Second, microprudential rules also differ for cross-border banks. There should be further alignment between supervisors' division of responsibilities per CRD/CRR and the supervisors' practical say in banks' operations. Banks with operations in many Member States face supervisory expectations to align practices at group level, while at the same time host supervisors may have the preference to extend a large proportion of their expectations also to those entities. This makes operating cross-border banks increasingly complex.

Third, national policy instruments' impact on other Member States should

be further considered. Recent initiatives from some Member States on bank taxes have affected banks' stock valuations across the EU, with implications also on financial stability. On the other hand, state aid structures are complex and vary across Member States, putting companies in differing positions depending on which jurisdiction they are located in. Similarly, differences in insolvency and privacy frameworks hinder the free movement of capital and services in the EU.

In discussing the completion of the Banking Union, focus has been on implementing the European Deposit Insurance Scheme (EDIS), and what obstacles should be overcome to achieve this. A credible deposit insurance system across the EU is of course important for managing bank failures, and deposit guarantee rules need further alignment. But agreeing on risk sharing in the form of EDIS seems to be difficult without breaking the bank-sovereign nexus. This in turn is likely to be achieved only by capitalising on the sovereign holdings' differences in credit and market risk.

However, there are good reasons to believe that a well-functioning single market for financial services can be achieved even before implementing EDIS. The banking sector has become markedly more resilient due to both regulatory and business changes since the last crisis, demonstrated by the low number of bank failures within the last decade. Regulators' focus should therefore be redirected from bank failure management to further enabling banks to provide funding to the economy in an efficient, risk sensitive manner. In order to achieve this, maximal alignment of prudential rules across the EU/EEA is required.

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## EU BANK CRISIS MANAGEMENT FRAMEWORK



### ANNELI TUOMINEN

Member of the Supervisory  
Board – European  
Central Bank (ECB)

### Crisis management: reform on the way

The current review of the crisis management and deposit insurance (CMDI) framework aims to improve the way we resolve crisis situations. Implementing the CMDI proposal is an important move to further enhance the European crisis management framework, making it possible to deal more effectively with the failure of smaller and mid-sized banks. This is a welcome step in the right direction. The urgency of having a proper crisis management framework in place cannot be overstated, as we saw last year.

I would like to emphasise a few aspects of the proposed reform.

When a bank does not meet or is unlikely to meet its supervisory requirements, we are empowered to take supervisory and early intervention measures aimed at keeping it viable and preserving financial stability. The proposed legislative changes include important improvements to the existing supervisory early intervention framework. This will

support us to swiftly adopt the necessary and most appropriate measure for any given situation.

One key aspect that should be a cornerstone when assessing the proposed reform, is the principle of optionality. From a supervisory perspective, we consider it crucial that all relevant stakeholders can deal effectively with banks in distressed conditions. Recognising that no bank crisis is identical, the relevant authorities should be able to choose the most appropriate tool for the situation at hand from a range of options and be able to make effective use of it. This optionality should exist at each phase. Policymakers should have a proper toolkit before a bank is declared failing, and they should also have access to robust tools once a bank has been declared failing.

An important element of the toolkit, is precautionary recapitalisation. We are pleased to see that the European Commission's proposal ensures that it remains available, subject to strict conditions. Though exceptional, precautionary recapitalisation is a useful part of the current crisis management framework, and its current conditionality appears appropriate. At the same time, the flexibility provided to relevant authorities to take the specific circumstances of each case into account should not be restricted.

Another notable development in the toolkit concerns the expanded role of deposit guarantee schemes (DGSs), traditionally seen as a safety net for depositors. The proposed changes call for DGS funds to be used for more than simply depositor payouts. For instance, instead of paying out covered depositors, DGS funds could contribute to facilitate transfers of assets and liabilities to an acquiring bank under what are known as "DGS alternative measures". The "DGS preventive measures" represent another form of DGS tool. These could be used in the pre-resolution phase by helping banks to ensure or restore compliance with the prudential requirements while they are still going concerns.

Ensuring adequate funding in resolution is an important precondition for the proposed expansion of resolution to medium-sized banks. The DGSs can also play an important role in helping to provide this funding.

Besides access to a robust set of tools, I would like to point out the need for close collaboration. The ECB and the SRB already cooperate very closely and exchange information based on a bilateral Memorandum of Understanding. We also work very closely with all other relevant stakeholders. The Commission's proposals to enhance cooperation and information-sharing are very much supported.

Finally, as the recent March turmoil in the US and Switzerland has shown, having proper arrangements in place for liquidity in resolution, is a crucial element to support a successful resolution. The Financial Stability Board considered in this respect that authorities need to have credible liquidity backstops and other frameworks in place that are overt and easily understood by market participants and depositors in order to restore market confidence when a bank is resolved.<sup>1</sup>

In conclusion, the CMDI proposal represents an important opportunity to further enhance the existing EU crisis management framework using the lessons learnt during the first years of its application. We hope the ongoing discussions will help to reach a consensus on these important changes to the European crisis management framework. At the same time, I would like to point out that, even if we reach a consensus and the crisis management reform takes

**A robust set of tools  
is crucial to deal  
effectively with banks in  
distressed conditions.**

place, that is not the end of the journey. The Commission's proposal does not address some fundamental elements of the broader crisis management architecture. The third pillar of the banking union, a European deposit insurance scheme, is still missing. Given its importance, we hope that this will be addressed in the next legislative term.

1. Financial Stability Board (2023), "2023 Bank Failures – Preliminary lessons learnt for resolution", October.



## DOMINIQUE LABOUREIX

Chair - Single Resolution Board (SRB)

### A more complete toolbox for crisis management in the EU

In the past, some small and middle-sized banks fell between the cracks of the resolution framework. Resolution authorities were not able to resolve them, due to the current definition of the notion of public interest. Instead, with the announced objective to preserve financial stability, such banks were dealt with outside of resolution using public liquidation aid. As a result, while regional financial stability was indeed preserved, taxpayers had to foot the bill. The Crisis Management and Deposit Insurance proposal (CMDI) will help addressing this loophole in the framework.

CMDI, in fact, aims to expand the scope of resolution to a number of smaller banks – as most of the larger ones are already earmarked for resolution.

Resolution has, in fact, a number of advantages over liquidation. First, in resolution, the use of taxpayers' money is explicitly ruled out. Also, for instance, when a failing bank reopens after the resolution weekend, customers keep access to its full range of services. This is not necessarily the case in liquidation.

This does not mean that all banks running into trouble should be resolved.

Even after CMDI, liquidation will stay relevant for most banks. The Banking Union is home to around 2 000 small banks – the so called less significant institutions (LSIs) – and, even after CMDI, for the most part, liquidation will remain the preferred approach in case of crisis. So, resolution will not be the general case.

Also, CMDI will never be a free lunch. We will hold those smaller banks, entering in the scope of resolution, to the same standards as their larger peers, in a proportionate way. In this vein, the Minimum Requirement for Own Funds and Eligible Liabilities (MREL) will still be the first line of defence to absorb losses. A proof of the intense resolution planning work carried out on smaller banks can be found in our recent LSI report<sup>1</sup>. These “resolution LSIs” are advancing toward resolvability (including MREL compliance), in line with their larger peers. The same rules will apply for banks entering in the scope of resolution thanks to CMDI.

Nevertheless, resolution authorities will need a more flexible toolset to deal with the resolution of these smaller banks. This is why CMDI introduces an alternative way of funding a market exit for the bank in crisis, if it is in the public interest. CMDI, in fact, allows for the use of Deposit Guarantee Schemes funds (DGS), and possibly of the Single Resolution Fund (SRF), to facilitate “market exits”, funding the sale of the ailing bank to a solid acquirer. By doing so, CMDI also curtails the risk that some uncovered depositors would suffer losses and cause a bank run.

**CMDI makes the resolution toolkit more flexible, increasing trust in the crisis management framework.**

Some stakeholders are concerned that this proposal would be expensive for the industry – through an increased need to fund national DGS and the SRF. However, these concerns are overblown. Our estimations are reassuring<sup>2</sup>. Even if CMDI makes the possibility of using the DGS (and the SRF) more plausible, such use in resolution would have limited impact on their finances – and, in turn, on the banks. This is because, as mentioned above, MREL remains the first line of defence, and due to the relatively small size of the banks concerned. Besides being low cost, the DGS funding of a sale

is a practical solution that has recently been contemplated also abroad.

The expansion of the scope of resolution and the use of DGS funding – the core of this proposal and the most debated issues – should be considered interconnected and mutually necessary. Expanding the scope of resolution without the source of funding would not work. If we are to take a decision to put a bank into resolution, we have to be certain we have the right tools. Otherwise, liquidation may become the only option.

Whatever compromise legislators may find on the sensitive issues around the creditor hierarchy, they should make sure it delivers the same results in terms of funding available for a resolution decision. To make it more concrete, if the legislators converge around multiple tiers for the depositor preference, then the least cost test, and its governance, have to be modified so that sufficient funding for resolution and alternative measures can still be unlocked in case of a need.

To conclude, the current framework works well and many of its aspects should not be modified. However, CMDI offers a great opportunity to legislators to make the crisis management toolkit more flexible, increasing trust and confidence in the crisis management framework. This opportunity should not be squandered or we risk going backwards to a more fragmented system, which would be particularly detrimental to the Banking Union.

1. Single Resolution Board, “Resolution planning and crisis management for less significant institutions”, October 2023
2. Single Resolution Board, “The Commission proposal to reform the EU Bank Crisis Management Framework: A selected Analysis”, December 2023



**HELMUT ETTL**  
Executive Director - Austrian  
Financial Market Authority

## Enabling an orderly market exit irrespective of banks' size

There is no “one size fits all” solution in banking resolution since small and medium-sized banks would often not pass public interest assessments. However, it is a misconception to say that only the very large, systemically important banks significantly impact our financial system and stability and therefore, a smooth exit of failing small and medium-sized banks must also be guaranteed.

Tackling the problem of small and medium sized-banks is necessary in order to complete the framework for failing banks. But how should we best go about it? The current resolution framework and requirements for resolvability are intrusive and costly – maybe excessively so for smaller banks. Substantially enlarging the public interest assessment (PIA) might not be the optimal solution. In Austria, for example, the existing insolvency regime has proven its effectiveness and suitability for smaller banks combined with the national Deposit Guarantee Scheme (DGS) on three occasions in recent years.

Nevertheless, past experiences have shown some room for improvement. One main issue is sufficient liquidity coverage, in the case that the problem

boiled down to a shortage of short-term liquidity rather than the asset quality per se. In such cases, interim financing would have been needed to avoid an insolvency. One possibility would be to consider a complementary liquidity regime for such banks in order to permit an institution's orderly and value-preserving wind-down. By embedding such a regime in a national administrative wind-down-procedure, a “least cost test” could fully avoid or at least limit the impact on the Deposit Guarantee Schemes and their member institutions.

There is a merit in an additional wind-down instrument for small and medium-sized banks. This instrument would require external liquidity support (e.g. from Deposit Guarantee Schemes, central banks, or the industry) and could be used in cases where a better economic outcome would be possible compared to ordinary insolvency, for example in crises that are liquidity-based rather than more asset-driven.

All these considerations must not weaken the existing Institutional Protection Schemes (IPS), as these IPS systems form an essential part of the crisis management framework. Ex-ante funds are available in the event of a sectoral imbalance for approximately two-thirds of the Austrian banking sector. Such IPS systems have proven themselves to be effective in the past. They should be considered rather than overlooked, when creating a comprehensive framework for exiting the market or for restructuring failing banks.

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**A complementary  
liquidity regime  
permits an institution's  
orderly and value-  
preserving wind-down.**

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In addition, the current regime contains a regulatory gap, which requires addressing. When a bank is declared as “failing of likely to fail” (FOLTF), a danger exists that a “zombie” bank might remain that neither meets the criteria for a positive public interest assessment, nor fulfils the insolvency criteria, thereby ruling out the bankruptcy regime. This occurs in the event that it is not possible for a bank's licence to be withdrawn immediately. The process to revoke the licence following the declaration of FOLTF should be harmonized within the European Union, while simultaneously ensuring that this does not create unregulated territory or a legal vacuum regarding the failing bank.

Moreover, harmonisation of insolvency law would be a further milestone to strengthen the European crisis management and the Banking Union. This would especially be the case for cross-border banking groups, where the heterogeneity of national insolvency regimes poses a challenge to successful cross border resolutions. For this reason, I do see considerable merit in making a further concerted attempt towards harmonising insolvency laws. Nevertheless, I would like to point out in this context, that the Austrian insolvency regime has proven to work very well and efficiently, especially in terms of the resulting recovery rates and the duration of insolvency proceedings. It has already proven itself to be a suitable and effective option for winding up smaller banks. Therefore, any harmonisation must not worsen the status quo of the Austrian insolvency regime.

Despite numerous achievements in recent years, there is still additional room for improvement to ensure a smooth market exit especially for small and medium-sized banks. However, we should not overlook one of the most significant outcomes post-2008, namely that the public, especially taxpayers, are no longer called upon to bail out failing banks. This must remain the overarching goal when completing the resolution framework.



## JACEK JASTRZĘBSKI

Chair of the Board - Polish  
Financial Supervision Authority

### The use of DGSs' funds in resolution: bank's total cost as a litmus test

On 18 April 2023, the European Commission published its proposal for updating the CMDI framework for banks, with a focus on small and medium-sized banks. The Commission has seen many failing medium-sized and smaller banks being managed using tools outside the resolution framework. That is something to avoid, especially as in some cases that involved using taxpayers' money instead of private, industry-funded resources. Hence, the general philosophy behind the CMDI is to address the problem while protecting both taxpayers and depositors. To that end, the CMDI package comes up with several new solutions. One of them is a facilitated use of the DGSs' funds in crisis situations.

In certain circumstances, the DGSs' funds could be earmarked for resolution. That would only be possible after banks have exhausted their internal loss-absorbing capacity, and only for banks that have already been earmarked for resolution in the first place.

Resolution shows undisputable advantages over traditional liquidation, usually involving an insolvency procedure and deposit insurance pay-outs. Liquidation

of a bank under the standard insolvency procedure, which triggers deposit insurance, is likely to involve public funds. This may be the case when the amount of covered deposits held by a bank significantly exceeds the amount of resources of a DGS. In certain cases, extraordinary contributions must be collected from the banking sector, which is an additional financial burden for banks and may lead to second-round-effects and higher systemic cost.

Despite the advantages of the resolution procedure versus regular insolvency procedure, sceptics highlight their concerns about the use of the DGSs' funds in resolution. They claim this creates a financial burden on the DGSs, many of which anyway have insufficient financial resources to finance their primary goals. Sceptics highlight that the DGSs were established for a purpose other than financing resolution, i.e. for the benefit of covered depositors. I do not believe that scepticism is well founded. I see a clear value of a pragmatic approach, allowing for the use of the DGSs' financial resources for resolution purposes. Ultimately, the resolution process is also to protect depositors.

Therefore, instead of being dogmatic, I advocate for a pragmatic approach. It calls for a case-by-case assessment whether the involvement of the DGSs' funds would minimise the total cost of managing the distress of a financial institution. The least-cost-test should serve as the ultimate indicator. The testing should be holistic, to include potential second-round-effects, the systemic cost related to all other banks forced to bear the burden of additional contributions, as well as opportunity costs of lost interest or other returns on the DGSs' funds.

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**In certain circumstances,  
the DGSs' funds  
could be earmarked  
for resolution.**

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The holistic approach to the least-cost-test and its relevance also bring me to the conclusion that a proper and comprehensive assessment of the total cost requires smooth cooperation, including information exchange and joint modelling efforts, between the national DGS manager and the resolution authority, be it the SRB or the national resolution authority. Future regulations should provide a robust legal basis for such cooperation. This also demonstrates an advantage

of the institutional set-up where the DGS is managed by the same institution which is competent for resolution. This is the case in Poland, where the Bank Guarantee Fund (Bankowy Fundusz Gwarancyjny – BFG) acts both as the DGS and national resolution authority.

Regardless of whether to use the DGSs' funds for resolution or not, other alternatives are worth exploring. In Poland, eight largest commercial banks have established an institutional protection scheme (System Ochrony Banków Komercyjnych S.A. – SOBK S.A.). The mission of SOBK S.A. is to support financial safety of its members and their clients and the stability of the banking sector in connection with resolution procedures conducted by the BFG. That support is granted using various instruments (in particular loans or subsidies), financed from the fund to which members of SOBK S.A. contribute. Being funded by the member banks, these are considered private funds.

In conclusion, the new European solutions in the area of crisis management, including the use of the DGSs' funds for resolution purposes, should consider the overall cost of such mechanisms. The litmus test here should be a holistic least-cost-test. Involving institutional protection schemes in resolution funding seems like a notable option as well.



## FERNANDO RESTOY

Chair - Financial Stability Institute (FSI)

### MREL for mid-sized banks

The philosophy behind the introduction of minimum requirements for own funds and eligible liabilities (MREL) in the European Union is in line with the global reforms of bank failure management aimed at reducing the costs of such events for taxpayers.

However, the way MREL was introduced in European legislation followed a narrow focus. The design of those obligations directly aimed to support a specific resolution strategy, called open bank bail-in (OBBI). Under this approach, the conversion of liabilities into own resources after resolution should allow a bank to continue operating by itself after resolution.

However, experience – including the recent bank turmoil – shows that in order to resolve mid-sized banks, sale-of-business (SoB) resolution strategies seem to be, when feasible, much more effective. In particular, the transfer of all or part of failing banks' sensitive liabilities (like deposits) in exchange for banks' assets and some form of external support, normally from the deposit insurance fund (DIF), has been extensively used to deal with failures of traditional mid-sized banks.

Although unlike in the case of OBBI, SoB banks would exit the market, MREL still plays a relevant – albeit different – role.

Together with the availability of external support, MREL can be instrumental for the success of SoB transactions as those liabilities would not be transferred to the acquirer but left behind in a residual entity that would be liquidated according to regular insolvency procedures. The asset counterparts of those liabilities would, however, be transmitted to the acquirer, thereby contributing to the compensation that the acquirers receive for assuming failing banks' deposits and other sensitive liabilities. Therefore, the larger the MREL, the more likely the success of the SoB transaction and the lower the need for external support.

External DIF support is limited in most jurisdictions by a least-cost constraint which caps the DIF contribution at the expected losses (net of recoveries) that the DIF would have to bear if it had to pay out covered deposits in liquidation. Available DIF support therefore crucially depends on the relative amount of covered deposits, the position of DIF claims in the creditor hierarchy and the efficiency of liquidation procedures.

Given the EU resolution framework's focus on OBBI strategies, the above SoB-specific considerations have been absent in European legislation and, therefore, in the MREL policies of the Single Resolution Board (SRB). Indeed, the initial MREL for most banks was conservatively calibrated as if they would have to be resolved with an OBBI strategy even if their preferred strategy in the resolution plans was SoB. In fact, given that DIF claims are super-protected in liquidation in the EU, the cap on DIF support is quite tight. That makes the feasibility of SoB transactions rather uncertain.

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#### A great contribution to crisis management with still suboptimal provisions on MREL.

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The revision of the Single Resolution Mechanism Regulation (SRMR) in 2019 required the SRB to establish MREL on the basis of the preferred resolution strategy. That led the SRB to adjust MREL targets for banks with a preferred SoB strategy.

At present, MREL adjustments for SoB banks are calibrated on the basis of criteria like balance sheet size, depositor base and asset valuation uncertainty. Those criteria try to approximate the attractiveness of the failing bank for potential acquirers. However, they fall short of recognising

how MREL calibration itself affects that attractiveness by impacting the volume of assets that could be transferred. Moreover, as the conditions for DIF support have not been changed, the uncertainty regarding the feasibility of the preferred SoB strategies remains.

The European Commission's recent proposal on crisis management and deposit insurance (CMDI) is an important improvement. By alleviating the least-cost constraint for DIF support by eliminating the super-protection of DIF claims, the CMDI proposal significantly increases the feasibility of well designed SoB strategies.

Yet the CMDI proposal still fails to recognise the need to adjust MREL to what is actually required, given the expected available external support, to maximise the chances of successfully applying the foreseen SoB transaction. Importantly, the explicit prohibition for the SRB to incorporate the (now more ample) available support from the DIF when calibrating MREL is, arguably, an important flaw. That prohibition prevents the SRB from properly considering factors like the proportion of non-covered deposits over total deposits, which affects the least-cost constraint for the DIF and has proven highly relevant in recent resolution cases. From a technical point of view, it is not easy to understand why the proposal for MREL accepts treating equally SoB banks which, due to their different capacities to obtain DIF support, would require different amounts of bail-in-able liabilities in order to make an SoB transaction feasible.





## JUAN POSWICK

Head of Recovery and Resolution - BNP Paribas

### What Crisis Management and Deposit Insurance (CMDI) framework review?

Further strengthening the CMDI framework and focusing on medium-sized and smaller banks, whose failures can be a risk for the whole economy, is an undisputedly desirable objective. The rationale and main principles of the Commission proposal appear well grounded. However, there is a gap between the stated intents and the actual text proposal. Only precise guidelines and rules would allow truly harmonized implementation across Member States and fair funding of resolution, and, on the other hand, impact assessments would be necessary before changing important elements of a reasonably balanced system, particularly concerning the creditor hierarchy.

First, to ensure harmonization, level playing field and financial stability, a consistent, floored MREL target should apply to all banks earmarked for possible resolution, regardless of their size. This is the corner stone of a fair resolution funding system. That many smaller banks are missing market access and cannot meet MREL targets above own fund requirements does not hold. In Nordic countries indeed, banks with a balance sheet of just a few billion euros do well issue Eligible Liabilities.

Furthermore, banks can also fulfil the MREL targets with CET1, at their option, and a ramp-up period should be allowed for those newly earmarked for resolution.

Then, easy use of DGSs to fund resolution and to facilitate access to the SRF should be avoided. If ever necessary, something must have gone wrong, MREL calibration, supervision, or timing of authorities' intervention. This means that such use should remain truly exceptional. No bank earmarked for resolution should expect it and, as per the Commission proposal, MREL calibration should disregard it.

If DGSs were used in a frequent, intensive way, it would undermine the depositors' confidence in the system rather than reinforce depositors' protection, it would be a sign of failure on the authorities' side, and it would unfairly burden the rest of the sector, with ensuing systemic risks. That's why a clear MREL floor for any bank earmarked for resolution is necessary. At 16% of RWAs plus combined buffer requirement and 5.5% of the leverage ratio exposure, that should not be too demanding given the actual average capitalization of EU banks. It would also ensure that, if a bank has lost all its regulatory own funds, it can still be recapitalized at the minimum level, which should allow a transfer without recourse to external support.

**A consistent, floored MREL is the corner stone of fair resolution funding system.**

A similar reasoning holds true for access to the SRF. Proper MREL calibration and a well-functioning framework should ensure that the SRF use to fund resolution remains exceptional too. The SRF is perceived by the investor community as a kind of disaster insurance fund, a pledge to financial stability in the banking union. Frequent and intensive use of it would undermine the confidence in whole the EU banking system, negatively impact the sector, and entail series of risks.

Also, next to minimum MREL targets, early intervention triggers should be further specified. This would prevent complacency and late interventions that entail use third party funds to finance resolution. A consistent approach should be defined such that if certain metrics are breached, e.g., if MREL plus combined buffer requirement are not

met for say 9 months, without breach of own fund requirements, a supervisor review of whether the bank must take recovery action is automatically triggered. This could be coupled with a subsequent assessment after a specified period of the FOLF status and need for further action.

Next, changing the creditor hierarchy appears quite controversial. Beyond easing the Least Cost Test and so facilitating the use of DGSs, no clear benefit can be identified. It would be ineffective in stabilizing corporate deposits, and, in liquidation, it would be unfair not to give a preference to retail and SME depositors. There would be drawbacks for the industry in terms of rating of senior debt and diversification of funding sources.

While a consistent creditor hierarchy across the EU would be welcome, implications might outweigh potential benefits. It might create legal uncertainty regarding the existing stock of senior debt and generate moral hazard. Clearly, before assigning all unsecured depositors the same insolvency ranking as covered deposits, a thorough analysis and impact assessment is mandated, including 2nd and 3rd order impacts.

Finally, is it worth risking disrupting the reasonable balance achieved through BRRD2 if the issue at stake is only to extend resolution to about 30 medium-sized banks, as estimated by the SRB? While reviewing the CMDI anyway, why not aiming at a simple, efficient, predictable system for all, with the same rules and a TLAC-like calibration of MREL for any bank earmarked for resolution, and no escape from liquidation for the other ones?



## KAROLIN SCHRIEVER

Executive Member of the Board - Deutscher Sparkassen- und Giroverband (DSGV)

### Improving the CMDI framework and maintaining the diversity of EU bank models

Later this year, the Banking Union will celebrate its 10th anniversary. And there is indeed reason to celebrate which has arguably been the largest European reform project since the introduction of the euro. After all, the EU banking sector as well as the respective authorities steered considerably well through the past years of multiple crises and increasing volatility. Most notably, the advantages of the Banking Union as well as banks' own efforts are likely to have played a pivotal role in 2023, when markets largely spared EU banks from the banking turmoil that was witnessed in other jurisdictions.

After almost a decade of lessons learned, it is only natural to take a step back and re-evaluate. EU Finance Ministers therefore appropriately designated the Crisis Management and Deposit Insurance (CMDI) framework as an area that warrants legislative attention and is politically attainable.

Indeed, there is a case for measured reforms in the area of CMDI. But

instead, the European Commission's proposals for a revised CMDI framework represent a fundamental change and a paradigm shift. They could bring far-reaching negative consequences for the EU's diversified banking sector, its customers and financial stability. Accordingly, there has been fundamental criticism from co-legislators and stakeholders from the outset. Nevertheless, in recent months, negotiations on CMDI have been driven forward at full speed with the end of the current legislative term approaching.

Under the current crisis management framework, an institution in economic difficulties can either be liquidated according to national insolvency proceedings or it is subject to the EU resolution regime. The latter is tailored to systemically important credit institutions that have to prepare complex resolution plans and raise MREL on the capital markets. For most of the smaller institutions however, liquidation offers a more adequate, reliable and proportionate set of instruments. Regrettably, the CMDI proposals missed the chance of providing further clarity. Instead of enhancing transparency on the outcome of the Public Interest Assessment, the proposed changes cause further confusion e.g. by introducing an unclear definition of "financial stability at regional level" that could assign virtually all institutions to the resolution regime.

**Banking Union is a European success story. What it needs is evolution, and not revolution.**

As a result, there is an increased need for funding to finance the use of resolution tools. As the European Commission acknowledges difficulties for smaller institutions to raise adequate levels of MREL, it proposes instead to facilitate the use of Deposit Guarantee Schemes (DGS) for the co-financing of resolutions. To allow for this, the proposals introduce far-reaching changes to the creditor hierarchy, a harmonized least cost test and an unlimited liability of DGSs. All this threatens DGSs with the risk of their financial depletion. The resulting loss of depositors' confidence would contradict the very reason of their existence.

The Deposit Guarantee Scheme Directive provides for the use of both alternative and preventive measures. These enhanced capabilities allow for

business continuity between a bank and its customers and therefore give DGSs the option to be more than mere pay-boxes. Regrettably, the CMDI proposals include significant obstacles to this flexibility. In the case of preventive measures that are used by Institutional Protection Schemes (IPS), this has severe consequences. The authorization of IPSs is based on comprehensive requirements set forth in Article 113(7) CRR. The CMDI Review conflicts with these provisions threatening the bare existence of IPSs. This concerns about 2,200 credit institutions in the EU that are organized in networks, including the German Savings Banks.

It remains obscure which benefits should be expected from rendering the use of preventive measures virtually impossible – after all, the European Court of Justice confirmed their use as recently as 2021. It rather seems that the CMDI review is seen as a means to set the ground for a European Deposit Insurance Scheme (EDIS) by facilitating a future integration of national DGSs into a European fund.

A focus on upgrading the existing framework would have allowed for meaningful progress. The European Banking Authority has issued no less than three opinions identifying various improvements to the functioning of DGSs. There is also a need to end the risk of 'limbo situations' for failing institutions, and there is room for better coordination between responsible authorities. Also, the Commission's 2013 banking communication finally needs to be brought in line with the crisis management framework. These are only a few areas where the efficiency of the resolution and deposit protection systems could be improved.

The past ten years and recent crises have demonstrated that Banking Union is a European success story. What it needs is evolution, and not revolution.



## JOHANNES REHULKA

Managing Director &  
Secretary General - Austrian  
Raiffeisen Association

### Careful consideration is the order of the day

In case of a review of the CMDI framework the fundamental objectives of the framework should always be kept in mind. After the financial crisis it was the political intention to adopt a resolution framework to wind down banks which's failure could have a negative impact on a member state or the common currency. According to one of the basic principles of the legal framework resolution tools shall only apply to those larger (cross border) institutions whose resolution is in the public interest. There are no strong arguments to generally assume a public interest in the resolution to smaller and medium-sized banks in Europe.

Small and non-complex institutions and the majority of mid-sized institutions should be liquidated in a normal insolvency proceeding as these procedures fulfill the objectives of the crisis management framework at least to the same extent in comparison to the resolution process. Furthermore there would be no obvious advantages of resolving smaller and medium-sized banks rather than liquidating them as the fulfillment of MREL requirements and the execution of the bail-in tool was exceptionally designed for major cross-

border banks with direct access to the capital market.

These considerations are even more true for small and non-complex banks which do not have a direct access to capital markets at all. For these institutions the application of the resolution framework would not make sense.

One of the most important point for the functioning of deposit guarantee schemes is the highest rank in insolvency proceedings for DGS. Based on the current legal text deposit guarantee schemes (DGS) and covered deposits have been granted the highest rank in insolvency proceedings (so called 'super preference'). This is the only way trust in the DGS system can be maintained and an effective payout procedure by DGS can be ensured without causing additional costs for DGS-members, which are the banks. If a bank goes bankrupt a DGS will payout the deposits up to 100.000 Euro within seven days. This swift payout ensures the trust of depositors in a safe financial system.

To uphold the financial stability the DGS in return has the highest rank in insolvency procedure. This ensures that the DGS fund is refilled by backflows out of the insolvency mass. If the highest ranking for DGS would be removed, they would receive reduced backflows in liquidation. Consequently, DGS would be financially exploited and their ability to function seriously weakened. In light of these considerations it's of fundamental importance that the highest rank for deposit guarantee schemes and covered deposits in insolvency proceedings remains unchanged.

### DGS shall not be weakened by the resolution framework.

The use of DGS funds for resolution purposes is also a highly sensitive issue. Based on the current framework the liability of a deposit guarantee scheme in the event of its use for resolution purposes may not exceed the amount corresponding to 50% of its target level (maximum of 0.4% of covered deposits). According to the Commission this liability limit should be eliminated and the use of national deposit guarantee funds for resolution purposes shall in future reach up to the amount that would have to be paid in the event of an insolvency (up to the target level of 0.8% of covered deposits). Implementing such a measure contains an inherent risk of a redirection of DGS means as

the main purpose of DGS funds is to payout depositors.

According to the Commission's proposal Institutions could rely on the fact that in the event of a resolution comprehensive financial means would be drawn from the DGS anyway. This weakens financial market stability due to the fostering of moral hazard and as a result this measure would not lead to more depositor protection and depositor trust, but rather to less. The proposed approach would cause deep uncertainty among customers who trust in proven, existing deposit guarantee schemes. This would achieve exactly the opposite of what the Commission postulates as the objective of its CMDI review package.

Moreover, according to the Commission's proposal all the financial resources of the deposit guarantee fund (0.8% of covered deposits) shall also be used by the resolution authorities to achieve the 8% bail-in minimum amount. Hitherto, a mandatory bail-in minimum amount of 8% has to be reached prior to the use of the financial means of the resolution fund.

This clearly demonstrates that the Commission's draft also leads to a further complete dilution of the bail-in tool which was already not applied consistently enough in the past by the resolution authorities in the event of a crisis.

For all these reasons, the contribution of deposit guarantee funds for resolution purposes should remain at a maximum of 0.4% of covered deposits.

## DIVERSITY IN THE EU BANKING SYSTEM



### GIUSEPPE SIANI

Director General for  
Financial Supervision and  
Regulation - Banca d'Italia

### Diversity in the EU banking system: future challenges and way forward

Diversity in banks' business models is and will probably remain a distinctive feature of the EU banking system, reflecting also historical, economic and social evolution of the EU countries. It might increase the resilience of the system in case of turbulence, as there is the chance to compensate the failure of the most affected banks. EU GSIBs represent less than 40% of the Euro Area Total Assets (TA), while LSIs represent around 16% of TA, with spikes in some jurisdictions (e.g. 38% of TA and 45% of Total liabilities (TL) in Germany). Business models different from GSIB and 'Universal and investment banks' (26% of TA) still represent an important part of the system, accounting for 35% of the Euro Area TA.<sup>1</sup>

EU regulation properly considers the need to recognize the different business models by allowing simplified application of the Basel prudential requirements and reporting needs, so as to duly apply the proportionality principle based on ex-

ante estimation of risk. Also supervisors apply proportionality by planning the so-called minimum level of engagement (MEL) and then evaluating the actual risk profile of the banks in the supervisory assessment (SREP).

Looking ahead, technological innovation might trigger potential reconsideration of the traditional classification of business models irrespective from the scale and main areas of activities; in particular, the banks' main strategic challenge is to seize the opportunities offered by technology and move towards the progressive digitalization of their business. Although the number of pure 'digital banks' is still limited, all major banking groups have adopted transformation strategies, fostering material changes in their relationships and reducing the close and direct geographical links between their customer base and their business.

To this end, small and medium-size firm too have increased their investments significantly to make the necessary progress (in particular in payment systems) both in their digital transformation and in the implementation of their strategic partnerships with third party providers (TPPs), thus reshaping their interaction with their customers.

In addition, the increased reliance on outsourcing exposes the banking and non-bank sectors to higher levels of interconnectedness, given also the concentration in the service providers' market. The gradual implementation of DORA will help mitigate risks related to TPPs, by requiring institutions to meet specific standards when outsourcing critical functions, and properly considering concentration risk, interdependencies, cybersecurity and data protection.

Drawing from the above, banks' business models can be impacted through three main channels.

Firstly, new business models have been implemented, for example 'banking as a platform', where platform banks incorporate business services offered by third parties, and 'banking as a service', where banks offer their own services to third parties which might not be licensed but provide them directly. Banks are thus experimenting structural changes in the profit-and-loss composition, as it mirrors the new – more fragmented - value chain of their business and reflects the actual sustainability level over time.

Secondly, smallest institutions too might overcome the limit of their size, traditionally a challenge for the sustainability in the medium-long period, thanks to services provided by TPPs and platforms. But increasing interconnection with non-financial parties could be at the cost of losing control on strategic decisions and of higher contagion risks due to the associated operational risks.

Thirdly, the growing competition of Big-Techs that provide financial and payment services have so far been mitigated by banks' strategic partnerships and material investments in fintech-related projects. The main advantage of Tech firms is operating with no legacy systems, thus allowing prompt and flexible responses to changing external conditions. Given that incumbents are confronted with stricter regulatory constraints, Tech companies can therefore exploit the information collected in their platforms by non-financial activities to design and offer new banking services. Banks are then called to review their digitalization strategies to face the ongoing competition.

### Technological innovation might change the traditional classification of business models.

Supervisors should properly implement the new regulation that has widened the traditional regulatory scope by monitoring on the underlying risks rather than the legal form of transactions and/or of the firms involved so as to mitigate level playing field issues. The focus should be on the sustainability of the business model over time and the adequateness of the internal governance, in terms of strategic planning capability and availability of necessary skills, both in the staff and in the management bodies. This holds true whatever the organizational and technical solutions chosen by the banks.

1. *Diversified lenders, retail & consumer credit lenders, corporate & wholesale lenders and others residual business models.*



## EDOUARD FERNANDEZ-BOLLO

Member of the Supervisory Board - European Central Bank (ECB)

### Effective supervision to enhance the resilience of European bank business models

ECB Banking Supervision welcomes the diversity of banking business models in Europe. This diversity is a key strength that enables various financing needs to be met and facilitates the inclusion of different groups of economic operators in the financial system. As prudential supervisor, our primary role is to foster the resilience and sustainability of all healthy business models. To that end, we must strike a balance between making meaningful horizontal comparisons and paying adequate attention to the specific characteristics of each bank or group of banks. Horizontal comparisons are a crucial part of supervision as they help us to ensure a level playing field for banks and to identify peer institutions and the best practices for similar customers or markets.

Our supervisory activities are particularly useful in the current environment of heightened uncertainty and elevated geopolitical risks. One of our key aims at present is to gauge the impact of

macroeconomic trends on different business models. We are analysing and challenging banks' financial projections in baseline and adverse scenarios to understand how banks are factoring the impact of the changing macroeconomic environment into their key financial and business decisions. We are also paying attention to structural changes, such as digitalisation and the green transition, and looking at how banks are seizing related business opportunities and managing the associated risks.

In parallel, we are focusing on the specific characteristics of individual business lines, banks or clusters of banks so that we can better address certain patterns or issues which require tailored supervisory actions. For example, we are currently examining the investment banking business line to better understand the risk-adjusted profitability measures applied and, in turn, adapt our supervisory approach. We are gathering information on the root causes and early warning signals of structural weaknesses in banks' business models with a view to devising an appropriate supervisory strategy to address them as early as possible. Such a strategy may envisage escalation and full use of our supervisory toolkit.

More generally, following up on last year's reviews of our supervisory practices by external experts, we are revising our approach, including how we carry out our supervisory review and evaluation process (SREP) and how the results feed into supervisory measures. We want to focus more on the most important issues while still maintaining sufficient checks to ensure that we do not overlook any areas of risk and that we deliver on our priorities. With this goal in mind, we are finetuning the processes established under the multi-year SREP approach so that our supervisors can better adjust the intensity and frequency of their analyses to individual banks' vulnerabilities and the broader supervisory priorities. This will go hand in hand with a focused increase in the use of our supervisory tools to ensure that priority issues are addressed. The exact changes to be made to the SREP methodology have not yet been decided, but the capacity to tackle major identified weaknesses will likely play an increased role, which should ensure that the specific characteristics of different business models are duly taken into account.

Our supervisory priorities for 2024-26 illustrate this new approach. In them, we emphasise the need for banks to enhance their internal governance and risk management practices. This includes traditional areas like credit risk and asset and liability management

frameworks as well as emerging challenges such as climate-related and environmental risks and risks associated with the digital transformation. Banks should also have the capacity to assess the risk/reward balance across business lines and benchmark their performance against their peers. To do so, they need effective, well-functioning management bodies with strong steering and enhanced risk data aggregation and reporting capabilities. Certain banks, with very different business models, have not adequately addressed major shortcomings in these areas. This is despite ten years of supervisory engagement – the Basel Committee on Banking Supervision's Principles for effective data aggregation and risk reporting were published back in 2013. Some delays are understandable, as banks may need to make major changes to existing IT infrastructure to resolve the issues, but it is crucial that they have a clear action plan in place with verifiable milestones. In all cases, measures to address the underlying weaknesses need to be carefully tailored to the specific situation of each bank, taking into account its legal form, ownership and organisational structure. This is why the ECB is seeking to establish best practices that are tailored to these characteristics. But the banks themselves also need to prove that the nature of their business organisation allows for effective remediation. This requires the right data to be able to take the right decisions.

**To reap the benefits of diverse business models, banks should build on best practices tailored to their specific characteristics.**

We are therefore convinced that focusing on the effectiveness of internal governance for remediation will benefit all banks. It will provide more flexibility to tackle new and emerging risks in a rapidly changing macroeconomic environment, where swiftly identifying emerging issues is critical for the sustainability of all business models.



## HARALD WAIGLEIN

Director General for Economic Policy, Financial Markets and Customs Duties - Federal Ministry of Finance, Austria

### Financial market stability: the basement for broad supply of financial services

The Supervisory Review and Evaluation Process (SREP) is a supervisory tool used by regulators to assess the overall financial soundness and suitability of risk management practices of banks. The SREP review involves a comprehensive assessment of a bank's risk profile, capital adequacy, governance, risk management and its overall financial health. By the use of quantitative and qualitative factors the comparisons of banks with similar business models, sizes and risk appetite is pursued. Supervisors are brought in a position to effectively address inappropriate business behavior to prevent systemic threats on the basis of a well-founded, justifiable method.

Effective supervision is a precondition for financial market stability and well-functioning markets. While the SREP process is valuable for ensuring the stability and resilience of banks, neither the inclusion of underserved populations nor the promotion of broader access to financial services is a focal point. Nevertheless, stable,

effective markets are a precondition for the participation of businesses and individuals in financial activities.

Even in a highly competitive and overbanked market, exclusion of certain customers from financial services is still possible. While competition can lead to innovation and increased access to financial services for many, there are several factors that may contribute to exclusion, especially for specific customer segments. If this is the case, financial inclusion should be addressed by collaborative efforts, targeted initiatives and policies. Specific challenges or barriers faced by underserved populations may have to be addressed by policymakers, regulatory authorities, and financial institutions.

Customers who may suffer from a limited access to finance may include small and medium enterprises (SMEs), in particular when such SMEs are new businesses or entrepreneurs who struggle to secure the initial capital required to launch or expand their ventures. In such situation, limited access to finance can stifle innovation and hinder the development of new industries.

Mature SMEs may have to adapt to a challenging business environment or struggle with gaining suitable financial means potentially impeding their growth, hindering innovation, and restricting their ability to create jobs. Individuals and businesses in some rural or non-urban areas may find it challenging to access banking services and credit facilities which could lead to economic disparities between urban and non-urban regions. People with lower incomes may face difficulties in obtaining affordable credit, impacting their ability to make essential purchases, invest in education or cope with unexpected expenses. Local governments may struggle to secure financing for infrastructure projects, public services, and community development.

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**Effective supervision is a precondition for financial market stability and well-functioning markets.**

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Limited access to finance can also affect consumer spending and the retail sector. Consumers may face challenges in obtaining credit for major purchases, and retailers may struggle with working capital and expansion plans. Industries that heavily rely on research

and development or technological advancements may suffer if access to finance is limited. Lack of funding can impede innovation and hinder the competitiveness of these industries on a global scale. A comprehensive approach involving collaboration between financial institutions, policymakers, and local communities is therefore needed.

Addressing these challenges and promoting financial inclusion is essential for fostering economic growth, reducing inequalities, and ensuring that a broad spectrum of customers can participate fully in economic activities. Policymakers, financial institutions, and other stakeholders play crucial roles in developing strategies to enhance access to finance for all customer segments. Initiatives that promote financial education, technological innovation, and targeted policies can help bridge the gap and ensure that small businesses, local governments, and individuals in non-urban areas gain better access to banking services. Digital financial services could reach a broader customer base, including those in non-urban areas.

Financial institutions could adopt inclusive practices, such as creating products tailored to the needs of underserved communities and engage with local communities to better understand their needs and being able to develop suitable financial solutions.

Targeted programs should enhance financial literacy to help individuals to make informed decisions about suitable financial products and services. By implementing a combination of such strategies, the access to bank financing for economic agents across all EU territories could be enhanced.



## CSABA KANDRÁCS

Deputy Governor -  
The Central Bank of Hungary

### World changes, but protecting vulnerable customers must remain a priority

In Hungary, the difficulties of the cooperative sector are to be traced back to several reasons, many of which can certainly be found in other Member States. Among these, operational problems need to be highlighted on one hand, as inadequate economies of scale and fragmented management systems. Technological development and the launch of various payment and transfer systems accelerated in the financial sector, and the increasingly diverse and largely disproportionate regulatory expectations and risk management technologies emerging in response to the economic crisis of 2008 induced capital-intensive banking investments (e.g. in IT). Due to their small size, cooperatives were not able to properly respond to these. On the other hand, it was a recurring difficulty to find qualified professionals at both expert and managerial levels.

The chronically low level of capital and emerging profitability problems were also due to the limited financial potential of clientele of cooperatives (typically lower-income clients with limited penetration of financial products). Weak ownership

(membership) control contributed to the difficulties, since the members neither having been engaged for the brand, nor they were able to exercise control over the management. Various institutional protection funds have been created, however these failed to provide an adequate umbrella, which was highlighted by the insolvency of several cooperatives. In 2013, the Hungarian legislator ordered the consolidation of cooperative credit institutions into a new cooperative integration. As a result of consolidation, by 2019, the former cooperative sector continued to operate as a single commercial bank with adequately sized operation and with a more balanced mix of clientele.

The above difficulties incentivised also commercial banks to improve their economies of scale. Substantial consolidation has also taken place in the Hungarian banking sector in the past 15 years following the 2008 crisis, the number of banks has decreased significantly. Most challenges for the cooperative sector are typical for small banks as well, the sustainable viability of small institutions needs in addition to organic growth, targeted acquisitions, or a clear strategy of specialised/niche-banking.

Even though most of us can handle their finances quickly and simply through mobile apps, access to finances has not ceased to be a challenge in the modern age. The harsh reality is that 1.4 billion people in the world (in Hungary around 12% of the adult population) continue to be unbanked. Disadvantaged people (e.g. unemployed, chronically ill, visually impaired) or those who live in rural areas often do not have adequate access to financial services, while many people do not feel comfortable using digital channels (e.g. older generations).

The global wave of digitalization and closing of branches might even worsen the situation of some and deepen digital financial exclusion, which makes this case a priority for policy makers, including central banks for ensuring that no one is left behind in the digital financial ecosystem.

The Central Bank of Hungary (MNB) has launched several initiatives that make the digital transition smoother and prepare citizens and SMEs for the related challenges. The Money Compass Foundation operates with the aim of launching financial awareness development programs for schools in cooperation with market players. The MNB's Financial Navigator program, which also includes a physical financial advisory office network across the country, provides important information chargeless for retail users about

everyday finances, consumer protection topics and even a platform to compare available bank account conditions. The MNB has a dedicated recommendation for credit institutions to support digital transformation, which encourages financial institutions to provide fully remote account opening and closing and to support less digitally confident retail and SME customers with educational practices and initiatives.

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**Our central bank  
has launched several  
initiatives making  
the digital and green  
transition smoother.**

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The transition risks caused by digitalization are managed also by the revised ATM regulation, which ensures that cash is easily accessible to citizens throughout the country. Finally, mitigating cybersecurity risks is a key area in digital financial inclusion. Involving all relevant authorities and market participants, the CyberShield project informs and educates people about the security risks regarding their digital financial activities.

Sustainability is a global megatrend that is a priority for the world as well. Central banks can be active players here too. The MNB is backing the green transition in Hungary with several tools. We believe that without compromising its original mandate, there are many steps a central bank can take to promote green initiatives.



## PERRINE KALTWASSER

General Manager of Risk,  
Compliance and General  
Counsel, of the Conglomerate  
& Member of the  
Management Board -  
La Banque Postale

### A more individualized supervision to cater for each kind of banking model

“Diversity in the banking system” is not a question of highlighting one type of governance or another, or of advocating the merits of less regulation or supervision for the benefit of one institution or another. Rather, the aim is to outline the diversity of the business models and to assess the conditions under which this diversity, if it does not prove problematic in terms of concentration (e.g. 2023 US failures), can add to financial stability and contribute to the financing of growth and Europe’s green transition.

Banks reflect the richness of culture, history and human needs, hence their diversity. They have to adapt their risk appetite to the upcoming huge funding and social challenges, and supervisors should help them keep the transformation momentum by adapting their own approach and tools.

### Diversity of banking business patterns is necessary, beneficial and should be encouraged

Diversity surely contributes to the resilience of the EU banking system and limits procyclicality under economic stress. It also ensures competitiveness (as long as the implementation of Basel standards is subject to a level playing field) and tailored services to various customers without discrimination, from local and small businesses to blue chips, vulnerable clients to high-net-worth individuals, local investments to State debt. Diversity is even more needed to ensure just transition for most affected clients and territories; with planned investments around €30 billion (according to the European Commission), the European Just Transition Fund will be far from sufficient.

Many regulatory provisions take account of this multi-faceted economic and social role of banks: climate stress testing and transition plans, green and transition ratios, the basic payment account, allowing financial advice for all,...

### Diversity should be preserved as an asset for EU stability.

La Banque Postale proves specific in many regards (Stated-owned, postal network, large retail customer base, operator of a service of general economic interest...), but it intends to both capitalize on differentiation and follow a path of “normalization” and maturity, being “a credit institution like others, but a different bank”.

### Diversity does not prevent from common regulation and financial solidity to reconcile with sustainability

Profitability standards can vary according to bank specificities (shareholding structure, mission-led company, public service mission...) but sufficient profitability, solvency and liquidity are required to at least cover the generation of capital and cost of risk. Adequate risk monitoring tools and governance also ensure robust decision making.

Profitability, solvency and access to liquidity over the long term are also essential to finance banks’ transformation needs, above all digitalization and the green transition.

Just as important, financial solidity is essential to support new needs of all European economic players (retail and

corporate) in terms of both ecological transition and digitalization. This is all the more true in a context where over 70% of European corporate financing comes from banks (versus 20% in the US), reaching 90% for individuals (versus 27% in the US)<sup>1</sup>.

Beyond the issue of financial robustness, there is the issue of regulation. Whatever the diversity of business models, we fully subscribe to the original European choice to apply the adage “*same activity, same risks, same rules*”. In this respect, the middle-size US banks setback in 2023 is an obvious example of the importance of this choice, which should be constantly reaffirmed in future regulatory developments (e.g. CMDI package).

In the same vein, prudential regulation must remain homogeneous, with proportionality only applying to reduce administrative and reporting burden.

### Diversity of business models needs a certain level of tailored supervision

Due to the diversity of bank business models, supervision should navigate between two pitfalls: one size fits all and bespoke supervision, the right balance being “smart supervision”, which involves anticipation, adaptability and consistency.

A “strong and intrusive supervision”, as noted by Franck Elderson in December 2023, is acceptable if it remains risk-based, without interference in business choices. To evaluate whether proportionality should be applied, size is not per se an indicator of risk and supervision could take inspiration from the G-SIB methodology, using criteria of interconnectedness, complexity and cross-border activity.

Furthermore, if benchmarking seems inevitable, it should not be rigid but carefully interpreted according to each individual context: constant dialogue and explanations are necessary to ensure a mutual understanding and a proper implementation of supervisors’ requests.

We therefore very much welcome the 2023 SSM initiative to “*embed agility and risk-focused approach that would translate into the introduction of new supervisory risk tolerance framework*” that should enable supervisors to better adjust their tools to bank specific business models.

1. Source: Eurostat





## DANIEL QUINTEN

Member of the  
Management Board -  
National Association  
of German Cooperative  
Banks (BVR)

### Diversity in the EU banking system: contribution to financing needs, future challenges and way forward

**What are the challenges and consequences that innovation and digital transformation might pose to the diversity of banking business models?**

Technical innovation and digital transformation foster diversity as they bring new enterprises with new business models as challengers in the market. At the same time, more diversity and complexity of business models makes it increasingly difficult for legislators and authorities to establish a balanced regulatory framework and to ensure fair competition. In this context „less could be more” especially if one considers competitiveness of Europe.

**Are there examples or problems of a level playing field between banks, fintechs and the Gafams, particularly when it comes to technological choices**

**and the implementation of new models for developing digital financial services (platforms, open banking, etc.)?**

The dynamics between traditional banks, fintech's (financial technology companies) and GAFAs in the financial services sector have indeed raised concerns about a level playing field. The aim must be to have the same or equivalent standards regarding competition, data protection and data-sharing, conduct of business, operational resilience and financial stability.

Big techs offer a diverse range of services and thus, their activities fall under several different regulatory authorities, such as central banks, financial regulators, but also competition and data protection authorities. As such, it can be challenging to coordinate policy for big techs, especially in a cross-border context. Big techs are headquartered in only a few countries but provide services across many different economies, within the same region or around the world. Host authorities may have very little traction against large foreign players for whom the respective market is very small compared to the overall business.

It is therefore very encouraging that the European Commission has taken measures to ensure access of market participants to mobile wallets for payments or other technologies. It must be avoided that digitalization and innovation lead to a concentration of economic power with a handful of actors.

Moreover, traditional banks are subject to very complex regulatory frameworks that may not always apply directly to fintechs or GAFAs companies. This creates an uneven regulatory landscape. For example, fintech startups might operate in regulatory sandboxes, allowing them more flexibility to experiment with innovative solutions without immediately facing the full regulatory burden.

The access, control and ownership of customer data are crucial in the digital financial services space. The EU's open banking initiative is promoting standardized APIs (Application Programming Interfaces) that enable data sharing between financial institutions and third-party providers. However, the sharing only goes one way. FIDA will give BigTech companies access to financial data held by banks, but the latter will not have access to data collected by BigTechs. This threatens to further concentrate power and increase strategic dependence on GAFAs.

**How can we ensure that prudential supervision is as neutral as possible when it comes to technological choices and encourage the development of innovation, even when the initiatives come from traditional banking players?**

Regulatory frameworks need to be technology-agnostic, focusing on outcomes rather than specific technologies. This allows traditional banks to adopt innovative solutions without facing unnecessary regulatory hurdles.

For banks, as it is currently the case for fintechs, there should be regulatory sandboxes that provide a controlled environment for testing new technologies and business models. This would allow banks to experiment with innovative ideas without the full burden of regulatory compliance.

Moreover, digitalization and innovation are part of doing business; therefore, supervisors should handle digitalization and innovation as integrated in business and not as separate aspects.

Regulators must actively engage with industry stakeholders, including traditional banks, to understand their technological challenges and aspirations. This collaborative approach helps regulators stay abreast of industry developments and ensures that regulations are responsive to evolving needs.

Lastly, since the financial crisis lots of regulation and new authorities had been developed, leading to a good level of financial stability. It is time for a pause now to allow banks to concentrate resources in technical innovation (and not oblige to allocate them to continuously implement regulation). Regulators and supervisors should leave sufficient room and steadily encourage and support banks to adapt to technological changes and promote innovation.



## CHRISTIAN EDELMANN

Managing Partner Europe -  
Oliver Wyman (UK)

### It's time for banking supervisors and investors to focus on business models

The post-global-financial-crisis efforts to create a safer and more stable banking system were put to the test last year as Credit Suisse, Silicon Value Bank, Signature Bank, and First Republic all failed within the span of a few months.

Much has been written about the interlinkage of interest rate risk, bank funding, and capital in these failures. Whilst there are important lessons to be drawn in terms of deposit characterization, fund transfer pricing, and IRRBB, arguably the primary cause of these failures was the lack of a convincing business model — or management's inability to execute on that model.

Business model analysis is a critical component within the European Banking Authority; Pillar 2 capital add-on requirements are based on “a detailed analysis of the viability and sustainability of banks”.

Yet for a long time a simple approach to categorizing business models has been missing. As recently as 2018 the EBA authored a paper on “a novel approach to classifying banks in the EU regulatory framework”.

Business model categorization is important for two main reasons. First, it provides authorities with a benchmark for classifying institutions and supports the application of the proportionality principle to adapt capital and governance requirements to individual business models. Second, it provides shareholders with a differentiated “investment thesis” when they assess the risk/reward profile of each institution and each business model.

On the regulatory and supervisory side, more can be done to take business models into account. Different types of banks, such as local or international universal institutions, are materially different from, say, cooperative or mutual institutions. In terms of governance and organization structure, many cooperative banks put forward the principle of proportionality, since the cost of regulatory compliance can be relatively high for such institutions. Also, many have governance systems that allow clients to be elected in the governing bodies, which can make it difficult to comply with associated regulatory requirements.

In terms of capital requirements, asset mix, and shareholder structure, cooperative banks serve predominantly small- and medium-sized enterprises, and risk-weighted asset mechanisms to calculate capital requirements will result in higher capital for these institutions. In case of a deviation from minimum regulatory targets, cooperative banks might have to reduce financing capacity if direct member contributions are not forthcoming in sufficient capacity.

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**For a long time a simple approach to categorizing business models has been missing.**

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From an investor standpoint, the European banking sector remains challenged in terms of valuations. Despite a recent recovery, European banks trade at 60% of book value, with the spread among leaders and laggards remaining largely the same since 2021. Recognition of various business models by investors is not differentiated enough, and many banks resort to share buybacks and dividends as primary valuation-support levers.

Given the increasing correlation between the price/book ratio of a bank and its perceived strength, business model recognition is becoming increasingly important. Investors

will trust bank management more to redirect capital towards business model strengthening when the models are clear and recognized by regulators.

At the same time, banking regulation and supervision need adapt to the ever-growing importance of the non-banking financial sector and its interconnectedness with the banking system.

Despite the explosion of debt in the system, European Bank Balance sheets have remained stable over the past decade at 27 trillion Euros and have shifted towards mortgages and liquid assets. Return on assets has dropped as a result, impacting profitability.

Non-bank financial institutions (NBFIs) have assumed a more important role as financiers, gaining market share in lending from banks, often holding the riskier—and more profitable—part of the assets.

On the retail side, open banking has facilitated client information flow from financial services providers to other financial services providers but also a much broader set of institutions, including fintechs and large global tech companies. While the benefits for customers are evident, open banking could create an unlevel playing field as traditional banking players are ultimately strengthening the large tech companies' already dominant customer data position. Thus, Banking regulation and supervision should capture the services provided (such as mortgage financing, deposit taking, and advisory services), irrespective of the type of provider.

This is not an easy task—but it's essential to support a robust, flourishing, and diversified European banking sector.



## BENOÎT DE LA CHAPELLE BIZOT

Head of Public Affairs and  
Advisor to the Chief Executive  
Officer – BPCE Group

### Moving towards a SREP that heeds cooperative banking

Policymaking is all about cycles, and 2024 is one of those pivotal years. The policy cycle which started after the financial crisis 2008 is hopefully coming to an end with the implementation of Basel III reforms in Europe. Those reforms have been successful: European banks are now much more solid, with significant improvements in capital, liquidity, and asset quality. Moreover, a crisis management framework now protects both depositors and the overall financial stability.

But does that mean that our work is over? Certainly not. The next policy cycle should be all about tailoring our current regulatory framework and, more importantly, supervisory practices. After more than a decade of uniformization, our next battle should be to adapt our regulatory and supervisory framework to the diversity of the banking sector. The specificities and characteristics of cooperative banks should be fully recognized, as they are central when it comes to ensuring that our customers, SMEs, and local communities have access to adequate financing and financial products. All stakeholders need

to be enrolled if we want to overcome the challenges linked to the environmental, digital, and societal transitions.

The SREP review in 2024 is, therefore, a great opportunity for European policymakers and supervisors to make a difference in the real economy. Reviewing how the SSM assesses a bank's profitability and sustainability of each business model, designs its benchmarks, and puts forward its recommendations will be key to ensure that cooperative banks will have the capacity to accompany all local stakeholders. In short, supervisory tools and indicators should better heed cooperative banks.

On profitability, we stand with our view that a better indicator for supervisors could be the residual income after distribution, and the actual capacity to endogenously create CET1, since dividends reduce the profit channeled to CET1 for commercial banks.

Furthermore, the SSM's supervision is largely based on benchmarking and comply or explain processes. We believe that supervisors should recognize in practice the specificity of banking models in Europe, especially those who proved to be sustainable over time, and supervisors need to adapt samples according to the different business models.

In our view, JSTs should not be guided only by standardized benchmarking for banks' profitability, cost and risk management, and governance. Cooperative performance and community impact metrics which reflect our business model should be included in the benchmarks.

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### Adapting our regulatory and supervisory framework to the diversity of the banking sector is key.

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For instance, new metrics could highlight the diversity of our clients (i.e. underserved communities, associations, SMEs), the geographical repartition of our branches and the diversity of our activities, which include an important share of social and fair financing.

Furthermore, new benchmarks could involve comparisons within the European cooperative banking sector. This would also allow cooperatives to learn from each others' successes and challenges.

With these new metrics included in benchmarks, the SSM could assess the impact of JST recommendations on the cooperative business model: this would be the basis for a "business model adequacy test". Symmetrically, a bank should be able to raise an issue regarding the integrity of its business model to JSTs (impact of a recommendation), who would then have to assess the issue. The process should be further defined within the SREP review by the SSM and with a dedicated action plan.

I believe that the European cooperative banks can work hand in hand with the SSM and regulators to leverage our central role for Europeans and SMEs to be fully active and involved in the environmental, digital, and societal transition in all territories. We are hopeful that the new chair of the SSM will be sensitive to these issues.

I look forward to this new policy cycle, and I'm hopeful that it will lead to significant advancements in the recognition of the cooperative business model in Europe. For BPCE, it is essential to preserve the DNA of our Group, which supports 35 million customers - individuals, professionals, associations, corporates, or local authorities - over the long term and at every stage of their lives, by financing their future projects but also by accompanying them in difficult times. BPCE, among other commitments, is the leading private funder of the hospital and social housing in France. We are also the first bank for the social economy and for protected adults, with 640,000 vulnerable customers, including 142,000 equipped with a specific offer for vulnerable customers.

## CHALLENGES FACING INSURERS



### JONATHAN DIXON

Secretary General -  
International Association of  
Insurance Supervisors (IAIS)

## Finishing the puzzle: completing the global insurance regulatory framework

The end of 2024 will mark the culmination of a period of significant policymaking for the global insurance supervisory community. Last year, the Financial Stability Board (FSB) endorsed the IAIS' Holistic Framework for the assessment and mitigation of systemic risk in the insurance sector and this year we will finalise the global Insurance Capital Standard (ICS). Taken together, these policy initiatives will ensure more robust international standards to better protect policyholders and to help maintain global financial stability.

The Holistic Framework includes three elements: globally-consistent macroprudential supervisory measures; an annual Global Monitoring Exercise (GME) and robust assessment of its implementation by IAIS members.

The GME provides an important empirical basis, allowing for a data-driven assessment of the key risks and trends in the global insurance sector – covering more than 90% of the global written premiums. Sector-wide highlights from this work are published in the IAIS Global Insurance Market Report (GIMAR), and individual insurer results and measures are reported to the FSB. The 2023 GIMAR shows that solvency, liquidity and profitability positions decreased slightly in 2022, albeit remaining well above regulatory thresholds on aggregate. Key drivers of these declines were lower asset valuations – including declines in equities – widened credit spreads on corporate and sovereign debt, higher volatility of interest rates and weaker currencies in some jurisdictions. Looking ahead, most supervisors expect a stable or slightly negative outlook for the insurers in their jurisdictions, particularly in light of uncertainties in the economic and geopolitical environment.

Our 2023 risk assessment had a particular focus on liquidity and credit risk in the face of challenging macroeconomic conditions. The GME also provides a basis to consider ongoing trends in the sector. For example, we are examining structural shifts in the life insurance sector, including the trend towards greater investment allocation to more complex, less liquid assets and increased use of asset-intensive cross-border reinsurance. The outcomes of our analysis are highlighted in the 2023 GIMAR and will be the topic of discussion for a Eurofi panel in Ghent.

Implementation of the Holistic Framework is progressing well. Last year the IAIS published a report on our assessment of implementation of the Holistic Framework standards in 10 major insurance markets. The assessment showed good levels of observance across many of the standards, with further work identified to address remaining gaps. This year we continue our assessment in six more major markets.

This year will see the finalisation of the global ICS. Our adoption of the ICS in December 2024 will be the culmination of a journey of more than a decade, marked by extensive analysis and consultation. The ICS will create, for the first time, a common language for the supervisory discussion of the solvency positions of Internationally Active

Insurance Groups (IAIGs). In addition, it will help enhance global convergence among group capital standards, incentivise prudent management of IAIGs and enhance transparency.

Last June, we consulted on the candidate ICS as a Prescribed Capital Requirement (PCR). Last year we collected over 30,000 individual data points per insurance group, even before counting information on financial instruments. In total, we have collected over 4 million data points over the last three years, meaning that the ICS is one of the most empirically tested and widely consulted global regulatory standards.

**These reforms will  
strengthen supervision  
of IAIGs and the  
stability of the global  
insurance sector.**

In parallel, US supervisors are developing an Aggregation Method as their implementation of the ICS. Last March, the IAIS published the final criteria by which it will assess whether the Aggregation Method will provide comparable outcomes to the ICS. The comparability assessment is now underway. It will be a robust, technical and evidence-based analysis of comparability. If deemed comparable, the AM will be considered an outcome equivalent approach for implementation of the ICS as a PCR.

Finalisation of these reforms will strengthen supervision of IAIGs and the stability of the global insurance sector. As we complete the policy design phase this year, increasingly our focus will shift to implementation support and assessment, alongside our continued priority on forward looking risk assessment.



## GARY ANDERSON

Commissioner - Massachusetts  
Division of Insurance

### Weathering an evolving insurance climate

Climate perils. New ownership models. Cybercrime. Interest rate swings. Alternative investments. The insurance industry is no stranger to emerging issues and challenges; however, given the increased frequency and expense, the industry is at an inflection point where insurers and supervisors must adapt to ensure competitive, fair and safe markets. Fortunately, the strength of the U.S. system is its flexibility to address evolving risks.

U.S. state insurance supervisors reached an inflection point in the early 1990s following a tumultuous 1980s that saw a large number of insurer insolvencies. These failures highlighted problems with the then current regulatory framework and the need to be more risk-focused.

As a result, a new Risk-Based Capital (RBC) approach was developed that would better account for these factors. RBC formulas for life, non-life and health were implemented in 1993, 1994, and 1998, respectively. This system has proven incredibly resilient and robust since its inception, having weathered major crises in 2008, 2020, and 2023, especially in comparison to other financial sectors.

U.S. state insurance supervisors understand that no system can remain

static. Challenges, such as innovation in both insurance products and insurer investments, and evolution of other risks, like climate, have led to reviews of RBC to ensure that the new risks are being captured appropriately. Looking forward, work is underway to address evolving risks including climate risk and resiliency and insurer investment practices.

Climate risk and resiliency remain a top priority to U.S. state insurance supervisors. After careful consideration, the NAIC climate survey was updated to align with the TCFD to better harmonize data globally, and the RBC calculation has been reviewed to include the addition of wildfires. Convective storms are expected to be considered soon as well. The NAIC will be conducting a data collection on the availability and affordability of insurance, empowering our members to better understand each jurisdiction and regional trends. Cutting edge solvency tools are being implemented to help analyze future scenarios to better understand solvency issues for the insurance sector. Information on these and other recent collective action taken by the state insurance supervisors can be found in the forthcoming NAIC National Climate Resilience Strategy document.

#### Fortunately, the strength of the U.S. system is its flexibility to address evolving risks.

Regarding the emergence of complex organizational structures and complex investments, the NAIC has been active in monitoring these developments, including creating a list of 13 primary regulatory considerations. As part of addressing these considerations, U.S. state insurance supervisors are reviewing existing guidance and considering updates and/or new requirements to enhance their ability to assess riskier activities associated with these business models.

Maintaining a risk-based supervisory approach that can be flexible enough to address evolving risk and opportunities requires supervisors to gain a strong understanding of each insurer, including the products they write, the corporate structure they operate within, and the market forces that may be impacting them. This requires a greater level of knowledge, training, and expertise amongst staff. However, this too is an ongoing challenge with factors such as the rapid pace of change

and turnover and retirement amongst experienced staff.

Finding ways to navigate these evolving risks in a changing insurance sector does not occur in a vacuum. International collaboration among insurance supervisors on a global scale can help ensure risks are being addressed effectively and in a timely manner. The International Association of Insurance Supervisors and its members have a variety of workstreams focused on these evolving risks and are taking steps to finalize important policy developments, including the International Capital Standard that aims to provide a common understanding of the capital adequacy of internationally active insurance groups. Part of this project includes an assessment of whether the Aggregation Method provides comparable results to the ICS. While we look forward to a successful conclusion on comparability and that the final ICS is ultimately fit for purpose, projects such as this reinforce the importance of supervisory collaboration and understanding.

The insurance sector landscape has changed since the introduction of the RBC system 30 years ago, but the system has demonstrated itself to be incredibly robust, recognizing the importance of flexibility to address evolving risks. By looking out for new risk and responding accordingly, the insurance sector can address the challenges we face in a forward-looking and comprehensive way.



## ALBERTO CORINTI

Member of the Board of  
Directors - Italian Insurance  
Supervisory Authority (IVASS)

### The impact of the sudden increase of interest rates on insurance

The “low for long” interest rate context of some years ago represented one of the main global challenges for life insurance. The subsequent sudden and dramatic increase of interest rates has presented different but equally serious challenges which we must not disregard, but rather learn from.

In Italy, on average, the increase in interest rates has impacted insurance companies through a combination of increased surrenders on the liability side and of valuation losses on the asset side. The consequent materialization of liquidity risk was not related to the inability to convert assets into sufficient cash flows to face increased liquidity needs, but instead to the difficulties in getting those cash flows without selling depreciated assets and realizing economic losses.

The intensity of the impact on individual companies depended on a number of factors; the main ones being:

- The degree of liquidity of the liabilities: i.e. the easiness for policyholders to surrender the

policies in response to market factor movements. Insurance policies are normally associated with lower liquidity than pure financial products. However, their design and other market factors (e.g. level of surrender penalties, significance of the protection component compared to the pure investment component, habits of consumers) could make the level of surrenders more sensitive to the return that can be earned by investing in pure financial products;

- The type of distribution channel: banking or financial distribution networks tend to emphasize the financial component of insurance policies, using selling practices that present insurance policies as an alternative to pure financial products. This is particularly relevant in case of non-proprietary networks, where the interests of the insurance company might not always be aligned with those of the distributing entity. Market evidence in Italy showed this very clearly;
- The company's asset allocation and the correlated amount of valuation losses: this obviously depends on the amount and duration of fixed interest bonds in the portfolio.

**Liquidity becomes a concern whenever the design of the products departs from traditional insurance.**

In principle, the combination of the above features has the potential to impact the solvency position of companies and - on a large scale - trigger systemic effects.

What can we, as supervisors, learn from that?

First of all, experience confirmed that, even if liquidity is not in principle a primary risk for insurers, there are situations that require appropriate monitoring tools, effective preventative measures and capacity to intervene if necessary. The closer a company's business model resembles that of a bank or an investment firm, the more the typical insurance supervisory tools and practices need to be enhanced. The review of Solvency II will introduce new tools to monitor and manage liquidity risk and the IAIS, in the context of the Holistic Framework, has enhanced its prudential standards in this regard,

also as a mitigation of systemic risk. It remains to be seen whether this will be sufficient. In any case, supervisors should pay attention to the companies' combined liquidity risk exposure, also considering structural and qualitative aspects such as the design of their products, their distribution model and the features of any related commercial agreement.

Also, experience has shown that the exposure to liquidity becomes a concern whenever the design of the products departs from traditional insurance. This is also connected to the wider issue of the social role of life insurance and the importance of maintaining the protection purpose at the core of the insurance business model. A life insurance market where the protection component is negligible might not only fail to fulfil the need of consumers, but also become less sustainable in the long run.

Finally, the experience underlined the importance for insurers to take all risk exposures into account in their risk governance system, including risks which are not considered in the standard calculation of capital requirements. Indeed, asset allocation or other management actions could sometimes be shaped to a dangerous extent with the only purpose to minimize capital requirements on certain risks - thereby disregarding the consequences on other risks, including those that do not imply capital requirements, such as liquidity risk.

We have to recognize, however, that the current economic context is quite extraordinary and that, despite its challenges, the insurance sector has demonstrated resilience, also thanks to its good solvency position and risk governance.



## PETRA HIELKEMA

Chairperson - European  
Insurance and Occupational  
Pensions Authority (EIOPA)

### Global challenges – Global solutions

With a business model relying heavily on the aggregation and diversification of risks, the insurance sector has naturally developed a strong international dimension. This materialises through a large number of Internationally Active Insurance Groups (IAIGs) operating cross-border, and the importance of international reinsurance markets.

The financial services industry, especially the insurance sector, has grown more interconnected across sectors and geographically. The range of activities of insurers expanded from traditional biometric and casualty coverages to investment and saving products with large impacts to their risk profile. In this environment, international cooperation is crucial to address current challenges.

One area in which this is visible concerns global financial stability. The former entity-based G-SII model, while adequately capturing signals from individual entities, missed the ability to intercept trends or common behaviour in the insurance industry. Working together at the International Association of Insurance Supervisors (IAIS), the global supervisory community developed the Holistic Framework (HF), which aims at addressing such limitations. Building on the three pillars

of the Global Monitoring Exercise (GME), enhanced policy material (ICPs and ComFrame), and Implementation Assessment, the HF establishes a globally consistent supervisory approach to contribute to financial stability.

The shift from the G-SII designation to the HF represents a leap forward, also in terms of complexity. Widening the scope of the assessment and extending the application of standards to a larger number of groups upon supervisors' assessments requires a high level of cooperation, transparency, and consistency in the approaches to grant a robust and homogeneous risk assessment globally. Moving forward, the supervisory community will need to ensure that the HF evolves to capture key trends and risks that might emerge at individual and sector level.

Another global challenge facing the insurance sector concerns the availability and affordability of nat cat insurance coverage, as shown by recent statistics on protection gaps across the globe.<sup>1</sup>

The IAIS' call to action highlights the role of insurance supervisors in addressing nat cat protection gaps.<sup>2</sup>

Supervisors are part of an ecosystem to support the availability of insurance and to advise government and industry on financial inclusion and societal resilience. This involves advising on the design and implementation of public-private partnerships or insurance schemes.

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#### Challenges to the insurance sector don't stop at national borders - Global cooperation is key.

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Sound and effective supervisory cooperation can be largely enhanced if the relevant authorities share, to the extent possible, a common language and supervisory approach. This is what the IAIS is pursuing with the development of the Insurance Capital Standard (ICS).

The aim of the ICS is to define a common language for the supervision of internationally active groups. In this regard, the journey and the destination are important. The monitoring period has already been a success, improving mutual understanding and enabling the development of a robust, risk-based standard that was subject to a public consultation last year.

EIOPA has always been fully engaged as a member of the IAIS to promote effective

and consistent global supervision of the insurance sector. We believe the ICS should reflect the key building blocks of Solvency II, which have proven to be effective. We look forward to the finalization of the ICS and its expected adoption as a Prescribed Capital Requirement (PCR) this year, as we believe it will strengthen the resilience of the sector worldwide at a time of global transformation.

Being a minimum standard, jurisdictional implementations of the ICS will be key to determine its effectiveness. In the EU, Solvency II should be the practical implementation of the ICS, as it delivers on all the key elements of the ICS with a sufficient degree of prudence. EIOPA is open to the ongoing IAIS comparability assessment of the Aggregation Method (AM), as the possible solution for implementation of the ICS in the United States. Building on the agreed set of robust IAIS criteria, it is crucial that the assessment remains credible and evidence-based.

The insurance sector faces numerous challenges, many of which cannot be effectively addressed by national supervisors operating individually. EIOPA will keep cooperating closely with its international counterparts for the benefit of policyholders and financial stability, both in the EU and globally.

1. *Record thunderstorm losses and deadly earthquakes: the natural disasters of 2023 | Munich Re.*
2. *IAIS-Report-A-call-to-action-the-role-of-insurance-supervisors-in-addressing-natural-catastrophe-protection-gaps.pdf (iaisweb.org).*



## HIDEHIKO SOGANO

Member of the Board of Directors,  
Managing Executive Officer -  
Dai-ichi Life Holdings, Inc.

### Challenges facing the Japanese insurance sector in the fast-evolving world

The environment surrounding Japan's life insurance market is not necessarily positive, with structural factors such as a declining and aging population, long-term sluggish growth in real income, and low insurance participation rates, especially among young people. If we look at the value of new contracts, it has been on a gradual downward trend for the past 15 years. In addition, in recent years, various negative factors have been added, such as a decline in sales due to the COVID-19 pandemic, an increase in natural disasters, and the appearance of conduct risk on the sales side, making management difficult.

However, major companies have taken prudent asset and liability operations and there are no acute solvency issues. In other words, we have a huge stock of long-term insurance contracts from the past, and stable long-term investment, mainly with the government bonds supplemented by the conservative alternative investment.

There is a possibility that Japan will finally be able to break away from the

zero-interest rate policy, but for the time being, it will likely be limited in scope. In addition, most insurance contracts in Japan come with a protection feature and given the difficulty of re-enrolling such as the surrender penalty, we believe that a rise in interest rates is unlikely to cause an extreme increase in cancellations, though we should not neglect the liquidity risk in the insurance sector.

Currently, listed insurance companies are pursuing capital efficiency and governance reforms. The risk-free rate is expected to gradually rise in Japan in the coming years, but investment capacity is increasing by improving capital efficiency through measures such as reducing market risk by divesting equities and utilizing reinsurance. Investment targets include, firstly, IT investment based on a new digital strategy, as the use of AI has the potential to dramatically transform business efficiency, and secondly, not only pure insurance business, but also investment in a platform to expand our business into areas surrounding insurance to become a lifelong partner for the customers, and thirdly, overseas markets that are expected to grow in the future. As we will develop these in an inorganic manner, we may see meaningful changes in the business models of the insurance companies and their governance reforms.

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**Insurance industry is in a phase of business model transformation over the years.**

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Regarding climate change, transition risks and physical risks in the Japanese insurance industry are becoming more likely to materialize and need to be firmly recognized as management issues. In terms of physical risks, the extreme heat in the summer is becoming more severe, which is jeopardizing the public's health and leading to an increase in insurance claims. We have experienced an increasing number of large typhoons which damaged offices and houses. Regarding transition risk, given Japan's industrial structure, its potential risk is greater among the G7 countries. This is a matter of great concern, and all Japanese insurance companies, as institutional investors, are very actively addressing this issue.

I believe that outlining transition plans in line with the framework of the GFANZ is significant in clarifying the current challenges. While reducing insurers' emissions is crucial and a good way to raise employee awareness,

a more fundamental theme is how to achieve a reduction in the emissions of investees and how insurance companies can contribute to this. In Japan, we try to encourage regional financial institutions to promote such initiatives and to foster understanding among SMEs in the regions. Therefore, the development of easy-to-use data collection tools is urgently needed, and we do hope that the NZDPU (Net-Zero Data Public Utility), launched at COP28, will be available soon.

In addition to the risk of being held accountable for the mismanagement of climate risks by insurance companies, there is also the litigation risk arising from the impact of climate change on investment decision-making. While there haven't been prominent lawsuits in Japan yet, information disclosure and communication are certainly becoming more critical than ever to ensure stakeholders have a correct understanding.

Lastly, we also find a variety of entities are developing climate-related risk assessment tools for the insurance sector. One ESG vendor quantifies the impact of climate change on investees and insurance companies can refer to the results when selecting companies to invest in and finance. When using such tools, we should be prudent that these assessment tools still have issues in terms of accuracy, effectiveness, and transparency. Therefore, it is important for insurers not to use them at face value, but to accurately understand the logic of each evaluation method and utilize it appropriately in management decisions.





## MIREILLE AUBRY

Direction Prudential Regulation  
Standards & Foresight - COVEA

### The fundamentals of insurance have not changed and the sector remains resilient

The unprecedented changes encountered in the financial, economic, and social environment have created a very challenging environment for market participants for decades. Our economies are still penetrated by the leftovers of the 2008 crisis. The banking sector has been at the core of this crisis due to unsustainable lending and investments behaviors. Conversely, the traditional insurance sector has not been an underlying determinant of the crisis and has not suffered from interconnectedness with banks but rather from the consequences of the management of the crisis with non-conventional monetary policies that have created ever lower interest rates.

The low interest rates have had strong negative impacts such as the creation of bubbles in the value of real estate and other assets such as equities in complete disconnection with actual domestic production and paving the way for future inflation that has eventually soared. Negative interest rates have been observed in real terms and even in nominal ones, both situations strongly disincentivizing the investment of savings in the productive economy, the very one unique true fuel which

should be recognized, cherished and encouraged for long-term investments.

The industry sector in France has suffered from insufficient financial returns on investments that have impacted both life business (unfair remuneration) and non-life business (the absence of remuneration of reserves not contributing to dampen the price of insurance covers).

Because of the soaring of inflation, interest rates have abruptly been driven upwards in 2022. This has caught many actors by surprise, including regulators for instance in the context of the solvency 2 review, which started at a time of historically low interest rates. The focus remains on the need to remove barriers to the long-term financing of a productive and sustainable economy. Higher interest rates are in fact a general positive news since financial remuneration is desperately needed. The abrupt change in interest rates in a short space of time has been absorbed by the adequate ALM stance that has been deployed during the low & negative interest rates period whereby the duration of fixed-income assets was reduced with very significant cash holdings, thus much limiting sensitivity to the upward shock and enabling accreditive investments swiftly on high rates and longer durations. The Eurovita's resolution in Italy remains a marginal case that may be more attributable to factors intrinsic to the company.

The industry sector in France faces many other challenges such as the rising of claims costs for property and casualty both through severe inflation and the cost of new technologies and equipment, the increase of the cost of natural disasters. Yet all this appears manageable with the typical risk management tools and actions insurers have available.

The insurance sector shows a strong resilience, it remains the best rated sector with the fewest defaults.

The fundamentals of the insurance business model have not changed. Asset allocation remains based on the triptych of quality/security, profitability and liquidity. It remains essential to have an "entity-specific" asset allocation, i.e. one that is adapted to the nature and risk profile of all liabilities (in particular policyholder liabilities and equity horizon). Investments based on these target allocations must also incorporate adequate diversification. For all this to function though, we desperately need to remain accurate in our analyses and fundamentally risk-based. Any bias whether inadvertently or intentionally

forced in may ruin the equilibrium of insurance. For instance, non-life insurance may prove very resilient until insurers are not hindered in their ability to reprice according to the real cost of covers by inappropriate rules.

With regards to the cost of natural disasters, it is closely monitored through frequency, scale, and cost. Studies are ongoing and measures have already been taken to ensure the solvency and sustainability of the French CatNat public-private partnership under which an elaborate functioning is operating so that all stakeholders have a complementary and effective role to play. The system is providing a compensation response commensurate with the scale of damages: average events are borne jointly by insurance and public reinsurance, more serious events or claims are covered to a greater extent by public reinsurance, and major events involve all players: insurance, reinsurance and the State.

**Any bias whether inadvertently or intentionally forced in may ruin the equilibrium of insurance.**

With regards climate change, the weighs of physical risks appear clearly manageable all the more so that a common major risk under French non-life insurance, such as winter windstorm is not affected. With regards transition risks, they are happening everyday and much of the climate and sustainability issues are already informing financial markets in a way that embeds it with numerous other factors and cannot be isolated.

## INSURANCE PROTECTION GAPS



### PETRA HIELKEMA

Chairperson - European Insurance and Occupational Pensions Authority (EIOPA)

## The supervisory duty to address insurance protection gaps

In 2023, losses caused by natural disasters globally amounted to 250 billion US dollars and more than 74,000 fatalities, while insured global losses amount to 95 billion US dollars.<sup>1</sup> Extreme weather events rank as the environmental risk most likely to present a material crisis on a global scale in 2024.<sup>2</sup> The WEF Global Risks Report 2024 places extreme weather events as the second most severe risk, while projecting it to become the most significant risk over a 10-year period.

Based on the latest update of its nat cat protection gap dashboard, EIOPA confirms a persistent insurance protection gap for natural catastrophes, with only about a quarter of losses caused by natural perils insured across the EEA.<sup>3</sup>

EIOPA's work to address protection gaps considers the empirical evidence that insurance coverage not only

directly impacts the financial resilience of policyholders, but also GDP growth. When the share of insured losses is low, large-scale disaster causing over 0.1 per cent of GDP-worth of direct losses can reduce GDP growth by around 0.5 per cent in the quarter of impact. Inversely, if a high share of damages is covered by insurance, the indirect impact on GDP growth may be significantly reduced. Countries with a substantial history of catastrophe losses relative to their GDP also tend to experience a considerable insurance protection gap. This can impact the sustainability of debt. Natural disasters can be a further source of systemic risk for financial institutions and financial markets. For example, the insurance protection gap can increase the exposure of banks to physical risk and reduce the value of collateral.<sup>4</sup>

These impacts, and the high risk of failing to limit the global temperature rise to 1.5 degrees Celsius, require us to adapt to physical risks caused by extreme weather events. With climate change, and increasingly severe or frequent extreme weather events, the future cost of insuring natural catastrophes becomes a critical issue if no adaptation measures are taken. The acute and chronic physical risks of climate change for life and health insurance business are increasingly coming to the forefront of discussions.<sup>5</sup> The reliance of primary insurance on reinsurers to cover these risks is significant, and the challenges may increase with a tightening reinsurance market.

### Addressing protection gaps is crucial to safeguard policyholders and preserve financial stability.

Public authorities and the private sector are under pressure to provide solutions through prevention and adaptation. EIOPA's recent initiatives to promote solutions for nat cat insurance protection gaps include measuring protection gaps, incentivising risk prevention, and addressing obstacles to the take-up of insurance. Building up its capacity as a centre of excellence on catastrophe modelling and data, EIOPA aims to provide European supervisors, policy-

makers, and insurers with expertise, studies, tools and data to enable them to effectively assess, monitor and supervise these catastrophe risks.<sup>6</sup>

EIOPA's analysis on measures to address the demand-side highlights potential consumer-related implications that can be addressed to reduce protection gaps. EIOPA is developing a blueprint to increase awareness on natural catastrophe risks and to incentivize consumers to take prevention measures to reduce losses. Beyond this, EIOPA is actively engaging with supervisory and public authorities to identify how protection gaps are best addressed at a regional or EU-level. These initiatives show the importance of not only addressing the offer, but also the demand for insurance.

EIOPA is likewise engaging with supervisors, consumers and stakeholders to address cyber protection gaps.<sup>7</sup> This includes collecting information on access to cyber coverage by SMEs and identifying barriers to the coverage and take-up of insurance.

These efforts illustrate the opportunity of supervisors to address protection gaps in a concerted action with public authorities and the private sector, based on the supervisory duty to protect policyholders and contribute to global financial stability.

1. *Record thunderstorm losses and deadly earthquakes: the natural disasters of 2023* | Munich Re.
2. *WEF\_The\_Global\_Risks\_Report\_2024.pdf* (weforum.org).
3. *Dashboard on insurance protection gap for natural catastrophes - European Union* (europa.eu).
4. *Policy options to reduce the climate insurance protection gap* (europa.eu).
5. *PSI-Life-Health-ESG-Guide.pdf* (unepfi.org).
6. *Centre of excellence for catastrophe modelling and data - European Union* (europa.eu), *Catastrophe Data Hub - European Union* (europa.eu).
7. *Measures to address demand side aspects of the Natcat Protection Gap* (europa.eu).



## CARMINE DI NOIA

Director for Financial and Enterprise Affairs - Organisation for Economic Co-operation and Development (OECD)

### Building financial resilience against disaster risks – An increasing challenge

Building financial resilience against disaster risks should be an important public policy objective for governments, especially in countries faced with significant exposure to disaster risks or limited capacity to manage their financial impacts. Disasters generate a broad range of impacts, including loss of life and bodily injury as well as damage and disruption to property and infrastructure. Severe events destroy capital, disrupt economic growth and can create fiscal risks due to the need to support economic recovery and fund reconstruction. According to the Swiss Re Institute, economic losses from catastrophes – floods, storms, earthquakes as well as major industrial or transport accidents – have averaged USD 220 billion annually between 2013 and 2022.<sup>1</sup> This is more than the 2022 GDP of 20% of OECD member countries and more than annual general government revenues in about 40%.<sup>2</sup>

The frequency and severity of many types of natural and human-made catastrophes are likely to increase. A number of economic, social and

environmental trends – a changing climate, digitalisation, globalisation and urbanisation – could lead to greater economic impacts. A changing climate is expected to lead to an increase in the severity of cyclones in some regions, more days of conditions conducive to wildfire ignition, and changing precipitation patterns that could lead to more flooding and more frequent droughts. There is already some evidence of an increase in losses – for example, annual average economic losses from weather-related catastrophes were more than 200% higher in 2015-2019 than they were in 2000-2004 (in constant dollars).<sup>3</sup> Losses from other perils such as cyber attacks are also on the rise as the “ransomware epidemic” continues to disrupt the provision of critical public and private services and as a more volatile geopolitical environment leads to increasing concerns about potential cyber warfare.

Insurance markets play a critical role in protecting households, businesses and public finances from the financial impacts of disasters. Households and businesses with insurance coverage have access to the funding they need to rebuild damaged property and recover lost revenue and income. They are less likely to depend on public financial support to recover or default on their loans or mortgages. However, levels of insurance protection remain low for many disaster risks. Between 1995 and 2019, almost 40% of storm-related losses and 82% of flood losses were uninsured, and the level of coverage for emerging (or re-emerging) risks such as cyber risks and infectious disease outbreaks is even lower. Despite efforts to expand insurance coverage, there has been limited progress in closing these “financial protection gaps” for many disaster risks.<sup>4</sup>

#### Regions of the world risk becoming uninsurable if increasing losses lead to unaffordable premiums.

Some regions of the world (or some perils) risk becoming uninsurable if increasing losses lead to unaffordable premiums or insurance coverage withdrawals – and we are already witnessing signs of this in some areas. Maintaining insurability will require increased investment in building societal resilience to disaster risks and cooperation between the insurance sector and governments in identifying areas at risk and assessing financial protection gaps. In some cases, catastrophe risk insurance programmes

(often referred to as public-private partnerships) will be needed to respond to capacity constraints or affordability challenges, particularly if other types of interventions to maintain access to affordable insurance are unsuccessful.

Building financial resilience has been a priority for the OECD Insurance and Private Pensions Committee and a core part of its work programme for many years. This work is anchored in the recently updated *OECD Recommendation on Building Financial Resilience to Disaster Risks* which provides guidance for governments on how to assess the financial impacts of disaster risks, establish policy, regulatory and supervisory frameworks that enable the availability and take-up of financial protection tools and respond to potential fiscal risks. This guidance will become increasingly important in the context of increasing losses and insurability challenges that have the potential to thwart efforts to build financial resilience.

1. Swiss Re Institute (2023), “Natural catastrophes and inflation in 2022: a perfect storm”, *Swiss Re sigma* No 1/2023.
2. OECD calculations based on data from *OECD Government at a Glance (general government revenues)* and *OECD National Accounts Statistics (GDP)*.
3. OECD calculations based on data provided by *Swiss Re sigma*.
4. For example, - between 2015 and 2019, approximately 57% of natural hazard losses were uninsured – relative to about 58% between 2000 and 2004.



## SHIGERU ARIIZUMI

Vice Minister for International  
Affairs - Financial Services  
Agency, Japan (J-FSA)

### Narrowing the protection gap: the role for insurance supervisors

Last year was the hottest on record. As average global temperatures continue to rise, we know as supervisors we need to stand ready to address the consequences for insurers' solvency and for policyholder outcomes. This is a key priority for the IAIS.

In recent years, our focus on climate has increased, including work to update the guidance in our global standards and develop further supporting material to effectively integrate climate-related risks into insurer risk management frameworks. We are currently consulting on application papers on climate-related consumer protection considerations and approaches to effective scenario analysis. In addition, we have integrated climate data elements into our annual Global Monitoring Exercise to analyse the impacts of climate change to the insurance sector.

Over time, we expect to see greater damage due to climate-related natural catastrophes (NatCat) and the widening of insurance protection gaps, mainly driven by accumulating exposures in high-risk areas and the impact of

climate change. As these gaps grow, societal vulnerabilities will intensify and the insurance sector is likely to face considerable pressure. As a result, last year the IAIS broadened the scope of our climate work to consider the role supervisors can play in helping to address increasing NatCat protection gaps.

The report is a call to action, outlining five major areas of supervisory activity that can contribute to addressing NatCat protection gaps. This is supported by case studies from jurisdictions spanning all IAIS regions. Importantly, the report emphasises that all supervisors have a strong basis for action to help narrow NatCat protection gaps, regardless of their mandate, given the potential impact of protection gaps on financial stability, policyholder protection and financial inclusion objectives. For those supervisors that have mandates to promote financial inclusion and market development, actions to address protection gaps and resilience are particularly critical.

Our report outlines practical steps insurance supervisors can take to incentivise risk prevention and reduction of insured losses. This includes promoting adaptation and risk mitigation measures to reduce policyholders physical risk exposure to NatCat events. Supervisors can also play a role in socialising useful and reliable sources of information on NatCat events or tools or portals to help consumers assess their risk. For some supervisors, there may be a role in publishing information such as flood maps which can foster better decision-making by governments, as well as business and individuals.

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**All supervisors have a  
strong basis for action  
to help narrow NatCat  
protection gaps.**

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Another key area of supervisory action is advice to government, as well as industry. Supervisors can act as a bridge between government and industry, leveraging their established links with insurers and understanding of the insurance sector to enhance coordination of government response. For instance, they can inform policymakers on areas where insurance is unaffordable because of the level of risk or the limited financial capacity of consumers, guiding effective interventions in risk reduction or financial inclusion. One such risk reduction measure could be to consider drivers behind construction

and development in high-risk areas. Additionally, they could bring a risk perspective to a range of government activities such as building codes, housing and urban planning.

Our report has already catalysed discussions among insurance supervisors, the insurance industry, policymakers and other relevant stakeholders on how to narrow protection gaps. This work by the IAIS was also highlighted in the Communiqué of the G7 Finance Ministers and Central Bank Governors Meeting in May 2023. As supervisors can most effectively contribute to building enhanced resilience against NatCat events through collaboration with other parties, the IAIS is undertaking follow-up activities with partner organisations, including the A2ii, the Global Shield against Climate Risks and the OECD, building on the findings of the report.

Our initial focus has been on NatCat protection gaps, but it is possible to extend our work to other protection gaps over time. When we move forward with such work, multistakeholder engagement will be key to tackling the complex problems that result in protection gaps.



## CHRISTOPHE BORIES

Head of Service for the Financial Sector - Ministry of the Economy, Finance and Industrial and Digital Sovereignty, France

### Adapting the French insurance sector to rising climate risks: what is at stake?

Over the past two decades, climate has changed and we have observed a significant increase of costs for the insurance system. By 2050, climate change will further exacerbate climate risks and have a significant impact on drought, flooding, marine submersion and cyclonic risks in particular. The Caisse Centrale de Réassurance (CCR) - a publicly-owned company offering reinsurance with a public guarantee for natural disaster risks - estimates that the increase in claims due to climate change will be between 27% (RCP 4.5 scenario) and 62% (RCP 8.5 scenario) on average by 2050. The increase in insured stakes in high-risk zones, as well as inflationary pressures and improvements in policyholder coverage are additional causes of climate-related costs for the insurance sector.

As a consequence, the potential withdrawal of insurers from areas exposed to climate hazards is a major economic and social risk for policyholders and for the market equilibrium of the French insurance system. The extent of this phenomenon is quite difficult to estimate accurately.

The key challenge for policymakers is to determine the most effective incentives in order to avoid a widening of the protection gap for natural disasters.

Pooling risks among all policyholders is necessary to achieve a broad insurance coverage, including in areas most exposed to climate hazards. Insurance models based on market freedom, giving insurers the freedom to underwrite and price risks according to their climate exposure, can leave households and businesses uninsured, while generating instability in the insurance market. These market limits have led to government interventions as a last resort, either to subsidize the insurance offer, to support access to insurance or to provide post-disaster emergency budget response.

France is one of the very few countries with a system guaranteeing all its citizens adequate compensation, in the event of loss or damage caused by natural disasters such as floods, mudslides, tidal waves, drought and landslides. This natural disaster compensation scheme was introduced in 1982. It is based on a public-private partnership, which combines private insurance with a non-mandatory state-guaranteed public reinsurance that provides cedants operating in France with coverage against natural disasters and extreme risks. This system combines two principles:

- i) solidarity, based on an additional premium set by the government at a mandatory uniform rate on every P&C insurance contract; and
- ii) responsibility with a minimum compulsory deductible set by the government.

However, the development of geographic segmentation tools to guide risk selection policies could jeopardize this compensation scheme, as they could lead to anti-selection in areas with high exposure to climate risks. The potential consequences for the stability of the Nat Cat compensation scheme imply that policymakers need to be better informed about the geographical areas where the protection gap is widening and to anticipate the evolution of this phenomenon.

Strengthening individual and collective prevention and adaptation efforts is a priority in order to contain the projected rise in claims costs. In particular, several studies have demonstrated the effectiveness of deploying flood risk prevention measures to reduce insurance costs:

- A recent study concludes that French public investments dedicated

to the reinforcement of hydraulic structures (96 M€/year) reduce the average annual loss by 130M€.

- A regulation enacted in 2020 on the construction of new homes located in clay zones is expected to save up to 200 M€ yearly on insurance claims due to geotechnical drought. In the French context, this risk represents the largest cost of claims for the Natural Disasters Compensation Scheme ("Cat Nat"), with an annual cost averaging 1.1 billion euros in 2022-2023.

The uncertainties related to climate change suggest the need to regularly question existing prevention measures with a view to adapting them to the evolution of risks. Historically, in France, flooding was considered the main threat in terms of insured losses, which led to efforts to develop public policies to prevent such damages. However, geotechnical drought has become the most dynamic threat in terms of losses.

In 2023, the French government announced the launch of a commission tasked with drawing up recommendations on the challenges facing the French insurance system with respect to climate risks. The mission is part of the ecological planning work being carried out under the authority of the Prime Minister. Its proposals aim to guarantee the sustainability of the Cat Nat compensation system and to strengthen the role of the insurance system in preventing, mitigating and adapting to climate change.



## FRANÇOISE GILLES

Group Chief Risk Officer – AXA Group

### Closing the climate protection gap in insurance: call to intensify the dialogue

With more frequent and severe natural disasters, climate change requires actions combining innovative adaptation strategies and enhanced public-private cooperation. The current and expected increase of extreme climate events underscores the need for public authorities to prioritize climate change consequences in their prevention measures and mitigation strategies. On their side, insurers also have key components and expertise to bring in support to the overarching objective of making societies more resilient. To achieve this goal, we stress the need for public authorities and private insurers to cooperate.

On one hand, the primary role of public authorities is to spearhead efforts in risk assessment and disaster prevention by defining and enforcing the required measures that will reinforce their overall adaptation to climate risks and contribute to risk reduction.

- Public authorities are responsible for raising the awareness of citizens e.g., through communication campaigns and regular crisis exercises that

will prepare communities for the impacts of climate-related events.

- Public authorities can develop measures to reduce vulnerability and ensure the adaptation and maintenance of public infrastructures (e.g., water pipes, dams, etc.). This includes the development of robust building codes, implementation of land-use planning to avoid development in high-risk areas, enforcement of building bans in vulnerable locations, and mandating resilience plans for local governments. They have the ability to support risk reduction and mitigation in the private sector and among individuals and SMEs through various incentives.
- Lastly, they play the role of insurer of last resort for citizens, which provide the necessary economic safety net to the society. Such role is even predetermined by some existing schemes in certain countries (e.g., France's NatCat regime, Floor Re in the UK).

On the other hand, the private insurance sector has major components to bring in support to the overarching objective of making societies more resilient.

- At the underwriting level, insurers have a unique risk knowledge through risk modelling and access to precise data on geo-coding of risks and perils and can therefore promote individual prevention measures. For instance, they can incentivize good practices through actuarially justified (or risk-based) premium reductions.
- Moreover, in case of major events, they can provide their ability to indemnify and give effective support to citizens through management of massive claims (through mobilization of networks of experts, repairers, etc.).
- On the broader scope, they develop innovative insurance products such as parametric insurance or ILS/ Cat Bonds that enhance risk-sharing mechanisms.

Adequate insurance coverage is important but is not a standalone solution, particularly as the economic impacts of climate change are increasing and the demand for insurance coverage against natural catastrophe is lower than it should. National and EU-level strategies for climate-related natural disasters are key to increasing the overall resilience of European economies. However, as the perils' diversity across Europe calls for solutions tailored to

each country's specific needs. A robust framework in place at national or regional levels for awareness, adaptation measures and risk reduction are a prerequisite to a framework that could be developed at European level.

Cooperation between public authorities and private insurers is needed to face issues posed by extreme climate events and a certain number of conditions is required to make it successful. Among them, the preliminary requisite is for governments to provide clear information about the extent and conditions (incl. implementation of prevention measures) of financial state intervention during such events to avoid moral hazard. Moreover, any cooperation should aim at enhancing risk-sharing and leveraging technology to increase effectiveness of disaster management (such as data analytics shared between both parts, Artificial Intelligence for risk assessments, etc.). Eventually, a regular monitoring and evaluation of the partnership's activities would help in understanding its effectiveness and in making necessary adjustments.

#### Insurers stand ready to engage a constructive dialogue with public authorities.

While insurers play a critical role in indemnification, managing risks and providing innovative solutions, the primary responsibility for prevention and climate change adaptation lies with public authorities. Insurers stand ready to engage a constructive dialogue with Public Authorities to address the issue of extreme climate events and their impacts.



## IVO MENZINGER

Head EMEA, Public Sector  
Solutions - Swiss Re

### Global protection gaps and what we can do about them

The world has faced extraordinary shocks in recent years, from the COVID-19 pandemic to geopolitical conflicts and 40-year high inflation in major economies. Combined with megatrends such as digitalization, climate and demographic change, these shocks pose fundamental challenges to the resilience of households, businesses and economies.

Swiss Re tracks these developments in the context of its annual resilience and protection gap research<sup>1</sup>. The value of unprotected risk exposure globally rose steadily between 2018 and 2022. We estimate the global protection gap at a record USD 1.8 trillion in premium equivalent terms for 2022, representing a cumulative 20% increase since 2018. In the context of our research, three key areas stand out in terms of a need for increased resilience: food security, natural catastrophes and health. Specifically, we estimate that 60% of global insurable crop production was unprotected against natural disasters and accidents in 2022, amounting to a global crop protection gap of USD 113 billion. The global natural catastrophe protection gap of physical assets stood at USD 368 billion, implying that 76% of natural catastrophe risk was unprotected. The global health protection gap rose to USD 888 billion, up by 3.2% from 2021.

While developments and underlying factors vary greatly by sector and geography, protection gaps are the largest in emerging markets. At the same time, it is worth noting that overall resilience has not been improving in advanced economies in general, and in Europe in particular.

What can be done to address large protection gaps? Increasing resilience requires consideration of two overall strategies: reducing expected losses and increasing insurance cover. First, loss prevention measures structurally narrow protection gaps by reducing the risk of damage to crops, property or infrastructure. By reducing risk, they also foster insurability. Second, beyond loss prevention, risk transfer comes into play.

Re/insurers can support on both. When it comes to incentivizing loss prevention, re/insurers can help through pricing signals and client engagement. With respect to risk transfer, recent developments have been encouraging. By using modern analytical tools and data sets, re/insurers are now able to design covers for risks that used to be assessed as uninsurable. And ongoing innovation around data, analytics and distribution are set to further expand the scope of insurance to access new and under-served risk pools.

However, re/insurers' ability to expand the availability of risk transfer solutions is contingent on appropriate actions being taken by public stakeholders. Governments and regulators have numerous tools at their disposal to foster insurability. Mandating insurance coverage for health and workers' compensation, supporting crop insurance via public insurance schemes or subsidies, offering tax benefits to promote life and health insurance and reducing taxes on property insurance premiums are just a few examples. Beside incentivizing risk transfer, public measures are pivotal when it comes to fostering loss mitigation behavior, for example through building codes, zoning laws or fiscal rules.

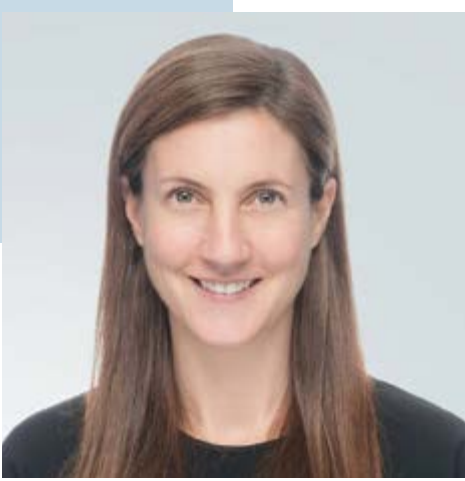
Public-private partnerships are key to facilitating insurability of hard-to-insure risks. These partnerships work both ways: on the one hand, there is a need for government backstops as insurer of last resort for risks that exceed the capacity of private markets. These could be cyber catastrophe risks from large, coordinated attacks, future pandemics, or solutions for affordable natural catastrophe insurance in peak risk zones. On the other hand, there is a need for insurance of public assets for countries under fiscal stress, where risk transfer through the global re/insurance market

comes at a lower cost of capital. There is also a strong case for transforming international disaster assistance from post-event grants to ex ante solutions via insurance or cat bonds.

### As global protection gaps are increasing, what can insurers and policy-makers do to restore resilience?

The renewed attention of European authorities to protection gaps – as evidenced by the EU Commission's ongoing Climate Resilience Dialogue<sup>2</sup>, and EIOPA and ECB's recent call for an increased uptake of climate catastrophe insurance<sup>3</sup> – is positive. However, some recent developments have been counter-productive. Above all, regulators should bear in mind that re/insurers' ability to help reduce protection gaps greatly depends on their ability to diversify risks across jurisdictions. By promoting open markets and removing trade barriers, such as the mandatory holding of collateral or the localisation of assets, regulators will be able to unlock the full potential of re/insurers on the path to sustainably closing protection gaps.

1. *sigma* | Restoring resilience | Swiss Re Institute | Swiss Re
2. *Climate Resilience Dialogue* - European Commission (europa.eu)
3. *EIOPA and ECB call for increased uptake of climate catastrophe insurance* - European Union (europa.eu)



**PENNY SEACH**  
Group Chief Underwriting  
Officer - Zurich Insurance

## Investing in resilience is key to tackling global protection gaps

The increase in frequency of climate related natural catastrophes in recent years has brought increased attention to the challenge of gaps in the protection provided by insurance to individuals, families and businesses. In fact, the world is facing — and growing — gaps in insurance protection in a number of areas: EUR 0.9 trn (US \$ 1trn) a year for pensions; EUR 0.8 trn (US \$ 0.9trn) for cyber; EUR 0.7 trn (US \$ 0.8trn) for health, and EUR 0.092 trn (US \$ 0.1trn) for natural catastrophes (source: Geneva Association). All four of these protection gaps are widening, reinforced by global trends from climate change and demographics to macroeconomics, geopolitics, and digitalization. If not addressed the consequences of those gaps for our communities and society as a whole will be significant.

Providing protection against these global-scale risks is a critical challenge for insurers, but there is also clear agreement across the insurance industry that the traditional mechanisms to spread financial losses will not be sufficient to address the scale of the challenge. We need to acknowledge that there are emerging risks which present challenges to insurability, as well as traditional risk transfer mechanisms

and need to look to other approaches to address protection gaps.

In the context of climate change, the traditional role of insurance is to transfer risk through paying a premium and increase the insured's capability to withstand or recover from any financial loss arising from natural catastrophes like major floods or a tropical storm. However, insurers can also contribute to climate change adaptation, through their underwriting and pricing signals in the marketplace.

At Zurich Insurance, risk mitigation and risk transfer has been our business for more than 150 years, and we continue to refine and evolve our solutions and approach as we adapt to an evolving risk landscape. With our Zurich Resilience Solutions (ZRS), we provide specialized insights and risk management tools to support commercial customers proactively manage their risks. We also work with the public sector, for example we are currently working with Madrid City Council to help identify and quantify the hazards associated with extreme heat to define adaptation measures for their Climate Resilience Plan – providing a template for how cities across Europe might enhance their resilience and reduce the costs of extreme weather events.

Drawing on our experience, we see three actions that should be prioritized in the quest to close protection gaps.

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**A prevention mindset  
needs to develop  
across our economies  
and embedded in  
policy thinking.**

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First, we need to develop a prevention mindset. Ensuring our communities are resilient in the face of more frequent climate related natural catastrophes is increasingly essential. Financial support to help with post disaster recovery is important, but far better to avoid the worst impacts of a catastrophe in the first place. Insurance can help plug income gaps in the event of illness, but far better for individuals and companies if we can work to prevent ill health in the first place. Better that a company has protections in place against cyber-attacks rather than having to rely on insurance payments to make up for lost income after they have been hacked. Ex-ante measures and a prevention mindset need to develop across our economies and embedded in policy thinking.

Without prevention, protection gaps will only continue to grow.

Second, we must (re-)establish trust in insurance. Communities, corporates, households that are insured are more resilient, but many find insurance complicated and too many are unaware of the risks that they face. As a result, insurance coverage is partial and governments tend to rely on ex-post compensation schemes, which lack incentives for investment in resilience.

Third, there needs to be better collaboration between public and private sectors if we are to make meaningful progress to address protection gaps. Dialogues like those at this EUROFI conference are important to advance thinking on how we can address protection gaps, and we need to replicate this at national and local level. In this dialogue, we can also address shortcomings in regulatory frameworks our commercial customers have shared with us. The construction industry, for example, plays a key role in the transition to lower carbon economies and low carbon materials are available. However, many tender processes, especially in the public sector, apply a significant weighting to overall cost. This slows down the adoption of these materials and results in missed opportunities to hasten the Net Zero transition.

Clearly, these actions will not happen overnight, and the challenges ahead are manifold. But I remain optimistic that the insurance industry, in conjunction with strong public sector partnership, can be a catalyst for helping society at large and preparing a better future for next generations.



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## DIGITAL FINANCE: KEY PRIORITIES



### PETRA HIELKEMA

Chairperson - European Insurance and Occupational Pensions Authority (EIOPA)

## The trend towards the increasing digitalisation of the insurance sector

Over the past years, an increasingly important role has been assigned to digitalisation as a way to enhance the design, development and distribution of innovative insurance products and services through new digital platforms, ecosystems and other digital distribution channels. The digitalisation of the European insurance sector is currently varied and, in most cases, still at an incipient stage. There is a wide range of practices in the market and the level of digitalisation can substantially differ from one insurance undertaking to another and can evolve quickly.

However, it is clear that leveraging on the increasing availability of data and new technologies such as Artificial Intelligence, Open Finance, Blockchain or Internet of Things, digitalisation offers a wide range of new opportunities for insurance undertakings, insurance distributors, consumers, and supervisors. Digitalisation and innovation also bring new challenges—frictions between market practices and regulation that was not designed with these in mind, alongside new risks for consumers and the market.

A Europe fit for the digital age has been one of the key priorities of the current Commission. The aim has been to empower people with a new generation of technologies and to make this Europe's "Digital Decade" by strengthening digital sovereignty and EU standards, rather than following those of others. The focus is on data, technology, and infrastructure.

The insurance sector has been heavily impacted by this strategic priority over the past years. In 2020 the Commission adopted a digital finance package, including a Digital Finance Strategy, setting out how Europe can support the digital transformation of finance, while regulating its risks.

The strategy set out four main priorities: removing fragmentation in the Digital Single Market, adapting the EU regulatory framework to facilitate digital innovation, promoting a data-driven finance, and addressing the challenges and risks associated with the digital transformation. The latter includes enhancing the digital operational resilience of the financial system.

The strategy was accompanied by proposals on DORA, MICA, and DLT Pilot Regime. Furthermore, proposals were published on the Data Act, Digital Markets Act, Common Data Spaces, Digital Services Act and Data Governance Act, European Single Access Point (ESAP), AI Act and Financial Data Access (FIDA).

The pace of innovation has created an urgent need for such a regulatory framework. The very recent uptake of generative AI is an example. The same speed has also made it challenging to complete policy cycles and to take the time necessary for implementation.

Today, more and more financial services policy making happens through cross-sectoral proposals. This is the case for the AI Act, the Data Act, the Digital Markets Act, the Digital Services Act and others. This trend is expected to continue. Going forward, it is important to thoroughly consider the impact of cross-sectoral legislation on insurance and to engage with the insurance and supervisory communities early on in the process. This way, sector specialties can be considered and the whole regulatory framework can fit together well.

In addition, it is important to consider diversity and inclusiveness when making policy, by listening to Member States for practical examples on digitalization, including the smaller ones. Regulation needs to remain fit for purpose, proportionate, and forward-looking, and at the same time, allow for benefits to materialize. This is important for the European insurance sector in order to remain globally competitive without hindering our common values.

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**Forward-looking regulation can help the European insurance sector remain globally competitive.**

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The trend towards an increased digitalisation of the insurance sector is expected to progressively continue in the years to come. In this process, EIOPA will continue to support the supervisory community and the industry to mitigate the risks and seize the opportunities of the digital transformation, including by further promoting a data-driven culture. This is indeed one of EIOPA's key priorities, as recently published in our Digital Strategy.

In implementing the strategy, EIOPA will consider the best interest of consumers first, adopting a technology neutral approach. EIOPA also aims to be flexible to keep pace with innovation, without compromising its mission. EIOPA's role will range from monitoring developments, facilitating and promoting innovation, contributing to digitalisation of National Supervisory Authorities and implementing its own digital transformation.



## MARIA TSANI

Head of Financial Services Public Policy and Regulatory Affairs EMEA - Amazon Web Services (AWS)

### Financial regulation and supervision in an evolving digital environment

In recent years digitalization has changed the face of the financial sector, from the way we bank on a daily basis to the emergence of crypto assets and many other use cases. The digital transformation has undoubtedly brought considerable opportunities in terms of enhancing the customer experience, enhanced resilience and security. Thanks to technologies such as cloud services, financial institutions can improve their security and ability to meet compliance requirements, including on resilience, data protection and confidentiality, while also allowing them to innovate faster. At the same time, the regulatory community is grappling with new challenges arising from emerging market dynamics and the entrance of new players. Such a sea change requires authorities and supervisors to significantly rethink their approaches and even the way they operate.

As regulators turn increased scrutiny on cyber resilience, there is understandable focus on the use of cloud by financial entities. This has materialized in the EU with the Digital Operational Resilience Act (DORA), in the UK with the Critical Third Party (CTP) regime, and in other regions as well with a number of emerging initiatives. Novel challenges require novel solutions. In this context, we must apply digital-era thinking and supervisory approaches in an evolving digital system to deliver a satisfactory and effective response.

In the EU, DORA represents an opportunity for the EU to raise the bar in terms of security and resiliency. In order for the framework to be effective, it should prioritize what is important in terms of security and resiliency, and use this to proportionately protect financial organizations. It is also important that, given the fast pace of technological innovation, the framework remains flexible enough in order to handle dynamic complexities and the evolving technology environment.

Technologies like cloud, artificial intelligence and machine learning are central to how financial firms will drive innovation and global competitiveness in the future. The EU's regulatory framework will need to be suitably flexible in order to accommodate the fast changing technology landscape, and ensure firms can continue to access world class technology platforms.

From the perspective of a technology provider, we have different experiences to those of firms traditionally under the remit of financial supervisors. For example, AWS provides services to firms not only in the financial space, but in many others as well as to governments. In this sense, a tailored approach to regulation and supervision that considers these different realities would be not only more efficient, but also lead to better outcomes in managing risks. Furthermore, given the global nature of cloud operations, any approach must entail

global regulatory and supervisory coordination, as recognized internationally by the Financial Stability Board (FSB).

Operational resilience and security have been rightly identified by the regulatory community as key policy concerns of the digital age. Well implemented, cloud can deliver significant resiliency gains for firms and the overall financial system. Equally, the ability of our customers to leverage our cybersecurity capabilities means a significantly higher level of encryption than legacy technology, leading to watertight security.

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**It is imperative we collectively get digital operational resilience right.**

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Digitalization has not only impacted regulatory and supervisory priorities, but has also introduced new tools to better address them. Key to supervision in the digital age is the effective use of data, and we see supervisors are increasingly enhancing their data infrastructure and leveraging advanced analytical techniques harnessing the power of the cloud. As a key enabler of supervisory technology (SupTech), cloud services allow regulators to access and deploy cutting-edge tools, such as AI, to oversee the financial system in a more efficient and secure way.

As the financial sector becomes increasingly digitalized, it is imperative we collectively get digital operational resilience right.

At AWS, we want to be an active and collaborative partner in discussions in how to achieve the robust baseline of cyber resilience we need. This is an objective we certainly share with the regulatory community.



## JOE HENEGHAN

Chief Executive Officer, Europe - Revolut

### Europe's Digital Single Market needs a revolution

Europe stands out as a market with forward-looking regulation that promotes innovation and competition. Regulatory initiatives, such as Open Banking and Open Finance, play a pivotal role in the growth of the digital finance sector. Setting regulatory frameworks for newly emerging areas, such as crypto, and embracing new technologies such as AI also impact the attractiveness of the EU as a market with clearly defined rules, regulatory clarity, and a focus on promoting new developments.

If we look at some of the most widely used metrics to assess the level of digitalization (market capitalization/revenues of FinTechs, use of digital payments versus cash, and the number of FinTechs founded), Europe is holding the top positions and is expected to maintain this status.

At the same time, there are also lessons to be learned from how digitalization is happening in competitive markets. Taking China as an example, the Asia-Pacific regional leader, we see its strong position in the digital space attributed to BigTech giants (Tencent and Alibaba) driving the FinTech revolution. They control e-commerce and social platforms while venturing into the financial services space. Using big data from users' interactions with platforms helped them scale and adopt tailored solutions for customers. This demonstrates the benefits of Open Data economies, which can boost European GDP in 2030 from about 1 to 1.5 percent<sup>1</sup>.

The second market, relevant for the EU, is the US, generally defined as the most developed innovation ecosystem involving venture capital firms, entrepreneurs, and access to funding. The US has successfully fostered an ecosystem that encourages financial support for innovative ventures, enabling them to flourish and contribute significantly to economic development. Europe has made major progress since 2016 when venture capital investment amounted to €6.5 billion compared to €39.4 billion in the US<sup>2</sup>. Nevertheless, by taking the example of the US, the EU can further promote its Capital Markets Union and access to finance for digital companies.

Closing the gaps and bringing Europe to the forefront of digitalization should be one of the priorities for the next political cycle and a key component here is the EU's truly Single Digital Market, allowing seamless access for companies to almost 500 million European citizens. It can bring Europe to the next level of the digital revolution and advance its competitive edge against other big markets, such as China and the US.

As a pan-European champion with over 20 million users in Europe, we have good insights into the barriers to the Single Digital Market, namely: (1) IBAN discrimination; (2) different implementation of rules across Europe; and (3) the lack of pan-

European solutions. While some of the above issues might be solved via new rules and policies, such as new harmonised frameworks, the heavy lifting is on enforcement and single procedures and practices.

For almost 10 years now, there has been no market where one European IBAN has been accepted across all countries with no obstacles. It is a question for the next European Commission's term whether additional means to enforcement are needed, such as a single European IBAN number or allowing payment service providers to receive an IBAN without the need to open a branch.

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**Our hope is that Europe takes the opportunity to deliver a truly Single European Digital Market.**

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Having operations across Europe as well as launching branches of our bank in four countries, we see how every country is unique in its approaches and market practices. The price we are paying is the absence of the Single Digital Market.

Lastly, simple tools like data sharing schemes or more sophisticated tools such as a pan-European payments solution could bring immense benefits to the effectiveness of the financial system and allow citizens to benefit from a secure and uninterrupted experiences as consumers move around Europe.

Our hope is that Europe takes the opportunity to deliver a truly Single European Digital Market, enabling seamless interoperability, and driving the continent's digital finance ecosystem to new heights.

1. <https://www.mckinsey.com/industries/financial-services/our-insights/financial-data-unbound-the-value-of-open-data-for-individuals-and-institutions>
2. VentureEU: Pan-European Venture Capital Funds-of-Funds Programme: [https://ec.europa.eu/commission/presscorner/detail/en/MEMO\\_18\\_2764](https://ec.europa.eu/commission/presscorner/detail/en/MEMO_18_2764)



## BENOÎT DE LA CHAPELLE BIZOT

Head of Public Affairs and Advisor  
to the Chief Executive Officer - BPCE Group

### Towards a stronger EU leadership in digital finance

The digital transformation of the financial sector has accelerated during the pandemic and continues to be fostered by emerging technologies and changes in customers' expectations. Digital finance is key, as it contributes to the overall transformation of the economy, which is paramount to find new opportunities for growth and development.

With the rise of fintech startups and tech giants, the financial sector faces increased competition through new models of collaboration and innovation, which are based on an open architecture available to external parties. For instance, Bank as a Platform (BAAP) allows customers to benefit from an enriched banking offer, and Bank as a Service (BAAS) provides core banking services via third parties.

The core challenge for digital regulation is to organize and accelerate this natural evolution of the market without undermining the EU's overall competitiveness, the safety of customers, and the stability of the financial sector. And this all depends on how it is designed and implemented.

The EU digital transition being a key priority for the current Commission, an impressive number of new regulations has already been implemented, while many are still under negotiation. The scope of these regulations covers, among others, crypto assets, digital resilience in financial institutions, digital identity, digital platforms, artificial intelligence, blockchains, payments and most recently Open Finance.

Even if we naturally support the priorities of the European Commission's Digital Finance strategy, one of the key questions is whether these numerous regulations will really support the market transformation and not have the unintended consequence to hinder competition.

For instance, we appreciate that the proposal for a Regulation on a framework for Financial Data Access (FIDA) is built around some key principles: a contractual approach between stakeholders for sharing responsibilities and costs, the development of tools to give customers meaningful and effective control over their financial data, and the eligibility rules to make sure that all data intermediaries are subject to authorization and supervision. These principles are important to ensure the level playing field and to secure data sharing while building trust in the ecosystem.

However, we have some concerns regarding both the level of ambition of some provisions and the vagueness of others. FIDA could also have consequences in the competitiveness landscape as it does not provide for any cross-sectoral reciprocity provision and does not prevent "gatekeepers" from accessing data. It could also have an impact on the voluntary ecosystems spontaneously developed by the market.

The cumulative impact for retail banks of various regulatory packages, including FIDA, PSD3 / PSR, the Retail Investment Strategy, and the Digital Euro proposals is also a major concern for us. These regulatory changes could trigger major challenges for retail banks' business model, whose core pillars are both mutualization (universal banks serve all kind of clients) and granularity (universal banks serve all geographical areas).

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**The Commission must now focus on consolidating the existing digital regulation.**

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After a period of intense regulatory activity, the next European Commission should, therefore, focus on consolidating existing regulations and ensuring that they are properly enforced rather than introducing new regulations that may weaken both the competitiveness and profitability of EU financial institutions.

It will be, for example, specifically important to finalize the Level 2 regulation on DORA, MICA, and the soon-to-be-voted IA act to avoid regulatory uncertainty and to allow for a harmonized implementation. The proper implementation of the EU digital identity wallet will also be key, as it will be essential in many digital finance customer journeys. And finally, Europe must not get its Open Finance framework wrong either: the framework is not implementable as it is and should be deeply reviewed.

Boosting European competitiveness should be the top priority for the incoming European mandate. In that perspective, we strongly support Ursula Von der Leyen's decision to ask Mario Draghi to prepare a report on the future of European competitiveness, with proposals to revitalise the European Union's economy in the face of competition from China and the United States.

## CYBER AND DIGITAL OPERATIONAL RESILIENCE



### GERRY CROSS

Director Financial  
Regulation, Policy and Risk -  
Central Bank of Ireland

### DORA – One-step closer to finalization

The European Supervisory Authorities (“the ESAs”), who are tasked with jointly delivering the regulatory standards implementing the DORA ICT risk management framework, have come one-step closer to finalisation. On 17 January 2024, the Chair of the Joint Committee of the ESAs submitted the first batch of finalised DORA Level 2 regulatory standards to the Commission. This marks the first milestone in the DORA implementation, achieved through close collaboration by the ESAs and amongst members of the JC SC DOR, established to deliver these standards.

Prior to finalisation, the first batch of Level 2 policy products underwent a three month public consultation ending in September 2023 and the ESAs received more than 400 comments from interested parties. Following a comprehensive analysis and consideration of these comments, three final Level 2 regulatory technical standards (RTS) on ICT risk management, on major ICT-incident classification and on on ICT services

performed by ICT third-party providers together with one implementation technical standard (ITS) on templates for a register of information (for ICT services provide by third-party providers) are now publically available.

The second batch of policy products is currently in public consultation until 4 March 2024. This batch contains a RTS and an ITS on the content, timelines and templates on incident reporting, a RTS on subcontracting of critical or important functions, a RTS on oversight harmonisation and a RTS on threat-led penetration testing (TLPT). Furthermore, the consultation includes two Guidelines, one on aggregated costs and losses from major incidents and one on the oversight cooperation between ESAs and competent authorities. Stakeholders in the DORA Regulation are invited to take this opportunity to provide important and valued feedback on the draft technical standards and guidelines to ensure a solid policy product that is addressing key ICT risks while also being implementable.

### For 2024, firms should have a strong focus on implementing DORA.

For 2024, firms should have a strong focus on implementing DORA. From industry engagements, we understand that many sectors are already working in this regard and are progressing well in implementing DORA requirements into their ICT processes. However, it is of utmost importance that financial firms from all sectors effected by DORA identify their respective implementation challenges and have a sound implementation plan. In order to do this, all financial firms must have a detailed understanding of the various ICT systems and ICT assets supporting their business functions. In simple terms, firms need to know what ICT they have in order to adequate safeguard their ICT systems and assets in accordance with DORA.

Despite the different implementation efforts and understandings on ICT systems and assets, financial firms in different sectors are likely to have a different ICT risk management maturity that correlates with existing

regulatory requirements. Sectors that currently have no or only light ICT requirements are encouraged to assess the new requirements DORA brings. Sectors where ICT risk management guidelines exist, for example issued by the EBA (Guidelines on ICT and security risk management, 2019) or by EIOPA (Guidelines on information and communication technology security and governance, 2020), need to perform a gap-analysis to identify additional requirements stemming from DORA.

DORA’s oversight framework for critical third-party providers (CTTP) of ICT services to financial entities is currently been developed. The ESAs in collaboration with competent authorities are continuing to focus on developing organisational structures to deliver the CTTP oversight. A cross-ESA high-level group of senior members has been establish to drive forward the organisational aspect of the CTTP oversight, while the JC SC DOR continues to focus on policy work. A crucial tool will be the aforementioned register of information, finalised this January, and ESAs together with National Competent authorities are developing the necessary ICT infrastructures to collect and analyse ICT services provide by third-party providers to allow the designation of CTTPs.





## FRANÇOIS- LOUIS MICHAUD

Executive Director - European  
Banking Authority (EBA)

### The ESAs are getting ready for the implementation of DORA

The Digital Operational Resilience Act (DORA) will increase convergence and efficiency in supervisory approaches when addressing ICT third-party risk in the financial sector. Its implementation requires from the European Supervisory Authorities (ESAs – EBA, ESMA and EIOPA) to: (i) develop the adequate policy mandates and (ii) establish the oversight framework over critical third-party providers (CTPPs).

In 2023, the ESAs have advanced a wide range of policy mandates to detail the requirements for ICT risk management, the classification of ICT incidents, the ICT third-party service providers' policies and the template for the register of information. The final reports on these instruments were published and delivered to the European Commission in January. They build on the feedback received from stakeholders (e.g. on proportionality, complexity and the degree of prescriptiveness).

First, proportionate rules and a principle-based approach were applied for the regulatory technical standards (RTS) on ICT risk management

framework which now allow for further flexibility, more streamlined requirements and additional clarity. Similarly, in the RTS on ICT incident classification, smaller and non-complex entities have been exempted from the application of some requirements and many proposed classification thresholds increased. Second, regarding the overall complexity and prescriptiveness of the mandates, the RTS on risk management framework now integrates a risk-based approach by referring only to critical or important functions, or to ICT assets supporting critical or important functions'. In the same vein, the classification approach and criteria for major incidents have been simplified and streamlined to limit the burden to financial entities, focusing more on the impact of the incident.

The second set of policy products was published for consultation in December 2023 and will be finalised in July this year. This will complement the ICT-related incident reporting framework, provide further details on ICT sub-contracting and on threatened penetration testing, as well as specify some of the requirements of the oversight framework. The ESAs expect the high-level of engagement from stakeholders (financial entities, industry representatives, associations) observed thus far will continue, to ensure that the policy products will be fit for purpose. Once all DORA policy mandates are available, the attention will turn to supervisors and the ESAs, for ensuring a convergent application of the new requirements for the financial entities.

The ESAs are now focusing on the operational set-up of the oversight and beyond, which includes the reporting of major ICT-related incidents and the set-up of information sharing mechanisms, to be ready for the application of DORA in January 2025. The ESAs have been preparing for this novel oversight framework in various ways, and ran a high-level survey to start map the provision of ICT services to the EU financial entities by ICT TPPs<sup>2</sup>.

Their report identified around 15,000 ICT TPPs directly serving financial sector entities and showed that the frequently used ICT TPPs directly support many critical or important functions and provide a large range of services (e.g. software, network infrastructure, data centres, cloud computing and data analysis).

Second, the ESAs have engaged with financial entities, overseers and supervisors on the expectations for oversight framework, the risks posed by ICT TPPs to the financial sector and

how these risks are currently assessed and mitigated.

Third, the ESAs are working closely together with supervisory authorities to establish a new common oversight framework, whereby one ESA will be designated as Lead Overseer for each of the CTPPs. This entails intensive work on new sets of processes and procedures, including the designation of the CTPPs, the conduct of general investigations and on-site inspections and the issuance of recommendations to CTPPs.

### In 2024, European Supervisory Authorities will be focussing on the DORA oversight set-up.

Finally, the increasing interconnect- edness of the financial sector requires supervisors to coordinate swiftly their actions in case of cyber-threats. The ESRB highlighted in a Recommendation the need for a coordination framework for systemic cyber incidents, inviting the ESAs to start preparing for its development, building on one of their roles under DORA, i.e. to develop communication channels to enable a coordinated response to ICT incidents with systemic impacts on the financial sector. The ESAs are setting up this framework, assessing synergies with other frameworks across the EU and already anticipating the supervisory community's need to intensify efforts in the identification and prevention of cyber risks, coordinating activities such as crisis management and contingency exercises.

1. Article 3(22) of DORA defines critical or important function as "a function, the disruption of which would materially impair the financial performance of a financial entity, or the soundness or continuity of its services and activities, or the discontinued, defective or failed performance of that function would materially impair the continuing compliance of a financial entity with the conditions and obligations of its authorisation, or with its other obligations under applicable financial services law".
2. See ESAs Report on the landscape of ICT third-party providers in the EU. The analysis was carried out on the basis of voluntary information provided by a sample of entities across the EU financial sectors.



## DENIS BEAU

First Deputy Governor -  
Banque de France

### DORA: 2024, a decisive year for a successful implementation

DORA “level 2” acts are under finalization. They end a successful rulemaking process, despite a constrained timeline. With technical standards on track, public and market actors must now overcome operational challenges, linked to resources and IT systems, to turn DORA into a reality. Considering DORA’s enforcement starts in January 2025, prompt identification of strategic priorities is necessary for timely readiness.

DORA rightly levels up resilience requirements in a context of rising cyber threats, which can have system-wide destabilizing impacts. The recent ransomware attack against the US subsidiary of the Chinese bank ICBC which impacted the T-bill market liquidity, could have been not a so gentle reminder had the parent company not injected emergency capital. Under DORA, the main responsibility for enhancing operational and cyber resilience lies with financial entities. They must take necessary measures to align their governance and risk-management procedures with the new standards. 2024 is also the last year for them to review their existing contractual arrangements with third-party providers and make them compliant with DORA mandatory clauses, to help ensure more balanced contractual relationships.

Moving on to public authorities, one major challenge to make DORA work is to set up a fully operational reporting system by January 2025. For instance, the framework for incident and cyber threat notification and response is likely to generate a complex reporting architecture, as it requires coordination between multiple financial, NIS and enforcement authorities with various missions. All options for streamlining it, to inform the right people at the right time, should be pursued rapidly, such as dual and harmonized reporting from financial entities to DORA and NIS authorities. Large scale cyber crisis exercises, an increasingly common practice, will be inevitable here to ensure an effective setup. Another significant task relates to contractual registers of information, which will be crucial for mapping service providers within the supply chain and identifying the critical ones; they will also be used as the main database for critical third-party ICT-service providers (CTPP) supervision.

While financial entities should expect the reporting template to be comprehensive and prepare to manage this requirement, supervisors need to develop appropriate tools to process this data flow. European shared platforms are obviously preferable to fragmented systems with 27 national legs. We therefore call for promptly agreeing on efficient transmission hubs and workable formats for swift information sharing.

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**With technical standards on track, public and market actors must now overcome operational challenges.**

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Supervisors will have a brand new mission in the oversight of CTPPs. Compliance and preparation challenges are maximal: authorities need to start their oversight tasks as soon as possible, by 2025, since the dependencies on major providers are already critical for EU’s financial stability and sovereignty. Two drivers will be key to build the oversight framework.

First, technical standards should sufficiently empower public authorities to deliver on their oversight mandate; this is one of the most important issues of the public consultation.

Second, EU authorities will have to allocate adequate staff and expertise to the Joint Examination Teams (JETs)

in charge of overseeing CTPPs. This effort will be substantial in the current resources-limited environment. This requires a considerable amount of preparatory work with ESAs and NCAs to agree on a target organization, pooled sources and common operating methodologies and tools in the course of 2024.

Last but not least, getting ready for the oversight framework is a big challenge for service providers. Major players, which are likely to be designated as CTPP, should take advantage of 2024 and proactively tackle their preparedness issues. Indeed, in the upcoming more supervised ICT market, those who provide high-quality and secure services will benefit from a competitive advantage. In parallel, it is only natural that authorities shortly give a first taste of their expectations to CTPPs to fuel the supervisory dialogue.

In the longer run, an enlargement of DORA’s scope will be worth considering. It could make sense to use the review clause to extend DORA’s requirements to other critical areas of the EU financial sector, such as payment systems and payment technical providers.



## ANNELI TUOMINEN

Member of the Supervisory  
Board - European  
Central Bank (ECB)

### Digital Operational Resilience Act: the next step in a connected digital world

The Digital Operational Resilience Act (DORA) aims to achieve a high common level of digital operational resilience across European financial entities. This is a welcome step in an increasingly connected world that is ever more exposed to cross-border information and communication Technology (ICT) risks and cyber risks.

The Act lays down requirements for ICT risk management, reporting major ICT-related incidents to supervisory authorities, digital operational resilience testing and the sound management of ICT third party risk. It provides a direct legislative basis for the work we have been performing for several years as part of our supervisory priorities<sup>1</sup>, including collecting information on cyber incidents from banks. In addition, it establishes an oversight framework for critical ICT third party service providers.

The joint committee of the European Supervisory Authorities submitted the first set of final draft technical

standards to the European Commission, addressing items such as ICT and third party risk management as well as incident reporting frameworks.<sup>2</sup> The ECB welcomes these final draft technical standards. Given the tight timeline for developing the legislation and its potentially complex implementation, I believe that stakeholders may find it challenging to meet all the requirements in a timely manner, particularly the new ones relating to threat-led penetration testing (TLPT) and oversight of critical third party providers (CTPPs).

However, there are ways of facilitating a successful outcome, including interaction with stakeholders, which will be key. For example, oversight of CTPPs will be an important addition to the regulatory and supervisory framework. The criteria used to define the list of CTPPs will be very important. It will therefore be essential to involve the relevant stakeholders at this stage. At this juncture, it may also be worth considering consistency and interoperability between authorities from other jurisdictions. In addition, oversight of CTPPs will require close monitoring and possibly on-site inspections similar to those carried out for financial intermediaries. It is important that CTPPs will be ready to take part in these discussions.

**DORA is a step in the  
right direction, that will  
help us manage ICT and  
cyber risk together.**

Regarding the set up and organisation of the work of the joint examination teams (JETs), we will need to go through a full oversight cycle before we are able to establish a comprehensive operating process for them. Further clarification on the number of CTPPs and the type of resources needed, for instance, could help to ensure that the competent authorities provide the appropriate level of support. By building on their shared experience, regulators and supervisors should ensure that priorities for the JETs are correctly established. They should also ensure the teams have the requisite balance of competencies and flexibility to perform the tasks assigned to them. How the teams actually operate is likely to evolve over time.

DORA will have a significant impact on banking supervision activities. First, supervisory practices will have to adapt to overseeing new types of entities and working in a new operating environment where innovation is continuous and

driven largely by technology. Second, the Act will help to reinforce supervisory activities. For instance, as mentioned earlier, it will help to improve the cyber-incident reporting framework in place since 2017 by streamlining it and making it more consistent. DORA will also create several new tasks, including conducting TLPT and the contribution to JETs in charge of the oversight of critical third party service providers.

To perform these tasks, we will need to update the existing methodologies and toolkits used to supervise ICT risk and monitor the impact of technology on business models. The improved understanding of ICT risk introduced by DORA will need to be integrated into the overall supervisory view on banks' safety and soundness. A specific approach will be needed for CTPPs due to their specific technical nature and the additional amount of work overseeing them is likely to generate.

Finally, let me add that a mechanism for sharing information and achieving a common level of digital resilience is very important since digitalisation affects operational resilience and banks become more dependent on third party service providers. At the same time, we should not forget that having DORA in place, does not mean that all risks are managed. We need to closely monitor the evolution of more sophisticated cyber threats originated by criminal and government attackers. DORA is a step in the right direction that will help us rise to these challenges together.

1. ECB Banking Supervision (2023), "SSM supervisory priorities for 2024-2026".
2. Joint Committee of the European Supervisory Authorities (2024), "Final report - Draft Regulatory Technical Standards to further harmonise ICT risk management tools, methods, processes and policies as mandated under Articles 15 and 16(3) of Regulation (EU) 2022/2554", January.



## FERNANDO RESTOY

Chair - Financial Stability Institute (FSI)

### The oversight of CTPP: the need for further international consistency

Despite recent developments in several jurisdictions, including the EU, the prevalent approach is an indirect oversight approach, in which financial institutions are expected to manage their risks arising from acquiring third-party services. The regulatory and supervisory focus therefore is on the assessment of the adequacy of financial institutions' outsourcing and contractual frameworks. These frameworks should ensure that financial institutions have, among other things, an assurance process regarding third parties' operational resilience.

This indirect oversight approach is not enough to address potential systemic risks arising from critical third parties. The FSB recognises this limitation of the approach but notes that many financial authorities may not have the legal powers to adopt a direct approach. The FSB report on third-party risk management and oversight therefore proposes some tools to help financial authorities identify systemic third-party dependencies and spot and manage potential systemic risks.

However, authorities in a few jurisdictions are moving towards a more direct oversight approach. The Digital Operational Resilience Act (DORA) in the EU is an example. Those jurisdictions that have implemented or are in the process of implementing a direct oversight approach need to address a few practical challenges.

At the national level, authorities need to keep financial institutions incentivised to take third-party risk management seriously, despite the fact that critical third parties are already subject to oversight by financial authorities. This can be addressed by regular assessments by financial authorities of their third-party risk management.

In addition, the oversight of critical third parties should not just be a dialogue between the authorities and the third parties. There should be regular interaction that involves the financial institutions. This way, all parties will have a common understanding of the authorities' concerns and expectations, how they are addressed by critical service providers and how they should inform financial institutions' risk management.

It is also important to avoid subjecting critical third parties to multiple assurance processes – from financial institutions (because of the requirements under the indirect approach) and from the competent authorities. In that regard, coordination with other relevant national authorities that also oversee critical third parties in the financial sector is important. Indeed, in some jurisdictions there may be national frameworks for critical infrastructures and critical third parties outside the remit of financial authorities (eg Australia's Security of Critical Infrastructure Act 2018).

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**For global third-party critical service providers, there may be a need for a global oversight regime.**

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At the cross-border level, differences in approaches have implications for the scope for fruitful coordination. That justifies the DORA requirement for critical third parties to establish subsidiaries to facilitate enforcement actions. It is deemed that "there are no suitable alternative mechanisms... by way of effective cooperation with financial supervisors in third countries" given that there is an "absence of comparable arrangements in other jurisdictions...". Yet, at the same time,

in exercising its relevant powers in third countries (ie for critical third parties that provide services to EU financial institutions from outside the EU), DORA states that relevant authorities of the third country should be informed of, and not have objected to, the exercise on their own territory of the activities of the EU Lead Overseer.

That points to the need to further develop mechanisms to facilitate international cooperation. This includes the establishment of a global methodology for identifying critical third parties and of global resilience standards for critical third parties.

Furthermore, for third parties that may be critical across multiple jurisdictions, there is a special need to adopt a robust oversight regime entailing the coordinated participation of relevant national authorities working under mutually agreed procedures and distribution of functions. That global oversight regime, which could take the one currently applied to Swift as a reference, should foresee regular cross-border resilience testing.



## PAOLO CARCANO

Partner -

PricewaterhouseCoopers  
Business Services S.r.l.

### How DORA & RTS shift the business paradigm of IT & Cyber Risk

#### Ensuring Digital Resilience: DORA & RTS as catalysts for Financial Services

In response to the dynamic shifts in the market and the evolving landscape of cyber threats, European regulatory bodies have taken decisive actions to shape a future where financial institutions stand more resilient against digital risks. Leading this charge is the DORA, enacted by the EU Commission in 2022 and slated to be directly applicable from January 2025. DORA mandates specific cybersecurity measures for financial entities operating in Europe, ensuring their readiness to prevent, withstand, and respond to potential cyber threats.

DORA presents itself as a highly sophisticated regulatory framework. To reinforce these efforts, the European Supervisory Authorities (ESAs) are issuing additional norms, including Regulatory Technical Standards (RTS), Implementing Technical Standards (ITS), and Guidelines (GL). Furthermore, the ECB is also publishing additional regulations. Notable among these are the *Cyber Stress Test* (crafted to fortify the

*resilience of the financial system, the Cyber Stress Test involves the implementation of a series of supervisory controls) and the TIBER-EU Framework (aims to enhance cyber resilience through controlled cyber-attacks).*

Together, these measures meticulously outline indispensable organizational and technological requirements for effectively managing relevant threats, with a particular focus on the ransomware threat, transforming DORA from a conceptual idea into a tangible reality. The DORA is thus situated among a series of complex regulations that European regulatory bodies have been implementing in recent years, even addressing highly innovative themes.

Notable among these are the *AI Act* (which establishes ethical guidelines for AI systems, emphasizing human control and cybersecurity), the *Digital Services Act*, and *Digital Markets Act* (aimed at ensuring digital security, protecting user rights, and promoting fair competition).

#### DORA & RTS reshapes ICT & Cyber Risk by prioritizing end customer trust.

#### Cybersecurity trends in EU: escalating threat landscape

The numerous regulations introduced by European regulatory bodies are clearly reflected in alarming threat intelligence analyses. Over the years, these analyses have highlighted a growing trend of cyber attacks and an increase in the number of victims. Moreover, the World Economic Forum's "Global Risk Report 2023" predicts a complex and catastrophic cyber attack on the entire European financial system by 2025. Additionally, the WEF has also studied the ongoing rise in economic damages caused by cybercrime: from \$3 trillion in 2015 to \$6 trillion in 2021, with the potential to reach \$10.5 trillion annually by 2025. The critical role of European regulations becomes evident in the face of a growing cyber threat. In light of this data, the implementation of DORA, RTS, and regulations issued by the ECB becomes crucial in addressing threats and safeguarding the European financial system.

#### ECB Cyber Stress Test as the first practical application of DORA pillars for banking sector

DORA requires financial institutions to review their organizational models to

ensure a strengthened involvement of top management in strategic decision-making and risk assessments. This involves securing adequate financial and organizational resources based on strategic choices and risk evaluations. However, it is important to emphasize that the commitment required by DORA goes beyond corporate leadership, involving business functions as well and setting priorities for the implementation of resilience solutions.

DORA is revolutionizing the landscape of ICT and cyber risks by placing the end customer at the forefront and ensuring trust in financial services. In this contest, the traditional Disaster Recovery (DR) and Business Continuity (BC) plans, designed primarily for scenarios affecting availability are now deemed inadequate.

DORA and Cyber Stress Tests both highlight the risk of data integrity loss, rather than solely focusing on their unavailability resulting from ransomware attacks. This risk materializes because systems are often restored after an attack using a non-real-time-synced backup, requiring data reconciliation actions that may extend over several days. These extended RTOs translate into significant economic and reputational impacts. Therefore, appropriate contingency solutions should be implemented during such RTO periods.

From our standpoint, the 2024 ECB Cyber Resilience Stress Test has challenged European banks with a scenario of core system disruption lasting an average of three days, peaking up to seven days. This scenario demands a profound reevaluation of recovery solutions, where Business functions are tasked with defining new contingency measures capable of safeguarding client interests. The subsequent impact assessments reach significant values, against which the investments in IT and cyber resilience mandated by DORA find a deep business justification.



## CHARLOTTE HOGG

Executive Vice President  
and Chief Executive  
Officer - Visa Europe

### Increasing digitalization requires a considered stock-take of cyber and operational resilience

Over the last decade, a steady stream of innovation has made digital payments easier and more convenient for everyone. We pride ourselves on the knowledge that a Visa transaction will always work. Visa performs as close to perfect reliability as is possible in our industry – or any – something which requires an enormous amount of careful investment and management.

To underscore the scale of this achievement; the Visa network handles up to 65,000 transactions a second, all of which have 27 different routing options, across digital and physical network infrastructure which could stretch around the world over 400 times to ensure payments work seamlessly for merchants and consumers in real time. This contribution to Europe's payments landscape is something we are rightly proud of.

This does not however mean that we are complacent about cyber and operational resilience. Our response is

constantly evolving, underscored by €8 billion in technology investments over the past five years and over a thousand cybersecurity specialists to deliver on our availability and resilience promise. Visa is also a first mover in leveraging the benefits of AI and data infrastructure, already having invested €2.5 billion towards risk management in the past decade. Responding to the constantly changing and increasingly borderless cyber attackers remains a challenge – for example, cyber terrorists can coordinate ATM runs across multiple jurisdictions, from another part of the world, in real time which require leveraging global data to detect and respond to them. Through a complex interlinking of innovation and expertise, we have been able to reduce fraudulent Visa transactions to less than 0.1% across Visa transactions – a historic low – preventing over €20 billion in fraud annually.

Visa's payment network is built around the truism that everything that can break at internet scale will break – and therefore, you cater to that with what we call pessimistic design. This means building the network in a manner that can handle a lot of unexpected turbulence – like natural disasters, technology disruptions, cyber threats – but also a sudden surge in demand for digital payments, as we have witnessed over the past few years. What we learnt from the complex threat landscape is that our network continues to be highly resilient.

In Europe, political appetite is growing for regional alternatives to global payment networks like Visa to reduce overreliance on certain or global networks. Whilst an important concern, developments must ensure there remains many options available to Europe's consumers and merchants to prevent a single point of failure and to ensure the best resilience practices are available to Europeans. We consider a well-functioning European payment landscape to be a shared goal with policymakers and want to contribute through our expertise and network to make this a success.

As the tech gets better, we also observe criminals focusing on the weakest link in the payments chain - people. Scams are increasingly sophisticated, and anyone can be caught out. To mitigate this on our network Visa is working with clients to educate consumers – and make sure they can get their money back.

Other networks face different challenges. Instant credit transfer transactions volume is growing in Europe but faces a heightened vulnerability to fraud due to faster settlement times. For example, instant payments can be a lot like sending

cash in the sense that once you send it, it's gone. If you are duped into sending money to someone misrepresenting their identity, that money may be gone forever. Similar challenges exist in crypto and digital currencies, where there is no "claw back" mechanism if you make a transfer to some anonymous scammer's wallet. When using any of these new technologies, it's important to know who exactly you're dealing with on the other end of the transaction.

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**As the tech gets better, we also observe criminals focusing on the weakest link in the payments chain – people.**

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European regulation is setting new parameters to level up risk and fraud management across the financial services sector as well as providing regulators with more insight on current risk management practices employed by firms today. Nevertheless, the levels of sophistication and the level of the best performing sectors, like payments, is the product of many years of innovation and expertise. It is important regulatory frameworks remain proportionate, principle based and reduce duplication where possible to give firms the necessary flexibility and focus on achieving the best resilience possible.

We are however optimistic about the current regulatory approach and Visa stands ready and confident to meet our clients' expectations in meeting the new requirements.

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## EU AI AND DATA FRAMEWORKS



### FAUSTO PARENTE

Executive Director - European Insurance and Occupational Pensions Authority (EIOPA)

## The AI Act and its impacts on the European financial sector

With the adoption of the Artificial Intelligence (AI) Act, the European Union has positioned itself at the forefront of AI regulation from a global perspective. While the AI Act is an important milestone, much remains to be done to implement it, to promote the responsible use of AI in the financial sector, and to enable European citizens to harness the benefits of AI and the data economy.

The AI Act will impact the financial sector in a number of ways. On the one hand, AI-based creditworthiness assessments by banks, as well as pricing and risk assessments in life and health insurance are considered high-risk AI use cases and will therefore have to comply with heightened requirements for such AI applications.

These requirements are expected to be further developed by European

standardisation bodies. Subsequently, national competent authorities (NCAs) will need to ensure that financial institutions comply with the new AI governance and risk management requirements and standards, while assessing the extent to which more detailed sectoral guidance may be required for these AI use cases.

The AI Act will also introduce new requirements for so-called general purpose AI systems, including large language models and generative AI applications. Working closely with service providers such as Bigtechs, financial institutions are already experimenting with these new tools and assessing how they can take advantage of the significant opportunities they offer. The expectation is that these tools will become mainstream rather soon.

The European Commission's new AI Office, which will be responsible for enforcing and overseeing the new rules for general-purpose AI systems, should ensure that service providers fulfil their responsibilities and assist users in implementing these systems. Under sectorial legislation financial institutions remain ultimately responsible for the tools and services they outsource. The oversight framework set out in the Digital Operational Resilience Act (DORA) for so-called "critical third-party service providers" could be useful here.

### Balancing innovation, risks, and consumer control is fundamental to responsible AI adoption.

The remaining uses of AI in the financial services sector would largely be developed and used in accordance with existing legislation, without additional legal obligations arising from the AI Act. Given that the use of AI in use cases such as claims management, anti-money laundering or fraud detection in the financial services industry is already quite extensive, supervisors need to assess the extent to which existing rules are sufficient and where additional guidance may be needed for specific use cases. This would take into account considerations such as proportionality, fairness, explainability and accountability.

From another perspective, the European data strategy, which includes legislation such as the Data Act and the Data Governance Act, also plays a key role in shaping the landscape for the use of AI in the European financial sector. It facilitates the re-use of public sector databases or access to private datasets from connected devices, such as health wearables or connected cars, which could enable financial institutions to develop more innovative and tailored products and services, thereby making broadening competition in access to and use of data.

This is also the aim of the proposed Financial Data Access (FiDA) regulation, which will open consumers' data held by financial institutions to third parties. In the insurance sector FIDA could facilitate the development of insurance dashboards, where consumers can access information about their insurance products from different providers on a single platform. This could potentially increase competition and enable consumers to make more informed choices.

Open questions remain about what data should be made available, how it is used, and on consumer protection. These will need to be addressed during the legislative process. Financial institutions should not be disadvantaged compared to non-financial ones, and consumer should always remain in effective control of where their data goes and how it is used.

NCAs will need to ensure that they integrate these new frameworks into their day-to-day supervisory activities. To this end, initiatives such as the ESA's Digital Finance Supervisory Academy can bring economies of scale and support more agile up-skilling. In addition, NCAs should also progressively embrace the use of new technologies for supervisory purposes (Suptech), for instance deriving actionable insights from large datasets through AI.

Finally, it is also important to promote convergence, taking into account emergent European regulation, at the international level, as the International Association of Insurance Supervisors (IAIS) expects to do with the development of an AI application paper in the course of 2024.





## TSVETELINA PENKOVA

MEP, Committee on Industry,  
Research and Energy -  
European Parliament

### AI Act and European data strategy - Supporting the uptake of AI in finance

In the ever-evolving landscape of technology, data has emerged as a pivotal resource capable of driving value creation, fostering innovation, and reshaping entire industries. The financial services sector, in particular, stands to benefit significantly from harnessing the power of data. As financial institutions collect and analyse customer data, opportunities arise for the creation of innovative products and services, streamlining internal processes, and reducing operational costs. With the increasing migration of socio-economic activities to the digital realm, the EU has responded with legislative initiatives such as the AI Act and the European data strategy to provide a comprehensive framework for supporting the uptake of AI in finance.

Financial services companies are increasingly relying on data to develop innovative products and services, thereby boosting revenue streams. Moreover, data-driven optimisation

enables these institutions to streamline internal processes, leading to lower operational costs. The exploitation of data promises to create value across various operations, from optimising global manufacturing value chains to enhancing energy and resource efficiency through smart technologies.

The EU recognises the transformative power of data-driven innovation in fostering growth, resource efficiency, economic competitiveness, and social well-being. It is a crucial component for achieving the goals of the twin transition. As we grapple with global challenges, such as energy efficiency and economic competitiveness, the EU sees data-driven innovation as a driving force towards solutions.

Thus, the deployment of artificial intelligence in finance holds the promise of driving competitive advantages for the entire financial sector through new finance solutions. However, the adoption of these technologies introduces potential risks, both financial and non-financial, as well as concerns related to consumer trust.

Recognising the transformative potential of AI and the associated risks, the EU has introduced legislative frameworks, most notably through the AI Act and the European data strategy. These frameworks aim to ensure transparency, accessibility, and human oversight in the development and deployment of AI systems in the financial sector. By fostering a secure and customer-friendly environment, EU legislation strives to strike a balance between promoting innovation and growth and minimising associated risks.

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**The EU recognises the  
transformative power of  
data-driven innovation  
in fostering growth.**

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The AI Act plays a pivotal role in facilitating and encouraging the use of AI in the financial sector. By mandating transparency, it seeks to build a foundation for responsible AI deployment. The act addresses concerns related to ethical AI use, data privacy, and security, emphasising the importance of balancing automation with human expertise. In doing so, it not only supports the growth of the financial sector but also ensures the minimisation of associated risks.

In tandem with the AI Act, the Data strategy is poised to unlock even more

data, fostering increased competition in the data market. This not only benefits established financial institutions but also creates opportunities for smaller players and newcomers to thrive in the financial landscape. The broader access to data encourages innovation and ensures that a wider array of market participants can contribute to the evolving financial ecosystem.

The AI Act and the European data strategy represent critical steps in providing a comprehensive framework for the responsible adoption of AI in finance. These legislative frameworks aim to build trust among consumers and foster an environment conducive to innovation and growth.

As we navigate the future, these regulatory measures position the EU at the forefront of shaping a digital financial landscape that balances technological advancement with ethical considerations.



## CAROLINE CASEY

General Manager Customer Experience and Innovation - Moody's Analytics

### Balancing act: navigating AI deployment in financial services and beyond

#### Rules for AI deployment

Artificial intelligence (AI) has continually evolved since its origins in the 1950s, with big advances in fields such as machine learning, deep learning, and more recently generative AI (GenAI)

GenAI can generate content such as text, images, code, video, audio or synthetic data. OpenAI's ChatGPT was released in November 2022 and changed the game by making GenAI accessible to a broad audience thanks to a chat-based interface with GPT3.5. It garnered 100 million users within two months, making it the fastest growing application in history.

#### Limitless applications

The highly engaging and user-friendly interface [of ChatGPT/GenAI] significantly democratizes access to AI technology.

Any individual, even with minimal technical skills, can harness its power,

facilitating its rapid adoption. This has led to the discovery of innovative ways to streamline existing workflows and develop solutions that were not previously feasible.

There are limitless use cases for GenAI in the financial sector, particularly due to its ability to analyse and interpret large data sets. There are also use cases that are relevant across sectors, these include streamlining customer service efforts and directly interfacing with customers in new ways with highly tailored responses, augmenting developer workflows with coding assistants, enhancing sales efforts by identifying leads and tailoring pitches, and devising marketing materials including images, video and audio.

Moody's Annual Innovation Survey 2023 identified key finance sector use cases as the following: loan origination and underwriting, risk assessment and management, along with compliance and reporting.

**GenAI has immense potential in finance due to its ability to analyse and interpret large datasets.**

GenAI has immense potential in finance, but it also presents certain risks, including the possibility of algorithmic bias and concerns about data privacy. This means a regulatory framework is needed that balances the need for innovation with risk mitigation. The European Union's proposed AI Act is a significant step in this direction. It aligns with Europe's Single Digital Market and aims to provide a safe and unified environment for businesses to navigate AI technologies.

#### Evolving regulations

The AI Act aims to ensure a human-centric and ethical development of AI and provides for certain transparency and risk-management rules for AI-systems in the EU, with a focus on AI systems used by big tech companies. However, the dynamic nature of AI necessitates a future-proof regulatory framework. The AI Act provides a good starting point but, it will need to evolve continuously to keep pace with technological advancements.

This will require an ongoing dialogue between policymakers, industry stakeholders, and technology partners.

Importantly, organizations will need to ensure their tech partners are actively aligning with the AI Act, similar to requirements for GDPR or DORA.

Financial firms should also devise their own guardrails. This includes the need for putting in place controls around intellectual property and ensuring datasets are not inappropriately or inadvertently used to train large language models. Furthermore, financial institutions should be vigilant to prevent AI-generated hallucinations that could potentially mislead customers. This involves implementing measures to identify and mitigate any instances where the AI system might produce inaccurate or misleading information, especially when clients are relying on GenAI solutions. By setting clear guidelines and controls, financial firms can enhance the responsible and ethical use of AI, fostering trust and reliability in their AI-driven processes. Approaches like Retrieval Augmented Generation can be leveraged to reduce these risks.

#### Creating guardrails

In the process of developing AI solutions, organizations should be attentive to comparing their outputs against traditional or classical approaches. This entails employing techniques like "red teaming," a practice where external experts critically assess and challenge the system, and engaging in continuous testing. This iterative evaluation is essential, especially as technology evolves, to ensure that the AI system's performance is measured against established benchmarks and validated against established methodologies or industry standards.

Moody's has long been a pioneer in using AI, natural language processing and machine learning to build advanced credit risk models and extra data that delivers value and impact for our customers, and we've embedded the best guardrails above in our own principles for using AI responsibly.

Overall, it will be a fine balance for policymakers to provide an appropriate framework which instils confidence in AI for consumers and corporations, whilst avoiding stifling innovation or the ability of smaller players to enter the space.



## JON ANDER BERACOECHEA ÁLAVA

Chief Scientist - Banco Bilbao  
Vizcaya Argentaria (BBVA)

### It's been a hectic year for AI. It's only the beginning.

The buzz around Artificial Intelligence is impossible to ignore. It's everywhere, and at times, it feels like the hype is spiraling out of control. But here's the catch: despite the noise, the rapid pace of AI advancements points to real, profound changes in the financial industry. This isn't just talk; it's a reality unfolding before us.

At BBVA, we recognize AI's transformative potential and have integrated it as an essential part of our strategy. We're, effectively, on a journey where the road ahead is paved with algorithmic intelligence. From client identification and onboarding to sophisticated marketing strategies, AI has become indispensable. It enhances our fraud detection capabilities, sharpens our market-making strategies, and refines financial forecasting. It plays a pivotal role in augmenting the financial health of our clients and strengthening our anti-money laundering measures. Not everything relies on ultra sophisticated algorithms necessarily but the trend is clear and the trend will not stop.

#### The advent of Large Language Models (LLMs)

2023 has certainly been a strange year for us. Exciting and, at times, surreal.

No matter how you look at it, the introduction of LLMs is a game-changer. The ability of LLMs to understand and interpret human language, paves the way for many revolutionary applications in customer interaction and internal process optimization. The speed at which these innovations are happening is breathtaking and, given that the pace is maintained, one can easily see the rise of a very different financial industry in the not so distant future.

In this context, the task of regulating and controlling AI, particularly following the advent of LLMs, becomes crucial. It's about striking the right balance – ensuring innovation isn't stifled while keeping a tight rein on the potential risks.

#### The AI Act: balancing innovation and control

We consider the European AI Act to be a significant advancement. Regulating AI presents inherent challenges, especially in light of the ongoing debate regarding its definition. Nonetheless, the AI Act's risk-based approach seems balanced, in principle. It aims to create trust and legal certainty and enable its practical implementation. It rightly focuses on the applications of AI, ensuring that any potentially hazardous use is either prohibited or subject to stringent controls.

Having said that, there is a long road ahead. On the one hand, authorities will play a key role in the implementation of the regulation and its real impact on the development and adoption of AI by companies. On the other hand, the regulation of LLMs under the AI Act requires particular attention. These models, due to their inherent complexity and wide-ranging applications, necessitate a nuanced regulatory approach. While the Act makes strides in promoting reinforced transparency –which we certainly welcome–, its practical application would be subject to the scrutiny of bodies with no background in this field. This could lead to implementation challenges that could hinder the development of the technology in the continent.

#### Data accessibility: The Key to Unlocking AI's Potential

Regulating and controlling AI is not the only area that deserves political attention. Another crucial aspect of leveraging AI is the access to client data, which is essential for training models and applying data analytics. In this context, policies on data portability and third-party access to user data must adopt a cross-sectoral approach. Such an approach prevents competitive asymmetries and acknowledges the blurring boundaries between different sectors in a digital world.

#### Looking Ahead: priorities for the next political cycle

As we navigate this landscape, policymakers should focus on the following priorities:

- **Clarification and implementation:** We need further clarity on the nuances of the AI Act and its implementation, ensuring that it is consistent with existing financial regulations and is implemented homogeneously across the EU.
- **Promoting AI as a growth driver:** Europe must not only lead in regulating AI but also in its development and application. This requires a balanced approach that fosters innovation while ensuring responsible use.
- **Cross-sectoral data policies:** Emphasizing the need for cross-sectoral data policies will be crucial.
- **Strengthening AI literacy:** Building a workforce that is AI-literate and capable of adapting to new technologies will be essential for the banking sector and Europe as a whole.

**We need to ensure  
that the AI Act is  
consistent with existing  
financial regulations.**

In conclusion, at BBVA, while we celebrate our achievements in integrating AI, we acknowledge the long road ahead. The transformative effect of AI is undeniable, and navigating this journey requires a collaborative approach between the banking sector, regulators, and policymakers. Together, we can ensure that AI not only drives growth but also upholds the highest standards of security, ethics, and equity in the European banking sector.

## CRYPTO REGULATION



### MARTIN MOLONEY

Secretary General -  
International Organization of  
Securities Commissions (IOSCO)

## A CDA implementation roadmap, towards similar outcomes in an evolving environment

In less than 18 months, IOSCO's recommended approach for crypto-assets markets for regulation and supervision, including Decentralized Finance (DeFi), have been delivered with unanimous support from the regulatory community. We published our two sets of Policy Recommendations on Crypto and Digital Asset (CDA) Markets and DeFi, along with an Umbrella Note in the final months of 2023.

By issuing these recommendations, we are helping securities regulators apply relevant existing IOSCO objectives, principles, standards, recommendations and good practices, which will promote greater consistency in the regulation and oversight of crypto-asset activities.

As we have delivered on our ambitious policy-focused Crypto-Asset Roadmap, we now turn our attention to helping jurisdictions globally – spanning the wide IOSCO membership – work to effectively implement these Recommendations into their local regulatory frameworks.

Some jurisdictions already have appropriate regulatory frameworks, and the task is about supervision and international cooperation. Some jurisdictions have bespoke regimes but need to assess whether those meet our recommendations. Some jurisdictions are in the process of building out their crypto regimes and can use our recommendations to finalise that.

We have developed a three-year Implementation Roadmap which will pave the way for a fully embedded approach to assessing implementation of our recommended approach through our Assessment Committee by 2027.

Our initial focus will be on the implementation of the CDA Recommendations so that the large crypto markets are better regulated.

In relation to the DeFi Recommendations, efforts will focus more on helping regulators to assess the new products that are emerging.

Our global membership enables us to promote ever more intensive cross border cooperation among regulators and this is an essential part of our approach to tackling the inherently global crypto market.

Will we achieve a sufficiently consistent global approach? Regulatory initiatives are either under way or at implementation stage in all G20 countries – the EU's own MICA of course came into force in June 2023, although will not apply until the end of 2024 – but the picture is blurrier where emerging markets are concerned.

As our members begin their journey towards policy development and implementation, we will likely to glean further insight into any impediments to effective and consistent implementation of our policy measures thanks to our planned stocktake exercise.

Jurisdictions may be taking different approaches in tackling crypto-asset markets – whether it be through the application of existing regimes or

the development of bespoke regimes. But our goal is to achieve sufficiently similar outcomes that investors are protected, and market integrity is preserved – irrespective of the regulatory approach adopted.

We have to achieve this at the same time as the crypto marketplace itself continues to evolve. In terms of emerging issues, while not new, the topic of tokenization remains an area of acute focus for regulatory authorities.

Another area of crypto-asset regulation that may necessitate a closer look is recovery and resolution. In traditional financial markets, there is the built-in expectation that entities will fail and there are regimes in place to manage this risk. Regulatory authorities need to have the right tools to wind down CASPs that get into difficulty. As has been exemplified on many occasions over the past couple years, CASPs do fail. CASPs will likely continue to fail, but how will regulatory authorities ensure that recovery and resolution takes place in an orderly manner and that investors are not held to ransom?

A third area that may become part of the debate would be a combination of crypto and Large Language A.I.

As regulators around the world increasingly get into authorisation and supervision engagements with crypto entities, we expect a rich feedback to us in IOSCO on the practical realities of protecting investors and maintaining market integrity in this fast-evolving space.

In addition, we remain conscious that while crypto is not a substantial financial stability risk today, it has a number of characteristics which mean that situation could change quite quickly. We will be coordinating closely with the Financial Stability Board (FSB) on these efforts.

1. <https://www.atlanticcouncil.org/programs/geoeconomics-center/cryptoregulationtracker/>



## FRANÇOIS- LOUIS MICHAUD

Executive Director -  
European Banking Authority

### Comply and converge: instilling sound practices in stablecoin issuance

The Markets in Crypto-assets Regulation (MiCAR) will apply to stablecoin issuance, in the form of asset-referenced tokens (ART) and electronic money tokens (EMT), from 30 June 2024.<sup>1</sup>

In view of this fast-approaching application date, and the finalisation of the associated technical standards and guidelines,<sup>2</sup> the EBA is stepping up its actions to encourage industry and supervisors to sharpen focus on consistent and timely implementation.

As a starting point, in 2023, the EBA published a statement with 'guiding principles' to which issuers are encouraged to have regard until the application date.<sup>3</sup> The principles are intended to facilitate early alignment with the MiCAR rules, for instance as regards the fair treatment of potential acquirers and holders of ARTs and EMTs, and for sound governance and effective risk management.

Additionally, the EBA consulted promptly on an extensive set of technical standards and guidelines to ensure industry has the best possible notice

of the likely additional requirements established by those mandates and can proactively anticipate and adjust compliance systems and controls.

For supervisors, the EBA has established a new Crypto-asset Supervision Coordination Group (CSCG) to facilitate the exchange of very practical supervisory experience and supervisory actions. The CSCG is a specialist body to support knowledge exchange, help present a truly EU-aligned approach, and facilitate supervisory alignment in the application of MiCAR, including on authorisations and enforcement. The CSCG is expected to be very helpful until the EBA's new Crypto-asset Standing Committee becomes operational (Q1 2025).

As a further step to foster consistent application, in 2024, the EBA will develop a supervisory handbook for ARTs and EMTs guiding the EBA's and national authorities' supervisory practices for ARTs and EMTs. The supervisory handbook will provide guidance on the MiCAR application to support authorities in their day-to-day supervision activities. The goal is to facilitate ex ante convergence in supervisory practices and foster the consistent treatment and level playing field for ART and EMT issuers across the EU. It will facilitate the smooth transfer of supervisory responsibilities between national authorities and the EBA in the case of significant ARTs and EMTs thereby ensuring a continuum in supervisory approaches benefiting the supervisors and supervised issuer.

#### In 2024 the focus will shift to the sound implementation of the prudential framework for ART & EMT.

The EBA has also activated its 'Q&A Tool'<sup>4</sup> to clarify questions on the practical application or implementation of legislation within the EBA's remit, including MiCAR and the AML/CFT framework, again with a view to promoting harmonised application.

Looking beyond the EU, the EBA is promoting discussions and dialogue on supervisory issues with third country authorities to prepare for the establishment of supervisory colleges for all significant ARTs and EMTs. The EBA continues to engage proactively in discussions for setting international standards (e.g. BCBS and FSB) to reduce the risks of forum shopping.

In light of the ongoing developments at international level, including implementation of the BCBS standards on banks' exposures to crypto-assets, the recently agreed CRR/CRD package includes a transitional prudential treatment for crypto assets taking into account the MiCAR requirements and specifying amongst others the capital treatment of EMTs and ARTs and disclosure requirements of exposures to crypto-assets and related activities. This is complemented with requirements on issuers set out in the EBA's draft RTSs on the liquidity requirements for the reserve of assets which are closely aligned with BCBS consultative document crypto standard amendments published in December 2023.<sup>5</sup>

Overall, the EBA will continue to foster sound collaboration and coordination between industry and supervisors and among supervisors with a view to ensuring the new framework for ART and EMT issuance is consistently and vigorously applied and I look forward to our discussions at EUROFI.

1. For information about the EBA's roles under MiCAR see: <https://www.eba.europa.eu/markets-crypto-assets>
2. All consultation papers are available from the EBA's website: <https://www.eba.europa.eu/regulation-and-policy/asset-referenced-and-e-money-tokens-micar>
3. [https://www.eba.europa.eu/sites/default/files/document\\_library/Publications/Other%20publications/2023/Statement%20on%20%20preparatory%20steps%20towards%20application%20of%20MiCAR/1057527/Statement%20on%20timely%20preparatory%20steps%20towards%20the%20application%20of%20MiCAR%20to%20asset-referenced%20and%20e-money%20tokens.pdf](https://www.eba.europa.eu/sites/default/files/document_library/Publications/Other%20publications/2023/Statement%20on%20%20preparatory%20steps%20towards%20application%20of%20MiCAR/1057527/Statement%20on%20timely%20preparatory%20steps%20towards%20the%20application%20of%20MiCAR%20to%20asset-referenced%20and%20e-money%20tokens.pdf)
4. <https://www.eba.europa.eu/single-rule-book-qa>
5. <https://www.bis.org/bcbs/publ/d567.pdf>



## CARLO COMPORTI

Commissioner - Commissione Nazionale per le Società e la Borsa (CONSOB)

### Crypto Assets regulation: charting a course amidst complexity and innovation

The recent approval by the US SEC of spot bitcoin Exchange-Traded Funds (ETFs) confirms the trend of hybridization of crypto and traditional financial markets. This trend exacerbates the risks for investors (particularly retail ones) and for financial stability due to increasing interconnections between these markets. A consistent regulatory response cannot be further delayed.

IOSCO and the Financial Stability Board have recently adopted - under a remarkable tight timetable - standards and recommendations on crypto assets. Regulators and supervisors have now the responsibility to implement these measures in their national regimes through a sensible and globally convergent approach.

The EU has set the tone with the adoption of MiCAR (Markets in Crypto Assets Regulation) aimed at addressing market failures emerged in the inherently speculative crypto space. Guidelines and secondary rules will complement this framework, under the

leadership of ESMA and EBA. In parallel, market participants and regulators are called to ensure a smooth, timely and well-organized transition to MiCAR. Communications to retail investors should complement these actions to raise awareness of the intrinsic risks of crypto assets (due to their complexity, volatility and high exposure to losses) and of their distinctive features, compared to other regulated investment products.

Regulators need to ensure that the journey to MiCAR is smooth, orderly, and expeditious. This goal requires the prompt designation of national authorities and their empowerment with adequate resources and effective powers. Nowadays, global crypto groups operate across multiple EU Member States, navigating diverse national laws and setups. In this context there is a need to avoid that such legacy may hamper the safeguards provided by the new regime, creating uncertainty and limiting protection for investors during the transition to MiCAR. Supervisory convergence from the inception of the journey to MiCAR is a top priority for ESMA and for national authorities.

Many risks stemming from crypto markets depend on the same fragilities observed in traditional capital markets, others are new and deep-rooted in the underpinning technology. While traditional financial risks can be addressed through conventional tools, novel dynamics call for a fresh, innovative approach. Regulators are requested to adopt a holistic and open-minded approach to comprehend these dynamics and address both existing and emerging vulnerabilities, respecting the principle “same activity, same risks, same regulation”.

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#### Supervisory convergence from the inception of the journey to MiCAR is a top priority.

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Blockchain introduces new technological and governance risks, such as the trilemma, which encompasses scalability and security issues. Governance challenges surface during protocol changes or when engaging with Decentralized Autonomous Organizations (DAOs). Moreover, a safe cross-ledger interoperability remains a significant hurdle that is far from being achieved and difficult to be modelled in or prompted by regulation. These areas warrant further exploration in preparation for the future MiCAR review and beyond.

Market surveillance is another critical challenge. In public permissionless blockchains, financial incentives and game theory interlace with technology. The domains of finance and technology have merged, becoming inextricably intertwined. The state of a distributed ledger relies on consensus mechanisms, with consensus being achieved through the financial incentives embodied in crypto assets. As a result, the efficiency of price formation mechanisms and market integrity are fundamental for the good functioning of the entire ecosystem. However, achieving proper pricing in highly speculative crypto markets, where shared standards are lacking, is complex. Data-driven and proactive approaches are essential for detecting emerging abusive behaviours and tracing beneficial owners behind multiple wallets.

As the regulatory landscape navigates the complexities of crypto assets, ESMA and national authorities are committed to establishing a fair regulated environment, actively working to prevent and mitigate both longstanding and newfound vulnerabilities.



## SASHA MILLS

Executive Director, Financial  
Market Infrastructure -  
Bank of England

### Balancing stablecoin risks and opportunities for UK retail payments

Innovation in money and payments driven by the private sector initiatives has been fast paced in recent years with the digital assets emerging as instruments of payments. Given the volatility of unbacked cryptoassets, stablecoins emerged to facilitate trading and other transactions in the cryptoasset world. One key feature of stablecoins is that they are issued and transacted on blockchains which offer novel features such as programmability, leading to potentially faster and cheaper payments. Therefore, they may rapidly become attractive to consumers and at scale.

These opportunities come with specific risks. Stablecoins are susceptible to 'de-pegging' which can cause losses for investors, pose contagion risks, undermine confidence in money and payments and pose a threat to financial stability.

International principles such as the FSB's High-Level Recommendations for Global Stablecoins and CPMI-IOSCO's Guidance on Stablecoin Arrangements were developed to mitigate stablecoin risks and we welcomed and contributed to their development. Multiple jurisdictions also developed detailed regulatory regimes based on these

principles, such as the EU's Markets in Crypto-Asset Regulation.

In the UK, one of the Bank of England's (the Bank's) core objectives is to preserve the financial stability, which can be defined as protecting essential services which people and businesses rely on. An essential element of this is ensuring public confidence in money and payments is underpinned by our remit to regulate systemic payment systems and supervise financial market infrastructures.

Against this backdrop the Bank's Discussion Paper on a 'Regulatory Regime for Systemic Payment Systems Using Stablecoins and Related Service Providers' (DP) was published in November last year, accompanied by other UK regulators' proposals i.e. the Financial Conduct Authority's discussion paper on non-systemic stablecoins, and the Prudential Regulatory Authority's Dear CEO letter for deposit takers who look to innovate in the payments space.

The proposals aim to give regulatory clarity, providing a holistic picture for stablecoins in the UK and illustrate the options available to firms and associated regulatory requirements.

Aligned with our objective to maintain financial stability and the FSB's recommendations, our DP focuses on stablecoins used in *systemic payment systems*, i.e., those with the potential to scale up and become widely used as a trusted form of sterling-based retail payments. The Bank already regulates operators of systemic payment systems and service providers that provide essential services to these payment systems once these have been recognised by HM Treasury (HMT). Last year's legislative changes expanded this to operators of systemic payment systems that transfer 'digital settlement assets' (DSAs). The Bank will also be able to regulate service providers to these, as well as DSA service providers that are systemic, subject to HMT recognition.

We uphold the expectation of 'same risk, same regulatory outcome' set forth publicly by the FPC in 2019. This means that to the extent that systemic payment systems using stablecoins and service providers pose similar risks as traditional payment systems and existing forms of privately issued money, the Bank's existing approach to those should apply equally and they should be subject to equally robust standards.

The DP's requirements on stablecoin issuers, therefore, aim to ensure that stablecoins used in systemic payment systems always maintain their value, can be used for payments with confidence,

and that coinholders can redeem their funds at full value at all times. Guaranteeing that systemic payment stablecoins meet equivalent standards to those expected of commercial bank money though without the backstop that is usually available in a banking context is a priority for us. Currently, the backstops available for banks such as the Financial Services Compensation Regime are not available for stablecoins, which necessitate the requirements on backing assets to be stricter to ensure consumer protections are equivalent to those in existing systems.

To deliver on this, the Bank proposes to require issuers to fully back stablecoins in issuance with unremunerated deposits at the Bank of England. Moreover, the proposed regime seeks to be flexible over how stablecoin payment chains are structured and which functions are performed.

Going forward, the Bank plans to consult on policy proposals and enforceable rules after considering input from the industry on our DP. We look forward to working with stakeholders to maximise the opportunities engendered by stablecoins and enable safe navigation of this nascent industry.

On the international front, we look forward to engaging with other jurisdictions to promote regulatory and supervisory coordination, and to continue international work to further understand the risks, identify any gaps in our principles, and seek ways to address them.



## MARCO SANTORI

Chief Legal Officer - Kraken  
Digital Asset Exchange

### Navigating MiCA: a closer look at implementations across the EU

The European Union's fintech regulatory landscape is undergoing a transformative shift with the implementation of the Markets in Crypto-Assets (MiCA) Regulation. Scheduled to take effect this December for the majority of the crypto-asset market, MiCA introduces a critical juncture for existing registered firms as well as for the new entrants. The nuances of MiCA's transitional arrangements, the differing regulatory interpretations across EU Member States, as well as the missing piece of ESA's final round of consultations underscore the importance of the need for a more explicitly convergent approach by the authorities. The final piece of the puzzle will be how MiCA fits with the crypto frameworks globally.

#### Transition periods

MiCA, set to be applied from December this year, allows Member States the discretion to introduce a transition period for existing registered firms to move to this new framework. While the maximum transition period enshrined in MiCA stands at 18 months, ESMA recommends a 12-month transition. Thus far, we have seen divergent approaches from Member States. Some

have remained faithful to the 18 months agreed by the co-legislators, some are following the 12 months suggested by ESMA, and others have decided to scrap transitional periods altogether.

The divergences have the potential to create uncertainty and confusion for both the consumers and the practitioners across the EU. For example, consumers may not pick up legal nuances between jurisdictions and therefore be unsure whether they already benefit from the protections that MiCA will bring. Even for the practitioners, the specific regulatory requirements of each Member State during the transition period remain unclear. This may cater to regulatory arbitrage and negatively impact the competition.

#### Whitepaper regulatory interpretations

Unlike in traditional finance, MiCA does not put the liability of producing a whitepaper solely on the issuers. Instead, the preparer of whitepapers can also be offerors of crypto assets, or trading platforms. This can create confusion among the practitioners around who should be the first mover and which party should assume the burden of ensuring that all the information in a whitepaper is correct. In the scenario where a number of offerors decide to draft their own whitepaper for the same asset, consumers may receive different levels of information in different versions of whitepapers. This risk is exacerbated where the information in the whitepaper relies on estimates or assessments, for example on sustainability metrics.

### The transitional arrangements and regulatory interpretations call for more convergence.

While MiCA resolutely puts the whitepaper obligation on newly issued tokens, there are several ongoing industry debates related to tokens already trading pre-MiCA. For example, whether some of the most popular tokens that hold a significant share of the crypto market today will require a whitepaper for trading. This will become even more relevant after December 2027 when this requirement is fully in force regardless of whether they started trading pre- or post-MiCA.

#### Pending Level 2 and 3

The European Supervisory Authorities (ESAs) are still finalising the Regulatory and Technical Standards (RTS) and

Guidelines mandated by MiCA. MiCA contains an unprecedented number of these empowerments which means that a significant portion of the final text will be rolled out close to the go-live date and will require a quick, nimble implementation by the broader crypto industry.

For example, the crucial, yet pending, definition of whether crypto is a financial instrument has potential to significantly impact the industry. This is because firms that are providing services in crypto assets that are deemed as financial instruments will need to change their strategic direction and licensing plans towards MiFID. Given that this clarification comes late in the process and closer to the implementation date, it could create disruptions within the market, and impact client trading experiences.

#### Way forward

To ensure market consistency and consumer protections, it is vital for authorities to promote convergent regulatory approaches and to commit to a smooth transition. This process will include harmonising the transition period lengths to the extent possible and providing clarity on which regulatory requirements will be applicable during the transition period.

We suggest that the National Competent Authorities and ESMA collaborate closely to help the industry navigate the path towards compliance by among others ESMA issuing guidance addressing the possible multiplicity of whitepapers per asset. Overall, such an approach limits opportunities for regulatory arbitrage and increases consumer protection.

The impending Technical Standards and Guidelines, including on definitions of crypto as a financial instrument, should ensure that MiCA is not hollowed out and that crypto assets do not end up almost accidentally in traditional finance frameworks as this would miss the whole point of putting the EU at a competitive forefront with MiCA.





## ARNAUD MISSET

Chief Digital Officer - CACEIS

### Digital assets challenge for traditionnal players

When dealing with crypto and digital assets, we have to be clear exactly what we're talking about because it covers such a wide range of asset types from cryptocurrencies such as BTC and ETH, to NFTs, utility tokens, securities tokens, stable coins, and the upcoming CBDCs. Secure custody is the core business of an asset servicing company like CACEIS, and our one-stop shop approach means we have to be in a position to cover our clients' needs across all the aforementioned digital and crypto assets. Having said that, it is essential to closely analyse potential IT, operations and control functions issues (i.e. legal, compliance & risk) as these new asset types are a source of both opportunities and threats.

The industry is aligned on the benefits of digital assets and blockchain technology which bring major efficiency gains for settlement times, reporting and reduction of complexity across the value chain. On the IT side, it is common knowledge that a private key management system is essential to security, whatever the underlying digital asset. However, on the Operational side it is a different story, and discussing risk and compliance issues is key. This is where regulation is necessary to clarify methods of operation. The regulatory environment is nevertheless

a complex framework of rules and although securities tokens fall nicely under MiFiD and the traditional way of working, assets like utility tokens, cryptocurrencies, NFTs and stable coins operate under a new set of rules that are currently fragmented across Europe. The industry hopes that MiCa will set out a common rule book across Europe. We now know that tokenized financial instruments and the rest of the digital assets family won't have to comply with the same set of rules, so let's look at both frameworks.

Tokenised financial instruments are commonly viewed as a part of the potential future for the financial industry. For many years, successful trials have been run and have not revealed any particular regulatory or operational issues. These instruments could see a major take-off in the industry if the following two challenges are resolved:

- The first challenge is managing the cash side of a transaction in the form of a token. This is essential if we are to benefit from one of the most valuable features of traditional finance - the Delivery versus Payment process. CBDCs do provide a solution here but currently lack any official regulatory status and there are no plans to implement one any earlier than the two or three years. Questions are also raised around the use of stable coins, their reliability and the quality of the issuer.
- The second challenge is setting up a secondary market for tokens, as the OTC market on its own is definitely insufficient. The DLT Pilot Regime was intended to provide a boost in this area but to date has not performed as expected. In addition to this, support by the industry's custodians is also essential in the wide-spread adoption of tokens as investors need providers with token safekeeping capabilities.

Other newer digital asset classes such as cryptocurrencies, utility tokens and NFTs, are still perceived as higher risk assets especially from a compliance and reputational point of view. MiCa will definitely help align industry thinking and underscore the importance of acquiring robust and adequate IT systems along with the in-house capabilities and expertise needed to comply with regulators' expectations. This is mainly things like AML/KYC and the newly-introduced concept of KYT - Know Your Transactions.

Clearly, traditional and digital assets will have to co-exist for quite a time. This will bring additional challenges for players

along the value chain, as investors will expect processes, communication and reporting to be harmonised. Technical discussions around Blockchain have probably been too abstract, with investors only interested in the potential cost savings but less willing to adopt new standards. We shouldn't forget that the European market already operates with a high standard of efficiency, and the investor won't accept being exposed to the additional complexity of private key management, smart contracts and interoperability between the various protocols. Industry stakeholders involved with these new assets will need to strike a balance between the investment required for new systems, specialist IT teams and legacy system interfaces, and the expected commercial gains and increase in client satisfaction.

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**For custodians, having  
to deal with digital  
assets is highly complex  
and yet unavoidable.**

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In conclusion, for custodians, having to deal with digital assets is highly complex and yet unavoidable. With the current patchwork of unharmonised regulations, new regulation soon coming into force, the need for large IT investments, the size of the operational workforce required, and industry-wide education still to be delivered, we are facing major hurdles. But isn't that what makes business life so interesting...?

## BLOCKCHAIN AND DEFI TECHNOLOGY



### GIUSEPPE SIANI

Director General for  
Financial Supervision and  
Regulation - Banca d'Italia

### DeFi in TradFi: expected impacts, implementation challenges and policy aspects

Decentralized Finance (DeFi) refers to new ways of providing financial services that aim to eliminate the need for traditional centralised intermediaries. The underlying rationale does not lie in the type of services provided by most DeFi applications as they substantially mimic those provided by the traditional financial markets; rather, it lies in the way they are provided, given that DeFi creates an ecosystem that relies on automated protocols. This is made possible by (more or less) decentralised ledgers of transaction (“permissionless blockchains”) coupled with automated algorithms (“smart contracts”), thus allowing financial services through “decentralised applications” (dApps).

Some features underpinning DeFi applications such as automation, or the “composability” of services may have an impact on the innovation of traditional

financial markets even where governance remains centralized. For example, programmable, self-executing contracts may allow for process automation and potentially lower frictions in settlement activities (e.g. shorter settlement time) and consequently may reduce operational costs, thus enhancing access to financial services.

Moreover, decentralized technologies could also improve the interoperability of payment systems in cross-border payments and foster the use of digital identities that can reduce compliance costs for the financial sector in customer on-boarding and payment authentication.

Finally, it may increase transparency of financial infrastructures and foster innovation, given that both smart contracts’ code and the transactions registered on blockchains could be potentially publicly observable, traceable and verifiable by everyone.

On the other hand, potential benefits are always complemented by several risks, also from the legal standpoint. Firstly, such open ecosystems often lack a robust and transparent governance. In addition, both protocols and underlying DLTs are not immune from operational risk; flaws in the code could make it vulnerable to exploitation; cyber risks are magnified, as the use of smart contracts – including the so called “bridges” allowing the transfer of assets across different blockchains – may lead to an increase of the attack surface and heighten dependence on third parties, due to greater reliance on developers to deploy and maintain the underlying code. An additional source of concern relates to money laundering.

Insofar, no DeFi applications have actually achieved wide-scale adoption; in principle, regulators and supervisors can significantly contribute to enabling the financial system to explore the potential benefits of DLTs, smart contracts and tokenisation. For example, the BIS-lead Project Mariana tested the cross-border trading and settlement of wholesale CBDCs. The relevant DeFi components, particularly automated market makers, might represent the foundation for the next-generation of financial market infrastructures.

In addition, the Eurosystem has started to consider potential solutions for central bank money settlement

of wholesale financial transactions recorded on distributed ledger technology (DLT) platforms aiming to gain insights into how various solutions can enhance the interaction between TARGET services and DLT platforms. Banca d'Italia significantly contributes to this work with a solution centred on the Eurosystem’s TIPS instant payments platform and DLT-agnostic APIs to synchronize the asset-leg and the cash-leg, making an instantaneous Delivery versus Payment transaction possible on a 24/7 basis.

DeFi underlying technologies have created very challenging scenarios to regulators that need to strike the right balance between promoting innovation and mitigating the relevant risks. One possible avenue clearly relates to ongoing collaboration between the public and private sectors, for example in the joint definition of standards and best practices. The memorandum of understanding signed by Banca d'Italia and two Italian universities for the definition of smart contracts standards for financial services represents a concrete example in this regard.

**Public and private  
sectors’ collaboration  
reinforce the definition  
of standards and  
best practices.**

From the supervisory perspective, technological innovation requires authorities to reconsider and adjust current methods and tools to capture the new nuances of traditional risks, exploring new opportunities offered by innovation and the use of new technologies.

In this evolving landscape, financial intermediaries are also called upon to do their part; in particular, they should take prudent decisions in selecting developers and technology providers, aiming to effectively mitigate third-party risks, prevent business continuity, lock-in scenarios, and address IT/Cybersecurity concerns, will play a pivotal role in navigating the complexities of an ever-changing technological environment, ensuring the resilience and security of financial services.



## FRANÇOIS HAAS

Deputy Director General,  
Financial Stability & Deputy  
Secretary General - Autorité  
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de Résolution (ACPR)

### Blockchain: promises for the financial sector and challenges to overcome

If the tokenisation of finance is still a nascent phenomenon, it has gained significant attention in the last years. Thanks to blockchain technologies, the tokenisation of financial assets could lead to potential efficiency gains in post-trade activities, through greater automation, increased transparency and improved traceability. In the longer term, the tokenisation of real-world assets could increase the liquidity and accessibility of their underlying markets (e.g. real estate) and the intrinsic characteristics of tokenised assets such as fractionalisation and programmability could enable the creation of new services or innovative products.

Blockchain technologies have been primarily used to issue crypto-assets and offer financial services on crypto-assets with the so-called “decentralised finance” or DeFi. And, crucially, these activities have been deployed on public

blockchains, i.e. open and decentralised infrastructures with no prominent operator, with the ostensible aim of avoiding traditional financial intermediaries.

However, TradFi players are increasingly trying to leverage blockchain technologies through experiments and new services to harvest the potential benefits of tokenisation. For example, in France, some traditional banking institutions have recently begun issuing digital green bonds on public blockchains. This demonstrates the determination of TradFi players not to be outdone by crypto-assets players. As a result of this competition, the tokenisation of finance is emerging in a fragmented way between DeFi and TradFi, each relying on different types of standards. There is still a long way to go to allow the market to embrace blockchain, and this will require to solve a number of operational and regulatory issues.

With regards to operational issues, the challenge for central banks and financial supervisors is to securely support and accompany innovation. This involves two main lines of action. First, by helping financial players to test their innovative solutions in a secure environment. At the European level, the exploratory Pilot Regime on the use of DLT for financial market infrastructures will enable us to move from theory to practice through real-life experimentation, raising real questions and challenges, such as the finality of settlements. It will also allow us to identify potential barriers in the current regulatory framework, in order to build a robust framework supporting innovation while guaranteeing investor protection, market integrity and financial stability.

Furthermore, central banks can provide market participants with a more secure and trusted settlement asset than private stablecoins, which carry liquidity risk, but remain widely used due to the lack of a tokenised form of central bank money. From this point of view, CBDCs could be a game-changer in terms of legal certainty. With this in mind, the Eurosystem has recently launched exploratory work on three solutions to settle transactions on tokenised assets in central bank money, including CBDC, the latter using the DLT provided by the Banque de France.

Alongside the operational challenge, there are also important regulatory issues. In the EU, central banks and financial supervisors have framed connections between TradFi players and the crypto-asset market. On the one hand, the MiCA regulation, which will come into force in 2024, contains provisions allowing certain financial institutions to issue tokens and provide

financial services on crypto-assets. On the other hand, the new standards set by the Basel Committee on Banking Supervision, which will apply from 2026, remain rather conservative on the holding of crypto-assets by banks for their own account, in order to limit the risks of contagion to TradFi.

When it comes to DeFi, there are still regulatory uncertainties regarding the management of this decentralisation. It is not clear whether, within the current regulatory framework, TradFi players will be able to seize all the opportunities offered by the use of public blockchain and the adaptation of the innovations brought by DeFi. Decentralised market infrastructures challenge the current regulatory framework based on the PFMI and some key concepts, such as “system operator”, “transfer order” or “accounts”.

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**We want to support and  
accompany innovation,  
while preserving  
financial stability.**

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In addition, DeFi is not yet fully covered by the current MiCA regulation, which prevents it from being vested directly by TradFi players. This is why the French supervisor (ACPR) proposed regulatory avenues for DeFi in a discussion paper<sup>1</sup> published in April 2023. The paper’s proposals could inform a “MiCA 2” regulation alongside other issues such as crypto-conglomerates and the treatment of NFTs.

The operational and regulatory challenges ahead go hand in hand. By overcoming these challenges, we want to support and to accompany innovation, while preserving financial stability.

1. <https://acpr.banque-france.fr/en/decentralised-or-disintermediated-finance-what-regulatory-response>



## CARL MAGNUS MAGNUSSON

Policy Analyst Financial Economics - Organisation for Economic Co-operation and Development (OECD)

### Technology will modify, not metamorphose, financial markets

Technological forecasting is a risky business. Paul Krugman's 1998 prediction that by 2005 the internet would have proved to have no greater economic impact than the fax machine should make lesser economists shy away from making predictions that risk a similar fate. One must be cognisant not just of the tendency to overestimate short-term impacts but also to underestimate long-term ones. Further complicating this thankless task, innovations can unexpectedly cross sectors, as Nvidia's transformation from a gaming company to the centrepiece of the AI revolution attests.

Anticipating blockchain and DeFi's likely impact on financial markets poses similar difficulties. There are clearly use cases for distributed ledger technologies and other DeFi elements such as smart contracts, ranging from clearing to market making and proxy voting that are already being implemented by corporations, market infrastructure providers and regulators alike. It is possible that this will eventually completely transform the structure of financial markets.

The more likely outcome, however – carefully treading the treacherous grounds of forecasting – is a piecemeal implementation of these technologies in certain parts of the existing market infrastructure, improving efficiency over time. How widespread those changes will be naturally depends on the regulatory environment, but also on other factors. Financial market actors are typically adept at economically rational decision making. If implementing a blockchain-based solution can feasibly bring benefits, we should expect it to happen in any reasonably competitive market.

If market structures do not change in the way we expect, we should therefore consider whether the main obstacle really was technical. Low take-up could also be an effect of excessive upfront investment, or implementation requiring alterations elsewhere in the system to function efficiently, making coordinated efforts necessary. Financial markets are highly interconnected ecosystems; changes to individual parts can seldom be done in isolation.

One should also be careful not to put too much faith in technological solutions to non-technical issues. Consider bond trading, for example. It is possible that the efficiency of issuance and trading can be significantly improved by tokenisation and moving the process to a blockchain. What it is not likely to do however, counter to what is sometimes implied, is markedly increase liquidity. The limited liquidity of (corporate) bonds follows from the nature of the instrument and the buy-and-hold strategies of its main investors rather than from trading limitations. Blockchain/DeFi solutions are technical tools, not agents of metamorphosis.

That underscores an important distinction between the potential of new technologies to improve existing market processes and the idea that they will completely transform them. This is particularly relevant for DeFi, which is not just a technology but also an ambition for a conceptually new way of organising financial markets. It remains comparatively minuscule (at the time of writing the total value locked is roughly equivalent to Verizon's \$49bn bond offering in 2013) and the financial stability risks are likely overplayed, but the central idea of total disintermediation merits consideration. The ambition seems to miss a crucial point – intermediaries are not at the centre of financial markets by chance or because of technical limitations. They are the (highly regulated) effect of decades of deliberate efforts to construct a stable financial market infrastructure.

The regulatory search for a central accountable entity is not just a knee-jerk reaction, but a necessity for market functioning. Financial markets do not necessarily require trust between counterparties, nor even mainly in the market infrastructure as such, but they do require trust in the rules governing that infrastructure and the authorities' capacity to enforce them. Total decentralisation would obstruct that ability.

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**We should be careful not to put too much faith in technological solutions to non-technical issues.**

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What, then, should be the regulatory approach? Firstly, humility and openness to innovation. There should be no undue hurdles to new ways of structuring financial market processes – perhaps they should even be incentivised – if they can operate safely. Still, technology-neutrality must remain a guiding principle and the overarching goal of market integrity should not bend to enable specific technologies. Regulators should be proactive early on, engage with market players and recognise self-regulation as a starting point for later formal regulation. Regulatory sandboxes and observatories are appropriate initiatives underway around the world. Finally, given the global nature of capital flows, regulatory efforts must be internationally coherent, benefitting from discussions in multilateral fora.

This can help ensure that innovations translate into improvements in market functioning. Blockchain and other DeFi technologies have great potential. Just don't mistake the tools for the final construction.



## SUYASH PALIWAL

Director, Office of International Affairs - U.S. Commodity Futures Trading Commission (U.S. CFTC)

### View from the US: Responsibly innovating with blockchain and DeFi

Disruptive technologies – which blockchain, distributed ledger technology (DLT), and decentralized finance (DeFi) may be – typically garner reactions from disbelief, to varying levels of acceptance and adoption, to utopian dreaming. The potential benefits of DLT and DeFi, including transparency, accuracy, efficiency, and open access, suggest that the technologies should not be ignored. But new technologies, even those that are new ways of doing old things, often bring new risks. The task of market regulators and participants is to harness the benefits while safeguarding essential protections.

#### DLT revolution – great promise or greatly exaggerated?

On one end of the spectrum is the vision that financial activity can be migrated to, and radically enhanced by, the blockchain. The promise of transparency, access, reliability, and speed from automated systems of engaging in and recording transactions through a decentralized ledger system, undergirded by encryption, can be enticing. However, realities temper this promise with pragmatism.

To name a few challenges, many have rightly questioned how truly decentralized DeFi is in current blockchain applications, without which, many of the purported benefits of added transparency and reliability can give way to opacity and vulnerability to manipulation and fraud. The need for security, accountability, and user protections sometimes counsel for the use of permissioned blockchains, but at some levels of scale, a good internal ledger system may be more appropriate than a blockchain platform and DeFi protocols. Some disintermediation can reduce costs, but intermediation adds meaningful protections and can sometimes be costly to replicate if reverted to a bilateral basis.

In cleared derivatives, for instance, even if operating via decentralized protocols, a central counterparty (CCP) would still enter into the transactions interposing itself as common counterparty after novating a bilateral trade, through which CCPs provide the default management and loss mutualization functions that have spawned safer swaps and futures markets. CCP members provide an important layer of protection to the resilience of the derivatives clearing ecosystem, beyond their role as intermediaries facilitating trades.

#### Use cases conceived, and observed

Against this backdrop, a few use cases emerge as possibilities. As a decentralized system of records with the underpinnings of automation and encryption, a natural candidate to streamline is the trading and settlement cycle. In derivatives, application of DLT can be explored for steps including matching, execution, confirmation, settlement, and data reporting, as well as life cycle events. Setting and calling initial margin, as well as determining, calling, and processing variation margin, can also be candidates for exploration.

And, while speed and automation can have positive potential, the same speed and automaticity would take place in a time of stress. Observers noted the speed at which the failures of Silicon Valley Bank and Signature Bank occurred in the U.S., which in that case was largely driven by social media. The speed of DLT brings this to another level. Layer on top of this the speed and opacity that artificial intelligence can bring, and the onset of distress could occur at a dizzying pace – too fast to rein in?

#### Risks, and regulatory responses

Regulators cogitating policy approaches to DLT frequently harken back to the idea of same activity, same risks, same regulation/regulatory outcome. Indeed, this has underpinned IOSCO's Policy Recommendations for DeFi released last year. The same protections expected of the traditional financial sector – including anti-fraud/anti-manipulation, governance, accountability of responsible persons, customer protection, market integrity, and mitigation of systemic risk – would need to be maintained if providing traditional financial services via DLT. As evidenced by the ever-increasing number of enforcement actions brought by the CFTC and other US regulators against bad actors using innovative technologies, using DLT or DeFi will not inoculate actors from responsibility to abide by the rules. In addition, in the context of using DLT, ensuring operational resilience and risk management would be elevated as important safeguards.

DLT clearly offers promise and potential, but must be explored and pursued responsibly.

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**Using DLT or DeFi will not inoculate actors from responsibility to abide by the rules.**

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Nonetheless, such possible incorporation of DLT is not without risks and challenges. Implementation at a scale to be meaningful may require integrating multiple systems that presently may not be interoperable. Where a process requires several sequential steps, different speeds at different stages could result in the slowest link capping the speed of the sequence, at best, or logjams at worst.



## MARY-CATHERINE LADER

Chief Operating Officer -  
Uniswap Labs



## JON FINK ISAKSEN

Head of Policy, EMEA -  
Uniswap Labs

### DeFi - The next wave of automation in traditional finance

Decentralised finance (DeFi) is the next evolution of the technology underpinning crypto-assets and distributed ledgers. It is enabling a reduced reliance on centralised intermediaries, cost savings, and more transparent financial services.

The sector has innovated quickly, creating net new concepts such as *automated* market makers like the Uniswap Protocol. In just five years, the Uniswap Protocol has safely processed over €1.65 trillion in transactions.

Foreign exchange (FX) is a €6.9 trillion market where DeFi can reduce remittance costs by up to 80%, according to our analysis of data from Uniswap Protocol pools.<sup>1</sup> This evolution of FX opens the door to 24/7/365 markets, offering unprecedented access and liquidity. The Bank of International Settlements concluded recently: “*DeFi elements tested in (our project to improve foreign exchange), specifically automated market makers, could form the basis for a new generation of financial market infrastructures.*”<sup>2</sup>

Some jurisdictions – led by the EU and its flagship MiCA framework – have taken early steps to regulate crypto-

asset activities, but international competitiveness is a relay race that never ends. The next leg we expect is adaptations of traditional frameworks that enable tokenisation. With other jurisdictions pushing ahead on tokenisation, the EU’s pilot regime to test distributed ledger technology may not be sufficient for the Union to maintain its early lead. At Uniswap Labs, we are following these developments closely because we believe that tokenisation will change how we think about, create, and exchange value.

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**DeFi is the continuation of financial markets’ relentless pursuit of efficiency and innovation.**

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The big question for policymakers is how to create these frameworks while preserving the advantages of the technology – instead of recreating the inefficiencies and dependencies of traditional financial markets. Consider DeFi’s enhanced resilience to cyberattacks: re-centralising DeFi by requiring the participation of intermediaries would erase this benefit by re-introducing honeypots of data and vulnerability.

We believe the solution is to lean into the technology’s inherent consumer protections. For example, because all transactions happen on a public ledger, anyone can monitor the financial health of intermediaries in real-time. Regulators should take advantage of this real-time reporting rather than requiring the laborious and lagged quarterly reporting of current financial institution supervision.

Still, while DeFi improves on traditional finance in some areas, other risks persist, and new ones arise. The challenges are surmountable. Regulators need to develop a deep understanding of the novel technology. In response, industry needs to create new innovations that mitigate risks that could prevent DeFi from reaching its full potential. For example, public-private innovation on digital identity and security standards is one underexplored area that could enhance consumer protection and combat illicit activity.

DeFi is the continuation of financial markets’ relentless pursuit of efficiency and innovation. Markets have always embraced technology, reshaped operations, and pursued offerings in order to meet client demands, and this time is no different. As more markets change, the regulatory system cannot remain stagnant. It must keep up, embrace new opportunities, and evolve to mitigate the novel risks.

1. Adams, Austin and Lader, Mary-Catherine and Liao, Gordon and Puth, David and Wan, Xin, *On-Chain Foreign Exchange and Cross-Border Payments (January 18, 2023)*. Available at SSRN: <https://ssrn.com/abstract=4328948> or <http://dx.doi.org/10.2139/ssrn.4328948>
2. BIS Innovation Hub (BISIH) (2023): *Project Mariana Cross-border exchange of wholesale CBDCs using automated market-makers*, September 2023.



## ADRIEN TRECCANI

Senior Vice President  
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### Crypto comes of age - And banks are joining the party

The world of finance is undergoing a radical transformation, with 80% of global finance leaders due to adopt crypto in the next three years. Far from signalling a 'Crypto Winter', the industry is now poised for a seismic shift in interest from traditional finance players. If the debut of the Bitcoin ETF is anything to go by, where \$4.6 billion exchanged hands on the first day, then crypto is on the cusp of a new era in financial services.

As momentum builds for blockchain and digital assets, banks now recognise that this technology offers faster, cheaper, more secure, and more transparent value exchanges. The crypto industry is maturing, and companies focused on real-world utility are rising above the noise of bad actors and industry myths to deliver progress and exceptional services via blockchain technology.

Regulators have a vital part to play in securing our industry's long-term future.

#### The Rise of blockchain in traditional banking

The hype cycles of crypto, like those we've seen in the past, can stifle progress but what truly endures amid the noise is genuine innovation and utility. That's

why we're seeing traditional institutions break ground in the crypto space and find opportunities to partner with digital asset firms, and blockchain providers, to upgrade their infrastructure and improve their services.

Payments are crypto's pioneering application and serve as the gateway to a new world of possibility in crypto. There's already clear use-cases and instant benefits being delivered, providing unrivalled speed, transparency, efficiency, and cost-savings. Take the XRP Ledger, for example, currently being used by *Heirloom* to help individuals manage their digital identity online in a way that is stable and energy efficient but fast in terms of its transaction times.

But beyond payments, blockchain technology is making significant inroads within traditional banking. We've seen banks like HSBC and BNP Paribas adopt bespoke custody technology to expand client exposure to digital assets, offer staking, and digitise traditional investment assets, like securities, all while meeting customer need for security.

#### Regulators have a vital part to play in securing our industry's long-term future.

Smart contracts, deployed on blockchain networks, deserve special mention too. They can automate financial processes like loan agreements and derivatives, boosting efficiency, transparency, and fostering financial inclusion. We're already seeing many institutional financial players experimenting and testing different solutions that adopt smart contracts and distributed ledgers, helping bridge the gap between crypto and traditional finance.

#### Regulatory challenges in the digital age

It could be argued that the future of crypto within traditional finance is at risk, however, due to an absence of clear regulation and operating guidelines from jurisdictions around the world. It's critical that regulators remain in-step or ahead of the industry so that crypto can continue to innovate safely and build long-term relationships with banks and financial institutions. After all, frameworks designed for traditional financial systems will not adequately address the unique characteristics and challenges posed by decentralized technologies.

Jurisdictions are currently moving at different speeds and a lack of cohesion or interoperability could jeopardise growth and banking adoption. The EU, Singapore, Japan, Brazil, and the UAE have made considerable progress, which is welcome, but ongoing collaboration between the industry and regulatory bodies is crucial to fostering innovation while ensuring consumer protection, market integrity, and financial stability.

Notably, the EU's Markets in Crypto Assets (MiCA) regulation has led by example globally. By laying down specific rules tailored to the sector, MiCA not only offers legal certainty for all actors wanting to operate in the EU, but also operational clarity that will fuel crypto innovation across the region, and ultimately, sets a precedent for other frameworks worldwide. This is global best practice, so it's no wonder that we've already seen a number of crypto providers and finance institutions expand operations within Europe to benefit from this clarity. And we'll no doubt see this trend continue as this regulatory position resonates with banks. With the final rules being put in place this year, we're nearly there in Europe.

The crypto industry has left its old 'Wild West' label behind as it demonstrates to banks and institutions how the solutions it is building can improve payments, digitise financial processes and instruments, and provide better services to their customers. Pro-active regulation, like the EU has achieved, has been key to this. This engagement by regulators needs to continue alongside ongoing innovation by industry. Continuing innovation needs operating frameworks that are agile and forward-thinking, and which balance the need to protect customers with nurturing growth. As the financial landscape continues to evolve, embracing the transformative power of blockchain and digital assets is not just an option, but a necessity for those looking to stay relevant.



## DANIEL KAPFFER

Chief Financial Officer & Chief Operating Officer - DekaBank Deutsche Girozentrale

### Blockchain has the potential to change financial markets fundamentally

For the purpose of this article, we will define blockchain as a new technology that combines a series of distributed ledgers in which a chain of transactions is recorded when these transactions are verified according to a defined consensus mechanism. Decentralized finance is an approach to offer financial services without centralized institutions. Because the approach is decentralized it is often based on blockchain technology.

Most discussions about blockchain today are limited to process efficiency for financial institutions. It is argued that once a transaction has been agreed, processing it can be much faster and less costly. However, if you look at most of the costs associated with settlement, they are technology agnostic. One could even argue that the parallel processing of digital and traditional assets increases complexity for financial service players.

More fundamentally, with blockchain technology existing assets can be digitalized as well as fractionalized and new crypto assets can be issued.

The impact of all of this goes well beyond process efficiency: Less Intermediaries are required in the settlement but also the distribution value chain and therefore business models and fee structures are disrupted. Assets may be mobilized therefore enabling a secondary market – however they will not become more liquid through technology alone. Moreover, new financing opportunities become available especially for SMEs and startups. Also, institutional and retail clients can choose to invest in additional asset classes and finally cross-border infrastructure may be facilitated.

Hence blockchain has the potential to support two priorities of the EU: the capital market-based financing of SME's and the Capital Markets Union.

**Policy aspects are addressed for now, but significant practical challenges remain to be solved**

With MiCa and the DLT pilot regime the EU has made progress with regard to most of the policy aspects. However, the DLT pilot regime is to limited. Being able to trade a digital security on a regulated market without the requirement to keep it with a CSD is needed as a further step forward. Also, the EU lacks a mutually accepted digital currency to settle digital assets in Delivery-vs-Pay.

In addition, there are significant practical challenges. For example, the legal framework needs to be solid enough, especially for cross-border transactions. Otherwise DLT could be used on top of the paper-based process. Thus, sufficient market participants are needed that to act as trustworthy custodians for digital assets. Also, a common DLT infrastructure that enables seamless interaction is crucial to avoid the need to bridge many DLTs in the end.

And finally, the fundamental question for each blockchain use case needs to be answered: Is there already an existing infrastructure and what would the investment be to change it, and are the benefits worth it?

**Whether traditional or challenger – the innovator takes it all**

The race for leveraging the blockchain technology is well underway. Traditional players such as DekaBank are exploring services for customers along all three dimensions. Firstly, the infrastructure to support issuers in issuing digital assets, customers in terms of self-custody wallets, digital asset custody and tokenization. Secondly, in the issuance of digital assets themselves: digital bonds as well as digital investment funds. And finally, by investing in a shared infrastructure for the distribution of digital assets called SWIAT.

**DeFi will not be more than a fix for missing centralized infrastructure**

Most technology enthusiasts completely underestimate the specific know how and resources (e.g. liquidity, capital) required to provide financial services. Technology is a major input for delivering financial services, but not the output. Many discussions are about what is technically feasible, but not about what adds value to customers, markets or institutions or what makes sense from a policy makers perspective.

**...with blockchain technology existing assets can be digitalized as well as fractionalized and new crypto assets can be issued.**

This is why structures without centralized institutions will not work. People who would otherwise hold their money in a current account or a fixed-term deposit will not be able to grant a larger and more complex loan. They simply lack the liquidity, the ability to assess the credit risk and price it accordingly. They would also not be able to cover the risk of loan defaults. The situation is similar for a stock exchange or any other trading venue. The operation of a trading venue already requires a central institution.

In addition, market makers are needed to ensure liquidity. Finally, from the point of view of stability, certain roles on the financial markets should only be assigned to institutions that meet exceptional requirements - for example, central securities depositories.

Therefore, DeFi will be limited countries, types of financial instruments or participants that would otherwise not have access to the relevant services.





## STEPHEN PROSPERO

Executive Director, Innovation Strategy and Digital Assets - The Depository Trust & Clearing Corporation (DTCC)

### Leading the Path to the Future: Advancing the Digital Asset Ecosystem

Over recent years, there has been increased momentum in the adoption of digital assets and distributed ledger technology (DLT). While industry reports continue to project growth in digital assets, last year, most projects (74%) involved six or fewer participants<sup>1</sup>, highlighting the next challenge for the financial industry: how to progress from the current smaller, isolated projects to meaningful, industry-wide initiatives that support the scale of the global financial markets? After years of exploration, many in the industry want to see results. Three things will be critical to realizing these results: leveraging FMs to advance the ecosystem, ensuring use cases deliver real near-term value and working with regulators to protect, and propel the ecosystem.

#### Leveraging FMs to advance the ecosystem

As regulated entities governed by rules that promote safety and soundness, orderly markets and the safekeeping

of investor assets, FMs have a proven track record in establishing operational standards and maintaining high levels of operational resilience. Because of this, FMs are well positioned to bring these same benefits to the digital asset ecosystem.

For example, FMs can help progress digitization efforts by encouraging standardization of smart contract controls, data and processes. Smart contracts, which are decentralized computer applications that can automatically execute agreements based on predefined conditions, offer the potential to streamline and automate thousands of disparate financial processes. However, if each financial institution develops their own smart contract standard, spread across infinite DLT technology stacks, it could create a patchwork of decentralized systems that are more complex than today's systems and processes. To avoid fragmentation, FMs can help to develop consistent standards and controls that support an interconnected ecosystem while providing governance of decentralized applications to ensure they remain compliant and secure. This mutualization function will reduce industry costs and accelerate the industry-wide adoption of Web3.

#### Delivering Real Near-Term Value, with new business and operating models

As we consider the path forward, the industry must shift its approach from a re-platforming mindset to seeking new business and operating models that maximize the value of the tech. Solely replicating existing processes or undertaking lengthy and costly re-platforming exercises will not lead to the successful digitization of financial markets on any near-term timeline. We need to think differently and lean into what differentiates this technology and the impact it could have on our ecosystem. Several potential use cases come to mind: first, use cases that notably improve the rails upon which assets move (think infrastructure for private and alternative assets which are massive in size, but still incredibly manual in nature), and second, use cases that create meaningful capital efficiencies (think solutions that facilitate streamlined and optimized movement of collateral measured in seconds, not days).

DTCC's recent acquisition of Securrency to form DTCC Digital Assets, a developer of institutional grade, digital asset infrastructure, underscores our commitment to unlocking the value of digital assets and providing new operational capabilities and models to guide the industry safely through its

transformation. The new capabilities will be a key enabler to fostering industry-wide collaboration to promote acceptance and adoption of digital assets.

#### Working with regulators to protect - and propel - the ecosystem

Safety and soundness are a top priority for regulators around the world. As the digital asset ecosystem evolves, regulators will continue to expect those performing regulated activities in the form of digital assets to adhere to the foundational requirements which ensure the same, if not greater, integrity of our markets. This means considering any shifts in business/operating models and market structures that may result in the use of the underlying technology. We are still in the early days of DLT adoption and what's possible - we should work closely with regulators to advocate for rules that evolve alongside the industry's use of the technology.

**It is likely that broader adoption of new models will drive significant industry transformation.**

Ultimately, digital assets present a tremendous opportunity for financial markets - as use cases come to fruition leveraging the learnings from past exploration, it is likely that broader adoption of new models will drive significant industry transformation. FMs will play a critical role in helping drive industry consensus around the standards, controls and frameworks that will enable scale. At the same time, the industry will seek new ways to operate and deliver client value. We expect that regulators will stay close to the topic and set guardrails to help protect investors and the market. And in the end, real transformation will occur. With time and focus, the industry will see results.

1. ISSA 2023 Survey, "DLT in the Real World", July 19, 2023

## OPEN FINANCE: FIDA PROPOSAL



### MARCEL HAAG

Director, Horizontal Policies, DG for Financial Stability, Financial Services and Capital Markets Union - European Commission

## A step closer to open finance with a framework for financial data access

In June 2023, the Commission proposed an important step towards an open data space for finance in Europe. The proposed regulation on financial data access (FIDA) will promote data-driven business models that can benefit financial services customers and financial sector firms.

FIDA aims to put customers in control of their data held by financial institutions. Customers should be free to decide what they want to do with their data: they should be able to grant access to their data and they should know who it is being shared with and why. FIDA gives them this choice and empowers them to grant access to their data for the purposes of obtaining financial and information services.

Customer permission is central to FIDA. No data must be shared unless the customer wants to share it. And only if

the customer has given permission to share their data financial institutions will be obliged to grant access to customer data across certain areas of financial services (investments, insurance, pensions, mortgages, and savings accounts). Permission dashboards will facilitate customer control and make it easier to monitor, grant and revoke data sharing permissions.

FIDA builds on the access obligations under PSD2 and extends this obligation to non-life insurance, pensions, investments, loans, savings and credit accounts. However, where financial exclusion risks may outweigh the potential benefits customer data remain excluded from the access obligation. This concerns notably creditworthiness assessments of natural persons and life, sickness, and health insurance.

To ensure responsible data handling, data access is limited to licensed entities. Only licensed financial institutions and licensed Financial Information Service Providers (FISPs) will be able to access customer data in scope. The fifteen categories of entities covered include inter alia insurance providers under Solvency II, investment firms under MIFID and credit institutions under CRR/CRA. A closed data circuit limited to financial institutions and FISPs will ensure the high security of data. They will also be subject to the Digital Operational Resilience Act.

Both data holders and data users will be obliged to join data sharing schemes to agree on the modalities of access, including standardisation, liability rules and compensation levels. To prevent anti-competitive behaviour, compensation levels are modelled on the principles of the Data Act.

On the basis of FIDA data holders can also become data users that access data. In fact, the Commission expects that the majority of data users will be financial incumbent firms. Using machine-readable access, data users will be able to provide improved and innovative services to the customer. While FISPs would only be allowed to provide financial information services, licensed financial institutions will be allowed to provide the financial services for which they are authorised. They can reap efficiency gains by making the sales process for financial services and

products faster and cheaper. And they will be able to collect relevant customer data to offer investment, insurance and mortgage products better tailored to the customer's needs.

And also the customers stand to gain significantly: consumers could gain easier access to financial advice or personalised insurance offers and retail investors could get a better overview of their personal finances.

FIDA also requires data holders to make data accessible to the customers themselves. One effective way to achieve this is through digital customer interfaces. We expect that financial service providers without such interfaces will now put them in place. In addition to being beneficial to their customers, this would improve their own efficiency by promoting digitalisation. The digital transformation of financial institutions will also be promoted by enabling their access to customer data held by other data holders. This development could already be observed under PSD2 as banks are nowadays offering payment accounts data aggregation services to their customers.

**FIDA promotes innovative data-driven business models to the benefit of customers.**

It is now for the European Parliament and the Council to decide how to move forward on FIDA. The legislative negotiations on FIDA are at an early stage. In 2023, the Spanish EU presidency organised several Council working party meetings to discuss key aspects of the proposal, notably: scope, permission dashboards, financial data sharing schemes, and the rules on FISPs. The rapporteur of the European Parliament's ECON committee has presented a draft report on 11 January 2024 with a deadline for amendments set for 30 January.

Once in place, FIDA has the potential to lead to better and more innovative financial services for consumers and businesses, to drive the digital transformation of and boost competition in the financial sector.



## JOSÉ MANUEL CAMPA

Chairperson - European  
Banking Authority (EBA)

### Financial Data Access in the EU: an opportunity to build on experience

Open Finance has the potential to empower consumers and businesses to benefit of services better tailored to their needs helping more informed financial decisions and innovation in the financial sector. But Open Finance also brings challenges, such as ensuring the security and control of customer data, and addressing exclusion risks for consumers.

In June 2023, the EU Commission published a proposal for a framework for Financial Data Access (FIDA), also referred to as Open Finance. The proposal aims to enable consumers and businesses to share their financial data in a secure way with third party providers to benefit of value-added services. The scope of the proposed framework covers data relating to loans, savings, investments, pensions and non-life insurance. Payment account data, covered by the Payment Services Directive (PSD2), is excluded.

The experience gathered with the implementation of PSD2 can offer valuable insights to support the development of Open Finance. And we welcome that some of the lessons learnt from the PSD2 are reflected in the FIDA

proposal, such as mandating the use of APIs for data sharing. APIs can provide a more secure way of sharing data with third party providers (TPPs, referred to in FIDA as 'data users') compared to other techniques for accessing data like screen scraping.

The EBA also welcomes the provisions on data dashboards, which aim to strengthen customers' control over their data, by enabling customers to have an overall view of all permissions they had granted to third parties to access their data and withdraw access where they so wish via the institution holding their data.

However, there are also aspects in the FIDA proposal that differ from the approach taken in PSD2 and that may raise concerns. FIDA does not include any specific authentication requirements, which is different to how PSD2 introduced open banking, where access to payment account data was accompanied by the imposition of strong customer authentication. In this context, greater detail on security requirements and the allocation of liability between data holders and TPPs is warranted to enhance customer protection.

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**FIDA drives the  
EU's innovation and  
competition, but some  
aspects need refining.**

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Relatedly, FIDA requires data holders, when making customer data available to TPPs, to request TPPs to demonstrate that they have obtained the customer permission for access without specifying how TPPs would be able to demonstrate such permission. This would have to be done without impacting the ability of data holders to timely share data with TPPs as required by FIDA itself. Furthermore, it should be consistent with the approach taken in PSD2 and in the PSR proposal, which prohibits account holders from requiring additional checks of the permission given by the customer to the TPP, beyond those foreseen by the regulation such as the authentication of customers.

Furthermore, based on the EBA's experience with PSD2, we believe that more details on the minimum functionalities and performance of the APIs used for sharing data with TPPs are warranted. Such details will provide legal clarity for market participants and for competent authorities responsible for supervising the implementation of FIDA.

A key challenge of the framework will be to strike a proper balance between competing objectives. A clear example will be how to ensure that the objectives of promoting innovation does not come at the cost of protecting vulnerable groups of customers. In this context, FIDA could further clarify the scope of the regulation in terms of the data covered (for instance data not digitally available), and on the perimeter for the use of the data so as to mitigate risks of financial exclusion of consumers with an unfavourable risk profile.

Another area for further clarification is access to financial data in the scope of FIDA by entities with no establishment in the EU in a manner to assure the effective supervision of such access, as well as consumer protection and the preservation of the single market.



## CHRISTOPHE BORIES

Head of Service for the Financial Sector - Ministry of the Economy, Finance and Industrial and Digital Sovereignty, France

### Unveiling FIDA: navigating the transformative landscape of open finance in the EU

In the dynamic realm of the global data-driven economy, the financial sector is undergoing a profound transformation, placing data management and data valuation at the forefront of its priorities. This shift is notably exemplified by the rise of Open Finance, a groundbreaking concept designed to streamline access to financial data and foster collaboration across institutions. In the European Union, the proposed Framework for Financial Data Access (FIDA) aims to be a decisive step advancing the Open Finance agenda.

The FIDA proposal presents a promising opportunity to operationalize Open Finance within the EU, extending its reach beyond payment accounts to encompass a diverse array of financial data. A meticulous examination of the implications of such extensive data sharing is of course necessary, acknowledging that certain data categories may offer marginal benefits compared to the costs of defining data formats and infrastructure. However,

the potential advantages for consumers and the market are undeniable.

To reach its full potential, FIDA must be seen as an integral part of the overall EU legal framework. Clarity for stakeholders and coherence with existing regulations, including the Data Act, GDPR, and a new regulation replacing and supplementing PSD2, are pre-requisites for its effectiveness.

This approach lays the groundwork for the evolution of data-driven financial services, personalized to individual customer preferences, thus fostering synergy among various financial services, stimulating innovation, enhancing user experiences, refining financial products and services, and empowering consumers to make more informed financial decisions through a comprehensive overview of their financial situation.

Yet, an interconnected financial landscape brings its own set of challenges and risks. Navigating the uncharted waters of Open Finance prompts concerns, from intricate data security nuances to the potential misuse of sensitive financial information. A nuanced and comprehensive risk assessment becomes paramount, ensuring the resilience and security of the financial ecosystem.

While FIDA has the potential to unleash the capabilities of Open Finance in the EU, it is crucial to tackle operational challenges, in particular those linked to API quality and standardization. Indeed, inadequately standardized data and API interfaces are important hurdles in the development of Open Finance, resulting in insufficient interoperability within its ecosystems. Moreover, as FIDA introduces new concepts and roles, establishing clear terminology is vital, especially in the definition and implementation of financial data sharing schemes (FDSS).

Beyond the technical challenges posed by the development of market-driven technical interfaces, such as permission data boards or FDSS, there is a pressing need to address significant political considerations surrounding the FIDA project. Its potential for high disruption lies in its fundamental philosophy of embracing openness and the circulation of retail financial data across various financial aspects, including credits, savings, and insurance. Therefore, a thorough examination of how this innovative approach may impact the industrial positions of European actors in comparison to their non-European counterparts is essential. This critical analysis should pave the way for a fully-informed and comprehensive political debate, on all potential implications of the FIDA proposal.

Drawing from past lessons, the FIDA proposal demonstrates a proactive stance in addressing challenges encountered during the implementation of Open Banking under PSD2. Shifting towards contractual-based data sharing with the FDSS and compensation simplifies the legal intricacies surrounding data access, fostering collaborative interactions and incitation between financial institutions and third-party providers. This transition aims to facilitate smoother and more secure data exchange, contributing to the seamless evolution of the Open Finance ecosystem.

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**To steer the market in the right direction, FIDA should strive to strike a balance between ensuring security and incentivizing Open Finance.**

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To steer the market in the right direction, FIDA should strive to strike a balance between ensuring security and incentivizing Open Finance. A collaborative effort, combined with clear regulatory guidance, could pave the way for a thriving Open Finance ecosystem within the EU. This would benefit consumers but also would fuel financial innovation for years to come.

Much work still lies ahead for legislators to overcome the currently unresolved technical and political challenges. The forthcoming resumption of discussions at the Council under the Belgian Presidency is eagerly anticipated, marking a key moment for collaborative efforts to navigate these complexities.



ONDŘEJ  
KOVÁŘIK

MEP - Committee on Economic  
and Monetary Affairs -  
European Parliament

## Is it time to expand from open banking to open finance?

Following the implementation of Open Banking, we've seen a number of benefits, not least the possibility for smaller innovative companies to enter the banking and payments space. This was facilitated by data sharing, enhanced competition and a more level playing field by traditional banking institutions and new companies such as fintechs.

In that sense, if we look on a broad level, expanding open banking to open finance can bring positives to the market, and particularly for consumers who would be able to manage all of their finances through one dashboard. I do see a broad willingness to explore Open Finance in the EU. We have to bear in mind also that data sharing is already happening cross-sector, just not in a structured manner, and the question is then whether the best approach is to develop a fully fledged and ambitious Open Finance framework, for example using FIDA as a basis, or whether to let that market develop more organically.

One aspect that is particularly important in Europe is that we are not left behind in the global data race, thereby losing any possibility of competing with other

jurisdictions which are ahead of us on the curve of innovation in data use.

From my perspective therefore, developing open finance should be a priority, but not at the expense of driving potentially competitive innovators out of the market or imposing huge costs on our own home-grown businesses.

Specifically looking at the FIDA proposal from the Commission, I consider the objectives to be well considered. However, it seems to me that the deeper you dive into the proposal, the more potential hurdles or pitfalls you come across. This is why from my perspective it is incredibly important that the legislators take the time to consult with as broad a range of stakeholders as possible before completing the legislative process. From my perspective in the European Parliament, it is a tricky time to make concrete progress on the file, given the fact that in reality we only have one month after EuroFi before we would have to vote on an ECON position, given the run in to the European elections. Any such ECON position would not tie the next Parliament down to accepting it, but gives an indication of where the majorities lie on different issues.

Bearing this in mind, I think that what is important from all sides, whether it be legislators, regulators or stakeholders, is to engage frankly and explore all of the various possibilities for the EU's first foray into a legislative framework of some kind for Open Finance. I think it still remains an open question as to whether the proposal as set out by the Commission - an overarching Act, is the best way forward at this stage. It should be considered whether we take more time both in the drawing up of the text but also in the implementation stages. Perhaps a step-by-step approach could be an alternative. But this all depends on an analysis from industry of the type of proposal that best fits their aims and enhances business and innovation opportunities in Europe, and also greater analysis on the benefits and risks for consumers.

At this stage, I am keeping an open mind as to the way forward, but I do see potential, if we can get it right, for greater interoperability and cooperation between actors in the different financial and non-financial sectors that would be affected. Digitalisation is a reality that cannot be ignored. It will happen continuously and more than likely at a much quicker pace than any legislation. So while FIDA could fit in to adapt to that digitalisation and potentially help firms maximise opportunities, and consumers maximise choice, I don't believe that in itself it would be a driver of greater digitalisation.

Looking into the specifics of FIDA, we have a proposal from the Commission for a mostly market-led approach to developing data access, or in the Commission's draft data sharing, schemes. I believe the ambition for harmonised APIs is good, but I do question whether in practice it would be possible given the fragmented landscape across different sectors such as banking, insurance, pensions etc.

**Developing open  
finance should be a  
priority, but not at the  
expense of European  
competitiveness.**

Not to mention the wide variety of EU law which these industries already must comply with, and the differing rules in member states on other related aspects. I see all of these as challenges to overcome, and once again I think time will be critical to allow all players in the ecosystem to do so. I am not very much in favour of the Commission devising their own data access schemes and you will have seen in the amendments I tabled to the Parliament's draft report that I consider a better option is cooperation between everyone from the outset, with sharing of information on schemes that work well, are developing well and are not overly burdensome for industry.

In my view, the Commission, competent authorities on the EU and national levels, and national administrations should all be working with industry from day one to maximise the opportunities of the data-driven economy in Europe.



## MARC ROBERTS

General Counsel - Raisin GmbH

### Open Finance and the Financial Data Access proposal

The terms open finance and open banking are most commonly used in the context of financial information management services. Many of the legislative initiatives are based on the premise that regulated institutions have a large repository of data that could be harnessed by innovative Fintechs to create new products and services for customers. PSD-II opened up payment accounts for payment initiation and account information services. FIDA will extend the information services to further products, including mortgages, loans, savings products and certain types of insurances. Indeed, there are successful companies that offer services integrating payment initiation on APIs into existing app or website structures. Such services help to improve the user experience and make it easier to offer services without media disruption.

However, open banking goes beyond regulated access to data, it also includes bank cooperations with Fintechs. If we look at some of the most successful ventures - particularly in Europe - in the financial sector over the past years, there are also other companies that are data driven. Many of them do not focus on the regulated access to data under PSD-II, but on cooperation with banks or other Fintechs. Open finance in such a wider sense includes many cases, in which products or services, which are for different reasons not core to an

institution, are provided via integration of third party products or services. There are numerous reasons for such cooperation including:

- A product may be new on the market and therefore requires special knowledge and technology that are offered by third party providers.
- The cost for incumbent players to develop new products may be higher. In case of a separate development the fixed cost can economically be shared between several service recipients.
- The products can be rolled out quicker as companies specializing on a product provide these to other market players who then act as distribution partners.

The potential scope of such arrangements is as large as the banking sector itself and may be relevant in all parts of the value chain. This covers the more known areas of the payment sector, where the use of third party payment initiation, may even help create the basis for compliant identifications, but also sectors such as the savings, credit and insurance. Raisin for example offers a savings platform for deposits and investment. This allows around 300 banks to offer their deposits on market-places in Europe, the UK and the US. It also allows large banking groups to offer their customers best in class savings products.

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**Open banking goes beyond regulated access to data, it also includes bank cooperations with Fintechs.**

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Such integrated services are also highly beneficial to the customer. They allow for a larger variety of products. Some products - such as wealth management - were previously only available for the richest clients and can now be accessed by many more. Open banking on a cooperation basis also makes cross border offerings of financial products substantially easier and last but not least the products can be offered cheaper as the development costs can be shared among market participants.

The Commission's proposal on financial data access now goes another step and includes further financial products, such as savings, credit business and certain types of insurances into the perimeter of data access rights for third party

providers. The rules on the technical integration are different from PSD-II as they require a membership in a data sharing scheme. Further, data holders are obliged to implement a permissions dashboard that gives customers the possibility to decide to grant access to their personal data to service providers. While addressing important and large financial markets in the EU the regulation - similar to the PSD-II regime - does not address open finance based on cooperation. For example, financial market participants using platforms for certain products - together with other players - should have the clear possibility to use already existing mechanisms for aggregating customer data. The regulation should address platforms as a potential means of fulfilling the obligations under FIDA.

As with PSD-II one of the main challenges of FIDA will probably remain the technical implementation and the incentivization of the data holders / regulated entities. The rules of the membership-based financial data sharing schemes will cover these topics. The market players, but also consumer associations, shall be represented and decide on rules for the access to the data and a model to determine the maximum compensation for sharing data. The rules allow for the establishment of more than one scheme and it remains to be seen whether this will effectively lead to a uniform market standard for institutions across sectors and jurisdictions.



## BARBARA NAVARRO

Head of Research and Public Policy - Banco Santander

### “In for a penny, in for a pound”: a strong political will for a renewed data sharing framework

A strong political will for a renewed data sharing framework FiDA marks a significant step forward in the evolution of the financial services landscape. By empowering consumers, enhancing transparency, and fostering innovation, FiDA has the potential to revolutionize the way we interact with our finances. As the EU embarks on this transformative journey, it is crucial to address potential challenges while embracing the opportunities that open finance presents. To fully unlock the benefits of data-sharing, FiDA must be a step further towards a cross-sectoral, customer-centric, open data end-game scenario.

In June 2023, the European Commission unveiled its vision for a comprehensive Open Finance framework, embodied in the proposed FiDA Regulation. It aims to establish a harmonized approach across the European Union, empowering consumers to access, share and control their financial data with trusted third parties. In the context of the European Data Strategy laid out back in 2020, FiDA comes together with other set of regulations such as the DMA (Digital Markets Act – the open data

from the so-called bigtechs categorised as gatekeepers), Data Governance Act, Data Act (IoT data) and AI Act as the overarching file that completes the data-sharing and model building panorama.

Importantly, having as base a very welcome market-driven approach and vital elements (i.e. incentives and liability frameworks for sharing data), it still falls short in relevant aspects: it only covers the financial services related data, probably deepening the asymmetry with other sectors started with PSD2.

While FiDA offers a promising framework, there are still some challenges that need to be addressed:

- **Cross-sectoral approach:** In the provision of financial products and services it is the combination of data from different sectors holds the greatest potential. As a matter of example of open data use cases, combining financial data with energy consumption, carbon footprint, digital behavior or public administrations activity could let financial services companies build more accurate lending solutions, carbon offsetting or fraud mitigation use cases, impossible or hard-to-build nowadays under current data-sharing constraints.

### The combination of data from different sectors holds the greatest potential.

- **Ensuring consumer awareness:** Consumers need to be aware of the benefits of the broader data economy (important data literacy) and their rights and responsibilities under FiDA to fully benefit from the regulation.
- **Establishing the data sharing schemes:** While the market-driven approach is a great opportunity for ecosystem participants to really focus on clear use cases, it's important that the regulation gives to this endeavor the necessary time to be deployed (initial proposal of 18 months is not considered feasible for any stakeholder).
- **Incentive Model:** Also, adding core elements such as a compensation model and a liability regime also brings incentives for data holders to participate more actively and, in the end, benefit the customer through more innovation and competition.

- **Addressing security concerns:** Data users need to implement robust security measures to protect consumer data from unauthorized access or misuse. The reference to the Digital Operational Resilience Act (DORA) here is much welcome.

### Global trend present in every jurisdiction

The FIDA Framework is still in its early stages of development, but the momentum for Open Finance is gaining traction across the globe. Several countries, including the United Kingdom, Australia, México, Brazil, and Singapore, have implemented, or are exploring Open Finance initiatives.

In the United States, the Consumer Financial Protection Bureau (CFPB) has proposed a rule on data access and portability, which could pave the way for a more open financial system in the country.

### Epilogue

Imagine a world where your financial data is no longer locked away in silos, inaccessible to you and third parties and the innovative services that could be built to help you make better financial decisions. That's the promise of Open Finance, a concept that has the potential to democratize finance, boost innovation and put the power in the hands of consumers. This revolution is spearheaded by a groundbreaking regulation known as the Financial Information Data Access (FiDA) Framework that needs to be followed applying its openness to other productive sectors. Only this way we can build together an open data economy and promote a true lever of growth and competitiveness for Europe.



## DIANA PAREDES

Chief Executive Officer &  
Co-founder - Suade Labs

### Key operational considerations for a successful FIDA implementation in the EU

The Financial Data Access (FIDA) proposal, presented by the European Commission on June 28, 2023, marks a significant stride toward bolstering the digital capabilities of the EU's financial sector. It delves into the realms of open finance, encompassing critical aspects such as data sharing incentives, data quality, and standardisation. By addressing these key components, FIDA endeavours to establish a secure and transparent framework for accessing customer data, extending beyond payments, and paving the way for innovation and competition in the EU financial sector.

FIDA strives to address the challenge of incentivising data sharing by granting data holders with the right to request fair compensation from data users. This proposal calls for an objective, non-discriminatory methodology for calculating compensation, directly tied to the costs of data accessibility—a marked departure from the preceding Payment Services Directive (PSD2) open banking regulations. Furthermore, FIDA mandates that data holders and users participate in one or more Financial Data Sharing Schemes (FDSS). These schemes are responsible for governing access to

customer data in compliance with FIDA and other applicable EU rules, crafting uniform standards for data sharing and interface requests, defining contractual obligations for members, and instituting effective dispute resolution mechanisms.

However, while FIDA holds immense promise, it also raises complex challenges in the realms of data protection, foreign entity supervision, and practical data sharing. Despite the growing acceptance of data-driven services and the willingness of many customers to share their data, a significant portion still lacks trust in their ability to control and limit data use. Moreover, uncertainties persist regarding the supervision of foreign Financial Information Service Providers (FISPs), particularly those operating outside the EU while accessing EU data. The European Data Protection Supervisor has voiced concerns over the broad definition of customer data under FIDA, and questions loom regarding the practical safeguarding of sensitive business data and trade secrets. FIDA's broad scope covers a wide array of customer data and financial institutions, potentially introducing complexities during implementation.

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**The challenge lies in ensuring that all participants can actively engage in the open finance ecosystem.**

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The implementation of effective open finance systems in the EU, as envisioned by the FIDA framework, hinges on addressing various operational aspects, including the adaptability of IT systems, interoperability, digital identity, and more. Agile IT systems are essential for financial institutions to swiftly adapt to evolving requirements, integrate with emerging technologies, and offer innovative services in response to dynamic market demands. European financial institutions exhibit significant disparities in digital maturity, with some leading the charge in digital transformation, while others grapple with less flexible legacy systems. The challenge lies in ensuring that all participants can actively engage in the open finance ecosystem. Consequently, ongoing investments and upgrades in IT infrastructure are indispensable to fortify systems, enhance security, and accommodate the demands of open finance.

Interoperability is also crucial in facilitating seamless integration across

diverse systems and applications across the financial sector. While the EU has made notable progress in promoting interoperability, achieving full compatibility remains a great challenge due to the diversity of systems and standards in use. Consequently, continued efforts are required to develop unified standards and protocols that bolster interoperability, with FDSS playing a pivotal role in this endeavour.

Furthermore, heightened data sharing mandates a robust cybersecurity posture. Financial institutions must be well-prepared to counter the increased risks of data breaches and cyberattacks. Aligning with regulations such as GDPR and ensuring compliance with emerging frameworks like FIDA is also essential for the successful implementation of open finance. Additionally, a robust digital identity framework is imperative for secure and efficient customer authentication and authorisation processes within open finance systems.

In conclusion, the EU is making substantial strides in establishing a framework for open finance. However, operational challenges, including the assurance of agile IT systems, interoperability, and a unified approach to digital identity, persist. Overcoming these hurdles necessitates collective efforts from regulators, financial institutions, and technology providers. It is an ongoing process of evolution and adaptation to ensure that the EU's open finance ecosystem is secure, efficient, and advantageous for all stakeholders. This transformation will enable Europe's diverse financial sector to offer data-driven products and better cater to customer demands in the data economy.



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Q&amp;A

**JÉRÔME GRIVET**Deputy Chief Executive Officer -  
Crédit Agricole S.A.

## The main question is not why there should be a digital euro, but how

How can we make the digital euro useful?  
How can we address citizens' needs? How can we address citizen adoption challenges? How can we make the digital euro popular?

We all share the ECB's goals: financial innovation, strategic autonomy and a public monetary anchor in the digital world. It is normal and legitimate that the ECB should try to achieve these goals.

So how can the digital euro be made to work?

It must be simple from the start. The digital euro report drafted by the Centre for European Policy Studies (CEPS) recommends: *"Start with a digital euro that is as simple as possible and with basic functionalities"*. I agree the focus should be basic utility for consumers and then phasing-in additional services according to need.

However, to secure citizen uptake, I think we also need to clarify what the use-cases are. Ask anyone about the digital euro. They're likely to answer: "How is that different from my credit card?"

As efficient private solutions have already been adopted, the digital euro would overlap and not fill any gap. Also, let's not forget the value that people place on convenience and continuity.

It must be integrated with banks' own solutions. As of today, people have properly adopted banking apps, through which they do a large proportion of their banking. Adding the digital euro to this framework would only help its uptake. This means banks need to oversee front-end and back-end systems.

The digital euro must offer a high level of privacy. In the 2021 survey conducted by the ECB (Report on the public consultation on a digital euro, 14 April 2021), privacy came first with 43% of respondents saying it's what they wanted the most

from a digital currency. The European Data Protection Board made recommendations (Joint Opinion on the Proposal for a Regulation on the establishment of the digital euro, 18 October 2023) on this aspect, underlining the need for improvement.

We need to focus on simplicity, use-cases, integration in the current landscape and privacy.

Online, offline, account-based, wallet-based, how can we best answer needs?

To me, users' needs are not so clear-cut. Offline payments are where I see the most added value for peer-to-peer and day-to-day payments, and the closest we can come to replicating cash. Offline is also the solution that offers users the most privacy. However, despite being the most innovative, the offline functionality is the least attractive for the respondents of the 2021 ECB survey – with only 8% saying it's what they favoured the most.

The online aspect is key to ensuring a presence in the digital world, for instance for e-commerce. Here, the challenge is that it would overlap with well-established private solutions. It would need to be better integrated in the current payment landscape.

On whether it's account-based or wallet-based, I think what matters most is the underlying technology. If it's token-based, then the device on which the tokens are stored needs to be sufficiently secure. If it's account-based, we need to think about connection to databases for transaction updates and instant accounting systems. Each solution comes with specific challenges.

How can we build a robust business model for the digital euro? How can we avoid reinventing

## the wheel and not duplicate existing payment infrastructure in order to reduce the additional costs?

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To be robust, the business model needs to be balanced between incentives and obligations for all payment-chain actors.

The forecast model would involve a deficit for banks and other PSPs since it is supposed to be free for users and offered at a better price than card payments for shops, while high costs are behind it. To give a non-exhaustive idea, commercial account keepers would bear the costs of AML, KYC and reimbursing clients for fraudulent transactions. PSPs providing wallets would need to integrate the D€ wallet in the app, deal with transaction data and develop a suitable off-balance sheet accounting system.

The model would be better balanced if the reverse waterfall system is remunerated. Otherwise, third-party wallet providers would offer the wallet without having to deal with the linked bank account and receive all the interchange fees. Commercial banks, responsible for the account, would still be faced with most of the costs. This would create a strong windfall effect in favour of the GAFAM wallet-providers.

To remedy this situation, the business model would need to introduce interchange fees between the bank and the third-party wallet provider, in what could be called a two-level interchange system, the second level being the compensation between the intermediary wallet provider and the commercial bank holding the account. Wallet providers could also be made responsible for other costs, including fraud.

Adapting and using the ATM system for the digital euro would also mean costs requiring compensation from third-party wallet providers.

Clarity, balance and fees between wallet providers and commercial account holders would be a sensible way forward.

## How may the digital euro contribute to the EU's strategic autonomy?

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I understand the concerns with strategic autonomy as other jurisdictions are developing CBDCs, private companies are developing stablecoins and a number of foreign companies are seen as having a privileged position due to their market share.

I think there are three aspects to consider when it comes to the strategic autonomy claims behind the digital euro. Firstly, are central banks around the world moving forward that fast with their own CBDCs? In countries like China, CBDC uptake has been relatively low compared to private methods. As for relations with Visa and Mastercard, I note that there are national card schemes, like CB, that do not depend on them. The issue is cross-border payments, but the EPI project is also a way to provide interconnection and fulfil needs.

In addition, as the business model is linked with high costs for European banks, the digital euro may limit the means for innovation, with a potential shift in favour of big techs.

Finally, disintermediation and disruption to the EU banking sector would also pose a threat to the EU's strategic autonomy, of which the banking sector is a major enabler. Indeed, it supports the green and digital transition, industry and all key sectors in our bank-financed economy. So, for the D€ to

contribute to the EU's strategic autonomy, we must find a way to build on synergies.

## How can we avoid bank disintermediation (financing of the economy, payments)?

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Disintermediation is bound to have a significant impact, since bank funding would need to be replaced at a cost, thereby impacting lending channels, cost and availability of credit, and affecting the financing of the economy. Costs would be higher for consumers, citizens and businesses. To avoid this, I recommend integrating the digital euro into bank-provided solutions such as apps. As I have mentioned, this would only help CBDC uptake and create added value for users since banks would be able to add on services.

Then, a holding limit is an absolute necessity, and wouldn't stand in the way of the digital euro. Online payments would be covered by the waterfall and reverse waterfall system, so holdings are not needed. When you use a credit card, you do not need to provision a specific account or dedicate a sum to it. It is linked to your bank account. It should be the same for the digital euro with the waterfall system. For offline payments, a very low limit would work if, like cash, the digital euro is expected to be used for small payments. According to the ECB 2022 Space 2 study, four out of five purchases at the point of sale for less than €5 were paid in cash. Above €50, cards become the most common payment method.

Finally, the digital euro should not be remunerated, to avoid public-private competition for deposits.

## How can we limit the risk of financial instability entailed by the digital euro?

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The threat of financial stability is central and needs to be mitigated.

Financial instability would come with deposit outflows. Users might be tempted to transfer funds from their commercial deposit accounts to digital euros. According to a Copenhagen Economics' study for the European Banking Federation, a holding limit of €3,000, with a 100% uptake, may lead to an outflow of up to €739bn from bank deposits, or 10% of the total household deposit base.

High digital euro demand is a condition of deposit outflows. Yet, some factors could lead to this scenario. Times of stress, market instability, whether perceived or real, could be a trigger, thereby exacerbating outflows, intensifying bank runs and contagion effects. Especially if you can transfer funds to your digital euro account very quickly, at close to no cost, and with a high threshold. Meanwhile, co-legislators are discussing how to prevent contagion risk in the event of bank failure via another piece of legislation, CMDI.

To limit the outflow risk, I stress that the holding limit needs to be much lower than €3,000 and the digital euro cannot be remunerated, as rightfully proposed in the Commission's draft regulation. It is not in the spirit of replicating cash and is bound to have a detrimental impact.

## DIGITAL EURO KEY SUCCESS FACTORS



### BURKHARD BALZ

Member of the Executive Board -  
Deutsche Bundesbank

### Unleashing potential with a digital euro

According to a recent Eurobarometer survey, 69% of Eurozone residents believe that the euro is a 'good thing' for their country. A key factor in this positive view is likely to be that many people find it easier to make payments than in the past. In everyday life, it is above all the possibility of paying abroad using the same currency that adds noticeable convenience. In the past, this mainly applied when visiting other euro area countries and paying at a point-of-sale. But in recent years, European cross-border online retail trade, like online retail trade as a whole, has also increased significantly.

Paying cash, as the only existing form of central bank money, is not an option for cross-border online retail trade. Due to its physical form, cash's uses in online retail trade are inherently limited. For digital payments, the buyer is very often forced to use globally operating networks such as PayPal, Visa or Mastercard. However, no retailer can be blamed for not integrating dozens of solutions that are widely used at a national level, such as the girocard or the carte bancaire. According to the European Commission, the potential of cross-border online trade has not been fully exploited. One reason could lie in the potential mismatch between checkout options and the preference to use trusted and well-known domestic payment services. In any case, however, it renders payers and payees in the eurozone increasingly dependent on the few available globally operating payment networks.

The example of cross-border online retail trade shows what a digital euro could achieve: it can create noticeable added value for citizens, reduce barriers to trade and create a common European payments infrastructure. Building a European infrastructure is one of the key tasks associated with the digital euro. This must be done in a series of steps. The now-completed investigation phase laid down core principles for the infrastructure. The Eurosystem has recently decided to continue its project by conducting further preparatory work. During this phase, the Eurosystem will continue to refine the technical concept and specify components to be developed internally or procured externally. In addition, a rulebook is being drafted for the digital euro scheme, which will serve to establish a comprehensive and harmonised system around the core infrastructure of the digital euro. This rulebook is being drafted by a specially created group, the Rulebook Development Group (RDG), whose members represent all relevant stakeholder groups. The scheme offers the opportunity to create the necessary standardisation at checkout counters in the

eurozone. One example would be a uniform frontend standard that creates consistency for merchants in terms of integration and usage and for consumers in terms of recognisability. For financial intermediaries, the RDG process should ensure that a digital euro fits as well as possible into the existing ecosystem, thereby allowing merchants and intermediaries to reap synergies. An initial version of the rulebook was issued for consultation among RDG members and their organisations in December 2023. The rulebook is due to be completed in 2024.

### Building a European payment infrastructure is one of the key tasks associated with the digital euro.

Once the groundwork has been completed with the legal framework, the rulebook and the provider selection, the ECB's Governing Council will decide whether to move on to the second phase of preparations and thus pave the way for the issuance of the digital euro. A key factor for such a decision will be political agreement on the applicable legal framework. The actual launch would then take place in stages. A phased approach has clear advantages: it provides more flexibility and minimises risks. As a first step, possibly in three to four years, an initial version that supports person-to-person and online payments could be introduced. As a second step, the functionality could then be expanded to payments at physical checkout counters. As physical stores use payment acceptance hardware, adding digital euro functionalities needs to be well coordinated with the usual renewal cycles. This would give merchants more time to adapt their systems and ensure a smooth implementation.

Once the decision has been made following completion of the legal framework, the job will not yet be finished. Actual introduction would be a challenge in its own right. One must bear in mind that this is a project for roughly 350 million citizens and many millions of firms.

The digital euro in its final form would have great potential to make the euro an even better thing for people and businesses. The future should not just be an extension of the present, and the euro is no exception.



## EVELIEN WITLOX

Digital Euro Project Director -  
European Central Bank (ECB)

### The digital euro: a digital form of cash with European reach

The euro stands as one of the most tangible symbols of European integration. The latest Eurobarometer survey highlights that a large majority of respondents sees the euro as beneficial for both the European Union (79%) and their countries (69%).

This steadfast support endures despite the massive changes in the appearance of the euro and the way we pay. Twenty-five years ago, when the euro was first introduced, people almost entirely used banknotes and coins for their daily payments. In today's increasingly digitalised economy, people's payment behaviour is different and continues shifting at an unprecedented speed: in the last three years alone, cash payments in the euro area have dropped from 72 to 59%, with digital payments becoming more popular.

However, a crucial gap persists. While European citizens can use central bank money in physical transactions thanks to cash, they cannot for digital payments in shops or online purchases. A digital euro would fill in this gap by complementing cash and other electronic payment methods, offering citizens with central bank money for their day-to-day digital transactions.

A digital euro would futureproof our currency by also providing something that currently does not exist yet: a digital payment solution that is exclusively European and seamlessly usable throughout the entire euro area, like banknotes are today. In that way, a digital euro would be a complement to cash – not a replacement – that would also contribute to minimising Europe's dependence on non-European payment providers, which remains high.

Our financial system – with supervised intermediaries at its centre – is stable and it is part of the ECB's mandate to safeguard this stability. This is why the Eurosystem is designing a digital euro in a way that preserves banks' key role in ensuring the efficient provision of credit to the real economy.

To minimise any potential risks a digital euro may pose to the financial system, the Eurosystem will establish a digital euro holding limit to prevent excessive outflows from commercial bank deposits into digital euro. This limit would be defined closer to issuance, considering the economic conditions of the time.

In any case, such holding limit would not pre-empt users' transactions. The digital euro is currently being developed with a waterfall functionality that will enable users to link their commercial bank accounts and make digital euro payments beyond the holding threshold if desired.

Making digital euro available would require collaboration between the public and private sectors in order to maximise their respective advantages.

Payment Service Providers (PSPs) would be in charge of the distribution of the digital euro throughout the euro area, becoming the direct counterparts for digital euro users. This distribution model would ensure the digital euro's true pan-European reach, while bringing added value to European acquirers. A digital euro would lay the foundations for private providers to further innovate and develop new value-added financial services for their customers beyond their national borders. A single set of rules, practices and standards defined in the digital euro scheme would also ensure that euro area residents would be able to pay and be paid in digital euro, irrespective of the PSP with which they open their digital euro account or the countries in which they make payments.

The Eurosystem has consistently collaborated on all these aspects with a diverse range of stakeholders since the inception of the digital euro project in October 2021. This inclusive approach involved also active engagement with private market participants to ensure that digital euro could add value for all players in the euro area's diverse payments ecosystem.

This engagement effort with market participants, civil society, other EU institutions and policymakers will continue and intensify throughout the digital euro preparation phase, which started in November 2023. In the next two years, the project team will continue developing a digital euro by finalising its scheme and starting with the selection of external providers to support the development of a possible digital euro infrastructure. Moreover, the Eurosystem will also dive deeper into key digital euro issues, such as its offline functionality.

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**A digital euro would fill this gap providing central bank money for day-to-day digital transactions.**

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But the digital euro is not just a payment solution. It is a truly European initiative geared towards preparing the single currency for the digital age. This is why all actors have to play their part in making the digital euro a success.

The European Commission initiated the legislative process for a digital euro with the publication of a legislative proposal in June 2023 and the European Parliament and the Council are currently working on such proposal. The draft legislation is consistent with the rationale for a digital euro, and the Eurosystem remains committed to continuing working together with other EU institutions towards introducing a digital euro to ensure our currency is fit for the digital age.



## HARALD WAIGLEIN

Director General for Economic Policy, Financial Markets and Customs - Federal Ministry of Finance, Austria

### The Digital Euro – Between being a success and being dead on arrival

The year 2024 could prove decisive for the fate of the digital euro. While the European Central Bank and the European Commission are pressing ahead with the realisation of the digital euro, other actors including Member States' governments, important parts of the financial sector and the general public seem to put on the brakes. If these other actors cannot be convinced to jump on the digital euro bandwagon, the digital euro might be dead on arrival.

In order to avoid such a scenario, I will take a closer look at three issues which notably influence the support for the digital euro and express my thoughts on how to progress on them. These issues are: (1) the degree of clarity about the functions of the digital euro, (2) the limits to the discretion which is given to the ECB to shape the digital euro and (3) the persuasiveness of the political narrative of the digital euro. I will argue that more clarity, greater Member States' participation and improved persuasiveness are key for the success of the digital euro.

#### Clarity about the Digital Euro and limits to the ECB's discretion

In mid-2023, the Commission published its legislative proposal on the digital euro. There was hope that this proposal would provide clarity about the functions of the digital euro. Moreover, it was anticipated that the ECB's discretion in shaping the digital euro would be limited by allowing other actors to participate in decision-making processes regarding the digital euro. Although the Commission managed to shed light on some matters, many fundamental questions were left unanswered and the ECB's discretion remained extensive.

An important example for insufficient clarity about the digital euro is the application of instruments to limit the use of the digital euro as a store of value. If the digital euro can be used to store and accrue value like a bank deposit in an unlimited way, its attractiveness for users could increase significantly. However, a digital euro with such capabilities would also have the potential of triggering a massive outflow of bank deposits from commercial banks to the ECB.

As a result, commercial banks, which are still key in providing debt finance to the real economies of EU Member States, would be impaired in their ability to provide credit to businesses. This could have serious repercussions for financial stability and economic growth within EU Member States. Instruments that limit the use of the digital euro as a store of value can prevent such consequences.

The Commission's legislative proposal on the digital euro addresses these instruments and other vital functions of the digital euro with a broadly formulated and in part even ambiguous text. With regard to the relevant instruments, it avoids defining

them and instead gives the ECB unrestricted discretion to do so. From a regulatory and a central banker's perspective, the broad wording of the proposal and the ECB's discretion to shape the digital euro seem sensible. The digital euro is in its infancy and there should be enough room for economic and technological changes in the future. Moreover, the ECB wants to be in a position where it can accelerate and use the brakes with regard to the take-up of the digital euro at the same time.

However, it is also clear that Member States' governments and the financial sector are not thrilled about the lack of clarity and the idea of issuing a blank check to the ECB to decide on key functions of the digital euro. They want to participate in the process of controlling the effects of the digital euro on their economies and business models.

Therefore, Member States' governments and the financial sector understandably demand amendments to the legislative proposal on the digital euro to increase clarity about the functions of the digital euro and better participation in shaping the digital euro. The willingness of the ECB and the Commission to let this happen could markedly increase the support for the digital euro.

#### Political narrative

Various ideas have so far been brought up to explain the need for the digital euro to the people. Nonetheless, the public and financial sector sentiment towards the digital euro has not been overwhelmingly positive.

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### More clarity, greater Member States' participation and improved persuasiveness are key.

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Many EU-citizens are confronted with the challenge of understanding what the digital euro really is. People also fear that the digital euro will be used to monitor them and soon replace cash. Thus, a better job needs to be done in explaining the added value of the digital euro, the mechanisms to ensure privacy and the safeguards which aim to guarantee the use of cash.

The financial sector must be reassured that it will be able to recoup its investments for distributing the digital euro. In addition, businesses must be given a better perspective on the benefits of the digital euro for their own business models. This could be done for example by providing more and better cost-benefit analyses of different digital euro scenarios.





## TIM HERMANS

Executive Director - National Bank of Belgium (NBB)

### The digital Euro: a project guided by the times

The issuance of a digital euro would signal the Eurosystem's unwavering commitment to ensuring - as it has always done over the past 25 years - that money is aligned with the ever-changing needs of society. The advent of the metaverse and artificial intelligence heralds a transformative shift to the digital realm, to which our common currency must adapt. To achieve this goal, it is imperative that the digital euro seamlessly integrate into the digital realm the most appreciated features of cash, such as confidentiality, offline usability, generalised acceptance, and a distinctive European brand identity.

But the digital euro is more than just a response to technological trends; it is a strategic move to position our currency at the forefront of the digital age, effectively strengthening Europe's autonomy and resilience in the digital financial landscape. Accordingly, the digital euro is intended to be a technologically diverse payment method, developed under pan-European governance and applicable to all retail scenarios, including person-to-person transactions, in-shop purchases, e-commerce, and payments to and from public authorities. In essence, it would be the virtual equivalent of cash, reducing the fragmentation of the European cross-border payments market and the uncertainty surrounding the acceptance of electronic means of payment by merchants.

#### The financial sector as a partner

The commitment to future-proofing does not exclude the use of established distribution channels. It would indeed be a mistake to overlook the expertise in front-end activities acquired by the financial sector, in particular banks, over the last few decades. The financial sector is therefore recognised as a key partner, with distribution of the digital euro to be handled by payment service providers (PSPs) through their legacy applications. This will require PSPs to engage in user management (onboarding, payment instrument management, etc.), transaction management (transaction initiation, authentication, etc.) and liquidity management (funding and defunding of the digital euro account) in relation to the daily use of a digital euro account or wallet, located on the European Central Bank's balance sheet.

Moreover, excessive deposit outflows and related consequences for PSP liquidity could be prevented by means of a holding limit, while proposed "waterfall" and "reverse waterfall" functionalities - whereby any excess/shortfall would be automatically credited to or debited from the user's regular bank account - would prevent that holding limit from becoming a transaction limit.

The path described above, as well as the various functionalities already endorsed by the Eurosystem (see the ECB's stocktake on the digital euro for more information), is intended to

facilitate, insofar as possible, the integration of the digital euro into user habits, while ensuring that confidentiality is not neglected. Aside from offering best-in-class privacy for online transactions, the digital euro could be used to carry out untraceable offline transactions, as is the case today with cash.

#### The road ahead

The National Bank of Belgium, in collaboration with its Eurosystem counterparts, is currently focused on the preparation phase, as the investigation phase, dealing with key issues relating to the design and distribution of the digital euro, ended on 18 October 2023. This new phase aims first to finalise the rules necessary for its issuance. It is also intended to allow more in-depth analysis of the various components of the platform that will need to be set up for tendered services, as well as of the private and public entities responsible for providing these services.

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### The commitment to future-proofing does not exclude the use of established distribution channels.

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Moreover, European lawmakers took a decisive step with the publication of the European Commission's Single Currency Package in June 2023. This proposal is currently being examined by the European Parliament and the Council. Importantly, the Commission included in its legislative proposal a provision on the legal tender status of cash, to preserve and protect its role in our society. The Commission's objective, which is aligned with that of the ECB, is clear: the digital euro is not intended to replace physical cash but rather to serve as an additional payment option for consumers and merchants.

In conclusion, the abovementioned partnership with the financial sector, as well as the ongoing dialogue with lawmakers, showcases a collective effort to shape a digital euro that prioritises the needs and aspirations of European citizens. When embarking on this progressive journey, ensuring clear and accurate communication will be crucial to improving public understanding and building trust in the project.



## JORN LAMBERT

Chief Digital Officer - Mastercard

### A digital euro that puts the European consumer at the centre

As the payments ecosystem continues to rapidly evolve, European policymakers are preparing to act on two fronts. On one hand, the declining use of cash and emergence of potentially disruptive payment solutions like stablecoins has led many policymakers to identify a need to reinforce the role of central bank money as an anchor to the stability of the monetary system. At the same time, an increasingly challenging geopolitical landscape has amplified policymakers' desire to have a pan-European payment network that sits within the EU.

For many, the digital euro project is considered the perfect way to address both these issues simultaneously. Growing interest in central bank digital currencies (CBDCs) around the world have provided a receptive backdrop to embark on a payment project of unprecedented scale in European context.

Properly executed, such a project will deliver a range of benefits, including providing consumers with new payment options and supporting the resilience of the broader European payment system. Improperly implemented, the digital euro could stifle competition, undermine the security, resilience, and diversity of payments, and hinder future investment into new payment innovations in Europe.

The digital euro project is more likely to be successful if policymakers, beyond replicating what already exists, provide a compelling use case that includes tangible, easily understandable benefits to both people and businesses. These benefits will only be possible if there are substantial competitive elements, and that requires fair and equal competition. Ultimately, this can lead to positive effects on innovation, choice, and resilience for the entire European payments landscape.

#### Introducing an element of choice

Regardless of what is purchased or how it is paid for, a core set of facts are true about how people think about payments: They want to choose the method that is best suited for each particular transaction, they want it to be convenient to use, and they want to feel confident that the transaction is safe and secure. To deliver that choice and flexibility customers need – and increasingly expect – the market needs to offer a wider range of payment solutions that are specifically tailored to consumer preferences. This element of choice will also be critical for a digital euro.

By leveraging existing technologies and networks (an “open acceptance model”), the Eurosystem could enable a wide range of payment networks to distribute the digital euro across a variety of payment rails, promoting it as another choice available to consumers in support the singleness of

the currency. Consumers would then be able to use whatever payment solution they feel most comfortable with, while also allowing the Eurosystem to remain the operator of the settlement infrastructure in central bank money. This could be done without waiting for, or relying solely on, the development of a new pan-European payment network. That's not to say that a new payment system under European governance can be pursued in parallel, but it is by its nature a longer-term endeavour.

#### Allowing for fair and equal competition

There are also concerns about the potential effects on competition – and the risks that a publicly subsidised pan-European payment network could pose to existing structures. To ensure a level playing field between all types of digital payments, a new network must comply with all applicable legislation, including anti-trust laws, and apply a compensation model that both recuperate costs incurred, and allow intermediaries to charge for the value they bring to consumers, businesses and governments. Importantly, the digital euro project should consider the power of public-private partnership to deliver central bank money, given the connectivity that open infrastructure built by existing rails provides in addition to value-added services that are unlocked by private companies.

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### Improperly implemented, the digital euro could stifle competition.

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Implementing and operating a pan-European payment network would also be an expansion of the ECB's current operations, beyond simply issuing a digital version of cash and providing the necessary regulatory framework for that instrument. The ECB would instead act as both operator and the supervisor of a consumer-facing scheme that is competing directly with supervised private payment infrastructures. It will thus be essential to introduce a clear separation and independence between ECB's dual roles.

The digital euro project marks an important step in making the Euro fit for an increasingly digital world. By carefully considering the circumstances under which a digital euro can be implemented in an already well-functioning European payments landscape, the envisioned stability and security objectives of the project can be achieved alongside increased competition and greater consumer choice. All Europeans would benefit from such development.



## KOEN HOLDTGREFE

Global Head of Government & Regulatory  
Advocacy - Deutsche Bank AG

### The digital euro would be a milestone for innovation and digital transformation, but only if well-designed

Money and payments are fundamental infrastructures for the functioning of the real and the financial economy. History shows that monetary systems have evolved in parallel to the developments and needs of economies and societies. Innovation and geopolitical dependencies have given cause to review the status of the euro.

With regards to innovation, the ECB initiatives on new digital forms of the euro focus on a digital euro for retail payments, as well as on new technology for wholesale payment infrastructures. They are logical next steps in the context of the strategic digital transformation of the EU and go hand-in-hand with the objectives of EU legislators to enable innovative technologies for new forms of money and digital assets.

At the same time, the constant focus on innovation of payment solutions and products by the private sector in the past 2 decades catapulted payments to the heart of digitalisation in financial services.

Commercial banks continue to improve money and payments through the use of new technologies. For example, for corporate payments, they are exploring the opportunities to tokenise commercial bank money for Distributed Ledger Technology (DLT)-based value chains, such as international supply chain management or trade finance solutions. The ECB work on new technology for wholesale payments is an important component to that future ecosystem. Introducing a digital euro for retail purposes however has fundamentally different practical implications for the wider public and the economy. The development of this new infrastructure requires a careful calibration of multiple policy objectives amongst EU institutions and Member States.

A key decision to be taken is around the ECB mandate: can the ECB introduce a digital form of cash as a new form of digital money on the basis of the EU Treaties? Can it become a payment service provider governing a payment scheme? The latter would require building a payment platform, directly competing with private sector payment solutions and payment schemes.

Whilst the issuance of a digital euro as a new form of central bank money is in scope of the competencies of the ECB, the proposals from the ECB to act as a full payment scheme manager are not.

Having the ECB acting as payment scheme manager has the potential to significantly disrupt the well-functioning European payments landscape without adding value for citizens and businesses. The expected legal obligation for merchants to accept the digital euro and for banks to offer the ECB-built user frontend as a default will undermine market competition.

When looking at geopolitical considerations, a key policy objective for the ECB for the digital euro is to maintain the sovereignty of the European payment landscape. That is because daily payments in the 27 EU Member States, and in particular inter-EU cross-border payments, are dominated by non-EU payment service providers. This leads to a geopolitical vulnerability.

In the past 5 years, the EU private sector launched a number of initiatives to address this gap: the European Payments Initiative (EPI) as well as the envisaged cooperation between the Spanish Bizum network with Bancomat in Italy and SIBS in Portugal are reflective of how the private sector addresses this political objective.

A key advantage of these solutions is that they will be established well before the launch of the digital euro. Payment users will be able to easily tap into this EU-wide network which can in future facilitate access to the digital euro. The EPI banks, for example, when fully launched in 2025, will cover initially 60% of the EU wide digital payment transactions and service 120 million users.

Another positive aspect is that these payment solutions are capable of processing payments in all EU currencies and for multiple types of digital money. EU citizens will benefit from convenient one-stop shop solutions and businesses can be cost-efficient by leveraging existing technical infrastructure.

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### There is a true merit in issuing a digital form of the euro...

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This is why co-legislators should thoroughly review the scope of the ECB mandate for the digital euro in the legal framework. The overarching political objective for the ECB mandate should be retaining sovereignty of our common currency whilst contributing to making the eurozone competitive in the digital age.

There is a true merit in issuing a digital form of the euro, especially from a wholesale perspective. If it is integrated efficiently in the EU payment landscape, a digital euro will enrich the EU payment landscape and, together with the innovations in the private sector, will bring the Eurozone to the forefront of digital payments.



## MARCO SIRACUSANO

Chief Executive Officer - PostePay S.p.A.

### The Digital Euro: abalancing risks, opportunities and expectations

The digital revolution is having a deep impact on payment behaviors: over the past three years, cash payments in the euro area have dropped from 72% to 59%, substituted by digital payments. Therefore, the launch of a digital euro as CBDC seems to address this growing preference for electronic payments. It seems unavoidable that a Euro CBDC will have to complement with cash payments, offering to all Europeans access to means of payment as a form of universal service: free of charge, easily accessible and easy to use, supporting financial inclusion. The digital euro is expected to complement not only cash, but also other electronic payment means. This is critical to safeguard our monetary sovereignty while strengthening Europe's strategic autonomy, allowing adaptation of the global payment infrastructure to the new CBDCs.

The European economic system would benefit by a digital Euro, alongside the existing range of choices for retail payments, supporting the growth of e-commerce across all the UE. The key aspect of a digital euro should be its accessibility. It would provide costless access to a simple, risk-free and trusted digital means of payment, accepted throughout the euro area. In the digital era, it would preserve the public good that the euro provides to European citizens. If we consider the Digital Euro as a new European public good-universal service, we could expect it to have a series of characteristics: it could be used for payments anywhere, by anyone and at any time – just like cash in the physical world; it should be easy to understand, easy to use and easy to transfer; it would increase privacy in digital payments thanks to the involvement of the central bank, which – unlike private suppliers of payment services – has no commercial interests.

The digital euro has a great potential as catalyst for the global role of the Euro – also considering that the ECB is ahead of the game if compared to other Central Banks - generating much needed efficiency benefits in cross-border payments, providing interoperability with other international digital currencies.

This digital euro also powers innovation, with benefits for the European payment infrastructure. This is a crucial network for the entire economy, as e-commerce is becoming an engine of growth and efficiency.

Commercial financial intermediaries will anyway maintain a big role on distributing the Digital Euro. The size of the payment ecosystem is expected to grow and transform into a series of connected platforms. The creation of a digital euro as platform currency will generate new business models and opportunities, where commercial intermediaries will have a key role to play, adapting new payment solutions to the transforming economy, with innovation at its center.

Still, a Digital Euro solution brings some uncertainties and it requires careful risk assessment: its main strengths – security and liquidity – can affect monetary and financial stability on three fronts, if not adequately designed:

- Consumer unpredictability- With a new financial crisis, account holders could massively convert their assets in commercial banks into risk-free digital euros. Banks will have much less capacity to introduce capital controls than with ATMs and branches.
- Cybersecurity- Central banks are not immune to cyber-attacks, so criminal hackers or hostile nations could disrupt the digital infrastructure by targeting a central bank issuing it or commercial intermediaries.
- Distribution issues- Even if the digital euro were available to everybody, would they use it? Many people do not understand what the digital euro is and cannot see the benefits, also fearing they may lose privacy.

There are mitigations for any of the risks aligned here, but the introduction of a Central Bank currency will have to deal with concepts of trust, reliability and practicability, this without compromising the stability of the existing infrastructure. As the investigation phase of the Digital Euro is nearing an end, it will be important the financial community feel their considerations and concerns are addressed and that the Digital Euro is designed as an engine of innovative solutions, new services and renewed trust pact between the financial industry and the European citizens.

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**It seems unavoidable that a Euro CBDC will have to complement with cash payments.**

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Furthermore, to find a balanced market position between digital Euro and the existing digital payments, all the stakeholders (Legislators, Financial Institutions and Business Community) should work together to identify the use cases where Digital Euro can effectively add value by offering new services and simplifying the payment processes, such as:

- promoting the usage of “off-line” micropayments in digital Euro;
- allow the direct or indirect programmability of the Digital Euro to enable payments embedded to the execution of contracts;
- identify rules and procedures to manage disputes in case of e-commerce and other “deferred” payments transactions (when the payments and the good or service are delivered in a different time).



## GERDA HOLZINGER-BURGSTALLER

Chief Executive Officer & Chief Retail Officer -  
Erste Bank Österreich

### Let's not put the cart before the horse

More than 100 jurisdictions around the globe are currently experimenting with their very own Central Bank Digital Currency (CBDC). While some governments believe that they are the future of payments, others have already expressed significant doubts. Likewise, views seem to diverge within the EU over the question if introducing a digital currency is the right way forward. Should Europe, which has the ambition of playing a greater global role in digitalization and innovation, thus take a step back and call off its Digital Euro project, as some critics call for?

While there are certainly legitimate reasons to criticize the Digital Euro, I believe that completely hitting the breaks on the project would go too far at this stage. What is instead needed is a serious and thorough discussion about its chances and risks, so that we can make sure that the economic costs of the project do not exceed its benefits. The problem is that preparatory work on the technical has already been pushed to a perceived point of no return. Additionally – and very importantly – citizens, who will be most affected by the project, have never sufficiently been put in the center of attention.

A recent survey in Austria, conducted by the Austrian Society for European Politics (Österreichische Gesellschaft für Europapolitik), bears witness to this as more than a third of the 1000 participating citizens didn't have any basic understanding of what the Digital Euro is, and roughly half reject the project altogether.

This is a rather concerning finding since the Digital Euro is not only a niche project for the few who believe in the potential of digital currencies, but one that might have a great impact on all of us. This is not mainly due to the reason that it will provide customers with new payment options - so far there seems to be no use case that is not already solved by existing payment options - but because of its (unintended) potential side effects.

In order to make to project work for European citizens it will thus be important to address a number of key aspects:

- First, we need to identify new use cases for citizens: The Digital Euro should only be introduced if it addresses an existing market failure instead of creating duplicities.
- Second, under any circumstance, it needs to safeguard the privacy of citizens: Central banks must be bound by the highest data protection standards and as little personal data as necessary should be made available to them.
- Third, financial stability needs to be ensured: Citizens certainly do not have an interest in scenarios in which the financial stability of banks is being played with. The only remedy to this problem is holding limits, which will need to be carefully set at a sufficiently low level, in line with daily payment needs of citizens.

- Fourth, avoiding a negative impact on the economy can also be mitigated with the help of a reasonably low holding limit, as any money held in the form of the Digital Euro, instead of conventional bank deposits, cannot be deployed for the purpose of lending activities.
- Fifth, and perhaps most significantly, it will be essential to explain the rationale behind the project as well as its implications in a transparent and consistent manner to the European public. EU institutions should thus set up a shared communication strategy to provide clarity and avoid unnecessary misunderstandings.

As Europe is about to get ready for the next EU elections, and legislative processes will come to a halt, it is the right time to take a step back and get ready for a broader discussion that involves all relevant stakeholders and in particular citizens.

A concrete proposal to this end:

- The ECB and Members of the European Parliament, who represent citizens at EU level, could hold a monthly exchange to publicly debate the biggest concerns from the various constituencies across the continent and ensure democratic accountability.

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### A broader and more in-depth political discussion, together with citizens, is urgently needed.

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- Dialogues with citizens at local level, should take place in all corners of Member States (carried out e.g. by representatives of the national central banks), to explain the ambitions, opportunities and risks of the Digital Euro directly, thus fostering a better understanding of those most concerned and impacted.
- Finally, additional impact assessments are required by both the Commission and the ECB in order to fully understand the effects and costs of the Digital Euro.

Let's not put the cart before the horse but have a thorough political discussion first. The Digital Euro is too important for such a mistake.

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## EU PAYMENTS

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### DENIS BEAU

First Deputy Governor -  
Banque de France

## The future of payments – The importance of trust to unlock innovation

The EU has faced exceptional challenges in the last years, and several external developments have affected the payment ecosystem: the COVID pandemic of course, but also the tense geopolitical landscape, which generates new cyber threats. Moreover, new digital players and big technology firms, are now developing new products at an unprecedented pace.

These developments of the payments landscape create new challenges for regulators, supervisors and overseers. As payments go more digital, the EU needs to tackle in particular two main challenges, namely to achieve strategic autonomy of and to maintain confidence in our payment system.

Indeed, while innovation and digitalisation carried out within a controlled framework are delivering means of payments that are more secure, faster, more convenient and user

friendly, that have upped our reliance on non-European and unregulated or less regulated entities. At the Banque de France, we consider that central banks have an important role to play to help address those challenges, both through their support to adapted regulatory developments, to appropriate private-sector led initiatives like the EPI one, and in evolving their central bank money services.

Regarding the support to regulatory developments fitted for the digital age, those developments should support innovation while putting in place proper safeguards. This means that they notably should address issues related to the observation that multiple actors, whether they are banks, fintechs, specialised technology providers or bigtechs, now provide regulated and unregulated services across a fragmented payment chain. This implies that regulators need to increase their focus on addressing operational, security and cyber resilience issues along the whole chain, and that all actors providing critical services for the smooth operation and security of payment transactions should be adequately regulated. The legislative proposal on a third Payment Services Directive (PSD3) and associated regulation, which was published by the Commission last June, is a welcomed step forward in this direction. Certain service providers that are currently unregulated like digital wallets and payments gateways, would see their liability regime clarified regarding the critical role they play in the processing of payment transactions.

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**We should support innovation while putting in place proper safeguards.**

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Moreover, as our economic lives are increasingly online, payment fraud risk needs to be all the more mitigated. Maintaining trust in payments is critical to fully unlock the potential of innovation, but it cannot be achieved without a regulatory framework that ensures consumers and businesses are adequately protected against the risk of fraud or errors. This is why we welcome that the upcoming instant payments regulation, which will

mandate the provision of this service by all payment service providers offering credit transfers, will also require them to match the IBAN and the name of the beneficiary in order to alert the payer of a possible mistake or fraud before the payment is made.

Regarding the adaptation of our central bank money services to the digital age, an important step has been made recently as the Eurosystem launched the preparation phase that will lay the foundations for the potential issuance of a digital euro. The digital euro would be designed as a “digital banknote”, displaying the same characteristics as cash: it will be accepted everywhere across the euro area thanks to its legal tender status and it will meet the highest privacy standards. In addition, the digital euro will be usable where cash is not available today: it will allow the use of central bank money in e-commerce and in remote peer-to-peer payments.

Importantly, the digital euro scheme we are developing in conjunction with market stakeholders will enable the emergence of open acceptance standards, fostering convergence and offering common ground on which to build further innovation. EPI and its wallet Wero will be able to take full benefit of it to achieve its pan-European ambition.

The EU payments agenda is rightly flourishing both on the regulatory and operational fronts as payments become more digital. It should reflect our collective ambition to embrace a digital transition that benefits the lives of European consumers and businesses, while still ensuring universal access to a full range of secure payment means, including cash.



## FRANÇOIS- LOUIS MICHAUD

Executive Director - European  
Banking Authority (EBA)

### PSD3 and PSR: enhancing competition and combating fraud

In June 2023, the EU Commission published a proposal for a revised Payment Services Directive (PSD3) and a new Payment Services Regulation (PSR). The goal is to build on the momentum of PSD2 in 2016 and enhance the security of retail payments in the EU, the convenience for payment service users, innovation and competition, and ultimately achieve an EU single payment market.

The track record of PSD2 in achieving these objectives is impressive. Competition has intensified, with more than 400 payment and electronic money institutions (Pis/EMIs) now authorised in the EU to provide the new account information (AIS) and payment initiation services (PIS). Full transparency about their operations is provided through a central EBA register, which contains information on 2,000+ Pis and EMIs and 100,000+ agents. It is downloaded 200,000 times each month from 90+ countries, which suggests that firms outside the EU-27 use it to gather intelligence ahead of a potential entry into the EU market.

A higher security level was achieved, primarily through the EBA's Technical

Standards on Strong Customer Authentication (SCA). An EBA initial analysis in 2021 indicated a reduction of fraud by 40-60% for payment cards alone, even though several EU countries had not fully implemented the SCA requirements at the time. Fraud data during the first semester of 2023 period are now being collected by the EBA in the context of an analysis it will publish in the 2nd quarter of 2024 which it expects to confirm this trend and show further improvements.

However, innovation also exists in fraud, and other, new attack vectors, such as social engineering fraud have been developing and need to be addressed. Barriers also remain which do not allow the objectives of Open Banking to be fully reached. Some other, interpretative issues with PSD2 did not allow for its objectives to fully materialise, especially as far as security provisions, authorisation and legal definitions are concerned. With this in mind, the EBA response to a Commission Call for Advice on the PSD2 put forward very practical recommendations.

In the Commission's proposals of June 2023, the EBA has particularly welcomed the provisions in the PSR on the strengthening of the security measures to prevent fraud, such as the sharing of fraud-related information between PSPs, the educational initiatives on payment fraud, the clarifications on the application of SCA, and the improvements to SCA accessibility.

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#### EU payment security and competition should continue to progress.

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It also worth noting the measures proposed to further advance Open Banking competition objectives which would benefit from a number of measures such as: mandating the use by PSPs of application programming interfaces, specifying the functionalities required of APIs and providing a non-exhaustive list of obstacles, requiring AISP to perform their own SCA instead of the account provider, and requiring permission dashboards for consumers. Finally, we welcome the proposals on the calculation of own funds, improving the access of Pis to payment systems, and the strengthened provisions on enforcement.

Discussions will continue during the Belgian Presidency. This will provide opportunities to further reflect on some of the key features of fraud

prevention, such as the design of Strong Customer authentication (SCA) or the 'fall-back' access.

In terms of consumer protection, it will be important to clearly delineate between authorised and non-authorised transactions and on the concept of gross negligence, which determines the extent to which it is the consumer or the PSP that bears the financial burden in case of fraud. Similarly, discussions in the coming months will probably focus the delineation between payment and e-money services, the definitions of 'payment account', 'payment instrument' and 'agent' (PSD3 and PSR), local substance requirements (PSD3), the interplay between PSD3/PSR and MiCAR, and the allocation of product intervention powers under PSR.

The EBA is fully committed to the objectives of reducing fraud and enhancing competition, and stands ready to assist in the finalisation of this important legislative file.



## JEAN DIACONO

Vice President & Manager,  
Global Merchant Services  
Continental Europe -  
American Express

### Navigating the new landscape of European payments: the Role of PSD3 and PSR

In 2023, the European Commission took a significant step to further harmonise the European payments ecosystem with the introduction of the Third Payment Services Directive (PSD3) and – for the first time – a Regulation in the form of the Payment Services Regulation (PSR). These regulatory changes, coming five years after the entry into force of PSD2, promise to enhance integration, efficiency, and innovation in payments. They aim to balance cost efficiency with fair competition and push for technological advancements.

With these proposed regulatory changes as the backdrop, the European retail payments market is navigating a dynamic era of transformation and innovation. This market, traditionally dominated by cash payments, is increasingly embracing digital payments. This transition, however, is not just about phasing out cash; it is also about expanding and diversifying payment options in a consumer-centric manner. This approach ensures that

the move towards a cashless society is inclusive, offering a panoply of payment choices to meet diverse consumer needs.

As the negotiations on the Payment Services Package unfold, it is now worth taking a look at what issues the PSD3/PSR aim to tackle and the policy changes necessary to achieve the principal goal of EU legislators: a true pan-European single market for payments.

When introduced, PSD2 was a game-changer, especially in fostering an open banking framework, but it fell short in creating a more competitive European market. PSD3/PSR seeks to build on this by levelling the playing field between banks and non-bank payment actors, improving fraud prevention, and enhancing open banking and Strong Customer Authentication (SCA) protocols. There are, however, concerns about potential disadvantages for smaller players such as Amex. To achieve stronger competition in the European payments ecosystem, a number of changes to the proposed Payments Package need to be made.

For instance, the fragmentation of the surcharging rules across Member States has been an unfortunate consequence of PSD2. While 18 Member States have fully banned the practice of charging consumers for the simple act of paying, the remaining Member States still allow the practice for smaller cardschemes such as Amex and other payment instruments not covered by the Interchange Fee Regulation. Today, we find that this only partial surcharging ban has discouraged innovation by new market entrants with alternative business models, resulting in fewer options for consumers, and leaving dominant players in a position to increase prices.

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**A concerted effort is  
now needed to achieve  
a full EU-wide ban  
on surcharging.**

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As such, a concerted effort is now needed to achieve a full EU-wide ban on surcharging for all payment instruments. This will help protect consumer rights, ensure a better customer experience, encourage merchant transparency, end abusive practices, and create a level playing field among payment service providers (PSPs).

Another area of focus should be the ability for PSPs to operate on a pan-European basis, making better use of passporting rights. In the context of

passporting, we continue to call for a change to the rules to allow payment institutions (PIs) to issue credit on a pan-European basis beyond the existing 12-month credit term limitation in Article 10(4) PSD3. This restriction only applies to PIs and not to banks, which poses a competitive disadvantage and is contrary to fundamental principles that underpin the single market. Indeed, this provision makes it impossible for Amex and other PIs to offer credit cards across the single market in competition with bank card issuers, which de facto is pushing these non-bank players to obtain a banking license in order to operate on a cross-border basis. Removing this unnecessary and unwarranted burden on non-banks would therefore improve competition in the European payments market and bring more options to consumers, especially in smaller Member States.

The proposed PSR also brings forth essential changes in Strong Customer Authentication (SCA), fraud prevention, and transaction risk analysis. Amex appreciates the revised approach to SCA, advocating for a risk-based and outcome-oriented strategy. However, we continue to call on co-legislators to explicitly allow the use of behavioural biometrics in authenticating consumers as part of the 'inherence' factor of SCA. This would enable easier authentication of payments, particularly for less technologically savvy customers, while keeping very high safety levels.

As the European payment ecosystem evolves, PSD3 and PSR will play key roles in this transformation, aligning with goals of market integration, innovation, and security. Effective collaboration between the industry and regulators is, therefore, essential to ensure that these changes benefit not only the current market but also prepare for future challenges and opportunities.





## RICHARD NASH

Vice President, Government Relations - PayPal

### Enabling safe and secure frictionless payment experiences in the EU

The European payments market is dynamic and competitive. Europeans enjoy a variety of payment methods available across the European Union that are both secure and fast. The benefits of the SEPA project, turning previously fragmented national markets into a single market for payments, cannot be understated. Neither can the positive impact of the PSD1 and PSD2 in creating a single rulebook for payments, making domestic and cross-border payments in the EU more efficient, secure, and more transparent. The proposed PSD3/PSR package continues to finetune this single rulebook, to level the playing field and to foster the development of innovative payment services.

Another driving force contributing to the EU market's dynamism and competitiveness is the customer: the way they shop, buy, and spend. The pandemic increased the use of digital payments, both online and mobile payments, including in-store. Accelerated technological development has made it possible to meet these evolving customer needs, leading to new and more diversified payments products and services. Digital wallets are among

the leading payment services favored by consumers for instance.

Customers expect payments to be safe, secure, fast, and seamless. They also expect choice: the ability to choose their preferred payment method and their preferred experience, whether that is with more friction, or less, and which may even vary depending on the amount of the transaction. And more choice for customers leads to better experiences for merchants, ultimately promoting digital growth and enabling digital trade. A payment provider's ability to provide safe and secure frictionless payment experiences, in any context and on any device, will remain a key differentiator in this increasingly competitive market.

It is therefore important that legislation appropriately considers these evolving consumer expectations, as well as the concurrent technological innovation driven by payment firms to meet them. We believe that onboarding and authentication journeys are essential to providing great customer experiences. An enabling regulatory framework that is built on an outcome- and risk-based approach, would facilitate current and future innovation, and enable payment providers to meet customer expectations of secure, fast and frictionless payments.

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#### Innovation is enabling secure experiences that are also convenient and seamless for customers.

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The draft PSR's focus on more accessible, data-driven and innovative SCA solutions, that can be performed using a single device, will be key to making authentication services more innovative, inclusive, and competitive. The regulation should embrace innovative technologies that enable more convenient experiences, such as device recognition, (behavioral) biometrics, and other data-driven methods, provided that they can deliver equally high levels of security. Importantly, the regulatory approach to SCA should be future-proof: adaptable to emerging security infrastructure and technologies that enable secure and seamless experiences. An outcome-based approach – with security and convenience at its core – would permit the use of emerging technologies to meet SCA requirements, rather than maintaining prescriptive solutions based on outdated technologies.

A good example is FIDO's passkey technology, which has the potential

to revolutionize the future of payments across the world, including in the European Union. Based on cryptographic keys and device unlock mechanisms (such as biometric readers), passkey technology offers a secure and convenient means of authentication, removing the weaknesses of traditional password-based methods. This makes online purchases easier for consumers and removes checkout friction for merchants. As the landscape evolves, passkey technology could usher in a new era of secure and convenient payment experiences.

A risk- and outcomes-based approach to authentication in the PSR would give payment providers the flexibility to innovate to respond to evolving security threats, whilst also meeting the complex and diverse needs of customers. It would permit an appropriate balance between ensuring high levels of security and consumer protection, whilst enabling convenient customer experiences using innovative technologies. This would foster more competition and allow innovative payment providers to continue investing in customer-focused solutions.

PayPal's experience is that providing secure payment services is fundamental to build and maintain consumer trust, especially as we continue to drive cross-border, including intra-EU, commerce for SMEs and consumers.

Technological innovation is enabling secure experiences that are also convenient and seamless for customers. It would be a lost opportunity should the review of the PSR not embrace the opportunities this provides.



## MASSIMILIANO ALVISINI

Senior Vice President Europe  
CIS & Africa - Western Union

### The way forward for a Single European Payments Market

The European payments market has seen rapid change over the last few years, facing economic and social challenges requiring timely and innovative responses to foster growth, cohesion and employment. With customers demanding quick, easy-to-use and, importantly, safe ways to pay and transfer money, the sector has adapted, driven by technological developments. This article explores some of the recent achievements of and challenges faced by the payments sector and offers potential solutions.

At Western Union, we are in the unique position of operating in all European markets – many for over 30 years. For us, providing customers with flexibility and ensuring their trust is a key priority. We believe the payments sector would benefit from a move towards greater harmonization. We are pleased to see the proposal by the European Commission for a Payment Services Regulation (PSR) underpinning the Third Payment Services Directive (PSD3). A single set of rules across the EU will allow payment service providers (PSPs) with a presence in multiple European markets to operate across borders more easily, contributing to the development of a truly Single Market in payments.

Other areas that could be improved to increase efficiencies and legal certainty in the European payments markets include:

- Non-bank PSPs in the EU, and particularly the remittances sector, still face significant challenges with unwarranted de-risking. This is particularly acute in certain Member States, leaving entire sectors unable to provide a stable product offering to their customers. The current proposal still leaves several loopholes, such as potential excessive compliance costs used a ground to refuse access.
- Another important topic is the provision of transparent information to money transfer consumers transfers, including regarding fees and currency conversion. This is something that Western Union strongly supports in a way that ensures that the information provided supports users' needs. The PSR aims to enhance transparency, fairness, and consumer protection in payment services. However, proposals to display FX margin may not improve consumers' ability to make an informed choice and could even be confusing. Similarly, proposals to adopt national central bank reference rates may not be appropriate for this type of requirement, as they may not consistently provide reference rates for all global currencies that are accessible to market participants. An independent benchmark rate may be more appropriate to use.

#### Ensuring a level- playing field for all market players.

- Lengthy and divergent registration periods for agents of service providers can create significant business and operational challenges for the timely provision of services to consumers can be easily shortened. A more harmonised process with shorter registration periods would address this challenge.
- IBAN discrimination constitutes another challenge to a Single Market. It is already illegal for payment service providers to discriminate between domestic IBANs and IBANs in any other EU Member State, when making payments. However, our experience is that country-specific interpretations and practices vary greatly, in effect

leading to IBAN discrimination. Enhancing the requirements and penalties for non-compliance and expanding requirements to the non-Euro zone could significantly remove additional friction for all EU consumers and businesses and ensure fair access across the EU Single Market.

When reviewing proposed changes to existing payment rules within the context of growing digital transactions, such as those proposed in the PSD3/PSR and the Instant Payments Regulation, it is worth bearing in mind EU policy objectives to facilitate financial inclusion. While these proposals are necessary to follow the shift towards more digital and mobile-based payments and remittances, many corridors remain significantly cash-based. It is imperative that the EU rules are also designed in a way that ensures the ongoing provision of cash-based financial services without onerous and complex requirements.

With all the changes taking place at the European level, it is also important to assess how the Union is integrated into the global payments landscape. Western Union is supportive of the EU's objectives to adopt open strategic autonomy that aims to enhance Europe's self-sufficiency and independence in critical areas while, importantly, staying open to global trade and cooperation. An alignment of EU actions with the efforts carried out at the G20 level with the roadmap on cross-border payments is therefore imperative.

Every year, Western Union serves around 120 million customers globally, many in the European Union and including some of our biggest markets. As a leading money transfer player, we are acutely aware of our responsibility to our customers, and to the wider market. We are committed to contributing to a Single Market for payments, meeting the European objectives of open strategic autonomy, innovation and more secure payment transactions.

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# NEXT EUROFI EVENT

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## THE EUROFI FINANCIAL FORUM **2024**



**BUDAPEST - HUNGARY**  
11, 12 & 13 SEPTEMBER 2024

## CROSS-BORDER PAYMENTS AND GLOBAL INFRASTRUCTURES



### MARGARITA DELGADO

Deputy Governor -  
Banco de España

### Cross-border payments: a little more conversation, a lot more action

The quality and efficiency of domestic payments is clearly higher than that of existing cross-border payments. This relative lack of efficiency is a well-known and long-standing problem, and recent improvements in domestic payments may have even exacerbated this perception. The good news is that there is a firm commitment at the highest level to tackle this problem. In 2020, the G20 leaders tasked the FSB, in coordination with other global committees and international bodies, with improving the situation by 2027. We have come a long way since then, analysing the frictions behind the shortcomings in cross-border payments, identifying areas of improvement and establishing an initial roadmap to address them. An analytical framework has been built over the last two years to update guidelines and identify best practices in these areas. Quantitative targets have also been set and a monitoring framework put into place.

In February 2023, the FSB published a revised roadmap, detailing the priority actions that need to be taken to make progress towards the targets by 2027.

As we are roughly halfway through this process, I think it is a good moment to take stock of the progress made so far and analyse what remains to be done in the coming years. In my view, the most important factors to take into account are the following:

- First, the work carried out to date lays a good foundation for the road ahead, but we need to substantially change the approach for the next steps. In particular, we need to clearly shift the focus from analysis to implementation, while gradually increasing the involvement of national authorities and payment system operators in the application of the measures agreed. We also need to broaden the scope of stakeholders, securing the commitment of the private sector, central banks and public authorities beyond the G20. To this end, the FSB has already set up several working groups and task forces in which all interested parties are expected to actively participate.
- I also believe that building consistent data series to track progress is essential, as this is an area in which reliable data has traditionally been scarce. In this regard, the FSB has recently published a dataset of Key Performance Indicators (KPIs) to track progress towards the targets. It is fundamental that these indicators continue to be refined and monitored on a regular basis to determine whether real progress is being made and to continue driving the initiative forward.
- This is a multifaceted problem and there is no simple, one-size-fits-all solution to all the issues identified. While acknowledging the different starting points of specific jurisdictions and corridors, there are a number of complementary approaches that can be pursued: we need to improve the existing rails, consider possible regulatory changes, work on standardisation and also think about cross-border compatibility when developing new infrastructures. In this regard, I would like to highlight two areas that seem particularly promising in the very short term: the use of common

standards for payment messages based on ISO 20022, and the interlinking of fast payment systems. While these infrastructures have mainly been developed to modernise payments within a single jurisdiction, many experiments and initiatives suggest that they could be equally beneficial in a cross-border context.

- Finally, we need to recognise that the pace of progress will vary across jurisdictions and regions. Not all countries and corridors start from the same place or share the same problems. Regional initiatives can therefore be a good short-term response to reduce costs and improve service levels for a significant proportion of global payment flows in the transition to a more efficient global cross-border payments network.

In summary, over the past few years we have developed what I believe is a solid plan for improving cross-border payments worldwide. As with construction, having a good plan is not the same as having the building, but it is a necessary step towards it. At this early stage, these analytical foundations have been developed mainly by central banks and other public authorities, largely in the context of the G20.

### The solid plan agreed for improving cross-border payments worldwide needs to be implemented.

In order to move forward, we need to broaden the conversation to include the private sector and public authorities from around the world. More importantly, we need to collectively move from words to the implementation of the practical measures that follow from the analytical work. Only through action will we be able to improve cross-border payments, making them cheaper, faster and more accessible and transparent for the benefit of end-users worldwide.

To paraphrase the old Elvis song, I would say that the recipe for the next few years is to have a little more conversation but a lot more action.



## VICTORIA CLELAND

Executive Director for  
Banking, Payments and  
Innovation - Bank of England

### Measuring and maintaining progress on the G20 Roadmap to enhance cross- border payments

Significant progress has been made since 2020 when the G20 Finance Ministers and Central Bank Governors tasked the FSB, CPMI, and others to develop a roadmap to enhance cross-border payments. Given an increasingly global and interconnected world, cross border payments are growing in significance, and enhancing them can make a difference across the board from wholesale, to retail and to remittance payments. Improvements here will be far reaching for economies worldwide: so the prize is high.

Once the challenges of cross-border payments had been articulated, authorities around the world have collaborated to build a strong, analytical foundation to tackle them.<sup>1</sup> Best practice and assessment frameworks for addressing the key frictions and the actions for the public and private sector to alleviate them have been set out. This is underpinned by a number of working groups and public and private sector

taskforces to implement and to monitor progress. And the G20 Leaders adopted quantitative targets for improvement by 2027, covering speed, cost, access and transparency for wholesale, retail and remittance payments.<sup>2</sup> These targets give a clear focus on where we need to get to and a tool to prioritise our focus.

The roadmap was always envisioned as a 'living document' it has now been restructured around 3 priority themes of Payment System Interoperability and Extension; Legal, Regulatory and Supervisory Frameworks; and Data Exchange and Messaging Standards. These themes will help as jurisdictions move from analysis to implementation and will also help the private sector organise around a renewed set of 15 Priority Actions, to move from a focus on analysis to implementation of the changes that will make a real difference.

In October 2023 the FSB published, the *Annual Progress Report on Meeting the Targets for Cross-Border Payments: 2023 Report on Key Performance Indicators*, alongside the *G20 Roadmap for Enhancing Cross-border Payments: Consolidated Progress Report for 2023*.<sup>3</sup> This is the first time we have data showing not only how we are progressing against the overall 2027 Targets, but also insights into some of the differences between payment corridors. While none of the targets has yet been achieved in full, with nearly 4 years to go we are now in the position of being able to measure progress as we move from analysis into implementation of the roadmap. Findings from the KPI report show that user experiences differ significantly across regions, and across market segments (wholesale, retail, and remittances), though payments involving typically lower income regions tend to be furthest from the targets.

Each jurisdiction now needs to assess which of the elements of the roadmap would make the most difference in their area. The Bank of England has already made progress for example through the implementation in June 2023 of ISO 20022 messages. And in early 2024 will address two other key areas of the roadmap with the publication of discussion papers outlining the findings of our internal reviews into operating hours and access policies, which were conducted using the frameworks developed by the Committee of Payments and Market Infrastructures as part of the Roadmap. Increased hours and wider access are beneficial in their own right, and also act as foundations for further enhancements such as interlinking. These papers aim to seek feedback from the industry to help us develop an approach that balances our public policy objectives, the evolving

payment needs of an increasingly digital economy, and the current industry demand and capacity to make the necessary changes.

Enhancing cross-border payments has been an objective for many decades. What is different now is that we have a clear vision, targets and a holistic approach on how to address the disparate set of underlying frictions. And the work is taking place at a time of rapid innovation in the payments industry and national payment systems, creating an opportunity to build on existing change programmes.

1. *G20 Roadmap for Enhancing Cross-Border Payments: Consolidated 2023 Progress report* (fsb.org)
2. *G20 Targets for Enhancing Cross-Border Payments* (fsb.org)
3. *Annual Progress Report on Meeting the Targets for Cross-Border Payments: 2023 Report on Key Performance Indicators - Financial Stability Board* (fsb.org)



## MARC BAYLE DE JESSÉ

Chief Executive Officer -  
CLS Bank International

### Tackling FX settlement risk: the power of public- private partnerships

The smooth functioning of cross-border payments is crucial in today's interconnected world. These payments often involve the settlement of an FX transaction, which requires payment of one currency for receipt of another. A primary risk in such transactions – settlement risk – is that one party delivers the currency it sold but does not receive the currency it bought, resulting in a loss of principal. This risk is heightened by the timing gap between delivery and receipt, as currencies are paid at different times of the day.

In October 2020, the Financial Stability Board published the *G20 Roadmap for Enhancing Cross-Border Payments*, an initiative addressing the challenges of cost, speed, transparency and access in cross-border payments. Building Block 9 of the Roadmap focuses on mitigating FX settlement risk for cross-border payments – a key challenge for the wholesale market – by encouraging the use of payment-versus-payment (PvP) arrangements. The G20 initiative acknowledges that while existing PvP arrangements like those provided by CLS Settlement have made significant progress in reducing settlement risk, there are still obstacles to broader PvP adoption.<sup>1</sup>

The proportion of FX trades not settled on a PvP basis has increased in recent years, driven by the growth in emerging market (EM) currency trading. According to the Bank for International Settlements 2022 Triennial Survey,<sup>2</sup> the share of non-CLS eligible currencies grew from USD0.2 trillion average daily turnover in 2010 (ca. 5.5% of trades) to USD0.7 trillion in 2022 (ca. 8.5% of trades). One way to address the outstanding settlement risk is to make PvP available to a broader range of currencies – particularly heavily traded EM currencies.

Analysis conducted with a subset of CLS settlement members indicated that CLS successfully mitigated around 90% of the settlement risk exposure associated with their FX trades in the 18 CLS-eligible currencies, with full PvP. The challenge to further reduce settlement risk lies primarily in the currencies not currently eligible for CLS Settlement, some of which pose legal and/or geopolitical challenges. For example, adding new currencies to CLS Settlement is a complex endeavor subject to several high hurdles, particularly the satisfaction of crucial legal, risk and liquidity standards in the target jurisdiction. Local authorities – and not CLS – determine the timing and pace of onboarding. Also, a successful onboarding requires broader participation in CLS from both local banks and CLS members across the global FX market, which takes time to cultivate. Any solution to mitigate settlement risk in these currencies will require contributions from both the public and private sectors working in close collaboration to overcome these challenges.

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**CLS believes that public-private partnerships are the best means to tackle challenges in the FX industry.**

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CLS believes that public-private partnerships are the best means to tackle challenges in the FX industry. These partnerships ensure a deep understanding of market needs and help garner sufficient industry investment and support. In fact, CLS was established in 2002 as a response to the public sector's call for the private sector to address FX settlement risk. Since its inception, CLS has maintained its commitment to public-private collaboration, most recently via its participation in the CPMI-led Payments Interoperability and Extension (PIE) Task Force.

Shortening the securities settlement cycle to T+1 poses a new obstacle to implementing PvP. This change, taking place in the US and Canada in May 2024, may have implications for the FX trade lifecycle. Asset managers and funds in particular may face difficulties in ensuring timely settlement, as the change could make it more difficult for some of their FX transactions to meet CLS's cut-off times.

CLS is actively engaging with buy- and sell-side market participants to fully understand the potential impact. A member survey is exploring the feasibility of adjusting CLS Settlement processes to accommodate later cut-off times. The results will inform decision-making and be shared with relevant stakeholders. Any decision will consider client needs in view of CLS's mission to maintain stability and mitigate risk in the FX market.

CLS has also established a Market Advisory Forum to provide advice and feedback on key market issues that impact the FX industry, including the transition to T+1. The Forum will help market participants understand the challenges arising from a shortened settlement cycle and explore how CLS's products can assist with the transition in the short term.

Given the projected growth in cross-border transactions, policymakers and market participants must continue to prioritize mitigating FX settlement risk. While this risk has been successfully addressed for CLS-eligible currencies, the challenge remains in achieving broader PvP settlement for heavily traded EM currencies. Addressing this challenge requires close collaboration and active contributions from both public and private sector stakeholders – an approach that CLS fully embraces.

1. CPMI (2023) *Final Report – Facilitating Increased Adoption of PvP*
2. BIS Triennial Central Bank Survey; [bis.org/statistics/rpfx22.htm](https://bis.org/statistics/rpfx22.htm)



## MARIANNE DEMARCHI

Chief Executive EMEA - SWIFT

### Navigating the G20 goals for enhancing cross-border payments

In 2020, the G20 launched its Roadmap for Enhancing Cross-Border Payments – the first attempt by the international financial community to address the challenges of sending money across borders in a holistic way.

The roadmap stated that faster, cheaper, more transparent and inclusive cross-border payments would unlock significant socioeconomic benefits. Enshrined into it was the importance of private-public collaboration in meeting its goals.

But in an increasingly fragmented world, characterised by geopolitical uncertainty, rising customer expectations and emerging technologies, it is more important than ever that financial institutions work together on responsible innovations to power a frictionless and interconnected payments system that meets the G20 targets.

#### Laying the foundations

There is no 'one size fits all' approach to reworking and improving payment infrastructure and, with money as we know it evolving and taking increasingly digital forms, individual institutions may struggle to provide seamless

cross-border payments within a global network of disparate payment systems.

Indeed, a high proportion of payments are stalled at the recipient bank. Only 54% of transfers are credited to the customer account in one hour, and 93% within a day. The G20 targets are 75% and 100% respectively. We know, though, that 89% of Swift transactions arrive at the beneficiary bank within an hour and that delays arise due to variations between jurisdictions' ACH opening hours, capital controls, and additional compliance checks.

These sources of friction can't be addressed on their own – organisations must come together to create plans for powering cost mutualisation, creating joint oversight frameworks, improving infrastructures, enhancing data quality, and setting new payment arrangements.

#### Helping Europe pioneer instant payments across borders

Europe is leading the way in creating a pan-regional instant payment landscape. In a landmark move to modernise its payment infrastructure, the European Council and European Parliament are in the process of adopting Instant Payment Regulation, paving the way for a seamless, real-time payment experience for consumers and businesses across the continent. In parallel, the European Payment Council's OCT Inst scheme, which was launched in November, provides the pan-regional infrastructure and interoperability framework that enables instant payments across Europe to be processed more rapidly than ever.

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**To meet the G20 targets for cross-border payments, we must innovate with a global mindset.**

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To reduce frictions and costs, Swift has implemented tools such as Payment Pre-validation and Case Management. Payment Pre-validation utilises pseudonymised and aggregated transaction data from our network – that's over 9 billion messages between 4 billion accounts globally – to verify the accuracy of message information before a payment is initiated, reducing errors and potential delays.

The European Instant Payments legislation, if adopted, would mandate banks to offer confirmation of payee services to their customers. Swift's

Payment Pre-validation enables data from outside an institution's own jurisdiction to be validated before a payment is executed, and would mean simple compliance with the European legislation without the need for heavy investment. When issues do occur, Case Management streamlines investigations, improving efficiency and reducing costs for financial institutions.

With new technologies promising to revolutionise the way money moves around the world, the risk of domestic divergence increases. This introduces the need for a common standard, so that different systems can 'speak to each other' in one language. This is exactly what ISO 20022 – a new standard for data exchange between financial institutions – provides for global payments.

#### Private-public collaboration

The G20 roadmap identifies interoperability as a key area of work, and driving this is private-public collaboration. The global Swift network of more than 11,500 institutions is well placed to help guide the industry towards collaboration and provide the single centre through which our community can transact, with different networks interoperating seamlessly across borders. What's more, our core services are built to accommodate the assurances of transparency, cost, accessibility and speed that the G20 roadmap identifies.

The introduction of Swift GPI revolutionised cross-border payment transparency by providing end-to-end visibility on transactions, and we complemented this with Swift Go – our service dedicated to low-value payments. Built on the same rails as Swift GPI, Swift Go prioritises transparency of fees at the outset, without compromising security.

Although progress towards the G20 goals is well underway, there is much work left to do. The challenges across cross-border payments are often complex and require incremental efforts to effect change: it won't happen overnight. But as change does take place, we can ensure that fragmentation is minimised by innovating with a global mindset.

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Q&amp;A

**PAUL M. DONOFRIO**

Vice Chairman - Bank of America

## The role of the private sector in the energy transition

The private sector has embraced its important role to help drive the transition to sustainable renewable energy. As just one indication, more than 1,000 companies and philanthropic organizations joined together at COP28 in Dubai in late 2023 in the first-ever Business and Philanthropy Climate Forum, institutionalizing the presence of companies of every size, public and private, to help shape the important work ahead. Ensuring the secure availability of affordable energy through the transition will require the continued innovation, talent, and financial resources of the private sector, which already has mobilized trillions of dollars in investment and capital commitment to the task.

According to an estimate by the Climate Policy Initiative<sup>1</sup>, \$6 to \$7 trillion of is needed annually. That totals almost \$200 trillion between now and 2050. This represents an enormous opportunity for businesses to gain market share, grow revenue and invest in new technologies. The financial services industry has a unique role to play as a transmitter of global markets and economies, working with companies in every sector to help them on their own transition paths and helping ensure capital is directed toward the best opportunities.

At Bank of America, we are leading by example in our own operations. For instance, we purchase 100% renewable electricity for our buildings and have been engaging with our suppliers on their emissions for years. We reached carbon neutrality in our scope 1 & 2 emissions in 2019. We work with our suppliers to understand their own transitions and we have a goal that 70% of our global suppliers, by spend, set greenhouse gas emissions reduction or renewable energy targets by 2030.

While this work is critical, where financial institutions can help drive real progress is outside of their own walls. Why? Because operations and supply chains represent only a fraction of a bank's emissions. For Bank of America, it's 5%. As a consequence, the vast majority of our attention is on the emissions generated by our corporate customers: so-called financed emissions.

The financed emissions of financial institutions receive significant attention in many of the initiatives to address

global climate objectives. While this focus on financial institutions is understandable, the real emission-lowering work is being done by countless operating entities in every sector: public and private, as they set and make progress toward their own goals. Working together with our clients, we can address the shared priorities we have in helping shape a just energy transition. The good news is that this work is well underway.

For the world to transition to net zero over the next few decades, some estimates suggest lift to the global economy as great as that of the industrial revolution. Companies that transition well will likely see their revenue and market share grow significantly. Similarly, the incentives for financial institutions to deepen customer engagement and deploy capital are equally compelling and significant.

Bank of America has embraced this opportunity.

As an example, in 2021, we announced our goal to mobilize and deploy \$1.5 trillion in sustainable finance capital globally by 2030 in support of the 17 United Nations Sustainable Development Goals (UN SDGs). Of the \$1.5 trillion, \$1 trillion is dedicated to the environmental transition with the remainder dedicated to inclusive social development. In the three years since announcing this goal, Bank of America has mobilized and deployed more than \$500 billion in total sustainable finance capital that contributes to both environmental and social sustainability, well ahead of pace.

We are doing this by engaging with our clients across all industry sectors and providing a comprehensive suite of financial solutions that includes lending, capital raising, advisory, investment services, and risk management. As an example, we are a leader in renewable energy tax equity financing, with a portfolio of approximately \$135 billion at the end of 2022. Our investments have contributed to the development of approximately 40.7 gigawatts of total installed renewable wind and solar energy capacity in the U.S.

Clients also are asking for commodities related to the energy transition, and to support this demand we offer low-carbon

solutions such as trading in metals used in batteries, clean fuels used in transport, and other transition commodities. In addition, our Global Markets business is one of the largest market makers in European compliance carbon markets.

Beyond our capital commitments, we are working with clients directly on their own net zero transitions. This is shaped by a key goal guiding our path forward: to achieve net zero emissions across our financing activities, operations, and supply chain before 2050. In support of this goal, we announced 2030 interim-science based financed emissions targets in high-emitting sectors, including energy, power generation, automotive manufacturing, aviation and cement. By working with clients in these and other sectors we can help them achieve their sustainability goals.

To drive this progress, in 2022 we began providing training and support to our bankers on the business opportunities and on our own objectives for net zero: the risks and opportunities, decarbonization pathways, benchmarking, reporting and how Bank of America can help. This included sector-specific primers and case studies of leading industry players across a wide range of high-emitting sectors.

The public sector has been helpful in creating incentives and lowering traditional obstacles, as we have seen in the U.S. through the Inflation Reduction Act and Infrastructure Investment and Jobs Act. These incentives are encouraging even more innovation in decarbonization technology, driving down the green premium to commercialize technologies and thus speeding up the demand / supply flywheel.

This energy transition will not be easy, and challenges abound. But these are matched by the opportunity for companies to innovate, grow revenue and gain market share. The transition will be impacted by macro-economic factors that always influence economies and markets, including political instability and even war. But the capital is there and, with strategic collaboration among the private sector, public sector and philanthropic entities, we can scale the private investment needed to drive a successful transition.

1. *Climate Policy Initiative and Allen & Overy, "How Big is the Net Zero financing gap?"* <https://www.climatepolicyinitiative.org/wp-content/uploads/2023/09/How-big-is-the-Net-Zero-financing-gap-2023.pdf>

## REDUCTION OF GREENWASHING



### EVERT VAN WALSUM

Head of Investor Protection and Sustainable Finance Department -  
European Securities and Markets Authority (ESMA)

## EU supervisors are taking action against greenwashing risks

Sustainability-related financial products and markets have experienced remarkable growth in the EU and an important share of retail investors want to invest sustainably. However, professional investors and consumers alike have expressed concerns about greenwashing risks. In a survey EIOPA conducted in 2023, 51% of consumers replied they do not trust sustainability claims made by insurance and pension providers. While the figure signals improvements compared to 2022, when 63% of consumers expressed such distrust, this situation is not satisfactory for EU authorities. In its Progress report on greenwashing, ESMA found greenwashing risk to be material across all key segments of the sustainable investment value chain and to be the result of both conduct issues and structural problems.

To maintain trusted markets for sustainability-related financial products and services, an effective regulatory framework is critical. ESMA and the other ESAs will continue to advise the European Commission on ways to further facilitate the investor journey towards sustainable investments. In parallel, with the sustainable finance regulatory framework now closer to completion, the focus of ESMA and national authorities is shifting to providing guidance and to effective and consistent supervision and enforcement. In January 2023 ESMA launched a Union Strategic Supervisory Priority focused on ESG disclosures. Concretely, ESMA and national authorities agreed to take common supervisory actions (CSAs) and have been dedicating important attention and resources to preventing and tackling greenwashing notably focusing (1) on corporate sustainability reporting and (2) on the application of SFDR and the integration of sustainability aspects by investment service providers, as described below.

High-quality corporate sustainability reporting is critical for a well-functioning value chain and it is best supported through convergent supervision in the EU. This area is therefore a priority for ESMA. The new Corporate Sustainability Reporting Directive requires standardised and audited sustainability statements for about 50,000 companies active in the EU. These disclosures will include science-based data on sustainable activities along the lines of the EU Taxonomy. In parallel with these EU measures, international standardisation is also necessary to promote sustainable investment globally. ESMA therefore encourages interoperability between EU and international standards and supports IOSCO's endorsement of the ISSB standards for global adoption in jurisdictions where no sustainability reporting standards are in place.

As laid out in ESMA's Progress report on greenwashing, further down the value chain, areas of concern for investment management

comprise product-level claims about impact, ESG performance, and broader aspects of ESG strategy and governance as well as practices regarding naming of products. For investment services, areas of concern comprise the personalised advice provided to investors when presenting the sustainability features of products. Mitigating greenwashing risks in these areas is particularly important to support informed retail investor decisions and hence participation in financing the transition.

### The focus of ESMA and national authorities is shifting to effective and consistent supervision.

To tackle these issues, ESMA is committed to provide the market with regulatory clarity and consistency. Regulatory clarification can help prevent greenwashing, especially when it fosters more precise clearer and appropriately substantiated sustainability claims. One of ESMA's priorities in the funds industry is to address misleading naming practices. Funds' names are a powerful marketing tool, central to retail investors' decisions. That is why the use of ESG, sustainability and transition-related terms in fund names should be reflected in funds' investments. ESMA recently consulted on Guidelines addressing this area of concern and plans to adopt these Guidelines shortly after the revised UCITS and AIFM Directives enter into force. ESMA also updated its MiFID II guidelines on suitability and product governance to help firms with incorporating sustainability aspects in the provision of investment services.

ESMA has been promoting common approaches to supervision in these sectors. In a concerted manner, NCAs are assessing (1) marketing material of financial products, including potential greenwashing practices and (2) compliance of the funds industry with provisions related to sustainability disclosures and risks. In 2024, ESMA will launch a CSA to assess the implementation of the new requirements on the integration of sustainability into suitability assessment and product governance. Finally, the ESAs published in November a Financial Education factsheet on sustainable finance, to help improve retail investors' ability to understand ESG markets.

The sustainable finance regulatory framework is close to completion and its various components coming into application. In coming years, the priority for ESMA and national authorities will be on supervising the application of these rules.



## MARK T. UYEDA

Commissioner - U.S. Securities and Exchange Commission (SEC)

### A Q&A with SEC Commissioner Mark Uyeda

**In 2023, greenwashing seems to have been less in the headlines than before. Do you think that the importance of this issue has diminished?**

In the asset management space, “greenwashing” generally refers to funds or asset managers that exaggerate their environmental, social, and/or governance (ESG) investment strategies or the extent to which their investment process integrates these ESG factors. Similarly, public companies that greenwash attempt to mislead investors about how environmentally friendly their products or practices are, among other things.

The impact of greenwashing may ultimately depend on the success of ESG-focused products. According to the Investment Company Institute, the number of ESG-oriented funds has grown since 2019, from 489 to 991 funds in 2022. The assets under management have also grown since 2019, from \$276 to \$460 billion in 2022. Since 2022, however, the number of new ESG funds has dropped significantly and net redemptions from ESG funds has increased. In short, are these products are themselves “sustainable?”

There is debate as to whether ESG strategies are more costly and underperform other investment strategies, and if so, whether investors will accept that tradeoff for a “greener” investment. Investors that prioritize ESG strategies are faced with complex questions as to whether the investment meets their personal values. For example, some investors may prioritize investments that seek to achieve a particular social good, notwithstanding the environmental impact. Others may face difficult choices, such as whether to invest in companies that mine metals used in “green” technology, where the mining raises environmental, worker safety, and other questions.

**What is the situation regarding greenwashing in the USA and what is the policy of the SEC against greenwashing?**

U.S. federal securities laws are generally focused on disclosure for securities and financial products. Essentially, it is a “truth in securities” law. Purposefully misleading investors about material aspects of their product or services – such as how “green” these products or services are – can violate the antifraud provisions of our laws. The SEC’s Enforcement Division has brought actions for greenwashing, such as funds that claimed to integrate ESG factors into their investment process but did not, or a mining company that made materially misleading statements about the safety of its dam, which later failed catastrophically.

Given the existing antifraud laws and our ability to enforce them, I have questioned whether additional rules to address greenwashing are needed to protect investors. To the extent

that new rules are intended to achieve environment or social objectives, this approach may not only ineffective and inefficient, but also outside the Commission’s statutory authority and expertise. Such concerns are best addressed by our legislature.

**What are for you the priorities in the United States for greenwashing in the coming years?**

The SEC’s current regulatory agenda has two proposals that implicate ESG and greenwashing. One proposal relates to new climate change disclosure rules for domestic and foreign companies, including requiring certain climate-related governance, strategy, risk management and metrics and goals, and information about greenhouse gas emissions. We received over 5,000 comments on this proposal. The other proposal relates to prospectus and other disclosures for funds and investment managers that use ESG. Interestingly, some commenters thought that this proposal could lead to more greenwashing, as the disclosures could elevate ESG factors above others. However, others noted that the proposal’s standardized disclosures could provide transparency.

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**The ultimate impact of greenwashing depends on whether ESG-themed products are a short-term trend.**

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Greenwashing and ESG are important topics subject to vigorous debate. Our public consultation process provides valuable insights into the different perspectives about our proposals’ costs and benefits. I also appreciate learning about how regulators, investors, and industry around the world, including Europe, approach these issues.



## JOS HEUVELMAN

Member of the Executive Board - Dutch Authority  
for the Financial Markets (AFM)

### Towards a functional sustainability framework for investors and suppliers

Sustainability is playing an increasingly important role in choices made by investors. Accordingly, suppliers of financial products are also increasingly promoting and differentiating their products in terms of sustainability. To maintain trust in sustainable products it is of great importance that there exists a common system to assess the sustainable characteristics of financial products that is clear, meaningful, and feasible for both investors and suppliers.

For investors to make informed sustainable investment decisions that match their sustainability preferences, they need to be enabled to clearly and easily assess the sustainability features and claims associated with financial products. Convergenerly, suppliers need to be given more clarity as how to market, promote, and inform the market about the sustainability aspects of their products. Currently, investors and suppliers lack this clarity; as a result, investors are not always able to make clear and targeted sustainable investment decisions and suppliers are not able to effectively position and inform investors about their product offering. At the AFM, we have identified two ways by which clarity surrounding sustainability features could be improved.

Firstly, sustainability claims made in marketing communications, in prominent website information, or in the naming of products do not always conform to the existing requirements that information needs to be fair, clear, and not misleading. This is problematic as we found that investors are primarily guided by this kind of information over mandatory disclosures such as SFDR information. To support suppliers in adhering to the requirements that information needs to be fair, clear, and not misleading, we published guidelines on sustainability claims. These guidelines provide guidance by means of principles to market participants on how to correctly implement the information requirements. The principles state that sustainability claims need to be (i) accurate, representative, and up to date, (ii) specific and substantiated, and (iii) understandable, appropriate, and easy to find.

Secondly, the SFDR – which plays an important role in mandatory sustainability disclosures – faces several issues that make it difficult for investors to assess the actual degree of sustainability of a financial product. The information that is disclosed based on the SFDR is not always easy to understand and compare. Additionally, the categorisation of financial products along the lines of SFDR Articles 8 and 9 has led to their incorrect use as sustainability labels in the market.

Now that the SFDR is being reviewed, we propose to move away from the current SFDR distinction between products with “sustainable characteristics” and “sustainable investment objectives” as this does not correspond to the objectives and expectations of investors. Current market practices regarding

SFDR Articles 8 and 9, however, do demonstrate a clear desire for consumer-friendly sustainability product classifications. To ensure alignment of disclosure and categorisation with investor expectations and objectives, we propose to introduce three distinct sustainable product categories that investors can understand: “transition”, “sustainable” and “sustainable impact”.

Transition products invest in companies that are not yet sustainable (but plan to become so) and aim to create impact through active management of the investments. Sustainable products do not necessarily make measurable, active impact through the investment but are intended to cater to investors that demand investments in sustainable assets only. Sustainable impact products seek to make direct and measurable impact through investments, by financing underserved markets or companies that have a tangible positive impact on sustainability factors. These categories, coupled with minimum quality requirements and additional disclosure requirements, can guide financial market participants, distributors, and investors through the complexity of sustainable investment decisions.

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**For a well-functioning sustainable  
finance market, investors and  
product suppliers need clarity.**

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To have a well-functioning sustainable finance market, both investors and suppliers of financial products need clarity. We believe that by providing guidance as to (voluntary) sustainability claims based on existing general disclosure requirements and by altering the SFDR framework, suppliers will be able to effectively meet the information needs of investors, allowing them to make well-informed sustainable investment decisions.



## DAVID HENRY DOYLE

Vice President, Head of Government Affairs  
& Public Policy, EMEA - S&P Global

### Scaling EU sustainable finance: from market disruption to efficient marketplace?

The revolutionary reforms of the EU Sustainable Finance Agenda have disrupted norms in the global financial system. A new financial system is emerging in Europe which features ground-breaking reporting, measurement, and screening tools to target genuine sustainability outcomes. However, despite early progress, the EU's new system can be optimised to improve its efficiency and maximise its potential output. Given the scale of the sustainability challenges and increasing global competition for investment, European policy makers and market participants must intensify their work to calibrate, clarify, and – if necessary – correct key aspects of the EU's sustainable finance framework.

#### The scale of the sustainable investment challenge

The scale of investment needed to tackle the global climate, biodiversity, and sustainability emergencies is immense. The financial system can - and must - play a leading role in addressing these crises. Yet, to understand the necessary investment expected from financial markets it is useful to make a comparison to existing markets. The United Nations global stocktake at COP28 estimates that €4 trillion per year needs to be invested in clean energy up until 2030 to align with net zero targets. From 2030 to 2050 global investment to achieve net zero needs to rise to €4.6 trillion per year. For perspective, according to the Bank of International Settlements, the entire outstanding value of the French bond market in 2022 was €4 trillion.

The European context is equally daunting. According to the European Commission, every year from 2021 to 2030 the EU will need to invest €700 billion more than it invested from 2011 to 2020 to decarbonise its economy. For context, €700 billion is roughly the value of the entire bond market of Belgium, our current Eurofi hosts.

In short, the green investment gap at global level and European level requires the development of new sustainable markets the size of the French and Belgian bond markets every year from now until 2050. Every annual target missed increases next year's gap. Moreover, there will be increasingly intense competition for these markets.

#### Efficient rules create efficient systems

How can the EU sustainable finance system reach the scale needed at the necessary pace? In a word, efficiency. Efficiency is a critical factor in the success of any system. An efficient system ensures that inputs are optimised to produce the desired output. Efficient systems also enable maximum productivity with limited resources. However, the final output of any system is always less than the input due to friction. Unwanted friction drains the system of energy and lowers overall output.

It is no secret that there is friction in some of the EU's sustainable finance regulations. Interpretative, informational, and conduct concerns have emerged when applying the new rulebook. The ability of the EU's new system to deliver on its full range of objectives at scale and in a competitive international environment will depend on its ability to resolve this friction.

Europe will have a competitive advantage if its capital markets are efficient at producing sustainable results. For markets to be efficient the rulebook governing them must be optimised. The efficiency reforms under the Capital Markets Union project are equally important for the success of the Sustainable Finance Agenda.

#### Positive momentum

The EU's Sustainable Finance Platform's latest report notes positive momentum. EU Green bond issuance reached 6.5% of total EU corporate bond issuance in 2023. Investment funds that track the EU climate transition benchmarks and EU Paris aligned benchmarks are reported to have grown considerably and have a current value of €110 billion. In 2022, EU governments issued €266 billion of green bonds, compared with €85 billion in 2019, equal to 1.7% of EU GDP.

#### For markets to be efficient the rulebook governing them must be optimised.

These results demonstrate that equipped with the right tools, financial markets can be a powerful and efficient force to transform potential investment into sustainable projects. This heralds the promise of even greater output if refinements to market practices are accompanied by streamlining of complex regulations like the SFDR and Taxonomy.

#### Looking forward

In the next mandate, the focus should be on calibrating the design of the EU's new sustainable finance system to maximise its efficiency. This may mean embracing tough political choices to focus on technical adjustments rather than sweeping new initiatives. The trade-off between optimising the existing system and pursuing additional disruption should be carefully weighed.

Meaningful technical adjustments in the short term which reduce unnecessary friction within the EU financial system will mobilise more input, generate more output, and yield more efficient allocation of capital to sustainable investments in the long term. By contrast, if inefficiencies and friction are not addressed Europe risks losing its head start in sustainable finance.



## STÉPHANE JANIN

Head of Global Regulatory Developments and  
Public Affairs - AXA Investment Managers

### Does the EU want to be consistent in reducing the Greenwashing Risk?

Up to now, the EU has been at the international political forefront in promoting ESG. Through the 2018 Sustainable Finance Action Plan, the EU revealed a very high ambition in orientating the financing of EU real economy towards sustainable activities.

In particular, the Action Plan aimed at setting a series of requirements for various types of players involved in the EU sustainability value chain, such as issuers, banks, insurers and asset managers. More recently, EU institutions have wondered if that official orientation in favor of ESG was not going to lead to risks of misleading information or false claims of ESG investments by such players – the “Greenwashing Risk”.

What is the reality today of greenwashing risk and how to reduce it?

First of all, let's recall that in practice the specific risk of greenwashing may be captured by more general rules applicable to the financial sector. For instance, in the US, even without federal legislation dedicated to ESG, the US SEC was able to capture instances of suspected greenwashing by listed issuers through more general regulations applicable to misleading statements. That approach was interesting to observe, to wonder if a regulatory framework dedicated to greenwashing as such is really needed to prosecute players disclosing misleading information in the area of ESG or sustainability.

But if a political decision were made to introduce a specific framework on greenwashing risk, which approach should be followed? The answer seems to be obvious: to reduce the greenwashing risk, all the ESG value chain should be covered. In particular, when professional investors have to comply with sustainability reportings (e.g. EU Sustainable Finance Disclosure Regulation) or make sustainable investments (e.g. based on the EU Taxonomy), it is key that they can rely on the quality of information they receive from issuers or external providers.

At the level of issuers themselves, disclosure of reliable information is currently being tackled at EU and international levels, in particular in the EU with the Corporate Sustainability Reporting Directive (CSRD) and more widely at global level through the International Sustainability Standards Board (ISSB).

But regarding ESG Data Product Providers, their commercial provision of re-disseminated issuers' data or own ESG data estimates has not been captured at EU level yet. While the European Commission (EC) published a draft Regulation before the summer 2023, it included ESG Ratings but not ESG Data products from providers.

The fact that the EC does not intend to manage ESG data product providers within the EU sustainability value chain soon is very difficult to understand. On a regular basis, EU (and non-EU) based investors identify wrong ESG data among those sold to them by

global ESG data providers. If those providers are not tackled by any framework, it will remain a missing link in the value chain, leading to unintended use by investors of wrong data impacting their own sustainability reportings or investments.

It would mean that at the end of the day, regulated professional investors might be prosecuted by regulators or clients for greenwashing, although due to providers out of the regulatory framework.

As long as major ESG data product providers are not identified within any framework while being central for reducing the greenwashing risk, they will not feel responsible in the quality of ESG data they sell (being issuers' re-disseminated data or their own estimates). This missing piece in the overall sustainability value chain framework does not make sense from an EU standpoint.

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#### EU lack of action and compliance with IOSCO on ESG Data Product Providers is difficult to understand.

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In addition, at global level in November 2021, the International Organization of Securities Commissions (IOSCO) asked national securities regulators to act on ESG data product providers, precisely to reduce greenwashing risk. Since then, many Asian jurisdictions have started complying with the IOSCO's Recommendations including major jurisdictions such as Japan, Singapore and Hong Kong.

And in the European region, at the end of 2022 the UK FCA took the initiative to launch an industry-led working group aimed at building a UK Code of Conduct applicable to ESG Data Product Providers, based on IOSCO Recommendations. While the UK approach is voluntary to allow for ESG Data Product Providers to sign it or not, the peer pressure on the UK marketplace will lead to get the major providers signing in. And ultimately, it will significantly reduce the risk of greenwashing for investors in the UK.

Two main regions have not taken action on ESG Data Product Providers yet: the USA and the EU.

In the USA, we may understand that for the time being at political level there is no clear majority in favor of any ESG framework more widely.

But in the EU, that lack of action and compliance with IOSCO standards on ESG Data Product Providers is difficult to understand.

It should therefore be fixed urgently. Now.





## THOMAS BEHAR

Chief Financial Officer - CNP Assurances

### Towards sustainable, green and ESG savings products

In March 2018, the European Commission adopts a strategy on sustainable finance after realizing that the achievement of the objectives of the 2015 Paris Agreement, requires the contribution of private investments. In parallel with the “European Green Deal” of 2019, a new complex regulatory corpus that affects all insurance professions is emerging. The three objectives of the European regulations can be summarized in increasing product transparency on sustainability at company level, designing and distributing sustainable products, integrating sustainability into all levels of governance and key corporate functions. The various components of the European Union’s sustainable finance strategy were intended to help savers better navigate the jungle of sustainable, green, ESG, SDGs, climate, and transition products.

According to an EU-wide survey<sup>1</sup> carried out by EIOPA in June 2022, 62% of EU consumers do not trust the sustainability claims made by insurance undertakings or distributors, while a similar percentage (63%) says that sustainability claims about insurance products are often misleading... 75% of EU consumers think also that it is difficult to really know if a product is sustainable as the documentation provided is too complex to understand...

Customers and policyholders still need a clear vision of the sustainable and green nature of their savings products. The EIOPA’s report<sup>2</sup> on Greenwashing in June 2023, provides a very accurate and eye-opening list of gaps, inconsistencies, and issues in the current EU sustainable finance legislative framework which don’t help to lead to a better vision:

- The assessment of whether insurance products are indeed sustainable is challenging due to the unclear, inconsistent, and changing regulatory framework. Skipping the current RTS revision to go directly to the SFDR level 1 review could move into the right way.
- The divergent interpretation of sustainable finance regulatory requirements and the lack of consistency of the terminology used by the various EU regulations does not help the overall understanding.
- The Taxonomy Regulation DNSH ‘Do no significant harm’ is not applied in the same way as the SFDR DNSH.
- SFDR does not further specify what promoting environmental or social characteristics entails.
- SFDR does not set threshold regarding the minimum share of sustainable investments that a product needs to make to fall under Article 9 To avoid greenwashing, the European Commission needs to urgently tackle these gaps and inconsistencies.

- The use of numbers “SFDR 8” or “SFDR 9” is clearly only suitable for a well-informed public and doesn’t speak to a wide audience. Going to the use of very precise defined European labels could make a great step forward.

Furthermore, the main limitation of the Taxonomy is that it does not apply to sovereign debts, which constitute a significant part of insurers’ asset allocation. It is urgent for Europe to define the technical criteria that a State should respect to be aligned with the Taxonomy, even if we can anticipate lively political debates to reach a consensus. On a same way, it is important that SFDR applies to all components of a life-saving insurance contracts and not only the unit linked component. Multi-Options products should be fully covered, and a methodology developed for that.

It is crucial for the client, to understand the ESG characteristics of a fund and compare the sustainability of different funds/products with each other. Of course, we support the use of labels as simple communication tools, and we encourage the creation of European sustainable finance labels inspired by existing national labels by harmonizing them. The review of the ISR label is an improvement but raises the problem of the ‘shelf life’ of a label compared to the ‘shelf life’ of a product, very complex for a customer.

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#### Clarifying the EU regulation to better inform customers and avoid a greenwashing suspicion.

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This double materiality is at the heart of the CSRD regulation. The companies must consider both the impact of society and the environment on the financial performance of their company but also the impact of their activities on society and the environment. A ‘freeze frame’ without implementing new RTS standards, seems to be interesting to take advantage of the work already done and to converge to more consistency between reports (SFDR/CSRD/Taxonomy), less complexity of data and a harmonization of indicators. The review of the SFDR regulation seems interesting to achieve these objectives.

1. *Consumer Trends Report 2022 – EIOPA.*
2. *Advice to the European Commission on Greenwashing – Progress report - EIOPA-BoS-23/157 - 01 June 2023.*



## FIONA MELROSE

Head of Group Strategy and ESG - UniCredit

### Sustainability regulation and corporate finance: the impacts and the way forward

At this stage, the framework continues to be somewhat unclear, so individual investors may well still find themselves confused. While regulation is in place for both lenders and investors, some areas remain unclear and uncovered, and more consistency is needed among the various regulations.

In particular, it is important to clarify the most important definitions and concepts that we are working with as an industry, i.e., identifying precisely what can be included in targets, not to double count overlapping perimeters and how to identify social categories. Additional regulations at this stage risk increasing complexity, whereas what the market needs is to clarify the existing framework.

With ESG ratings becoming more and more used and increasingly influencing investor decisions, we see the new regulation as a necessary improvement that will help investors make more informed decisions when it comes to ESG related investments.

Banks too will have the opportunity to be fairly evaluated. The regulation is designed to enhance the governance and transparency of ESG rating activities, driving higher quality of service and higher levels of consumer and investor protection. All of this contributes to preventing greenwashing, social washing and other types of misinformation.

We welcome limitations and controls around market entry, as it may prevent the proliferation of substandard raters, ensuring higher-quality ratings. On top of this, the transparency afforded by the regulation will help foster reliability and empower informed decision-making in the market, while helping the banking system as a whole to understand which areas need more effort to improve.

We also support AFME's position on the exemption for ESG ratings incorporated in products of regulated financial undertakings which are already subject to regulation. This may add uncertainty and bring within scope already highly regulated products, different in nature to ESG ratings produced by specialized ESG ratings providers.

New regulation on ESG ratings should focus on maximizing benefits by ensuring greater transparency of methodologies and making it easier to compare ratings and rated companies and not introducing new requirements for products that are already regulated.

Certainly, taxonomy and CSRD regulation represents a positive first step in increasing transparency: the first clarifies what counts as green, and second enlarges the perimeter of application for mandatory disclosure. However, they do not yet cover the full spectrum of issues, and small companies are still struggling in finding guidance for their application.

And while the EU Taxonomy is a key element in sustainable finance and essential to preventing greenwashing, applying it is a complex exercise. Banks are expected to verify technical aspects with their clients that go beyond their traditional area of expertise, and this makes the taxonomy less effective. Even the European Banking Association (EBA) in December 2023, suggested that the European Commission support banks with a voluntary EU label for green loans based on a common definition, introducing more flexibility.

For this reason, we have adopted an internal policy to ensure consistency in our activities across our geographies. This includes guidance on how to apply regulations, coverage of grey areas, and a specific focus on the topic of marketing and comms. We have also defined a very clear set of ESG commitments and targets, that we constantly keep monitored.

Overall, the CSRD aims to create a more robust, transparent, and standardised framework for sustainability reporting, providing numerous benefits for companies, investors, and society at large, such as enhanced transparency, improved stakeholder trust and comparability across organisations.

Interoperability between different sustainability reporting standards (i.e. ESRS developed by EFRAG for CSRD and IFRS S1 and S2 developed by ISSB for IFRS) is crucial for providing a comprehensive view of a company's performance. Despite these efforts towards standardisation, achieving complete interoperability is an ongoing challenge due to differences in focus, methodologies, and stakeholders involved in financial and sustainability reporting. Ongoing collaboration between standard-setting bodies, regulatory bodies, and companies is essential to develop a more unified and cohesive reporting framework.

For sure, the priorities in Europe in the fight against greenwashing for the coming years are a clear and consistent legislation is the first priority – ensuring regulation requires the same level of disclosure and provides the same definitions to all actors, also considering the European Supervisory Authorities' report issued last year. Continuing to push for transparency from banks without making it easier to access reliable data puts the industry at risk in many cases.

This to be extended also to social definition, we need standardisation of social definitions.

We are adopting internal processes and rules to make sure we are coherent and consistent, but this is not a standardised approach across the whole industry, which makes it impossible to compare firms fairly.



## PATRICIA TORRES

Global Head of Sustainable Finance Solutions - Bloomberg

### Global coordination is key for ESG regulation to drive real change

A key question societies and financial companies are asking is 'how can we deliver real-world impact?'. Governments around the world are setting ambitious sustainability objectives, while regulators are implementing rules aimed at promoting transparency and credibility in the market. But how can regulation serve as a positive force for real-world change?

First and foremost, regulation provides much-needed transparency. For transparency to lead to the far-reaching structural changes required, at the ambitious pace needed, regulation needs to focus on the problem, be accessible and have international ambitions. There also needs to be coordination across regulators to promote standardisation to ensure market comparability and consistency, while recognising nuances and differences across industries and market participants. When regulation creates burden and complexity without creating opportunity, there is a risk that only few companies will be able to move beyond a 'tick-box' approach, which will reduce its ability to drive real change in business and investment practices.

The Corporate Sustainability Reporting Directive (CSRD) is a critical piece of legislation, which should significantly improve the availability and quality of ESG data. To ensure its success, it is fundamental that the CSRD complements and remedies existing data gaps around reporting for other EU sustainable finance regulations, such as the Taxonomy Regulation and Sustainable Finance Disclosure Regulation (SFDR). Reporting under the CSRD will be complex, as companies grapple with over 1000 data points (176 of those mandatory, 647 subject to materiality assessments, and an additional 279 voluntary). Clarification and guidance on how sectors should report on double materiality will therefore be key to supporting effective implementation by the market.

Outside the EU, the International Sustainability Standards Board (ISSB) is working with jurisdictions to implement IFRS S1 and S2; these efforts are vital to improving the quality of ESG data at the global level. However, it will be imperative for jurisdictions to keep any changes to the core of IFRS S1 and S2 to a minimum. Otherwise, there is a risk we will see divergent local ISSB regimes emerge, causing additional complexities for the global financial market.

Regulation can also help provide clarity on what is considered 'environmentally sustainable'. This is where taxonomies play a valuable role. In the EU, the Taxonomy Regulation provides transparency around how companies perform against EU environmental objectives. Globally, over 40 public sector-led taxonomies have emerged. As more taxonomies are developed, it will be important for policymakers to coordinate and consider how to improve interoperability between jurisdictions.

Regulatory efforts to establish criteria and/or labeling regimes for financial products claiming to be sustainable are also welcome, because they help build trust and credibility in the market. In the US, the SEC amended its Names Rule to include new criteria as part of efforts to prevent misleading investment fund names. In the UK, the FCA set out criteria for UK asset managers using sustainability-related terms and introduced four new labels through the new Sustainability Disclosure Requirements regime. It will be important for the EU to consider these developments in its review of the SFDR, as consistent regulatory approaches to ESG fund labeling will help ensure clarity and interoperability for the global investment community.

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**There is a risk for regulatory fragmentation in the market in the absence of global coordination.**

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There has also been increased momentum to regulate ESG ratings, as concerns are raised around the risks they may pose to investor protection and capital allocation. The EU's efforts to address these concerns are an important step to improving transparency and credibility in this nascent industry. Other jurisdictions are also considering their own approaches to enhance ESG ratings through Codes of Conduct. However, it is essential to understand that there are a wide range of products that may resemble 'ESG ratings'; these are constructed in different ways and used for varying purposes by different users. Therefore, it is key that regulators do not pursue a 'one-size-fits-all' approach and instead, focus on protecting transparent eco-systems where users benefit from product diversity, and are ultimately better equipped to navigate their sustainability strategies. Regulation of ESG rating providers should not, however, replace users' due diligence.

Ultimately, there is a risk for regulatory fragmentation in the market in the absence of global coordination, posing significant challenges for global market participants operating in multiple jurisdictions. The greater the complexity and divergence between regulatory regimes, the greater the cost associated with compliance, the slower the adoption, and the lower the real-world impact. Regulation has the power, but does it have the will to build inter-connected bridges that facilitate convergence and drive real-world impact?

## TRANSITION PLANNING IN THE FINANCIAL SECTOR



### JEAN BOISSINOT

Deputy Director, Financial  
Stability & Head of Secretariat,  
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### One (single, multipurpose, consistent) transition plan to rule them all

Forget about “net zero”, “transition plan” is the new catchword of the climate discussion. Only an intuition a couple of years ago, the idea of corporates and financial institutions devising and disclosing “transition plans” is fast becoming a regulatory reality with the adoption of CSRD, CSDDD, and CRR3. A very appealing feature of transition plans relates to its ability to provide a forward-looking perspective on issues that the usual backward looking disclosure fails to capture. Indeed, the NGFS started to develop its thinking on transition plans when realising that transition risks are only very poorly captured through the disclosure of past (scope 1, scope 2 or even scope 3) emissions or the implementation of a taxonomy (see “Capturing risk differentials...”, May 2022).

However, as for all popular ideas, careful design and skilful implementation are

required to avoid turning a sensible idea into an intractable and eventually pointless compliance exercise. As the practitioners are working on the first generation of transition plans, it might be useful to keep four potential pitfalls in sight to ensure the relevance of the exercise.

The first challenge relates to the nature of the exercise: before coming up with a transition plan, a firm should start by planning its transition, i.e. clarifying how it plans to navigate the transition to the end goal of a net zero economy. In that respect, transition planning comes first and is a combination of revisiting the strategy of the firm and thinking through the operational planning and delivery.

In the case of financial institutions, this both requires clarifying the positioning of the institution toward its clients and the economy as well as its vision of the transition and encompasses a wide range of topics from products to engagement with clients, sectorial policies, risk management, etc. This process might be broader and deeper than most strategic reviews and the supervisor would have an interest in the quality of the planning of the transition even before considering its outcome.

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**Transition plans need to be carefully designed or risk being an irrelevant compliance exercise.**

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The second difficulty arises from the high expectations that a large number of stakeholders have. The first take away of the NGFS report on transition plans (“Stocktake on Financial Institutions’ Transition Plans...”, May 2023) was that “transition plan” is a multifaceted concept. It needs to speak to a wide range of users with various use cases: analysts would want to understand how the firm approaches a changing business environment while supervisors need to be satisfied that the risks are identified, assessed and managed.

Rather than a piecemeal approach, this calls for a modular solution: the transition plan should be the outcome of a unified transition planning exercise with a core document being complemented by modules providing relevant additional

details. This solution is probably the only way to ensure that the various needs are satisfied in a consistent manner.

The third challenge speaks to the need for transition plans to connect with the reality of the economy. The transition of a financial institution is closely intertwined with the transition of its clients. This calls for developing a rather granular view of the transition: broad brush macro views of the transition are never sufficient in that respect and attention should be paid to both sectors and geographies.

While the development of sectorial transition pathways has started, little attention is paid to a significant issue: the transition toward a net zero global economy is very different across countries and regions:

- In Europe, while low carbon electricity is or is fast becoming a reality and we benefit from large interconnected electrical grids, the main challenge relates to the shift to electrification.
- In East Asia, where generating electricity still largely rely on fossil fuels and with a more limited potential for renewable (across the archipelagos), both the starting and the end points differ.
- In low and middle-income countries, especially in Africa, the transition is a development agenda where access to energy is enabled by natively low carbon energy systems.

Failing to recognise these differences and to account for the countries’ own strategies will make transition plans irrelevant.

Last but not least, the best plan does not matter if circumstances change or if it is poorly executed. In that respect, the fourth risk is to fail to update the plan and assess the delivery. While not yet a challenge at this stage, the disclosure associated with transition plans needs to provide meaningful information on adjustments and achievements. Otherwise, transition plans will only be aspirational gimmicks being rolled over to tomorrow.

Expected to serve very different purposes by providing a forward-looking understanding of how a firm strategically approaches its transition across its business lines and geographies and gets ready for a challenging execution, transition plans need to be carefully designed or risk being an irrelevant compliance exercise.



## JOSÉ MANUEL CAMPA

Chairperson - European  
Banking Authority (EBA)

### Transition plans: seizing the momentum for financial institutions

The width and breadth of the transformation required to shape our economies towards sustainability entails significant updates in the business models of companies and financial institutions. Along the way, organisations expose themselves to new transition - related drivers of financial risks.

Understanding the implications of such evolution requires familiarity with at least two concepts: “transition planning” and “transition plans”. Transition planning is commonly understood as the internal process undertaken by an organisation to deliver on its climate - related targets and/or to prepare a long - term response to manage the risks associated with that transition. Transition plans are the documents used to disclose to relevant audiences the results of the transition planning process.

In the EU, the Corporate Sustainability Reporting Directive (CSRD) and the Corporate Sustainability Due Diligence Directive (CSDDD) will require companies and banks to develop and implement specific plans to ensure that their business model and strategy are compatible with a sustainable economy in line with the Paris agreement and

the objective of climate neutrality by 2050. For EU banks, the revised Capital Requirements Directive (CRD6) requires them to develop and monitor specific transition plans as well, with the aim to monitor and address financial risks arising in the short, medium, and long term from the adjustment towards legal and regulatory sustainability objectives in the EU.

Of course, a forward - looking dimension is critical and transition plans should establish different time horizons, including specific milestones. Short-, medium- and long-term objectives are essential in that regard. For example, in the EU jurisdiction, an important milestone is the reference year 2030, which corresponds to the Union’s 55% reduction objective in GHG emissions. In short, institutions should carefully define and select scenarios and pathways underlying targets.

In that perspective, what are the main building blocks necessary for a financial institution to build robust transition plans?

The EBA has been mandated to issue Guidelines to specify requirements for the identification, measurement, management, and monitoring of ESG risks. Their goal is not to force institutions to exit from carbon intensive sectors but rather to stimulate their proactive reflection on technological, business, and behavioural changes, including risks and opportunities that will drive their business.

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#### Transition planning remains crucial to managing financial risks in sustainable economies.

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Consequently, a critically important building block will be the materiality assessment, which should be consistent with the institution’s business strategy. The plans must also demonstrate consistency with risk and funding strategies, including risk appetite, ICAAP and risk management frameworks. This implies setting clear targets with supporting metrics. Responsibilities tied to the governance of the plans should be clearly allocated. Along the way, engagement with counterparties is key, especially considering or reviewing their own transition plans. Such consideration is particularly relevant for transition finance, as robust and credible

counterparty plans can positively inform loan granting processes and investment due diligence.

As institutions build these transition plans trust needs to be preserved. Therefore, avoiding greenwashing that may ultimately result in weakening such trust is an important concern. To avoid such risks, it is of utmost importance to have a consistent oversight framework. Supervisors and other public authorities need to cooperate closely with clearly defined remits for transition plans. Prudential authorities should focus on risk - related aspects: how does an institution’s transition plan effectively allow to manage environmental financial risks considering its sustainability concerns? Other public authorities (e.g. agencies specialised in environmental affairs and market conduct or other relevant authorities) could focus on underlying scientific or public policy considerations and checking compliance with applicable (e.g. disclosures) requirements.

Finally, international cooperation is paramount. Various initiatives (e.g. ISSBB, GFANZ) have now published guidance and recommendations regarding the plans. In the field of banking supervision, I welcome the work conducted by the Network for Greening the Financial System, allowing to take stock of international practices and to explore further the link between financial institutions and corporate’ transition plans, as well as the work conducted by the Basel Committee to consider the role of transition planning in banks’ risk management processes and the potential role of prudential supervisors vis-à-vis transition planning. The momentum is being built. Let’s continue to seize it.



## ANTOINE VAN CAUWENBERGE

Head International Relations & Sustainability Policy - Financial Services and Markets Authority, Belgium (FSMA)

### The case for credible disclosures of climate transition plans

Developing a clean energy economy requires prompt and suitable policy actions, along with both public and private investments. Private funding should include bank financing and, even more importantly, capital market funding. Securing private capital requires reliable and comparable disclosures to investors, which is where capital market regulators play a key role, ensuring investor protection, market integrity and stability. Under the umbrella of the International Organization of Securities Commissions (IOSCO), the global community of market regulators have led the efforts for a globally coordinated approach to promote sustainability-related disclosures by corporates. Several jurisdictions have begun the process of using the International Sustainability Standards Board's standards, which were endorsed by IOSCO in July 2023 as suitable for capital markets. Adhering to ISSB or ISSB-informed standards, especially when entities are independently audited, will mitigate the risk of greenwashing.

Moreover, in recent years, there has been a growing focus on the publication

of transition plans to support net-zero commitments, with regular reporting on progress. When assessing the transition risks associated with an investment, financial institutions and investors may factor in information from transition plans.

The ISSB sets requirements for an entity to disclose its plans to transition towards a lower carbon economy, without mandating such plans. In this respect, market regulators are monitoring the transition plan landscape to assess the risks of net-zero greenwashing. To date, based on the disclosures, plans have varied in quality and often lack details on the actions intended to meet net-zero goals.

The fact that the Glasgow Financial Alliance for Net Zero (GFANZ) has outlined a structure for transition planning and plans for both financial institutions and the real economy is to be welcomed. In the EU, the European Sustainability Reporting Standards impose granular disclosure on transition plans and climate commitments by relevant entities. In addition, the European Commission's recommendation of June 2023 on facilitating finance for the transition to a sustainable economy includes non-binding recommendations to entities on the use of transition plans. Going forward, the forthcoming Directive on Corporate Sustainability Due Diligence will mandate that companies falling within its scope adopt a transition plan, without prejudice to transition plan requirements from a prudential perspective for banks.

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**Market regulators monitor the transition plan landscape to assess the risks of net-zero greenwashing.**

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In the UK, the Transition Plan Task Force combines a sector-neutral Disclosure Framework with additional sector-specific guidance, aimed at assisting entities in various sectors to interpret more accurately the disclosure framework for their specific industry needs.

In order to address risks of an alphabet soup of transition plan frameworks, IOSCO is monitoring any risks of fragmentation and inconsistency, focusing on investor protection and market integrity, and liaising with other international bodies such as the Financial

Stability Board. At COP28, IOSCO announced that it would examine how proper disclosure of existing transition plans by listed companies and asset managers with transition targets can work for the benefit of investors. IOSCO is also encouraging global standard setters to work towards globally agreed sustainability audit standards, since the use by auditors and assurers of a global framework of technical and ethical standards developed in the public interest will enhance the quality of the disclosures.

Additionally, the challenge of data availability should not be underestimated. Consequently, improving access to reliable and comparable climate transition data should be a key international focus. In this regard, the launch of the proof of concept for the Net-Zero Data Public Utility (NZDPU) as a free and centralised data repository could be a driving force in enhancing accessibility of company-level climate data. The repository may be used by financial institutions when assessing the emission levels of portfolio companies as part of an effort to develop transition plans. Entities may also use it when searching for comprehensive data on their value chains to measure and disclose their Scope 3 greenhouse gas emissions or benchmark their performance against their peers. To ensure cross-border comparability, jurisdictions might emulate early adopters by establishing connections between national and regional data portals and the NZDPU to populate the database.

In conclusion, it is important to acknowledge that developing reliable transition plans and disclosures can be resource-intensive and challenged by data availability, making it a gradual process. Nonetheless, it is in the best interest of entities to take this challenge seriously. A company's transition plan is essential for mitigating strategic and financial risks linked to the transition, while also providing clear insights into its business strategy that can draw in new investors.



## ERIC CAMPOS

Chief Sustainability Officer -  
Crédit Agricole S.A.

### An EU transition framework to promote climate transition and its financing

Human societies must solve an unprecedented equation whereby our 150-year-old economic and social model that has enabled the simultaneous growth of wealth production, greenhouse gas (GHG) emissions and nature loss must transition in just a few years if humanity is to continue to thrive. Science tells us that addressing the climate change consequences requires a drastic reduction in the GHG emissions and a parallel increase in residual emissions sequestration starting now in the hope to reach carbon neutrality by 2050 and limit global warming to 1.5°C by the end of the century.

At Crédit Agricole we believe the financial sector has a unique role to play to contribute to solving that equation: through our products & advice, client relationship & engagement, and credit analysis we can support the real economy transition. This is why our Group has joined the Net Zero Alliances and defined a “Net Zero by 2050” project to operationalize these commitments. This includes decarbonisation paths and action plans to reduce our GHG emissions across our financing, investment and insurance portfolios on 10 sectors based on the IEA scenario.

Our “Net Zero by 2050” project lays the groundwork for our transition plan, in line with new EU requirements<sup>1</sup> to implement transition plans towards the Green Deal 2050 carbon neutrality objective. Transition plans can usefully shed light on exposures to physical and transition risks and on our action plan to adapt to the net zero objective. However, the decarbonisation of our balance sheet can only be addressed through the decarbonisation of our clients’ activities based on credible transition plans.

To be comparable and rated in a credible way transition plans require a common transition framework at EU level, which could easily be structured on clear building blocks, based on existing initiatives<sup>2</sup>:

- Reference (science-based sectoral transition pathways), compatible with recognised international scenarios and with regional specificities where relevant to ensure certainty;
- Sectoral action plan structure (KPIs, milestones...) to guide companies as to how to get there;
- Means (Capex and Opex);
- Governance requirements to ensure transition is embedded in companies’ strategies and business models;
- Disclosure requirements (cf CSRD);
- Just transition considerations and impact;
- Significantly harmful activities considerations.

#### EU transition framework should also acknowledge and incentivise transition finance.

Such framework would help companies build their own transition plans and allow to identify and compare more effectively companies or activities whose transition is in line with the sectoral pathways and those that lag behind. Thus, transition plans can also very usefully support client engagement and advice.

That EU transition framework should also acknowledge and incentivise transition finance, thereby working as a lever to increase and mainstream transition finance. This is essential considering that in the EU alone transitioning will require

about EUR 700 bn annually in additional investments<sup>3</sup>. Currently the cornerstone of the EU sustainability framework is the taxonomy, usefully telling us where the landing zone is for an activity to be considered sustainable.

However, its transparency requirement, the green asset ratio (GAR), requires applying the taxonomy strictly, among others by forbidding the use of proxies and imposing compliance with all technical screening criteria on retail financing.

As a result, our GAR will be low despite tremendous efforts to produce it, while in parallel our work on transition finance is not acknowledged, regulatory speaking. For instance, over the last two years we have reduced our financed emissions in the oil & gas sector by 40%<sup>4</sup> but this cannot be reflected in the GAR. Considering that today’s efforts to support the transition will only materialise in the long run, a clear signal is needed now to promote transition finance efforts. For instance, the transition framework should provide that any financing which contributes to the client’s decarbonisation (within the EU transition framework) is considered transition finance. That would then allow voluntarily disclosing a “transition asset ratio” showing the extent to which financial institutions finance the transition and counterbalancing the GAR.

Finally, such a transition framework would be helpful to mitigate greenwashing risk. A science-based approach towards carbon neutrality, common definitions, actionable plans and transparency requirements would protect investors from greenwashing. At the same time, it would reduce reputational risk for both financial institutions and companies.

1. *under the CSRD, CRD6 and CSDDD*
2. *such as NZBA-Transition-Finance-Guide.pdf (unepfi.org), Oct. 2022*
3. *Annual amount needed to meet the Green Deal goals, RepowerEU and Net Zero Industry Act, European Commission Communication, June 2023, EUR-Lex - 52023DC0317 - EN - EUR-Lex (europa.eu)*
4. *Compared to 2020*



## ERIK LJUNGBERG

Head of Group Brand,  
Communication and  
Sustainability - Swedbank

### Transition planning – Reaching a net- zero society with energy efficiency funding

The financial sector has a crucial role to play in the transition to a net-zero society. Both as an awareness catalyst and capital allocator - driving behaviour and financial flows towards more sustainable activities. We have the opportunity, and responsibility, to break new ground. And perhaps, it is more important than ever. Looking back at 2023, the warmest year on record, the need and urgency to transition is undeniable. Yet, we are lagging - the global community is getting increasingly closer to failing to reach key international climate targets. In this, transition planning in the financial sector - and in turn society at large - has a key role to play in reaching a net-zero society.

A transition plan should be viewed as a strategic tool which is embedded across the company. It should reflect how the Executive Management and the Board are steering the company towards its sustainability commitments and transforming the business to respond to sustainability impact, risks and opportunities. The plan should be seen as

a dynamic document that continuously is adapted as regulations and strategy evolve. The plan can also be a useful tool to transparently inform stakeholders about a company's climate-related work. Internally, a clearly formulated plan does not only increase employee engagement but can furthermore support structuring climate-related work and identifying additional developments that could benefit the company.

Swedbank's vision is a financially sound and sustainable society. We are therefore determined to facilitate a just climate transition which not only aligns with the Paris Agreement and contributes to meeting the UN Sustainable Development Goals but also includes social aspects. Swedbank's plan is moreover closely aligned with our commitments to the Principles for Responsible Banking and the Net-Zero Banking Alliance. Going forward, the introduction of more detailed requirements of transition plans and disclosures in CSRD, CSDDD and CRR3 are welcomed aspects that can minimise the risk of greenwashing related to transition planning.

About 80 percent of our lending portfolio is related to real estate. Thus, our approach to transition focuses on incentivising the use of climate solutions and enhancing the energy efficiency of our customers' properties. Why? Because energy efficiency, small scale local production and storage of energy, have become some of society's most important tools to mitigate climate change.

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**Transition planning  
in the financial sector  
has a key role to  
play in reaching a  
net-zero society.**

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The world needs to double progress on energy efficiency and triple renewable energy capacity by 2030 to reach net-zero emissions from the energy sector in 2050.<sup>1</sup> Also, the transformation of the global economy needed to achieve net-zero emissions by 2050 requires 9.2 trillion USD in annual average spending on physical assets, which is 3.5 trillion USD more than today.<sup>2</sup>

Our estimates show that in our four home markets there is an opportunity to release up to 90 terra watt hours by making buildings more energy efficient based on an investment of EUR 200 billion until 2040. By providing funding

to our customers for the installation of heat pumps, procurement of solar panels, insulation improvement, energy storage or other solutions, we will make our customers are better off and more resilient. Increased energy efficiency in the real estate sector would also benefit society as greenhouse gas emissions can be reduced. In addition, significant volumes of renewable energy might be released that can be used to electrify sectors such as heavy industry and transport in Europe.

The shift towards a more energy efficient Europe will require research, innovation and production at scale. A new industry is emerging that literally will fuel growth. This is an opportunity for Europe to strengthen its competitiveness by becoming more energy independent while promoting new businesses and generating job opportunities. With the revised European Performance of Buildings Directive now agreed, the EU Commission and national governments must consider how they can support the acceleration towards an even more energy efficient society. In this regard, it is important that corporate transition plans and national energy and climate plans are consistent. Finally, if we are to limit the global warming to 1.5 degrees and reach the goals in the Paris Agreement, public and private actors need to be bold, foster more collaboration and make sure Europe puts on the yellow jersey in the race to net zero.

1. <https://www.iea.org/commentaries/tripling-renewable-power-capacity-by-2030-is-vital-to-keep-the-150c-goal-within-reach>
2. <https://www.mckinsey.com/capabilities/sustainability/our-insights/the-net-zero-transition-what-it-would-cost-what-it-could-bring>





## SHINICHI TSUNODA

Operating Officer & General  
Manager, Sustainable Business  
Promotion Department -  
Mizuho Financial Group,  
Inc. / Mizuho Bank, Ltd.

### Accelerating the net zero transition in Japan and beyond

The last year has seen Mizuho issue an updated corporate identity and medium-term business plan, with sustainability featuring prominently in both. This is testament to our commitment to the successful and orderly decarbonisation of the global economy, including supporting the transition of Japanese industry, within our home market.

At this pivotal time, we acknowledge the importance of robust transition planning, both in relation to our own business and that of our clients. We are also acutely aware of regional context and variations in what constitutes viable transition pathways, as there is no one-size-fits-all approach to decarbonisation. In addition to engaging with our clients, we actively contribute to transition-oriented multilateral efforts that can benefit us all.

#### Importance of robust transition planning

Our stakeholders have high expectations of Mizuho, as one of the leading Japanese financial institutions. Among others, we

are expected to assume a leadership role in Japan's industrial growth strategy, similarly in GX (green transformation), and to contribute to the sustainability transition elsewhere in Asia. The north star that we are working towards is net zero by 2050, in support of a low-carbon sustainable society.

With these aims and expectations in mind, Mizuho recognises the importance of transition planning, both in relation to our own business and that of the companies we finance – indeed the two are interlinked. We formulated our Net Zero Transition Plan in 2022 and have revised this more recently, in order to promote an integrated response to climate-related issues across the Group. Our approach revolves around facilitating a real economy transition while capturing business opportunities and enhancing risk management practices.

Importantly, we understand that transition planning should not only be about responding to climate change, but doing so while taking into account social and governance considerations – in other words, a just transition. For example, this means promoting respect for human rights and good governance practices.

#### Regional context for transition: idiosyncratic opportunities

Through our deep experience of financing Japanese corporates on the one hand, and the breadth of our global presence on the other hand, we understand that the net zero transition will not be uniform across economies. Transition pathways vary by region, as each geography needs a decarbonisation strategy fit for its economic and social realities (for example, its current energy mix and demographics).

**The north star that we  
are working towards  
is net zero by 2050.**

In Japan, we have identified technological innovation and business structure reform as the key drivers of the country's industrial competitiveness, and we see sustainability efforts as linked to and even instrumental to success in these areas. Geographic attributes also play an important part in identifying what is realistic and viable. For instance, Japan's renewable energy production prospects are influenced by a shortage of land for solar power and onshore wind power generation. However, this is offset by ample opportunities for renewable energy production through

offshore wind power, thanks to Japan's long coastline and good offshore winds. Mizuho's business focus in renewable energy in Japan is, accordingly, on offshore wind, alongside carbon capture and utilisation (CCU), carbon recycling and hydrogen.

#### Multilateral efforts

Our reach is not limited to Japan and we serve clients and engage with a range of stakeholders all over the world. Multilateral cooperation is crucial for the success of the global net zero transition – between governments, regulators, industry and financial institutions. To date, regulatory fragmentation in the spheres of climate risk and sustainability has posed challenges for businesses such as ours that operate across borders. Thus, we welcome increased multilateral efforts aiming for more consistency and regulatory convergence in these areas. Clarity and certainty will help financial institutions such as ours support the real economy transition, delivering the finance that is needed for its success.

Mizuho plays its part in multilateral efforts, for example, through our recent participation at COP28 in Dubai as part of the Japanese delegation. The scale of the financing and investment needed to meet the challenges we face is unprecedented and can only be met through collaborative efforts – for us, this was one of the key takeaways from COP28. We continue our ongoing involvement with industry bodies and organisations developing sustainability- and climate-related standards and frameworks, as well as regulators across the jurisdictions where we operate.

## EU SUSTAINABILITY FRAMEWORK



**SAM PRESTIDGE**  
ISSB Strategy Lead- International  
Financial Reporting Standards  
(IFRS) Foundation

### Towards global consistency – Interoperability between ESRS and ISSB Standards

The International Sustainability Standards Board (ISSB) was formed to develop – in the public interest – a comprehensive global baseline of high-quality sustainability disclosures to meet investors' information needs. The European Commission had already embarked on developing its Standards – the European Sustainability Reporting Standards (ESRS) – before the ISSB was established. Bearing in mind investors' need for consistent and comparable information, as well as to limit the burden and costs for companies, interoperability between ESRS and ISSB Standards is of the utmost importance.

Reliable, rigorous and easily comparable information is a vital prerequisite for the effective functioning of the capital markets. So too is the requirement for investors to have access to material information necessary for a

comprehensive analysis of companies' risks and opportunities. Sustainability factors have quickly become a crucial part of mainstream investment decision-making.

ISSB Standards have been developed as a direct response to this need for sustainability disclosures. ESRS have been developed with a complementary yet broader mandate. ISSB Standards focus purely on providing relevant information to investors, with the ESRS having an additional aspect to meet European public policy goals – financially material information is a common and shared goal.

Work undertaken by the ISSB, EFRAG and the European Union has successfully led to a high degree of alignment between the respective sets of standards, reduced complexity and duplication for companies who will apply both the ISSB Standards and ESRS.

Detailed work has been undertaken to map how a company can apply both sets of standards to reduce duplication, with publication of interoperability guidance due in the coming months. We are regularly reminded of the importance of this work from key stakeholders; and the importance of it being available to companies as preparations are made to report based on both European and international standards.

The interoperability guidance will highlight common disclosures between the respective requirements and those that can be aligned when particular choices are made, for example applying the Greenhouse Gas Protocol. Beyond this, the digital tagging of the disclosed information will be an important tool.

Work on interoperability will not conclude upon publication of the interoperability guidance. It is going to be vitally important that European and international standard setters continue to work closely together as the ISSB begins its work beyond climate and as European sector standards are developed.

Companies will be able to collect, govern and control decision-useful data once, and then determine which data is material information for different stakeholders, reducing duplication.

A determined effort has been made to reduce complexity and fragmentation; and to remove barriers to comparability

that might have undermined the usefulness of sustainability information in decision-making. ESRS and ISSB Standards aim to use the same language and definitions for disclosure requirements; and the same metrics where they are designed to address the needs of investors.

This collaborative approach to interoperability has extended to the mapping of each paragraph of IFRS S2, the ISSB's climate-related disclosure standard, to relevant paragraphs in ESRS. For matters other than climate, reciprocal references mean ISSB Standards refer to ESRS as a source of guidance to identify what information to disclose, to the extent it meets investor information needs. Equally, ESRS refers to ISSB industry-based guidance.

In 2024, the ISSB will continue to dedicate itself to working closely with regulators as they consider pathways to adopting the ISSB Standards; and we'll be supporting companies and investors to build capacity for this new reporting landscape.

As jurisdictions around the world make progress to introduce the ISSB Standards as a global baseline, European companies will be better prepared to meet disclosure requirements at home and abroad. This has important benefits. Thousands of European companies have value chains in jurisdictions that have already announced their intention to adopt ISSB Standards. The use of these international standards will ensure the reliability of the auditable data derived from them, which will be of particular value, for example, when European companies are required to report Scope 3 emissions to comply with ESRS.

The high-degree of interoperability between ESRS and the ISSB Standards is a shared success. But it is an ongoing process as the world continues to move towards being able to measure – and therefore truly value – sustainability.



## GEORGE THEOCHARIDES

Chairman - Cyprus Securities and Exchange Commission

### Sustainability at the heart of the EU capital markets

Sustainable finance and digitalisation have already made a deep impact in the EU capital markets and they will continue to drive the reshaping of the financial regulatory landscape for years to come - building upon the momentum seen in the last decade.

Regulation aimed at combatting greenwashing has been ramped up and will remain a key feature in 2024. For Europe, more detailed disclosures from firms will be required, and ESMA's ruling on the use of ESG related terms in fund names is also to be finalised.

In the UK, the FCA published its final rules on ESG investing and greenwashing rule and the US finalised its ESG investing rules and released the final versions of its climate risk disclosure and cybersecurity risk governance proposals, as well as new proposals related to human capital management and board diversity disclosures.

#### Implementation of sustainability standards

It is the role of regulators to identify future trends and to anticipate the potential risks and unintended consequences – and the known knowns. This means that not only do we need to

keep pace and move swiftly to protect investors from new and emerging risks, but we are also harnessing technology to drive innovation that increases the efficiency of our own operations.

This commitment revolves around upholding high standards of investor protection and confidence, while simultaneously fostering the healthy growth of the market with the introduction of new products and services. The rationale for ESG investment is that if capital is deployed in companies which represent positive trends for the benefit of mankind and engage in ethical and sustainable business practices, more companies will adopt these policies. Over time, the lower cost of capital will enhance their investment returns, whilst growing demand for their products and services and sound labour relations will contribute to a stronger operating performance. Hence, ESG investment is seen to achieve relatively strong investment performance, whilst supporting 'good' businesses relative to the pure pursuit of profit.

**It is the role of regulators to identify future trends and to anticipate the potential risks.**

The European Securities and Markets Authority (ESMA) has proposed new rules on using ESG or related terms in the names of investment funds. Under this proposal any fund that has any ESG or related term in its name, must have at least 80% of its investments supporting ESG characteristics, with an additional threshold (50%) if the fund is using sustainability, meaning that at least half of the 80% threshold should be in sustainable assets under SFDR.

The UK's FCA has outlined its SDR proposal, which is proposing to introduce three labels for sustainable investment products: Sustainable Focus (products investing in assets that are environmentally or socially sustainable); Sustainable Improvers (products investing in assets to improve the environment or social sustainability over time, including in response to stewardship influence of the firm) and; Sustainable Impact (for products investing in solutions to environmental or social problems to achieve positive, measurable real-world impact).

The FCA is also proposing more detailed disclosures in order to help consumers understand key sustainability features of products, as well as restrictions on how

certain sustainability related terms can be used in product names and marketing for products that don't qualify for these sustainable investment labels.

In the US, the MSCI has changed the methodology behind its fund level ESG ratings, which is resulting in a one-time downgrade of approximately 31,000 funds. These raise the requirements for a fund to be classified as AA or AAA, improve stability in fund ESG ratings, and add transparency.

#### Technological innovation

Regulators have a need to understand the challenges to financial markets posed by the growth of technology, in all its forms and be ever vigilant to the new and emerging risks. Amongst these is the rise of retail activity and increased market accessibility, which has led to aggressive marketing practices as well as false claims which include "greenwashing", practices that give consumers the impression that the product or service they are using prioritises ecology and green initiatives. CySEC's own monitoring of the market has shown that the number of fraudulent advertisements has increased dramatically, with young investors now the most vulnerable to potentially overly aggressive marketing strategies. These emerging challenges related to technological innovation are expected to be addressed through new legislations that are under the way.



## CARLO COMPORTI

Commissioner - Commissione  
Nazionale per le Società  
e la Borsa (CONSOB)

### Opportunities and challenges of the new sustainability reporting requirements

The EU has been at the forefront of shaping corporate sustainability practices through Directives on sustainability reporting.

The Non-financial Reporting Directive (Dir. 2014/95/EU or NFRD) applicable since 2017 marked a significant step in requiring large companies, particularly public interest entities, to report non-financial information. However, challenges arose, limiting its effectiveness, particularly in terms of completeness and comparability of information provided to the market.

The recent Corporate Sustainability Reporting Directive (Dir. 2022/2464/EU or CSRD), applicable to reporting years starting from January 1, 2024, aims to address these issues and marks a significant progress in the evolution of the sustainable reporting framework. The remainder is focused on what may be considered the three primary advancements.

Firstly, the CSRD is explicit in requiring entities to disclose information to

allow investors and stakeholders to understand the impact of companies on people and environment and to assess financial risks and opportunities arising from climate change and other sustainability matters.

Secondly, the CSRD specifies the content of the sustainability report directly in legislation and entrusts the development of reporting standards to a single standard setter, EFRAG, so as to ensure that the standardization of information promotes completeness, accuracy and greater comparability of sustainability data.

Thirdly, the CSRD underlines the importance of linking financial and sustainability information and, by doing so, it aims to provide a holistic view of a company's operations, offering stakeholders a more integrated perspective.

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**The new priority is to  
support companies  
to adapt to the new  
requirements.**

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This significant progress does not come without challenges:

1. The double materiality test, which is at the core of sustainability reporting, is far from being straightforward. When identifying the sustainability matters and information to be disclosed, companies have to assess both impacts on society and environment (impact materiality) and impacts on company's performance, financial position and cash flow (financial materiality), albeit such double materiality test is complex to perform. Among other difficulties, it involves the engagement of many stakeholders and requires the use of non-financial metrics related to ESG aspects. These metrics often lack standardization and makes it difficult to establish consistent benchmarks across different industries.
2. Granularity of information required by reporting standards is another area of difficulty. Gathering detailed data across the organization can be a complex task, especially when dealing with diverse business operations.
3. The third and most prominent challenge lies in the substantial increase in the number of companies that will be subject to CSRD and the expanded reporting contents. At EU level we expect to move from

11.600 companies subject to NFRD to more than 50.000 companies directly impacted by the CSRD. The expanded reporting contents mandated by CSRD and ESRS (European Sustainability Reporting Standards) may pose a significant burden on companies, especially smaller ones, as this will require significant investments to adjust internal processes and systems to the new requirements.

Even more important is that the number of companies indirectly impacted may be significantly higher than estimated, as CSRD requires companies to consider the impact across their entire value chain. This approach means that not only large public-interest entities, but also small and medium enterprises (SMEs) will be required to disclose sustainability information.

The new reporting requirements embed some degree of proportionality, since for listed SMEs the set of information is more limited and the reporting obligations will have to be complied with following a phased-in approach. Although unlisted SMEs and micro-enterprises are excluded from the scope, EFRAG is developing an ad-hoc voluntary standard, taking into account that such companies are indirectly involved in the reporting process because, often, they are part of the value chain of large companies.

Ensuring that SMEs possess the necessary capabilities to understand the new reporting framework and provide meaningful ESG information remains an important challenge. Collectively, we need to support SMEs in the sustainable transition. Across the EU, governments and policymakers are launching various initiatives with the specific goal of supporting SMEs in their sustainable practices, with a view to enhance their ESG reporting. These initiatives include targeted educational programs designed to raise awareness among SMEs, as well as the facilitation of collaborative platforms that bring together SMEs and sustainability experts to enable the knowledge sharing.

Now that the reporting framework has been finalized or almost finalised, the new priority is to support companies to adapt to the new requirements, which is paramount to achieve high quality reporting and, ultimately, fostering sustainable transition.



## SACHA SADAN

Director of ESG - Financial  
Conduct Authority (FCA)

### Creating the ecosystem for reliable sustainability data

From regulators to international bodies, stakeholders are closely examining how to collect reliable sustainability data while simultaneously developing methods to disclose this data in a simple way. Historically, traditional methods such as corporate reporting have been central to collecting sustainability data. However, the ESG sector has quickly developed in the last few years and innovative data collection tools, such as transition plans are opening the door for new datasets. We see forward looking data as an essential instrument to solve systemic issues and at the FCA, we are thinking about data and how best to support market participants navigate their sustainability journey.

As we regulate firms that span across many jurisdictions, we want to support them and by being consistent with international frameworks and standards as far as possible, as we believe in global solutions to global problems. We also believe that it's important to hold firms to account as we expect the data to be credible and so do investors.

Implementing regimes that promote comparable data is necessary to broaden the scope of sustainability data available. To support this, we have been early advocates of the International

Sustainability Standards Board (ISSB) and its goal to create a common baseline of sustainability reporting standards. We look forward to the standards being launched this year. In the meantime, we welcome the UK Government's work to establish a process to review and endorse the standards for use in the UK while at the FCA, we hope to consult on updating our climate disclosure rules to refer to the ISSB standards.

It cannot be understated that trust in numbers is vital as such we welcome another milestone from December 2023; the International Auditing and Assurance Standards Board (IAASB) consulted on their proposed International Standard on Sustainability Assurance (ISSA) 5000, General Requirements for Sustainability Assurance Engagements. This is the first step on a long journey to a baseline sustainability assurance standard.

Furthermore, the sustainability journey is based on outcomes for the future in which transition plans are a pivotal tool for forward-looking data. Transition plan disclosures can provide transparency in the market by increasing the availability and credibility of sustainability-related information provided to investors when assessing a firm's future prospects. Data from these plans can enable the markets to function more effectively, for example, corporate transition plans can inform capital allocation decisions and investor stewardship. Transition plans are an important factor in identifying the firms that are walking the walk.

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**The sustainability journey is based on outcomes for the future in which transition plans are a pivotal tool for forward-looking data.**

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The FCA is an active member of the Transition Plan Taskforce (TPT) which launched its Disclosure Framework and Implementing Guidance in October; the TPT supports the scaling up of transition plans by encouraging material, robust and comparable forward-looking information to be adopted in the plans. Additionally, we intend to consult in 2024 on disclosure requirements based on the ISSB standards and TPT Disclosure Framework as a 'complementary package'.

Additionally, we are examining how to improve traditional backwards looking data in the ESG ratings space by increasing availability and quality of

forward-looking data. We also think a ratings user should be able to distinguish from what data is backwards looking versus forward. Technology and digital innovation can help address this and scale up the availability of sustainability-related data whereby the data from transition plans should also remedy concerns by integrating forward looking information into a rating score.

A key focus at the FCA is ensuring the credibility of sustainability-labelled finance instruments and products. Sustainability data needs to be accessible in clear and simple terms, to be able to be understood by consumers and build their trust in the market. We recently launched our Sustainability Disclosure Regime (SDR) which provides for a consumer-driven framework to simplify and help navigate the complex sustainability investment landscape by presenting sustainability claims from funds in a clear and not misleading manner while highlighting key KPIs in two pages.

It is also important to take advantage of what other players across the world are doing. For example, it is necessary to provide a central point to increase the accessibility of data, we have been supporters of the Net Zero Data Public Utility (NZDPU) as a free tool to help increase the transparency of climate data in the transition by centralising data from a variety of different sources.

Each stakeholder has a role in ensuring that sustainability data is available. Global public actors must provide organisations with the tools and frameworks for reporting and disclosures, while firms need to ensure their data is reliable and accessible. We recognise that this is a long-term journey that will continue to develop as the green transition progresses.



## DANIELA MARILUNGO

Head of International Public Policy - Bank of America

### Fulfilling the promise of sustainability data

The EU's 2018 Sustainable Finance Action Plan recognised the promise of high quality sustainability data as a means of driving Europe's transition to climate-neutrality. There has been significant progress since then on advancing the requirements for non-financial reporting, leading to a more consistent and comparable disclosure framework. This will in turn facilitate the allocation of capital to initiatives that accelerate the transition to net zero and realise the ambitions of the European Green Deal. But there is still more to do, not least improving the availability of data from smaller companies.

The development of the European Sustainability Reporting Standards (ESRS) means the EU has now put in place a comprehensive reporting framework. Their development has happened at pace, and the outcome is a full suite of standards across environmental, social and governance issues. Once fully embedded in the non-financial reporting framework, they will provide what is effectively a self-policing mechanism for ~50,000 companies in Europe. The powerful tool of transparency will allow a light to shine on business strategies and practices across the economy.

Of course the ESRS do not come without challenges. The implementation and application of the standards is an onerous process, not aided by their breadth, their extra-territorial reach, and the need to apply judgement which will inevitably lead to varying approaches across sectors. The ESRS also require double materiality assessments – i.e. not just how the business is affected by sustainability issues, but also how their activities affect the outside world – which implies an added level of complexity for reporting entities.

In parallel to the EU standards, the ISSB has developed its own, narrower, set of standards that offer a baseline for adoption globally – IFRS S1 and S2. In contrast to the ESRS, the staged approach taken by the ISSB means the initial focus is on climate disclosures only, with further environmental, social and governance standards in the pipeline. Critically, there is no requirement for a double materiality assessment – marking one of the principal differences with the EU's approach.

A growing number of jurisdictions across the planet – including major economies – have already expressed their support for the ISSB standards, signalling their intent to adopt them in the near term. Considering it took nearly two decades for the adoption of the IFRS accounting standards, the race is on to achieve a similar (or better) adoption rate in five years or less.

When taken together, the ISSB standards and the ESRS promise the replacement of a patchwork of voluntary reporting standards, which adopt often very different approaches, with a more consistent and inter-operable set of mandatory standards. The consequence will be easier comparability, and a non-financial reporting framework that is much more akin to its financial reporting equivalent.

Further progress will however be hindered by the limited coverage of the requirements. The European Commission intends to develop a set of separate standards for listed SMEs, while encouraging unlisted SMEs to adopt them voluntarily. But the level of overall coverage of the mandatory standards means that there is a greater onus on voluntary adoption and/or market-based solutions to fill the 'data gap'.

Data aggregators are seeking to offer value-add products, but fundamentally their offerings are held back by a lack of data availability. Simply put, not enough companies are producing the data that is needed. So how can we address this without over-burdening smaller

companies with onerous requirements, given their more limited means?

The private sector is already responding to this challenge, with financial institutions weighing up the best way to collaborate on solutions to ensure there is sufficient data available on smaller companies. The Net-Zero Public Data Utility – backed by GFANZ – also offers encouragement. Its mission is to provide "a trusted, central source of company-level climate transition-related data that is transparent and openly accessible to all". In December 2023, it unveiled a proof of concept, illustrating the potential of the initiative.

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**There is still more to do, not least improving the availability of data from smaller companies.**

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Policy-makers can help too. The European Commission can utilise its tri-annual reviews of the ESRS to further refine the standards, minimise their burden on in-scope entities and deliver greater alignment with international standards. Global advocacy to boost the adoption of the ISSB standards will also help. As will efforts to refine existing green taxonomies and develop internationally consistent taxonomies so that there is common understanding of what constitutes 'green'.

We can take heart from the progress made in recent years, while acknowledging that a further push is still needed. Fulfilling the promise of sustainability data in contributing to the transition to a net zero economy will require a joint effort from the public and private sectors.



## CORNELIA ANDERSSON

Group Leader, Sustainable Finance and Investment - London Stock Exchange Group (LSEG)

### Deliver on net zero targets: 5 principles for ESG data to support the transition

Global capital markets are a complex environment. Whether asset owner, asset manager, broker, investment bank or consultant, resources are limited, and difficult decisions need to be made as to where to commit capital. Those decisions are first and foremost rooted in good quality data.

Reliable information is critical to help investors and the broader ESG stakeholder community to look past the public messages and the hype. Investors need effectively to understand the reality of corporates' climate-related risks and opportunities, to ultimately efficiently allocate capital and manage risks in a sensible way.

Despite the clear need for robust and transparent data, good ESG quality data is still missing.

As an example, scope 3 GHG emissions data is not only still scarce, but also very volatile when reported. LSEG's research concluded that half of the corporate

reported scope 3 values varied by 20% year on year, and a third by 50% (up or down). This volatility can have a knock-on effect on the effectiveness of climate benchmarks and related ETFs, among other financial products, as it creates uncertainty and risk that disincentives the use of those metrics by investment professionals.

Fortunately, the adoption of regional or global standards for sustainability reporting (European Sustainability Reporting Standards (ESRS) in the EU, International Sustainability Standards Board (ISSB) globally) represents major progress for sustainable investment.

Policymakers should now focus on implementation and support to corporates to improve data availability and quality.

In order to ensure good quality data, standard setters and regulators should follow 5 key principles:

- First, data should be available: although the EU has been a first mover with the adoption of the CSRD, the rest of the world is yet to catch up. This is why LSEG supports ISSB's call for global adoption of its sustainability and climate-related standards ("S1" and "S2") by 2025, across the globe and across market segments, be they public or private.

#### In order to ensure good quality data, standard setters should abide by 5 key principles.

- Second, data should be reliable, as per the scope 3 example above. Assurance or audit processes can help. However, in order to be effective, assurance should be rolled out progressively and in a coordinated manner, to ensure sound capacity building in this new field. IOSCO should define global principles of assurance and audit of ESG data to support regional policymakers' efforts. Reliability also warrants a certain level of simplification, or at least a focus on key proxies that provide insights into a corporate's management of sustainability risks. Detailed reporting can lead to too much noise, blurring a corporate's actual performance or exposure to ESG risks.
- Third, comparability is key to good quality data. Capital markets are global and so is climate change. For ESG data to be usable and contribute

to an effective net zero transition, there must be absolute clarity on the interoperability of ESG standards frameworks. If full alignment is not achieved, then at least indicator-level mapping between the various frameworks is needed.

- Fourth, usability is critical. This requires global coordination in digital tagging. Granularity and consistency in digital reporting (e.g. XBRL) means that identical data points under ESRS and ISSB should have the same digital tags, even though the frameworks themselves are not entirely identical. Digital tagging coordination would facilitate rapid collection and, ultimately, integration of ESG data in investment decisions by the financial sector.
- Finally, policymakers should strongly care about corporates' capacity building and preparedness. Private institutions and public institutions should work hand-in-hand on this matter. Companies like LSEG, which operate across the lifecycle of global capital markets, can partner with standard-setters. By leveraging our industry's platforms, policymakers can further amplify their voice and support to the financial and economic community, from investors to issuers, from brokers to regulators. This is especially true for standards with a global or extraterritorial reach, where global corporates are less familiar with regional developments.

Having those principles rooted in the implementation of ESG standards frameworks is central to a successful delivery of both EFRAG and ISSB work and ultimately to the effective integration of sustainability considerations in investment and lending strategies. We need the right foundations to start delivering on the net zero journey and are committed to support the general transparency effort.

## FINANCE AND NATURE



SYLVIE  
GOULARD

### Nature matters as much as climate

According to scientists (IPBES, IPCC), the degradation of nature is rapidly accelerating. For centuries, we took ecosystem services provided by nature for granted: water, pollination, climate, soils seemed to be available for free, as Jean-Baptiste Say, the French economist, stated this at the beginning of the industrial revolution. We now know that it is not true. We live in a limited world, where resources are scarce and nature in danger. According to The Stockholm Resilience Center, we already crossed six „planetary boundaries“ out of nine assessed in 2023.

In December 2022, 196 governments adopted the Montreal Kunming biodiversity framework aiming at better protecting nature. They commit themselves to restore 30 % of degraded land and water ecosystems, and protect 30 % of earth, to 2030. This huge ambition requires private financing, as target 19 of the agreement clearly states.

As nature is a common good, private finance cannot be the only solution but, to succeed, it is bottom-line to channel capital and investments toward sustainable productions and stop financing activities that destroy the

nature further, such as changes of uses of earth and seas (for example building without respecting ecosystems or abusing of pesticides); overexploitation (fisheries); climate change, pollution. As many companies begun already to work on climate, less on nature-related issues, it is worth underlining that both challenges are intertwined. Nature is a carbon sink. To destroy forests or pollute further the oceans will only accelerate climate transformation. And we should be aware of the existing trade-offs (electric cars requiring for example massive mining of raw materials).

Protests, political ideology and demands for getting « more time » to adapt will not stop nature transformation, nor climate change. The later we act, the more costly it will be; if some tipping points are reached, the consequences could be irreversible.

So, what can we do?

- i. firstly, public and private actors must understand how much their survival depends on nature, take responsibility both for regulation and disclosure.

Governments must implement the Kunming Montreal agreement and rapidly deliver on their promises. In the EU, as well as in California, disclosure rules are already compulsory, which is good news. As soon as companies measure their impact and dependencies, they realize how far they are from a sustainable path, becoming nature positive being as important as moving to net zero. In other jurisdictions, the efforts made by TNFD to develop a framework, as well as ISSB standards could be of a great help for companies acting on a voluntary basis.

- ii. Secondly, the degradation of nature poses a real economic and financial risk and should be treated as such. Supervisors and central banks can play a role in stressing the vulnerabilities of our economies, taking into account dependencies and impacts. According to a study published by the ECB in June 2023, around 72 % of banking loans in the euro area go to companies that are dependent or highly dependent to ecosystem services.

For private companies, it is not only a reputational issue. For many, it is

already a business issue. For agri-food for example, changes in climate conditions, invasive species or water scarcity can impact massively on value chains.

- iii. Finally, public and private investments must be swiftly directed towards the restoration of nature.

Multilateral and bilateral development banks can channel public money and they are beginning to do. “Blended finance” could help. Private finance can also provide new financing, taking into account the specificities of nature related issues. Biodiversity is always appreciated locally. There is no one metric such as the CO<sub>2</sub> ton. Furthermore, the interaction between ecosystems is a complex matter.

**We live in a limited world, where resources are scarce and nature in danger. Finance has a role to play.**

To achieve all these goals, biodiversity credits will certainly not be sufficient. However, if well calibrated, they belong to the most credible options. Any credit or « certificate » should be based on sound scientific analysis, be high integrity and allow Indigenous people and local communities, worldwide, to steward the projects.

The purpose of the International Panel on Biodiversity credits, launched by the French and the British authorities, I have the honor to co-chair with Dame Amelia Fawcett, is to put in place a set of principles, imagine archetypes, foster investment. We will deliver our work in Colombia during the next biodiversity COP in October 2024. It will certainly not be the end of the journey. Our success will depend on the mobilization of finance key players and corporate, acting with NGOs, scientist and of course IPLCS. The global biodiversity treasury is in our hands.





## NATHALIE BORGEAUD

Lead, Financial Markets  
Stakeholder Engagement -  
Taskforce on Nature-related  
Financial Disclosures (TNFD)

### Demystifying the Taskforce on Nature- related Financial Disclosures

TNFD provides the tools to integrate nature into decision-making and take action on nature.

A healthy economy depends on healthy ecosystems. The science is clear: due to human activities, nature is deteriorating globally and biodiversity is declining faster than at any other time in human history. There is growing evidence that this poses risks for businesses, capital providers, financial systems and economies. Yet, neither companies nor financial institutions are adequately assessing their dependencies on nature, their impacts and related risks and opportunities. The Taskforce on Nature-related Financial Disclosures (TNFD) aims to make action easier by providing the tools to integrate nature into corporate decision-making.

In September 2023, the TNFD published its Recommendations for organisations to report and act on nature related issues. TNFD seeks to inform better decisions by companies and capital

providers and help shift global financial flows toward nature-positive outcomes.

TNFD is a market-led, science-based and government-supported global initiative. The 14 TNFD Recommendations help business and finance to identify, assess and disclose their exposure to nature dependencies, impacts, risks and opportunities. Similarly to the climate disclosures of the Task Force on Climate-related Financial Disclosures (TCFD), they are structured around four pillars: Governance, Strategy, Risk management and Metrics and Targets. Companies and financial institutions are encouraged to adopt the TNFD Recommendations on a voluntary basis, to help halt biodiversity loss, regenerate nature and make their business models more resilient.

The TNFD Recommendations have been designed to enable the achievement of the global policy goals outlined in the Kunming-Montreal Global Biodiversity Framework, signed by over 190 countries at COP15 in December 2022.

In parallel, the NGFS (the Network for Greening the Financial System, including over 130 central banks including the ECB) has been leading work to mainstream the consideration of nature-related risks and help guide action by central banks and financial supervisors. It published its Conceptual Framework on nature related risks last September.

Over the past two years, the European Financial Reporting Advisory Group (EFRAG) and the TNFD have worked closely together to reach a high level of consistency in the language and the approach of the ESRS environmental standards. All 14 TNFD-recommended disclosures are incorporated into the ESRS. ESRS refers to the TNFD LEAP approach for companies conducting materiality assessment on environmental topics. A draft paper showcasing the interoperability mapping between ESRS and TNFD, co-written by both, is currently available for review.

Today, many market participants are already taking action on adopting the TNFD: 320 companies and financial institutions from 46 countries have announced their intention to publish TNFD-aligned disclosures over the next two financial years. They already represent over USD 4 trillion of market capitalisation. Among them are 100 financial institutions, including asset owners and asset managers with AUM of USD 14 trillion, and 7 of 29 GSIBs.

TNFD 'Getting Started' guidance helps companies embark on the nature journey. TNFD also provides a detailed methodology to *Locate* nature issues,

*Evaluate* impacts and dependencies, *Assess* risks and opportunities and *Prepare* reporting. The so-called LEAP method has been piloted by over 200 companies and offers a practical approach. Guidance is also provided for keys sectors including the sector guidance for Financial Institutions. The TNFD Data Catalyst hosts over 120 data and analytics providers, showing that a range of data sources is already available to help organisations get started.

**TNFD provides the tools  
to integrate nature into  
decision-making and  
take action on nature.**

TNFD encourages organisations to expand the depth and breadth of their nature-related disclosures over time. In identifying their nature challenges companies will come across issues they can immediately address, and some which may require long-term plans. By doing so, they will be moving forward on building internal capabilities, reducing future business risks and taking positive action on nature. Starting now, with the information currently available, is a necessary step for moving the real economy and the financial system towards nature-positive outcomes, leading to a more sustainable future for all – the economy, the society and nature.



## PHILIPPE BLANCHOT

Director of Institutional,  
International and European  
Relations - Caisse des  
Dépôts (CDC)

### Caisse des Dépôts promotes biodiversity in a multilevel commitment

The ecological transformation is at the heart of the Caisse des Dépôts Group's ambition. It plays into all our strategic objectives, with the aim of aligning all our activities with a pathway of limiting global warming to 1.5 °C. The preservation of biodiversity, defined as all living beings, the ecosystems in which they live and the interactions between them and with their environment, is essential in the fight against other environmental scourges such as climate change, desertification, the scarcity of water and pollution. Since 2020, CDC's entities have set themselves goals in terms of biodiversity through initiatives relevant to their activities (such as "Finance for Biodiversity" or "Entreprises Engagées pour la Nature – act4nature France").

During COP-15 Biodiversity in December 2022, Caisse des Dépôts Group published its very first biodiversity policy, which constituted a major step forward, as it promotes factoring biodiversity into

all of our activities through a dozen commitments corresponding to the themes set out in the Kunming-Montreal Global Biodiversity Framework as adopted at COP-15. In this context, CDC also signed a joint statement drawn up by the UNEP Finance Initiative (UNEP FI), the Principles for Responsible Investment (PRI) and the Finance for Biodiversity Foundation, including the firm commitment to contribute to the protection and restoration of biodiversity and ecosystems through their financing activities and investments.

CDC's biodiversity policy covers the Group-wide's operational businesses and the internal running of its entities, as well as its financial business lines and is supplemented by various biodiversity action plans at subsidiary entity level. It is structured around four key blocs:

#### 1. Measuring the biodiversity footprint

With the creation of a dedicated "CDC Biodiversité" subsidiary in 2007, CDC positioned itself ahead of the curve in preserving biodiversity. The consulting firm specialised in positive actions for biodiversity launched in 2022 its Global Biodiversity Score (GBS), a tool to measure the footprint of economic actors allowing to assess their biodiversity impact in all areas of their activity. Like a carbon footprint, the GBS measures the impact of companies, across its entire value chain based on their activity data and expresses it in a single metric. This allows the definition of objectives and trajectories in line with the Global Biodiversity Framework (Kunming-Montreal Accord) and a methodical monitoring of commitments. The GBS approach is aligned with international frameworks (TFND, SBTN) and European regulatory requirements (CSRD).

This common measuring language allows for a large ecosystem of users and is complemented by the BIA-GBS database developed with Carbon4Finance for measuring the biodiversity footprint of portfolios of listed assets. In 2022, CDC Biodiversité has carried out 33 biodiversity footprint assessments for companies (Schneider Electric, Hermès, Vattenfall), financial institutions (BNP Asset Management, CDC) and local authorities.

#### 2. Reducing negative impacts

CDC's biodiversity policy includes criteria to mitigate its direct and indirect negative impacts on the five "pressures" on biodiversity and ecosystems as identified by the IPBES (Intergovernmental Science-Policy Platform on Biodiversity and Ecosystem Services): changing use of land and sea, natural resource use and exploitation, pollution, and invasive

species, with climate change already being covered by a dedicated policy.

The policy focuses on reducing the Group's impact in terms of deforestation (by excluding companies involved in the exploitation of high-risk raw materials and which do not have a recognised prevention policy), urbanisation of green spaces, destruction of sensitive areas, overfishing, and chemical pollution.

By creating "CDC Biodiversité" in 2007, CDC positioned itself ahead of the curve in preserving biodiversity.

#### 3. Stepping up initiatives to promote biodiversity

CDC's policy foresees that the restoration of biodiversity should be financed, through mandatory compensation, natural offset sites, the offsetting of agriculture, the renaturing of cities, payment programmes for environmental services. As part of its recovery plan, CDC has committed an overall €3bn for biodiversity-friendly projects in 2020-2024. Our Nature 2050 programme allows companies to finance nature-based solutions at regional level, which has already helped to support more than 60 nature-based solution projects, dedicated innovations and solutions, and partnerships and contributions to collaborative initiatives. Overall, a total of 3,236 hectares of greening projects have been financed by CDC Biodiversité in 2022.

#### 4. Research, training and awareness-raising

CDC is actively involved in financing research around biodiversity issues through the Economy and Biodiversity mission led by CDC Biodiversité (€7.9 million over 2020-2024), as well as through programmes run by the CDC Institute for Research and Société Forestière. In addition, training and awareness-raising initiatives are organised by many entities within the Group.



## SINTHUJA YOGARAJAH

Associate Director -  
ESG Integration - Federated  
Hermes Limited

### Nature's financiers - Balancing growth and green stewardship

*"The planet is in the midst of a biodiversity and climate crisis... and we have a last chance to act... A nature-positive future needs transformative - game changing - shifts in how we produce, how we consume, how we govern, and what we finance."*  
Marco Lambertini, the Director-General of WWF International.

Ecosystem services are essential for human well-being and survival. They include provisioning services like food, water, and materials; regulating services for climate, water purification, and disease control; supporting services like biodiversity and nutrient cycling; and cultural services, providing recreational, aesthetic, and spiritual values. Humans rely on these services for daily needs, economic activities, and cultural enrichment. However, human activities threaten these services, emphasizing the importance of sustainable practices and conservation efforts to ensure their continued availability for present and future generations.

What can the financial sector do to help preserve and restore biodiversity?

1. Increase investments in sustainable projects and companies – encourage and promote investments in envi-

ronmentally sustainable projects such as conservation initiatives, renewable energy and sustainable agriculture.

2. Expand green finance mechanisms that are transparent – issue and/or use green bonds/loans and adopt green lending practices.
3. Invest in innovation and technology – increase investing in technologies that contribute towards environmental conservation and restoration.
4. Price in externalities and improve risk management – enhance risk assessment models to incorporate environmental risks and improve disclosure of exposure to these risks.
5. Promote incentives and regulation to create enabling environment – advocate for regulatory frameworks that promote sustainable practices and penalise harmful activities. Support policies and align financial incentives that help preserve/restore biodiversity. Contribute to the creation of and adopt industry standard disclosure frameworks on reporting environmental impacts and dependencies such as the TNFD and ISSB.
6. Build partnerships and support development of industry best practice– collaborate with governments, NGOs, industry initiatives and the private sector to grow expertise and resources. Partner with conservation organisations to support projects aimed at preserving biodiversity.

**Balancing growth and green stewardship is not only a responsibility but also an opportunity.**

7. Consider the social impact – in all the above actions, consider all environmental and social impacts of your investments including any unintended consequences. Financial investments should have a positive social impact where impact on all relevant stakeholders including the local communities are considered, and most importantly,
8. Act as active owners of your investments – engage with your investee companies to understand how they are assessing and mitigating nature-related risks and opportunities and encourage companies to commit to having a net-positive impact

on biodiversity throughout their operations and supply chains.

For those that are at the start of the journey, the two priorities I would recommend are captured under points 4 and 8:

- Assess the impact and dependencies of your current investments using frameworks such as the TNFD. One might find that you're not able to incorporate all of the TNFD recommendations in your first year of assessment and there are some barriers in achieving this including the lack of reliable data that is available in a useful format. Therefore, identify parts of the recommendations you can implement and start the journey.
- Engage with your investee companies to encourage them to evaluate the extent to which their business models rely on biodiversity and ecosystem services, considering both risks and opportunities. Additionally, urge companies to understand, mitigate and reverse the negative impact their operations and supply chains are having on biodiversity and ecosystems. This will include mitigating their contribution to the drivers of biodiversity loss, such as climate change, pollution and land use change.

The financial sector, as nature's financiers in partnership with governments, plays an important role in preserving and restoring nature. By prioritising the above listed actions, financial institutions can contribute significantly to a more sustainable and resilient global ecosystem and financial system. Balancing growth and green stewardship is not only a responsibility but also an opportunity for the financial sector to shape a future where economic prosperity goes hand in hand with environmental health.



## HIROTAKA HIDESHIMA

Counsellor on Global Strategy,  
TNFD Taskforce Member -  
Norinchukin Bank

### The case for getting started with TNFD

#### The need of having a holistic view incorporating nature

Climate change is one aspect of nature degradation. Scientists point out that dealing with nature is equally, if not more, urgent as dealing with climate change. At the same time, policy aiming at addressing climate only can have negative impacts on nature. One example is the construction of renewable electricity generating facilities by cutting down trees in the forests. As such, policy needs to be formulated with a holistic view dealing with nature as a whole. The need to avoid a narrow focus on climate-only is becoming all the more stronger with the increased pressure to increase renewable power following COP28. The European Sustainability Reporting Standards (ESRS), which covers a much wider range of environmental issues than just climate change, supports this view.

#### Increased attention from supervisors

The Network of Central Banks and Supervisors for Greening the Financial System (NGFS) has published “Nature-related Financial Risks: a Conceptual Framework to guide Action by Central Banks and Supervisors” in September 2023, and “NGFS Recommendations toward the development of scenarios

for assessing nature-related economic and financial risks” in December 2023.

#### The TNFD recommendation

The Taskforce on Nature-related Financial Disclosures (TNFD) published a set of disclosure recommendations on 18 September 2023. The disclosure recommendations accommodate the different approaches to materiality in use currently and are aligned with the goals and targets of the Kunming-Montreal Global Biodiversity Framework adopted in December 2022. The recommendations and accompanying guidance will help business and finance to integrate nature into decision making, and ultimately support a shift in global financial flows away from nature-negative outcomes and toward nature-positive outcomes.

The disclosure recommendations are structured around four pillars, consistent with the Task Force on Climate-related Financial Disclosures (TCFD) and the International Sustainability Standards Board (ISSB) to enable integrated climate- and nature-related reporting. The four pillars are: governance, strategy, risk and impact management (risk management in TCFD and ISSB), and metrics and targets. The TNFD replicates all 11 TCFD recommended disclosures for nature-related issues, and adds three, making the total number of recommendations 14. The TNFD has been working closely with the EFRAG (European Financial Reporting Advisory Group) to align the TNFD recommendations with the ESRS. The EFRAG and the TNFD signed a cooperation agreement to further advance nature-related reporting on 21 December 2023.

#### Getting started with TNFD

Recognising that not all organisations (report preparers) are likely to be able to disclose all aspects of the disclosure recommendations across the whole value chain from the beginning, the TNFD has also published a guidance on how to get started with the TNFD recommendations. The guidance presents seven steps, but my personal view is that the following five are critical among the seven:

- Start with what you have
- Plan for progression over time
- Monitor and evaluate your own adoption process
- Gain buy-in from management and board, and
- Register your intention to start adopting at the TNFD website

This basically means that organisations do not have to wait until they can disclose

the full TNFD recommendations. They can (and should) start with partial disclosure with a clear plan to expand the scope, and a monitoring framework to check the actual progress against the plan, with a view to change the plan if necessary. The board level buy-in is important as a full commitment by the organisation. Registration on the TNFD website will make it easy for observers to see the list of TNFD adopters at a glance.

**Adopting TNFD is one obvious way to start the urgently needed work addressing nature-related issues.**

#### Early adopters

Until 10 January 2024, the TNFD has been inviting organisations to become “Early Adopters” of TNFD, organisations which intend to start making disclosures aligned with the TNFD recommendations in their corporate reporting for the financial year 2025 results (or earlier). On 16 January, the TNFD announced the inaugural cohort of Early Adopters, which was 320 organisations from over 46 countries. European domiciled companies are 43% of the list, and Asia Pacific 42%, with 80 organisations from Japan, 46 from the UK, 19 from France, 14 each from the United States and Taiwan.

It is true that, in the nature area, there is still no equivalent of the 1.5 degrees target for climate change. However, there seems to be growing understanding that rather than waiting for a target to be set, we need to start working in this area before it gets too late.

Adopting TNFD is one obvious way to start the urgently needed work addressing nature-related issues.

# Seminar organised with the contribution of the Eurofi members



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**FRANCESCO VANNI  
D'ARCHIRAFI**

Chairman - Euroclear Group

## CMU and digitalisation as key enablers for a resilient and competitive EU

What overall assessment can be made of the CMU initiative so far? Are the regulatory measures adopted since the initiative was launched likely to have a significant impact in terms of growth and integration of the EU capital markets once they are fully implemented?

A great deal of work has been undertaken in the two CMU action plans and related workstreams. It is important to highlight some key areas of progress: for example, the EU has remained a global leader on sustainable finance, as demonstrated by the levels of ESG bond issuance. The future establishment of the European Single Access Point and the consolidated tape(s) for financial instruments will be major milestones with the potential to deliver significant value to investors and the single market.

It is clear that some initiatives will require further efforts, including at the national level. We need to enhance our capacity to generate deep pools of long-term capital through pension funds and insurance assets. This is vital to promote the competitiveness of our markets and mobilise the capital resources required to finance the green and digital transformations.

Equity finance is an area where Europe is punching below its weight. It has been worrying to see several cases of European companies favouring the US market. One of the drivers has been, in my view, the availability of deeper pools of investable capital in the US – including many large institutional investors and a strong retail investor base – which can lead to a more attractive environment for raising capital. The regulatory environment is also important: the recently agreed measures under the EU Listing Act will hopefully bring the benefits we all expect.

Despite the challenges, the opportunity remains. I am very encouraged to see that the CMU is a top priority for the

policy makers, with a renewed sense of urgency. Without a well-functioning European financial market, there will be no powerful Europe on the global stage.

What should the priorities of the next stages of the CMU: implementing the measures already adopted, completing the existing action plan with further incremental actions, or does the approach to CMU need changing? In which areas is further work needed?

The CMU project is a marathon, not a sprint. The recently adopted initiatives will need to be given time to take effect. Future EU initiatives should remain targeted and focused on core objectives such as increasing the capital market financing capabilities of companies, supporting market liquidity and promoting the global competitiveness of businesses.

Arguably the most pressing priority will remain the need to effectively deploy the vast pools of long-term household savings into productive investments. There is a strong relationship between the availability of deep capital pools from retail and institutional investors and the capacity of companies to raise capital. This in turn drives the development and expansion of the capital markets ecosystem to support both issuers and investors.

Tax incentives play a major role in encouraging citizens to deploy their savings more effectively. Measures undertaken in Sweden some years ago were successful in mobilising retail investors and supported a strong ecosystem for SMEs planning to list. A comprehensive strategy involving European and national measures is needed towards achieving similar results on an EU-wide scale. This would truly transform the EU's capital markets landscape.



Would a more top-down approach, as recently proposed by C. Lagarde be relevant and if so, what should it involve? Is it possible to further consolidate market infrastructures and would that facilitate the achievement of the objectives of the CMU?

It is difficult to compete globally without the scale of the single market. A bottom-up dimension focusing on national reforms and local ecosystems is complementary to top-down measures to improve regulatory harmonisation and integration in a manner that delivers economies of scale. To achieve this, it is key that Member States agree to common objectives and prioritise actions accordingly. I sense that there is a renewed sense of urgency across Member States which is positive.

The fragmentation of the European post-trading landscape has been an area of reflection for many years. This is driven to a large extent by the jurisdictional fragmentation of the EU, featuring divergent legal frameworks and national regimes in areas underpinning the functioning of markets. Consolidation is not always possible (due to remaining national barriers) or not necessarily required. Indeed, market integration has been pursued and achieved gradually and through different channels, not all of which require full harmonisation of practices or formal mergers between companies or legal entities. Euroclear for example has delivered integration of seven CSDs (and ICSD) in its group which has allowed us to reap many synergies to the benefit of our ecosystem of issuers, investors and intermediaries. Also, relentless efforts over the last twenty years of harmonisation in various areas of the securities industry (for example in the frame of Target2Securities) have rendered the cross-border processes more efficient.

The promotion of interoperability and open access among diverse infrastructures operating in the single market can also effectively deliver practical market integration and connectivity for the benefit of issuers and investors.

The EU has also opted to allow increased competition between financial market infrastructures. Issuers and investors can today choose which infrastructure to use. This should encourage the concentration of activity, and hence increased scale.

Euroclear has always been, and will remain, ready to engage in an open debate on how our ecosystem should continue to evolve to promote safety, efficiency, and liquid financial markets for sustainable economic growth.

What are the prospects of technologies such as DLT, tokenisation, CBDC, AI, cloud etc... in the post-trading space? What are the main opportunities and challenges to overcome (e.g. in terms of migration of legacy systems, changes in terms of market structure and value chain)? Is it expected that core settlement processes will eventually migrate to blockchain based systems?

Artificial intelligence has been the dominant topic in most conferences and board rooms over the past year, overshadowing DLT and tokenisation. This change of focus can be explained by the fact that AI is believed to be more disruptive and offer more concrete benefits for the financial services industry in the short term than DLT.

Although it is less visible, financial institutions and public authorities do continue to investigate how DLT can be used to the benefit of the capital markets. We are now at the end of a first phase of experimentation. The second phase should be more collaborative as most financial institutions now understand that a sudden and complete shift to a DLT environment is not feasible and would increase fragmentation. The market will have to operate in a hybrid mode between the legacy and the DLT environment for several years. And for that, co-creation and interoperability will be key.

We very much share this view, and it is in line with the white paper Euroclear recently issued with DTCC and Clearstream, calling for more industry collaboration to advance towards a digital asset ecosystem.

And to follow up words with actions, Euroclear launched last October a Digital Securities Issuance service with a first digitally native note issued by the World Bank, raising EUR 100 million. Our DLT issuance platform is connected to our legacy infrastructure to allow the continued provision of services such as secondary market activity, which ensures liquidity. This while being fully compliant with CSDR, which demonstrates our commitment to innovate without weakening the regulatory standards.

There is no doubt about the huge opportunities that digital technologies can bring to the capital market and how they can enhance the provision of core CSD services. The digitalisation journey will, however, be a long-term endeavour and will require broad regulatory harmonisation and industry-wide collaboration. And we are ready to play our part.



## Q&amp;A

## DAVID SCHWIMMER

Chief Executive Officer - London  
Stock Exchange Group (LSEG)

## A holistic regulatory strategy will strengthen EU capital markets

There are several ongoing initiatives at both the EU and Member States level looking to relaunch the CMU project. What are LSEG's views on what is needed for the development of strong EU capital markets and the CMU to succeed?

Capital markets are critical to funding the companies and institutions that foster innovation, generate jobs, and drive economic growth. As a leading financial markets infrastructure and data provider, LSEG sits at the heart of the world's capital markets. We provide the data, analysis, and infrastructure needed to raise and deploy capital across every major financial centre and jurisdiction, including the EU. The vital role that we play in the world's financial ecosystem has enabled us to make a few observations on how the EU can strengthen its capital markets.

Our first observation is that improving the EU's capital markets will require a holistic approach that looks beyond primary markets. There is a tendency within Europe to judge the health of capital markets solely by the number of IPOs. However, thriving capital markets are supported by a wider ecosystem, consisting of both local and international market infrastructures, banks, private investors, and providers of data and technology. It is only by considering this whole environment that truly healthy capital markets can be established.

Our second observation is that EU policymakers could better define the objectives of the CMU. On one hand, they could make the CMU a globally competitive financial market ecosystem that allows EU-based companies and market participants to raise, attract and allocate capital as well - or better - than other globally competitive financial markets. On the other hand, they could make the CMU an industrial policy mechanism that seeks to incentivise activity within the EU in the interests of "strategic autonomy", not international competitiveness. Our strong view is that the former would be a far more effective path to sustainable growth and efficient capital markets in the EU.

Our third observation is that the EU is unique, as both a single jurisdiction and 27 separate jurisdictions. The approach to EU capital markets reform needs to reflect this reality. Indeed, further harmonisation is necessary to support EU cross-border and global flows of services, products, and investments. This can be better achieved through supervision than regulation. EU legislation tends to be overly detailed to cater for the lack of common supervision and the risk of diverging interpretations within the EU, even in the case of regulations. This makes the EU framework sometimes burdensome and less adaptive than those of other jurisdictions. Direct supervision of EU-wide firms by a single, pan-European authority is core to ensuring a more outcome-based regulatory framework, which would in turn further support the competitiveness of EU capital markets. While some argue that local regulators are better placed to deal with the idiosyncrasies of their respective markets, this ceases to be advantageous the moment a business expands beyond national borders. The current debate around the supervision of EU CCPs within EMIR 3 is a missed opportunity to address this issue.

### What should be the priorities of the next stages of the CMU and overall development of EU's capital markets?

First and foremost, the European Commission should evaluate whether the existing financial services rulebook is fit for purpose, focusing on whether all the different EU regulatory frameworks work well together. The Commission should address frictions and barriers across all sectoral legislations if it wants the CMU to progress well.

The European Commission should then incorporate competitiveness as a core mandate for EU institutions, combining this with a focus on the digital and green transitions. Reviews and new legislations should look to enhance the global attractiveness of EU's financial services in addition to addressing other crucial components such as resiliency and environmental impact. This will guarantee better outcomes for the EU and the future of its financial ecosystem.

Achieving the European Commission's desired outcomes will require strong cooperation between policymakers and financial markets participants. This dialogue is essential for a well-developed financial ecosystem. While the current legislative structure does allow for this cooperation, it can be enhanced to provide significant additional value.

### Is the implementation of new technologies such as DLT, digital assets, AI, cloud, etc... a key objective for LSEG? How are these technologies expected to change the financial services market in the coming years? What are the challenges to overcome?

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Throughout LSEG's history we have used and adapted to new technologies and innovative solutions to serve our customers' evolving needs in an ever-changing global environment. We continuously explore new solutions that technological innovations permits.

An example of this is distributed ledger technology (DLT), where we are exploring the development of an asset-class agnostic digital markets infrastructure to support issuance, trading, settlement, and post trade processing of tokenised assets. This would allow participants in multiple jurisdictions to be able to interact, while simultaneously complying with all the rules, laws, and regulations of their respective jurisdictions, which is not currently possible. New asset classes are where we see the most natural fit for deploying blockchain technology, tokenising, or digitising assets, and using DLT to improve processes and efficiency.

LSEG already provides data on digital assets through our Data & Analytics division, but also FTSE Russell's flagship FTSE Global Digital Asset Index Series. We have also announced the launch of Digital Asset Clear at our Paris-based CCP, LCH SA (subject to regulatory approval), which will help the industry to better manage their risk related to investments in digital assets.

In addition, leveraging the expanding capabilities of artificial intelligence (AI) is core to our innovation and competitiveness. Generative AI holds the potential to revolutionise a broad array of business functions for financial services.

Advancements in the field of large language models (LLMs) are growing exponentially. Through LLMs, generative AI can draw sophisticated insights from data sources. LSEG holds significant amounts of data, and while we have been using AI and machine learning in our business for years, we are building more advanced AI functionality into our platforms and workflow to enhance customer productivity, creating more valuable insights through proprietary analytics.

One of the biggest and fastest growing challenges in AI is data trust, which includes data governance, rights management,

security, and privacy. The fact is that AI models are only as good as the quality of the data they are trained on. In this regard, I have two comments:

- First, our industry relies on pinpoint accuracy and if LSEG were to tell our customers that our data and analytics were only 95% accurate, it simply would not be good enough. We are very focused on ensuring the quality of our data and ensuring the integrity and lineage of our model inputs.
- Second, the quality of AI models is subject to the underlying data ecosystem remaining open and cross-border data flows being relatively unrestricted. These flows are also key to facilitating the development of innovative data-based solutions and the efficient functioning of financial markets. Ensuring that cross-border data flows remain relatively unrestricted should be a priority for the EU.

### In the last few years, significant progress has been made on sustainability reporting. Do you think this is enough to support the net zero transition? What more is needed?

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The environment of sustainable finance has evolved dramatically over the past five years. Reliable and comparable data is essential to efficient capital allocation for the net zero transition and is central to tackling greenwashing concerns.

Important progress has been made on this with the implementation of the Corporate Sustainable Reporting Directive (CSRD), and globally with the adoption of the ISSB standards. LSEG is a strong supporter of ISSB's work and the call for all jurisdictions to implement ISSB standards by 2025.

However, the net zero transition remains an extremely complex task, and one that should be tackled first and foremost in the real economy. Policymakers should adopt global standards to enable investors and other stakeholders to assess and compare corporates' transition plans and hold them accountable. We encourage the ISSB to build on their S1 and S2 standards to integrate standards on transition planning, that could be interoperable with the CSRD's existing standards.

Second, regulators need to acknowledge this complexity by avoiding binary regulatory approaches and support corporates in their operational journey. This starts by giving companies flexibility as they get started on transition planning. One cannot expect perfect and all-encompassing plans across the industry from year one.

Third, dialogue with companies is key to further educate them about the implications of the climate transition at both a micro and macro level. This interaction would help to get buy-in from the companies that play a central role in the economy.

## CAPITAL MARKETS UNION: STATE OF PLAY AND FUTURE PRIORITIES



### JOHN BERRIGAN

Director General - DG for Financial Stability, Financial Services and Capital Markets Union, European Commission

### CMU – looking towards the next political cycle

The EU has come a long way in developing its capital markets over the past few decades. The Commission has taken action on all the topics of the second Action Plan on Capital Markets Union and many legislative proposals have been agreed with the European Parliament and the Council. However, the integration of capital markets within the EU still lags well behind the integration of markets for manufactured goods and labour. This means that EU capital markets fall short of what the EU needs.

This has enormous opportunity costs, such as lower potential economic growth, less resilience to economic shocks and less choice in financial products for EU citizens. On top of this, more opportunity costs are emerging. One is the inability to finance the generational challenge of transitioning to a climate-neutral and digital future. This 'twin transition' requires the mobilisation of huge amounts of private money - and capital markets are a vital channel for this. Another opportunity cost is less capacity for innovation, due to a lack of financing opportunities for higher-risk projects, which need direct funding sources provided by capital markets.

The coming decades will most likely see fierce competition between economies for innovative, high-tech industries. If the EU cannot compete in the innovation race, it will fall behind economically and risks not being a relevant economic contender at all. In this future landscape, the opportunity costs of not having large and liquid EU capital markets are stark. Capital Markets Union is not just a 'nice-to-have' but a 'must-have' for Europe, alongside an integrated banking system.

With the stakes so high, it begs the question as to why progress is so slow on developing and integrating EU capital markets. Often the answer involves political will, which in turn is impacted by a number of factors. Take market integration, for example, which requires taking a myriad of very specific and technically complex actions. This makes it hard to build an appealing narrative. Capital market integration isn't easy from a "portfolio" perspective either, as many of the measures extend well beyond the financial services sector. Vested interests are another challenge, because the benefits of market integration are large yet typically diffuse, whereas its costs are more concentrated among vested interests and are therefore readily brought to the attention of national governments. Lastly, competition among Member States for the location of financial service providers in a multi-polar EU capital market landscape further complicates things.

Against this backdrop, it is encouraging to see the recent dynamism of the political debate on Capital Markets Union and the high-level political support being expressed. We have seen it included in repeated European Council conclusions; the joint declaration by the troika of Council Presidencies, the Parliament and the Commission to conclude legislative work on all the outstanding CMU legislative proposals; and the Eurogroup's work to identify priority areas for capital market policy by this coming March.

**Capital Markets Union has to be about one large and developed capital market for the EU as a whole.**

Meanwhile, the Commission is starting its own internal reflections on possible areas for future action. While the specific priorities will be defined by the new Commission later this year, I believe that they should reflect the need for our capital markets to increase in size and liquidity in order to become more efficient and competitive. This means we need to be careful about calls for a greater national focus in the approach to EU capital markets – the so-called 'bottom-up' approach. While this approach has its merits, national specificities are very often a source of fragmentation rather than an opportunity. Capital Markets Union has to be about one large and developed capital market for the EU as a whole and not a collection of separate national markets, however developed they become. Therefore, in building a single EU market, we must focus on the fundamental features that characterise any single market. These include a common insolvency law, common tax procedures, common supervision, common accounting standards and common corporate laws.

I am confident that, if we keep these considerations front and centre, and if we make use of the current political momentum in favour of Capital Markets Union, we will be able to make changes in our capital markets policy that make a real difference, benefiting markets and the economy as a whole, and most importantly, all EU citizens.



## VERENA ROSS

Chair - European Securities and Markets Authority (ESMA)

### A collective endeavour towards a shared vision for EU capital markets

Capital markets have always played an important role in the development and modernisation of European economies. In the Netherlands in 1602, the establishment of the Amsterdam Stock Exchange and the creation of the world's first publicly traded company marked the birth of modern capital markets, a pivotal moment in economic history. The Industrial Revolution in the 18th and 19th centuries saw the emergence of stock exchanges across Europe playing a crucial role in financing industrial expansion and new technologies. After World War II, with Europe facing the daunting task of reconstruction, capital markets again helped to channel funds from the Marshall Plan to help rebuild industries and foster economic recovery.

In the intricate tapestry of European financial markets, the Capital Markets Union (CMU) stands as a bold endeavour with the aspiration of an integrated, resilient, and competitive European capital market landscape. Despite much progress over the years to deepen and further integrate our capital markets in the EU, completion of a genuine CMU remains work in progress.

The 49 measures rolled out through the Action Plans of the European Commission in 2015 and 2020 represent in my view incremental yet vital steps forward. The positive effects of some of these initiatives, like the European Single Access Point or the consolidated tapes, will be likely demonstrated over time. Similarly, other ongoing changes, like the Listing Act reform, should bring some tangible benefits in terms of regulatory and procedural efficiency.

Alone, each of these measures may only produce marginal improvements. But together, they represent a meaningful step forward. Having said that, I would argue that there is still a necessity to further shape a capital market ecosystem in the EU that will genuinely serve the needs of citizens and businesses.

While there is still space for additional EU-led regulatory initiatives going forward, for example in reviving the securitisation market or improving the agility of rulemaking, there are limits in terms of what such measures can achieve in isolation. Therefore, we must think more broadly. Financial regulatory measures at EU level must be complemented by national efforts to truly fortify the effectiveness and attractiveness of EU capital markets. These should include, for example, the implementation of tax policies that would stimulate investments at the domestic level, or comprehensive reforms in national pension frameworks to mobilise significant pension capital, which can provide greater long-term benefits for citizens. While recognising the unique strengths and challenges in each EU Member State, these national measures must harmoniously coalesce with EU efforts, creating a more holistic strategy to propel the CMU forward.

The same holds true for the financial services industry. Ensuring the mobilisation of long-term capital for the challenges that the EU economy faces demands not only supportive regulatory, legal and fiscal frameworks but also proactive engagement and ingenuity from financial institutions. The onus is on the industry to design and offer suitable financial products that resonate with retail investors caring for their savings returns and future pensions. Simultaneously, responsible investment advice, focused on the best interest of the client, becomes paramount - guiding retail investors toward informed decisions that align with their financial goals and risk appetites. By embracing this role, the financial industry can become a key driver in bridging the gap between retail investors and the capital markets, fostering trust, confidence, and integrity.

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#### National measures must harmoniously coalesce with EU efforts.

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Furthermore, EU regulators and supervisors also have additional work to do. We must continue to drive towards both a more agile regulatory framework and more consistent and harmonised day-to-day supervision, to tackle fragmentation and avoid diverging supervisory outcomes.

As in the past, when Europe turned to its capital markets to support economic and societal transformations, the EU again stands on the precipice of major change. The Commission has estimated that the green transition will require additional investment of €620 billion per year, while the digital transition will require a further €125 billion per year. These funding pressures are compounded by other demographic, geopolitical, or societal changes, such as the ageing EU population.

We need a collective effort and common vision, across all public and private sector actors in the capital markets to shoulder this challenge. As ESMA, we will continue to bring our energy, expertise and EU spirit to bear in order to drive forward an effective EU capital markets and a genuine CMU.



## BERTRAND DUMONT

Director General of the Treasury - Ministry of the Economy, Finance and Industrial and Digital Sovereignty, France

### A renewed, pragmatic approach to the CMU

The deepening of European capital markets will be crucial to finance the dual ecological and digital transitions and, more broadly, to strengthen Europe's strategic autonomy and global competitiveness. This observation is now widely shared in a context where public finances face growing pressures and traditional bank financing is constrained by prudential requirements. This new sense of urgency has led Ministers Lemaire and Lindner, in a joint op-ed, as well as other European leaders, to put the Capital Markets Union at the top of political discussions in recent months.

As the mandate of the current European Commission nears its conclusion, the timing is opportune for an assessment of the progress made since 2015 and to contemplate potential adjustments in the approach moving forward. During the last two Commission mandates, we have conducted a dense legislative work, through successive reviews of the whole EU financial markets regulatory framework. However, the effects remain disappointing at this stage: the disparity between EU and US equity market capitalizations has widened, deposits still constitute 34% of EU households savings and European companies continue to tap capital markets far less than their US competitors.

Progress may have been hampered both by the heterogeneity in the level of development of capital markets and the multiplication of pursued objectives. These mixed results, combined with the intensity of the legislative activity, has at times contributed to a discernible "CMU fatigue" among some Member States and industry stakeholders. It should nevertheless be acknowledged that some recent achievements could yield interesting results however, notably with the upcoming consolidated tapes, the creation of the European Singles Access Point and the launch of ELTIFs 2.0.

In this context, France would like to propose a new approach moving forward, with more clearly identified objectives and benchmarkable progress. Each key action could be directed towards three central objectives for the success of the CMU: mobilizing the abundant savings pool of EU households, improving the funding conditions for EU businesses and facilitating the development of pan-European capital markets champions.

In a new approach, European policymakers, legislators but also key institutions such as the ECB, the EIB and ESMA, would focus on a limited number of truly ambitious and transformative actions. To mobilize the massive European savings, a joint work among like-minded Member states could explore how coordinated actions could enhance its channelling towards the funding of our firms. The revitalisation of the EU securitization market is another priority action frequently discussed. While prudential adjustments are acutely needed,

other actions could be considered in order to stimulate both the supply and demand side for securitized assets. On supervision, rather than repeating past discussions, we might explore a pragmatic approach starting with concrete business cases of some pan-European players which are put at a disadvantage due to the fragmentation of supervision for market activities.

Moreover, considering the apparent decline in market shares of European players in key financial services segments, the potential impact of any action on the competitiveness of EU market participants should be systematically assessed within the new agenda.

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**European policymakers, legislators but also key institutions such as the ECB, the EIB and ESMA, should focus on a limited number of truly ambitious and transformative actions.**

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In order to identify key measures which could structure the future Commission's agenda under the new approach suggested, Minister Le Maire has recently tasked an expert group comprised of several finance experts from private and public institutions, chaired by former Banque de France Governor Christian Noyer.

In parallel, discussions are currently ongoing at the Eurogroup level and will lead to a final report presented in March. While agreeing on the concrete tools could be challenging over this course, agreeing on the main objectives and the approach to conduct would be an encouraging first step, laying the ground for constructive discussions in a second phase.

In addition, to these EU level reforms, there is a widely accepted recognition of the necessity to promote capital markets development at the national level, in a bottom-up approach. This is seen as a complementary effort to the initiatives undertaken at the EU level. Several Member states have recently introduced comprehensive domestic reforms aimed at fostering the growth of their capital markets and enhancing the appeal of listing for their companies, which is a highly positive development.



## MARKUS FERBER

MEP, Committee on Economic and Monetary Affairs -  
European Parliament

### Member states need to step up to achieve a Single Market for financial services

The Single Market is at the very heart of European integration and is also an engine for wealth creation within the European Union. In many areas, we have made great progress at moving towards a fully integrated Single Market. However, the same cannot necessarily be said for the Single Market for financial services. Both the Capital Markets Union and the Banking Union still remain “work in progress”.

However, there has not been a shortage of attempts to change this unsatisfactory status quo. On the contrary, the European Commission has presented various ambitious proposals that would have contributed to a better integrated European market for financial services. In many instances, the European Parliament was also quite supportive to push this agenda forwards. The culprit for why we did not make more legislative progress in the past couple of years is easy to identify: during negotiations on various financial services files, the Council, i.e. EU Member States, has been pushing back against deeper integration, instead championing carve-outs, grandfathering clauses and national options.

This pattern of obstruction becomes most obvious in the area of supervision, where the Council has time and again succeeded in watering down the Commission's proposals for either a European level of supervision or at least a better and more structured cooperation of national competent authorities in cross-border cases. In certain instances, there is actually a strong case for designating European authorities with certain supervisory powers.

After all, financial markets are often transnational in their very nature and arbitrarily designating supervisory responsibility based on national borders makes supervision more complicated and less effective. Having a more European approach to supervision with stronger powers for the three European Supervisory Authorities would certainly help integrating European capital markets better. However, this will only work once Member States are ready and willing to give up a small part of their supervisory powers.

The other two big roadblocks that are holding back the integration of European capital markets are the fragmentation when it comes to insolvency proceedings and taxation. Cross-border investments lose a lot of their appeal if investors must fear that, in case of failure, they cannot recoup any of their investments due to complex, opaque and materially different insolvency procedures in another jurisdiction. The same goes for taxation: Currently, cross-border investments are comparatively unattractive, not least due to the complicated procedures when it comes to offsetting or reimbursing withholding taxes. These complicated procedures make cross-border engagement particularly unattractive for retail investors.

Both points, the fragmentation in relation to insolvency and taxation issues, are nothing new though and multiple attempts have been made to resolve them over the years. Unfortunately, the progress that been made is quite limited. Both issues go to the very heart of national sovereignty and thus require a political consensus in the Council. This has been hard to come by in the past.

That shows: Progress towards a true Single Market for financial services, requires national ownership. As the lack of progress can be clearly traced back to the Council, this is where the problem needs to be addressed in the first place. However, the idea proposed by the French government for a Capital Markets Union of different speeds is not the right way forward. Such an approach would only increase the fragmentation between those that want to move quicker and those that want to move less quickly. What is needed is a clear unambiguous agreement in the Council regarding how a reinforced Capital Markets Union could look like. However, such an agreement would only help if it does not omit the most controversial points such as insolvency, taxation and supervision. The reports by Mario Draghi and Enrico Letta, which deal with European competitiveness and the Future of the Single Market respectively, could help with building a foundation for that process, but only if they are bold enough to also address the most controversial points.

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#### Progress towards a true Single Market for financial services, requires national ownership.

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In the end, everything will depend on Member States' ability and willingness to compromise, which in the past couple of years was unfortunately not very pronounced. Historically, most progress has been made when their was a strong external push such as a financial crisis, that had created some urgency to act.

While a crisis can certainly be a catalyst for further integration, we should not wait for the storm to arrive, but should aim to fix the roof while the sun is still shining.



## BJORN STORIM

Chief Executive Officer - The Bank of New York Mellon SA/NV

### What the CMU needs - Simplicity, transparency, and a flag

As the current EU legislative cycle draws to a close, it is the right time to look back at the Capital Markets Union (CMU) Action Plan that the European Commission issued in September 2020.

It is good to remind ourselves of the three core objectives of the Action Plan, namely, making capital market financing more accessible to European companies, encouraging individuals to save and invest for the long-term, and integrating national capital markets into a genuine single market.

It is also good to remember that September 2020 was a time of cautious optimism, as there were indications that the shock of Covid would lead Europe to a new period of dynamism, and that the 16 actions in the CMU Action Plan would contribute to this.

Yet three and a half years later the situation, and the mood, are very different. In its recent report on CMU Key Performance Indicators, AFME arrives at the very sobering conclusion that there has been no visible medium-term progress on the CMU. This is obviously a disappointing situation. The single market is one of the great strengths of the EU, and yet the EU is failing to deliver a single market for investments and savings.

There is the major question of what can be done about this. At BNY Mellon we believe that there is no alternative, but that the CMU has to be on the agenda of the next Commission.

We suggest that the CMU agenda of the next Commission focuses on four policy areas, namely, Access, Rights, Information and Tax, as progress in these four areas is a core pre-condition for progress towards a single market. Access is about giving issuers the effective ability to access investors, and about giving investors the effective ability to access issuers. Enabling funding across borders without fiscal or regulatory barriers.

Rights is about ensuring that all issuers and investors have the same rights, no matter where they are located, and no matter how they access market infrastructure. From the perspective of a major custodian, the inability to provide depository services to investment funds across the single market stands out as a particular deficiency.

Information is about ensuring that all parties have access to the information that they need to participate effectively in the market.

Tax is about ensuring that all parties are subject to a tax process that is highly efficient, digitally enabled and timely, that taxes at the correct rate, and that does not impose undue double taxation.

We do, of course, recognise that there has already been work in these areas. The Commission has taken valuable initiatives in the current legislative cycle, and we do want to highlight the importance and value of the proposals on the Consolidated Tape and the European Single Access Point, and the potential importance of the FASTER tax proposal. In the case of the latter, we are concerned about the effective outcome of the current legislative process and would welcome greater ambition on the part of Member States to deliver an effective pan-European operational approach to collecting and processing withholding taxes.

But we are also convinced that there is scope for much more work. We believe that to make real progress in these areas it is important that the work is shaped by two foundational principles, namely, simplicity and transparency.

There is a common, and very valid, perception by many parties, especially non-European investors, that European capital markets are complex and opaque. It is critical that this reality and this perception be changed. We need to ensure that when people invest in European capital markets they do not require 27 different legal opinions, 27 different operational processes, and 27 different tax forms.

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**We also need a project that  
can mobilise people, a flag that  
is recognised from afar.**

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But we also need more. We need a project that can mobilise people, a flag that is recognised from afar. The original single market project was an example of a project that mobilised people and businesses. They adapted their own planning based on the expectation of the future success of the project, thereby creating additional momentum. On a smaller scale, the recent issuance to private investors of a Belgian *staatsbon/bon d'état* benefited from a similar snowball effect, leading to a major success in expanding capital markets activity.

The CMU project has so far not managed to create such an effect. We hope that the next EU Commission and the EU Parliament, in cooperation with Member States, can make real progress and deliver on the CMU, as an essential building block for the EU.

But we need to find a theme that can act as a flag around which people and businesses can rally, and which can create momentum.





## NIELS BRAB

Head of Group Regulatory Strategy & Chief  
Regulatory Officer - Deutsche Börse Group

### Honesty is the best Policy: a new agenda to finally unleash the CMU's potential

With a new EU legislative cycle on the horizon, a decisive year lies ahead that provides the opportunity to advance on key challenges of our time. In light of geopolitical realities, sluggish economic growth, and constraint public finances, it will be particularly critical for the EU to ensure nothing less than a new vision for the Capital Markets Union (CMU). Despite decades of efforts, our capital markets remain underdeveloped compared to global markets, and their size does not correspond to the magnitude of the EU's economy.

Key strategic objectives to boost our markets' performance have been missed by placing the focus rather on technicalities. A new vision must be paired with profound reflections around the open strategic autonomy. It is time to move the needle with fresh ideas tied to the overall EU industrial strategy. With an eye on the future financing needs and different geopolitical realities it is clear: The advancement of the CMU is not optional anymore.

And while Rome was not built in a day, tangible results are needed with a more successful translation of the broader political objective into regulatory realities. This means boosting our primary markets and IPO ecosystem, addressing fragmentation, revitalizing our securitization markets, ensuring that citizens truly endorse our markets by guaranteeing better participation, tackling elements of incentivization such as taxation – and finally, establishing an EU equity fund supporting both retail and institutional investments. In a nutshell: EU capital markets must become the “first choice” for investment and financing.

The number of EU companies listing abroad or delisting from European exchanges has been a consequence of the failures of the past. The EU should nurture its equity ecosystem with a clear strategy to boost IPOs. We must aim for at least 25% of all global listings taking place in the EU by 2030. The figures clearly show that next to a competitive environment that is fit for start-ups and companies, we need to ensure deep liquidity pools and reduce fragmentation.

A powerful lever to increase liquidity and market capitalization is to mobilize capital which is currently held in bank accounts or tied in low yield pension schemes. Citizens must be given the tools to participate in markets: A new equity culture is needed. In this context and due to rising pressure on public budgets, the EU should urgently establish an EU equity fund that structurally boosts the EU's ecosystem by improving financing realities for the economy while allowing for a better participation by citizens and investors, covering all major indices from all 27 Member States, weighted by the respective market capitalization. With such an approach, all parts of the EU would benefit, and a fair distribution is being ensured. This should be paired with more streamlined tax systems

and an increased attractiveness for citizens and investors via targeted tax incentives.

We need a policy-making approach that is based on empirical evidence and builds on best practices from other successful markets. Honesty is the best policy as Benjamin Franklin once put it. The consolidated tape certainly has great potential to support EU equity markets and exchanges remain committed to delivering via the EuroCTP joint venture. However, we should not forget that market structure continues to be the backbone of our ecosystem's effectiveness – where a hyper fragmentation driven by unfair regulatory competition continues to tilt the level playing field towards alternative execution venues (e.g. systematic internalisers), reducing the global competitiveness of our equity markets by an overly pronounced focus on explicit trading costs in secondary markets. Globally leading equity markets are marked by significantly less fragmentation and are home to a long-term strategy focused on “the greater good”.

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**In a nutshell: EU capital markets must become the “first choice” for investment and financing.**

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We should not forget that we need our markets to be successful at global level in order for both politicians and civil society to see the benefits of a powerful and healthy capital markets ecosystem. This will also support a much needed political will to overcome the widespread risk aversions towards capital investments and market dynamics while profiting from long-term revenues.

The encouraging signs of the past months, including the drafting of competitiveness reports by former Italian Prime Ministers and various statements of key EU leaders, are strong testimonials to the new momentum and the urgency. Let's now focus on pooling our strength to deliver on a true roadmap that finally unleashes the much-needed CMU potential. We have it in our own hands – the time is now!



## SYLVIA ANDRIESSEN

General Counsel - Euronext

### Consolidation, single supervision... and much more

On 17 November 2023, ECB President Christine Lagarde addressed the European Banking Congress and underlined the need for Europe to complete the Capital Markets Union to foster the economic potential of our continent. She suggested two areas that would significantly contribute to the achievement of this objective. First, she noted that “stock markets which are part of wider groups perform better in terms of depth, IPO activity and liquidity, with the benefits particularly powerful for smaller exchanges”, and she encouraged further consolidation of market infrastructure and exchange groups. Second, she explained that “supervision remains largely at the national level, which fragments the application of EU rules” and argued for direct, single supervision based on a single rulebook.

Euronext is the living proof that exchanges and financial infrastructure groups thrive when they join forces. Twenty-three years ago, the stock exchanges of Amsterdam, Brussels and Paris merged to form Euronext, the first pan-European capital market infrastructure, with the ambition to build the backbone of integrated capital markets in Europe and to connect the countries and markets of our continent. Today, regulated markets in Amsterdam, Brussels, Dublin, Lisbon, Milan, Oslo and Paris are operated by a common pan-European company to offer a single liquidity pool, empowered by a single technology platform. A true pan-European financial markets infrastructure provider across trading, clearing and settlement, Euronext helps overcome issues of fragmentation, providing benefits to investors and issuers alike. Following the migration of the trading of Italian equities to the Euronext technology platform in 2023, investors and issuers can benefit from a single liquidity pool with an aggregated market capitalization of more than €6.5 trillion, which is twice the size of that on the London Stock Exchange. In 2023, c. 24% of European equity flows were traded on the Euronext platform.

Consolidation should be encouraged in Europe across the value chain and asset classes. Enhancing equity financing of European economies is a critical objective to strengthen industrial capabilities in Europe, and the next Commission must focus on creating a favourable environment for consolidation opportunities to emerge. Also, European capital markets would largely benefit from a unified access point to European custody, through a consolidation of European CSDs.

But consolidation is not a silver bullet. When pan-European groups face similar, but different rules, enforced by multiple national competent authorities, the resulting complexity prevents value creation commensurate with the potential of European economies. Today, Euronext still faces divergent applications of rules across its European markets. We must progress towards a single set of rules, enforced by a single supervision authority. It requires the phasing-out of national exemptions and domestic ‘gold-plating’ of EU regulations, as

well as a reformed and empowered European Securities and Markets Authority. In the short-term, pan-European groups should transition under a single supervision authority to ensure a true level-playing field with subsidiaries of global financial firms operating from a single country.

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**We have a collective responsibility  
to act. If not now, then when?**

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The next European Commission must go above and beyond facilitating consolidation and creating single supervision. The global mandate of investors and the rise of passive investment have shifted European capital away from European equities. We must integrate fragmented legal landscapes across Europe, in particular regarding tax regimes applying to savings and investment as well as insolvency laws. We must solve the lack of deployment of private savings into equity markets. We must be committed to revamping pensions and saving systems to channel retail and institutional investments into European listed equity, and to introducing strong incentives for investors with a mandate focused on European mid-sized companies. We must protect the liquidity of smaller listed companies, through forceful measures such as, for example, a ban of internalization of flows below a certain level of stock liquidity, a mandate of trading least liquid stocks on the most liquid venue, and an option for SMEs to prevent their stock from being admitted to non-primary venues. We must de-regionalize European research coverage to increase the liquidity of smaller companies, through the public incentivization of sectorial rather than geographic coverage. Finally, we must increase retail participation through a harmonized treatment of retail investors across Member States and a roll-out of systematic financial literacy training.



## FABRICE DEMARIGNY

Global Head of Financial Markets - Mazars

### Refocusing the CMU to finance the Open Strategic Autonomy

The European Council declarations of Versailles and Granada call for an increase of the EU strategic autonomy of several key economic sectors by strengthening its own capacities in a carbon neutral, digital and innovative manner. Accordingly, the Single Market is repositioned as a core priority of the Union with the task of diminishing external dependencies to become a self-sufficient economic bloc. This new ambition requires the EU to set the adequate financing conditions. Unfortunately, the EU has not yet completed two efficient financing pillars: the Banking Union and the Capital Markets Union (CMU).

Diminishing dependencies by relocating factories, favoring the emergence of EU Digital and Artificial Intelligence companies, and financing a more sustainable economy, requires long term investments. Completing the Banking Union by allowing a free allocation of liquidity and capital permitting banking sector consolidation and more straightforward securitization alleviating banks' balance sheet, are two preconditions. As regards market financing, the key focus should be on equity capital – the basement to leverage any subsequent financing. Unfortunately, 80% of the significant amount of EU savings are left in bank deposits, invested in short term and debt financial products.

So far, the CMU has only been an attempt to unite national capital markets by favoring the free movement of financial services. Two full legislative cycles have led to repetitive updates of existing legislation and a disagreement to provide to a single supervisor significant central power. Regrettably, these intense legislative efforts have not translated into palpable results on the ground. Market financing has decreased and the share of the EU of the global capital markets has lost 8% in the last 15 years nearing 10%. In addition, apart from the debt markets, inter Community capital markets activity remains low and 70% domestic.

Possible ways forward to allow efficient capital allocation, would be for the CMU to go beyond the mere agglomeration of national capital markets and progressively become a Single Capital Market with 27 entry doors. The fundamental objective would be to create the missing congruence between abundant existing savings and the forthcoming capital needs. This could be achieved by acting both on the offer and demand of capital, by:

1. **Generating more long-term savings:** On the offer side, several saving products existing in some Members States, directing household savings toward more long-term investments, can be given an EU wide reach. Their success will depend on tax incentives given by Member States individually, regrouped in a reinforced cooperation or by unanimity. They can take the form of (i) an individual tax-free long-term equity holding wallet, (ii) a workplace saving

plan, possibly abounded by the employer, and valid across the Single Market or, (iii) an autoenrollment individual pension plan valid in the entire Single Market.

2. **Developing Equity markets:** On the demand side, access to capital can be increased by (i) creating a dedicated segment of the Regulated Markets devoted to Small and Mid-Caps with proportionate listing requirements defined from scratch considering their age, size and ownership structure, before moving to the main segment (ii) favoring a joint venture between key EU Exchanges pooling together their Small and Mid-Sized segments to create a single IPO access to the EU public markets, (iii) allow this joint venture to be directly supervised by ESMA.
3. **Moving towards more integrated supervision:** adopting a bottom-up approach by which ESMA is progressively and pragmatically given more central powers by (i) measuring market integration each time a Directive or Regulation is reviewed and allocating to ESMA central powers if supervisory efficiency is better achieved at supranational level, and/or (ii) allowing cross-border markets or market players to opt-in for a direct supervision by ESMA.

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**The CMU should create the missing congruence between abundant savings and forthcoming capital needs.**

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The capital markets need resulting from the Open Strategic Autonomy call for a refocusing the CMU on its basic economic role: the EU wide meeting between offer and demand of capital. Clearly, moving towards a Single Capital Market will require the EU Institutions, the Members States as well as the financial sector industry, to measure the benefits of such further progressive integration. These benefits are numerous and go beyond the financial sector and include: long term financial vehicles in adequacy with and ageing population, better capitalized companies to finance the transition towards and more Sustainable Digital economy and, a more diversified, competitive and self-sufficient industrial and services EU ecosystem.

## COMPETITIVENESS OF EU CAPITAL MARKETS



### EVA WIMMER

Director General - Federal  
Ministry of Finance, Germany

### CMU to-do's for next EU cycle

Finance Ministers and decision makers across the EU are calling for measures to strengthen the Capital Markets Union. Capital markets are well-suited for the long-term investment cycles that we need for the green and digital transformation of our economy. Innovators rely on market-based funding to turn their ideas into new inventions. Deep and well-functioning EU capital markets are thus crucial in order to meet our economic challenges and to boost growth.

There can be no question that we need to improve capital market competitiveness. We have the biggest single market, the deepest pool of savings, and yet our share of global capital markets activity is shrinking. At the same time, this situation gives EU capital markets plenty of room to grow, if we succeed in turning this trend around.

We will see important improvements in the near future, as we are working on finalizing and implementing a number of measures at the end of this EU legislative cycle.

A European Single Access Point will soon make financial and sustainability reports easily accessible for investors. The Listing Act will make it more attractive to raise funding through public markets in the EU. Improvements are urgently needed, given that in recent years the number of de-listings has exceeded the number of listings and that we have seen successful European companies turn to New York for their IPO.

With the the MiFIR Review we will bring our market infrastructure for securities trading up to date, reduce fragmentation and increase the level of transparency across EU stock, bond and derivatives markets. In particular, with the establishment of EU-wide consolidated tapes we can make a big step towards truly single EU bond and equity markets. To be effective, the consolidated tapes will need to be well integrated into the EU trading landscape. ESMA will have a key role in properly calibrating the conditions and in selecting the right candidates for the provision of the service.

The decision taken in the MiFIR Review to ban payment for order flow (PFOF), however, is likely going to increase trading costs for retail investors, putting a significant damper on otherwise positive developments around shareholder culture. We should avoid similar risks in the context of the Retail Investment Strategy. Here, as we are advancing the negotiations, we should not end up doing more harm than good by overly restricting the use of inducements that could severely limit retail investors' access to financial products.

A strong, resilient capital market cannot to a large extent depend on offshore actors when it comes to its key functions. We need an eco-system that is capable of satisfying the demand for the clearing of Euro-denominated over-the-counter derivatives in the EU. Consequently, in the negotiations on the EMIR Review, Germany has pushed for a careful balance: requirements that effectively support a build-up of clearing capacity in the EU without unduly burdening market participants.

Looking towards the upcoming legislative cycle, there are a number of logical next steps that we could take. Building on the Listing Act, we should explore further options to make listing in the EU more attractive, including a

possible harmonisation of the rules on prospectus liability.

In 2024, the US as well as Canada and Mexico will move to a t+1 settlement cycle. This change has potentially large ramifications on the relative competitiveness of different global financial hubs. The EU should thus consider to follow suit.

We should scrutinise our framework for securitisations and look to optimise it, while keeping the lessons of the financial crisis in mind. We need securitisation as a bridge between bank lending and capital markets.

We could modernize the Settlement Finality Directive and Financial Collateral Directive to reduce some legal uncertainty around netting that has arisen due to new technological developments and a different degree of harmonisation across member states.

We should also try to leverage our leading position in Sustainable Finance by streamlining and improving our existing framework, ensuring transparency while making sure that requirements are manageable.

**There can be no  
question that we need to  
improve capital market  
competitiveness.**

In 2025 we will have the 10-year anniversary of the first CMU Action Plan. The debate on the future of the Capital Markets Union is well underway. In September 2023 the French and German Finance Ministers published a joint CMU roadmap to move the discussion forward. Since June 2023, EU Finance Ministers have engaged with market participants in a workstream on the priorities for the next legislative cycle. Germany is pushing for an ambitious to-do list as a foundation for a productive CMU agenda in the next years.

Building a strong Capital Markets Union is a marathon, not a sprint. Crucial issues like improving financial literacy take time. We still have a lot to do in order to build a Capital Markets Union that provides a tangible benefit to all EU citizens.



## FRANCESCO CECCATO

Chief Executive Officer -  
Barclays Europe

### Successful European Capital Markets require hard decisions

#### How competitive are EU capital markets at present?

There is good news and bad news. The good news is that EU capital markets are growing. Nearly all sectors of capital markets are bigger and deeper than they were before CMU was launched in 2015. The bad news is that the growth is not nearly sufficient. In nearly all sectors of capital markets, the EU's share of global activity is less than its share of global GDP and the trend remains downward.

#### In which areas does the competitiveness of EU capital markets need improving most?

Deep pools of long-term capital such as pension and insurance assets are the starting point for deep and effective capital markets. The next step is to connect that capital with companies, particularly innovative and potentially high-growth ones. On both of these metrics the EU is not where it should be and as a result has, for example, a declining proportion of global equity market capitalisation of listed shares.

#### What enhancements can be expected from on-going MiFIR, CMU and Eurosystem initiatives in this regard?

Reducing barriers and increasing efficiency between the national systems is what the EU level focus should be on. The EU should prioritise proposals through the lens of CMU. Potentially costly or complex initiatives which risk the attractiveness of investing in European markets [such as T+1, increasing settlement fail penalties or enforcing clearing at EU CCPs], however well intentioned, should be weighed carefully to ensure the medicine does not kill the patient. The MIFIR reforms set out a framework to introduce meaningful transparency in the most liquid instruments in EU markets. While the recent agreement offers a welcome boost for a consolidated tape more can be done and the EU should continue to increase its ambitions to add pre-trade equities data through the mandated reviews.

**In combining top-  
down and bottom-up  
reforms, we mustn't  
try to boil the ocean.**

#### Would a more top-down approach to the CMU be needed and if so what should be the priorities?

It has become popular to emphasize either 'top-down' or 'bottom-up' measures as the key to developing EU capital markets. The reality is, of course, that a combination of the two is required. In some areas, take pensions reform, action at member state level will have a more significant effect than action at EU level. It is difficult to harmonise when the building blocks don't really exist. In other areas, we probably have too many building blocks – too many sub-scale options for trading or clearing – and EU level action is the only way to address it. The things that will really make the difference, whether at Member State or EU level, are the most difficult, however. The low-hanging fruit only gets us so far.

#### What are the alternatives / other approaches to consider?

It is difficult to overstate the importance of the Capital Markets Union. Political buy-in is key and it is encouraging to see France and Germany working together to propose a Roadmap for CMU. It is also encouraging that in the limited time available to the Belgian Presidency before the European Parliament elections, it is putting an emphasis on negotiations

with the European Parliament to bolster the Capital Markets Union.

Another key point is to ensure that in combining top-down and bottom-up, we don't try to boil the ocean. A limited number of significant actions, with political buy-in, will do more than tinkering around the edges in a wide range of different areas.

- National level pensions reform to create larger pools of capital while helping to secure sustainable retirement provision for European citizens.
- Harmonisation of the corporate insolvency framework is particularly important in addressing the challenges of fragmented legal regimes that hinder the debt market.
- Building on company law frameworks such as the "societas europaea" and the takeover bids regime, the development of a system of pan-EU company law.
- Reform of the European Securities and Markets Authority into a single, strong, centralised securities regulator.
- A clearer focus on transition finance to ensure that the EU can maintain and expand its leadership in ESG financing.
- Education to build confidence and trust in equity markets is critical to developing an investor culture resulting in significant investment from individual EU consumers.

Finally, there is an extent to which a true banking union is a pre-requisite for a true CMU. The market needs to see the development of banks that are truly integrated pan-EU firms which can act as the facilitators of capital flows between savers and the real economy.



**NICK DUTTON**  
 Chief Regulatory Officer -  
 Cboe Europe

## Making EU capital markets more competitive on the global stage

As the European Commission nears the end of its current term, it's a good time to reflect on the state of the EU's regulatory landscape and the key priorities during the next mandate. In the capital markets domain, we should consider what aspects of the regulatory framework have performed well and what the focus of regulators should be to ensure EU markets are competitive and grow in the years to come.

The decisions facing EU policymakers are pivotal: across many metrics EU markets have underperformed compared to those in other developed countries in recent years, including trading volumes, liquidity and listings. We should therefore be ambitious in our efforts to increase the visibility of EU issuers to the rest of world, make our markets easier and cheaper to access for end investors, and be more attractive to investors globally.

As policymakers consider how best to further these goals, it is important to recognize and learn from the successes of the last 20 years: EU markets are much more competitive than they were 20 years ago, particularly in market infrastructure. In equity trading and clearing, we now have a well-established competitive framework that has lowered

costs, encouraged innovation and forced incumbent players to raise their game – all to the benefit of end investors.

Cboe Europe's success – we operate the largest pan-European stock exchange by market share, the most connected pan-European CCP and a fledgling equity derivatives exchange – is proof that this competitive framework works and is what market participants want. We embody a vision of European Capital Markets through our pan-European approach, that helps simplify access to and dramatically reduces costs for those wishing to access EU markets. This is a fundamental aspect of growing European capital markets: we must preserve and enhance the spirit of open competition in our capital markets to ensure the future competitiveness and attractiveness of EU markets, and to create connections across European markets for the benefit of all end users.

To this end, amongst all the discussion about “top down” and “bottom up” approaches to delivering more effective capital markets, we believe significant responsibility sits with the industry to continue to develop structures that support that objective. In many cases the role of policymakers – whether at national or European level - should not be to regulate more effective capital markets into existence, but rather to create an environment in which the industry can deliver them.

Part of this will undoubtedly be effective implementation of what has been agreed under the current European Commission mandate – particularly around the MiFIR/D review. The agreed text solidifies the ability of investors to access markets through a range of execution methods and provides a mandate to create a Consolidated Tape framework for equities, which has the potential to deliver incredible benefits for European capital markets by democratizing access to data and enhancing visibility for EU issuers to the rest of the world. On this latter point, it is vital that the Level 2 work being undertaken by ESMA in 2024 delivers a competitive bidding process that attracts operators that are committed to providing a sensibly priced tape that enables broad adoption of the CT and provides a true consolidated picture of liquidity, therefore maximising interest in European companies.

But more can be done to enable the EU to attract investment. We believe competition and innovation need to be consistently considered at all stages of the legislative process. We must also not lose sight of the fact that that a more integrated capital market remains a worthy goal.

Furthermore, and perhaps most importantly, capital markets need to work for retail investors. The national fragmentation of European retail activity is one reason why EU markets have underperformed. As EU policymakers seek to enhance retail participation by driving greater harmonisation and by enhancing investor protection, their priority should be to encourage customers towards competitively quoted, centrally cleared exchange-traded products such as options and ETFs by removing any barriers to investment in simple products and ensuring exchange-traded products are not disadvantaged through excessive disclosure requirements.

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**Competitive and integrated EU capital markets that embrace innovation have never been more important.**

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Cboe will always do what it can to bring greater efficiencies to Europe's trading and post-trade architecture, whether that is its established trading or clearing businesses or its recent launch of a derivatives exchange and its plans for corporate listings. But there is always more that can be done, and we look forward to working with policymakers this year and beyond to enable the EU to perform on a global stage as a financial centre.



## VIRGINIE SAAFE

Head of Government  
& Regulatory Policy,  
EMEA - Citadel

### EU Consolidated Tape: a catalyst for competitiveness

*Transparent markets  
drive competition and  
capital formation*

Increasing the competitiveness of the European capital markets has long been at the core of EU policy makers' agendas and remains a central element of reforms to spearhead the creation of the Capital Markets Union (CMU).

A transparent, well-functioning and resilient EU capital market supports the real economy by opening up new sources of funding for European businesses, facilitating more efficient capital formation, attracting investments and fuelling growth across the EU.

One of the CMU's objectives in this context has been to improve the visibility of the EU's trading landscape for the benefit of both institutional and retail investors – a challenging task in the highly fragmented European trading environment. Introducing a well-functioning consolidated tape that provides a comprehensive view of the prices and volumes of various financial instruments traded across the EU is key to achieving this objective.

Transparent markets drive competition and capital formation, allowing for more efficient price discovery, more effective allocation of capital and investments, reducing transaction cost and enhancing liquidity. Academic evidence has demonstrated that transparency benefits all types of investors, from retail to large institutional investors. With the recently completed review of the Markets in Financial Instruments Regulation (MiFIR), the EU is finally getting closer to reaching that goal and the upcoming establishment of consolidated tapes in four key asset classes – bonds, shares, ETFs and derivatives – is a very welcome and long overdue development.

There are multiple benefits of a well-tailored consolidated tape. Providing market participants with an affordable and aggregated view of capital market activity empowers all investors to make more informed investment decisions. The real-time publication of comprehensive transaction price and volume data at a low cost via the consolidated tape removes information asymmetries and creates a more level playing field among market participants. By enabling investors to compare accurate data on the prices they receive from liquidity providers with concurrent trading activity across the market, a consolidated tape will promote price competition and facilitate entry to the market of new liquidity providers. It will also facilitate more accurate assessments of execution quality by providing a neutral and reliable source of trading activity and pricing for the purpose of transaction cost, risk management, and best execution analysis.

By providing a consistent set of standards regarding data submission, a well-functioning consolidated tape should also help solve the conundrum of data quality that has been long causing headaches for various stakeholders. Ultimately, the information value and usability of the consolidated tape will be a function of the quality of the data it receives.

Overall, the key defining criteria for determining the true value of the consolidated tape will be the delivery of data to the market in a timely fashion, the quality of data, market coverage and overall costs for market participants. As a bonus, the comprehensive data flows will inform academics and policymakers when they assess possible changes to the regulatory regime in the future.

In addition to improving the overall trading environment for market participants, the consolidated tape also has more macro-level implications. It enhances market resilience by ensuring

that changes in supply and demand are more efficiently reflected in current price levels, and as such decreases the likelihood of investors pulling back from the markets during times of volatility.

Finally, a consolidated tape promises to strengthen European capital markets by enhancing investor confidence and access to liquidity, which will ultimately result in stronger and more liquid capital markets that promote capital formation, job creation and economic growth.

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**A consolidated tape  
promises to strengthen  
European capital  
markets by enhancing  
investor confidence and  
access to liquidity...**

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Building competitive and attractive European capital markets is a long-term and complex process. With dynamically moving markets and a challenging geopolitical environment, a critical part of ensuring European markets' competitiveness is creating a forward-looking regulatory framework that facilitates active involvement by international participants, allowing EU markets to remain open and integrated in the global financial ecosystem.

## INCREASING EQUITY FINANCING



**RODRIGO BUENAVENTURA**  
Chair - Spanish Securities and Exchange Commission (CNMV)

### It's all about the right incentives, not deregulation or supervision

It is evident that European capital markets have not developed sufficiently the last decade. We know that European companies will have to increase their equity in order to strengthen their balance sheets and fund massive investment projects. European citizens, on average, have a low level of participation in capital markets, which takes a toll on their long-term financial well-being. All this means that revitalising equity and long-term debt markets should constitute a strategic priority for the European Union.

However, we should not confound our diagnostic. The problem of EU capital markets is not one of lack of regulatory harmonisation, too much competition, or a lack of central supervision. The problem is that we are failing to attract companies and investors in sufficiently large numbers.

The rules in wholesale markets are identical. All key rules that affect issuers

and trading venues end with a capital R (Regulation): MiFIR, EMIR, CSDR, Prospectus Regulation, MAR, IFRS reporting, etc. We do have already a pretty consistent single rulebook for companies that get listed. And a real tool (ESMA) to converge in its supervision.

Then there is a question of competition between exchanges and execution venues. Let's be clear: competition is not tougher in Europe than in the US or the UK. Alternative trading venues and firms compete for trading flow and that has benefited European investors. Should we promote the consolidation of venues? Well, competition should do that, not regulation. You can have deep markets with fierce competition among venues: ask the US if in doubt. You can also have true liquidity and market depth with the current EU market rules. Ask Sweden, if in doubt. But we definitely can not have them if long-term institutional investors (pension funds) are absent and if companies don't find the right incentives and environment in public markets.

Another debate is about whether centralised supervision would make a difference when attracting more companies and investors to EU capital markets or integrating them further, with more cross-border flows. I don't think central supervision is a good recipe for integration of intra-EU flows and consolidation. A perfect case is single supervision of large banks in the Euro area. It has been there for a decade and we have not achieved a banking Union yet. Cross border banking flows even went down in the years following the inception of the SSM; banks don't lend significantly in other EU countries; they don't merge between them and citizens don't deposit their savings in other Member States. The banking "union" is not the right reference for the capital markets union.

Centralization of supervision towards ESMA, indeed, can have its benefits in some areas, but is largely irrelevant when attracting companies in large numbers to capital markets. Does anybody think that SMEs would rush towards equity markets because their prospectuses or their financial reports would be approved or enforced by ESMA instead of their local supervisor? Does anybody think that a central supervisor is a cheaper and more efficient solution for issuers? This should not be the main driver. Instead, the energy that such

project would consume would mislead us from our true main goal.

We need a new political consensus here, for sure. But it is not mainly about financial regulation, but about incentives and disincentives to get listed and invest in capital markets.

Some important measures we could take to attract more companies are in fact unrelated to financial rules: the asymmetry of tax treatment of interest versus dividends acts as a clear disincentive to get listed. Similarly, when we choose listed companies as a target group to introduce important rules to advance our societies, we widen the divide between listed and non-listed companies. If non-financial reporting on climate matters or gender diversity are important for our societies (and for sure they are), why do we require them differently for listed companies?

### The banking "union" in not the right reference for the Capital Markets Union.

When we talk about attracting new investors to capital markets, we need to do that carefully, without exposing them to unnecessary risks. Greater financial awareness and a favorable tax treatment of their investments are essential. A larger weight of long-term collective investment, as we have learned from the US, is critical. But direct participation and stock-picking is not always the smartest solution. Collective investment can offer a professional, diversified and less risky alternative, provided that costs are fair.

Those two dimensions should be the main focus of our policies. Europe needs to identify concrete incentives to make markets more attractive to companies and investors, instead of looking for a silver bullet that does not seem to exist.





## LUÍS LAGINHA DE SOUSA

Chair - Portuguese Securities  
Market Commission (CMVM)

### Companies need to take center stage

If we believe that companies are essential instruments for value and wealth creation, then it is only natural that capital markets come to the forefront of our attention - they are an unmatched channel for equity funding, the foundation for competitiveness.

Equity investors and, to a variable extent, investors in debt securities, allow companies to invest in a variety of critical and capital intensive components such as research, product and infrastructure development and talent. The diversification of the companies' funding structure, lowering their dependency on bank financing, can positively impact their growth and shock absorption capacity.

Moreover, capital markets are a very democratic mechanism, since they give access to anyone wishing to share both the risks and returns of companies. This aligns the interests of investors with the company's success, fostering a collaborative and long-term relationship that contributes to more stable economic conditions. It also allows investors to affirm their societal values as well as environmental concerns through their investment choices, given that companies play a decisive role in these domains too.

It is worth noting that these benefits derive both from public and private capital markets.

If companies and investors are able to adequately explore the potential benefits of capital markets, European economies will be better equipped to face the numerous and complex challenges ahead.

Venture capital funds and private equity funds form a segment that has significantly grown in Portugal over the last five years, and recent regulatory changes intend to further stimulate it, considering that Portuguese figures still lag behind other Member States' ones.

However, as the OECD reported in 2020<sup>1</sup> and is still valid, "with a remaining high dependence on bank loans, a decreasing number of listed companies, lack of new listings and scant presence of institutional investors, Portuguese capital markets have not developed to their fullest potential." This is also the case in Europe, as attested by various international organizations, such as the International Monetary Fund<sup>2</sup>.

In the CMVM's view, this is not primarily deriving from inadequate market structure or regulatory framework, even if we must continue to improve it, mainly by introducing simplicity, proportionality and the flexibility needed to address constant change.

That is why CMVM is very committed to contributing to the discussion on the CMU's initiatives being negotiated and also on its way forward. Initiatives such as the listing act and the retail investment strategy, where we need to strike the right balance between competitiveness and investor protection, require ambition.

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**We need to promote  
more competitive  
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global markets.**

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More importantly, we need to go beyond frameworks on capital markets and adopt an holistic and interdisciplinary approach, paying attention to the overall outcomes of our political and regulatory choices in the economy, society, environment and global competitiveness.

The sustainable finance agenda is an example of a valuable initiative that only at a later stage was complemented by RepowerEU and Net Zero Industrial Act, building blocks of a much desired

comprehensive agenda for sustainable growth in Europe, where companies must take center stage.

Bearing in mind that achieving deep and integrated (which is different from centralized or concentrated) European capital markets, is dependent on stronger national ones, it is our view that we need to further address national specificities in defining priorities. Fiscal and insolvency frameworks are certainly to be considered.

In Portugal, we need to go further in dealing with the financial literacy levels and the proportion of household savings invested in capital markets, acknowledging as well that there is a bank based finance prevalence, alongside the fact that SMEs represent more than 99% of our economic fabric.

Building on this context, the CMVM has developed specific projects to promote the Portuguese capital markets. The Issuers Guide, the Roadmap for market-based financing and the sandbox Market4Growth (M4G) are tools for companies wishing to know more about market access rules and costs. The sandbox M4G additionally enables a personalized diagnosis of the level of preparation of companies to access public or private capital markets and to allow them to simulate the entire process, including after listing or the first investment operation.

The CMVM is committed to increasing market-based financing and promoting more competitive European companies, a road to be built and travelled together if Europe truly wants to have a leading seat in the global markets.

1. *OECD Capital Market Review of Portugal 2020: Mobilising Portuguese Capital Markets for Investment and Growth, OECD Capital Market Series.* <http://www.oecd.org/corporate/OECD-Capital-Market-Review-Portugal.htm>
2. *IMF Background Note on CMU for Eurogroup, JUNE 15, 2023*



## LĪGA KLAVIŅA

Deputy State Secretary on  
Financial Policy - Ministry of  
Finance of the Republic of Latvia

### Capital market development – Combined effort at national and EU level

With rising geopolitical tensions, fragmentation and urgent challenges such as the climate change and digital transition, European Union and their member states need to bolster its resilience to shocks and invest strategically. One of the central elements of this strategy is the creation of an integrated capital market – a vision set out by European Commission in 2015, commonly known as capital market union.

There is no doubt that there have been considerable policy achievements during the last years. However, despite some major improvements, the EU has not closed the gap in capital market financing and continues as predominantly bank lending-based economy.

Developed capital market is critical for financing the green and digital transition and for boosting the innovation and growth. Capital market financing is more suited for specific growth sectors and there is some evidence that equity financing is positive for emission mitigation. Banks are generally less suited to financing innovative firms and

significant infrastructure projects, start-ups and small firms heavily investing in R&D that are often riskier and have few tangible assets to pledge as collateral.

European capital markets are relatively small. The market for equity, measured as a size of the total market capitalization of listed domestic firms relative to GDP, is much larger in the US and in Japan than in Europe. But even within Europe there are major differences. There are a handful of countries (Luxembourg, Ireland, Sweden, Denmark, the Netherlands) where total market capitalization is much higher than in other EU countries. Looking at EU capital markets in different sectors of capital market activities in all EU member states, there is a huge range in depth that show little sign of narrowing. According to the latest report by New Financial, Luxembourg`s capital market are 35 times deeper than Latvia`s, while Dutch markets are twice as deep as in Italy. The range between member states is greater than the range between the EU and the UK. This is one of the reasons why harmonizing capital markets is necessary but challenging.

Baltics have a developed and integrated capital market infrastructure. Nasdaq Riga is the only stock exchange in Latvia and belongs to the Nasdaq Baltic Exchange group. It is part of unique structure, consolidating the common market platform and capital market infrastructure for the three Baltic States. The Baltic Exchange provides a trading platform for shares for companies from Latvia, Estonia, Lithuania, and maintain bond listings for companies from all three Baltic countries.

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**For effective capital  
market we need to  
combine efforts at  
national and EU level.**

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In private equity and venture capital sectors, despite being a relatively young market, the Baltic industry has shown substantial growth and is reaching record heights in its latest year`s activities. Since 2010, the Baltic private equity and venture capital sector has demonstrated rapid growth, with 2.2 billion euros of total capital raised. Capital raised by Baltic funds in 2022 reached 298 million euros, with the amount raised by venture funds reaching an all-time high of 244 million euros, a year-to-year increase in capital raised of over 130%.

As in other countries, capital markets for Baltic businesses are an increasingly

important source of finance. Seeking alternatives for bank financing and considering high risk aversion of banks, companies are looking for opportunities to tap Baltic, Scandinavian and Eastern European exchange with bond and equity listings.

Latvia`s corporate sector, including state owned companies, is over reliant on bank financing and large share of firms remain credit constrained. Moreover, SME sector which plays a pivotal role in the economy, has a low level of capitalization and significant share of credit constrained companies.

Latvia has three pillar pension system, but the limited development of the domestic securities and equity market is preventing pension funds for diversifying their portfolios toward more investments in Latvia.

Considering the relatively low starting point there is potential significantly increase the depth and liquidity of our capital market. Listing the minority shares of state-owned companies, diversify the access to finance for SME`s that have capabilities to grow and become more significant players in respective economy and abroad is priority areas of the government. Considering that raising equity capital for SMEs is more challenging due to investor preferences for size in market capitalization, state supported special accelerator SME IPO fund is in implementation stage together with Lithuania.

For effective capital market we need to combine efforts at national and EU level as there are member states that have significant room for growth in market-based financing and potential to promote a more effective use of citizens savings.



## IGNACIO GUTIÉRREZ-ORRANTIA

Head of Europe Cluster and Banking - Citi

### Increasing equity financing: a joint role for public and private sectors

Since the European Commission introduced a new Action Plan on the Capital Markets Union (CMU) at the beginning of its current mandate, much has been achieved to facilitate the financing of European companies through external equity. Thanks to the joint ambition of the Commission and the co-legislators, important initiatives have passed such as a European Single Access Point for investor information, a review of the European Long-Term Investment Fund Regulation (ELTIF), Solvency II, and others. We have seen important improvements to Europe's post-trading landscape with the adoption of the Central Securities Depositories Regulation (CSDR) review.

Anticipated changes to new listing rules for companies as well as important structural changes to secondary markets in the Markets in Financial Instruments Directive (MIFID) review will have positive effects on both the primary and secondary markets in European equities. Investors are looking forward to improved transparency and availability of market data and measures to streamline the level-playing field between execution venues.

Notwithstanding these laudable developments, more work remains to be done to reduce Europe's overreliance on bank finance and create a thriving single market for capital. The need is enormous. The Commission estimates Europe's financing requirements until 2030 at 620 billion euro for the green transition and a further 125 billion euro for digitization – per annum. Funding of this magnitude simply cannot come from government budgets and bank lending alone.

What Europe needs is a structural shift to market-based financing. This will take a joint effort by both private and public sectors and Citi will play its part. As one of the world's largest banks, our unique global network allows us to connect European companies with 160 markets. We move trillions of dollars daily - across borders and currencies. Every day, our bankers meet European companies at every stage of their development and get inspired by their leaders speaking about their growth potential.

The financial industry can do a lot to grow capital markets in Europe. Additionally, policy interventions are needed. More regulatory obstacles to capital markets integration and development can be removed. National gold-plating should be limited in time and aimed toward convergence towards a common EU standard. Examples include the collection of withholding taxes and the processing of double tax treaty refunds, which cause important operational challenges. The harmonization of settlement finality rules would help safeguard the viability of clearing and settlement systems and of their participants. Securities and company laws should be reformed to ensure greater convergence, starting with a common definition of 'securities' and 'shareholders'. National rules around multiple voting rights shares, share classes, takeover and threshold rules, public offerings, and capital increases are further examples. The lack of legal certainty here reduces capital markets attractiveness and incentivizes the use of non-EU law. Greater harmonization across member states would reduce complexity and create a more level-playing field for investors.

Not least, making EU capital markets more attractive to international investors and companies is essential to gather additional sources of funding for the net-zero transition. This could be achieved by extending 'UCITS-style' labelling logic to pension funds, ELTIFs and infrastructure funds, enticing them to become more active in capital markets. Furthermore, expanding the opportunities for common EU debt issuance will help create a true European

## INCREASING EQUITY FINANCING

risk-free rate. There is also the clear need to develop an EU-wide standard for debt private placements. Public Eurobond markets are exceptionally deep but, given the investor requirement for liquidity issuance, size needs to be large. The documentation standards and costs involved currently limit access to large and often investment grade companies.

**Greater harmonization reduces complexity and creates a more level-playing field for investors.**

Much has been achieved since the last European elections. More needs to be done in the new legislative cycle. The recent political discussions on the need to distinguish between bottom-up and top-down measures promoting capital markets are helpful. Equally important will be that different measures taken at different levels of decision-making are well-coordinated and aligned. Now is the time for private and public sectors to work together to drive capital market integration forward and make equity financing more available and more attractive for European companies.

The future funding challenge remains vast. If not addressed, Europe's future competitiveness will be at stake. We at Citi stand ready to play our part in moving the EU forward.



## ROLAND CHAI

President European Markets, Executive Vice President - Nasdaq

### Nasdaq's Blueprint for a CMU that supports innovation and growth in the EU

The Nasdaq European market across the Nordics and Baltics (encompassing 22% of EU states) has become a success story of European equity financing over the last 10 years. It's a living blueprint for the success of the European CMU. This success story unfolds through a set of multiple necessary strategic initiatives which as a combination of initiatives transformed the Nordics into a thriving hub for international equity financing. These included regulatory dialogues, public and private investment, taxation and company law initiatives, leading technology, and strong national support across the financial ecosystem. As the leading European engine for SME listings with over 630 listings since 2014 on First North and the celebration of the 130th transfer from First North to Nasdaq's Main Markets in 2023 Nasdaq has shown how successful equity markets can help fund growth, innovation, and job creation across Europe.

Secondary market liquidity is critical to equity funding. On Nasdaq's European markets companies have raised over 26 times what was raised at the point of IPOs. The region has witnessed a

harmonization of trading systems and rules, providing a consistent and seamless experience for members across all Nordic and Baltic markets. The inclusive market structures cater to a diverse range of investors and companies of all sizes, ensuring a fair and transparent price mechanism that serves as a stable reference price for the benefit of the whole market. This diversity is crucial for maintaining an active secondary equity market where over 300 SME companies raised 11,6 bn EUR in 2023 to support their growth journey.

Comprehensive stakeholder engagement across the whole ecosystem has not only allowed streamlining of for instance listing rules and processes but is the key to First North having developed into one of the best growth markets in the world. Nasdaq is currently initiating new rounds of 'IPO Task Forces'. Advisors, institutional investors, analysts, corporates, VC and private equity, retail brokers, CSDs, etc. All pieces of the ecosystem need to cooperate and contribute to efficiency and trust in the market.

Additionally, Nasdaq's emphasis on technological innovation underscores its commitment to market security and resilience on a global basis. This naturally includes the operations of markets in Europe. The integration of advanced cybersecurity measures and artificial intelligence in market surveillance ensures the safety and efficiency of the markets. Nasdaq's blueprint for an inclusive CMU extends beyond its own initiatives within the ecosystem, to the unwavering support it receives from the national political and regulatory environment.

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**The power of harmonising capital markets while leveraging the unique local identities.**

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Regulatory cooperation is a cornerstone, with supervisory colleges established for all Nasdaq markets, clearinghouses (CCPs), and central securities depositories (CSDs). The merging of four CSDs in the Baltics and Iceland is an example of improved operational efficiency and taking down barriers which had not been possible without political and supervisory support across the region.

Private and public investment is crucial. The pension systems in the region play a pivotal role, with national pension funds actively investing locally in both main and growth markets. Individuals are

empowered with the choice to allocate their pension funds, aligning with the vision of an inclusive CMU.

Retail investments are encouraged through administratively simple Investment Savings Accounts (ISK) and tax incentives that foster active investments as well as entrepreneurship. The integration of financial literacy into school curricula aims to nurture an equity culture and the ability to engage on one's private financial situation from a young age.

Company laws, like allowing companies to have dual class shares, support active long-term ownership. Principles-based Corporate Governance Codes allow flexibility for optimal decision-making, fostering an environment conducive to sustainable growth. In conclusion, Nasdaq's blueprint for an inclusive CMU is a testament to the impact of leveraging local strengths and initiatives on a global scale.

Nasdaq's successful growth of the Nordic and Baltic markets showcases the power of harmonising capital markets while leveraging the unique local identities. As Nasdaq continues to champion these principles, the region stands as a beacon for the future of equity financing within the broader context of the European capital market.

The Danish philosopher Soren Kierkegaard introduced the concept of the individual's interconnection with society rooted in historical and societal context as a precursor to actualizing the potentialities and possibilities in one's existence. Equally in European Capital markets we are at a unique point where we can take the diversity and complexity that makes our markets great to another level by understanding and actualizing the potentiality of these markets.



## GELSOMINA VIGLIOTTI

Vice-President - European  
Investment Bank (EIB)

### How to create future champions with equity finance

Equity finance is essential to support young and innovative firms. This type of funding enhances productivity, competitiveness, and economic growth. However, equity markets in the European Union are struggling as demonstrated by two trends. First, companies in EU countries rely more on bank financing than in most developed economies, and the capital market is fragmented. We still don't have a true EU capital markets union that could get more finance flowing across borders and provide businesses with a greater choice of funding at lower costs. Second, the EU equity market's positive developments over the long-term are still insufficient to make up for the gap with more developed markets.

#### Political and economic uncertainty

According to the European Investment Fund's 2023 European Small Business Finance Outlook and the data from the trade association Invest Europe, the upward trends have been hurt by geopolitical turmoil, macroeconomic uncertainties and rising interest rates. In 2022, investments by equity funds in the EU dropped 11% and equity exits dipped 27%, a negative trend that continued in the first half of 2023. The total funds raised by private equity reached

unprecedented levels in 2022, resulting in record amounts of uninvested cash. But in 2023, this funding is decreasing below the levels of the last five years. In this gloomy scenario, two positive elements emerged. First, the decline is more moderate than what we witnessed after the dotcom bubble and the great financial crisis. Second, surveys and experts agree that investment activity will soon start recovering.

#### Public sector must work harder

To help the EU close the gap with more developed equity markets, public institutions need to work harder. We need more effective regulation to open the markets and more active participation.

Equity markets need more support to grow. This can be done by offering more incentives to make investments in equity funds. Given that Europe's financing system is organized around bank savings, working on the link between banks and capital markets would be an important step. Securitisation markets transform illiquid loans to small and medium businesses into an asset class with adequate market liquidity. This frees capital that banks can use for risk finance. In Europe, national banks and the EIB Group play an important role in the development of this market, acting as direct buyers and guarantors. Looking at the issue of channelling more savings into the equity market, another striking difference with the United States is how little pension funds participate in equity funding in the EU. The EU launched the pan-European personal pension product in 2022 to give people more ways to save for retirement, but the initiative has encountered a lot of difficulties that need to be addressed.

#### Building the tools

On the investment side, the instruments needed to support the EU equity market are harder to address. A full recovery will be driven by two factors: the incentives funds have to invest the money they raised, and a stabilization of the macroeconomic outlook. Public actors can also contribute to the recovery of investments.

Regulatory, legal and linguistic differences across countries create a fragmented market and make it hard for companies to expand across national borders. The lack of information on cross-border investment opportunities, the preference of investors to invest locally and differences in tax incentives are among key factors hurting investment. Reforms that support information sharing and a level playing field are essential.

Public financial institutions need to effectively address market failures, help underserved sectors and provide thematic investment where most needed. Perhaps the most striking example of EU equity market failure is the area of scale-up financing. Scale-ups are high-potential young companies that need substantial investment to grow and evolve into large companies after the start-up phase. For these companies, the financing gap is severe. In the EU, firms in the scale-up segment need more rounds of financing and more time to reach a \$500 million market valuation, compared to their US peers. This gap forces highly innovative companies to look beyond the local capital market, and it leads to investments by foreign buyers and often relocation abroad.

### Public intervention in the form of venture funding helps scale-ups grow and succeed.

Public intervention in the form of venture funding (equity and debt) helps scale-ups grow and succeed, while attracting private funding. This is why some EU Member States, together with the European Commission and the EIB decided to set up the European Tech Champions Initiative (ETCI), a €3.75 billion fund of funds which supports large-scale venture capital funds and provides more growth financing to European high-tech companies in the late-stage growth phase.

This type of support, combined with the right regulatory incentives, are what the EU equity markets need. The hope is that tools and initiatives like ETCI will be increasingly used in Europe to support the growth of equity markets.



## ARMAND KERSTEN

Head of European Affairs -  
European Investors'  
Association (VEB)

### Equity markets: from CMU and MiFIR review to a Schengen for financial markets

Pairing the CMU Action Plan and MiFIR cannot escape the consolidated tape briefly preceding an equity markets wish list with the retail investor slant to be expect from us.

Increased transparency on pricing and execution venues facilitates better, more efficient and fair price formation, and best execution. It does away with the artificial competitive advantage of systemic internalisers. The consolidated tape addresses the fragmentation of the markets.

A simple argument favours the pre-trade consolidated tape: attainment of best execution. Only with pre-trade data at their disposal can market participants establish on which markets their transactions can be performed at the most favourable (lowest) price. A catalyst for true competition among trading venues, clearly promoting the interests of retail investors and facilitating optimal allocation of their financial contribution to the EU economy.

We applaud the MiFIR-outcome: a consolidated tape that provides the best bid and offer prices, as well as the transaction volumes. We do not close our eyes to the areas identified as potential drawbacks. We applaud that ESMA assesses whether the consolidated tape framework indeed mitigates information asymmetries.

What should take priority for the next political cycle? In driving the success of the CMU, on balance the emphasis ought to favour the demand side. *Flash Eurobarometer 525* reinforces this perspective. The reason for retail investors not having investment products is lack of prosperity. Worrysome: the youngest age group being invested in crypto-currencies 'explains away' their underrepresentation in financial products.

The CMU Action Plan's fundamentals on retail investor participation in capital markets are clear: investor protection expresses the universally known truth: retail investor participation hinges upon a drastic change in the equity culture – only to be achieved if retail investors are confident that acceding the capital markets is to their benefit and that their rights are adequately protected. Ensuring adequate legal protection. Retail investors should be persuaded to take greater responsibility for their financial future. This may only be expected if consumers are awarded greater protection, over and beyond being enabled to make informed choices.

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**Europe needs a  
'Schengen' for financial  
markets; investing  
across the EU feels  
safe.ure retirement.**

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Investor protection is never a safe haven. There is always the threat coming from issuers and intermediaries not respecting investor' interests. *Flash Eurobarometer 525* tells a sorry tale: 45 per cent report feeling not confident. Client centricity (acting in the customers' best interest) is of the essence in developing new rules. Intermediaries and advisors must be legally forced to put their clients' interest first under all circumstances. This will do away with suboptimal incentive schemes and inducements. These are hardly ever in the real interest of investors.

The retail points of sale of investment services are the main source of investor information for EU citizens. Intermediaries' advice may be biased

to products for which they are higher rewarded. There is little access to bias-free investment services, resulting in little access to investment products which are closest to the capital markets, and to the real economy.

The EU has made considerable strides on withholding taxes and insolvency laws. Another structural weakness remains: pan-European effective collective redress mechanisms. We wish to see more pan-EU investments. However, investing abroad is considered to be far more risky than investing domestically. Retail investors' access to redress abroad is absent in practice or extremely complex and costly. Retail investors shy away from this risk.

Wherever registered within the EU, companies must be liable for infringement of corporate reporting or disclosure obligations. There must be legal remedies allowing investor compensation across the EU. The Collective Redress Directive, faced implementation problems. Some member states pay lip service to accommodating effective collective redress.

We canvass further convergence and consolidation of financial markets' supervision and oversight. Each member state has its own (financial markets) supervisory authority, with diverging powers, mandates, and practices. Many existing divergencies are rooted in culture. A truly internal market, effectively protecting retail investors, and, importantly, a true European approach to awarding protection where foreign investors grant their business as well as their trust to financial industry players rooted within domestic cultures, stands to gain from a level playing field on market supervision and its enforcement.



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## CLEARING: EMIR3 AND ISSUES AHEAD



### KLAUS LÖBER

Chair, Central Counterparties  
Supervisory Committee -  
European Securities and  
Markets Authority (ESMA)

## Reconsidering the national bias to fiscal responsibility and supervision

Central counterparties (CCPs) operate in a highly globalized financial landscape where clearing transactions transcend national boundaries, serving multiple currencies and participants across a wide range of jurisdictions. However, the supervision of CCPs mostly remains to this day a national affair, with National Competent Authorities (NCAs) overseeing entities established within their borders.

While the argument for maintaining national supervision often revolves around fiscal responsibility and the assumption that national governments may need to use public funds as a last resort to resolve a crisis, recognizing the limitations of this reasoning in the context of CCP clearing is essential.

Within the European Union, clearing members and clients of CCPs are very often situated in Member States

different from the place of establishment of the CCP. CCPs calculate and collect collateral from clearing members against their exposures to financial contracts and are allowed to mutualise those resources in case of a member default, creating a complex web of interconnectedness. In the event of a disruption at a CCP, the impact is not confined to the national fiscal domain. It may not even fall primarily on the CCP home jurisdiction, as the CCP itself did not accrue the risk. The repercussions can permeate across borders, affecting key financial and corporate entities across the Union – and beyond.

Considering the consequences that the failure of a CCP and the subsequent implications may have on the financial system and the economy of a Member State, the EU recovery and resolution framework has been put in place to complement EMIR and set in stone the distribution of competences among relevant supervisory and resolution authorities across the life cycle of a CCP. It has also been designed to enable swift and decisive action to stem contagion.

To avoid the recourse to public money and limit moral hazard, the CCP Recovery and Resolution Regulation requires that CCPs and resolution authorities respectively draft recovery and resolution plans including the possibility to require additional resources beyond the margins and default fund contributions foreseen under EMIR. In effect, these position and loss absorbing tools would largely be borne by the clearing participants to ensure the continuity of the contracts into which they entered. In such cases, and while less significant in total amount, the second layer of 'skin-in-the-game' of the CCP would be used first as an incentive mechanism for the CCP to support the proper risk management and recovery of the CCP.

In doing so, the CCP Recovery and Resolution Regulation effectively clarified where the additional funds necessary to cover losses from a CCP failure would be sourced. As a last resort, the fiscal responsibility of the Member States where clearing participants are established may be engaged, which may be challenging, in particular in the case of non-banks (insurers, funds) which do not have a proper resolution regime.

Therefore, while fiscal responsibility is a valid concern, the misconception

that fiscal responsibility rests within the Member State of the CCP should be dispelled, as the onus is rather on the Member States of the clearing members and clients.

In this context, a much more integrated and coordinated supervisory framework at EU level would be warranted, taking into account the situation in all those of Member States which may be most exposed in case of a CCP failure. A national authority on its own can intrinsically not achieve such a holistic assessment of the cross border picture.

The creation of a Joint Monitoring Mechanism proposed by the European Commission under the EMIR 3 proposal is a positive move in the direction of a more horizontal view on central clearing. However, more is needed to recognize and reconcile the multiple fiscal responsibilities which exist in the Union, as a disruption at a CCP can reverberate across the EU, necessitating a collective and comprehensive response.

**In the event of a  
disruption at a CCP,  
the impact is not  
confined to the national  
fiscal domain.**

Acknowledging the broader implications of CCP disruptions and fostering collaboration among relevant authorities are indispensable steps towards ensuring the stability of the European Union's financial system in an increasingly interconnected world.

Similar considerations apply on the global scale for CCPs which serve as providers of clearing services in multiple jurisdictions. For the most systemic among them, traditional models of collaboration between authorities – including global supervisory colleges, primarily set up to share ex post information – have limits, which may call for a rethink of global supervisory structures in due course.





## DANUTA HÜBNER

MEP, Committee on Economic and Monetary Affairs - European Parliament

### EMIR 3.0: making the EU clearing framework more competitive and resilient

The clearing landscape in the Union has changed significantly since the adoption of the European Markets Infrastructure Regulation (EMIR) and its revisions.

The role of CCPs - and the risks that they manage - has grown considerably, and the withdrawal of the United Kingdom from the Union significantly altered the market dynamics and increased the reliance of EU clearing members (CMs) and clients on market infrastructure of third-country jurisdiction.

The global pandemic, the Russian aggression on Ukraine, the energy crisis, and high-inflation, all increased the risks in the system, affected the orderly functioning of markets and offered invaluable lessons for the future of the EU clearing ecosystem.

EMIR 3.0 is an important opportunity to adapt the rulebook for the Union's clearing ecosystem, and ensures that it remains safe, robust and competitive.

Given the key role of post-trade market infrastructures in supporting efficient

capital allocation and vibrant capital markets, the review is also coherent with the broader objectives of the Capital Market Union (CMU).

The position of the European Parliament (EP), for which I have the honour of being Rapporteur, seeks to seize the opportunity provided by the review to implement ambitious and forward-looking changes, grouped around three main thematic blocks: supply-side measures, demand-side measures (i.e. Active Account Requirement) and supervision.

On the supply side measure, the EP amendments reflect the view that providing the conditions for CMs and clients to choose to clear with EU CCPs may be the single, most effective and most sustainable way to increase clearing in the EU and reduce the reliance on third country (TC) CCPs. More efficient regulatory approval timelines are essential for the competitiveness of EU CCPs on a global scale. The EP's amendments thus seek to enable EU CCPs expanding their offerings more rapidly, simplifying and reducing the burden that they face.

On the 'Active Account Requirement' (AAR), the EP opted for a gradual phase-in of the measure, in light of the novelty of the requirement and its potential impact on the competitiveness of EU CMs and clients. The proposed approach introduces a 'qualitative' first phase, followed by a 'quantitative' second phase, where a minimum level of activity to be maintained at EU CCPs would be introduced.

#### Any EU policy [on] EU clearing should be part of a clear long-term strategy for our CMU.

However, the introduction of the threshold would be subject to a series of pre-conditions, such as detailed assessment of its impact on the competitive position of EU counterparties on the global market, thereby addressing the inherent tension between the political goal of reducing reliance on TC-CCPs and protecting the competitiveness of EU firms.

The phased approach will also allow ESMA and the Commission to collect the data to assess the costs and benefits of the AAR and to measure the impact of its implementation. Finally, the EP has called on the Council and the Commission to use this review

to 'update' the Union's supervisory framework and make it fit for the future.

The current approach of decentralised supervision is no longer suitable to address the increasing cross-border exposures cleared at EU CCPs and the systemic interconnectedness between CCPs, CMs and clients. A more coordinated and integrated approach to the supervision of EU CCPs is necessary, especially as more systemic activity is expected to shift towards the Union via the AAR.

More centralised supervision would strengthen EU-wide risk monitoring and ensure a level playing field in the Single Market. It would reduce divergent interpretations by NCAs, increase efficiencies, and ensure that risks concentrated in EU CCPs are adequately managed, minimising systemic risk and spill-over effects across Member States.

ESMA should be empowered with a direct supervisory role vis-a-vis EU CCPs. NCAs could continue to have an active role as part of the College and in the context of Joint Supervisory Activities, ensuring that the local specificities of each market are taken into account. This set-up would allow ESMA to take a proactive approach on EU financial stability risks and achieve efficient supervision that takes into account the cross-border issues. In short, the changes proposed by the Parliament are focused on the long-term challenges that Europe will face. More notably, they are underpinned by the view that any EU policy to further develop EU clearing should be part of a clear long-term strategy for our Capital Market Union (CMU).

In this sense, much of the discussion has been narrowly focusing on the Active Account Requirement, possibly losing sight of the bigger picture.

All three elements of the proposal: supply-side measures, AAR and the changes to the supervisory framework will shape the EU clearing ecosystems for years to come, and increase its attractiveness in a decisive and sustainable way. Concluding this review and striking the right level of ambition is a necessity, and an opportunity that Europe must not miss.



## GIUSEPPE GRANDE

Deputy Head of Market and Payment Systems Oversight - Banca d'Italia

### Central clearing in Europe: policy challenges in an ever more integrated market

EMIR 3 can be considered as adequately designed to reduce the EU's excessive exposure to UK-based central counterparties (CCPs), enhance the supervisory framework for CCPs, and make the latter more efficient and resilient. However, it is fair to say that the concerns expressed by national authorities and industry stakeholders during the EMIR 3 negotiations are leading to less ambitious results than expected.

A case in point is the review of ESMA's role in the supervision of EU CCPs. In the growing and increasingly integrated EU clearing market, ESMA's mission of ensuring supervisory convergence across national authorities is becoming even more important. Nevertheless, the final outcome of EMIR 3 is unlikely to strengthen ESMA's role as significantly as originally envisaged by the European Commission. In this context, the Italian authorities put forward a proposal that aims to: i) keep the supervisory system simple; and ii) make it more integrated, without interfering with the supervisory and fiscal responsibilities of

national authorities. In this proposal, ESMA would play a more active role in the supervision of CCPs and, more specifically, would co-chair the EMIR colleges. In the event of disagreement between the co-chairs, the final decision would rest with the national competent authority, which should provide an accurate explanation if it deviates from ESMA's proposal.

It is now time to start thinking about the conditions for an effective implementation of the new measures. These conditions are diverse and require a balanced approach.

First, the active involvement of all industry stakeholders is key to achieving the expected results. Public authorities can do a lot to create a favourable environment, promote good practices and catalyse innovation. However, the power of market incentives in advanced financial systems should not be underestimated. The recent increase in LCH SA's share of the credit default swap market, undoubtedly facilitated by Ice Clear Europe's decision to exit this market segment, signals that the geography of clearing flows is more fluid than one might think and that supply-side effects also play a role in the market for clearing services. Structural characteristics such as currency diversification, margin transparency, accessibility of the testing environment and ease of client portability can all greatly contribute to the attractiveness of the EU clearing industry.

Secondly, in addition to carefully monitoring the effects of the measures taken to ensure that the efforts are justified by the expected results, it is essential to adhere to the principles of gradualness and proportionality during the implementation phase. This implies gradually adapting to the new rules and avoiding excessive burdens or abrupt discontinuities in industry practices. In line with these principles, especially with regard to the active account requirement, we support the adoption of differentiated requirements depending on the size of the portfolio (proportionality) and we believe that appropriate phasing-in stages should be defined (gradualness).

As far as future policy work beyond EMIR 3 is concerned, there is no room for complacency, as the industry is constantly subject to powerful drivers of changes, the first of which is innovation. With regard to the clearing of crypto-assets, we need to assess the extent to which the EMIR regulation is applicable and able to cover risks; we also need to look into its possible interactions with other regulations (e.g. MiCAR). The rapid development of private and

public forms of digital money may lead to a search for new types of settlement assets or settlement modes, which would require an assessment by the authorities of their compatibility with a safe and sound CCP ecosystem. As regards the shortening of the settlement cycle, the shift from "t+2" to "t+1" would not call the business model of CCPs into question, whereas a shift to "t+0" could have far-reaching consequences.

The second driver of change is the structural evolution of the clearing industry. A noticeable development is the concentration in the provision of clearing services by clearing members. As for CCPs, competition between them is increasing and this puts pressure on the cost of clearing (direct fees and opportunity costs of posting guarantees). These trends may have a number of undesirable consequences in terms of availability, affordability and resilience of clearing services for the investor community.

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**Ensuring competitiveness and fair competition, keeping up with innovation.**

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Another aspect that cuts across innovation and other structural factors is the quality and timeliness of the data contained in trade repositories. Reliable and rapidly accessible data on trading flows are key factors for monitoring and analysing market developments.

The fast-moving market environment affects the nature and intensity of the concentration, operational and liquidity risks faced by CCPs. Public authorities will continue to monitor market developments closely and stand ready to take appropriate action.



## ISABELLE GIROLAMI

Chief Executive Officer,  
LCH Limited - London  
Stock Exchange (LSEG)

### Competitiveness as a guiding principle

LSEG is a financial market infrastructure provider headquartered in London, with significant operations in Europe, where we employ over 3000 people across 19 Member States.

LSEG operates two leading multi-asset class clearing houses (CCPs): LCH Limited, headquartered in London and of which I am the CEO, and LCH SA in Paris. LCH Group's CCPs offer clearing services to members and clients across the globe and as such are subject to the supervision and regulation of numerous jurisdictions. This includes the EU, where LCH Limited is directly subject to the EU EMIR framework and directly supervised by ESMA as a Tier 2 CCP.

While it might seem odd to say so, we welcome both the cross-border supervisory scrutiny and stringent rules we are subject to. Our customers thus not only get access to a large and diversified clearing community but also robust risk management standards, subject to the requirements set by the most demanding jurisdictions in the world.

As such, we welcome EMIR's ambition to strengthen the supervisory framework for EU CCPs and streamline approval processes. Better supervision

is conducive for a safer ecosystem, which combined with a CCP's ability to quickly adapt to market demands will only result in a more attractive and competitive landscape.

However, we are still concerned with the complexity of the EU supervisory structure. EMIR 3 negotiations are unlikely to fully address the fact that EU CCPs face diverse European regulators, both at the national and EU level, sometimes in a duplicative manner. Considering the cross-border, and even pan-European role of some EU CCPs (including LCH SA) we are of the view that direct EU supervision would simplify the structure and support the global competitiveness of EU CCPs.

As per the third country aspects of the regulation, I am pleased to see an enhancement of the cooperation agreement between ESMA and the competent authorities of Tier 2 CCPs. If the objective is to mitigate an eventual crisis and preserve financial stability, this seems to me the best course of action. These will complement the current framework ensuring strong cooperation, direct application of EMIR, and ESMA supervisory and enforcement powers over Tier 2 CCPs such as on-site inspections and the validation of new initiatives.

**Direct EU supervision  
would simplify  
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Yet, active accounts might thwart these efforts and increase systemic risk within the EU itself. EU firms are concerned that such requirements would dictate where and how they must conduct their clearing operations. Such decisions should be left to risk managers and not impose the use of a particular central counterparty. Active accounts will negatively impact EU capital markets by introducing fragmentation and loss of netting benefits and make the Union overall less resilient to market stresses, with no clear benefit to its financial stability. While operational accounts are unfortunately now a reality, we urge ESMA and EU regulators to apply as much proportionality as possible when introducing them to limit their potential damage to the financial ecosystem.

I want to conclude with two forward-looking thoughts.

Up until now the regulatory spotlight has mostly been shining on banks and financial market infrastructures. Yet, they only represent a section of the broader financial ecosystem, with the remainder including what is traditionally known as the 'buy-side' such as pension funds, hedge funds, asset managers, to name a few.

Central clearing solutions can provide those actors with increased transparency and overall enhance the resiliency of an ever-growing integrated network.

The U.S. recently acted on this front, with the SEC releasing final rules requiring central clearing of certain U.S. Treasury securities secondary cash market transactions and the broader clearing of repurchase and reverse repurchase transactions. Whilst we are not advocating for a similar mandatory approach this side of the Atlantic, we still believe both industry and policymakers should ensure the full leverage of clearing to improve the way risks are managed.

Finally, operational resilience must remain a focal point for regulators and industry alike. I recommend regulators not to be too caught up with the nitty gritty and focus instead on outcome. Industry needs to spend its energy in preventing operational risks rather than imposing stringent requirements that can turn into tick-box exercises. DORA sometimes misses the need to focus on outcomes. I would also point out the importance to ensure policymakers facilitate access to best-in-class providers such as Cloud Service Providers (CSP) to support CCPs operational resilience. Rather than impede their usage regulators should equip themselves with the proper tools to mitigate any concerns they may have.



## ERIK TIM MÜLLER

Chief Executive Officer -  
Eurex Clearing AG

### Getting ready for EMIR 3.0: preparation as the key to success

The EU has been at the forefront of thought leadership when it comes to clearing regulation. And while it is not only a great achievement that financial stability has been safeguarded in recent periods of market stress, EU CCPs have also set the global benchmark when it comes to anti-procyclicality, transparency and a superior predictability of margin calls. However, in light of challenging economic and geopolitical realities, we should not get complacent and continue to foster the resilience and attractiveness of the EU clearing ecosystem – which is where EMIR 3.0 comes in.

Addressing the stability concerns associated with offshore clearing of systemically relevant business and promoting EU clearing activities remain crucial elements in the broader context of the Capital Markets Union and the EU's open and strategic autonomy agenda. It is reassuring that EU regulators are strongly committed to finalize EMIR 3.0 ahead of the EU elections, setting the scene for the strategic agenda of the upcoming legislative period with a view to structurally strengthening EU markets and CCPs long-term.

In particular, co-legislators converge on the need for the active account requirement to reduce overreliance on third country infrastructures. In line with Eurex Clearing's commitment to support the market's adaption to the new regime and keep the transition impact to a minimum with our OTC IRD and STIR clearing programs, we have achieved a stable 20 percent market share. Other EU CCPs have launched initiatives, too – providing the market with more choice, increased competition and reduced systemic risk concentration.

However, those rebalancing efforts have not yet led to an equilibrium that satisfies EU regulators. It appears that without clear regulatory guidance and enforcement, the status quo will not change, leaving substantial systemic risk concerns in third countries unaddressed and exposing the EU both politically and financially. The co-legislators therefore propose a quantitative element for the active account to ensure effectiveness – the Council by requiring a minimum replication of a firm's UK portfolio in the EU via the representativeness criterion, and the Parliament by installing quantitative targets in a staged approach.

The proposed proportionality by differentiating firms' sizes and activities, strikes the right balance between the regulators' stability concerns and implications for market participants. If those proposals are combined constructively, a meaningful regime can be ensured that truly helps the market to transition towards a healthier market structure while safeguarding firms' global competitiveness.

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**In the spirit of the  
Presidency's motto  
"protect, strengthen,  
prepare", let us jointly  
continue to get ready.**

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In addition, we should not forget that EMIR 3.0 contains a number of critical elements that boost the EU clearing system structurally – meaning that we should remain optimistic about its future strength and competitiveness rather than focusing on why the status quo could never change. These elements include, for example, a shorter time-to market reality, an improved supervisory regime for EU CCPs, and a review of EU CCP's access to central banks. In combination, the EMIR 3.0 implementation will therefore transform the EU's clearing ecosystem

by introducing the next era in regulatory evolution and advancing on the EU's path of resilience while boosting global competitiveness.

With the new EMIR 3.0 requirements soon entering into force, market participants are well advised to kick-off preparatory work and to ensure readiness for a successful implementation to stay ahead of the curve. Especially the active account is expected to kick-in already six months after finalization and publication of the new legislation, requiring the set-up of EU accounts by early 2025. In this context, we should not forget that EU regulators estimate that 40 percent of all affected entities are not yet connected to any EU CCP.

To support operational readiness, including robust testing through structural simulation environments, Eurex Clearing complimented its partnership and incentive programs with a dedicated onboarding information platform. This will help to avoid another cliff-edge scenario and effectively bolster market participants' implementation efforts.

In the spirit of the Presidency's motto "protect, strengthen, prepare", let us jointly continue to get ready for a successful EMIR 3.0 as the key building block of an EU clearing framework that underpins not only the stability but also the global competitiveness of the future EU financial market.



## STÉPHANE GIORDANO

Deputy Head of Public Affairs,  
Responsible for Wholesale  
and Financial Markets  
Activities – Société Générale

### EMIR 3.0. or Beta-test for a revived CMU?

Almost 5 years after Brexit, the UK remains the largest European clearing hub for OTC derivatives, across all currencies (including euro and other EU Member State currencies). In response to this issue which was already causing concern in certain quarters pre-Brexit (notably the ECB's 2011 location policy challenged by the UK at the ECJ) the European Commission, with several provisions in its "EMIR 3.0" 2022 proposal, aimed to rebalance the clearing of EU market participants towards EU CCPs alongside measures intending to strengthen their supervisory framework.

Fast forward to 2024, the discussions held at the Council and at the Parliament have resulted in different positions, both with proposals of high quality for the future of EU financial markets. Legislators have in common that they have wisely avoided the temptation of forcing a rapid and brutal relocation of clearing activities of EU market participants, which would be extremely damaging for financial markets, notably for EU market intermediaries.

It is likely that a strict quantitative rule for relocating activities would

ultimately miss its objective – it would only generate an increasingly isolated and illiquid EU pool, as EU global players would face sharp restrictions on their business with international clients. This scenario would undermine the EU competitiveness agenda, in total contradiction with the common institutional goal to increase EU open strategic autonomy.

With now both positions stabilized, two topics seem of paramount importance in the context of the triologue negotiations - the competitiveness of EU market participants and the effectiveness of EU authorities' oversight. Far from being only technical, the EMIR 3.0. debate is an important building block for the creation of a CMU useful for the EU economy.

First and foremost, we need to define an active account which works sensibly in practice.

Firstly, there should be no misunderstanding about the aim of such an active account. A CCP framework which works well is one that is functional in times of crisis, and a quantitative criterion is objectively not required to determine whether an account is active or not, provided one can ensure that this account provides an operating fall-back solution if access to non-EU CCPs comes to be jeopardized for EU participants. To put it plainly, the only requirement is that EU CCPs are scalable enough to clear a significantly larger number of transactions if such a scenario arises.

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**EMIR 3.0. is an important  
building block for the  
creation of a CMU useful  
for the EU economy.**

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Secondly, a differentiated and progressive approach makes sense for the implementation of such a measure. If we want to minimize disruptions to the market and allow the EU ecosystem to adapt smoothly, the most efficient direction of travel is to follow a gradual path, with review clauses, mindful of the competitiveness of market participants.

The other critical question is the supervisory framework and ESMA's mandate in this context. Considering financial stability as a common objective, this seems an ideal case for ESMA to be more directly involved with the supervision of the most critical EU CCPs. There is a deep paradox in the current situation, where ESMA is mandated to secure supervisory over

CCPs outside the EU, when it does not have such rights in the EU.

Notwithstanding the need for the authority to develop its expertise, it would be reasonable to grant the ESMA extended supervisory powers over the most systemic European CCPs, i.e., those which have non-negligible market shares of the clearing of derivatives that are otherwise cleared outside the EU by "super systemic" CCPs and are accordingly likely to be the main beneficiaries of the implementation of active accounts.

In brief, getting EMIR 3.0. right will be an important step towards the establishment of a strong and efficient Capital Markets Union (CMU). Behind the technical debate is the drive to create a robust and autonomous CMU, to drive the financing of the EU economy. 2024 will be a key year for determining the future course of the CMU, with the Enrico Letta report "on the future of the single market" and that of Mario Draghi on "European competitiveness", but we should also look at EMIR 3.0 as a beta-test to put into practice the high-level principles of this "CMU of tomorrow".

## POST-TRADING ROADMAP



### FIONA VAN ECHELPOEL

Deputy Director General,  
DG Market Infrastructure  
& Payments - European  
Central Bank (ECB)

### The post-trade space is ever evolving

With several workstreams going on and new challenges arising, levels of excitement in the post-trading space are gathering pace! Harmonisation in securities post-trade processes and in collateral management continues as it constitutes a *conditio sine qua non* for an integrated European financial market, while new areas require our attention as well.

The Eurosystem's Advisory Group on Market Infrastructures for Securities and Collateral (AMI-SeCo) has made significant progress in the past years by agreeing on standards for European markets and committing to their implementation. AMI-SeCo is a market stakeholder forum sponsored by the Eurosystem (i.e., the ECB and the National Central Banks of the countries that have adopted the euro), bringing together central securities depositories, central counterparties, banks, central banks, issuers and industry associations and covering the European Economic Area, UK and Swiss markets.

An integral part of AMI-SeCo's work is monitoring and reporting on the progress of implementation of agreed standards:

- AMI-SeCo and its predecessor, the T2S Advisory Group, have monitored compliance by T2S markets with the T2S harmonisation standards for more than 10 years (TARGET2-Securities - T2S – the Eurosystem-operated settlement platform). The overall level of compliance with the T2S standards is around 90% by now, with only a few remaining non-compliance cases.
- The 7th AMI-SeCo SCoREBOARD reporting the progress in implementing the Single Collateral Management Rulebook for Europe (SCoRE) Standards was published in December 2023. SCoRE Standards cover Triparty Collateral Management, Corporate Actions and Billing Processes (while AMI-SeCo aims to define further SCoRE Standards). Although significant progress has been achieved overall by the monitored actors, several markets reported delays. The rescheduling of the Standards implementation date to November 2024, in line with the go-live date of the Eurosystem Collateral Management System (ECMS) which also builds on the SCoRE standards, allows more time for the markets to prepare.
- AMI-SeCo published the 2023 Corporate Events Compliance report which provides an assessment of the current levels of compliance with European corporate events standards, i.e. Market Standards for Corporate Actions Processing, Shareholder Identification and T2S Corporate Actions Standards. The monitoring exercise shows some advances in compliance. Many markets have concrete plans to improve compliance, with the SCoRE Standards and ECMS-readiness acting as a catalyst. In 2024, AMI-SeCo will initiate preparatory work on the creation of a single rulebook for corporate events which will further consolidate the existing separate sets of standards in this domain.

AMI-SeCo is also taking stock of the remaining barriers to post-trade integration and cross-border access. The findings will form the basis of future AMI-SeCo harmonisation/

market integration initiatives as well as potential recommendations by AMI-SeCo to European or national law-makers and regulators.

Other authorities are also active in the post-trading domain. In this regard, the Eurosystem welcomes the increasing regulatory and market focus on settlement efficiency led by the European Securities and Markets Authority (ESMA) as well as the investigations into the reasons for settlement fails and possible measures for preventing settlement fails.

Understanding the root causes of settlement fails and ways to prevent them is also essential for any discussion on European securities markets moving to a shorter settlement cycle. It needs to be ensured that, if such a move were decided, it would not lead to a deterioration of settlement efficiency levels. Overall, the question of a potential shortening of the settlement cycle is multidimensional and requires analysis on the basis of market evidence.

**Harmonisation continues while new areas require our attention as well.**

New technologies are adding another interesting dimension to the post-trade field and the Eurosystem is actively examining how central bank money settlement in euro could take place in the presence of technologies such as Distributed Ledger Technologies (DLT). The Eurosystem is rolling out its exploratory framework with market participants on the use of new technologies for central bank money settlement. Within this framework the Eurosystem will allow eligible market stakeholders to experiment and/or trial (with real-life transactions), settlement of assets or payments against euro central bank money based on new technologies. This work will also help to meet demand for central bank money settlement during the market's own pilots (for example under the EU DLT Pilot Regime) and is considered part of the Eurosystem's contribution to the further digitalisation of finance within the EU. Harmonisation and integration also remain key themes within this new workstream.

Exciting times lie ahead!



## MONTSERRAT MARTINEZ PARERA

Vice Chair - Spanish  
Securities and Exchange  
Commission (CNMV)

### Shortening settlement cycles: is T+1 the way to go?

Ten years ago, European markets transitioned to the current T+2 cycle from T+3, requiring all transactions executed on trading venues to be settled in two business days. It was a significant undertaking across EU securities markets. Since then, settlement efficiency has improved notably, particularly after the disciplinary measures introduced in 2022. However, the improvement has not been even across all jurisdictions and assets classes, and it still can be strengthened.

The recently adopted CSDR Refit is precisely envisaged to tackle certain issues related to settlement failures. This is important. Settlement efficiency plays a critical role in the execution of financial transactions, ensuring both certainty and timeliness, which keep counterparty credit risk under control. Indeed, reducing settlement fails to a minimum will enhance the functioning and competitiveness of the European capital markets. ESMA's recently published consultation paper aims precisely to contribute to this goal by enhancing settlement discipline measures.

However, there are two additional main trends to consider within the settlement business: the steps being taken by some jurisdictions to further shorten the window cycle towards T+1 and the potential of new technologies (distributed ledger technology (DLT)) to revolutionize the settlement process.

Both trends point towards an acceleration of the settlement cycle, but I will focus on the former. Questions arise whether Europe should follow this path, and if it does, what benefits it would bring to the European markets. Answering these questions is not straightforward, and the implications need to be carefully weighed.

On the one hand, reducing the settlement cycle could reduce liquidity needs and counterparty exposure thereby reducing margin and collateral requirements. These associated savings in margins are usually presented as one of the main benefits.

Additionally, the upcoming shift to T+1 in the US, Canada and Mexico in May 2024 poses additional pressure on us to follow the same approach to avoid a potential gap in the perceived competitiveness of European markets. Other jurisdictions such as India have already made the move. And more importantly, current discussions held in the UK should be followed closely.

This context aside, the unique nature of the European Union infrastructure means important challenges remain to be considered. Multiple trading venues, central counterparties, and central securities depositories, together with several currencies, help create a complex ecosystem with additional frictions. Navigating this fragmentation requires a comprehensive understanding of diverse regulatory frameworks and market infrastructures, adding yet more complexity to the T+1 adoption process.

The impact on the resilience of settlement systems requires a thorough assessment. With less time available to settle trades operational risks may increase. If a shorter settlement cycle is implemented, settlement fails run the risk of increasing which would also lead to a cost increase due to cash penalties.

It should also be mentioned that embracing a shortened settlement cycle would require a high level of automatization and investment costs, with uneven effect on market participants. In this context, smaller players may find it difficult to adapt their systems to a shorter settlement cycle and would require sufficient time to prepare. It is also important to consider to what extent the financial implications

of such investments could be passed on to retail clients.

ESMA has already initiated a call for evidence to obtain the perspectives of stakeholders on these matters that will help us to better understand and address any of the risks and challenges before taking the decision to move to T+1. In cooperation with the members of the ESCB, ESMA will prepare a report to guide European authorities on the potential shortening of the settlement cycle.

### Regulators should take risks and challenges into account to foster a smooth transition.

Many believe the question is not if, but when and how. In this rapidly evolving environment, European markets can not be caught napping. However, a careful consideration of associated risks and costs needs to be conducted, given that moving to a faster settlement process could also have a negative effect on our attractiveness. A successful transition would also require proper time to allow a smooth compression of the settlement timelines and, more importantly, a joint purpose and coordination of all stakeholders involved.

Europe already has experienced a successful transition from T+3 to T+2 which was the result of planning, testing and coordination across the industry. We are now considering whether to tackle an even more challenging change and it should be done after careful analysis.



## PHILIPPE LAURENSY

Managing Director, Head of Product Strategy & Innovation - Euroclear Group

### Driving the next phase of securities markets evolution – A collaborative effort

The drive towards ever greater levels of integration and efficiency in the post-trading ecosystem has rightly been a vital component of the European and global securities markets agenda for many years. Advancements in technology and the shift towards a shorter settlement cycle are driving another major evolution in the world's financial markets.

#### Transitioning to T+1 settlement

Major markets are now focused on a shorter settlement cycle. This is now a topic that looms large in the policy agenda. The transition to T+1 settlement is soon to become a reality in the United States, Canada and Mexico. This is today's reality for many European players active on the global stage, and their experience in North America will be valuable when the shorter life-cycle is rolled out in Europe.

A compression of the settlement cycle carries the prospect of reducing risks and costs in securities markets, as well as furthering the modernisation of capital

markets. While these benefits represent powerful drivers, the challenges should not be underestimated. These are not so impacting on the market infrastructure themselves, which can and do handle same-day, real-time settlement. But for dealers, custodians and their clients, shifting to T+1 settlement cycle will require major investments and a collective, coordinated effort among authorities and market participants, underpinned by international collaboration and shared learning.

In the case of the EU, the challenges are compounded by the unique complexities of the single market, involving multiple jurisdictions, settlement locations, stock exchanges, currencies and distinct legal frameworks. The EU therefore needs to carefully consider its next steps and the potential roadmap, taking all asset classes into consideration.

We should also not lose sight of the needs of the end-users of our capital markets – issuers and investors, including the requirements of cross-border investors from outside the region. Assuming the successful migration of North American markets to T+1 this year, harmonising settlement cycles across developed markets will become a compelling driver for EU markets to follow. Regional synchronisation is another major consideration. The EU and the UK should align as much as possible their approaches to T+1 to maintain well-functioning markets. Already desynchronisation of settlement cycles between North America and Europe is creating hurdles for asset managers and ETF providers as well as FX challenges.

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**We are in an exciting phase of market development where FMIs will need to play a central role.**

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Finally, shortening the life cycle will definitively increase funding challenges and dependency on efficient secured financing transaction markets including repo and securities lending. Europe will especially look to learn from the US experience in this sector of the market.

#### Advancing the digital transformation

The rise of DLT, AI and other technologies has the potential to transform the ways in which financial market participants issue, invest and process different asset classes.

In the specific case of DLT and digital assets, we have seen a growing number of initiatives drive a new maturity in the use of this technology, including our own initiative on Digital Securities Issuance end of last year.

Whilst we remain in the early stages of adoption of these technologies, there is little doubt about their long-term potential to support liquidity and deliver benefits at every step of the trade lifecycle, including in relation to settlement acceleration and efficiency.

The digitalisation journey is a long-term endeavour. Work will need to continue on broader regulatory harmonisation and industry-wide standardisation to build the necessary infrastructures and connectivity across DLT protocols and legacy platforms.

A prospective wide-scale introduction of DLT is subject to a longer-term timeline compared to the near-term efforts to shorten the settlement cycle and enhance efficiency. A full transformation towards a digital ecosystem is not a prerequisite to achieve the T+1 transition. These two evolutions need to be advanced in parallel, according to their different time horizons.

#### Supporting strong European markets on the global stage

Much has changed in the European post-trading market since the work of the Giovannini group over 20 years ago. The current juncture represents an opportunity to reflect on what has been achieved and the areas where further progress is needed. The overall competitiveness and efficiency of our financial markets and the needs of end-users, together with financial stability and market resilience objectives, should remain our core guiding principles.

Financial market infrastructures and the CSD community, including Euroclear's entities, have been supporting the evolution of financial markets for decades, providing scalable, resilient and trusted infrastructure on which the industry can build. We are in an exciting phase of market development where FMIs will need to continue to play a central role in collaboration with all market players.





## JESÚS BENITO

Head of Domestic Custody  
& TR Operations -  
SIX Group & Chief Executive  
Officer - Iberclear

### T+1 and beyond: a look into the future of securities settlement

So, it is almost here. The US move to the T+1. The decision which caused an international debate in the capital markets around the world, or at least here in Europe. It has been one of the highly debated topics for the past few months. Yet, it still needs to be analysed in a far more greater detail. By the end of May 2024, we will finally see how this move in the US, Canada and Mexico will affect our markets and the wider industry in reality. Europe should take a careful look at the potential lessons to be learnt, even though the American ecosystems are very different from ours.

The logic says, if it can be done faster and better, why not? Thanks to the highly advanced digital technologies, we are living in an unprecedented world, where speed of delivery of services and products accelerated to a level where the customers expect the instant gratification. Technology gets faster, and the patience grows thinner. It will become even more so in all aspects of our lives facilitated by new technologies and demanded by new generation of digital natives. The post-trade industry will not be an exception.

The new technologies that facilitate T+1 settlement are the GenAI, data, robotics, cloud, automation and APIs, among others. Distributed ledger technology ('DLT'), however, is a totally different ball game. DLT allows the so-called atomic settlement, which is a gross settlement at the very moment when trading is being executed. From this perspective, the atomic settlement not only reduces the settlement cycle, but also it actually eliminates the very concept of the 'settlement cycle' itself, as there will be no gap between trade execution and its settlement. Thus, atomic settlement means a brand new ecosystem. Therefore, it is necessary to distinguish the T+0 settlement cycle in the current legacy system from the atomic one in the DLT ecosystem. With the current technology, a move to T+1 is rather feasible, which cannot be said about the T+0. Therefore, from my point of view, any further shortening from T+1 cycle should be based on a new technology, completely replacing the current legacy systems by a DLT based one.

As many industry representatives have highlighted, there are both advantages and disadvantages to further shortening of the settlement cycle. Detailed cost and benefit analysis, instead of 'copy and paste', should be performed by all stakeholders in order to decide when and how the EU should move to T+1. ESMA's public consultation is the right move in this direction. When EU decides to do so, it would be optimal to do it in a harmonized way together with the UK and Switzerland.

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**The logic says, if it can  
be done faster and  
better, why not?**

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The path towards achieving T+1 is undoubtedly fraught with challenges. From time pressure and settlement complexities in FX markets for funding cross-border transactions, ETFs difficulties to settle on due date, which is difficult even in the T+2 environment, to navigating corporate events' relevant dates and securities lending, possible surge in operational risks and administrative costs, heavy upfront investment in technology and automation, all to be added to the 'Challenges' list.

However, if there is one issue that worries regulators in Europe above all others, it is the potential increase of settlement fails from the current level, something that would be considered totally unacceptable in some markets.

All these considerations and decisions fall on the shoulders of the next political cycle of the EU, which will commence in the second half of the 2024. Aside from the shortening of the settlement cycle, in my opinion, there are three main topics that should be included in the post-trade agenda of the incoming EU institutions.

First, increasing the efficiency of post trade processes. In order to do so, the EU should further harmonize and increase cross-border transactions through the financial market infrastructures ('FMIs'), increase the EU competitiveness at the global level, enhance the regulations and tax regimes, and decrease bureaucracy. The shortening of the settlement cycle would fall under this priority, together with the improvement of settlement efficiency.

Second, application of the new technologies to the post trade services. This could be done through, but not limited to, the transition from the legacy systems to the DLT systems, tokenization, crypto assets, wCBDC, developing the AI possibilities, deploying robotics and automatization along the value chain, and extending the cloud solutions.

Lastly, the ESG. To realize our sustainability and ESG objectives, in addition to what we need to do internally, we must foster green listings, assist issuers in their green issuances, devise strategies to prevent greenwashing and promote shareholder identification, their active participation, and engagement in shareholder meetings.

Accomplishing these goals and priorities during the upcoming political cycle would not only facilitate a seamless transition to T+1 but also bring the EU one step closer to the completion of the Capital Markets Union.



## VALENTINO WOTTON

Managing Director and General Manager of Institutional Trade Processing - The Depository Trust & Clearing Corporation (DTCC)

### Strategies for accelerated settlement in the UK and EU

As the US inches closer to its implementation of a T+1 settlement cycle on May 28, 2024, the UK and EU are also exploring the case for accelerating settlement cycles in their markets to achieve greater industry harmonization and other benefits including reduced risk, lowered clearing fund requirements, operational efficiency and improved capital and liquidity utilization.

It is important to note that a successful transition to a T+1 settlement cycle in the UK and EU will require an increase to the current levels of post-trade automation. The Association for Financial Markets in Europe (AFME) published a whitepaper in Q4 2023 that highlighted pain points in current securities processing in the region, such as data quality issues and counterparty behaviors that affect the ability to match and allocate trades, and recommendations on how these obstacles could be removed. T+1 therefore provides an opportunity to enhance operational efficiencies by

encouraging market participants to automate manual processes and adopt industry standards and best practices.

#### Automating post trade processes

Specifically, trade matching is a critical part of the post-trade lifecycle and serves as the first safety check after execution has taken place. When the buyer and seller agree on all the details of their transaction, a trade match occurs, and the settlement process begins. Most importantly, trade matching allows counterparties to identify exceptions that may cause the transaction to fail. The sooner firms can move to settlement and address trade fails, the better the chances of meeting an accelerated settlement timeline. In support of this, we recommend that the UK and EU markets consider mandating that trade confirmation, allocation and matching take place on trade date, allowing for T+1 settlement.

Standing settlement instructions (SSIs) are another critical component of the post-trade lifecycle, as they play a key role in preventing trade fails. Manual SSIs and the absence of storing and sharing SSI data in a standard and automated fashion across the industry introduces risks and inefficiencies into the post-trade process. In fact, it has been observed that inaccurate or incomplete SSIs are often a primary reason for trade failures. Accurate, automated SSIs are key to the facilitation of accelerated settlement.

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#### Post-trade automation and standardization can increase settlement efficiency, paving the way for T+1.

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To address both areas - trade matching and SSIs - firms should evaluate best practice solutions that automate and improve post-trade processes. Today, automated central matching platforms enriched with golden source SSI data and workflows that facilitate accelerated settlement already exist and are key to achieving greater settlement efficiency.

According to DTCC's internal data most transactions leveraging an automated central matching platform are matched and agreed on execution date. On average, over 90% of all EMEA cash securities transactions that utilize automation are fully allocated and matched on execution date. At the same time, leveraging a central SSI repository

can provide increased transparency and automation while significantly reducing trade failure. This is because all respective market participants seed the SSI data, access the SSI data and enrich the data from a single source, in an automated fashion.

#### The need for standardization

In addition to the automation opportunities, the lack of standardization in post-trade processing should also be an area of focus in the UK and EU. Currently, there is no uniform identification reference added to transactions that persists throughout a transaction lifecycle. Securities markets should look to how derivatives markets solved this problem with the introduction of Unique Transaction Identifiers (UTIs) for trade reporting purposes. The UTI allows transaction identification to happen near instantaneously and creates greater visibility across the transaction chain. This enables quicker identification and resolution of bottlenecks or settlement lifecycle issues, while reducing operational risks and costs arising from potential settlement fails. The introduction and increased use of standards, such as the UTI, supports the facilitation of accelerated settlement cycles globally.

Understandably, settlement inefficiencies and risk receive a significant amount of attention from financial market infrastructures and regulators. Considering current levels of interest rates globally, the cost of settlement failure has also increased and has a significant impact on client processing from a risk, funding and even balance sheet perspective.

Introducing greater levels of post-trade automation and standardization can increase settlement efficiency, paving the way for accelerated settlement and reduced risk across the region while modernizing and advancing the industry's capabilities. There is no better time than today to advance these conversations.



## HAROUN BOUCHETA

Head of Public Affairs and  
Chief of Staff for Company  
Engagement & General  
Secretary, Securities  
Services - BNP Paribas

### T+1: does the EU really have to follow the US?

There is a clear trend at global level to accelerate settlement cycles for cash instruments from the global standard of two business days following the trade date (T+2) to one business day following trade date (T+1).

For jurisdictions where the move to T+1 is already mandated, like the US, the industry should support such a move to actively contribute to local systemic improvements, increased levels of automation and straight through processing.

Having said that, it is a fact that in some jurisdictions the overall environment notably with regards to the market structure could justify that such a move should be carefully assessed. In the EU, the move would imply not only operational and legal challenges but also significant costs and concerns on settlement efficiency.

The fact that ESMA is currently assessing the costs and benefits of a potential shorter settlement cycle in the EU is a good way to move forward but is also an

opportunity for the industry to reflect upon the following points.

#### 1. Should we simply move to T+0 settlement?

A move to T+0 - either on an end of business day basis or atomic - would require a much more fundamental change than moving to T+1. The legacy infrastructures and technologies would indeed probably not support such an extensive overhaul and therefore it would imply to be able to reshuffle the whole environment to suit a T+0 settlement.

In addition to this significant technological challenge, legitimate questions could be raised as to whether a move to atomic settlement is desirable. It could imply limited possibilities of netting and the need to prefund each individual trade and result in prohibitively high liquidity and funding costs, negatively impacting the economics of the securities industry.

#### 2. Is a shorter settlement cycle in the EU a competitiveness issue?

Cross-border transactions and international investors are directly impacted when settlement cycles are reduced to only one day as all post-trade processes need to be completed in limited operating hours with the additional constraints of different time zones. Among the main impacts, FX transactions, stock loan returns, corporate actions, global products with components from markets moving to T+1 (ETFs and depositary receipts) as well as time to get executed trades allocated/confirmed/affirmed/instructed are some of the biggest challenges. In addition, the choices made by the EU for a better settlement efficiency through a settlement discipline regime need to be part of the equation.

**We should avoid the situation where a rush to move to T+1 ultimately hurts EU firms and EU markets.**

There can be large differences in the volumes of cross-border transactions into different markets. In the case of the US, which is by far the most impacting market for Europe, the US Treasury shows that 19.6% of all securities and 16% of equities are held by investors outside the US (roughly half of these 16% are held in Europe). The UK is also a very

important market for Europe given the close links between both markets.

The US move to T+1 is expected on 28 May 2024 and the UK is also currently assessing the opportunity of shortening its settlement cycle. Does it justify that the EU speeds up the process and decides to move to T+1 having in mind competitiveness concerns?

The EU should not rush any recommendation to move to T+1 and should take the time to evaluate in detail the ratio of benefits versus costs, and in particular in terms of attractiveness and competitiveness for market participants, local and international investors, and the EU itself, while scrutinizing the US move and any development happening in the UK.

We should avoid the situation where a rush to move to T+1 may result in a massive misallocation of EU resources (human and capital) that could ultimately hurt EU firms and EU markets given the magnitude and costs of the project. In other words, moving to T+1 would not contribute per se to the competitiveness of the EU and to the CMU nor would it give any competitive edge to EU financial markets and EU players.

#### 3. What should be the next steps?

From a cross-border perspective, my view is that in addition to material implementation costs, any rush to move to T+1 in the EU or in the UK may result in exacerbated settlement market inefficiencies (more fails) coupled with a potential loss of liquidity. This risk is increased by the market fragmentation in Europe.

The EU needs to wait for the ESMA report on the costs and benefits. Also, the specificities of the EU should be considered such as its complexity and fragmentation and the associated costs for EU firms of any project to shorten the settlement cycle. This report should also incorporate elements from the US post-implementation and see what lessons can be learnt.

In addition, coordination between jurisdictions and especially within the same region should be encouraged to reduce any impact on operational processes and market liquidity. In other words, we need a truly open dialogue not only between the EU and the UK but also between the EU and jurisdictions where T+1 is mandated.

## RETAIL INVESTMENT STRATEGY



### STÉPHANIE YON-COURTIN

MEP and ECON Coordinator for the Renew Europe Group - European Parliament

## Why the Retail Investment Strategy can and should be the next CMU building block

Jacques Delors rightly said that the liberalization of capital movements required more European cooperation, to attract outside capital and increase our financial strength. We need to build on his legacy. But if our internal market has been up and running for 30 years, why are we still lagging behind with our Capital Markets Union (CMU)?

Although the need to ensure its completion has never been higher, we reflect each year on the same issues with yet little solutions to face them. Our markets are still fragmented and highly overbanked compared to other economies like the US. In addition to this, financing needs have never been higher. With an annual investment gap of 620 and 125 billions euros respectively for the green and digital transitions, we know that public money

will not suffice. Furthermore, current demographic evolutions increasingly raise the question of private financing solutions for pension schemes.

Building the CMU will require a long-term effort to achieve durable change. Legislation will only be one part of it, but nevertheless it has a decisive role to play. This is why we need a Retail Investment Strategy (RIS) at EU level, to tackle one of our most important challenges, which is the lack of retail engagement in financial markets. The work of EU legislators, notably the work I carry out as Rapporteur on the file in the European Parliament, is an opportunity for us to rethink the current system, putting ourselves in the shoes of European citizens. What hurdles do they face? What drives their investment decisions? This is the moment to identify the regulatory do's and don'ts.

My goal is to achieve a text that both, promotes a more protective and attractive financial environment for citizens, while ensuring its feasibility for market actors. Because to ensure durable change, we need everybody on board.

If our approach is ambitious, the impact of the RIS will be two folds. Not only will we optimise the current "traditional" investment environment but also we will seize current opportunities to create the next CMU milestone.

### The challenges of today represent an opportunity for building tomorrow's CMU.

Improving our current framework is one of its main objectives, which translates into making it more attractive and ensuring sufficient safeguards for citizens. This is done through multiple means. First, if almost 50% of Europeans still rely on financial advice, banning inducements would be counterproductive. Instead of cutting citizens' access to advice, let's address the issue in a targeted manner (transparency, better quality of advice, safeguards). Second, we need to ensure an ambitious value for money framework that gives supervisors better means to act, holds companies accountable, and ensures feasibility for market actors. Third, consumers need to be better protected

on national and European levels when they invest their money. This goes through giving more powers to national competent authorities. Forth, it is time for us to ramp up financial education on national level. The RIS is the perfect channel to set ambitious rules in that regard. These measures will be a game changer on the long term for citizens, giving them the tools and more trust when making their financial decisions.

But if we want to build the CMU, addressing current flaws is not enough. We need to adapt to a new world, where the fight against climate change, an increasing digitalised society, the need to secure our strategic autonomy, has become our new reality. Those challenges come with massive financing needs, for which we don't have any durable solution yet. This is why the RIS represents a huge opportunity.

The challenges of today represent an opportunity for building tomorrow's CMU. Younger generations are more socially, environmentally and politically engaged. A study showed that half of the respondents were more likely to invest in products financing the green transition. But if our continent is leading with its green financial agenda, and if there is demand for it, why are we not promoting it properly? This will be tackled in the RIS. In addition, digitalisation has taken over our societies in many areas, including finance. While it undeniably brought new opportunities to build our CMU, those come with risks and younger generations are the most vulnerable to them. If "traditional" financial advisors are subject to strict rules, "financial advisors 2.0" or so called "influencers" cannot fall through the cracks. The responsibility lies on us to ensure a framework that protects young consumers online, if we want them to continue engaging in finance through digital means.

All those elements show that the RIS can and should be the next CMU milestone. Today our system failed Europeans, that still are unwilling to engage in financial markets. The RIS is thus a now or never opportunity to build our CMU, by improving our current environment and seizing today's new challenges.



## GUILLAUME BÉRARD

Advisor, Policy Department -  
Financial Services and Markets  
Authority, Belgium (FSMA)

### RIS: a complex matter which deserves a more nuanced debate

The proposed Retail Investment Strategy (RIS) aims, as the name itself indicates, to increase retail investment in EU capital markets. It is part of a broader policy initiative aimed at enhancing the Capital Markets Union and creating the conditions to make EU capital markets as dynamic as in the USA.

The objective pursued is not an easy one. There are various reasons why retail participation in the EU capital markets remains (too) low. Those can be cultural or fiscal in nature, or, indeed, the result of regulation. The RIS is therefore proposing to modify the regulatory framework in order to allow for increased retail participation. Tangible effects are expected to appear in the medium term at the earliest.

Just as the issues it is trying to tackle, the RIS is complex and has a wide-ranging scope. It affects different parts of the retail investment journey.

An important objective of the RIS is to reduce the current fragmentation of the landscape. The fact that investor protection rules are currently set

out across different sector-specific legislation (mainly MiFID and IDD) adds to the complexity. The Council therefore decided, right from the beginning, to follow a topic-by-topic approach rather than discussing each instrument separately. This approach has the advantage of consistency among those texts. As far as possible, there should be similar rules in place irrespective of whether the services are provided via credit institutions, investment firms or insurance undertakings/intermediaries.

The debates at the Council have been constructive and insightful but given the complex and sensitive nature of the matter, more discussion is needed. While the co-legislators have not yet determined their respective negotiating positions, we have already seen and heard some strong voices on both sides. Opposition has been (loudly) voiced, for example against the proposed partial ban on inducements, one of the most talked-about elements of the proposal.

It is important to inject greater nuance into the debate. One should never forget as well that enhancing retail participation also means building trust. The proposals contained in the RIS require a careful assessment and we should try to ensure that the debate around those proposals remains as objective as possible and includes sufficient technical nuance.

The proposed RIS contains several important and complex measures which are interrelated and need to be assessed simultaneously. It is true that the proposal provides for numerous delegated acts. In many instances, this is motivated by the technical nature of these proposals.

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**It is important to  
inject greater nuance  
into the debate.**

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However, it remains important to find an appropriate balance here. First, essential parts of the framework should always remain in the level 1 text, while the level 2 texts should focus strictly on technical aspects. Second, we should be conscious of the fact that delegated acts mean, in many cases, a longer timeline, since those texts often require preparatory work by the ESAs and stakeholder consultations, and the relevant technical details should be available in a timely manner before the texts enter into application.

An area where delegated acts will be of particular relevance are the proposals on Value-for-Money, especially those

concerning the relevant benchmarks. This is one of the main novelties of the RIS. It is important to get it right, as this will have an impact on the products proposed to consumers. Some of the important questions that the concept of Value-for-Money raises and that will need to be properly answered to enable the system to work include: how will similar products be defined? How will the benchmarks be set up? What reasons should be deemed acceptable to deviate from the benchmark?

In order to make the Value-for-Money proposals workable in practice, many methodological issues need to be answered. It would not be possible, however, to incorporate every detail, for instance on product clustering, in level 1. This is an area where level 2 texts are more appropriate and where the expertise of ESMA and EIOPA will have an important added value.

In conclusion, I think that we need to be optimistic and always look for a way forward. Although it will not always be easy, we should not abandon this aim. The Belgian Presidency will therefore further build on the very useful work done by the Spanish Presidency. Tackling conflicts of interest, increasing cost transparency, and clarifying the Value-for-Money process are important topics on which we should try to bring meaningful changes, to the benefit of European retail clients.



## MARIE-ANNE BARBAT-LAYANI

Chair - Autorité des Marchés  
Financiers (AMF)

### The challenges of designing benchmarks for retail investment products

The Value for Money (VFM) framework proposed in the Retail Investment Strategy is among the topics that have sparked the hottest debates so far.

Every year, ESMA's report on the performance and costs of EU retail investment products points at retail products whose net returns are below zero once costs are deducted. This suggests some poor practices in the markets and room for useful legislative action.

To address the risk that some products may not always offer sufficient value for money to investors, the proposal therefore seeks to make firms accountable for the cost structure of their products. The product governance obligations of firms is enhanced with a new mandatory pricing process. The aim is to encourage firms, both at the product design phase and during the product lifespan, to carefully assess the level and nature of each cost component.

The pricing process is introduced horizontally in all relevant texts (MiFID2, IDD, UCITS and AIFMD) and aims to apply to manufacturers and

distributors alike, in broadly similar terms. This is highly commendable. As retail investors are exposed to several layers of costs (including for advice and distribution, and the cost of the insurance wrapper where the product is distributed through insurance packages), focusing the benchmarking exercise on manufacturers only would be seriously flawed.

As such, the new VFM rules consist of a two-step approach. In the first step, a firm is expected to identify and quantify all costs and assess whether they are justified and proportionate. This applies to the entire product range. It should not be contentious, as many firms already perform such assessment. The second step requires a firm to identify within its product range those products that may not offer value for money to clients and perform additional scrutiny on such "outliers". Since access to comprehensive cost data for comparable products from competitors may be challenging, the policy choice is to organize the filtering on the basis of centralized benchmarks which ESMA and EIOPA will develop. For that purpose, a large-scale reporting of cost, performance and risk data for all retail financial products available in the EU will be established.

It is fair to say that this second stage is the focus of many debates. It does face challenges that the co-legislators will have to address.

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**Focusing the  
benchmarking exercise  
on manufacturers  
only would be  
seriously flawed.**

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First, according to the proposal, benchmarks combine costs and performances. The use of performances raises difficulties, especially if these are absolute performances. If the intention is to consider as outliers those funds with the lowest (absolute) performance and the highest costs, then the exercise is likely to capture 'false positives', namely funds exposed to those economic sectors that performed the worst over a given period. In other words, market effects will pollute the identification of outliers. Performance may be used as a criterion to build peer groups, among other criteria, and to justify the proportionate nature of product costs. It should however not be used in a benchmark alongside costs to identify outliers.

As for the composition of peer groups, the exercise seems set on a course to create pan-EU groups of similar products. Still, does it really make sense to consider in the same peer group products which are distributed in totally different EU markets, through different distribution channels? Considering instead peer groups of products distributed in the same market would appear more relevant. There is a case for developing national benchmarks, not pan-EU ones, if one wants to avoid biased comparisons.

The draft proposal suggests that benchmarks would not necessarily be developed for all types of retail investment products. Yet, one might expect that the more one strives to make relevant peer groups of similar instruments that are granular enough, the more one runs the risk of ending up with a very high number of peer groups, insufficiently populated and of scarce statistical relevance. There is obviously a trade-off here.

Overall, the contours of the VFM mechanism will greatly depend on a methodology which remains unknown as it will be developed in Level 2 delegated acts. Such methodology will involve decisions on key parameters with wide-ranging consequences for firms' practices and for investors. If the VFM is to hinge on centrally-produced benchmarks, then more safeguards and clarity deserve to be set out in the omnibus directive on all the aspects above. This would secure the process and avoid years of potential messy implementation.

Besides, it is essential that a "proof of concept" be developed first as various methodologies are possible. Not only should they be assessed against each other to identify possible false positive and negatives, but a test-and-try phase should be provided in the law to ensure that biases and shortcomings are solved before firms are exposed to the full responsibility of complying with the new VFM rules.



## ALBAN AUCOIN

Head of Public Affairs -  
Crédit Agricole S.A.

### A missed opportunity for the European Union

The European Commission (EC) has proposed a Retail Investment Strategy (RIS) aimed at ensuring that retail investors can take full advantage of capital markets, in line with the objective of “an economy that works for people”. However, this proposal will miss its target.

The first reason is that retail investors can only take advantage of capital markets investment opportunities in a fully functioning Capital Markets Union (CMU). Unfortunately, scant progress has been achieved in this area during the current mandate. As a result, the RIS will not foster a CMU, but, at best, fuel 27 small capital markets, with limited new opportunities for retail investors.

Second, we need a RIS that makes it easier to invest in the EU economy to finance the green and digital transition. Europe has no lack of financial resources but it does lack physical investment, especially in sustainable projects. According to ECB balance of payments, the eurozone has a growing net positive International Investment Position of more than EUR 350 bn, meaning that we export our savings to finance the rest of the world. We need to channel EU savings towards investment projects in the EU; what the RIS will do is export retail EU savings more and foster investment abroad.

Third, one of the EC’s aims is to promote ETFs - funds that replicate market indexes. Not only does this goal overlook the fact ETFs are already developing and largely accessible to retail investors, it also potentially undermines the objective of increasing the EU’s strategic autonomy. Indeed, more than 60% of ETFs distributed in the EU are sold by American asset managers, who mainly sell indexes on US securities. The share of EU issuers in equity funds varies significantly by country: while it is 69% for funds domiciled in France, it is only 12% for those domiciled in Ireland, where most US asset managers operating in the EU are located. If ETFs are not composed mostly of European assets, they will mostly benefit investment abroad.

Fourth, the EC’s RIS proposal is likely to enhance consumer protection only for the wealthiest investors, to the detriment of the majority, who will lack appropriate guidance.

Indeed, one of the main obstacles to retail financial investment is a lack of financial literacy and risk culture. This means that most consumers need personal advice. However, the EC favours a partial ban on retrocessions, as a staged approach to a full ban. These retrocessions mainly finance advice, which has a significant cost. In countries that have banned retrocessions, such as the UK and the Netherlands, only the wealthiest consumers still have access to advice. Indeed, independent advice is proportionately much more expensive for small investors, who generate little inducement.

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**It is high time to  
focus on building a  
RIS that promotes  
the protection of the  
majority of consumers.**

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Savings in the EU are highly concentrated (30% of households account for 70% of savings, the median savings amount is 11 k€), especially for financial products, with 10% of households accounting for two-thirds of such investments in France, for example. Independent advisers will remain affordable for the wealthiest retail investors, while the majority, with very limited financial literacy, will be unable to pay for advice and will have to fend for themselves. In European jurisdictions with fee-based models, such as the United Kingdom and the Netherlands, net fund sales between 2013 and 2022 decreased substantially compared to other EU countries. So for

most consumers, this reform will not make it easier to invest.

Fifth, today there are different distribution models: with or without advice, in-branch or on-line, fee-based or commission-based. These models coexist and savers can choose freely between them based on both their income and wealth and their financial knowledge, with open competition between models. Consumers are not tied to their bank; they can go wherever they want. Banning most inducements would be a distortion of competition through regulation, calling into question the universal and relational banking model in favour of the transactional, brokerage model. We believe that reducing competition and an administered economy are invariably detrimental to consumers and to growing investment. Such measures would result in an advice gap, well documented in countries that have already banned inducements.

Sixth, banning inducements would entail a major reduction of the number of bank branches (-70% in the Netherlands in ten years), irrespective of differences between individual countries and consumers’ preference for personal relationships.

Last but not least, the proposal includes administrative benchmarks that put the emphasis on costs and do not take into account the actual qualitative elements of the products and services provided to retail investors. Such an approach would further reduce choice without adding benefits for investors.

It is high time to focus on building a RIS that promotes the protection of the majority of consumers, that really finances the EU economy and that allows open competition in a market economy.



## CHRISTIAN STAUB

Managing Director Europe -  
Fidelity International

### Balancing investor protection and competition: assessing the RIS

The Retail Investment Strategy (RIS) proposed by the Commission aims to enhance investor protection and foster competition in the European market. This strategy includes several well-intentioned approaches, such as the harmonisation of disclosures and the strengthening of consumer protection by prioritising the value for money (VfM) proposition. While these initiatives are commendable, it is vital to ensure, during the ongoing negotiations in the European Parliament and the Council, their effective implementation and consideration of the needs and expectations of investors, as well as potential unintended consequences.

A comprehensive evaluation of value for investors should extend beyond cost considerations. While cost management and appropriate disclosures are important, it is equally crucial to address other factors that impact investors' outcomes. These factors include performance outcomes, the quality of services provided, sustainability outcomes, and effective risk management. By adopting a broad perspective, the RIS can provide investors with a comprehensive value proposition that aligns with their needs and expectations.

It is therefore essential to define VfM as investor-centric outcomes that can be measured both quantitatively and qualitatively, rather than just as a cost equation. In the process, we must also be conscious of the different participants in the value chain, particularly the complementing roles that product manufacturers, distribution platforms, and distributors play. Finally, the fact that value for money is being overstressed may have the opposite effect of what policymakers want to achieve by undermining confidence in the whole financial system.

It is also necessary to carefully evaluate the potential consequences of the proposed ban on inducements for non-advised and discretionary managed services. Its impact on competition, particularly in the emerging digital investment platform sector, may undermine the very competition that the Commission aims to encourage, potentially limiting innovation and choice for retail investors. Implementing a ban before providing a credible alternative for investors to access advice would be a missed opportunity and risk suboptimal outcomes in the name of customer protections. Striking a balance will ensure that competition remains vibrant and innovative, while also safeguarding the interests of retail investors by providing a diverse range of investment options and opportunities to understand the implications of their decision making.

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**A comprehensive approach will provide investors with a well-rounded value proposition.**

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Maintaining a healthy and competitive European financial market is essential for our economy; any changes to established European funds with global recognition and success must be approached with caution. While it is important to regularly consider ways to improve our systems and operating models, it is also essential to recognise their strength and the positive impact they have had on retail investors. In line with the aim of the RIS focused on empowering investors, enhancing their trust in financial services firms, and ensuring they are protected, it is of the utmost importance that we maintain equilibrium between investor protection (OR what matters to investors) and fostering competition. It is a delicate task and should not be an afterthought.

To support the successful implementation of the RIS, it is necessary for the Commission to provide clear guidelines and detailed explanations. Clarity and timely communication are crucial to prevent confusion and unintended non-compliance. Market participants need a clear understanding of their obligations to comply effectively and maintain confidence in the industry and capital markets. Additional clarity will also be required for the timelines of any changes that the industry can anticipate and innovate accordingly. Collaboration with relevant stakeholders, including industry experts, consumer advocacy groups, and regulatory bodies, can further strengthen the RIS and ensure its effectiveness.

In conclusion, the Retail Investment Strategy holds significant potential to enhance retail investor protection and further strengthen capital markets in the European Union. By addressing concerns regarding clarity and the potential overemphasis on cost, the co-legislators can ensure that the RIS achieves its objectives while promoting competition. Taking a comprehensive approach that considers various aforementioned factors will provide investors with a well-rounded value proposition.

Clear guidance, timely communication, and a balanced approach within the VfM framework will support the successful implementation of the RIS, benefiting retail investors and contributing to the growth and competitiveness of the European economy.





## ALEKSANDRA MACZYNSKA

Executive Director -  
BETTER FINANCE

### Don't let conflicts of interest ruin our chance to turn EU savers into investors

Can a significant improvement be expected from the Retail Investment Strategy in terms of retail participation in capital markets, considering the approaches of the co-legislators?

BETTER FINANCE, the European Federation of Investors and Financial Services Users, welcomed the publication of the Retail Investment Strategy (RIS). Despite significant and regrettable opposition from the financial industry, the European Commission (EC) managed to incorporate elements in the Proposal that hold the potential to finally improve the situation for consumers. Now, over half a year later and with a slow progress on this file, we still consider RIS a once-in-a-lifetime opportunity to create a capital markets union that really works for people (and improves their financial well-being, as well as the competitiveness of the European economy). We acknowledge that the legislative proposal is not perfect (e.g. it lacks any significant ban on “inducements” – even for execution only investments – and doesn’t address the serious disclosure issues of the Key Information Document), but it includes several significant advancements.

Abundant research has evidenced the consumer detriment caused by the current state of the distribution system in the European retail investment market<sup>1</sup>. If we want to encourage savers to invest more in capital markets, we must reverse the status quo that has served individual investors’ interests very poorly. We hope that the co-legislators will prioritise the interests of consumers and will support crucial steps in the right direction, such as the ‘value for money’ framework and the very limited ban on kickbacks for non-advised – “execution-only” – sales. We hope that they will acknowledge the RIS’s potential to reshape the highly dysfunctional European retail investment market: widespread conflicts of interest interest pushing sales of highly packaged products instead of giving access to capital market instruments such as listed stocks, bonds and ETFs, inconsistent rules, and inadequate key product information.

**We must change the status quo as it has served individual investors’ interests very poorly.**

Unfortunately, many market participants still fail to acknowledge the problem and the co-legislators seem to be influenced by the industry point of view and less by long-term and pension savers’ best interest. BETTER FINANCE and other NGOs representing consumers read the European Parliament’s, i.e. “the EU’s only directly-elected institution’s”, draft reports with severe disappointment: effectively all crucial elements of the Proposal that were of genuine value to individual investors, to the environment and society, have been removed without presenting an appropriate alternative.

What are conditions for a successful implementation of the RIS?

BETTER FINANCE fully supports the EC’s RIS objectives: consistent rules, enhanced retail investor protection, unbiased advice, competitive financial markets, and transparent and comparable product information. But for an appropriate RIS to be adopted and effectively implemented, the condition sine qua non is to first acknowledge the existence of a problem. Once this is achieved, the main elements of the proposal can be seen for what they really are: an attempt to solve the problem and not pure “controversies”.

Since being an individual investor is not a full-time job, we need urgently:

1. access to good quality independent advice, i.e. competent financial advisors whose advice is beyond doubt in the interest of their client,
2. value for money, and in case something goes wrong,
3. access to an EU collective redress mechanism.

For instance, advisors should assess and recommend products based on their capacity to meet the investor’s specific objectives and needs, selecting the most cost-efficient products among those deemed suitable, in line with the risk profile. Investors want advice, not a sales pitch: they are in dire need of a clear distinction between ‘sales of’ and ‘advice on’ investment products. To this end, the terms ‘advice’ and ‘advisors’ should be reserved for situations where a professional is remunerated by its client for researching and selecting the most suitable and cost-efficient products.

If adopted and implemented, the RIS has the potential to facilitate long-term investments by EU citizens. Supplemented with other measures on both EU and national level, like learning from best in class (e.g. Sweden) and adapting successful solutions, providing the right incentives and removing the barriers, it can finally connect people with their savings and the economy, turn them from long-term savers into investors and enable them to profit directly from the economic growth<sup>2</sup>. This long-term outlook is the very reason why trust as well as cost and performance of retail investment products are the core issues that need to be addressed if we want to increase individual investors’ participation.

1. See, e.g. BETTER FINANCE’s “Evidence Paper on Detrimental Effects of Inducements”
2. For the list of such measures please refer to BETTER FINANCE’s Manifesto (link)

## ASSET MANAGEMENT TRENDS AND CHALLENGES



### MARCO ZWICK

Director Executive Board -  
Commission de Surveillance  
du Secteur Financier (CSSF)

### Looking at some challenges and opportunities of the collective investment sector

Regulations impacting the asset management sector in 2024 include AIFMD II, ELTIF II, the current reconsideration of ESG/SFDR requirements, measures on fund liquidity risk management, the Retail Investment Strategy package, the Markets in Crypto-Assets Regulation (MiCA) and the Digital Operational Resilience Act (DORA). Even though this list of key regulations is not exhaustive, it provides a good indication of priorities of market participants and regulators/supervisory authorities.

These regulations and initiatives pursue some key objectives:

- Increasing the range of financial products available to retail investors, via the notable possible inclusion of alternative investment funds within the offering, such as European Long Term Investment Funds (ELTIFs) for example,

- Ensuring investor protection,
- Managing fund investment risks individually and avoiding systemic risks emerging from the collective investment sector,
- Further strengthening the control frameworks operated by IFMs, with a specific focus on operational and information technology risk management and resilience.

They impact the way how regulators interact with and monitor market participants and their product offerings, by using new and more efficient technology and communication channels to collect, analyse and manage data as a basis for a risk-based supervision. This presupposes the identification of the key risks impacting the collective investment sector, such as liquidity, credit, ESG/sustainability, asset valuation, leverage and information technology risks having been identified as most relevant and still increasing risks impacting investment fund managers (IFMs) and the investment funds they manage.

Market, operational and contagion risks are assessed to remain unchanged for the time being. As part of their prudential supervision, regulators assess and control the internal risk management frameworks operated by IFMs and monitor the emergence and evolution of macro-economic and systemic risks as well as other external risks facing organisations. Considering the latter, geopolitical tensions, the rise of interest rates, economic uncertainty causing volatility, climate change and investor protection considerations have contributed to setting the regulatory agenda, specifically in terms of supervisory priorities adopted at European level in terms of liquidity risk management, asset valuation, costs and fees and ESG/sustainable finance.

Economic and market developments continue to impact asset managers who regularly adjust product designs and investment strategies by putting an even greater emphasis on risk-adjusted returns, in response to increased market uncertainty as well as investor search for yield and need for capital protection. Both institutional and retail investors demonstrate an interest in ESG investments. On the investment side, asset managers more often rely on new technologies to improve their investment process and capability, by creating new products using artificial-intelligence-powered solutions and algorithm-based trading.

On the fund distribution side, asset managers consider the opportunity of implementing new technology to improve the safety and cost efficiency of their operations and cross-border distribution channels: the use of blockchain technologies, the implementation of cyber-security measures and the tokenization of investment fund shares and units just being examples. This is of particular importance in a sector where profit margins from product offerings decrease and where investments are needed at the same time to develop and support business activities and operations. This is to say that the increased costs currently borne by asset managers do not only stem from compliance obligations, and that they are or will be the result from strategic IT investments which are essential to make companies more robust and sustainable in the years to come.

**Regulatory initiatives are meant to support the offer of new financial products to a wider clientele.**

In addition to leaner and enhanced operational processes, the rationalisation of investment fund ranges and increased cross-border distribution contribute to a targeted international product offering by adopting efficient cost and risk management processes. In this context, the European passport which facilitates investment fund distribution of UCITS and ELTIFs within European member states is crucial to make this type of financial products available to investors and thereby guarantee their access to a variety of investment strategies.

The good functioning of the passport sets the foundation for the success of UCITS as well as for the “retailisation” of alternative investment funds such as ELTIFs. Alternative asset classes, such as private equity, real estate, and infrastructure, are expected to play a more prominent role in investor portfolios, offering diversification and risk-based investment performance. Regulatory initiatives are meant to support financial innovation including the offer of new financial products to a wider clientele in a transparent and safe mode.



## JÉRÔME REBOUL

Head of the Regulatory Policy and International Affairs  
Directorate - Autorité des Marchés Financiers (AMF)

### Upcoming priorities: ELTIFs, macroprudential rules and sustainable finance

New Year started with the long awaited entry into application of the ELTIF2 Regulation. ELTIFs represent a real opportunity for retail to diversify their investment portfolio, and have access to more long-term investment options to finance their retirement for example. It is also good news for EU economies as ELTIFs will be a source of long-term financing to support economic growth and the real economy and even the energy transition. The AMF welcomes the domiciliation of ELTIF2 in France.

ELTIFs may become the privileged retail vehicle used to invest in the so-called private markets, which historically have produced a higher yield than investments in public markets. That higher performance let us not forget, was in return of no access to the investment before the end of the fund's life. ELTIF2 tries to reconcile the higher performance and possibility for investors to access their investments.

As a product for retail, ELTIFs have to meet in full their liquidity promise made to investors. This requires an appropriate balance between the liquidity offered and the holding of liquid assets. The higher the redemption frequency offered to investors, the higher the liquid assets ELTIF should hold. This is the basic principle of fund structuring that i) will ensure that retail will receive their proceeds as promised; and ii) reduces the chances that ELTIFs will have to sell assets at a substantial discount in times of stress or only meet redemptions partially.

This second element is quite relevant in what could be a priority for the next Commission: a macro-prudential framework for investment funds, as part of the Non-Bank Financial Intermediated sector. The AMF believes that a combination of ex-ante requirements on leverage and liquidity (such as the above-mentioned principle in fund structuring), and the effective use of liquidity management tools, in particular anti-dilution tools, could already be the main elements of that framework.

In terms of data, a single comprehensive report, such as the reviewed AIFMD and new UCITS reports, to be shared by securities market regulators and central banks will significantly facilitate the supervision of the sector by both set of supervisors, while reducing operational costs for asset managers.

The last element of the framework could be the creation of a consolidated supervisory approach for large asset management groups. The objective would be, within a supervisory college, to globally assess the appropriateness of the group's risk management framework and have an understanding of the overall risk exposures of the funds managed by the group. This format will continue to foster the dialogue between securities market regulators and central banks to ensure the resilience of the sector.

Another priority should be to simplify and streamline the Sustainable Finance regulatory framework. In particular, we advocate for a review of the Sustainable Finance Disclosure Regulation ("SFDR") with a focus on:

- i. the creation of product categories and elimination of articles 8 & 9;
- ii. simplification of disclosures to ensure retail investors can actually understand them; and
- iii. the elimination of disclosure requirements at entity level.

The AMF has always welcomed the Commission's leading role in developing a regulatory framework that aimed to

channel capital to sustainable activities and finance the energy transition. We have to recognise, however, that the current rules do not facilitate retail investors' understanding of product claims on sustainability nor allow product comparability. Furthermore, the ambiguity in the rules have, in some cases, hindered supervisors from fighting and sanctioning greenwashing.

To facilitate the decision-making process for retail, the rules should be clarified and simplified. We advocate for the creation of a limited number of simple product categories relying on objective minimum criteria. These categories will not seek to be labels of excellence for the best sustainable products. Instead, they will ensure a minimum level of contribution to the different objectives of each category. These categories should also be used as a base for the MiFID questions to investors on their sustainability preferences.

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**As a product for retail, ELTIFs have to meet in full their liquidity promise made to investors.**

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In order to streamline the framework, the AMF proposes to introduce the same disclosure for all investment funds on how managers integrate sustainability risks in their investment decisions, as well as an assessment of the likely impact of those risks on their products' return. In addition, the funds within any of the categories should make some additional disclosures to justify that categorisation.

Our last proposal for the SFDR review is to use the Corporate Sustainability Reporting Directive as the legal text that regulates the disclosures for entities and to consider SFDR as a regulation only for product disclosures. This will eliminate the overlaps and facilitate the understanding and compliance with both texts.



## IVAN PASCUAL

Head of EMEA iShares & Wealth distribution - BlackRock

### Attracting investors: the keys to a thriving investment landscape in Europe

Asset management and collective investment vehicles are fundamental tools that have allowed individuals to deploy their savings efficiently to achieve their financial goals. Europeans however have on average lower participation in financial markets, compared to more mature markets like the US; this might affect, over the long-term, their financial well-being, and overall economic stability.

Yet for citizens to invest, it is key that the European investment landscape remains attractive and conducive to increased participation, across both healthy supply and demand dynamics.

On the supply side, a key strength of the European fund market is its broad offering of a very diverse set of products, instruments and providers. Preserving choice and encouraging product innovation are two key traits of a thriving investment sector.

The EU's regulatory framework plays an important role in ensuring these two attributes. For example, the UCITS regulatory framework serves as a world-class model of a legal vehicle that enables access to a diverse funds

universe for retail investors across and beyond Europe, whilst preserving a high level of investor protection.

Similarly in the alternative investments space, the evolution of the European Long-term Investment Fund (ELTIF) Regulation – and all the accompanying level 2 technical standards – will be essential to channel much needed long-term capital to Europe's small- and mid-sized, unlisted companies and democratise retail investors' access to a new asset class with attractive long-term returns, that is mainly being offered to institutional investors today. The rollout of the ELTIF 2.0 framework in 2024 is a positive step. To make sure its potential is fully realised, leaving room for future product innovation, technical standards on redemption terms will need to adequately balance investor expectations and liquidity risk management concerns.

Building investors' confidence, encouraging their participation and stimulating the demand side, is equally crucial. Here, our experience has shown that transparency, ease of access and education are the keys to a thriving retail investment market.

There are different levers to support a transparent, easily accessible funds market. Beyond regulation, which has certainly helped create cost transparency and reduce barriers to investing, Wealth Managers play a fundamental role. They support the retail investor journey and help savers to find investment solutions to support their immediate needs, their long-term goals and financial wellbeing.

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**Transparency, ease of access and education are the keys to a thriving retail investment market.**

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In addition to traditional Wealth propositions, Execution Only and Digital platforms have played a pivotal role in encouraging European investors' participation, in recent years. They offer a broad range of products with low barriers to entry, intuitive interfaces, and a low cost, democratising access to products and portfolio solutions. These platforms also encourage regular and long-term investment programmes, that benefit not just citizens but also contribute to the economic resilience of Europe. For example, in recent years, Exchange-Traded Funds (ETFs) and ETF savings plans, have catalysed the

interest of new investors, facilitating the shift from saving to investments. Often, such platforms also provide end-investor with educational material, and absorb trading, custody, and execution fees to minimise total cost of ownership. At end-September 2023, an estimated 7,6 million ETFs savings plans had been subscribed to in Europe – an encouraging number that is expected to quadruple by 2028.

For these propositions to continue to grow and attract new investors, it is crucial that the regulatory framework continues to preserve and support their economic viability, while preventing conflicts of interest in proposing solutions to end investors.

In conclusion, fostering an ecosystem that supports innovation in the investment industry is crucial for positioning Europe as an attractive destination. The regulatory framework must enable innovation and contribute to increasing the attractiveness of the European funds market. ELTIF serves as an example of how regulation, technology, and product design can align successfully. It is important therefore that existing and upcoming regulatory frameworks focus on supporting scalability and the use of technology so that investment vehicles can be adopted increasingly by investors, at a lower cost. As investor participation grows, maintaining a broad offering with ease of access will be vital for the sustained attractiveness of European investment vehicles.



## ANN PRENDERGAST

Head of EMEA, Executive Vice  
President - State Street Global  
Advisors Europe Limited

### A thriving EU investment fund sector is needed for a self- sustaining Capital Markets Union

Ahead of the next European Commission's mandate, and with the legislative agenda pausing during the European elections, it is a good time to consider what role the EU investment fund sector can play in the next phase of the EU Capital Markets Union project. A lot has been said and done in the past years on CMU but its central goal has still not been fully grasped: that of incentivising savers to invest in capital markets as they plan for their future. A thriving investment fund sector can offer two key solutions: it can represent a channel for long-term risk capital, and it can act as a means of empowerment for retail investors and savers. Let's start with the latter.

ETFs saving plans have been the perfect example, and a very popular one, of how our industry can continue to innovate and drive long-term wealth accumulation among new investors and outside traditional distribution channels. Germany has been at the

epicentre of a considerable growth: from a mere 150 thousands saving plans in 2014, the market has surpassed 7 billion at the end of 2023, for a combined EUR 15 billion of savings volume. Consistent growth is expected to remain strong in the coming years, reaching EUR 64 billion of new investments by 2028<sup>1</sup>. These plans have been popular especially among younger investors, who resort to neobrokers in their investment process, driven especially by the low costs of execution. The result is that, thanks to digital wealth platforms, retail investors can become self-directed investors and their savings are turned into new investments, thus bringing more capital into EU financial markets.

This continues the long tradition of ETFs as a vehicle that has democratized the way investors access capital markets. Looking ahead to future developments, index funds and in particular ETFs, continue to be characterised by a high level of innovation, further increasing investor choice and market accessibility. ETFs are evolving rapidly and their latest transformation is characterized by "actively managed ETFs", with a growing number of traditional active funds managers converting their mutual funds structures in ETFs. This responds to a demand from investors for lower fees and the ability to access more frequent portfolio updates compared to the more traditional mutual fund wrapper.

The development of the retail markets in Europe should be further encouraged, especially by considering ways to increase retail investors' access to ETFs at the point of sale. Here the Retail Investment Strategy should play a key role in supporting retail participation through these emerging ETFs trends, especially by safeguarding the low-cost execution models of digital engagement and distribution channels. The Retail Investment Strategy can also be an opportunity to build on the positive developments that we are seeing in local capital markets. Replicating these best practices across the EU would create a virtuous circle of investors participation in financial markets, fostering a bottom-up approach to capital markets integration.

At the same time, the fund sector can help in maintaining a steady flow of long-term capital into European private markets. The EU has a strong track-record in creating well-regulated and attractive investment fund structures, as demonstrated by the UCITS and AIFMD regimes, but has so far been less successful when it comes to facilitate investors access to private markets. In this regard, the promise around the revival of the ELTIF structure must be followed through in legislation, with

simplification and ease of accessibility being key for increased visibility, liquidity and uptake of the product.

A self-sustaining Capital Markets Union must rely on deeper sources of long-term risk capital, and this cannot ignore a further development of the pension markets in Europe through the realisation of European initiatives, such as the Pan-European Personal Pension Product, and the promotion of best practices at Member State level, as for example the implementation of auto-enrolment which can drive up pensions savings and increase investable capital.

**For a thriving fund  
sector the EU must build  
on digital distribution  
channels and investor-  
friendly products.**

To conclude, it is also important to continue fostering among investors a high degree of confidence in markets and in the fund sector. Regulatory initiatives should be careful in not framing the sector solely as a source of risk, nor should they make it the target of specific additional macroprudential regulation. In the past years, both regulators and fund managers, have been undertaking extensive efforts to increase the resiliency of the sector, ensure investor protection, and reduce the risks of propagating shocks throughout financial markets.

However, a sense of balance must not be lost, and over-restricting the financial intermediation capacity of investment funds can come at the price of preventing the positive added value that the sector offers to the economy in terms of financing opportunities. If anything, Europe needs more capital markets, not less.

1. *ETF Savings Plan Market in Continental Europe, published by extraETF Research, September 2023.*



## MATTHIEU GROSCLAUDE

Chief Operating Officer,  
EMEA - Invesco

### The EU has an opportunity to ‘walk the talk’ on capital markets

The upcoming European elections offer a useful opportunity to reflect on the progress made over the past decade under the EU’s Capital Markets Union (CMU) agenda.

To date, the EU’s efforts to develop a true single market for capital have done much to develop the regulatory framework governing market functioning and transparency, public listing, supervision, and, of course, investment management and product innovation.

However, while household savings and investment rates in the Euro area are trending slightly above pre-pandemic levels<sup>1</sup>, they have remained lower in recent years than in other developed economies including Australia, Japan, S. Korea, Switzerland, and the United States<sup>2</sup>.

With the EU’s green and digital transition plans estimated to cost around €645bn per year through the next political cycle and beyond<sup>3</sup>, and as public spending remains under pressure, it is clear that more needs to be done to mobilise private capital in Europe.

So, as policymakers begin to consider the next steps for progressing the CMU agenda, appropriate attention must be

given to implementing policies that are truly effective in:

- engaging and empowering a more diverse investor base in Europe;
- fostering a more proactive culture around long-term investment and retirement planning;
- facilitating greater participation in both public and private markets; and
- maximising the visibility and attractiveness of investment opportunities in Europe.

Making meaningful progress towards these goals is essential and will require EU policymakers to ‘walk the talk’ on developing capital markets.

For example, we commend the European Commission’s efforts to coordinate Member States’ initiatives to improve citizens’ financial literacy, and to develop financial competence frameworks for citizens jointly with the OECD. We believe that such initiatives can truly be brought to life through the institution at Member State level of financial health checks where citizens are encouraged to assess and understand their financial health at key stages in their life, in much the same way as they do in relation to their physical health, and to plan accordingly.

Improving citizens’ financial literacy will enhance their ability to take positive action in relation to their longer-term financial health, whether it be saving for a rainy day or life after retirement. As highlighted by EIOPA<sup>4</sup>, citizens are having to take greater responsibility for their long-term financial health, so policymakers must provide appropriate mechanisms to empower them.

In this regard, policymakers should seek to improve the availability of and access to best practices in relation to auto-enrolment savings plans at Member State level, as identified by the European Commission<sup>5</sup>. If closing the pensions gap remains “top of the agenda”, as EIOPA states, effecting positive change in this policy area represents a necessary step forward.

Further, as citizens look to make their money work harder over the longer-term, it is also vitally important that Europe gets its investment offer right. This includes, in our view, ensuring access to a broad range of investment opportunities and vehicles, including private market assets such as corporate credit and real estate, in a manner which ensures an appropriate level of

protection while offering exposure to potentially higher returning assets.

The EU’s recent legislative review of the ELTIF Regulation was certainly an improvement in this regard. However, some regulatory implementation issues remain to be resolved, including in relation to fund strategy and distribution, in order for the ELTIF to truly maximise its potential for all investors. In short, in order to ‘walk the talk’, the EU’s political ambition regarding the development of a true single market for capital – and all of its component parts – must be matched by regulatory reality.

Right-sizing the ELTIF Regulation represents one opportunity from the current political cycle to achieve this objective. Similarly, from a public markets perspective, ensuring the effective roll-out of a consolidated tape of record for market data that supports end-investors, and improves the transparency and attractiveness of EU capital markets, is another.

**The EU’s political ambition on capital markets must be matched by regulatory reality.**

The bigger picture, however, is ensuring that such holistic policymaking is carried through to the next political cycle and in the development and, crucially, implementation of the CMU 3.0 agenda.

Being effective in engaging and empowering investors, facilitating access to wide-ranging investment opportunities, and increasing the transparency and attractiveness thereof – in particular opportunities in the EU – is the only way policymakers will develop a true single market for capital in Europe and, more broadly, attract the private capital required to fund the bloc’s wider green and digital transition plans to the benefit of its citizens.

1. Eurostat, Jan 2024
2. OECD, Jan 2024
3. European Commission, Mar 2022
4. EIOPA, Nov 2023
5. European Commission, Nov 2021



## SIMON JANIN

Head of Governance and Public Affairs - Amundi

### Developing long-term investment products is key to finance the European economy

At the heart of the European Union (EU) capital markets lies a pressing challenge, where a significant portion of long-term savings remains locked in unproductive deposits, accounting for 44%<sup>1</sup> in 2022. This weighs on European economy, not only by limiting companies' access to diversified funding sources, but also because savers' earnings are not optimised. To address this enduring situation, the EU must develop - or improve - policies in key areas of persisting barriers. This is essential to efficiently support long-term investments along with mobilising more private financing towards the green and digital transitions.

Among these main barriers is the fragmentation of the European market. Despite the flows of EU legislations and the numerous initiatives of the European Supervisory Authorities, there still remain too many divergent applications and interpretations among Member States, together with gold-plating practices, that hinder the confidence of market players. This could be rationalised, through better harmonisation and coherent interpretation of EU legislation. Furthermore, asset managers are still required to duplicate many functions in different Member States, in order to

comply with the requirements of local supervisors. This creates additional burden and costs that go against the objective of encouraging more cross-border operations, and should be tackled. For instance, the concept of European group could be recognised, with the establishment of a single set of rules applicable to these EU groups to avoid unnecessary costs and delays.

It is also essential to foster more engagement of retail investors in capital markets, along with more long-term investments in EU companies. The precondition for this is developing financial education, all the more in the European context of predominant risk aversion. Financial literacy allows individuals to make informed financial decisions and better plan their future, and is thus a prerequisite for enhancing their participation in capital markets.

The second condition is to maintain easy access for all European citizens to effective and affordable advice, to support them in their investment decisions. In the context of current discussions around the Retail Investment Strategy (RIS) proposal, it is essential for the EU to avoid impairing the current distribution model by banning retrocessions, and avoid the unwanted consequences experienced in the UK, where the 2013 total ban on inducements resulted in insufficient access to advice for the vast majority of retail investors.

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**There still remain too many divergent applications and interpretations among Member States.**

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The third condition is to foster long-term investment products. The RIS also regrettably introduces a primary focus on costs, to the detriment of any other qualitative criteria or characteristics of the products that are essential for the long-term interests of retail investors. This cost-centric approach would lead to a reduction in investment products offer and especially those with ESG characteristics, which are built on enhanced expertise. In this respect, the European Long Term Investment Fund (ELTIF) is a great example of product that can be distributed to retail investors and gives them access to long-term investments. However, ESMA has recently proposed<sup>2</sup> level 2 measures forcing a high level of liquidity requirements, which will penalise the

return on investment, but also limit the pool of investment channelled towards long-term projects.

When setting the priorities for the new political cycle, it is essential for the Capital Markets Union's success that the EU focuses on rendering regulation consistent, developing pan-European investment solutions to finance increasing retirement needs. The support of tax incentives to steer savings in these directions is an additional important element to be considered.

Redirecting retail savings towards local businesses requires also competitive European market players, which in turn need regulatory stability and consistency. Given that predictability is important for both businesses and investors, it is essential to preserve the rules that have already proved effective, such as the UCITS framework.

Last but not least, adopting coherent legislations all along the investment chain, in which asset managers operate, is essential for efficient financial markets and investors' confidence. As such, some areas of the financial market ecosystem are still insufficiently regulated. This is the case in particular of non-financial data - notably needed to meet growing regulatory constraints. In this regard, the current proposal to unravel the legislative framework applicable to the vast majority of benchmarks, including ESG benchmarks, is a point of concern.

Addressing these issues effectively would strengthen the financing of a sustainable growth of the European economy and develop its strategic autonomy, as well as ensure that both EU businesses and citizens benefit from it.

1. *EFAMA Fact Book 2023*
2. *ESMA final report on ELTIF Regulatory Technical Standards - 19 December 2023*

## PENSION AND LONG TERM SAVINGS GAP



### PETRA HIELKEMA

Chairperson - European  
Insurance and Occupational  
Pensions Authority (EIOPA)

### Building on past initiatives to address growing pension gaps

Europe is facing substantial pension gaps. These are expanding due to an ageing population and evolving labour markets characterized by more fragmented and dynamic career paths. The shift from defined benefit (DB) to defined contribution (DC) places greater risk and choice on individuals.

According to Eurobarometer data from July 2023, only 45 per cent of Europeans are financially confident in their retirement—37 per cent of women and 47 per cent of men—making the gender gap evident. Most EU citizens fully depend on statutory pensions for their future retirement income. Only 23 per cent participate in an occupational pension scheme and 19 per cent own a personal pension product. Citizens with a supplementary pension feel more financially confident in retirement than those without one (53 compared to 37 per cent).

The development of capital-funded pensions can contribute to reducing pension gaps, while increased pension savings support the Capital Markets Union. They are a source of capital to finance the long-term growth of the real economy and its green and digital transition.

The European Commission has taken steps to increase coverage of occupational and personal pensions. These include commissioning a study on best practices and performance of auto-enrolment systems, and requesting technical advice from EIOPA on pension tracking systems (PTS) and pension dashboards as well as on the review of the IORP II Directive. Additionally, the PEPP Regulation started to apply in March 2022, paving the way for the new voluntary EU-wide personal pension scheme for people to save for their retirement.

There is scope for these initiatives to be further developed during the next political cycle.

Firstly, transparent information on retirement income generated by national pension systems is essential. Requiring Member States to establish a PTS covering all three pension pillars would enhance citizens' awareness of their future retirement income. In addition, a pension dashboard at the European and Member State level is essential to support policymakers in monitoring the adequacy and sustainability of pension systems and in closing pension gaps. EIOPA is ready to support the Commission in its development.

Secondly, to increase coverage of supplementary pensions, the EU could consider requiring Member States to introduce a system of auto-enrolment, where occupational pension saving is not yet mandatory, as citizens do not save enough by themselves.

Thirdly, improving the effectiveness of existing EU pension regulation is important. This includes assessing whether the conditions for providing PEPPs (Pan-European Pension Products) are viable in this developing market. Broadening the scope of the PEPP regulation to include occupational pensions would constitute another improvement, as there may be a greater demand for occupational than personal pension solutions at a pan-European level. EIOPA's advice on the review of the IORP II Directive should

be implemented as to better protect members and beneficiaries of IORPs.

Last year the Commission launched its Retail Investment Strategy (RIS), proposing to impose additional requirements on financial institutions to better protect retail investors. However, personal pension products tend to be excluded from the scope of retail investment products in EU regulation, such as the IDD and PRIIPs Regulation. While the RIS may strengthen existing requirements in the IDD for certain long-term savings products in the field of life insurance, in most Member States it does not ensure that personal pension products offer value for money. In addition, some types of private pension providers fall outside the scope of EU regulation. In some Member States the same financial institutions provide privately managed pensions across all pillars, including those in scope of the IORP II Directive.

**More transparency and greater trust in supplementary pension saving is key to closing pension gaps.**

A more balanced approach would increase trust in supplementary pensions. A first step would be to enhance EIOPA's remit beyond IORPs and PEPP, thus allowing it to make a supervisory assessment of all financial institutions that provide private pensions and of the value for money offered by all supplementary pension plans and products.





## JOS HEUVELMAN

Member of the Executive Board - Dutch Authority for the Financial Markets (AFM)

### Effective public policy and consumer focused products can close the pension gap

The Dutch second pillar pension is consistently ranked as one of the best in the world. Dutch retirees have among the highest living standards of retirees globally and old-age poverty is relatively rare. In this article, I will outline factors of our second pillar's success and possible solutions for the pension gap, looking at both the supply and demand side.

The first reason for this success is that pension saving is in many cases mandatory for salaried employees. While this takes away individual choice for pension savers (such as monthly premiums, how it is invested, which pension fund), it does solve inadequate pension saving resulting from inertia, 'presentism' and ordinary people's general lack of interest in pension affairs.

The second reason is our state-of-the-art pension tracking service. With a few mouse clicks, people can look up simple, instantaneous, and clear information about their accrued pension rights, and what they can expect in retirement - aggregated from all pension sources in the first and second pillar.

While Dutch occupational pensions are currently undergoing fundamental reforms, the large-scale, collective, and mandatory nature, high levels of protection and information provision will remain cornerstones.

Challenges, however, are on the horizon across Europe and, indeed, much of the world. Aging populations, low interest rates and decreasing expected returns across Europe are creating a gap between pension income that will be required and that is available. State social security systems become strained and occupational and private pensions are not always sufficient. EIOPA estimates that one in five EU citizens runs the risk of old-age poverty.

At EU level, various initiatives have been taken. EIOPA has provided excellent advice on pension dashboards and tracking services, which increase the information position of policy makers and citizens about pension adequacy. The European Commission has published a study about best practices in auto-enrolment in pension schemes. The Retail Investment Package aims to increase accessibility and attractiveness of Europe's capital markets for ordinary investors. The PEPP regulation has been passed several years ago.

By themselves, these initiatives are unlikely to solve the problem. Better information does not necessarily lead to better behaviour. Good products do not always attract customers: the take-up of the PEPP has been very limited so far.

More must be done, but the problem is as difficult to tackle as it is urgent. There are two directions from which the pension gap can be addressed. One is from the supply side: are retirement products accessible? Do they offer value for money and do they meet citizens' needs? The other is from the demand side: people dislike thinking about pensions altogether and put saving off until it is too late. They may simply not earn enough to put money aside.

On the supply side, supervisors and policy makers need to keep working at solutions for pressing problems: the financial industry has successfully lobbied against the European Commission's efforts to tackle the harmful effects of inducements. That has not made them any less harmful. Many products that are being used for retirement purposes are too expensive, hollowing out long-term returns for ordinary people and failing to fulfil one of the capital markets' core tasks vis-à-vis citizens. Providing a secure and adequate retirement income for ordinary citizens is a key function of financial markets. Too often, financial products and services are not up to the task.

On the demand side, we need to minimise the effects of negative behavioural tendencies (such as inertia, present bias, loss aversion) while boosting financial literacy and interest in financial markets. It would be a good idea if consumers would do a 'financial health' check every couple years or at major life events. Financial advisors, supervisors and financial literacy initiatives all can play a role here. In the Netherlands, the AFM is working together with the sector and government to develop ideas for a 'periodic financial overview'. This can help become people more aware of inadequate pension savings and other personal financial risks.

Another positive development that builds on behavioural finance insights is EIOPA's recommendation to the European Commission to introduce requirements in relation to IORPs choice environments.

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**Providing a secure and adequate retirement for citizens is a key function of financial markets.**

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The truth, however, is that the real solution to the pension gap is closely intertwined with tax, social and labour policies, which are mostly decided nationally. Member states may find it difficult to give up autonomy in these domains in favour of a European solution. Making it mandatory for every citizen to save for old age (which is not the case in the Netherlands, contrary to popular belief), either at the national or European level, would be the most effective policy option as a back-stop to close the pension gap but carries trade-offs between interests that are inherently political.



## MIQUEL MAGEM AMBROSIO

Global Head of Sales and Distribution - Allianz SE

### The long-term savings gap in Europe and the priorities to address it

#### The scenario that we will face

In the next 30 years, EU countries will be challenged to sustain the standard of living of their retired population. Currently, replacement rates (calculated as a percentage of pension income in comparison to pre-retirement salary income) in most EU countries are between 60% - 80%. But those ratios are based on having a dependency ratio of 3, meaning that there are 3 workers under 65 contributing to provide the pension of every above-65 retiree.

Eurostat projections show that dependency ratios in Europe will decrease from 3 to 2 (by 2050) due to low birth rates and the retirement of a large part of the workforce. As a result, replacement rates will decrease further and current public pension models will not be sufficient to keep adequate levels of pre-retirement standard of living. This will be further exacerbated by a very probable increase of personal contributions to health systems, due to the same effects.

We will need to turn to private savings for retirement. But surveys indicate

that almost 40% of Europeans are not saving for retirement beyond public contributions, mainly due to a lack of interest and knowledge. Additionally, the investment of savings in financial instruments by Europeans is for example less than half than in the US. Those two data points show a lack of financial literacy and awareness of the future challenges among vast majority of the EU population.

#### Priorities to change the trend

The long term solution to that problem will require a combination of several actions in the EU countries, involving both public and private sectors. The most relevant measure will be to drive an increased level of private savings - to be built individually during working tenure - and a more efficient leverage of those savings by investing them in financial instruments that generate adequate returns.

#### IBIPs product variety and insurance distribution models are key to address the long-term savings gap.

The proposed Retail Investment Strategy (RIS) aims to address the long term savings gap problem, evolving current insurance and asset management regulatory frameworks (inter alia IDD and MiFID) to motivate a higher participation of retail investors in the financial markets. That could be achieved through providing higher transparency to customers, strengthening products' competitiveness, ensuring a fair advice model, and leveraging on digital transformation in retail investment distribution. At the same time, beyond customer protection regulation, an increase in the financial literacy of the population is also a priority for the EU Commission.

#### The importance of insurance based investment products and insurance distribution models

The existing diverse life insurance products landscape supports the objective of long term savings building by retail customers. There is a variety of Insurance based Investment products (IBIPs) which are designed to cover any specific customer needs. Key dimensions in this context are holding period, risk profile - expected return, and any cover providing additional protection to the customer (e.g: mortality, longevity, morbidity).

On the other hand, the current insurance distribution model is also conducive to the aforementioned goals. Insurance intermediaries play a key role in regard to awareness generation and professional advice. Distributors are a very important player to make customers aware of the need to start saving regularly from an early age, based on their personal relationship with customers and their extensive footprint (in cities but also rural areas). Those distributors are already today required to act only in the best interest of customers providing tailored advice based on their expertise and assessing the suitability of any product to customer's needs. As such both current IBIPs product variety and insurance distribution models are key enabling factors to increase participation of retail investors in the financial markets and fulfil the objective of RIS.

#### Private and Public sectors should join forces to enhance financial education

Future higher customer protection ensured by regulation, and the awareness of the savings gap promoted by insurers and intermediaries will not be enough to turn around the observed trend. The most recent Eurobarometer survey on the level of financial literacy in the EU shows that only about a quarter of the respondents answered at least four out of five questions on financial knowledge correctly. The results are particularly concerning as they point to the need for financial education to target in particular women, younger people, people with lower income and with lower level of general education, i.e. those segments of the population most concerned by the future long term savings gap. Hence, the development of financial knowledge for all generations should become a political priority of EU member states. Coordinated programs among members states are needed with the insurance and asset management sectors standing ready to support such initiatives and joining forces with the public sector to build the desired financial knowledge.



## MICHELE RENDINE

Group Chief Life & Health  
Officer - Assicurazioni Generali

### Mind the pension gap! A way forward

European Governments are facing unprecedented challenges as their population is ageing rapidly and is expected to start shrinking by 2026. By 2070, over 30% of the EU's population is expected to be over 65 years old, and with it, the expenditure of age-related public services, including pensions, healthcare and long-term care, is expected to experience a significant increase. The challenge is exacerbated by the contraction in the working-age population, the reduction in saving propensity, especially among the younger generations, and the uncertain socio-economic developments.

If not properly and timely faced, the widening of the pension and long-term savings gap may hamper the social stability of the European continent, with systemic effects on the well-being of the European citizens. Notably, the persistent gender pension gap, whereby European women receive on average 30% less retirement income than men, poses an additional concern exacerbating these challenges.

Governments must focus on formulating public policy options to mitigate this gap, whilst exploring the role of insurance-based investment products as potential solutions.

The multitude of different factors affecting the widening of the pension

and long-term savings gaps require a multifaceted approach, involving several stakeholders making simultaneous progress in various areas towards the same goals:

1. Promoting financial literacy: according to the 2023 OECD International Survey of Adult Financial Literacy, European countries display heterogeneous results, with some of them showing alarmingly low scores. Without the proper level of awareness and competence, European citizens cannot make informed decisions. The collaboration between public and private sectors is crucial to launch specific educational programs, also embedded in the school system, aimed at improving the understanding of the different saving options and the related risks.
2. Nudging individual ownership: the sustainability of public pension schemes is under strong pressure in several European countries; for this reason, citizens must be stimulated to take personal responsibility for their retirement planning. This implies encouraging individuals to start saving for retirement since the beginning of their professional career and make adequate and consistent contributions throughout their working life. In addition to pension dashboards, public authorities should provide clear incentives, such as tax benefits, for individuals following a virtuous behavior.

### IBIPs can play a decisive role in reducing the pension and long-term savings gap.

3. Leveraging technology and innovation: pension management can be a complex task, particularly daunting for the individuals lacking adequate preparation. Advanced digital tools and platforms, such as pension planners and simulators, can be used to increase awareness, accessibility and engagement with pension information. This could be particularly effective for younger generations, more used to acquire information and take decisions leveraging innovative technologies.

In this context, insurance-based investment products (IBIPs) can play a decisive role in reducing the pension and long-term savings gap: the main characteristics of these products, the

presence of multiple investment options and the financial security they might offer make them viable for all type of customers. In fact, these products are typically very flexible and therefore well suited for a wide variety of potential investors, addressing different type of needs throughout different phases of their life.

An additional benefit provided by IBIPs is the possibility to gain direct exposure to capital markets (i.e. through unit-linked funds), providing customers with a significant long-term growth potential and the opportunity to preserve their lifestyle during the retirement years.

Besides insurance companies, regulators and Governments also play a crucial role in promoting a savings culture among European citizens: all the actions targeted at increasing the level of transparency and promoting a more inclusive approach through common standards, such as the CMU, RIS and IORP II review, can help increase the level of confidence and trust of customers, and hence their propensity to save with a long-term perspective.

The Retail Investment Strategy is a prime opportunity to make the EU a safer place for citizens to invest in the long term and to encourage participation in EU capital markets. The industry is ready to contribute meaningfully to the debate to enhance consumers' trust in the capital markets. More digital solutions will better serve customers and will continuously improve advanced advisory services.

In the current challenging times, regulators should ensure a level playing field for all financial service providers, in order to safeguard an efficient competitive landscape for the benefit of all European citizens.



## AGUSTIN REYNA

Director, Legal and Economic Affairs - The European Consumers' Organisation (BEUC)

### Mind the gap - The importance of saving for our twilight years

In today's uncertain economic climate, saving for a rainy day – whether for a pension or long-term savings – is more important than ever.

But for consumers, knowing where to invest can be tricky. In an investment product? Or maybe a guaranteed pension plan? What about crypto? It is easy to get lost in the overwhelming amount of information which is too often unreliable or inaccurate. That is why access to reliable and independent advice is so crucial.

#### Ask the expert

Financial systems are complex, so getting help from an expert for important decisions is the rational thing to do. But for that, we need experts available to help consumers. In medicine, you can speak to a doctor, for legal issues you can find a lawyer. In finance, this is not the case. When you approach a financial institution or any other so-called “financial advisor” for advice in most of the EU, you are actually talking to a sales representative. This person receives commission to sell products like life insurance or funds.

The higher the commission, the more attractive a product is to sell. The problem is that this translates into costs, reducing net returns for consumers. However, returns are the very purpose of an investment, especially for pension plans. This means that our market is suffering from adverse selection, the worst products are the easiest to distribute, which means the failure of the sales system negatively impacts product design.

#### Paying for bad advice

In our campaign “The Price of Bad Advice,” BEUC showed how harmful and detrimental conflicts of interest in financial advice can be to consumers. In almost all EU countries consumers have been affected by mis-selling scandals that led to significant financial losses. And this is just the tip of the iceberg. A recent study from the University of Regensburg used OECD data to measure the harm of inducements to consumers in the EU per year: a staggering €375bn. That is how much money households are losing because of the current system. Similarly, the European Commission's Directorate General for financial services (DG FISMA) found that retail investment products are 25% more expensive for consumers than products for institutional investors. This is unacceptable.

**We must establish genuine competition on product quality to create fairer private pension markets.**

#### A question of trust

Consumer surveys show people do not trust capital markets and financial advisors and that trust is a major factor in market participation. Consumers also keep much of their money uninvested, which could be used to finance the transition towards a more sustainable economy.

This is not a problem of transparency: what would consumers who receive bad advice do? They can accept it and take the loss in opportunities. They can get bad advice from a different seller with the same result. They can try to become financial experts, but few have the time to study very complex regulations. Or, too often, consumers disengage. Any meaningful reform will have to break this market power, to allow for fair competition on product quality.

#### Consequences on pensions

Both underperformance of investments and disengagement contribute to the pension gap on the demand side. The extent is notoriously difficult to define, however. There are differences by gender, by age, by country, socioeconomic status and it's partially a matter of definition: how much is too little? Finally, it may not be in all authorities' interest to spell out the size of the problem which is why there is a wide body of scientific literature on the subject which agrees on one point: We have a major problem.

#### Time to fix a broken model

The European Commission is well aware of the problem and has taken some steps to address it in its recent Retail Investment Strategy proposal. Unfortunately, due to heavy industry lobbying, the proposal fell short of taking appropriate action, which would require banning inducements and establishing a body of truly independent advisors. However, the proposal does contain measures that may improve the consumer experience. For example, the ban on inducements in sales without advice (for example, when consumers choose their own products online and only need an intermediary to follow through on their decision) or the Value for Money approach to improve product quality via supervisory intervention.

Decision-makers must now choose whether they want competition at the product performance level or if they want to support those offering higher commissions to sell the worst products. It is not possible to have both.

#### Finding the right balance

Ultimately, to fix the broken retail investment market, we need to fix the imbalance between vested interests on one side and consumers on the other. Doing so will help establish genuine competition on quality and create more efficient and fairer market outcomes for both consumers and society.

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## PRIVATE RISK SHARING AND TRANSFER: THE ROLE OF SECURITISATION



### FAUSTO PARENTE

Executive Director - European  
Insurance and Occupational  
Pensions Authority (EIOPA)

### Insurance regulatory framework for securitisation

The securitisation market in Europe, while smaller than pre-2007 levels, is now of higher quality and better regulated. Despite efforts to facilitate insurer and reinsurer investments through preferential treatment for Simple, Transparent, and Standardized (STS) securitisations under Solvency II, the appetite for securitisation investments remains low. Five years after the regulatory change, securitisations are an immaterial asset class for the average European insurer.

According to an analysis that the Joint Committee (JC) of the European Supervisory Authorities carried out in 2022, most insurers cite mismatched risk-return profiles and asset-liability management preferences as reasons for limited interest in securitisations.

The JC's analysis, based on responses from 98 European insurance and

reinsurance undertakings, stakeholder input, and an open consultation, aimed at assessing the impact of recent changes, especially the introduction of Senior Simple, Transparent, and Standardized (STS) securitisations in 2019.

The JC supports the objective of reviving the EU securitisation markets for insurers prudently. However, despite acknowledging the low participation of insurance undertakings in the securitisation market, the JC did not recommend changes to the current Solvency II framework for the prudential treatment of securitisation.

Concerning the key findings from the advice on the investment behaviour of insurance undertakings, approximately 12% of European standard formula insurers have investments in securitisation, with around 60% investing below 1% of their total assets. The introduction of STS securitisations in 2019 has not had a significant impact on insurers' investment behaviour. While 37% of respondents express an intention to increase securitisation investments in the next three years, the majority foresee no change. The Solvency II framework does not appear to be a significant driver for insurers' investment activity in EU securitisation, with preferences on risk-return profiles and asset-liability management.

**The appropriateness  
of the framework is  
likely to stay on the  
regulatory agenda.**

On the topic of the assessment of capital requirements, the evidence does not support a change in the calibration for securitisations meeting STS criteria or for the non-STs segment based on historical spread volatility analysis. The JC concludes that the current framework is fit for purpose, and no changes are warranted at this time.

Moreover, the analysis explores potential changes to the risk sensitivity of the capital calibration for mezzanine and junior tranches of STS securitisations and senior and non-senior tranches of non-STs securitisations. The JC suggested no changes to the existing framework due to uncertainties about their effec-

tiveness and the potential high cost, considering the low investment volumes and industry participation.

The European Commission sought an assessment of whether Solvency II could align with the Capital Requirements Regulation's securitisation framework. Also in that respect, the JC proposed no changes to the existing framework, citing concerns about increased complexity, uncertain effectiveness, and high potential costs.

In summary, the JC recommended maintaining the status quo within the Solvency II framework for insurers' prudential treatment of securitisation. The analysis indicates that proposed changes may not be effective or justified at this time, considering the complexity of the existing framework and the low volume of investments in the securitisation market by insurers. The survey carried out with (re)insurers as part of this JC work showed that the main drivers for them to invest are the risk return profile, the matching of the liabilities and the complexity of some of the products. These seem to prevent them from investing, rather than the capital requirement.

A more recent development is that the outcome of the Solvency II review might include a request to review the capital requirements for securitisation investments in Solvency II. Such a review could for example consider a more granular set of risk factors depending on the ranking of the securitisation tranches or differentiating different types of non-simple, transparent and standardised securitisation depending on their risks. Provided the availability of data, EIOPA stands ready to provide technical support to such a risk-based and evidence-based review.



## JON RELLEEN

Director, Infrastructure  
and Exchanges - Financial  
Conduct Authority (FCA)

### FCA supports a well-functioning and prudentially sound securitisation market

Securitisation is an important part of global wholesale markets. It is the process of bundling together loans and debt instruments (like residential mortgages or auto loans) and distributing the risk associated with them using a variety of investments that offer different tranches of exposures to investors. This means that they carry different levels of risks and reward to suit the appetite of different investors.

Securitisation is considered to have played a significant role in the Global Financial Crisis, due to insufficient transparency of the risk involved and the misalignment between investors' and manufacturers' interests. This created an impetus for reforms globally, with the introduction of criteria for simple, transparent and comparable securitisations by the BCBS-IOSCO, and the implementation of a new Securitisation Regulation in the EU and UK, in line with these international criteria.

The FCA believes that a well-functioning and prudentially sound securitisation market supports the real economy and can distribute risk efficiently across

the financial system. We acknowledge that compared to traditional financial assets, securitisation is relatively complex, making it more challenging to assess, measure and manage the risks and impacts of its interconnectedness with other markets. But we also view securitisation as a vital link between the financial markets and the real economy, facilitating funding, enhancing liquidity, and promoting economic growth. By providing access to capital and enabling risk sharing in the financial system, securitisation is pivotal in supporting lending, investment, and economic activities in various sectors. We therefore support a framework for securitisation that benefits businesses and consumers whilst ensuring the safety and soundness of the financial system.

We recognise that regulation is not necessarily the key driver in origination/investment choices by manufacturers and investors in securitisations, and that several other factors have significant impacts on securitisation market trends.

Firstly, macro-economic conditions drive both the amount of lending and the ability to issue securitisation. We have seen, for example, the significant drop in securitisation issuance during the recent pandemic.

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#### Clear and proportionate rules for the securitisation market will also support its growth.

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Secondly, the availability of alternative funding sources from Central Banks at relatively lower costs has decreased issuers' economic incentives to securitise. As Central Banks reverse quantitative easing, volumes in securitisation, particularly from banks, are expected to pick up. Additionally, in the UK, alternative funding sources are available, including covered bonds, which offer a secured long-term funding option at costs which are lower than the costs of funding through securitisations, irrespective of the macro-economic framework.

Nevertheless, ultimately, the FCA is of the view that clear and proportionate rules for the securitisation market will also support its growth because they help maintain market stability through appropriate management of, and sufficient transparency on, related risks. Market stability protects investors and consumers and builds confidence in the asset class.

With the Securitisation Regulation, the UK (and the EU) have sought to balance the needs of originators/sponsors with the protections of investors, aiming to address the harm identified during the Global Financial Crisis. A review of the regulation by HM Treasury in 2021 concluded that the regulation remains important to the functioning of securitisation markets in the UK but identified specific areas where improvements could be considered.

The UK authorities are in the process of making improvements through their work in transferring the Securitisation Regulation to the new UK regulatory framework. In particular, the FCA and the PRA are proposing rules which reflect a change from the regulation's provisions in order to provide greater clarity, improve the proportionality of the requirements, and remove unnecessary barriers to the issuance of – and investment in – securitisations, while maintaining appropriate protections for investors. In particular, because securitisation markets are international, it is important that we remove barriers to investment on a cross-border basis to promote the growth of a healthy and liquid global securitisation market. We must work together internationally to facilitate this while maintaining the appropriate guardrails.

Finally, the consideration of the environmental impact of financial activities has become commonplace in discussions of a future financial sector that supports an economy which is more sustainable. The FCA believes that a 'green' securitisation framework could support the transition to a sustainable, low carbon economy. While no consensus exists globally on what a green securitisation framework would look like, it could have the ambition of incentivising the use of securitisation as a method of refinancing green underlying exposures.



## CECILE NAGEL

Global Head of Corporate Trust - BNY Mellon

### Facing Europe's financing gap: the role of securitization

The EU has ambitious goals in green development, new technologies and SME growth. These goals require closing a funding gap estimated by some market sources to be as high as €700bn per annum for Europe's green and digital transition alone.

Yet traditional bank lending does not have the capacity to satisfy that need. Securitisation can play a much greater role in Europe's future economic landscape.

#### The potential role of securitisation

IMF data show under one-third of economic financing in Europe derives from Capital Markets compared to banks, versus over two-thirds in the U.S. In its Securitisation Data Snapshot for 2022, AFME identifies that in 2022 total European securitisation issuance was less than 10% of the size of U.S. securitization issuance, compared to 85% in 2008.

Regulatory action and investor appetite in the U.S. have helped securitisation flourish and provided financing beyond traditional consumer-facing asset-classes to receivables arising from, among others, data centres, fibre optics, mobile phones and infrastructure, and solar/wind farms.

A new European legislative cycle provides an opportunity to close this gap. As such, now is a critical moment to make securitisation a reliable mechanism for capital diversification. Doing so could deliver benefits such as investment diversification, credit risk distribution, market resilience and balance sheet efficiency.

#### The structural challenges

Policy makers and market participants learned many lessons from the events of 2008. More discipline around underlying assets and structures and more robust risk controls have already come into play. There is also a deeper understanding of the operationally stabilising effects provided throughout the investment lifecycle via the role of trustees, agents, and other similar institutional providers.

Further strengthening securitisation's post-crisis credibility - and realising its benefits - requires action from public entities and private market participants to achieve greater clarity and stability without limiting innovation.

Simple, Transparent, and Standardised (STS) criteria are one such mechanism. STS disclosure rules have already improved investor perceptions and will continue to spur confidence among investors. However, issuing parties must carefully manage their minimum risk retention requirements. Documentation and data quality also need to be addressed to avoid undue operational stress on issuers and their service providers.

Another relative European success story in recent years, helped by regulation including STS, has been the increasing use of Significant Risk Transfer (SRT) mechanisms by banks. As more banks and investors explore this approach, policymakers may wish to consider ways to streamline the current supervisory assessment process to manage increasing volumes, albeit without diluting standards.

#### The path forward

Forward momentum for securitisation hinges on further work from public authorities and private stakeholders.

**Policy-making:** Action on building a Capital Markets Union (CMU) is essential. The lack of an integrated market that explicitly supports securitisation is a significant gap. Securitisation and its regulatory framework should be high on the list of CMU priorities of the next European Commission.

**Issuance:** Aside from disclosure templates, private market stakeholders should also

consider whether more should be done to standardise rules, harmonise transaction documents, and rationalise post-issuance reporting and compliance. Doing so may alleviate complexities and expedite the issuance process while lowering the operational barriers that create friction for issuers and investors. Participants across the securitisation value chain should find agreement and put it into common practice.

**Investor access:** Investors need smoother inroads into securitisation. Institutional investors face stringent capital controls (e.g., Solvency II) that impact their participation. The critical question is how to recalibrate the capital framework without undue risk exposure. Expanding participation routes for individual investors (as envisaged by some regulators) may also help increase the size of Europe's capital market. However, retail investment creates challenges in managing amendments or defaults; it may be difficult to balance the interests of individuals and sophisticated institutional players. Both investors and trustees will need greater clarity on how to make this work.

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**Now is a critical moment to make securitisation a reliable mechanism for capital diversification.**

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#### The power of shared commitment

The potential future benefits from new and bolder policy changes are significant. Rebuilding market confidence is essential for making securitisation a larger element in Europe's capital markets. Important public policy steps have already been taken. The role of trustees and agents in providing confidence and operational stability for investors should also be recognised and supported. A larger role for securitisation can help drive sustainable growth and stability across the bloc.





## ALEXANDER BATCHVAROV

Managing Director -  
Bank of America

### EU CMU and EU securitisation: time to re-launch?

In 2023 EU securitisation (SF) issuance comprised: €70bn placed true sale, €110bn retained for repo and c. €150bn notional synthetic securitisations. In 2005, EU (ex-UK) issuance comprised €155bn of placed true sale and €116bn notional synthetic. To illustrate the economic impact, without multiplier and balance sheet effects: EU true sale SF was about 1.9% of EU GDP in 2005 and 0.4% in 2023, it offered €170bn of bonds in 2005 vs. €85bn in 2023. SF's contribution to EU economy today is much smaller, but much more needed, given the challenges of EU economic acceleration, digital and climate transformation, strategic autonomy in a multipolar world, etc.

Last 10 years, annual SF volume was about 0.4% in the EU GDP, 0.85% in the UK, above 2.0% in the US, c 2.5% in Australia. The average annual share of transferred loans (via securitisation or direct sales) in total bank balance sheet loans was about 1.8% in the EU and more than 10% in the US. US non-Agency SF issuance is almost on par with that of US Agency securitisation (\$700-\$900bn vs \$800-\$1,200bn p.a. recently). US Agency MBS (asset-backed un-tranched securities) are more comparable to EU covered bonds (CB) than to EU RMBS. EU CBs encumber more than €3trn of

resi mortgages on EU banks' balance sheets, while US banks have moved c €8trn out of balance sheet to the US Agency MBS market.

SF is not just a financing and risk management technique, but the main, often the only, technique that can offer:

- a conversion of illiquid assets into investable/tradeable securities accessible to a large diverse group of investors; smooth transformation of bank balance sheets from 'brown' to 'green';
- an increased velocity of bank balance sheet to induce more lending without generating need for expensive capital;
- simultaneous financing for a large number of small companies, e.g. EU SMEs, where financing through capital markets on individual basis is not possible or economically viable;
- a mobilisation of retail savings to direct to consumer and SME financing under EU economic priorities; access for corporates/sovereigns to the capital markets in times of duress;
- private sector solution to the ESG and climate risk dislocation in the insurance market;
- conduit for ECB monetary policy;
- support to transfer the credit risk of the large mortgage portfolios retained on banks' balance sheet to support their covered bonds, etc.

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**EU's 'securitisation stigma' narrative is non-existent in the rest of the world.**

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All that is along with funding against assets and risk transfer via notes with different risk profile to match different investors' risk preferences.

It is noted that securitisation is complex, but it is overlooked that the complexity arises from its application to many situations and assets. It is argued that the originate-to-distribute model is to blame for GFC but is forgotten that it is not only how the banks distribute the risk, but also how they originate the assets whose risk they shed. It suffices to compare EU and Australian resi performance with

that of the US, or of US consumer credit with US subprime resi loans.

The GFC and other crises clearly highlighted the need to differentiate among credit risk, downgrade risk due to exogenous factors and liquidity risk of SF instruments along their capital structure. Sadly, this is omitted in EU public debates. Almost-nil default rate and very small downgrade rate of investment grade tranches, better than corporate bonds, are rarely mentioned.

EU's 'securitisation stigma' narrative is non-existent in the rest of the world. It informed EU policy actions and led to the very onerous EU securitisation regulation (EUSR). It raised the cost of doing business and raised the barriers to entry for both issuers and investors. The STS framework has not met its goals. The number of EU market participants has not materially increase post EUSR. To illustrate the demand side: a typical STS EU auto ABS has 20-25 (35 active) vs. typical US auto ABS has 60-65 (over 200 active) unique auto ABS investors.

The EU intro of STS synthetics boosted volume along with private execution and no secondary market - the exact opposite of the US expected path given recent US regulatory guidance and related synthetic supply surge under way. Now AAA prime RMBS RAROC under solo Solvency II is nearly 11 times less than resi mortgages, 4 times less than equity, and about half of the charge for resi mortgages under CRR. AAA CLO RAROC under CRR is 30 times that under Solvency II. Despite evidence to the contrary, 'EUSR is fit for purpose' is often repeated.

The High Level Forum on EU CMU made many proposals in that respect, but their adoption is very limited to-date. We believe that time is of the essence for CMU and the challenges that the EU is facing now require urgent action. Action plans for short-term (disclosure, due diligence, policies realignment, synthetics, etc.) and long-term (Solvency II, CRR, LCR, etc.) changes are already drafted, but must be implemented quickly. Securitisation is key to both EU CMU and EU banking union: neglecting it puts these unions in peril.

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## EUROPEAN FINANCIAL STABILITY



### AGNÈS BÉNASSY-QUÉRÉ

Deputy Governor - Banque de France

## A resilient financial system in the face of rapid monetary tightening

The rapid tightening of monetary policy between 2022 and 2023 has not resulted in major financial instability in the European Union at this stage, despite exceptional levels of uncertainty. This resilience relies largely on the soundness of our banking and insurance sectors, reinforced by the European model of stringent regulation and efficient supervision and on an orderly pass through of monetary policy to the real economy.

The transmission of higher interest rates to non-financial corporates (NFC) and households results in increases of interest payments and lower financing flows. However, these impacts are gradual in countries like France, with a relatively high share of fixed-rate borrowing and a long-term structure of outstanding debt. While French NFCs are still highly indebted they have been able to absorb the deterioration of their interest coverage ratio so far and their credit risk remains contained overall. The number of corporate bankruptcies rose in 2023, but remained below its pre-pandemic average. Households also remain resilient thanks to the robust French home financing model and measures taken by the prudential authorities. As a result, French banks' asset quality remains stable.

However, vulnerabilities associated with non-financial sector indebtedness remain on the upside, especially for the most heavily leveraged participants, as the transmission of higher interest rates is ongoing. These vulnerabilities could be exacerbated in the event of an additional macroeconomic shock or if financing conditions tighten further.

Amid heightened geopolitical tensions and ongoing macroeconomic uncertainties, financial markets remain exposed to shocks especially if expectations of a soft landing of the economy, as reflected in equity and corporate bonds valuation, turn out to be overly optimistic. Moreover, volatility remains elevated on global bond markets. Notably, between the end of August and October 2023, long yields spiked before easing back, fueled by shifting monetary policy expectations and by a contagion from the US Treasuries market. Yet European sovereign debt markets have remained fully functional in this context of high volatility, with no signs of fragmentation across countries.

Overall, the absorption of ongoing normalisation of the Eurosystem's balance sheet (quantitative tightening) has been orderly so far. However, a localised market shock could strain the liquidity of some vulnerable non-bank financial participants, with potential side effects for the wider financial system. These

participants could experience significant financing needs in the event of a market shock, via margin calls or redemption requests, which could strengthen adverse market dynamics through forced asset sales. While the share of non-bank financing remains small in France, high interconnectedness between NBFIs and with the banking sector increase risks of contagion.

In a context of higher funding costs, French banks exhibit robust liquidity and solvency levels. They rely on a diversified funding base, as debt securities issuance represent 15% of funding, and deposits 60%, with a healthy balance between household and corporate deposits. Outstanding deposits are broadly stable, with significant reallocations into interest-bearing deposits. Reflecting this, liquidity indicators are not signaling vulnerabilities, whether at the individual or system-wide levels. Solvency ratios at French banks remain elevated, as confirmed to by the results of the European Banking Authority's 2023 stress-testing exercise. Euro area banks have enjoyed robust earnings growth, mainly due to wider interest margins, but uncertainties around earnings outlook have increased in a context of rising funding costs and slower lending dynamics. French banks got temporarily less of an income boost from higher interest rates than banks in other jurisdictions. Their net interest margin contracted slightly as the cost of their liabilities rose faster than interest income. However higher rates are expected to benefit them over the longer term.

### Markets risks remain elevated and could create liquidity stress for vulnerable NBFIs intermediaries.

Going forward, the financial system continues to face growing risks which call for close vigilance. NFCs and other real economy participants still have to absorb the remainder of the monetary policy pass-through and will face a slower growth environment. Markets risks remain elevated and could create liquidity stress for the most vulnerable non-bank intermediaries.

Banks and insurers are adapting to the interest rate environment thanks to their solid balance sheet structure but need to remain vigilant. On top of these cyclical challenges, the financial system still needs to step up its efforts to adapt to cyber and climate risks.



## KERSTIN AF JOCHNICK

Member of the Supervisory Board - European Central Bank (ECB)

### Financial stability under European banking supervision

European banking supervision was established to ensure that banks remain safe and sound and the financial system remains stable. The decision to grant the ECB supervisory powers was taken in the aftermath of a severe financial crisis which revealed that it was untenable for monetary policy to be managed at European level while banking supervision and resolution remained the preserve of national authorities. The single European supervisor was billed as the first of three pillars in a banking union that was meant to overcome the fragmentation of the financial system along national lines.

It's now been almost ten years since European banking supervision was established. So has the single supervisor delivered on its promise? And how can we adapt the financial stability agenda on the basis of what we have learned?

#### Resilient banks

Standard performance metrics for our supervised banks show that, in aggregate terms, they are now in much better shape than when they first came under ECB supervision in November 2014. The fact that this improvement has been sustained in spite of the large negative shocks that have hit the banking sector in recent years, including a global pandemic and the fallout from Russia's war in Ukraine, makes this development all the more remarkable.

In my view, the resilience of the banking sector can be attributed to two factors.

First, ECB Banking Supervision deserves credit for raising the common standard for the entire system. Various initiatives were instrumental in restoring confidence in the banking sector, including progressively lifting the capital bar faced by banks, focusing on reducing legacy non-performing assets and reviewing banks' internal models. These and other actions also mean that banks are generally in a better position to deal with external shocks when they materialise. It is also important to recognise that overhauling the Basel framework after the great financial crisis enabled these higher supervisory standards to be reached. This is why I believe that the revised framework has proven its worth – and also why it is crucial that the remaining Basel III standards are integrated into European law.

Second, when confronted with challenges on an unprecedented scale, both European and national policymakers have shown that they can act quickly and work together to respond appropriately to the severity of the situation at hand. Banks have also indirectly benefited from the support that was provided to the real economy, as this prevented the full impact of adverse shocks to growth from feeding through to their balance sheets.

#### Integration and crisis management

Over the last ten years, better regulation, more efficient supervision, well-capitalised banks and strong institutions have all helped make the banking sector more stable. While we should be pleased

with this development, we also know from our experience during this time that no two crises are likely to be the same. Thinking that past success is a reliable bellwether for future performance could be tempting, but it is ultimately foolish. We know that banks will continue to face a number of headwinds, as they are still adjusting to the recent sharp interest rate increases even as the near-term economic outlook deteriorates.

In order to further cement the resilience of our banking system, we need to foster the creation of a truly integrated banking market, refine our crisis management framework and address the gaps in our macroprudential framework.

First, we need to complete the banking union as originally foreseen. Advances in supervision and resolution under the first two pillars have helped weaken the links between banks and their sovereigns. However, as long as the third pillar – a common deposit insurance scheme at European level – is missing, there remains the possibility that the “doom loop” between governments and banks will resurface. Making progress in setting up the third pillar should also foster bank mergers across national boundaries, which have so far failed to materialise to any meaningful extent.

Second, the process for unviable banks to exit the market could be improved. The scope of resolution can be expanded to ensure that the failure of small and medium-sized banks can be addressed in a harmonised manner, and deposit guarantee schemes can be empowered to provide a wider range of crisis management options to address potential or actual bank failures. The recent proposals by the European Commission are a welcome step in this direction.

Finally, recent experience also suggests that policymakers will continue to be confronted with the question of how to ensure banks can use their buffers more effectively during a crisis, including by adjusting macroprudential frameworks to make these buffers “buildable” and “releasable” in a countercyclical manner.

1. Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (OJ L 287, 29.10.2013, p. 63).
2. For example, the weighted average CET1 ratio for banks supervised by the ECB increased by 4.7 percentage points between the fourth quarter of 2014 and the third quarter of 2023, while banks' liquidity coverage ratio rose by almost 29 percentage points, to 159%, over the same period. During this period, the NPL ratio of banks supervised by the ECB dropped by 6.1 percentage points, to 1.9%, in the third quarter of 2023, the latest quarter for which data are available.
3. This is also borne out by empirical studies. See, for example, Haselmann, R.F.H., Singla, S. and Vig, V. (2022), “Supranational Supervision”, LawFin Working Paper Series, No 50, Goethe University, Center for Advanced Studies on the Foundations of Law and Finance.
4. European Commission (2023), “Banking Union: Commission proposes reform of bank crisis management and deposit insurance framework”, press release, 18 April.



## MARGARITA DELGADO

Deputy Governor - Banco de España

### Navigating an uncertain and challenging environment

The crucial fiscal response to the outbreak of the COVID-19 pandemic led to significant increases in public debt levels among EMU member countries. The fiscal measures adopted since 2022 in response to energy and food price inflation have also contributed to maintaining the expansionary stance of this policy. Tighter monetary policy is increasing the cost of new public debt issuance, although its pass-through to the average cost of outstanding debt has been relatively slow due to the earlier lengthening of public debt maturity.

In any case, high public indebtedness represents a key vulnerability in the EMU, as it elevates cost sensitivity to potential new financial shocks and limits the fiscal space available. Thus, in 2024 European fiscal policies should generally adopt a tighter stance, within the new fiscal framework agreed by the Ecofin in December 2023.

Amid high inflation and rising interest rates, the debt servicing capacity of European households has been sustained by resilient employment, the recovery in real wages and the savings built up during the pandemic. In the case of non-financial corporations, the deleveraging in some countries following the global financial crisis (GFC) and the recovery in mark-ups after the pandemic have also helped to sustain their debt servicing capacity.

However, debt service-to-income ratios are being pushed upward and pressure could mount if downside risks to GDP materialise. Monitoring these risks remains a priority for financial stability authorities, even though markets are projecting lower interest rates.

At its meeting on 22 September 2022, the General Board of the European Systemic Risk Board (ESRB) pointed to the need for credit institutions to implement sound provisioning practices and capital planning and for EU and Member State supervisory authorities to monitor and address vulnerabilities, in close collaboration with each other and availing themselves of the full range of micro- and macroprudential tools. Since the ESRB issued its warning, very few of the identified risks have materialised, but the financial stability outlook is still uncertain and the warning remains relevant.

Over the period 2022-2023, the ESRB also adopted three recommendations on medium-term vulnerabilities in the residential real estate sectors of some countries, along with a general recommendation, adopted in late 2022, on vulnerabilities in the commercial real estate sector in the European Economic Area.

The ESRB has arguably acted in an overarching, proactive and pre-emptive manner, within its mandate, in response to an environment marked by extraordinary uncertainty. In terms

of delivering on its mandate, the current ESRB organisational model has proved equal to the challenge.

Turning to the broader issue of the sufficiency of the macroprudential framework in Europe, one aspect that stands out is the asymmetry in the tools available for banks and for non-bank financial intermediaries (NBFIs). The importance of NBFIs, from the perspective of systemic risk, has grown significantly since the GFC. As the ESRB warning also points out, prudential authorities must ensure they have the right macroprudential toolkit for each sector.

The recent period has been shaped by significant exogenous shocks to the financial system (e.g. the COVID-19 pandemic and the war in Ukraine). These have brought to the fore the discussion of whether to increase “macroprudential space” even beyond what would be necessary to address homegrown financial imbalances. It is argued that this could be achieved via a “positive neutral” countercyclical capital buffer (CCyB) rate, one that would be activated not only in times of excessive credit growth but also in normal times. Still work to do about the coordination of the conditions under which activation or release would take place. So far, activation of the CCyB rate is evaluated and determined nationally, but the ESRB can certainly play a helpful role by supporting and complementing the technical work undertaken by national authorities and acting as a hub for sharing experiences and identifying best practices.

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**In the current uncertain context, it is necessary to have sound provisioning and capital practices.**

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Finally, the build-up of risks in the real estate sectors of several EU countries also prompted the ESRB to recommend the development of common European standards for borrower-based measures. These macroprudential tools, available under the national regulations of most countries, help to bolster bank customer resilience and banks.

We need to consider whether common European criteria should be established for the design of such macroprudential tools, including to determine when and how they can be used.



## TANATE PHUTRAKUL

Chief Financial Officer - ING Group

### Let's cherish consistency and predictability as basis for our welfare

As a CFO thinking about the outlook, I monitor possible financial clouds that could be coming our way. Clouds can consist of interest rates, inflation and economic growth, but also of public policy, regulation and supervision.

#### **NBFI: regulate in a targeted, efficient and effective way**

One area where regulators have been very consistent, is in their increasing attention to non-bank financial intermediation (NBFI). This sector's role is easily underestimated. Compared to the US, the Eurozone is a bank-financed economy. Indeed banks are Europe's most important lenders and originators. Still, even in the Eurozone, almost half (48%) of business debt (loans and bonds) is held by non-banks. Even more striking: of the net business debt growth since 2008 in the Eurozone, 82% was funded by non-banks. So it is safe to say that NBFI play a crucial role in funding the economy in the Eurozone.

Yet, financial supervision, prudential in particular, remains focused on banks. Policymakers and supervisors build on what is already there, and the regulatory framework for banks is much more developed. Moreover, consistent regulation of a diverse sector like NBFI is complex.

So when thinking about NBFI regulation, the initial response by some is to regulate banks' exposure to NBFI. Indeed spillovers should be contained by limiting concentration risks. But banks should not be tasked with policing the NBFI sector like gatekeepers. This is undesirable, because banks often have bidirectional client relationships with NBFI and may compete in funding supply or demand. It is also untenable, because almost half of business debt is already held by NBFI, and NBFI are not necessarily depending on banks to get their funding. In fact, the desire to make the Eurozone less bank dependent, also entails further growing the NBFI sector and developing its bank-independent funding channels. This is part of the Capital Markets Union agenda, which deserves new momentum given the "twin transition" financing challenges Europe faces.

#### **Cherish stability and predictability of our institutions**

At a more fundamental level, the economic success and welfare we have achieved in Europe is in no small part a result of the solidity of our institutions and the predictability of public policy. I have confidence that such achievements are deep-rooted. Yet in banking, we have recently been confronted with several ad hoc policy measures. I am thinking about e.g. bank taxes that have been created or increased in response to recovering bank profitability in several countries. Policymakers sometimes admit that these taxes are merely the easiest way to plug budget holes, rather than that they serve a consistent, long-term policy goal. I am also thinking about governments

competing with banks' savings accounts by issuing bonds to retail investors, facilitated by ad hoc favourable tax treatment.

Even central banks, bastions of stability and predictability, are sometimes resorting to short term policy responses. Banks were taken by surprise by the unilateral change to TLTRO terms in 2022. The adjustment to the minimum reserve remuneration in 2023 equally caught banks off guard. An increase in the minimum reserve requirement (MRR), currently considered by the Eurosystem, would not help to achieve monetary goals. Moreover, it would set the Eurosystem apart from the Fed, the Bank of England and all other major central banks, that have abolished the MRR altogether, given the availability of other policy tools serving the same purpose of prudential liquidity management in a much better way.

#### **Ad hoc policies, while understandable, hurt predictability, consistency, and reliability of policy.**

The ad hoc nature of policy measures, be they taken by governments, central banks or supervisors, is quite understandable in the context of unprecedentedly rapid change in economic, monetary and fiscal circumstances, a society under pressure and severely limited room for manoeuvre. Yet it should also be noted that ad hoc policies do diminish predictability, consistency, and reliability of policy. And this is not just a bank shareholder issue. It is much broader.

We should not underestimate the importance of predictability and stability, the fundamental role they have as bedrock on which Europe's business, including banks, thrive, today and in the future.

Nurturing the good, while regulating the bad out of existence is a challenge. Even more so in an EU that is facing a in many ways challenging environment. But it is a challenge we must rise to, to preserve what has brought us prosperity, grow what is needed to finance the future, all while keeping the financial system safe.



## MASAMICHI KONO

Senior Advisor - MUFG Bank, Ltd, Member of the Global Advisory Board, Mitsubishi UFJ Financial Group & Trustee - IFRS Foundation

### The impact of faster changes for financial stability

The regulatory and supervisory response to the markets turmoil of March 2023, the collapse of SVB and other US banks, and the acquisition of Credit Suisse (CS) by UBS have proven that regulation and supervision of banks have come a very long way to ensure financial stability. The agreed Basel framework will fortify financial stability, and MUFG supports its timely and consistent implementation. It is of utmost importance for banks operating globally to have a consistent and harmonized set of rules in order to avoid as much as possible regulatory fragmentation and regulatory arbitrage because of the different speed of implementation across various jurisdictions.

As lessons learned from the most recent incidents, some improvements could be considered. First, the recent case of SVB, for example, has shown how fast outflows of liquidity could happen compared to the past. The impact of the new technologies on the speed of deposit outflows may warrant careful consideration, although it should not result in an across-the-board tightening of liquidity requirements. One option could be introducing stress tests that would reflect the characteristics of individual banks. A second possible element could be an improvement in managing the IRRBB. While a one-size-fits-all treatment should be avoided, there may be room for improvement in the identification and implementation of outliers.

We welcome the careful examination by the Basel Committee in this area. On AT1 bonds, we underline their importance in terms of capital requirements, but reviewing investor suitability rules may also be a point for consideration and ensuring clear communication towards investors is key. Of note, market uptake in Japan has been strong even after the CS case. Supervisors should also be able to assess and check bank's funding ability with a held-to-maturity-portfolio.

Another key element to consider in 2024 is the monitoring of developments in the non-bank financial intermediaries (NBFIs) sector. Over the last few years, the importance of NBFIs has increased visibly. Their increased market presence and their level of leverage has raised several concerns among supervisors and policy makers. In 2023, financial regulators and supervisors in EMEA and at the global level have intensified their warnings in relation to exposures of banks to lightly-regulated non-banks which could become threats to financial stability. In particular, the FSB and IOSCO have indicated NBFIs risk as a top priority for 2024 and are expected to design policy recommendations by the end of the year.

The industry recognizes the need to ensure financial stability by supervisors but it is important to recognize the benefits such as diversification and business opportunities that NBFIs could bring to the financial ecosystem. It is therefore important that any regulatory efforts strike the right balance

between those potential benefits and risks. Any initiatives and proposal for changing the current framework for the non-bank financial sector should be proportionate and carefully crafted. To maintain a level-playing field, it would be appropriate to adopt an activities-based approach to non-bank risks, rather than an entities-based approach where appropriate. As of now, regulated banks find themselves at a certain disadvantage against non-banks that provide essentially the same services at much lower regulatory cost.

Among other emerging risks, I would like in particular to highlight the risks from climate change and from digital transformation. On climate change and the transition to net-zero, MUFG is at the forefront of action towards net-zero. Risk management would focus on the identification of the physical and transition climate risk affecting banks, but should also closely work with clients so that the whole economy and society could transition in an orderly and just manner.

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**Increased uncertainty and new risks demands "agility" as bank's key feature for success.**

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Consistent and comparable sustainability disclosure standards applied globally are also a key element, and the work of the ISSB on this is crucial. Local standards need to be interoperable with the ISSB standards. On digital, it is important for banks to invest more in their transformation, especially in the areas of new technologies such as generative AI, while maintaining the viability and soundness of their businesses.

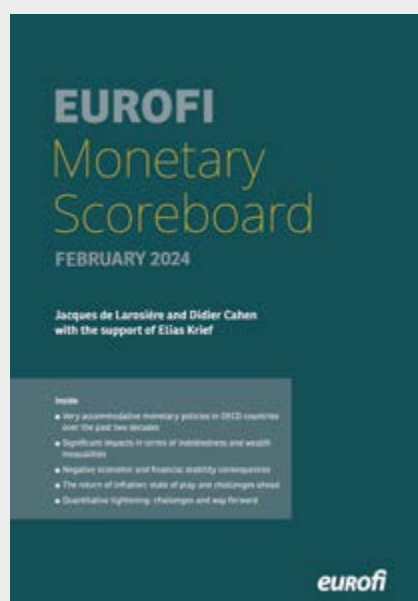
2024 will be a year of increased geopolitical uncertainty with several key elections, the military conflicts that continue in several areas of the world and with the expectations of changes in central banks' monetary policy directions resulting in a highly uncertain business environment. Increased agility for financial services providers will become more and more important for success.



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## NBFI RISKS



### FRANCESCO MAZZAFERRO

Director General of  
Secretariat - European  
Systemic Risk Board (ESRB)

## Tackling risks and vulnerabilities in Non-bank Financial Institutions and beyond

The need to address risks and vulnerabilities in Non-bank Financial Institutions (NBFIs) has moved up the international policy agenda in recent years.

There are several reasons for this: First, NBFIs have increased in size. For example, using a measure that comprises investment funds, insurance companies, pension funds and other financial intermediaries, the Financial Stability Board (FSB) estimates that the financial assets of NBFIs accounted for a little over 47% of the global financial system in 2022, compared to 42% in 2008. Second, several events in recent years, such as the collapse of the US family office Archegos in 2021 and the fire-sale of UK gilts by investment funds using liability-driven investment (LDI) strategies in September 2022, have put certain NBFIs into the spotlight.

Despite the prominence of NBFIs in the policy debate, I sometimes encounter several misperceptions when discussing the topic. I want to touch on three of these misconceptions in this article.

First, there sometimes seems to be a misconception that the focus on NBFIs is new. Far from it. The 2009 Leader's Statement of the Pittsburgh Summit in the wake of the global financial crisis referred to the need: "To make sure our regulatory system for banks and other financial firms reins in the excesses that led to the crisis". And the European Systemic Risk Board (ESRB) has been in the vanguard when it comes to looking beyond the banking sector. For example, one of the first ESRB recommendations focussed in 2013 on the need to make money market funds more resilient. In 2016 this was followed by a paper on "Macroprudential policy beyond banking" that set out a policy strategy to address risks to financial stability wherever they arise in the financial systems.

In the same year, the ESRB published the first edition of what has become an annual monitoring report of certain NBFIs. With respect to specific types of NBFIs, the ESRB published report on "Macroprudential provisions, measures and instruments for insurance" in 2018 – a time when few were talking about 'insurance' and 'systemic risk' in the same sentence.

Second, there sometimes seems to be a misconception that authorities – especially those with a financial stability mandate like the FSB or the ESRB – do not appreciate the positive contribution NBFIs make to the economy. To the contrary: one lesson of the global financial crisis was that a more diversified set of funding sources for the economy is important when the banking system becomes impaired. This narrative of a 'spare tire' still holds true. This is also reflected in the continued efforts by the European Commission to promote a Capital Markets Union. But NBFI can also pose risk to financial stability as they can be a source of shocks or transmit shocks to the financial system. By searching for vulnerabilities and trying to address them, authorities want to ensure that NBFIs and the broader financial system is resilient and can make a sustainable contribution to the economy.

Third, there sometimes seems to be a misconception that authorities are not

mindful of the great diversity across NBFIs and the differences with banks. This is not true. Authorities understand that the financial system is a complex ecosystem of entities with different business models and balance sheets that pursue a diverse set of activities. For example, the ESRB has a broad membership of around 80 institutions to reflect this diversity. In addition to central banks and banking supervisors, its membership comprises national insurance and market supervisors as well as the European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA). But it is true that terminology such as 'the NBFI sector' can give a wrong impression.

**A financial system that serves citizens requires that risks and vulnerabilities are addressed.**

The variety of entities that fall under the term NBFIs is sometimes compared to the diverse types of animals one finds in a zoo. We do not visit zoos and talk about seeing the 'elephants' and the 'non-elephants'. But the diverse set of financial entities beyond the banking sector, are being defined as 'non-banks'. Moreover, the terms NBFIs and market-based finance are also sometimes conflated, even though banks play an important role in financial markets.

A financial system that serves citizens requires that risks and vulnerabilities are addressed. This is true regardless of whether these risks and vulnerabilities relate to banks, NBFIs, or the markets where they interact. Removing misconceptions and arriving at a shared understanding between authorities and market participants can lead to better policies to address such risks and vulnerabilities. This is why the dialogue between market participants and authorities in fora such as the meetings of Eurofi is important.



## GERRY CROSS

Director Financial Regulation,  
Policy and Risk - Central  
Bank of Ireland

### A macroprudential approach to investment funds

Since the Global Financial Crisis, we have seen the global Non-Bank Financial Intermediation (NBFI) sector grow from EUR 72 trillion in 2008 to approximately EUR 200 trillion in 2022[1]. Despite a decline in total assets between 2021 and 2022, it still represents just under half of all global financial assets and is largely driven by investment funds.

The funds sector is playing an increasingly important and complex role in the global financial system particularly in financial intermediation with strong linkages to other parts of the financial sector and the real economy.

This brings many benefits, and as set out in the objectives of the EU's Capital Markets Union, enhancing our capital markets broadens financing channels, reduces reliance on traditional banks to fund businesses, creates jobs and enables investors to access financial products that meet their savings and investment needs while also diversifying their portfolios.

At the same time, as the sector grows in size and engages in an increasingly diverse range of activities, so does its systemic importance. Like all forms of

financial intermediation, investment funds can give rise to risks that in certain conditions can become systemically relevant. There is the potential for cohorts of investment funds to spread or amplify shocks to other parts of the financial system or the real economy, particularly at times of market stress.

We have seen this in relatively recent market events such as the 'dash for cash' at the beginning of the COVID pandemic and the disruption in the gilt market in September 2022 that highlighted the risks associated with high leverage in GBP Liability Drive Investment Funds.

International bodies such as the Financial Stability Board (FSB), the International Organisation of Securities Commissions (IOSCO), the European Systemic Risk Board (ESRB) and the European Securities and Markets Authority (ESMA) have all progressed work in recent years covering the role of investment funds and their relevance from a systemic risk perspective. National policy makers will need to consider how to implement their recommendations and the topics of liquidity and leverage will remain key areas of focus.

Ireland is a leading global funds jurisdiction and the Central Bank has played an important role in these discussions. We published Discussion Paper 11 - 'An approach to macroprudential policy for investment funds' last year setting out the rationale for and the importance of an internationally coordinated approach to macroprudential policy for investment funds.

The paper sets out a number of key considerations when assessing the potential systemic risk posed by investment funds including:

- Economic frictions arising from financial intermediation, such as incentive misalignments, asymmetric information, other externalities and coordination problems. These factors can mean that individually rational decisions by fund managers can lead to excessive risk-taking at an aggregate level across the financial system;
- Concentrated and over-lapping market positions can lead to spill over effects to other parts of the financial system and real economy. However, there have also been instances where a single entity has caused a systemic event.
- The materialisation of systemic risk from the investment funds sector typically follows a shock or trigger

event and the interplay between two factors:

- Vulnerabilities at the fund cohort level including leverage and liquidity mismatch. Growth in open-ended funds has changed the dynamics of liquidity demand and supply in certain market segments and increasing the likelihood of systemic liquidity stresses. Combined with the use of leverage and the overall size of the sector, such shocks can lead to rapid deleveraging and asset sales with corresponding market impacts; and,
- Interconnectedness within the system that can transmit or amplify such shocks to other cohorts and the real economy, which can happen directly through counterparty channels or indirectly through asset valuations and collateral pledges.

A key challenge is in the area of data. High-quality and timely data is a key enabler for an effective macroprudential framework and supports the identification of potential risks including interconnectedness and forms the basis for developing policy interventions. Ideally, this would be based on internationally consistent definitions to facilitate comparable risk assessments and data sharing and lower administration costs to industry.

**The funds sector is playing an increasingly important role in the global financial system.**

This is the core purpose of the Central Bank's paper, to establish a foundation and set of key principles on which we can now move forward to develop an international approach to this important topic.

This will ensure that the funds sector is more resilient to stresses and less likely to amplify adverse shocks and is positioned to serve as a resilient source of financing that supports broader economic activity, innovation and growth.



## ULF LEWRICK

Principal Economist - Bank for International Settlements (BIS)

### Building Resilient NBFIs and mitigating systemic risk

The expansion of non-bank financial intermediation (NBFi) has marked recent decades, fuelled in particular by the dynamic growth of asset management. While discussions often centre on the United States, it is crucial to acknowledge its significant surge in the euro area and emerging markets. According to the latest Financial Stability Board (FSB) monitoring data, the share of non-bank financial intermediaries (NBFIs) in total financial assets has ascended from 20% in 2002 to 49% in 2022 in the euro area and from 16% to 27% in emerging markets. This growth not only diversifies funding sources but also serves as a vital complement to the services provided by traditional banks.

However, this upward trajectory of NBFi is not without its challenges. The term “NBFi” encapsulates diverse business models, subjecting market participants to varied risks. We observe a notable shift from relationship-based funding, typical of banks, towards transaction-based funding, altering investor response functions and enabling them to unwind positions in response to adverse market developments.

At the same time, we note a rise in liquidity demand from the asset management sector, driven by pro-cyclical factors such

as the risk of large investor withdrawals, margin calls and deleveraging pressure. This trend occurs against the backdrop of a structural decline in liquidity supply in key asset markets, as traditional market-makers seek less balance sheet-intensive ways to provide liquidity.

These market developments highlight the trade-off associated with the growing NBFi footprint. While NBFi can act as a “spare tire” to cushion shocks, particularly those originating from the banking sector, it introduces greater pro-cyclicality in the supply of funding. Promoting stable market-based funding throughout the financial cycle based on a consistent policy framework is of the essence. In the end, “a flat spare tire is no spare tire.”

Research at the Bank for International Settlements, among many others, underscores the challenges NBFIs face in liquidity risk management and the need to account for negative externalities. An example of systemic risk in NBFi is evident in open-ended bond funds, where on-demand convertibility of illiquid investments into cash creates a liquidity mismatch. Large investor redemptions can force rapid asset sales, triggering adverse feedback loops and systemic risks. Liquidity risk management tools, though individually rational, may not align with broader financial stability goals. Tools, such as swing pricing, may require more stringent calibration to improve their effectiveness during episodes of market stress. Implicit reliance on central banks to provide a liquidity backstop, may underpin overly optimistic assumptions about portfolio liquidity under stress scenarios.

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**NBFi policy aims to build resilience in good times to curb collective retrenchment in crises.**

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Risks created by NBFIs and its implications for financial stability are clearly at the forefront of the policy discussion. Adopting a systemic approach to mitigate risks from NBFIs is crucial for more effectively addressing their structural vulnerabilities, such as liquidity mismatches and hidden leverage, while establishing sufficient shock-absorbing capacity. Systemic risk assessment requires examining channels of contagion and spillovers, emphasising the fallacy of composition, where individually rational actions may collectively lead to a destabilising market response.

NBFi policy aims to build resilience in good times to curb collective retrenchment in crises. This requires a comprehensive and balanced approach to avoid migrating risks into opaque pockets of the financial system.

At the international level, the FSB and the International Organisation of Securities Commissions (IOSCO), supported by other international standard setting bodies, are actively addressing priority areas for NBFi such as enhancing the resilience of money market funds, improving market participants’ preparedness for spikes in liquidity demand, and promoting the resilience of core funding markets.

In addition, recent revisions to the 2017 FSB Recommendations that address open-ended funds focus on providing clarity on redemption terms, promoting anti-dilution liquidity management tools, and encouraging their consistent use. The revised recommendations have been complemented by IOSCO’s guidance on liquidity management tools to support effective implementation.

As work progresses at both national and international levels, the overarching goal is to strengthen the stability of market-based funding, acknowledging the intricate interplay of risk and policy guidance in the dynamic landscape of NBFi.

*Disclaimer: The views in this article are those of the author and do not necessarily reflect the views of the Bank for International Settlements.*



## ROMAIN PASEROT

Deputy Secretary General -  
International Association of  
Insurance Supervisors (IAIS)

### Insurance sector risks in a changing world

The IAIS' Global Monitoring Exercise (GME) provides a robust empirical basis to analyse insurance sector trends and risks, the highlights of which are published in our Global Insurance Market Report. By gathering data from nearly 60 global insurers and market-wide data from 45 supervisors, we build a detailed picture of insurance sector risks.

GME data shows:

- Capital adequacy remains sound but slightly declined at end-2022 (-3.1%), primarily due to financial market developments such as lower asset valuations and rising interest rates. Most supervisors expect a stable or slightly negative outlook for insurers' solvency positions.
- A decrease in the insurance liquidity ratio compared to year-end 2021 (-29.1%), while remaining well above 100%. On aggregate, insurers hold large amounts of highly liquid assets to be prepared for potential liquidity needs including in adverse circumstances.

One potential source of liquidity stress is increased or mass lapses of life insurance

contracts, particularly in a context of rapidly rising interest rates. GME data shows that total surrender values add up to 30% of assets, excluding separate accounts. Half of these surrender values relate to contracts without any economic penalty, and are contractually redeemable within one week. There may however also be additional disincentives for policyholders to surrender, such as regulatory and tax implications. Additionally, the type of distribution channel and shareholder disengagement are believed to impact surrenders.

Credit risk is another area of attention. Data shows that the vast majority of participating insurers' fixed income investments are of high credit quality. Unrated assets and assets below investment grade increased at year-end 2022 compared with year-end 2021. At year-end 2022, 12.8% of total investments were unrated investments, while 3% were below investment grade. One area of increased attention going forward is real estate exposures – notably for commercial real estate. On aggregate insurers' exposures to real estate and securitisations are not material, however a real estate downturn may have a noticeable financial impact for those insurers with significant relative exposures.

The GME also dived considered a growing trend towards alternative investments and increased use of asset-intensive reinsurance which will mean a change to the liquidity profile of insurer balance sheets.

#### The GME provides a robust empirical basis to annually analyse insurance sector trends.

Firstly, the shift to alternative investments is material for some life insurers. This trend emerged in the low yield environment, particularly for long-term life insurance business, to capture additional yield against reduced liquidity. Although difficult to quantify with GME data, there is a slight upward trend in the allocation of capital to alternative assets in the dataset as proxied by level 3 assets<sup>1</sup>. Alternative investments, such as private placements and structured products, are associated with higher liquidity risk and complexity in terms of risk assessment and valuation compared to traditional investments. These assets may thus diminish insurers' ability to meet unexpected cash demands and may also exhibit an enhanced sensitivity to downturns in

the credit cycle. The long-term nature of certain alternative assets however offers a good duration match for insurers with long-term liabilities, such as annuity liability portfolios. IAIS members have stressed the need to ensure investment portfolio characteristics are sensitive to the liquidity profile of insurer liabilities. This places a focus on effective valuation techniques, rigorous credit analysis and robust liquidity management.

We have also observed a growing use of cross-border asset-intensive reinsurance, in which material investment risks, notably for long-tailed life insurance liabilities, are transferred to reinsurers. Asset-intensive reinsurance is utilised as a risk and capital management tool in the life sector, with varying degrees of adoption across different jurisdictions. The motivation for cross-border asset-intensive reinsurance transactions ranges from risk management (eg risk-sharing and consolidating blocks of business) and financial management (eg raising capital) to potentially leveraging regulatory differences across jurisdictions (eg valuation, reserving and capital requirements). Consequently, each transaction must be assessed on its individual merits. Supervisors are focused on ensuring a clear understanding of who retains the asset ownership (cedant or reinsurer), who manages the assets and which jurisdiction has supervisory authority over these assets, to allow efficient supervisory cooperation.

The global insurance sector has demonstrated its resilience across a series of major shocks, from the pandemic to the rapid change in the macro-economic environment. Perspectives however are still challenging, hence supervisory coordination through the IAIS work is all the more important to contribute to global financial stability.

1. *Illiquid, difficult-to-value assets held at fair value.*



## LÁSZLÓ VASTAG

Executive Director Prudential  
and Consumer Protection  
Supervision of Money  
Market Institutions - The  
Central Bank of Hungary

### Increasing supervisory vigilance and cooperation is needed

The phenomena of Non-Bank Financial Intermediation (NBFIs) have been always a challenge for supervisory authorities. The current macroeconomic context of high interest rates and relatively weak growth has added further risks to financial stability through the activity of NBFIs. In Hungary – and most probably in other countries as well –, there are basically two types of connected risks which can be mentioned in this regard. Banks finance the lending and leasing transactions of their own subsidiaries, but also of other financial institutions, therefore due to their potential poor risk management, repayment of refinancing loans may become questionable.

Furthermore, various investment funds can siphon liquidity away from banks with promises of high returns, and later with possible problems they can shake confidence in the financial intermediary system. Although banks themselves may invest in such funds, which investments may become unprofitable at later stage, nevertheless,

in the current macroeconomic situation, where liquidity is abundant, it probably does not appear much as an actual risk. Apart from these, other risks can also be mentioned, for instance the interconnectedness and the risk of contagion across sectors and within the non-bank financial sector, including domestic and cross-border linkages, from that point of view strong cooperation between supervisory authorities is much needed.

Risks to the stability of the NBFIs further increased due to rising geopolitical risks, elevated inflation and consequently the tightening of financial conditions. A broad-based economic slowdown and tightening financial conditions could increase credit risk. Some non-banks remain heavily exposed to interest rate-sensitive sectors, such as highly indebted corporates and real estate.

Market liquidity risk could put further pressure on NBFIs engaged in liquidity transformation, as it has been observed earlier in the deterioration of liquidity conditions in EU bond markets. Excessive use of leverage could amplify liquidity and market risks, as well as lead to contagion and magnify shocks to financial stability. Countries that more heavily rely on bank-based finance, such as Hungary, exhibit much lower systemic risk related to non-banks. A systemic feature of the Hungarian financial sector is the predominance of banking intermediation and the moderate interconnectedness between the banking and non-banking financial sub-sectors.

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**We shall ensure that  
banks' concentration  
risk stemming from  
shadow banking  
exposures is kept at bay.**

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NBFI's activity is even riskier if it connects to shadow banking, which can actually threaten the stability of the financial sector as a whole. Based on a relevant European Banking Authority Guideline (EBA/GL/2015/20), CBH also implemented its Guideline (2016/11) which concerns the shadow banking exposures, with regard the limitation of exposures to organizations that carry out shadow banking activities and conduct their banking activities outside the regulated framework. One of the key purposes of the CBH is to establish the methods that institutions required to use as part of their internal processes and regulations when examining and

managing concentration risk arising from exposures to shadow banking institutions. The recommendation also defines the aspects that apply to the determination of aggregate limits for exposures to institutions engaged in shadow banking activities, as well as individual limits to such institutions.

In addition, the EBA was tasked with developing a Regulatory Technical Standard that defines the conditions for classification in the shadow banking category, which was an important step regarding the CRR (Capital Requirements Regulation) requirement for credit institutions to provide information on their exposure to the 10 largest shadow banking organizations.

The NBFI category also includes non-bank financial enterprises (NBFEs). Most of these financial enterprises are licensed to lend in Hungary, but they operate outside the banking system. Given that NBFEs are not allowed to engage in deposit collection activities, the key risk from a financial stability perspective is the possibility of non-repayment of funds by credit institutions, though the volume of loans managed by them is quite small compared to banks. This is managed by CBH on two levels: through its mandate for constant supervision of their business operations; and as part of the supervision of domestic credit institutions, CBH also monitors financial enterprises as customers.

NBFEs operate with relatively high leverage, since the external fundings are mostly coming from credit institutions (both domestic and foreign), and the share of external financing from owners and related companies is also increasing. In the current macroeconomic environment, external funding can only be obtained at high interest rates, this may lead to a reduction of available resources which is considered to be a long-term operational risk for them.



## ANA ARSOV

Global Co-Head of Financial Institutions and Global Head of Private Credit - Moody's Investors Service

### Private credit will benefit from greater transparency amid rapid growth

The private credit market, estimated at \$1.7 trillion, is part of the non-bank financial intermediation (NBFI) market and has evolved significantly since the global financial crisis – driven by rapid growth among the largest alternative asset managers. These asset managers are building out new business platforms through acquisitions and through strategic partnerships with traditional financial market players, most notably life insurance companies.

This trend is supporting growth in direct corporate lending and new investments in asset-backed finance. By investing in insurance companies, alternative asset managers can increase their investable capital and gain stable, recurring fees generated from access to a sizable pool of perpetual assets under management.

For their part, insurers gain incremental returns by moving into higher-yielding private investments that, while largely structured as investment grade assets, include more speculative investments. However, the increased yield also brings higher credit and liquidity risk for insurers – as well as greater regulatory and political scrutiny.

### Public markets vs private credit for larger deals

Private credit lenders, including large and rapidly growing business development companies (BDCs) – which make up about 20% of private credit assets under management – are increasingly vying to lend for larger leveraged buyouts (LBOs), in addition to their traditional clientele of middle-market companies.

As LBO activity revives following the recent sharp contraction, competition will accelerate between these direct lenders and the broadly syndicated leveraged loan (BSL) structures. Public and private lenders will compete to offer more favorable pricing and terms, eroding credit quality and attractive returns. We forecast that the US speculative grade default rate will be around 4.1% a year from now – below the long-term average, but still elevated relative to past cycles – as markets continue to manage leveraged capital structures in an elevated rate environment. In an uncertain credit environment, smaller and more highly leveraged companies, especially those with credit ratings at B3 and below, face new and formidable challenges.

This segment makes up a growing share of the private credit universe, and more broadly the US economy. And unlike BSL lenders, private credit functions outside the purview of prudential regulators.

### Fewer protections amid increased defaults

Direct lenders are encountering an escalating array of risks as they navigate a challenging financial landscape with worsening credit metrics because of elevated interest rates, higher inflation, slower economic growth and lower valuation multiples. These factors are combining to undermine the credit metrics of borrowers within credit portfolios.

While BDCs and direct lending portfolios appear to be weathering tighter financial conditions for now, increasing levels of stress are starting to show in certain lending segments. This could potentially lead to markdowns on the carrying value of portfolios.

Amid more defaults, credit investors may face fewer protections than before – at least for the largest deals. Private credit has long offered lenders superior covenants but key protections such as term loan maintenance covenants have been falling away from bigger private credit deals. While this is a new phenomenon for private credit, it's consistent with long-established trends in the syndicated loans market.

### Potential systemic implications

The rapid growth of private equity has pushed more economic activity into the hands of fast growing asset managers, with strategies that increase leverage for mostly middle market businesses. As asset managers continue to grow their private credit portfolios, their investment, risk management and funding decisions could reverberate more strongly throughout the financial system and the broader economy.

However, asset managers typically are subject to lighter prudential regulatory oversight than the banking sector, and there is a lack of transparency about the growing importance of the financing they provide to the real economy. As a result, it may be difficult to see where bubbles of risk are forming.

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**Higher yields heighten credit and liquidity risks for insurers, prompting more regulatory scrutiny.**

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Although liquidity risks are modest, considering the absence of overnight liquidity demands for these funds relative to the liquidity difficulties of risky structures formed in previous cycles, banks are still the largest lenders to private credit funds, and therefore the linkage with the banking system should not be ignored.



## JOHN GOLDEN

Executive Vice President,  
Global Head of Insurance  
Regulation - Athene

### Liquidity risk in an evolving financial system

The financial sector has been in a period of transition following the Global Financial Crisis (“GFC”) and corresponding broad policy responses. Adjustments have been underway across banking, insurance, asset management and other sub-sectors. At the same time, the global economy is faced with unprecedented challenges, technological change and climate risk, to name but a few. The need for financing to address such transformative trends is obvious. It is the financial sector’s task and opportunity to satisfy this demand – through banks and equally insurers, asset managers and others. It is this diversity of financial players which contributes to a powerful and resilient financial sector, along with prudent risk-management and regulation tailored to the challenge.

In the context of these transitions, liquidity risk remains a key focus - every part of the financial sector has to consider liquidity in some fashion. Policymakers and supervisors have the difficult job of determining how to measure and oversee liquidity risks across many sub-sectors undergoing significant change, while markets are often observing reduced liquidity. Thus, policy dialogue regarding liquidity should begin with careful consideration

of the structural characteristics of the diverse products and investments in the sector with a view toward effective and tailored policy recommendations.

#### Case studies in structural mismatches

Three recent situations across sectors illustrate the difficulties of mitigating structural liquidity risk:

1. Silicon Valley Bank (SVB). Much has been written about the significant rate rise, technological change and other factors that contributed to the failure of SVB; while all of those had their part, the core problem was the age old difficulty associated with paring long duration assets with liquid liabilities.
2. Eurovita. Eurovita represents a similar example within insurance. Eurovita’s failure raised concerns that other customers surrender, creating potential for a “mass lapse” (insurance words for a bank-like ‘run’). In response, and rightfully so, supervisors were prompted to review prudential measures for certain liability types and other risk indicators for future sectoral stress.
3. LDI and U.K. Pensions. In late 2022, several UK pension funds deploying “liability-driven investments”, designed to address funding gaps, were subject to substantial collateral calls after a GILT spike and devaluation. The Bank of England intervened to support GILTs to avoid a deeper crisis.

Other significant structural risk exists in open-end funds - another well-known focus. Funds have \$10s, sometimes \$100s, of billions in longer duration assets associated with investor daily liquidity. Even the best risk overlays may be outmatched when faced with a structural liquidity mismatch such as this. Policymakers are understandably reviewing regulatory measures, including enhancements to risk management, swing pricing and fund reporting.

#### Addressing structural liquidity risk

Customer liquidity features are the leading indicator to any understanding of liquidity risk. When features are constructed with asset liquidity in mind, outside of demand deposits, run risk should be very low. Insurance is a good example. It is generally accepted that insurers present a structurally appropriate model to undertake longer duration credit risk, provided asset and liability liquidity features are closely matched. At Athene, products are tailored to target assets to the extent possible. For example, roughly 84%

of liabilities have current surrender protections, with assets and liabilities each having a roughly 8-year average duration. Cash flow requirements, ALM and stress frameworks are included on top of basic product design, with stress testing assumptions providing that illiquid assets are unavailable for short term liquidity needs.

This concept of tailoring assets and liabilities, with effective risk overlays, is not new and is available to many financial businesses, although some have more freedom to achieve it than others. Firms must consider that the greater the structural gap between assets and liabilities, the greater the measures that may be required from risk managers and supervisors.

Nearly all financial products have some liquidity element that needs to be designed and governed. However, product design and ALM are not the end of the story. The “currency” (investments) for funding liquidity demands is also subject to a range of factors impacting liquidity risk. Certain asset types may no longer be as liquid (reliable) for stress situations as they once were. As seen in the U.K. LDI situation, market illiquidity does not need to be triggered by “alternatives assets”, but can occur with assets that are considered the safest and most liquid. Another example exists in the U.S. where primary dealer inventory of corporate bonds has plummeted to a small fraction compared to pre-GFC levels, resulting in greater illiquidity during times of stress, even as the corporate bond market has seen steady expansion.

So what does it all mean? It simply means that assessing liquidity will remain a key focus across the sector. Policymakers and risk-managers are well founded to monitor evolving liquidity risks when assessing product design and risk mitigation, and should recognize liquidity dynamics agnostic to their location within the system. Over time, this will allow any policy measures to be appropriately and narrowly tailored, supporting a resilient and diverse financial system in the face of evolving market liquidity.



# NEXT EUROFI EVENTS

THE EUROFI FINANCIAL FORUM

**11, 12 & 13 September 2024**

**BUDAPEST - HUNGARY**

THE EUROFI HIGH LEVEL SEMINAR

**April 2025**

**POLAND**

## SUSTAINABILITY RISKS IN THE BANKING SECTOR



### FRANÇOIS HAAS

Deputy Director General,  
Financial Stability & Deputy  
Secretary General - Autorité  
de Contrôle Prudentiel et  
de Résolution (ACPR)

## Sustainability risks: new tools to enhance the framework and reach our goals

Global pressure for transition is increasing. The COP28 has recognized the need for strong cuts in greenhouse gas emissions and transitioning away from fossil fuels in this critical decade to meet +1.5°C pathways. It also emphasized banks' role to improve the assessment and management of climate-related financial risks.

2023 witnessed extreme climate events and has been confirmed as the world's hottest year on record. Environmental-related factors, notably climate change, can affect all financial risks a bank is exposed to: credit, market, operational, reputational/legal. Banks' activities also impact the financial system and the economy, should they worsen environmental risks by failing to align

with legally-imposed pathways. In order to improve the assessment and management of climate-related financial risks, banks and authorities should account for both financial and impact materialities in a systematic manner.

On this front, the EU is taking the lead by closing risk measurement gaps. The recent EBA report on the Pillar 1 treatment of ESG risks acknowledges current data limitations by recommending that banks integrate shortly these risks in their internal models through the use of expert judgment, as well as in collateral valuation, while swiftly building the relevant datasets. Moreover, to overcome these challenges in the medium term, the EBA will consider how scenario analysis could be used to enhance the forward-looking elements of the prudential toolset. Climate stress-testing will certainly help a lot for this; on the Commission's request, the EBA is developing a framework to make it a regular exercise.

Regarding transition risks measurement specifically, two streams of work strongly contribute to bridging the gaps. The first one relates to the identification, collection and methodology to analyse granular information on debtors' climate footprint and transition pathways, such as Banque de France's Climate Indicator initiative, which will expand to more sectors in 2024 to fulfil banks and authorities' needs. The second one is the Fit-for-55 exercise which will allow to assess the ability of banks to face the decarbonization of the economy by 2030. Of course, these public-led efforts should not avail banks from deepening their knowledge of financed emissions and adapt their risk management and activities via transition planning.

While measurement keeps improving, the EU is keen on developing prudential treatments and responses to ESG risks. Leveraging on the current supervisory framework, the ECB-SSM is taking firm actions following the outcome of its thematic review that has shown EU banks are lagging behind full compliance with supervisory expectations on the integration of environmental risks in governance and risk management. ACPR has led a similar exercise and will finalise the ensuing recommendations early this year.

Supervisors will also gain new tools through the new banking package that will enter into application in 2025. CRD6 introduces risk-based transition

plans; EBA guidelines will specify their content and translation into Pillar 2 requirements as part of a holistic assessment of a banks' climate-related financial risks. The supervisor will be able to step forward to ensure the effective implementation of these plans and adjust targets and actions in case of inadequate risk management. It will be crucial to ensure consistency with other transition plans and disclosures, such as those required by CSRD and CSDDD.

Apart from supervision, CRD6 will open new regulatory fields of work, with Pillar 1 mandates that will deliver conclusions by end 2025 on the effective riskiness of exposures impacted by environmental factors and a potential dedicated prudential treatment. In this process, authorities will keep in mind the need to facilitate transition financing without altering the risk-based nature of regulation nor giving way to greenwashing, e.g. in designing sectoral supporting factors or green loan guidance.

**EU advances on  
ESG risk will be all  
the more beneficial  
if all jurisdictions  
share such effort.**

Multilateralism has allowed to promote a common understanding of climate risks. The NGFS work on scenarios and data gaps helps supervisors to build capacity and identify priorities. In the next two years, it will focus on implementation; its reports on transition planning will feed into the work of standard-setters to foster global adoption. The Basel Committee's broad approach in exploring climate resilience, scenario analysis and regulatory treatment progresses; it reached a major milestone with the recently publication of a proposal for Pillar 3 disclosure of climate-related financial risks. Finally, to address a current, nearly blind spot, NGFS has put together a much needed conceptual framework for nature-related financial risks.

All these regulatory efforts are vital, as environmental risks could fuel the next major global financial crisis; taking into account jurisdictional constraints should not prevent us from acting.



## JOSÉ MANUEL CAMPA

Chairperson - European  
Banking Authority (EBA)

### Embedding ESG risk for an effective transitioning effort

Climate and overall ESG risks are here to stay, evolve, and potentially increase due to compounding effects. These risks are not new, but they have become more acute and chronic, impacting corporations' global value chains and transforming many business environments.

Predicting precisely how these changes will occur, and the implications for financial risk is challenging – this is why we need scenarios to help distinguish where the impacts and underlying risks may further develop from their current state. It's akin to predicting how brown syrup will spread within clear water over time, knowing it will not evaporate.

Risk management efforts by banks to handle ESG risks appropriately are crucial: their materialisation is already observable, and their future changes are uncertain generating various risk levels and types to consider simultaneously across different horizons.

The syrup analogy is apt: it changes the colour of the water, its density, its availability, its drinkability, and at different rates. Similarly, this dark syrup impacts the already identified risks to the water while potentially adding new ones. For the same reasons,

environmental and ESG risks are, at least partly, embedded into traditional ones and should be handled in a fully integrated manner. For instance, climate change impacts credit risks by adding to the uncertainties in collateral valuations.

Of course, ESG risks should also be viewed horizontally, where needed with the support of specific methodologies and processes, and this may lead to the outright creation of new risk categories.

The materialization of these risks – new, accumulated, etc. – will likely occur within different time horizons. For this reason, we are asking banks to conduct frequent, comprehensive ESG risk identification and measurement to estimate the materiality of these present and future risks in a timely manner. This is still a challenge for them in many ways: historical data is lacking, physical and transition risks are not always easy to isolate, technical knowledge is emerging but remains sparse, and mixing long-term macro-economic development and climate impacts within scenarios is not an exact science. Dealing with the different time horizons and the evolutive nature of the different ESG induced risks is still a struggle for some banks.

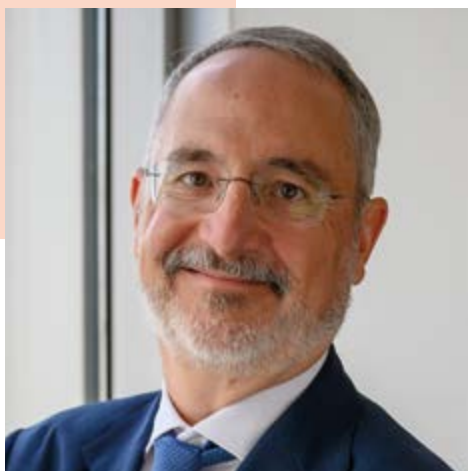
**Comprehensive,  
integrated ESG  
risk management  
frameworks facilitate  
transition.**

Institutions need to work on a long-term risk management effort, with some immediate effects expected. Some progress has happened. For instance, we can observe that banks' governance to address these ESG risks is clearly taking shape. Fewer and fewer banks are considering these risks in parallel, instead fully integrating them into their existing risk management. Institutions objectives, targets, and means are being shared with various stakeholders through disclosures and reporting – such as Pillar 3 disclosures or CSRD – further encouraging if not committing the banks to transition at an appropriate pace. These public commitments are now scrutinised by many stakeholders – investors, supervisors, employees, unions, NGOs, or government agencies. This scrutiny, which has already led to several actions, should limit the risks of greenwashing and foster further integration of ESG factors within the overall risk management framework.

Updated banks' governance with adequate skills and knowledge, holistic

ESG risk identification, business environment monitoring, are some of the key ingredients for a strategic update leading to a timely transition.

Are these measures necessary? Indeed. But are they sufficient? Probably not: further progress on risk identification based on more and reliable data, tractable scenarios, enhanced modelling among other things, will provide additional quantitative background to manage those risks appropriately. Continuing coordination between different standard setters and supervisors is also needed. A lot has already been done – this includes updates to the regulatory framework building on the recent banking package, such as new guidelines to banks on the identification, measurement, management and monitoring of ESG risks, currently subject to public consultation – and much more is expected in the coming months and year to further facilitate, support, and foster the embedding of ESG risk by banking groups.



## EDOUARD FERNANDEZ-BOLLO

Member of the Supervisory Board - European Central Bank (ECB)

### Banks must enhance their climate and environmental risk management frameworks

Since the ECB started to develop a prudential supervisory approach to climate-related and environmental (C&E) risks in 2019, four years after the Paris Agreement, significant progress has been made. Back then, less than a quarter of banks under our supervision had reflected on how the climate and environmental crises affected their strategy. Now, the climate and environmental crises have made it to the top levels within banks and some important steps have been taken. But swifter action is needed, as C&E risks are increasing.

Banks acknowledged the materiality of the climate-related risks in their portfolios in 2022, with 70% seeing material risks within their business planning horizon of three to five years. Encouragingly, over 85% of banks have at least basic practices in place for most of the areas addressed by our supervisory expectations on C&E risks, which we published in 2020. This means that

they have performed an initial mapping of their risk exposures, allocated responsibilities within the organisation, set initial key performance and risk indicators, and developed a qualitative mitigation strategy for at least part of their risk exposures.

However, the approaches are inadequate to meet the growing challenges ahead – they still lack methodological sophistication, the use of granular information on risk and/or active management of the portfolio and risk profile. As a result, more than half of the banks under the ECB's supervision are not implementing the practices effectively. Furthermore, some institutions are still lagging behind and have not shown any material progress. We need to push banks to do more, not only from the purely supervisory perspective of ensuring that they are fully aligned with all expectations by the end of 2024, but also from the broader perspective of ensuring C&E risks are adequately identified and managed at a time when science is clearly telling us that the underlying risk factors will only increase. This is why C&E risks continue to be classified as significant and increasing on the SSM Risk Map: there is an increasing likelihood of a disorderly transition materially affecting carbon-intensive sectors, posing challenges for banks and the economy as a whole.

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**Banks need to effectively implement their climate and environmental risk strategies in line with the EU climate objectives.**

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Our recent analysis of banks covering 75% of euro area loans shows that currently banks' credit portfolios are substantially misaligned with the goals of the Paris Agreement, leading to elevated transition risks for roughly 90% of these banks. The analysis shows that transition risks largely stem from exposures to companies in the energy sector that are lagging behind in phasing out high-carbon production processes and are late in rolling out renewable energy production. Therefore, banks need to draw up plans to address C&E risks arising from the process of adjustment towards climate neutrality by 2050, which will become a requirement under the revised Capital Requirements Directive (CRD VI). To that end, banks should gather relevant information from their clients and update their risk appetite accordingly. The plans should include concrete

intermediate milestones from now until 2050 and develop key performance indicators that allow their management bodies to monitor and act upon any risks arising from possible misalignment with their transition path.

Clearly, this will require significant effort and entail upfront costs. But analysis consistently shows that the benefits of a timely transition far outweigh the costs, especially when assessed against the alternative scenarios of doing nothing or doing too little too late. This is why we are ready to use all our supervisory tools to ensure that banks make this effort. And we are convinced that they can, as the good practices observed in numerous banks demonstrate how the sector can harness innovation to address the prevailing challenges. In 2022 leading practices were observed in 25 out of 30 areas under investigation, including in traditionally more challenging ones, such as data governance, risk classification and pricing. Since then, many banks have implemented good practices to measure and respond to C&E risks, including through client engagement and transition finance. We are therefore confident that a sustained effort can ensure progress towards full alignment with the expectations.

Our goal is to encourage the broader adoption of these best practices, developed by the banks themselves, in order to increase the resilience of the financial system and the economy as a whole.



## STEVEN VANACKERE

Vice Governor - National  
Bank of Belgium (NBB)

### No sound risk management unless ESG risks are fully taken into account

Climate-related and environmental risks and their impact on society and the economy are becoming increasingly clear. Physical risks will continue to materialise in the future and will not only have a devastating impact on the environment but will also adversely impact the macroeconomy, thereby giving rise to financial risks. Adaptation is therefore necessary and, in order to mitigate these risks insofar as possible, transitioning to a more sustainable, carbon-neutral economy is vital. Of course, this transition presents its own challenges. Every social and economic sector has a role to play – from the energy sector to manufacturing, transportation, construction, agriculture and forestry. Households and businesses, as well as banks, will need to be prepared.

As a prudential supervisor, it is our role to ensure that the financial system is resilient to climate-related and other sustainability risks. There are some overlaps in how environmental, social and governance (ESG) risks impact financial institutions and how they should be handled. Over the last few years, supervisory authorities and financial institutions have been making efforts to introduce these risks into the

supervisory framework at both the EU and international levels.

Thus, since 2023, European banks with listed securities have been required to include information on climate-related and environmental risks in their Pillar 3 disclosures, and financial institutions will soon be obliged to publish information on their sustainability risks and performance in accordance with the European Sustainability Reporting Standards. The fact that their large counterparties will be subject to the same disclosure obligation is of the utmost importance to financial institutions, as this information will allow them to better assess their exposure to these risks.

These disclosures will help close data gaps, which are one of the biggest challenges associated with the assessment of ESG risks. Other difficulties are the fact that these risks are unprecedented and that their measurement, materialisation, and timing are subject to substantial uncertainty. Forward-looking measures are therefore needed to assess ESG risks. Scenario analysis and stress testing exercises are vital to understanding and assessing their potential impact. Transition plans are another very important forward-looking tool.

### Prudential supervisors need to take the ESG Risks fully into account to ensure sound risk management.

Under the Corporate Sustainability Due Diligence Directive (CSDDD) and the Corporate Sustainability Reporting Directive (CSRD), large companies and financial institutions will be required to prepare and publish transition plans, including the actions taken to align them with major policy targets and how they plan to tackle the challenges resulting from the green transition. The new Capital Requirements Directive (CRD 6) also requires credit institutions to establish prudential plans that indicate how they will address upcoming ESG risks in the short, medium and long term, including those resulting from the misalignment of objectives with relevant policy targets. The EBA Guidelines on the management of ESG risks, published for consultation in January 2024, also contain a number of provisions on these prudential plans.

As a supervisory authority, we are aware of the crucial role played by the financial

sector in financing the necessary transition to a more sustainable economy and actively support this transition. We do so not by lowering capital requirements for green products - as these, too, can be subject to risks and prudential regulation needs to remain risk-based at all times - but rather by ensuring that financial institutions adequately measure and manage ESG risks. This will make their portfolios more resilient to these risks and guide their financing and investment decisions. Banks will play a pivotal role in the transition to net zero by providing firms with the necessary funding to reduce their carbon footprint. It is important, however, that these counterparties have credible transition plans in place.

Continued non-green lending without taking into account borrowers' transition plans is no longer compatible with sound risk management. At the same time, it should be clear that while supervisors and financial institutions can and should play a role, it is even more important for democratically elected governments to adopt the most efficient and effective regulatory measures to support the transition, while continuing to tackle the potential unintended effects on society. Consistent and predictable regulation and targets will also help manage ESG risks.



## LINE ASKER

SME Sustainability,  
Group Sustainability -  
DNB Bank ASA

### Transition plans as a measure to manage climate risk

Climate risk is high on the agenda both for regulators and in the banking sector. The transition to a low-carbon economy will entail transition costs, but also opportunities. The extent of the cost and opportunities will however depend on several factors, and several of these are hard to predict and estimate.

Banks and other financial institutions can, and should, be playing a central role in the transition to a low-carbon economy. Banks are now in the process of trying to understand the financial implications of climate risk on their portfolios, in light of the business environment and economy they operate in. This also feeds into strategic decision making processes where transition considerations are taken into account.

Banks can manage their climate risks by developing transition plans. Over the last couple of years, transition plans have become a mainstream concept in the ESG world, both by regulators and by the financial industry itself. EU regulations, such as the Corporate Sustainability Reporting Directive (CSRD) and Corporate Sustainability Due Diligence Directive (CSDDD), include provisions related to transition plans. In addition, the European Banking Authority (EBA) has recently

proposed that banks should develop prudential (transition) plans to address the risks arising from the transition.

In DNB, we have been taking steps to manage the Group's climate risk by developing a transition plan. In DNB, we are strongly committed to our strategic ambition of being a driving force in the transition, as well as to our ambition of becoming a net-zero bank by 2050. We strongly believe that the best path to net zero is the one we create together with our customers, through cooperation and dialogue. Engaging with customers to support their transition is vital to achieve real-world decarbonization.

In DNB's transition plan we have set targets covering around 70 per cent of our financed emissions in our lending portfolio. We have also set targets for our asset management activities, where we invest on behalf of our customers (via DNB Asset Management, DNB Livsforsikring and DNB Næringseiendom) describing how we'll use our position as an investor to drive real-world impact on emissions reductions.

This transition plan is an important strategic tool that helps us understand the business implications of our net-zero commitment, to navigate the challenges and opportunities presented by climate change, and the transition to a low-carbon economy. It sets out how DNB will drive the transition, and the tools we have at hand to engage with and guide our customers and the companies we invest in towards reducing their greenhouse gas emissions.

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**Institutions must be given flexibility and responsibility in their transition planning.**

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At the same time, the transition plan highlights key dependencies and external factors that are crucial to achieving our targets. Factors beyond our control will influence the progress we make and our ability to reach our targets. Collaboration and active engagement with public and private actors will be vital for ensuring a successful transition.

Even though the direction is clear, we must also acknowledge that future emissions reductions will most certainly not be linear. From one year to another, we may even see an increase in financed absolute emissions in certain sectors. For this reason, our transition plan is dynamic, and will be reviewed

and revised following progress on data quality, methodology and other material developments.

The global community will face several dilemmas on its journey towards net zero. As a financial institution, we need to balance the needs, demands and expectations of all our stakeholders when we make decisions – whether they are corporates, consumers, regulators, employees, or owners. We also need to strike a balance between a fast transition and a just transition – by taking human rights and impact on nature into consideration when developing new energy sources, for example.

The impact of climate change is also expected to vary substantially across the world. In addition, the exposure to high emitting sectors differs between countries and regions. As a leading Norwegian bank, we're a reflection of the Norwegian economy, with a large share of fossil fuel related industry. As such, we need to strike a balance between the aforementioned considerations and the need for energy security through the transition. The dilemma of energy security vs. national climate targets became clear when Norway had to step up to become Europe's largest supplier of gas in a critical phase following Russia's invasion of Ukraine. Our strategy is to work together with our customers through the transition – and to finance and advise on real-world decarbonisation, rather than exiting carbon-intensive sectors.

These dilemmas need to be acknowledged and it is important that the financial institutions are given a reasonable amount of flexibility and responsibility in their portfolio steering and transition strategies.



## HARM BOTS

President - MUFG Bank  
Europe and Chief Executive  
Officer, Head of EU

### Transition plans are not a risk management tool

Transition plans are now a well-established concept for G-SIBs committed to net-zero. Some of us have already published a transition plan, some of us are still in the midst of designing the strategy. This is a key priority for banks' management. Transition plans show the crucial role financial institutions play in enabling real economy transition. We should be clear about what transition planning really is, which is not about greening the bank's balance sheet only but is about ensuring we can achieve a low carbon and sustainable economy.

There is an important role to play for our climate risk management framework, which functions as a guardrail to understand where the key exposures are with respect to physical and transition risk. But transition planning should not be seen as a risk management tool, it is a business strategy. Therefore, it is important that any prudential treatment or policies in this area take this crucial role into account. This is particularly important for global banks operating in different regions characterized by different challenges.

At MUFG, the essence of our transition plan is our ability and willingness to support our clients towards their transition to net-zero, including in

hard to abate sectors. We are engaging especially with our clients in sectors like power, oil and gas, steel, shipping and real estate. For global banks operating across various countries, this sectorial client engagement is conducted across various geographies, posing different challenges. However, it is not about cherry picking certain sectors from which to divest our existing exposures for the purpose of achieving carbon neutrality on paper. We help all clients to transition away by investing in technologies that can help them to achieve their net zero strategy. Only this approach will help us greening both the economy and our balance sheets. This is a key element to understand: for banks, the transition of our clients is our transition.

Both at the EMEA and global level, senior MUFG leadership is actively involved and responsible for the overall transition planning process, considering the different challenges across the regions we are operating in. In April, we are planning to present our first group transition plan which will summarise the results to date of our transition planning process and further detail our transition to a net-zero strategy. This includes tangible strategies to achieve our sectorial interim emission reduction targets.

As stated earlier, climate risk management plays an important role in assessing the part of our balance sheet which is 'at risk' and may pose financial stability concerns and therefore needs the most attention in terms of transition financing. However, climate risk management is about ensuring we manage and to some extent mitigate the climate related risk on our balance sheet. A transition strategy ultimately is a business opportunity strategy, it is not a risk management exercise and the two should not be conflated. We take note of the recent developments where transition seems to be characterised by supervisors and regulators as a silver bullet for achieving net-zero and a risk management tool.

The Basel Committee has published a consultation paper outlining the disclosure requirements, including transition plans and financed emission "forecast". In Asia, the Monetary Authority of Singapore has published a consultation paper on transition planning. The Financial Stability Board has set up a working group to discuss how transition plans can be used to monitor "macro prudential" implications of transition. In our opinion, using transition planning for the purpose of supervisory risk oversight could raise some concerns and it seems there is a gap between how banks view transition planning in strong engagement with the real economy and how regulators seem

to be using the concept for effectively driving only banks to green their balance sheet, leaving the hard to abate sectors at the risk of not transitioning at all.

We agree that financed emissions (scope 3) of a bank is an important data point to understand the focus of banks' transition strategy, however it should not be used as a tool for how the bank is managing its climate risk. For example, supporting the real economy transition actually means in certain sectors that responsible banks with very sound risk management frameworks need to take on additional risk to ensure that hard to abate sectors can achieve their transition strategy.

**Transition planning is  
a growth story, not a  
compliance exercise.**

To conclude, we view transition planning as a growth story, not a compliance exercise. We strive to move forward in our path to transition and we urge all involved parties to ensure that as enablers of financing for the real economy, we are able to continue to support our clients transition at the global level while ensuring the stability of the financial system. Climate change and the necessary transformation of our economy is the main challenge of our time and needs the collaboration among all the parties involved.



## JULIA SYMON

Head of Research and  
Advocacy - Finance Watch

### Reconciling prudential measures with climate science

As the world, including the European economy, remains largely unsustainable and global greenhouse gas emissions continue to grow, climate-related risks in the banking sector remain high. Being the main providers of finance to the real economy, banks are exposed to transition risks associated with transformations needed in the economy to achieve the EU Climate Law objectives and international commitments. Recent estimates of the European Central Bank and European Systemic Risk Board (ECB/ESRB) indicate an elevated level of transition risk in the EU banking sector, as “the share of high-emitting economic sectors in bank lending is around 75% higher than its equivalent share in economic activity”. The level of physical risk is also increasing, as the required emission reductions have not yet set it. Consensus is growing among scientists that the world is headed for a “hot house” scenario with average temperatures exceeding preindustrial levels by 3°C.

The 2023 UN annual Emission Gap Report, which assesses countries’ climate policies compared to the required changes, confirmed this. Once critical temperature thresholds are exceeded, physical risks will be severe and non-linear, with disruptive and irreversible consequences.

Regulators and supervisors have long recognised that climate change represents a major threat to financial stability. There is also a recognition that due to the unprecedented and forward-looking nature of climate risk, reliance cannot be placed on historical data to measure this risk, giving rise to a high degree of uncertainty. Complex interlinkages between transmission channels, feedback loops between physical and transition risks, longer time horizons and the non-linear nature of climate effects pose major challenges when modelling climate risk and designing tools to address it. Despite these challenges, supervisors have reached a clear conclusion: There are clear benefits to acting early, as the cost of unabated climate change will by far outweigh the cost of timely regulatory action.

In search of prudential measures to address climate-related risk, regulators have so far focused on disclosures and qualitative principle-based requirements. They deferred more decisive action in expectation of more precise climate risk measurements. Yet, the models used to estimate the economic impact of climate change have so far predicted only a benign level of economic losses and, thus, benign effects on the banking sector. These models – known as dynamic stochastic general equilibrium models (DSGE) and integrated assessment models (IAMs) – were developed to deal with traditional financial risks and are not suitable for climate-related risks. They rely on backwards-looking data and make assumptions about economic equilibrium that may no longer apply, as climate-related impacts will be disruptive, unpredictable and permanent. Tipping points and feedback mechanisms, such as melting permafrost or the slowdown of the Atlantic Meridional Overturning Circulation could accelerate losses to levels far above those from recent financial crises.

**Realistic estimates of the economic losses of climate change should guide regulatory action.**

All supervisory climate scenario analyses use these models and, as a result, their estimates of the economic losses of climate change are clearly at odds with climate science. A major modelling flaw is the assumption that economic damages from climate change are a quadratic function of the warming level. This leads to unrealistic conclusions: In

the scenarios used by the Network for Greening the Financial System (NGFS), “an increase in global mean surface temperature by about 3,5°C until the end of the century would reduce global output by 7-14% in 2100”. Furthermore, the existing models ignore some of the most severe impacts of climate change. Notably, NGFS’s recent estimate of climate losses excluded costs arising from extreme weather, sea-level rise, migration and conflict.

Notwithstanding the usefulness of climate scenario exercises for supervisors, their outputs have sent the wrong message to policymakers, fuelling inaction. If the economic impact of climate change continues to be underestimated, cost-benefit analyses of prudential policies will be distorted. Inaction will reduce the future resilience of the financial system risking a major financial crisis.

There needs to be a radical rethinking of the approach to climate scenario modelling. Further, acknowledging modellimitationsandthesystemicnature of climate-related risks, precautionary holistic regulatory actions need to be taken. Ensuring adequate capitalisation of banks to cover future climate-related losses requires overcoming limitations of the existing prudential requirements, which are calibrated based on historical data and are largely based on one-year time horizons.

Finally, transition plan requirements for banks should be robustly defined to make banks effectively contribute to climate risk mitigation via real world decarbonisation.



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## AML: KEY SUCCESS FACTORS



### MARCUS PLEYER

Deputy Director General -  
Federal Ministry of  
Finance, Germany

## National lessons learnt: establishing authorities to combat financial crime

With the political agreement reached in December 2023/January 2024 on the entire AML package and in particular the Regulation establishing AMLA, we have reached an important milestone after two and a half years of negotiations.

The foundations have been laid to ensure that the European Union improves even further its committed and well-resourced fight against money laundering and terrorist financing. Even if we can congratulate ourselves on the fact that a large part of the legislative work has been completed, we should not stand still. Instead, we must focus on the tasks and challenges that lie ahead of us. The establishment of AMLA, and the work it will perform, are crucial to the success of the EU legislative package. AMLA is the key player that connects

national supervisors with each other as well as with FIUs. It bridges the gap between regulatory requirements and implementation in practice. What is needed to achieve this? We need to make AMLA effective and powerful.

In Germany, we have faced, and continue to face, a similar challenge: following our Mutual Evaluation by the Financial Action Task Force, the German government proposed establishing a new federal authority, the Bundesamt zur Bekämpfung von Finanzkriminalität (BBF), known in English as the Federal Financial Crime Agency. This agency is designed to assume a similar key position within Germany's AML system as AMLA will in the EU context. This is a good moment to take stock of a few points that can be considered critical success factors when carrying out a restructuring of this kind.

#### **Involve all stakeholders well before you require their support**

Without effective cooperation with the ESAs, the ECB, national supervisory authorities and FIUs, AMLA will not be able to properly fulfil its mission. These relevant stakeholders should be involved at an early stage, before they have finalised their role in the new AML ecosystem for themselves. Furthermore, for the establishment of AMLA, the AMLA task force which has already been set up at the European Commission should be mirrored by a task force in the future AMLA host country. This task force in the host country would have to include not only representatives of the government and the city, but also the owner of the headquarters building, for example.

Our experience in Germany has shown that the authorities needed for cooperation are much more willing to participate if they themselves have also been involved in weighing up alternatives, calculating costs and formulating common goals.

#### **Prioritise the authority's initial work and gradually expand to the full set of tasks**

The development of the BBF was approached in stages from the outset, because one thing was clear: you cannot (successfully) do everything at once. The same applies to AMLA: the implementation and technical standards, for example, are crucial to

ensuring that the entire set of rules works. AMLA's key new power, the direct supervision of cross-border and high-risk institutions, will also attract particular attention.

The step-by-step approach and clear prioritisation of tasks is key, because if everything is tackled at once with limited resources, the authority's teething troubles will increase. In practice this means: act agilely, take on tasks in small bites, and adapt to new circumstances at short notice.

**AMLA needs to  
be future-proof: a  
successful authority  
relies on well-trained  
and motivated staff.**

#### **Focus on the key success factors: talent, skills and technical support**

AMLA needs to be future-proof. How do we achieve this? An authority stands or falls with its people, who must be motivated and well-trained. Of course, the attractiveness of the AMLA location will play a decisive role: if the quality of life is good in the host city, you can also attract high-quality staff. Beyond that, AMLA will need to provide an excellent organisational and human resources infrastructure. This ranges from modern spaces for interactive work to project structures beyond rigid boundaries of responsibility. It includes a work culture based on employee empowerment that relies on autonomous work based on facts and arguments, and a modern leadership culture. This is the only way we will attract the national expertise from all corners of the EU that AMLA needs, including HR and IT specialists and, of course, anti-money laundering professionals. Last, but definitely not least: AMLA's success will also depend on the availability of the latest and smartest digital technology to fight money laundering and terrorist financing.

Setting up AMLA is no longer about drafting a wish list, but about making hard decisions on its focus and priorities. Let's share our knowledge and learn from each other to make AMLA a success.



## ANDREAS SCHIRK

Head of Division, Prevention of Money Laundering and Terrorism Financing - Austrian Financial Market Authority

### Preparing for joint AML/CFT supervision in the EU

As the work of the EU co-legislators is slowly coming to an end, having reached a deal on the AML package after years of negotiations, the preparatory work of supervisors is quickly picking up. National supervisory authorities (NCAs) and FIUs will play a key role in preparing the ground for AMLA and the future AML supervisory model in the EU to become successfully operational.

Joint preparation is key to set up the future AML supervisory model successfully.

Preparation needs to happen on both national and Union levels. First, NCAs need to look inwards to get (themselves) ready for the application of the EU's AML/CFT single rulebook and the new institutional architecture in AML/CFT supervision. This process is critical and involves all dimensions and levers of an organisation or unit – first and foremost its staff, its governance arrangements, its systems and processes, and importantly its culture. Second, supervisory authorities need to look outwards beyond the borders of their

own organisation to coordinate their preparatory efforts and define common priorities for taking on the tremendous job ahead in order to establish a common ground that AMLA can hit running.

When it comes to the preparatory (home)work of NCAs to get ready for AMLA, the Financial Market Authority (FMA) – similar to several other NCAs – has established a project-like structure to manage the transition to the EU's future AML/CFT supervisory model and to enable the necessary supervisory transformation. In a first phase, this includes, inter alia, a gap analysis and impact assessment from the AML package, a review of the FMA's current internal operating model, and an outlook at relevant changes occurring in financial services and supervision from innovation and technology. It will be crucial for NCAs to understand AMLA's role, and vice-versa, in order to avoid both redundancies and supervisory gaps but instead foster supervisory integration. Equally important, NCAs have to engage also with industry and other stakeholders as well as the general public to build and maintain trust and credibility in the new system and their role within it. In this context, a lot can be learned from the transitions to the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM).

**Joint preparation is key to set up the future AML supervisory model successfully.**

When it comes to the outward looking part of the preparation, the FMA – together with many other NCAs – has initiated the creation of a forum of EU AML/CFT supervisors under the umbrella of the EBA in order to exchange on shared challenges and discuss the practical implications of the shift to the new institutional set-up. In terms of main priorities, supervisors identified the following topics as the most pressing ones: human resources (i.e. having sufficient highly qualified staff in both NCAs and AMLA), data collection and management (i.e. collecting and sharing/reporting relevant data with the necessary quality and in collaborative system), and supervisory methodologies, practices and processes (including notably risk assessments).

To this end, the EBA and NCAs have already been taking stock of the data currently collected from supervised entities across Member States as well

as of the methodologies and practices applied for the purpose of AML/CFT risk assessments and related supervisory tasks. The outcome of this work should provide AMLA with a solid foundation for its own risk assessment. And similar exercises on the other main joint priorities will follow suit. This approach of joint preparation early on should foster broad engagement of authorities across the EU and help both NCAs and AMLA to get the new supervisory model up and running.

Joint prioritisation will also be key for AMLA to play its regulatory role successfully. AMLA will have to deliver many regulatory products (such as technical standards or guidelines specifying how the common AML/CFT rules are to be applied on the ground) within quite a short timeframe. Some of these deliverables cover similar ground as the existing guidelines etc. issued by the EBA, others are completely new. Again, AMLA will likely need to build on the preparations by NCAs under the EBA's steer and sequence its regulatory work prioritising those deliverables where no common standards exist and which are at the core of joint supervision.

In conclusion, a staggered approach following a clear prioritisation of tasks is key for AMLA to succeed, in particular in the first phase of limited resources. What is more, the SSM and the SRB have shown how important broad inclusion of the authorities in the Member States is when setting up a new supervisory model. Early buy-in of national supervisors will be key for building up the necessary capacities and setting the scene for effective and sustainable cooperation – we should seek to learn from previous experiences in this regard.



## KENNETH FARRUGIA

Chairman, Financial Intelligence Analysis Unit, Chief Executive Officer - Malta Financial Services Authority (MFSA)

### AMLA and digital euro – Some reflections from Malta

Today's Europe fits within a global movement towards increasing digitisation across all fields of everyday life and our financial system is at the very pinnacle of this constant metamorphosis. The European Union, its institutions, and national authorities are operating on multiple fronts, with new legislative and regulatory frameworks being designed to ensure a stable future and monetary initiatives aimed to maintain the relevancy of the euro. This article delves into the challenges related to some of the major changes on Europe's horizon, namely the implementation of a new Anti-Money Laundering Authority (AMLA) and the potential issuance of a digital euro, all within the context of a continuously developing technological landscape.

#### The transition to AMLA

The establishment of AMLA is a landmark move towards the Europeanisation of the Union's financial regulation, specifically with regards to AML/CFT. The Authority is intended to enhance the effectiveness of the EU's AML/CFT

framework. Moreover, AMLA will continue on the framework that has been built through the European Banking Authority's (EBA) efforts towards curbing ML/FT from a regulatory perspective.

The EBA is currently the sole European Supervisory Authority vested with a mandate towards, among other things, leading and developing AML/CFT policy, fostering effective cooperation between EU national authorities, and monitoring the implementation of EU AML/CFT policies and standards. This mandate will be handed over to AMLA upon its establishment. Imperative work is currently being undertaken by supervisory authorities in preparation for this transition. Specific working group discussions and exercises are being undertaken at EU level to ensure that AMLA hits the ground running.

The development of new and existent guidelines and the provision of expertise in specific preparatory exercises motivated by this transition assist AMLA's implementation. At this early stage, the Malta Financial Services Authority (MFSA) and the Financial Intelligence Analysis Unit's (FIAU) cooperation with the EBA and other member states' national authorities is vital. This preparatory cooperation, which builds upon past efforts by both the FIAU and the MFSA to strengthen cooperation with counterpart authorities, will need to be sustained and deepened further once AMLA starts its own direct and indirect supervision alongside national supervisory authorities. Hence, both the FIAU, as an AML/CFT supervisor, and the MFSA, as a prudential authority, are now preparing their internal organisations to ensure their ability to effectively cooperate with AMLA, respectively. Notwithstanding, the implementation of another European agency, its independence and autonomy, and its overall effectiveness will bring familiar challenges that characterise both the national and European-level context.

#### The digital euro

The digital euro is another major initiative indicative of the EU's direction towards its future. The EU has shown its intention to provide its citizens with contemporary payment means. The European Central Bank (ECB) has published its research findings and is now in the preparation phase of its digital euro project, laying down its foundations for potentially issuing the digital euro. However, while the added financial flexibility provided by this Central Bank Digital Currency will benefit financial inclusion and development, it may pose concerns related to how it is controlled. As the digital euro becomes a reality,

concerns about data privacy are coming to the forefront.

Striking the right balance between preserving user privacy and enabling effective mitigating measures will be a delicate task making it imperative for Europe to devise strategies that safeguard privacy while also protecting its citizens from the adverse effects of financial crime.

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**The collaborative efforts of supervisory authorities, both at national and EU levels, will shape the future of financial modernisation and regulation...**

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#### Conclusion

The harmonisation of AML/CFT regulation, adaptation to a Digital Euro, safeguarding data privacy, and fostering EU-level cooperation are pivotal tasks that demand careful planning and execution. The implementation of AMLA and the digital euro are two major EU initiatives that highlight the importance of finding the right balance between innovation and security. The collaborative efforts of supervisory authorities, both at national and EU levels, will shape the future of financial modernisation and regulation, determining how effectively the EU protects its citizens from financial ill-doers while embracing digital innovation.



## ANTE ŽIGMAN

President of the Board -  
Croatian Financial Services  
Supervisory Agency (HANFA)

### Artificial Intelligence's role in detecting AML risk

There is a growing expectation that the use of AI will revolutionize AML efforts by improving accuracy and efficiency of detecting and preventing suspicious activities. There is no doubt that AI can automate many of the manual tasks that currently take up precious human hours in AML functions, such as transaction monitoring and customer due diligence. This can free up human resources for other critical tasks, and reduce the time required for compliance reviews, allowing financial institutions to respond to potential threats faster.

AI has already found its way into CDD, KYC, efficient transaction monitoring, suspicious activity reporting (SAR), and automated risk assessment. AI uses advanced algorithms and machine learning (ML) techniques to detect suspicious activity faster and more accurately than ever. By using AI, there is vast potential for financial institutions to quickly identify potentially suspicious transactions and take action to mitigate risk.

ML changes the modelling paradigm significantly by switching from classical, simple hypotheses and based mathematical methods to a modelling method that is based on learning algorithms, which allow for accurate

predictions based on even highly non-linear and complex data. Simply put, AI can help identify previously unknown risks and improve the overall accuracy of AML programs.

However, the human factor will play an important role in proper AI implementation. While AI can automate many AML processes, human expertise is still required to make decisions based on AI-generated insights. Any AI deployed by the industry or by supervisors will depend heavily on the quality of training data. One more responsibility of the human factor in governance is to make sure that AI models follow the law and work in a way that is consistent with relevant legal provisions. AI systems are designed and programmed by humans to perform specific tasks and make decisions based on the data and algorithms provided to them. While AI systems can learn and improve their performance over time, they still operate within the parameters set by human factors.

AI should be seen as a combination of human and machine intelligence.

In December 2023, after months of intensive trilogue negotiations, the European Parliament and Council reached a political agreement on the Artificial Intelligence Act. The role of the AI Act is to make sure that AI systems used in the EU are safe, transparent, traceable, non-discriminatory, and environmentally friendly. AI systems should be overseen by people, rather than by automation, to prevent harmful outcomes. And privacy and data protection, as well as the prevention of discriminatory outcomes, are and should be top priority for AI usage.

**AML as a central  
EU AML hub should  
assume a significant  
role on implementation  
of AI in AML.**

According to the new AI Act, member states will need to ensure that national competent authorities are provided with adequate financial and human resources to fulfil their tasks under this Regulation. In particular, national competent authorities will need to have a sufficient number of personnel permanently available whose competencies and expertise include an in-depth understanding of AI technologies, data and data computing, fundamental rights, health and safety

risks, and knowledge of existing standards and legal requirements. The new rules will establish obligations for providers and users depending on the level of risk from artificial intelligence.

While many AI systems pose minimal risk, they still need to be assessed. In short to mid-term, even large financial institutions may struggle to find qualified personnel who can effectively (and safely) leverage AI to improve AML efforts or enhance their overall business models. Supervisors will be responsible to assessing the way the industry will apply AI and machine learning to their AML processes. The challenge to find and retain qualified staff will be even greater for supervisors.

AMLA as a central hub for AM/CFT at the EU level and as a direct supervisory body for a certain number of EU obliged entities should assume a significant leading and coordinating role in the proper development, implementation, and supervision of AI in AML. Of course, this can only be done in stages. Once up and running, AMLA should scan the current technological set-up (including the use of AI) in the AML/CFT field by the industry and supervisors and facilitate discussion and exchange of opinions on the best solutions and approaches. There are different practices and applications of AI in member states. There is an even greater difference between the available qualified human capacities with expertise in AI technologies.

AI expertise training and education of supervisory personnel should have a priority flag in the near future and AMLA's role is crucial in this process. AMLA can play a vital role by assisting and leading our common effort to find and scale up appropriate AI tools that we can all use at the EU level.



## JEAN HILGERS

Senior Advisor -  
Deloitte Belgium

### What are the key success factors for AMLA?

The recently adopted AML package provides for the creation of a new European authority for countering money laundering and financing of terrorism called the AMLA and a new AML/CFT supervisory system. While the EU co-legislators are yet to decide on the location of AMLA, reflections can already be made on what will be needed to make the AMLA successful.

#### Setting the scene: Reasons behind the creation of the AMLA and its roles and responsibilities

Money laundering and the financing of terrorism do not stop at national borders. This is especially true for a single market such as the European Economic Area. As such combatting ML/FT requires a seamlessly integrated EU AML/CFT supervisory system.

The current AML/CFT supervisory framework unfortunately does not reach this level of integration due to sizeable shortcomings:

- The quality and effectiveness of EU domestic AML/CFT supervision are uneven, displaying significant variations in resources, regulatory powers, supervisory practices and intensity of cooperation across Member States.

- There is a home country bias, which undermines the equal treatment of obliged entities and creates supervisory and regulatory arbitrage;
- The territorial nature of the AML/CFT supervision impairs the effective supervision of multinational groups; and
- Risk mapping and risk-based supervisory practices are fragmented and have a national focus.

These shortcomings are reminiscent of prudential supervision flaws witnessed before the 2008 financial crisis, which led to the creation of the ESAs and the SSM. Considering this, it is not unsurprising that the EU has opted for a similar solution, namely the creation of a new EU-wide mechanism of AML supervision centered around a new EU body- the AMLA.

While it will share many similarities with the EU supervisory mechanisms created before it, AMLA will nonetheless be distinguished by the plurality and diverse nature of its mandate: direct supervisor of high risk and cross-border financial institutions, gatekeeper of effective domestic supervision, standards setter, FIU's coordinator, facilitator, and cooperation enhancer,...

### AMLA to overcome multiple challenges to create a single supervisory culture.

#### What does it take to make the AMLA a success?

While only time will tell whether the AMLA will live up to expectations, some drivers will be key for the authority to perform successfully:

- In its policy work, which will undoubtedly be its earliest task, AMLA will have to strike the right balance between exhaustiveness and clarity of rules, on the one hand, and flexibility and a risk-based approach, on the other, to ensure the future-proof nature of regulation in a constantly evolving field.
- As a cross-border direct supervisor, AMLA will need to anchor its credibility by adopting a well-designed risk-based approach based on the deployment of modern supervisory tools and methods (qualitative and quantitative reporting based on insightful structured and unstructured

data, AI-based digital research and analytical tools, efficient off and on-site JST supervisory cycle, joint deep dives and cross-border analyses,...), in close cooperation with national stakeholders.

- The AMLA will have to instill a genuine common supervisory culture aimed at interpreting and applying the single rulebook the same way - in a proportional manner, given the diversity of obliged entities across member states. Based on the lessons learned from the SSM experience, this will probably be an iterative process of progressive fine-tuning requiring to become knowledgeable with national and sectoral specificities.
- The authority should foster a common intelligence culture, whereby FIUs will exchange and cooperate more intensively through updated tools (e.g.: FIU.net) while adhering to the highest standards of analysis and research.
- To ensure the buy-in and active cooperation of national authorities, AMLA will have to provide support and assistance to national supervisors and FIUs, so as to be regarded as an actual value-added partner in their daily work. AMLA governance should also ensure that national authorities' voices are sufficiently taken on board in the decision-making process.
- AMLA will have to foster intense cooperation and information exchange with prudential authorities, as prudential and AML/CFT supervision are inherently and explicitly linked.

#### How can obliged entities get to grips with the new AML/CFT supervisory system?

Based on the lessons learned from 10 years SSM, directly supervised obliged entities can expect AMLA to be proactive, challenging, risk-oriented and holistic in its supervisory process, assessing how they prevent, manage and mitigate AML/CFT risks through high standards methodologies and processes, consistent with the latest regulatory requirements and supported by highly skilled staff equipped with the latest digital resources. It will be key for them to revisit their whole AML/CFT governance, risk management framework and allocated resources accordingly, to ensure timely compliance.



## AYMERIC PONTVIANNE

Head of Economic Analysis -  
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### A balance between AML-CFT and data protection: the case of digital euro

The applicable regulatory framework for anti-money laundering and terrorist financing (AML-CFT) includes broad and far-reaching obligations for obliged entities to identify and know their customers, monitor transactions undertaken and report on suspicious ones. Such measures cover all persons using their services. It is, therefore, useful to address the interplay of this framework with the rules of protection of privacy and personal data, as well as their concrete application on the ground, including in the interest of legal certainty for obliged entities.

The European Data Protection Board (EDPB) is the views that, while the AML-CFT framework has to be compatible the rights to privacy and data protection enshrined in Articles 7 and 8 of the Charter of the Fundamental Rights of the EU, a closer articulation between the two set of rules would benefit, as far as relevance and accuracy of data are concerned of example, both the protection of personal data and the efficiency of the AML-CFT framework. Such a review has been started at the occasion of the

discussion of the AMF-CFT package and needs to be continued for level 2 and 3 acts, with a close cooperation between the EDPB and the Anti Money Laundering Authority (AMLA).

Against this background, the current legislative discussion on digital euro particularly illustrates the merits of a right balance between AML-CFT policy objectives and the protection of data and privacy in EU law.

The data protection authorities in Europe are the views that privacy and data protection will be a key factor of success for the digital euro. According to the ECB public consultation, finalized in 2021, confidentiality will be the most important feature for forthcoming digital euro users. Moreover, the value added of a digital euro, which shall be designed as close as possible to cash, in a highly competitive payments landscape, resides mainly in its privacy properties.

Against this background, the current draft regulation establishing a digital euro contains a specific AML-CFT regime for offline proximity payments, for which monitoring would only take place for funding and defunding of the wallet and not transaction by transaction, whereas the online payments, based on an account, would be fully transparent to the financial intermediaries to the first euro, namely for AML-CFT monitoring purposes.

For the data protection authorities, the absence of a privacy threshold for low-value online payments, under which no tracing of individual transaction shall occur, is a concern for the confidentiality of the day-to-day transactions of EU citizens, as compared to the privacy preserving features of cash. The AML-CFT risk profile of such transactions is currently undetermined, as it depends of the actual design of the digital euro, still to be further specified. This is clearly stated by FATF recommendations on virtual assets.

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**The absence of a privacy threshold for low-value online payments, under which no tracing of individual transactions shall occur, is a concern.**

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The exclusion of such a threshold from the outset reveals therefore an implicit, but real, unbalance between different policy objectives, which shall be corrected by the legislators.

As a matter of fact, the AML-CFT risk profile of low-value online transactions can be mitigated, during the design phase, by appropriate safeguards, so as to make it “low risk”. The specific AML-CFT regime for digital euro offline payments could thus be extended to such transactions.

As for the determination of the cap for offline transactions, the appropriate level of a privacy threshold for online payments would be set by way of delegated act. In this regard it would be of paramount importance that AMLA and EDPB cooperate closely upstream to provide the Commission with one common recommendation, reflecting the right balance between privacy and data protection, on one hand, and AML-CFT objectives, on the other.

The overall objective of the EU institutions should be the elaboration of a digital euro “privacy and data protection by design”, with recourse to a mix of privacy-enhancing technologies, decentralized architectures and local processing and storage operations. What a success, if the EU establishes a standard for a central bank digital currency (CBDC) carefully protecting rights and freedoms, including for the cross-border transactions with third countries.

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# ABOUT EUROFI

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## The European think tank dedicated to financial services

- A platform for exchanges between the financial services industry and the public authorities
- Topics addressed include the latest developments in financial policy and the macroeconomic and industry trends affecting the financial sector
- A process organised around 2 major international yearly events, supported by extensive research and consultation among the public and private sectors

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### OUR OBJECTIVES

Eurofi was created in 2000 with the aim to contribute to the strengthening and integration of European financial markets.

Our objective is to improve the common understanding among the public and private sectors of the trends and risks affecting the financial sector and facilitate the identification of areas of improvement that may be addressed through regulatory or market-led actions.

### OUR APPROACH

We work in a general interest perspective for the improvement of the overall financial market, using an analytical and fact-based approach that considers the impacts of regulations and trends for all concerned stakeholders. We also endeavour to approach issues in a holistic perspective including all relevant implications from a macro-economic, risk, efficiency and user standpoint.

We organise our work mainly around two-yearly international events gathering the main stakeholders concerned by policy work in the financial sector and macro-economic issues for informal debates. Research conducted by the Eurofi team and contributions from a wide range of private and public sector participants allow us to structure effective debates and offer extensive input. The result of discussions, once analysed and summarized, provides a comprehensive account of the latest thinking on financial regulation and helps to identify pending issues that merit further action or assessment.

This process combining analytical rigour, diverse inputs and informal interaction has proved over time to be an effective way of moving the regulatory debate forward in an objective and open manner.

### OUR ORGANISATION AND MEMBERSHIP

Eurofi works on a membership basis and comprises a diverse range of more than 70 European and international firms, covering all sectors of the financial services industry and all steps of the value chain: banks, insurance companies, asset managers, stock exchanges, market infrastructures, service providers... The members support the activities of Eurofi both financially and in terms of content.

The association is chaired by David Wright who succeeded Jacques de Larosière, Honorary Chairman, in 2016. Its day-to-day activities are conducted by Didier Cahen (Secretary General), Jean-Marie Andres and Marc Truchet (Senior Fellows).

### OUR EVENTS AND MEETINGS

Eurofi organizes annually two major international events (the High Level Seminar in April and the Financial Forum in September) for open and in-depth discussions about the latest policy developments impacting the financial sector and the possible implications of on-going macro-economic and industry trends. These events assemble a wide range of private sector representatives, EU and international public decision makers and representatives of the civil society.

More than 900 participants on average have attended these events over the last few years, with a balanced representation between the public and private sectors. All European countries are represented as well as several other G20 countries (US, Japan, China...) and international organisations. The logistics of these events are handled by Virginie Denis and her team. These events take place just before the informal meetings of the Ministers of Finance of the EU (Ecofin) in the country of the EU Council Presidency. Eurofi has also organized similar events in parallel with G20 Presidency meetings.

In addition, Eurofi organizes on an ad hoc basis some meetings and workshops on specific topics depending on the regulatory agenda.

### OUR RESEARCH ACTIVITIES AND PUBLICATIONS

Eurofi conducts extensive research on the main topics on the European and global regulatory agenda, recent macro-economic and monetary developments affecting the financial sector and significant industry trends (digitalisation, sustainable finance...). Three main documents are published every 6 months on the occasion of the annual events, as well as a number of research notes on key topics such as the post-Covid recovery, vulnerabilities in the financial sector, enhancements to the EU financial policy framework, sustainable finance, digitalisation trends and policies... These documents are widely distributed in the market and to the public authorities and are also publicly available on our website [www.eurofi.net](http://www.eurofi.net) :

- **Regulatory update:** background notes and policy papers on the latest developments in financial policy
- **Views Magazine:** over 190 contributions on current regulatory topics and trends from a wide and diversified group of European and international public and private sector representatives
- **Summary of discussions:** report providing a detailed and structured account of the different views expressed by public and private sector representatives during the sessions of each conference on on-going trends, regulatory initiatives underway and how to improve the functioning of the EU financial market.

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