2024-2029 European Priorities

A Resilient Financial System To serve Sustainability, Competitiveness and Innovation

PARIS EUROPLACE

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Executive Summary

It is no exaggeration to say that over the next term of office, 2024-2029, the European Union will have to face up to unprecedented challenges; be they geopolitical, environmental, digital or demographic, these multifaceted problems will force the European authorities to take urgent stock of the situation and come up with bold responses.

A clear-sighted approach is essential: for several decades now, the European Union has been faced with lower growth than other countries or regions, undermining positions it held hitherto in many sectors. Europe's economic growth and financial sector have been lagging their US counterparts – and increasingly so since the financial crisis of 2007-2008.

It is now vital to change the rules of the game to give European financial and non-financial companies all the room for manoeuvre they need to reduce this gap. There is an urgent need for quickly implementable, far-reaching policies and regulatory reforms to reaffirm the EU's place in the world and enable it to maintain a leading position in strategic areas where a revival of European sovereignty is critical. Europe's competitiveness must now be seen as a top priority, not only in its rhetoric but in specific regulatory and policy actions.

The Paris financial market promotes an ambitious and proactive vision of Europe's strategic autonomy, aimed at sustaining the bloc's attractiveness for projects, capital and talents, in order to support prosperity and make its model more sustainable. Hence, the Union's – in the European Commission's view – massive investment needs as regards implementing the objectives and strategy defined by its heads of state, must urgently be translated into concrete projects, at the level of each Member State and each sector. EU strategies need more projects and less paper.

Financing these investments requires a massive upscaling of financial flows, from an annual average of around EUR 400 billion to a target close to EUR 1 trillion per year until 2030, as per the Commission's estimates. Such upscaling will undoubtedly not be made without mobilising all financing sources, banks and capital markets in a twofold effort aimed at directing all the savings from households and businesses towards the sectors that need them most, and also at adapting the regulatory framework that governs the financial sector today. Businesses must be able to rely on strong and capital-efficient financial services providers that support their development without hampering their competitiveness.

15 years on from the global financial crisis, the regulatory overhaul has now achieved its goal of ensuring the financial system's resilience, notably in the EU. Such resilience has been demonstrated through the multiple recent crises, where financial institutions have been part of the solution rather than the problem. The next legislative cycle must now focus not on further "de-risking" of the financial system, but rather on its competitiveness and capacity to meet the massive needs of the EU's strategic agenda.

The mandate of regulatory authorities should therefore include the objective of facilitating the competitiveness of businesses and supporting medium-term economic growth, and to avoid unintended consequences, an in-depth impact assessment should be made jointly with industry experts on every European regulatory proposal. European regulatory and supervisory authorities should be made accountable for the impact their actions have on competitiveness. They should also adapt their governance and representativeness to better respond to pan-European imperatives, and ensure cross-sectoral consistency of their rules by relying more on their Joint Committee.

While to move further towards centralised supervision of market activities might be premature, beyond financial and non-financial ratings and data providers, recognition of the role of "lead supervisor" for financial groups operating across various Member States would be a major step in the right direction.

Last, fast-track decision-making procedures should be the rule rather than the exception, drawing on the lessons of the successful "quick fixes" implemented during the Covid-19 crisis. Reviews of existing regulations should be less systematic, as they create considerable regulatory uncertainty and implementation costs, and should be aimed more at tackling specific unintended consequences or new market developments. Regulations should be simplified, and the "gold-plating" often included in national transpositions of directives or in level 2 or 3 texts drawn up by European supervisory authorities (ESAs) with a pure risk-reducing mindset should be eliminated. The Commission should use its existing powers to screen more systematically the draft regulatory standards (RTS) and implementing technical standards (ITS) proposed by ESAs, and submit these too to competitiveness tests. Greater EU harmonisation could be achieved by using regulations (provided they meet subsidiarity and proportionality objectives) rather than directives, which can leave the door open to more fragmentation. The regulatory agenda should be made more consistent in terms of the content and sequencing of various pieces of regulation. In particular, the EU's ESG regulatory framework needs urgent harmonisation and simplification to enable the EU's aspired leadership to translate into conceptual and regulatory leadership.

Enhancing the regulation process would make it possible to swiftly tackle long-standing well-identified obstacles that prevent the financial sector from operating as a "Single Market for Finance", as follows:

— Beyond the implementation of the Listing Act and ELTIF, prioritise the development of an ecosystem to support scale-ups in the equity market, as a major goal in the sovereignty agenda.

— Give an ambitious boost to securitisation, which remains largely sub-scale under Europe's now extremely tightly regulated framework but could unlock significant funding for the green and digital transition.

— Redesign the Banking Union agenda, prioritising the use of waivers to promote the free flow of bank intra-group liquidity and capital, cross-border investments and the creation of European champions.

— Step up initiatives for the financial education of investors to increase risk awareness and ensure that their savings are put to the most productive use, without unnecessary over-protection.

— Create a pan-European, conditionally tax-free savings product dedicated to European equities, which other countries could also choose to offer.

European authorities should seize the opportunity, in a context currently marked by high levels of uncertainty, to set the Union on the road to recovering its financial strategic autonomy, based on solid and sustainable fundamentals at the service of the European economy and society.

Policy
Recommendations

For a more competitive EU properly equipped to face the numerous challenges to come, we suggest that EU authorities consider the following major proposals:

1. Ensure

that the political goal of developing European competitiveness and strategic autonomy is translated urgently into concrete, pragmatic regulatory actions:

a. After 15 years of financial reforms aiming at reducing risks associated with the financial sector, refocus the regulatory agenda to facilitate prudent risk-taking and investments;

b. Carry out credible independent competitiveness tests ahead of any new regulatory proposal;

c. Ensure a level playing field with non-EU jurisdictions for insurance companies, asset managers and financial market infrastructures.

2. Accelerate

the translation of EU green and digital investment programmes into concrete projects at the level of Member States:

a. Improve visibility and readability, and reduce the red tape hindering access to EU and Member State support programmes;

b. Annually update the EU's estimated medium-term investment needs in line with its objectives and strategy and with national commitments;

3. Review

the mandates and governance of EU regulatory authorities:

a. Add to regulatory authorities' mandates an objective of facilitating the EU's international competitiveness and long-term economic growth;

b. Improve ESAs' governance and representativeness to better promote EU-wide interests;

c. Make ESAs fully accountable to co-legislators for the competitiveness outcomes of their regulatory actions;

d. Deepen dialogue with practitioners via high-level groups, hearings and panels, and in particular involve them in *ex ante* impact analysis;

e. Develop group (i.e. lead) supervisor responsibilities for consolidated supervision of cross-border market activities, thus recognising the concept of "EU groups".

4. Initiate

a transition towards broader supervisory power for the European Securities and Markets Authority (ESMA) by:

a. Granting it direct supervisory powers over ESG and financial data providers;

b. Encouraging common supervisory actions between the ESMA and national competent authorities (NCAs) to tackle domestic idiosyncrasies.

5. Make

the regulatory process more agile and better aligned with policy goals:

a. Allow swift adjustments when rules appear to have unintended consequences (i.e. quick fixes, to be implemented in weeks rather than years), while avoiding systematic reviews to reduce unnecessary regulatory uncertainty and implementation costs;

b. Discourage gold-plating via more frequent use by the European Commission of its existing powers on level 2 or 3 initiatives that are inconsistent with level 1;

c. Prioritise regulations that meet subsidiarity and proportionality objectives over directives, to avoid transposition divergences and limit scope for national gold-plating;

d. Ensure better cross-sectoral consistency in the content and sequencing of the implementation of EU action plans, within DG-FISMA, between Commission directorates and across ESAs, including by strengthening the role of the Joint Committee of the ESAs to make their respective regulatory actions more consistent;

e. In particular, urgently review the ESG regulatory framework to ensure its consistency, usability and effectiveness, and restore EU leadership in this area;

f. Carry out an in-depth assessment of how useful a central bank retail digital currency would be for households, businesses and governments.

g. Broaden the ESAs' "No action letters" scope to allow implementation flexibility.

6. Promptly implement

the well-identified regulatory changes needed to remove well-flagged obstacles to cross-border investments:

a. Beyond the implementation of the Listing Act and ELTIF, prioritise the development of an ecosystem to support scale-ups in the equity market, including by strengthening the ability of public and private investors to act as anchor investors in IPOs (the EFSI or EIF's mandate could be broadened to one of corner investor) and by making financial advice, research, and credit and ESG ratings activities more viable for EU-based players;

b. Revive securitisation as a key tool to finance the additional investments needed and foster private risk-sharing across the EU and beyond;

c. Facilitate cross-border investments by banks through waivers on liquidity, capital and MREL;

d. Propose to interested Member States the creation of a harmonised, tax-free savings product dedicated to EU listed or non-listed shares.

7. Develop

a better understanding of the role of finance in the EU economy:

a. Increase retail investors' financial literacy to help them independently weigh up the risks and return associated with financial products;

b. Avoid designing consumer protection rules on the basis of risk avoidance;

c. Boost the EU financial sector's contribution to growth and job creation by consolidating educational and training systems to develop a more qualified workforce;

d. Improve administrative, housing and school facilities across Member States to attract and retain EU and non-EU talents, encourage intra-EU mobility and create a common financial and risk culture.

Introduction

The upcoming EU legislative cycle will start at a time of unprecedented uncertainty. European policymakers will have to tackle a new set of collective challenges, occurring simultaneously in a way not seen before and even more pressing given their magnitude:

— **Geopolitics**, with rapidly rising pressures leading to uncooperative policies, a growing fragmentation of the global economy, less efficient international organisations and an urgent need for security and defence investments at national borders;

— **Decarbonisation** and environmental risks, with the economic impact of climate disasters increasing every year and thereby necessitating more coordinated, consistent and targeted actions;

— **Digitisation**, which is a major source of productivity and growth but where the EU needs to be able to better support innovation, as global competition is especially fierce in this area, where oligopolies are common;

— **Demographics**, as a decline in the working-age population contributes to a further economic deceleration, sharpening the need to consider additional far-reaching structural reforms to preserve sustainable living standards in Europe over the long run.

EU policymakers must therefore adapt swiftly to this rapidly evolving environment. Decisive, concrete steps are needed now more than ever to achieve the goal of **strategic autonomy** that the European Council has been promoting since December 2013[1] and which it reiterated in October 2020[2].

We fully concur with the urgency of "designing a new growth and investment model for 2030", as envisaged in March 2022 in the Versailles Declaration[3], through three key vectors: bolstering defence capabilities, reducing energy dependencies and building a more robust economic base. Indeed, two years ago, EU leaders resolved to "make Europe's economic base more resilient, competitive and fit for the green and digital transitions, while leaving no one behind". However, there has been limited progress since then, and accurately assessing the instruments and means required to meet these objectives is now becoming crucial.

For its part, last year the European Commission detailed the scale of investment needed to achieve Europe's open strategic autonomy in the following terms[4]:

> "The **green transition** requires…additional investments of over EUR 620 billion annually [until 2030]… to meet the objectives of the Green Deal and Repower EU… Still, the full costs and consequences of the climate and biodiversity crisis are unknown. The increasing impacts of extreme weather events already today lead to severe economic losses[5]. Boosting the resilience to climate change in key areas, such as transport infrastructure… energy [or] buildings, will … entail significant resources. Furthermore, the increasing frequency of climate catastrophes could render insurance unaffordable for households and many businesses, and further increase pressure on public budgets [in some Member States]";

— The price tag of the new **geopolitics** may also be much higher than initially thought: for example, in 2021 alone, Member States' defence expenditure reached EUR 214 billion, representing a year-on-year increase of 6%, with further spending of EUR 75 billion forecast until 2025[6] to build adequate defence capabilities. In addition, the reconstruction of Ukraine will require, according to the European Commission's estimates, around EUR 384 billion over the next ten years, or USD 411 billion according to the World Bank's 2023 calculations[7];

— Bridging the EU's investment gap for the **digital transition** may cost at least EUR 125 billion annually, with four dimensions: investing in more and better connectivity (rapid deployment of 5G), strengthening industrial and technological presence in strategic parts of the digital supply chain (including artificial intelligence, cybersecurity, secure communication, data and cloud infrastructures, supercomputers, quantum computing and blockchain), building a real data economy as a driver for innovation and job creation (setting up common data spaces and

1 See https://data.consilium.europa.eu/doc/document/ST-217-2013-INIT/en/pdf.

2 See https://www.consilium.europa.eu/media/45910/021020-euco-final-conclusions.pdf.

3 See https://www.consilium.europa.eu/media/54773/20220311-versailles-declaration-en.pdf.

4 See https://commission.europa.eu/system/files/2023-07/SFR-23-beautified-version_en_0.pdf.

5 Estimated by the European Commission at EUR 9 billion annually for droughts and EUR 7.6 billion for river floodings.

6 https://op.europa.eu/en/publication-detail/-/publication/9acc6113-751d-11ed-9887-01aa75ed71a1/language-en.

7 https://documents1.worldbank.org/curated/en/099184503212328877/pdf/P1801740d1177f03c0ab180057556615497.pdf.

strengthening governance on issues such as data portability and access) and improving the legal framework for digital services, with clear rules for online platforms.

So overall, the additional investment required to fully implement the open strategic autonomy agenda amounts to around **EUR 1 trillion annually until 2030**, equating to EUR 7 trillion over the current 2024-2030 cycle. **This assessment will need to be updated every year** to ensure that the figures accurately reflect credible assumptions, evolving conditions in geopolitics and financial markets, and investment flows actually generated.

→ **Annually update the EU's estimated medium-term investment needs**
in line with its objectives and strategy and with national commitments (Recommendation 2.b).

Granted, EU and Member State budgets will have an essential role to play, as the EU has already pledged to spend EUR 578 billion – around 30% of its budget – on climate action over the 2021-2027 period, for example. But, given the limited fiscal leeway available at national level for many Member States, and considering the constraints on the EU's budgetary resources, it is clear that by far the greatest part of these funds will have to come from the **private sector**.

To get a sense of the magnitude of this scale-up, these numbers must be compared to the annual funding flows under "normal" conditions, for example over the 2015-2019 period: during these five years, new funding (available through financial intermediaries or directly on financial markets) was estimated at less than EUR 500 billion per year in the eurozone on average[8]. The challenge is therefore to **at least double the financial system's capacity** to finance the EU's growth and investment strategy. In this context, all sources of financing need to be rapidly scaled up: bank lending, insurance companies' investments and capital markets funding as well as retail and institutional investors, drawing on domestic, cross-border and non-EU capital sources.

In other words, any programme to ensure Europe's competitiveness and finance the transformation of our economies must include strategies capable of growing the EU's financial sector and making financial markets much more efficient at sourcing capital and more attractive for all types of players.

The recognition by EU policymakers that **the financial sector is an essential pillar** for effectively implementing the European open strategic autonomy is therefore vital. However, whereas the goodwill is there when co-legislators and regulators express the need to accelerate the implementation of the EU CMU agenda, concrete policy actions remain muted – or even work against the stated goal. For example, many regulatory failures are well-known but remain unsolved: the proliferation of norms that hold back business, the fragmentation of EU financial markets, the hurdles limiting private risk-sharing and the development of large European players, and the lack of liquidity available to finance SMEs are just a few of the challenges that still need tackling.

Accordingly, in order to better align policy actions with their ultimate goals, European decision-makers urgently need to:

— Take stock of the significant slippage of the European economy and financial market in the last few years, understand its root causes, and take vigorous steps to reinvigorate it;

— Develop a renewed **vision** of the role of the financial sector, enabling it to fully realise its societal function and support geopolitical, demographic and economic objectives;

— Ensure effective **consistency** between the general ambitions and actual outcomes of legislative and regulatory measures.

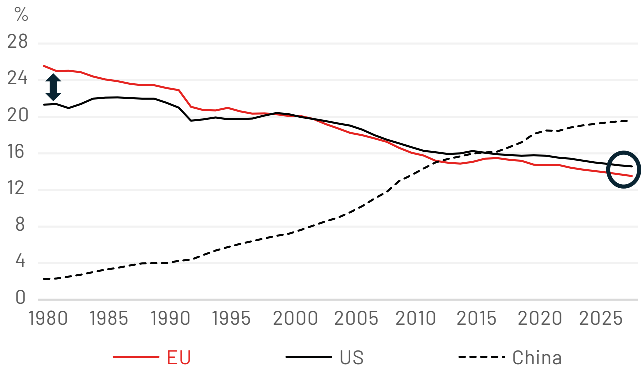
8 Source: La création monétaire bancaire pour financer la transition énergétique (revue-banque.fr).

1. Reinvigorating the EU's competitiveness is urgent

A. The EU's global footprint has shrunk worryingly...

Metrics clearly showing the EU's loss of competitiveness are legion. A quarter of a century ago, the EU still accounted for a symbolically higher **share of global GDP** (20.4% in 1998 at purchasing power parities) than the US (20.1%) and China (6.7%). Today, the IMF expects the EU's share to fall to 13.5% by 2028, lagging the US (14.6%) and China (19.6%) significantly (Chart 1).

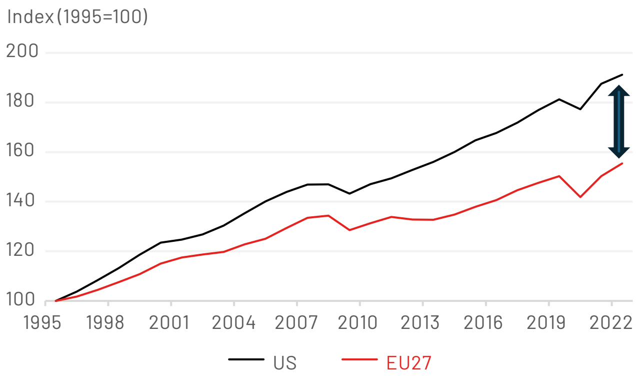
Chart 1 – Share of world GDP



Source: IMF. GDP calculations based on purchasing power parity.

This inversion of rankings largely reflects a **sluggish economic growth** in the EU compared to the US in recent decades: from 1995 to 2022, GDP grew by a factor of 1.9 in the US, compared with less than 1.6 in the EU (Chart 2).

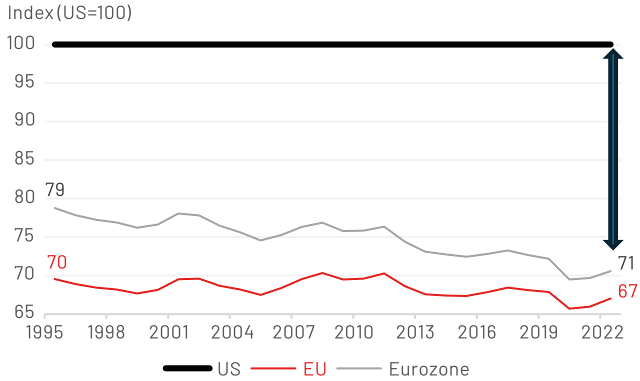
Chart 2 – GDP



Source: IMF. Constant prices in PPPs (purchasing-power parities).

For Europeans, the EU's relatively subdued economic activity of recent times has translated into relatively lower **per capita income**. EU GDP per head now stands at 67% of the level reached in the US, down from 70% in 1995 (Chart 3).

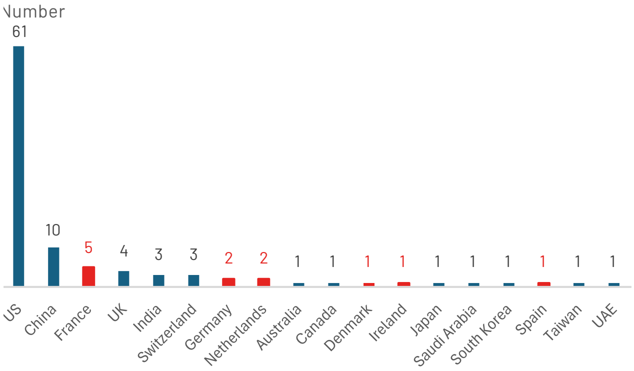
Chart 3 – GDP per head



Source: OECD. Constant prices in PPPs (purchasing-power parities).

Naturally, this overall picture has radical consequences for companies – and the financial industry in particular. Today, while more than 60% of firms ranked in the **top 100 market capitalisations** are US-based, Europe has only a dozen in this top 100 (Chart 4).

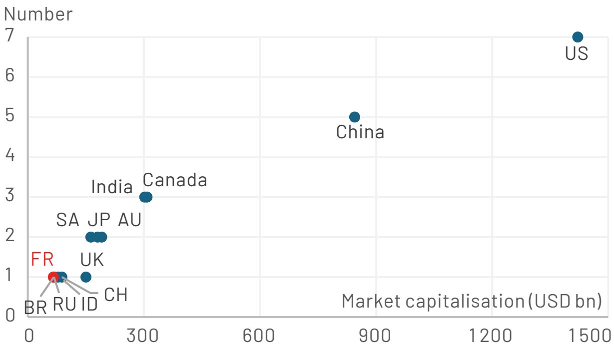
Chart 4 – Top 100 companies market capitalisation: country breakdown



Source: companiesmarketcap.com. Data collected on 15 February 2024.

Regarding **banks**, the comparison is even more unfavourable: the market capitalisation of the largest US bank exceeds the aggregate market capitalisation of the 11 largest EU banks, while only one or two EU institutions rank among the top 30 banks by market capitalisation (Chart 5).

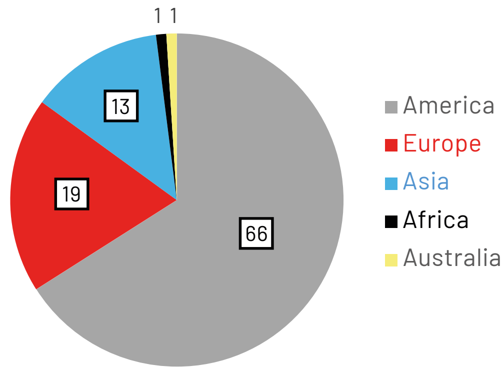
Chart 5 – Top 30 banks market capitalisation: country breakdown



Source: companiesmarketcap.com. Data collected on 15 February 2024.

Europe's **asset management** industry has suffered similar decline. Looking at the assets under management of the world's top 100 investment institutions, Europe's share of the global fund management market has dropped noticeably in recent years: in a highly concentrated sector, where the assets managed by the top ten institutions now represent 54% of the total assets managed by the top 100 firms, only one European firm ranks among the top ten, while two-thirds of the top 100 institutions are in the US[9] (Chart 6).

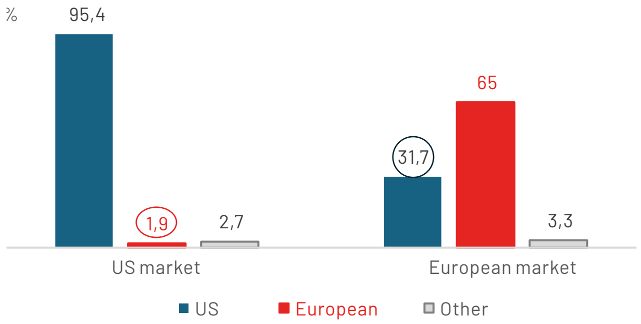
Chart 6 – Top 100 asset managers: country breakdown (%)



Source: Sovereign Wealth Fund Institute.

In addition, there is no reciprocity in overseas access to domestic markets: US-based asset managers have a much higher market share in Europe (around 32% at the end of 2023) than European institutions have in the US (2%) (Chart 7).

Chart 7 – Asset management in the US vs Europe: market share by nationality of institutions



Source: Broadridge, end-2023 data.

European financial institutions have lost market share in the EU in many other areas. Data shows that US banks now have a preponderant share of the EU corporate and investment banking market (around 50 %, while EU banks hold only 35%).

This asymmetrical situation shows that the EU's financial market is extremely open compared to other regions. In the "open strategic autonomy" agenda, therefore, openness should not be a priority.

European positions are also under pressure on the **insurance** front, with the US accounting for the majority of the world's top 25 insurers, which include only five European companies (the largest of which is French)[10].

9 Source: Sovereign Wealth Fund Institute.

10 Source: Reinsurance News. Insurers are ranked by net premiums written in 2022.

This overview is of course not exhaustive. Other metrics illustrate even more clearly the relatively modest footprint of the EU financial sector on the global capital markets stage:

— In many EU countries, financial and insurance activities represent a percentage of national output more than twice lower than in the US: around 4% in Germany and France, vs. 8.6% in the US[11];

— No EU institutions are among the top 100 hedge funds, which are made up of 83 US and 16 UK institutions[12];

— Just two EU firms rank among the 25 largest private equity companies, compared to 18 US institutions[13];

— As regards "unicorns" (privately held start-ups valued at USD 1 billion or more), only five EU companies rank among the world's top 100 firms, compared to 58 in the US[14].

Of course, size is not the be all and end all, nor the only driver of competitiveness. However, it gives large non-EU players much more capacity to invest than their EU peers, notably in technology – which compounds the competitiveness gap yet further. This relatively low level of investment in IT and digital technology in the EU is evidenced by the lack of European players not only among the top financial institutions, but also among Big Tech firms, platforms, data providers – as well as in the broader financial ecosystem as a whole, including leading credit rating agencies.

In particular, **Big Tech** represents a major and growing challenge for both EU champions and EU authorities[15], because Big Tech intra-group interdependencies (i.e. the interconnectedness between finance, data and technology) create new risks that, given the groups' size and international scope, are especially difficult to identify and monitor for both the companies themselves and the EU supervisory authorities. Indeed, the footprint of Big Tech firms is rapidly increasing in the financial sector, potentially enhancing financial inclusion and tailored (personalised) services for some individuals or small businesses – but also creating regulatory and supervisory challenges.

Such challenges mainly include an unlevel playing field, regulatory fragmentation, lack of transparency in terms of risks (data protection, cloud, cybersecurity and AML/CFT), with potential impacts in terms of financial stability, market dominance, price discrimination, algorithmic discrimination and user privacy risks (e-ID and biometrics, for example). Greater regulatory harmonisation and a technology-neutral, horizontal and flexible legislation should therefore be produced through collaboration between the relevant authorities and sectors, to facilitate technological interoperability across countries and in line with global standards.

While these trends are a major concern, it is not too late for the EU authorities to react. Indeed, the EU financial system continues to see a number of success stories, be they in banking, insurance and asset management or financial market infrastructures. These successes should be encouraged. The downsizing/refocusing strategies of some medium-sized and small players – which may not have the scale to absorb the rising costs of doing business – should be reviewed. The goal should be to maintain a wide diversity of players within the EU financial ecosystem, both in size and in business mix, because diversity is a source of resilience that should be kept intact to ensure that all Member States can benefit from an efficient and resilient financial system.

11 Source: OECD, based on latest available data.

12 Source: Sovereign Wealth Fund Institute.

13 Source: Private Equity International, based on private equity capital raised over the five years to 31 March 2023.

14 Source: Failory.

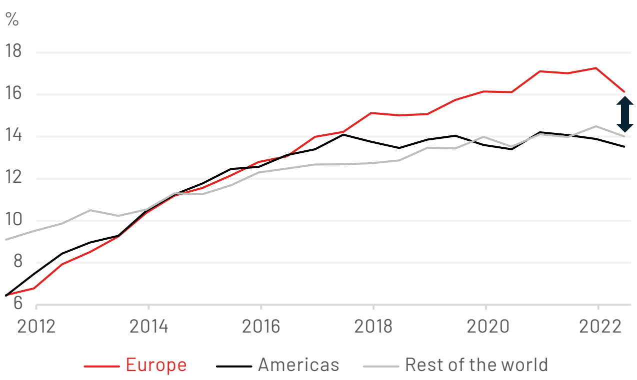
15 See in particular a recent Joint ESAs report: https://www.esma.europa.eu/sites/default/files/2024-02/JC_2024_02_Joint_ESAs_Report_on_2023_stocktaking_of_BigTech_direct_financial_services_provision.pdf.

B. … despite a resilient and highly regulated financial system…

Over the EU's last two legislative cycles, the main policy focus in the financial services area has been to increase the **resilience of the financial sector** as a key response to the global financial crisis and the eurozone sovereign debt crisis. This goal has incontestably been fully met, and the string of recent events and multi-faceted crises have confirmed the EU financial sector's undeniable robustness and ability to perform its shock-absorber role to perfection. However, this highly desirable outcome has been obtained to quite a large extent at the expense of its competitiveness.

There is no question that EU banks' **solvency** ratios have outperformed those of their US counterparts since the end of 2016 (Chart 8). Specifically, as of Q3 2023 EU banks had an average Tier 1 ratio of 15.8%[16], substantially higher than that recorded by banks located in other regions. But this has had the significant knock-on effect of limiting the distribution of loans to the economy and profits to shareholders.

Chart 8 – Bank Tier 1 ratios by region

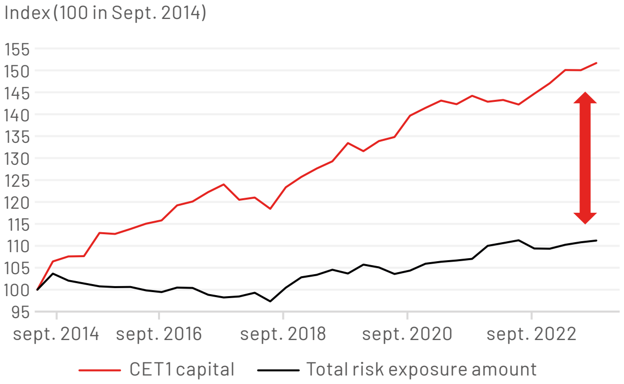


Source: BIS.

And while Tier 1 ratios (a key measure of a bank's capital strength) have been plateauing since 2016 in the rest of the world, banks in the EU have been continuously required by authorities to further raise their capital levels. While EU banks have increased their capital base by close to 40% since 2014, their risk exposure amount, i.e. the financing of the economy through lending and market activities, has barely increased since 2014 (Chart 9).

Over the last 10 years, most of the EU banks' retained earnings have actually been set aside to comply with regulatory and supervisory pressure, and only a minimal share could be used to finance organic growth or consolidation moves. Given the need to scale up the financing of the economy, it is crucial to urgently revert this pattern, including in the upcoming implementation of CRR3-CRD6.

Chart 9 – EU banks solvency indicators



Source: EBA.

In addition, banks operating across the EU are also subject to a complex set of supplementary, partially overlapping micro- and macroprudential buffers imposed by different authorities. The relatively opaque and extremely complex design of the buffer framework, combined with a lack of coordination between these authorities, contributes to regulatory duplications and capital overaccumulation within EU banks. This in turn weighs on their ability to generate revenue and remain competitive, with impacts on pricing and negative consequences for the financing of EU companies and households. In 2023, the accumulation of layers of buffers led to a record high average overall capital requirement of 15.5% for SSM-supervised banks, up 0.4% from 2022, in a period that can certainly not be considered as seeing overheating.

So, given that the 2014-2023 period saw a rise in the level of indebtedness of both companies and households in many countries, this implies that a large part of this additional funding has been provided from outside the EU banking sector – notably by non-EU banks or non-banking financial institutions.

In any event, the EU banking sector's capital strength now stands at record-high levels, as evidenced also by the very positive performance registered by EU banks in the latest round of stress tests. As the EBA noted in the Executive Summary of its report on the 2023 stress tests[17], where the adverse scenario entails losses of EUR 496 billion (an amount largely exceeding the losses incurred during the global financial crisis), "the results of the stress test

16 Source: EBA (https://www.eba.europa.eu/sites/default/files/2024-01/8039a4ea-6e61-45a9-a746-058fd070c34a/EBA%20Dashboard%20-%20Q3%202023.pdf).

17 Source: EBA (https://www.eba.europa.eu/sites/default/files/document_library/Risk%20Analysis%20and%20Data/EU-wide%20Stress%20Testing/2023/Results/1061374/2023-EU-wide-stress-test-Results.pdf).

indicate that on average banks finish the exercise in the adverse scenario with a Common Equity Tier 1 (CET1) ratio above 10% and show that banks can continue to support the economy also in times of severe stress".

Furthermore, banks EU-wide have demonstrated their resilience not only in successive stress tests but also in **real-life tests** such as the Covid pandemic and Russia's invasion of Ukraine, and therefore represent a core response for absorbing shocks in periods of tension and economic recession (or worse). They can be credited with:

— Supporting companies (mostly SMEs) and households during the pandemic, through government-backed loans and other forms of support such as debt moratoria;

— Offsetting the sudden halt observed in the corporate bond and commercial paper markets in early 2020, by providing companies with additional credit lines and syndicated loans;

— Absorbing part of the energy market disruptions at the onset of the Russian war by enabling major energy producers to continue to hedge their activities in derivatives markets despite skyrocketing margin calls;

— Implementing with unswerving diligence all resulting sanctions programmes, as a cornerstone of EU foreign policy.

Therefore, at this stage, any new increase in **capital requirements** looks very difficult to justify from a financial stability standpoint. Certainly:

— In implementing **CRR3/CRD6,** EU regulators and supervisors should uphold their objective of "avoid[ing] a significant increase in overall capital requirements for the EU banking system"[18], by recalibrating buffer requirements and allowing lower capital ratio targets.

— EU policymakers should avoid drawing inappropriate lessons from the 2023 non-EU banking turmoil. The liquidity issues experienced by certain US and Swiss institutions were not experienced by their EU peers, which did not suffer any type of contagion, showing therefore once again their strong resilience in the face of adverse financial conditions. There is thus no need to envisage any specific regulatory or supervisory response at the EU level, as the problems experienced by these non-EU banks were basically due to inappropriate implementation of internationally agreed rules (i.e. those of the Basel Committee on Banking Supervision – BCBS) or to supervisory inadequacies in their own jurisdiction. The EU Single Rulebook and the Banking Union's supervisory practices do not present any of these weaknesses.

— For this reason, and given the uncertainties in the timing and content of the implementation of the Fundamental Review of the Trading Book (**FRTB**) in the US and, to a lesser extent, the UK, it is essential now to implement the FRTB delegated act contained in CRR3/CRD6. Given the necessity to adapt its IT systems, the industry needs much more visibility, as 1 January 2025 is as good as upon us. Completing all the necessary steps to apply a delegated act will be a real challenge in an EU election year. The current European Commission should thus postpone this implementation immediately, to give itself more time later to recalibrate, if need be.

— In this regard, resetting the Banking Union agenda is fundamental. The focus on a single deposit guarantee scheme is both politically sensitive and financially misplaced, as the EBA[19] has established that 96% of depositors have their deposits fully guaranteed by their national guarantee scheme, based on existing EUR 100k thresholds. The key priority should be rather that EU banks operating in several countries be allowed to efficiently pool their liquidity to serve customers under similar conditions across the EU, fostering private risk-sharing, convergence of financing conditions and equal competition for businesses. Further consolidation of the EU banking sector could also raise the fastest-growing players to a level of competitiveness closer to that of their non-EU peers. In this regard, cross-border investments and the integration of entities with different national legal statutes should be facilitated.

— Last, the **macroprudential** framework should also be reviewed so as to avoid any future possible increase in capital requirements (including via the countercyclical buffer or the systemic risk buffer) on top of the already significant increase caused by CRR3, as that would further harm the position of EU banks.

→ Ensure a level playing field with non-EU jurisdictions

for insurance companies, asset managers and financial market infrastructures (Recommendation 1.c).

The resilience of the financial system is also apparent beyond the banking sector: the European Systemic Risk Board (ESRB), for example, has noted[20] that investment funds, financial market infrastructures and other financial firms, though playing an increasingly prominent role in the financing of non-financial companies (NFCs), have also remained resilient throughout recent crises. In particular, central securities depositories (**CSDs**), as key market infrastructures supporting issuers and investors by providing post-trade processing of financial instrument contracts,

18 Source: https://www.consilium.europa.eu/media/59970/st13772-en22.pdf.

19 Source: EBA (https://www.eba.europa.eu/publications-and-media/press-releases/increase-current-deposit-coverage-level-eur-100000-would-have).

20 Source: ESRB (https://www.esrb.europa.eu/pub/pdf/reports/nbfi_monitor/esrb.nbfi202306~58b19c8627.en.pdf?d568669efe80c0c436fa42878bdd41cf).

settled a vast number of public debt securities during the pandemic without incident, thus confirming their solid performance and resilient business model in crisis situations.

Ultimately, the transformational capacity of the banking sector alone can only work to a certain extent. Equity is needed to buffer external shocks, and will become increasingly essential to enable public equity capital markets to perform to the best of their ability in helping businesses weather and prepare for ongoing and future challenges. Periods of crisis also offer interesting insights into how the markets work: at times of high uncertainty, the importance of the primary markets is much more evident as more trading volumes go to regulated markets, where core price formation takes place.

In conclusion, the EU has reached a point where the legislative agenda should be redirected from focusing mainly on restoring financial stability to placing stronger emphasis on competitiveness and growth, to better finance the twin transition.

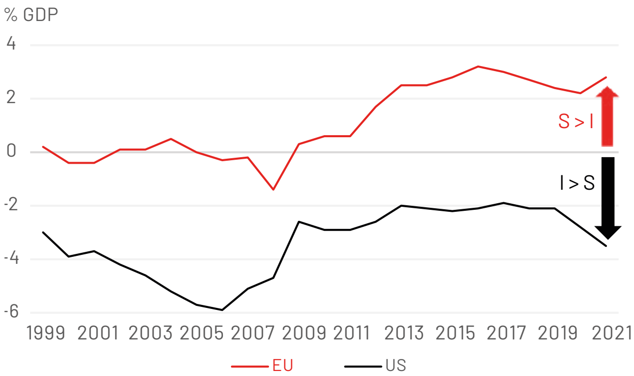
→ **After 15 years of financial reforms aiming at reducing risks associated with the financial sector, use the regulatory agenda** to facilitate prudent risk-taking and investments (Recommendation 1.a).

C. … hence an urgent need to promote appropriate investments…

The two Capital Markets Union (CMU) action plans issued in 2015[21] and 2020[22] clearly illustrated how active EU policymakers can be in defining new regulatory goals. Yet most observers now recognise that results on the ground have been somewhat meagre. Specifically, the set of heavy regulatory initiatives accumulated over the last five years has led to huge implementation costs but, for most Member States, no clear and measurable impact in terms of economic growth, competitiveness, attractiveness or even income distribution.

The excess of savings over investment in the EU, as conventionally measured by its (almost structural) current account surplus, has actually increased over the latest decade (averaging 2.6% of GDP over the 2012-2021 period), by contrast with the US, which invests more than it saves and thus shows a gap of the same order but in the opposite direction, at - 2.4% of US GDP over the same period (Chart 10).

Chart 10 – Current account balance



Source: European Commission.

This **gap in investment** now has to be tackled urgently for the sake of the EU's future. The approach adopted thus far – massive regulation – has been ineffective; we thus need less red tape and more investment projects. To boost investment, we urge policymakers to make CMU happen, credibly and quickly. Failing this, the multifaceted decline of the EU could well continue: EU gross fixed capital formation has already fallen over the last decade, averaging 21.1% of GDP from 2013 to 2022 compared to 22.2% between 1998 and 2007[23], before the global financial crisis.

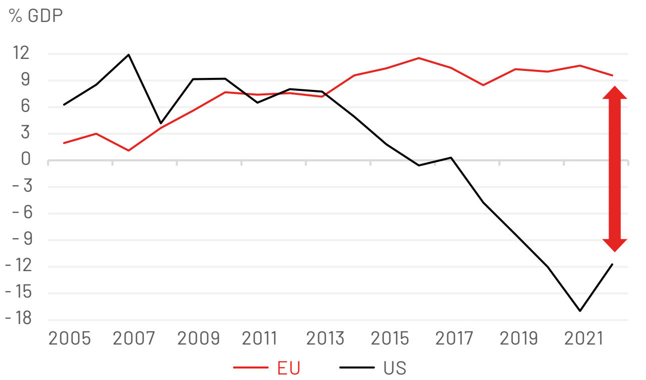
21 See https://finance.ec.europa.eu/publications/action-plan-building-capital-markets-union_en.

22 See https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/capital-markets-union/capital-markets-union-2020-action-plan_en.

23 Source: Eurostat.

More critically, historical foreign direct investment (FDI) data tells the same story: outward outstanding FDI (i.e. EU investments overseas) has largely outpaced inward outstanding FDI, whereas the US is now in the opposite position, receiving more foreign money than the amount it has invested abroad (Chart 11).

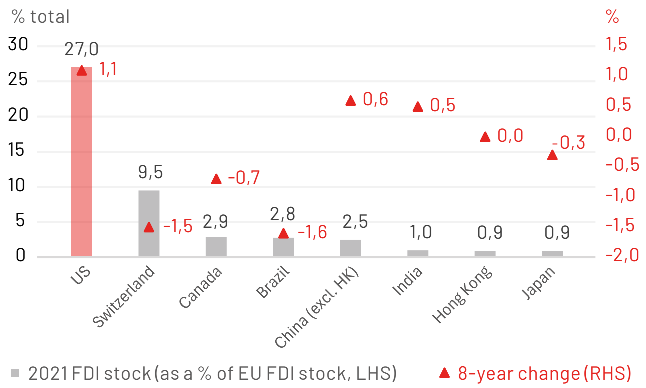
Chart 11 – FDI net position: "Outward" minus "Inward"



Source: OECD.

Admittedly, one might think that this position could be profitable and therefore positive for the EU economy, earning it large amounts of revenue that translates into richer companies and more jobs created at home. Unfortunately, the reality is different. Not only is the US now by far the biggest beneficiary of EU FDI (garnering more than a quarter of the EU's total FDI), but in recent years it has been increasingly favoured as an investment destination compared to other regions (Chart 12).

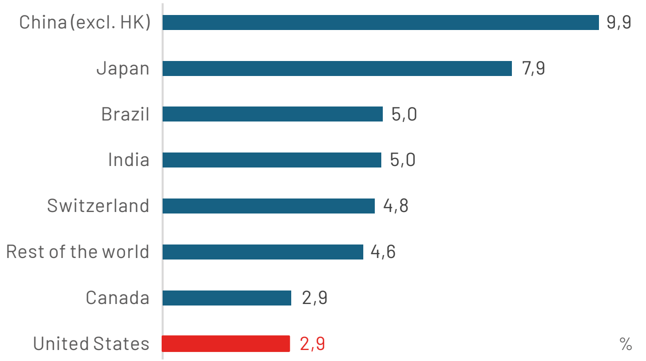
Chart 12 – EU FDI stock



Source: Eurostat.

Unfortunately, the **rate of return** on EU FDI poses a real issue on account of this geographical weighting in favour of the US: although the US is the main recipient of EU savings, the ratio of FDI income to FDI stock for the EU is substantially lower in the US than it is in other countries (Chart 13). In other words, the disparity between the regional breakdown of the EU's FDI position and its regional rate of return should be an important topic to consider for EU authorities, because the destination of EU savings seems less than perfectly rational in purely rate of return terms.

Chart 13 – Annual rate of return on EU FDI (2013 – 2021 average)



Source: Eurostat.

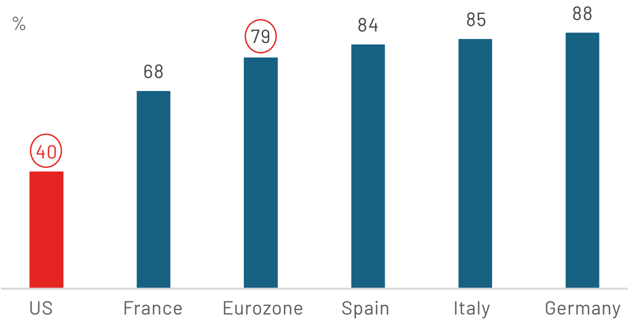
Given in particular recent pieces of legislation passed in the US, such as the IRA, this attractiveness of the US could well continue in the coming years. EU investment projects therefore crucially need to be accelerated, concretely feasible and precisely defined nationally and locally. Indeed, we advocate for much greater public but also essentially private investment within the EU – a crucial objective to meet for the bloc's future prosperity. Building highly attractive financial markets to obtain additional funds is therefore a prerequisite to making the EU's official pledges and goals a concrete reality.

→ Improve visibility and readability,
and reduce the red tape hindering access to EU and Member State support programmes (Recommendation 2.a).

D. ... through more attractive, defragmented financial markets

Among the various goals referred to in the latest CMU action plan, a key one was reducing the EU economy's excessive reliance on bank lending. A decade later, NFCs' **dependency** on bank financing remains unchanged (Chart 14): the share of NFC debt financed by bank credit is twice as high in the eurozone (79%) as in the US (40%).

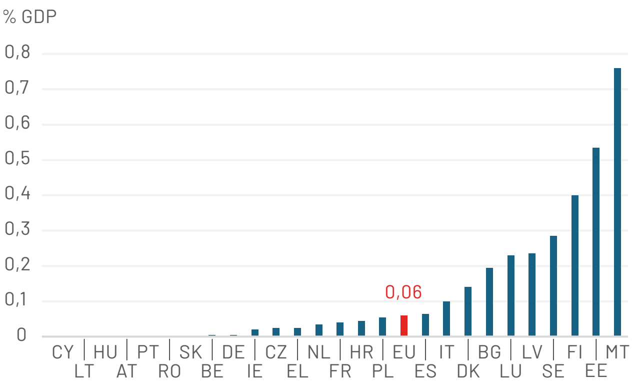
Chart 14 – Share of bank credit in non-financial companies' total debt



Source: Banque de France. Data as of 30 June 2023.

In fact, EU financial markets may not be well-enough adapted to convince NFCs that markets can be a cost-efficient source of money to finance investments and jobs. For example, the annual value of European initial public offerings (IPOs) averaged 0.4% of GDP between 2015 and 2022, according to the European Commission. For EU SMEs more specifically, capital raised through IPOs is paltry, totalling less than 0.1% of GDP per year and with large disparities noted across Member States (Chart 15).

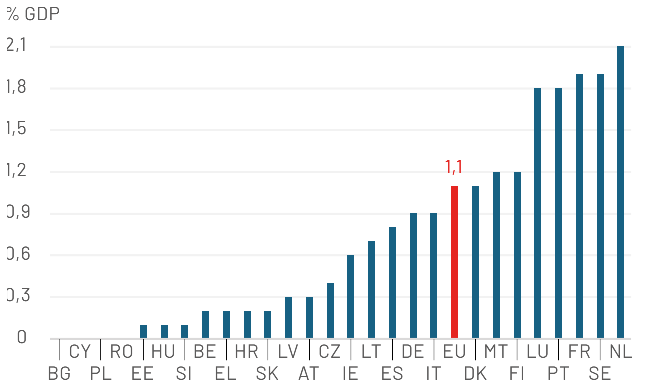
Chart 15 – SME IPOs



Source: European Commission. Data based on the 2021-2022 average.

But it isn't just IPOs: bonds issued by EU corporates, equivalent to 1.1% of GDP in 2022, present a similar picture: EU bond markets are simply not big or liquid enough to provide funding consonant with NFCs' investment needs, and substantial discrepancies still prevail at national level (Chart 16).

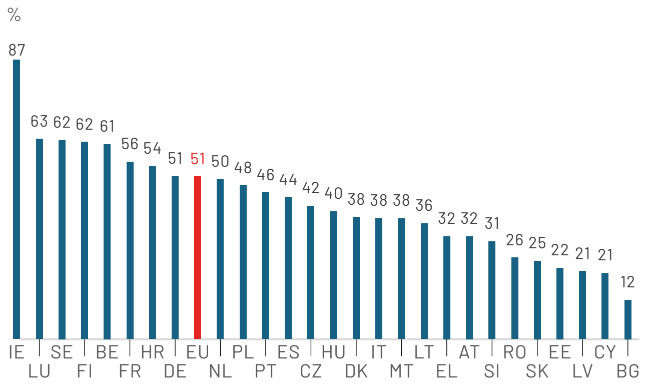
Chart 16 – Corporate bonds issuance



Source: European Commission. 2022 data.

As a result, scaling up business investments via easy-to-access financial markets is far from being a done deal for the EU. Calculating a market funding ratio by dividing the value of corporate bonds and listed NFC shares by the sum of those two and bank loans to NFCs produces a ratio that is still below 50% for a large majority of Member States (Chart 17).

Chart 17 – Market funding ratio



Source: European Commission. 2021 data.

Also, importantly, fragmentation is an ongoing phenomenon in both banking and capital markets. In the banking industry, despite the implementation of a Single Supervisory Mechanism and a Single Resolution Mechanism, capital and liquidity continue to be trapped within national boundaries, and banks still have to cope with the absence of meaningful cross-border capital and liquidity waivers, even within the eurozone. Even the ECB's ability to grant limited cross-border liquidity coverage ratio (LCR) waivers remains unused, as the decision-making process is still largely national. Moreover, this issue is exacerbated by the approach taken toward large-exposure exemptions, creating an unlevel playing field and, in some cases where limits are applied via national regulatory disposals, acting as a direct, legal impediment to the cross-border flow of funds[24].

→ Facilitate cross-border investments by banks
through waivers on liquidity, capital and MREL (Recommendation 6.c).

Banks aside, considering financial markets where some consolidation has already occurred at the level of exchanges, regulatory and post-trade fragmentation is still limiting the capacity for truly seamless liquidity. Granted, Target2-Securities (T2S) set out to lay the foundations for a single market for securities settlement, but it has stopped short of providing interoperability for operations performed by local **CSDs** in the absence of a harmonised legal regime across Europe, especially in securities and tax law. For instance, European equities are issued, held in custody and settled in around 25 different CSDs. Most of these CSDs operate a common settlement platform (T2S) but run their own issuance and custody platforms which support complex processes (corporate actions, tax, etc.) resulting from different local regulations.

Despite numerous industry attempts to standardise these processes as far as possible, there still remain significant differences between countries and CSDs. The fragmentation of CSDs arises essentially from a lack of harmonisation of the legal regimes governing securities, which makes it impossible to create a single platform for managing securities in Europe. For financial intermediaries, there is therefore a friction cost every time they want to access a new equity market. Moreover, many banks operate different local platforms to access different CSDs, making cross-border integration challenging. It is thus up to bottom-up projects such as the integration of the French, Dutch and Belgian CSDs owned by Euroclear into the ESES common platform (that of the Italian, Danish and Norwegian CSDs owned by Euronext), or that of the merged Latvian, Estonian and Lithuanian CSDs owned by Nasdaq, to provide partial economies of scale and market alignment.

Last, **investment fund markets** are also still highly fragmented in the EU, for various reasons:

— Regulatory divergence: each European country has its own set of financial regulations and regulatory bodies. This creates a complex and diverse regulatory landscape, in which fund managers face the challenge of navigating and complying with a variety of rules across different markets;

— Cultural and linguistic diversity: Europe is characterised by multiple languages, cultures and investor preferences. This diversity makes it difficult for fund managers to create standardised products that cater to the unique needs and expectations of investors in each country. Language requirements and marketing practices also differ significantly from one country to the next;

— Tax considerations: differences in the tax treatment of investment gains, dividends and other financial transactions can significantly impact the attractiveness of investment products;

— Market infrastructures such as trading platforms, settlement systems and custody services can differ across European countries, creating operational challenges for fund managers looking to operate seamlessly across borders;

— Distribution of investment products, investor behaviour and historical legacy.

→ Prioritise regulations that meet subsidiarity and proportionality objectives over directives,
to avoid transposition divergences and limit scope for national gold-plating (Recommendation 5.c).

24 Internal Minimum Requirements for own funds and Eligible Liabilities (MREL) also apply at the level of all subsidiaries and cannot be waived across Member States, even if these entities are not material subgroups but stand within the scope of a single resolution authority, i.e. the Single Resolution Board in the Banking Union. This EU policy goes beyond the internationally agreed Total Loss Absorbing Capacity (TLAC) standard rule. Lastly, cross-border waivers for capital (whether risk-based or under the leverage ratio) are not available and the recent agreement on the implementation of the final Basel 3 standard rules in the EU has only compounded the situation by requiring the application of one of its key features, the so-called output floor, also at the legal entity level or at best at a sub-consolidated national level.

2. A new vision for the EU's financial system: towards a Single Market for Finance

A. Finance is key to ensuring the EU's long-term prosperity...

In order to propose a new vision for the EU financial system, we need to remind ourselves how crucial it is to determinedly reposition **the financial sector at the heart of the EU's future,** as a cardinal economic and social engine. Indeed, for reasons that came to the fore in the aftermath of the global financial crisis, the EU financial sector continues to suffer from certain stigmas. We believe that the regulatory overhaul implemented since then should now allow EU policymakers to address this situation, provided that they adopt a pro-active, fact-based and constructive approach.

Given the high degree of resilience shown by the EU financial sector, recalibrating its popular perception is long overdue.

Fortunately, customers' trust in the financial industry's resilience has recently improved. Current resolution disposals, deposit guarantee schemes and other customer-related protection frameworks now make it very likely that any new crisis in the future can be solved without recourse to taxpayers' money, which would of course be very welcome.

As a result, the resilience witnessed by the financial system is now clearly translating into a higher level of **trust** in citizens towards financial service providers. In particular, according to the latest European Commission Eurobarometer survey conducted in June 2023[25], 69% of Europeans believe that the EU has sufficient power and tools to defend the bloc's economic interests in the global economy. Support for the euro in the EU as a whole also remains high (71%), close to its record of 72% reached one year ago and 20 points higher than the trough of 51% touched after the eurozone sovereign debt crisis, in 2013.

The financial sector has a large stake in society as an important job provider, totalling 5.4 million jobs in 2022 and close to 3% of total employment in the EU, a broadly stable share over the last 15 years. Brexit also played a role in relocating jobs to the EU, notably – but not only – in finance, with positive multiplier effects on domestic job markets and the opportunity to repatriate and retain talents.

Of course, a challenge for EU and national policymakers is now to continue to **attract and keep** these **mobile individuals** and their families, through appropriate administrative, housing and school facilities.

→ Improve administrative, housing and school facilities
across Member States to attract and retain EU and non-EU talents, encourage intra-EU mobility and create a common financial and risk culture (Recommendation 7.d).

In addition, talents have to be forged from the EU's younger generation, via upgraded educational and training systems, to better feed economic activity again – an ongoing project.

Comparing the contribution of finance to GDP of 3.9% in the EU with the 8.2% in the US shows that the EU's financial sector is underdeveloped and that its growth potential, both in terms of jobs and contribution to GDP, could be quite a significant lever for the EU's overall growth agenda.

→ Boost the EU financial sector's contribution to growth and job creation
by consolidating educational and training systems to develop a more qualified workforce (Recommendation 7.c).

25 Source : https ://europa.eu/eurobarometer/surveys/detail/3052.

A robust financial system is also essential as it probably constitutes one of the biggest drivers of technological innovation. This is particularly true as regards AI, distributed ledger technology (DLT) such as blockchain, payment systems, digital identity and cybersecurity, where financial players have been at the forefront of innovation for decades. Needless to say, the financial system will also remain a key lever for helping achieve the green transition.

In sum, to get a new Single Market for Finance agenda moving and ensure real consistency between official intentions and concrete policies, it is now essential to develop and share a positive narrative about the added value of the financial sector, in order to avoid the frequently negative rhetoric which led to excessively restrictive and unproductive policies in the most recent legislative cycles.

Above all, we believe that the initial narrative of the CMU, aimed at rebalancing the EU economy's over-reliance on bank funding, should be relinquished: considering the vast scale of investment needed in the EU by 2030 and beyond, we think all levers should be developed jointly and not at each other's expense.

B. … by prompting a refocusing of regulatory policies…

A deep **change of mindset** in the design of EU regulations is therefore urgently required to ensure that rules and objectives are consistent and aligned. Regulations should be examined specifically with a view to assessing the impacts they have on the ability of financial institutions and markets participants to be competitive enough, so as to provide the capital the EU economy needs to ensure a robust, sustainable future. This means that when a reform is on the agenda, its impact should be carefully and seriously assessed in terms of:

— The long-term performance of the EU's real economy;

— The competitiveness of EU financial players and markets, especially relative to their main overseas peers such as the US, the UK and Asia.

Credible **competitiveness tests** should thus be a key element of the impact assessments already carried out – which more often than not lack sufficient detail or are biased – by the European Commission for any new legislative initiative and by ESAs for regulatory drafts.

→ **Carry out credible independent competitiveness tests**
ahead of any new regulatory proposal (Recommendation 1.b).

Concretely, the official **mandate** of all regulatory and supervisory bodies should be amended to include competitiveness and long-term growth objectives, as observed in the US and, since 2023, in the UK. Indeed, the UK's Financial Conduct Authority now has a secondary international competitiveness and growth objective[26], as does its Prudential Regulation Authority[27]: it consists for both bodies in "facilitating the international competitiveness of the UK economy including in particular the financial services sector and its growth in the medium to long term".

As a consequence, introducing an explicit competitiveness mandate would be a critical step towards reducing the bias toward conservativeness and hawkishness that has too frequently proved to be a natural but very costly tendency shown by several ESAs and national competent authorities, since the 2009 crisis in particular.

26 Source: https://www.fca.org.uk/publication/corporate/secondary-international-competitiveness-growth-objective-statement.pdf.

27 Source: https://www.bankofengland.co.uk/prudential-regulation/secondary-competition-objective#:~:text=The%20secondary%20competition%20objective%20(SCO,our%20framework%20for%20prudential%20regulation.

→ Add to regulatory authorities' mandates
an objective of facilitating the EU's international competitiveness and long-term economic growth (Recommendation 3.a).

Moreover, additional safeguards are urgently needed to ensure proper accountability and efficient implementation of such a change. The recently introduced UK framework, modifying the Financial Services and Markets Act 2000[28], offers an interesting benchmark in that respect. Specifically, the UK has been putting in place a new operational processes by which:

— Each financial regulatory and supervisory institution has to release an annual **report** on competitiveness;

— Parliament organises regular competitiveness **hearings**;

— Each new regulation has to be examined, in order to "advise" the FCA or the PRA, through an independent "**Cost Benefits Analysis Panel**" made up of experts including at least two individuals from two different authorised firms and excluding any individuals remunerated by the FCA, the PRA, the BoE, the PSR or HM Treasury.

In practice, if the EU wants the competitiveness agenda to really filter down to the regulatory process and to give concrete meaning to its aspirations in this area, it should consider implementing similar initiatives.

→ Deepen dialogue with practitioners
via high-level groups, hearings and panels, and in particular involve them in *ex ante* impact analysis (Recommendation 3.d).

Today, financial regulation in the EU has become excessively complex and burdensome, piling up layers of unclear requirements and loading duty after duty onto any given economic activity, a practice virtually unseen in the world's other advanced economies. So, instead of ex-ante prescheduled reviews to amend rules, we suggest **targeted and flexible reviews**, which could be rapidly triggered once the need to adapt an existing piece of regulation has been demonstrated. Such reviews could thus quickly take into consideration significant changes observed in the EU or abroad, making the EU regulation adaptable to new conditions. For example, while the implementation of SFDR, a critical piece of the EU ESG agenda aimed at fostering trust in customers when buying a "green" product, has brought major flaws to light, with the need to amend certain fundamental aspects, the current process will likely only provide an answer by around 2027, much too late to channel savings into green investments before the 2030 Fit for 55 deadline. The EU needs a quick fix for the SFDR.

Indeed, increasing the agility of the EU level 1 legislative process is urgent. The ability of the European Commission and co-legislators to deliver "**quick fixes**" during the pandemic in a matter of weeks – rather than years as is generally the case – should become an example rather than an exception, and even a new target to aim at.

→ Allow swift adjustments when rules appear to have unintended consequences
(i.e. quick fixes, to be implemented in weeks rather than years), while avoiding systematic reviews to reduce unnecessary regulatory uncertainty and implementation costs (Recommendation 5.a).

In return, such a change would also require more explicit **accountability** of ESAs and supervisors toward co-legislators, as well as a much more constructive and systematic dialogue with industry participants.

→ Make ESAs fully accountable to co-legislators
for the competitiveness outcomes of their regulatory actions (Recommendation 3.c).

For sure, these new mandates would need to be framed by a process tightly controlled by the European Commission and the co-legislators, but this has the upside of offering another opportunity: although the European Commission already has the possibility of quashing a level 2 or 3 regulatory initiative if it is deemed **inconsistent with the spirit** of the level 1 text, very rarely does it use this option. Instead, it should be used more frequently when needed, in particular to impede or mitigate any **gold-plating**, whether this is intended or not.

→ Discourage gold-plating
via more frequent use by the European Commission of its existing powers on level 2 or 3 initiatives that are inconsistent with level 1 (Recommendation 5.b).

There are actually multiple cases of regulators or supervisors **gold-plating** level 1 texts at level 2 or 3. A recent example is the EBA's draft implementing technical standard (ITS) on Pillar 3 disclosures[29], published for consultation until 14 March 2024. This ITS, which aims to incorporate the changes introduced by CR3/CRD6 – notably the introduction of the output floor – into the disclosure requirements for banks, proposed to require the disclosure of the banks'

28 See https://www.legislation.gov.uk/ukpga/2000/8/section/1EB.

29 Source : https ://www.eba.europa.eu/publications-and-media/events/consultation-draft-its-pillar-3-disclosure.

capital ratios and risk-weighted assets in a "fully-loaded" way as early as 2025, therefore removing any benefit provided by the level 1 text from:

— BCBS' proposed phase-in approach for the output floor;

— The transitional arrangements that have been carefully drafted by the European Commission, the Council and the European Parliament, after an intense negotiation phase that lasted from 2019 to 2023.

Another recent example of gold-plating is EBA's January 2024 report[30] on the NSFR, in which it suggests reverting to the Basel standards and reintroducing asymmetry in the treatment of repos and reverse repos, on the basis that the impact is marginal on the NSFR ratios of the EU banking sector as a whole. However, Europe, similarly to all major jurisdictions, introduced the NSFR requirement with a divergence from the Basel NSFR standards for short-term reverse repos on sovereign bonds with financial customers by removing the asymmetrical treatment between short-term repos and reverse repos on such bonds. This was appropriate from a risk measurement perspective and necessary to ensure the smooth functioning of market making activities and financial markets, in particular the very critical EU sovereign debt market which represents 90% of the repo market, but also the transmission of monetary policy, and financial sovereignty – while also maintaining a level playing field with other jurisdictions.

In sum, strengthening the involvement of the financial industry and promoting expertise and independence in the cost-benefit analysis of consultation processes are without a doubt pre-conditions for a proper balance between resilience and competitiveness. By way of example, a recent case where the cost-benefit analysis was largely overlooked and underestimated by the European Commission is the **Retail Investment Strategy** (RIS) package[31], where the implementation costs were minimised and – as they are quite unlikely to materialise as expected – the argued benefits largely overestimated.

This is nothing new; other examples of such patterns abound, such as the clearing rules under EMIR, the potential misalignment with US rules of prudential rules regarding market risk for banks (FRTB), the burden of disorderly SFDR level 1 and 2 revisions and the Open Finance project, which opens the EU's door to Big Tech without appropriate safeguard provisions.

But surprisingly with the RIS, the 325-page impact assessment[32] accompanying its proposals contains important methodological deficiencies, skews information and omits relevant data. This inevitably leads to mistakes in assumptions and in the explanation of certain nevertheless correctly identified real issues, such as the need to properly managing conflicts of interest to be able to provide retail investors with crystal-clear, accurate information. Overall, the quality of the regulatory disposals proposed by EU authorities for the RIS is severely impaired, because incorrect diagnosis based on false assumptions and incomplete data leads to proposals that could present greater **negative effects for retail investors**.

Financial services should in fact be viewed as **value-added services** designed to earn legitimate revenue like any other standard economic activity. However, regulations in the past have taken a purely consumer-centric approach, considering finance as a common public good that should be delivered for free or at the lowest possible cost – even at the expense of service quality or viability of activities for EU players.

We view such an approach as highly detrimental to EU mid-size players in particular, as it creates sunk costs, barriers to entry and winner-takes-all situations, which are detrimental to fair competition. As for crypto-assets, and with Big Tech now entering such markets, EU authorities should systematically apply a simple principle when interconnectedness and economies of scale lead to oligopolistic positions: same activity means same risks and same risks means **same regulation**.

A renewed and clear mandate for ESAs would therefore avoid designing new rules that are counterproductive to the competitiveness of EU-based players – whatever their size. It is essential to ensure that concerns about open strategic autonomy do not translate into a further, naïve and unintended fragmentation and talent flight.

Defining the underlying ecosystem of the capital markets union (CMU)[33] **is also crucial when it comes to the EU's competitiveness and the efficiency of its financial markets**. Indeed, the CMU also involves an entire ecosystem of oligopolistic **non-financial players** (rating agencies, data providers, creators of indices and benchmarks). These actors – often unregulated and unsupervised, and predominantly non-European – play an essential role in the smooth functioning of European financial markets.

This dependency situation makes price formation defective, increases the cost of capital[34] and assigns no value to quality of service (data, rating, indices, etc.), with damaging effects at the end of the chain in terms of competition, investor protection and investment in the EU[35].

30 Source: https://www.eba.europa.eu/publications-and-media/press-releases/eba-publishes-analysis-specific-aspects-net-stable-funding.

31 See https://finance.ec.europa.eu/publications/retail-investment-strategy_en.

32 See https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52023SC0278.

33 See « L'autonomie stratégique passe par l'Union des marchés de capitaux », Fabrice Demarigny, 2024 https://encr.pw/LBID9.

34 See « L'autonomie stratégique passe par l'Union des marchés de capitaux », Fabrice Demarigny, 2024 https://encr.pw/LBID9.

35 See FCA 2024 study ("Wholesale data market study: benchmarks, credit ratings data and market data vendors") and BaFin market study ("Market study on the collection and handling of ESG data and ESG rating procedures by asset management companies").

Indeed, financing the economy and the twin transitions requires affordable and reliable data and benchmarks for all participants, whether investors (households and corporates) or authorities. Both financial and ESG data are crucial for ensuring stability, trust and market transparency, and thereby facilitating the channelling of funds into the right projects and companies.

However, EU financial markets players rely heavily on a small group of data providers to provide their services, fund the green transition and comply with EU regulations. This concentration on insufficiently (or un-)regulated data providers raises concerns about EU self – sufficiency and inefficient supervision, leading to a lack of transparency and reliability on key aspects of the EU investment value chain (customer information, investment allocation, supervision, transparency and reporting, etc.).

This puts asset managers and other market participants such as insurers at risk and increases the likelihood of accusations of greenwashing. Additionally, models could be calibrated based on a different market, posing a risk of misalignment with the EU's objectives.

Moreover, EU competitiveness should clearly be seen as a means of gradually enhancing performance not only within the bloc itself, but also in overseas financial, services and goods markets.

Crucially, the ability of EU financial and non-financial companies to expand their business outside the EU is a vital priority that should be at the core of the EU strategy, and regulation must be framed in accordance with a clear, appropriate agenda. This objective may require a differentiated and phased-in implementation of EU rules, especially when dealing with non-EU customers, whether in financial (e.g. securitisation) or non-financial (e.g. ESG) areas.

If all these conditions are met, we can expect the following specific benefits for the EU in addition to the general ones associated with global expansion:

— An enhanced ability to finance **emerging or developing** economies, notably in Eastern Europe and Africa, where geopolitical strains have been growing recently and climate-related investment needs are massive, notably to finance infrastructure projects;

— A wider **visibility** given to the EU's core values such as the fight against climate change, the free functioning of markets, the respect of privacy in liberal democracies and the need to ensure cooperative, consistent regulatory frameworks across regions, notably in areas where **traditional boundaries are blurry** or, such as in the case of the crypto-assets industry, where anti-money laundering and combating the financing of terrorism are vital;

— Support for EU industrial champions in their expansion across borders and promotion of these strong EU-based firms on the international scene, as a lever to implant EU **soft power** and indirect influence;

— A **diversification** of supply-chain providers (including via nearshoring) and revenue sources, potentially supporting firms' profitability along the whole value chain and thus strengthening the resilience and security of the EU as a whole.

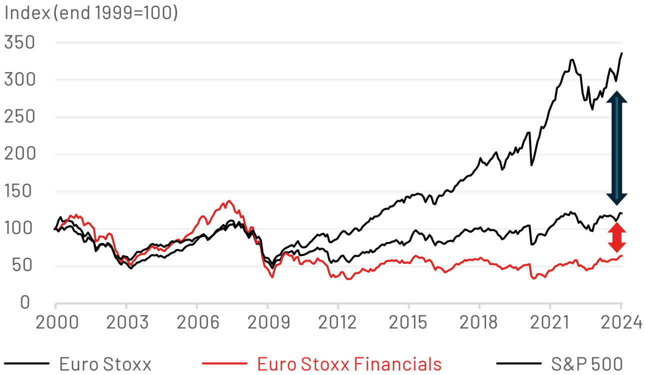
C. … and promoting fair competition to support EU champions…

As estimated above, the goals set by EU policymakers to achieve the twin transition and meet their geopolitical objectives require at least a **doubling of the annual financial flows** currently available to finance the EU economy. Inevitably, the size of EU financial players must be massively ramped up to avoid EU companies and households becoming increasingly dependent on third-country funding channels.

Granted, in some cases, on the simple grounds of having found a niche market or launched a new technology, some large or midsize companies (from the financial sector or not) are already well placed to scale up their business, provided that future regulations maintain a framework conducive to such an expansion. In that perspective, regulators should not only avoid any gold-plating, but also frame supervisory policies with a view to stability and predictability, while systematically ensuring consistency with level 1 objectives.

This policy in favour of EU champions could thus create a virtuous circle, further positioning the EU as a hub for champions. As stated previously, we think that the fragmentation of financial markets and the lack of liquidity, combined with the limited size of EU financial and non-financial companies compared to the firms included in the S&P 500, have been major contributors to the underperformance of EU **equity market indices** in recent decades, and all the more to that of financial institutions, compared to the US (Chart 18).

Chart 18 – Equity market indices



Source: ECB.

Another upside for EU authorities in supporting EU champions would be to avoid **home bias**, a situation where some non-EU financial institutions may be tempted or required, in times of stress (and as observed for syndicated loans in the first six months of 2020), to suddenly scale back or even stop their activities with EU customers, in order to quickly reroute their resources towards other regions deemed more critical. The flip side of this is that, when quick action is needed, EU firms are more likely than competitors headquartered abroad to use their best efforts to contribute to the smooth functioning of the EU economy and thus to preserve financial stability.

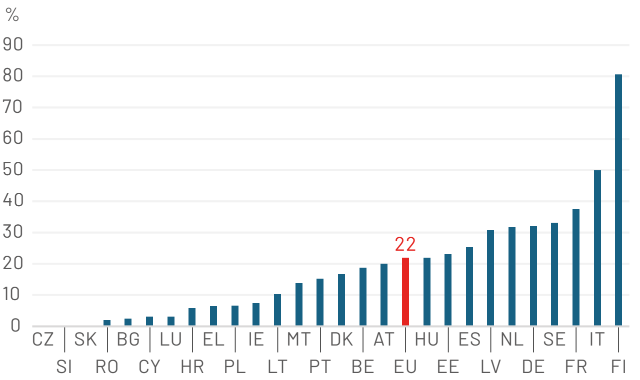
D. … by complementing the top-down by a bottom-up strategy

So far, the focus made by EU authorities on CMU action plans has led to a set of regulations aimed at harmonising regulation across 27 Member States, while maintaining supervision at national level – with the notable exception of banks.

Despite some successes, we note that this has translated into a highly complex regulatory framework, implemented in each Member State in specific ways. This **piecemeal and fragmentary approach** has limited positive outcomes at both national and European level. Barriers between national markets have not been removed, economies of scale have not materialised rapidly enough for the vast majority of players and not all market participants have been able to reap the associated benefits and offset these additional complexities by higher revenue.

All told, the **EU's markets continue to operate rather as a collection** of 27 minor, subscale domestic markets, coping with the necessity to address local basic needs, while the smallest participants are *de facto* excluded from some market compartments due to regulatory constraints. An example of such policy misfiring is the unbundling rules under MiFID, which made equity research unviable for many small firms and, for growth firms EU-wide, transformed the listing journey into an even more uncertain future. As a result, today only 22% of EU-listed SMEs are covered by at least one sell-side equity analyst (Chart 19).

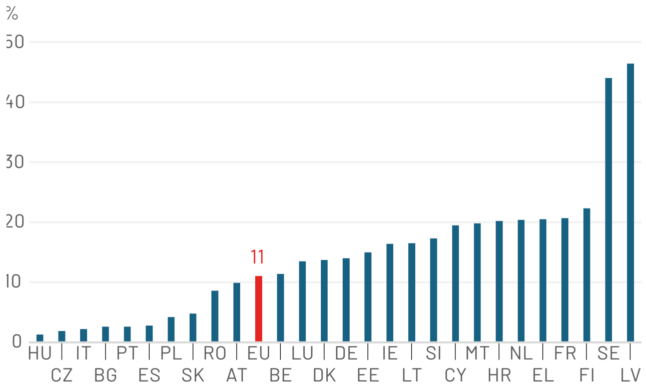
Chart 19 – SMEs with listed shares covered by analysts



Source: European Commission. 2022 data.

More worryingly, in the ECB's Survey on the Access to Finance of Enterprises (SAFE)[36], just 11% of SMEs in the EU said that equity is a "relevant" instrument for their expansion (Chart 20).

Chart 20 – SMEs indicating "equity is relevant"



Source: European Commission. 2022 data.

The next European Commission should therefore eschew this narrow regulatory approach and complement the top-down vision with a **bottom-up approach** to help develop successful national practices that can be shared as best examples across Member States with the support of the ESAs, in line with their existing **supervisory convergence** mandate. Joint initiatives of groups of Member States, within the "**reinforced cooperation** framework", should also be strongly encouraged to facilitate cross-border integration, in particular when progress seems unattainable at EU level in the short run.

Regarding convergence, there has been much discussion in recent years concerning the need or opportunity to launch a "Single Supervisory Mechanism" for financial markets activities, based on lessons learned from the SSM banking supervision. In November 2023, ECB President Christine Lagarde proposed that the EU create its own SEC[37].

While such a fundamental change should be a long-term objective, we doubt that it would be achievable within the next five years. Consequently, this goal should not be allowed to distract policymakers from the more concrete and pragmatic issues that need solving.

In particular, we believe that the conditions for evolving towards more integrated supervision are not yet in place:

— Extending the ESMA's remit to include **direct supervisory powers** over all market participants will deliver the expected benefits only if specific conditions are met. As things stand, the ESMA's positioning means it has little exposure to market realities. Interim steps should therefore be envisaged to deepen **dialogue** between the ESMA – at all levels – and market participants, in order to build positive, trust-based relationships with pan-European stakeholders, as is almost invariably the case with NCAs;

— In order to progress towards a single, harmonised set of rules, ultimately enforced by a single supervisory authority, we need to organise the progressive phasing-out of

36 https://www.ecb.europa.eu/stats/ecb_surveys/safe/html/index.en.html.

37 *Financial Times*, 17 November 2023: https://www.ft.com/content/acfc67d9-7f2a-4199-9c79-405fef9cb195.

national exemptions and domestic gold-plating of EU regulations, as well as interim steps towards a reformed and freshly empowered ESMA;

— In addition, adding a layer of supervision could significantly increase costs, complexity and red tape. In fact, the short-term target should not be centralised supervision but, as a minimum, an integrated supervisory mechanism leveraging both NCA and ESMA expertise. In this regard, the functioning of the SSM for banking supervision could provide some interesting lessons. In practice, the **common supervisory actions** already launched between the ESMA and NCAs are a good opportunity for the ESMA to exchange with practitioners promptly and directly – to better tackle national specificities, for example;

→ Encouraging common supervisory actions
between the ESMA and national competent authorities to tackle domestic idiosyncrasies (Recommendation 4.b).

— Launching such an ambitious project risks diverting time and energy away from the CMU's primary objective, which is to quickly deliver tangible improvements in financial markets and unlock growth potential. But in the long run, redirecting the ESMA's responsibilities towards a single supervisory entity must remain a critical objective.

Some policymakers have suggested an **"opt-in" scenario** as an interim step. In such a case, firms would have the right to opt for centralised supervision by the ESMA, with a view to facilitating and harmonising the supervision of their various subsidiaries or undertakings across the EU.

— Granted, this opt-in framework could be limited to a number of voluntary Member States as part of a "reinforced cooperation", as it seems unlikely to achieve unanimity among 27 Member States on this ambitious project;

— However, such an opt-in framework could create additional, complex implementation issues with NCAs. It could lead to different regulatory outcomes between opt-in firms and firms remaining under domestic supervision. This gap could even reinforce fragmentation and complexity around financial regulation.

— Instead, the next European Commission should focus on a few pragmatic steps towards more integrated supervision, which could include the establishment of a single set of convergent European rules and provision of the possibility for groups operating in more than one country to operate fully on a consolidated basis, i.e. allowing them to organise their functions as if they were a single legal entity:

— Give more powers to **the group, i.e. lead,** supervisor, in the form of a clear mandate for consolidated institutions and for facilitating cross-border business, working closely with the ESMA. Of course, this implies recognising the concept of an "**EU group",** as regards the asset management industry for instance, as well as market infrastructure players. Such classification would not only preclude any duplication of requirements by NCAs, but also alleviate constraints as regards "intra-group" delegation within the EU. Another category could be set up for cross-border infrastructures without a "home", which would be jointly supervised by an ESMA-led body rather than a lead home supervisor.

→ Developing "home", i.e. lead, supervisor responsibilities
for consolidated supervision of cross-border market activities, thus recognising the concept of "EU groups" (Recommendation 3.e).

— Direct supervision by the ESMA, based on the model of its current role with regard to credit rating agencies, could be extended to certain selected situations where a clear and real benefit could be expected in terms of efficiency and business consistency. **ESG** and **financial data providers** fall into such a category in our opinion.

→ Granting the ESMA direct supervisory powers
over ESG and financial data providers (Recommendation 4.a).

As a minimum, steps should be taken to implement a truly efficient Single Rulebook:

— Regulatory reviews should be seen as opportunities to expand or further specify the scope of regulations, as opposed to directives, which need to be interpreted by domestic authorities to be legally binding. Missed opportunities that need tackling in this way include in particular:

a. The **CSRD**, which could be interpreted and enforced differently across Member States in the near future, whereas its fundamental objective is to provide a harmonised and comparable set of ESG data. It remains to be seen whether all Member States will rigorously transpose the CSRD in line with the European directive and the ESRS delegated acts. France is the first Member State to have transposed the CSRD[38]; the others have until 6 July 2024 to do so.

38 The CSRD was transposed into French law by an ordinance dated 6 December 2023.

b. Better **harmonisation at product level** would also ensure equal access to financial services for retail investors and enhance risk-sharing among EU market participants of all sizes. Such harmonisation could prove difficult however regarding savings products, given the diversity of tax systems, cultural preferences and social facilities in operation in many countries.

— The EU also needs to prioritise cross-border investments as a key objective, and help financial markets infrastructures consolidate effectively. Challenging areas that require regulatory harmonisation should finally be addressed, notably by finding innovative ways to converge insolvency laws (such as a European regime) and tackling post-market hurdles to cross-border investment through more interoperability and by standardising the operation of CSDs.

— For this reason, an important step to reduce regulatory complexity and uncertainty would be, again, to broaden the scope of the **no action letters** that can be issued by ESAs and in particular the ESMA, by endowing it with a remit similar to that assigned to the SEC in the US. This would without a doubt significantly increase the EU's ability to react to rapid changes in market conditions, in an environment of fierce, sometimes unfair international competition.

→ Broaden the ESAs' "No action letters" scope
to allow implementation flexibility (Recommendation 5.g).

Consistency also needs to be improved not only between the ESMA and NCAs, but also **between the three ESAs**[39] (the ESMA, the EBA and the EIOPA). Another growing challenge, looking ahead to the next legislative cycle, is that more issues will have to be tackled in a transverse way, rather than by silos (i.e. by category of financial company). This is obviously the case for the ESG agenda, but also true for financial stability purposes and many digital topics, for example.

Indeed, most market participants are subject to regulations issued by several authorities. Although these mandates (such as the CMU or the Sustainable Finance agenda) are all part of the European Commission's action plan, different objectives followed by different ESAs often lead to contradictory approaches that create obstacles or unnecessary challenges in rapidly achieving the well-identified policy goals. Examples of such inconsistencies are abundant; they include:

— Inconsistencies between regulations contributing to the Sustainable Finance agenda: e.g. CSRD vs. EBA Pillar 3, CSDDD vs. CSRD, SFDR vs. CSRD;

— Inconsistencies and extreme complexity in the regulatory treatment of securitisation between banks (CRR/CRD), insurance companies (Solvency II) and other market participants (SEC-R).

The framework created by the **Joint Committee of the ESAs**[40] could therefore be usefully strengthened to enhance the quality of regulation and avoid inconsistencies or duplications: in particular, considering the possibility of introducing more European-wide governance, as well as dedicated stakeholder groups, would constitute real progress.

→ Ensure better cross-sectoral consistency in the content and sequencing of the implementation of EU action plans,
within DG-FISMA, between Commission directorates and across ESAs, including by strengthening the role of the Joint Committee of the ESAs to make their respective regulatory actions more consistent (Recommendation 5.d).

In addition, **current ESA governance** and **representativeness** rules continue to be dictated by boards of supervisors which, being made up of NCA representatives, represent only national bodies – if not domestic preferences. This is a serious weakness according to many financial industry representatives, in terms of the balance and need for a more marked priority to be given to EU-wide policies.

As long as this governance has not evolved into a true pan-European governance, the room for manoeuvre for achieving true integration of EU financial markets will remain insufficient. For this reason, while a major rethink of financial regulation and EU-wide financial markets supervision could be a longer-term objective, certain steps towards improved, more EU-focused governance and representativeness of ESAs should be taken as part of the next ESA review scheduled for 2025.

→ Improve ESAs' governance and representativeness
to better promote EU-wide interests (Recommendation 3.b).

39 https://finance.ec.europa.eu/regulation-and-supervision/european-system-financial-supervision_en.

40 https://www.europeansources.info/record/website-joint-committee-european-supervisory-authorities/.

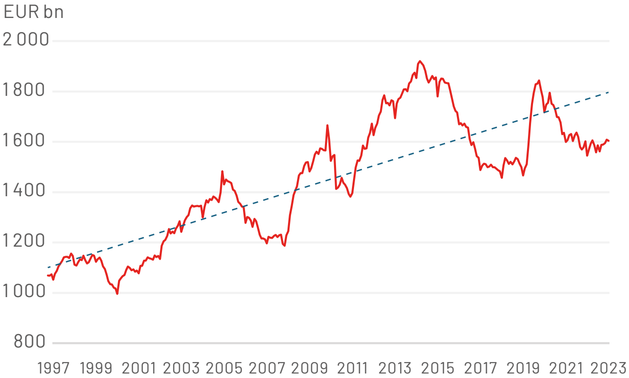
3. A new roadmap for an ambitious and stronger EU

A. The corporate sector holds the keys to the investment gap...

One should never underestimate the fact that private businesses are by definition the main way for an economy to create long-term added value and ensure prosperity for citizens. Unfortunately, for various reasons including regulatory ones such as the liquidity coverage ratio requiring banks to keep a minimum level of highly liquid assets, a growing part of banking sector liquidity is currently channelled into financing public expenditure via government bonds.

Although this direction of banks' resources into general government bonds has decreased latterly, it is part of a much longer-term upward trend that began more than a quarter of century ago (Chart 21), in line with increasing public debt ratios.

Chart 21 – Monetary financial institutions' holdings of euro area general government debt securities



Source: ECB.

The problem now is that large amounts of resources are given over to buying sovereign securities, especially in peripheral European countries where certain banks' sovereign risk exposure can reach three times their Tier 1 capital.

Admittedly, to better support EU companies in finding new money, changing this prudential choice quickly would not be realistic in the short run. Rather, we would recommend that EU policymakers consider how to develop much larger EU **equity markets**, as bond markets already face massive issuance of (and preference for) government securities.

Indeed, the EU currently stands far behind other key equity markets around the world: in September 2023, the Americas accounted for 47% of global market capitalisation, APAC for 30% and EMEA for the remaining 23%, according to the WFE[41]. This gap between the US and Europe cannot be explained solely by their respective numbers of listed companies, as these have converged, with around 4,200 in the EU vs. 5,700 in the US at the end of 2023, representing a tightening of 15% over Q4 2023[42].

This gap between the US and the EU is actually primarily attributable to a certain **valuation** effect: we estimate that on average the market capitalisation of a US-listed company is three to four times bigger than that of its European counterpart. On the other hand, certain studies of the **post-IPO performance** of European companies listed in US markets contradict this perceived advantage of listing in the US. While US equity markets are more liquid and may offer a higher IPO valuation for some European companies, in hindsight companies often make poor decisions in terms of which market to list on – a factor only compounded by the fact that listing administrative costs are much higher in the US than in Europe.

Consequently, the clear priority for EU authorities should be to **increase** the number of scale-up companies listing on EU equity markets – and to **keep** them listed. According to Christine Lagarde[43], launching a truly unified capital market in Europe could lead to the creation of 4,800 additional start-ups, raising an additional EUR 535 billion a year. Granted, the European Tech Champions Initiative launched

41 Source : https ://focus.world-exchanges.org/articles/market-capitalisation-q3-2023.

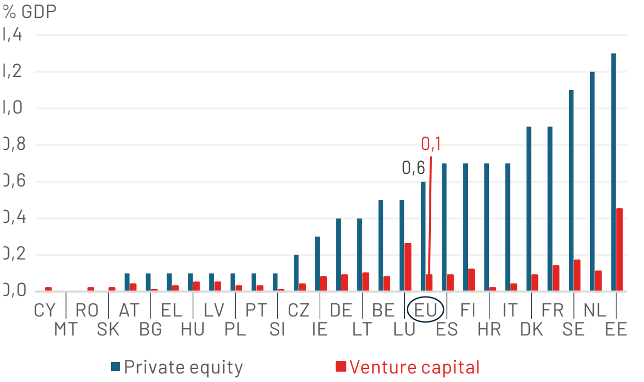
42 Source: https://focus.world-exchanges.org/issue/february-2024/market-statistics.

43 Financial Times, 17 November 2023: https://www.ft.com/content/acfc67d9-7f2a-4199-9c79-405fef9cb195.

in 2023 by the EIB and five Member States[44] is already a key positive step in this direction, but we think other gaps exist that need closing.

Undeniably, **private equity (PE)** and **venture capital (VC)**, which on average represent only 0.6% and 0.1% of EU GDP, respectively, are underdeveloped throughout Europe (Chart 22), meaning that numerous new businesses never get off the ground due to a lack of financing solutions.

Chart 22 – Value of annual private equity and venture capital investment



Source: European Commission. 2022 data.

Various complementary policies should therefore be developed, such as:

— Ensuring that VC/PE-backed start-ups and scale-ups can benefit from the same state aid advantages as other SMEs, including by revising the **European definition of SMEs**[45];

— Broadening the mandate of the European Fund for Strategic Investments (**EFSI**) or the European Investment Fund (**EIF**), to that of a corner/anchor investor for IPOs;

— Encouraging more transparent, intelligible and affordable credit and ESG rating of EU companies by EU-based entities.

Regarding this last point, we note that today fewer and fewer EU firms are rated by external rating agencies. Developing external rating would be a major driver for increasing these firms' attractiveness for investors, as it would provide them with harmonised **credit and ESG** assessment standards, make financial markets more transparent and expand the retail investor base.

→ Beyond the implementation of the Listing Act and ELTIF, prioritise the development of an ecosystem

to support scale-ups in the equity market, including by strengthening the ability of public and private investors to act as anchor investors in IPOs (the EFSI or EIF's mandate could be broadened to one of corner investor) and by making financial advice, research, and credit and ESG ratings activities more viable for EU-based players (Recommendation 6.a).

Thus, since rating offers an independent, objective assessment of a company's financial health and decarbonisation performance, this forward-looking view, based on a thorough analysis of past performance, should be given a clearer regulatory framework, as in theory it provides **investors with invaluable information**.

Given the complexity of corporate disclosure requirements, too few specialised analysts have the time available to provide an informed view on disclosures, however. As regards SMEs, and despite some welcome proportionality, the number of accessible securities is relatively limited and therefore does not really allow an appropriate compensation of equity research for retail investors.

An ambitious EU infrastructure for financial and non-financial data has yet to be established, as the EU largely remains dependent on a limited number of non-EU providers that are subject to neither European supervision and regulation, nor effective rules on cost transparency and conflict of interest management. Cross-cutting rules applicable to **all data providers** and covering both financial and non-financial data are urgently needed to remedy this issue.

We believe that caution is required in relaxing the existing rules applicable to **benchmark providers** through the ongoing review of the benchmark regulation (BMR). At the same time, in its "Wholesale Data" market study[46] published this year, the FCA warns of the consequences of "market power being held by most established benchmark administrators", implying that it "may provide limited incentives for benchmark administrators to lower prices, improve quality or innovate" and that "this can be exacerbated by firm behaviours or practices which use their market power to hamper competition." The BMR must continue to ensure a balanced regime for benchmarks, maintain transparency on methodology and conflicts of interest and add proportionality for systemic providers by aggregating the indices provided by a single provider to calculate the EUR 50 billion thresholds.

44 https://www.eib.org/en/press/all/2023-056-launch-of-new-fund-of-funds-to-support-european-tech-champions.

45 The conditions for accessing state aid are particularly important for EU start-ups and scale-ups. The discriminatory regulatory treatment of VC-backed start-ups and scale-ups should be reviewed to ensure that they can benefit from the same public subsidy advantages as other SMEs. The definition of SMEs should be revised, the general block exemption regulation (GBER) reviewed and a more flexible approach adopted towards SMEs whose securities are held by VC/PE vehicles.

46 https://www.fca.org.uk/publication/market-studies/ms23-1-5.pdf

Moreover, even large institutions are concerned by this issue. Banks, which generally have a strong credit analysis process across their business lines, will be subject to an output floor requiring them, at the end of the CRR3 transitional arrangements, to disregard their internal analysis and calculate a standardised capital requirement based on external ratings.

Lastly, looking beyond Europe, stronger initiatives should be considered to strengthen the EU's competitiveness and **global market reach**, promoting in particular exporters and euro-denominated trade. To be sure, given the geopolitical strains affecting international trade flows, a delicate balance has to be struck between the need to maintain efficient multilateral cooperation, through the OECD and WTO, for example, and to clearly assert the EU's autonomy in international trade with the aim of preserving the objective of an open EU economy.

On this point, very concrete progress has been made on the basis of the recommendations proposed in Paris Europlace's report[47] of June 2023 in terms of **speeding up the digitisation** of the documents used in international trade finance. Amending EU and domestic regulations to fully recognise the evidential value and the electronic value of "transferable" documents, meaning those that incorporate a right, will boost the EU's competitiveness in goods and services exports. With some four billion new documents currently produced every year, processing them in paper form represents a massive cost for companies that will now be cut.

B. ... and needs a much better allocation of savings...

In principle, as the EU enjoys a relatively high savings rate it should be quite easy for this deep pool of savings to be allocated more dynamically so as to provide higher returns to savers and significant funding to benefit the real economy.

However, Europe has long promoted a culture characterised by a very high level of security and a notable risk aversion concerning financial investments, despite these being not only frequently essential to the economy (e.g. for financing infrastructure) but also profitable for retail investors in the long run.

The key challenge will thus be to adequately incentivise investing public and private savings in equity markets. Europe's prevailing culture is one of risk aversion, and generally its lacks a vibrant equity culture. The bias towards debt and bank financing, coupled with an abundance of retail bank savings, creates a climate of cautious investment. European households currently hold around EUR 10 trillion of cash in bank accounts, and fewer than 10% actively invest directly in equities. In addition, the distribution of financial products is still based on unclear, costly questionnaires, which are supposed (but unfit) to precisely assess retail investors' risk appetite and financial skills.

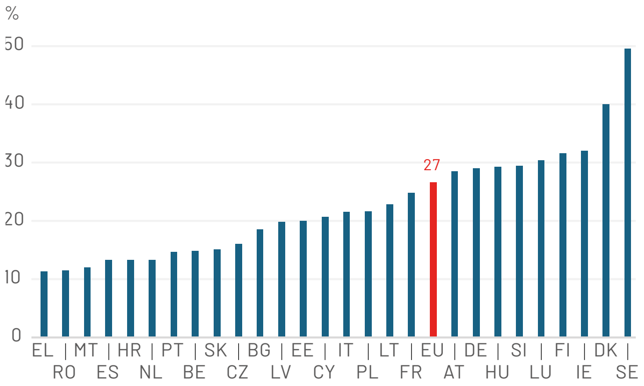
In sum, allocating the EU's savings is beset by significant hurdles today, notably:

1. A traditional, longstanding priority given to the financing of government spending, associated in many EU countries with record tax levels which heavily penalise the competitiveness of private companies. This focus on financing the government budgets is also detrimental to financial market liquidity, the success of IPOs and fundraising in general, not to mention equity market valuations in comparison with other regions;

2. While significant progress has been made with the recently agreed amendments to the **Solvency II** directive, we need to remain vigilant that the EIOPA's level 2 drafting does not impair these improvements, notably with regard to managing the volatility of insurers' balance sheets, which can hamper their ability to hold riskier asset classes (Chart 23 – current level of equity holdings in insurers' portfolios);

47 https://www.paris-europlace.com/global/gene/link.php?doc_link=/docs/2023144356_speeding-up-the-digitization-of-trade-finance-cle0b7815.pdf

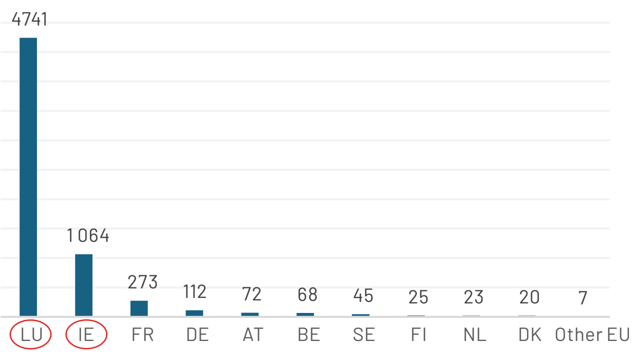
Chart 23 – Equity holdings of insurers



Sum of direct equity investments and investments via equity funds and private equity funds relative to insurance companies' total assets. Source: European Commission. 2022 data.

3. A structural **bias in the allocation** of European savings that benefits non-EU jurisdictions, notably the US. Our estimates suggest that a high proportion of asset managers established in certain Member States such as Ireland and Luxembourg invest mainly (more than 75%) outside the EU, compared with French UCITS, which invest much more (above 60%) in EU and domestic companies. This trend has recently intensified, as Irish and Luxembourg funds are more cross-border-focused than others (Chart 24). In our view, for one this is mainly due to the location of the managers (rather than the funds) and to a lack of available information about EU companies, apart from the largest ones. Ultimately, for this additional reason, the risk of EU firms delisting may increase yet further;

Chart 24 – Number of cross-border funds

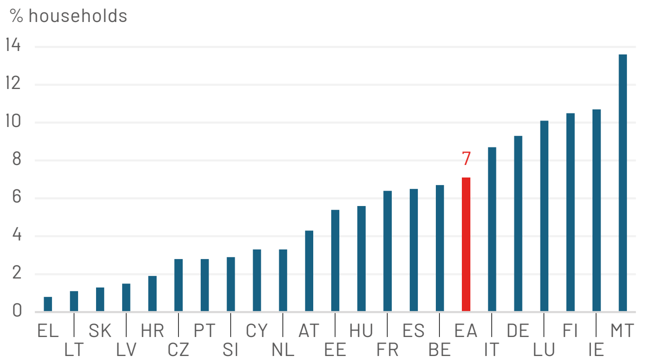


UCITS available for sale to retail investors in at least three Member States. Source: European Commission (2021 data).

4. An insufficient number of **pension funds** in the EU, where despite clear demographic challenges long-term savings remain low, in line with the still generous financial conditions granted to pensioners by public pension schemes; the costly funding of these public pension schemes through social contributions stymies the development of retirement savings;

5. A preference of retail investors, fuelled by domestic tax incentives and regulated savings schemes, for investing in housing, which limits the savings available for more productive investments. As a result, the share of households that directly hold bonds or listed shares is very limited, reaching an average of only 7% in the euro area (Chart 25).

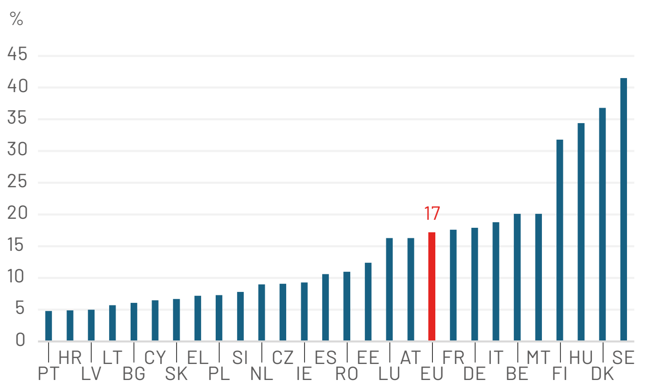
Chart 25 – Share of households that directly hold bonds or listed shares



Source: European Commission. 2021 data.

The number of households that invest in bonds and shares also remains too low to contribute significantly to the financing of the economy (Chart 26).

Chart 26 – Direct investment by households

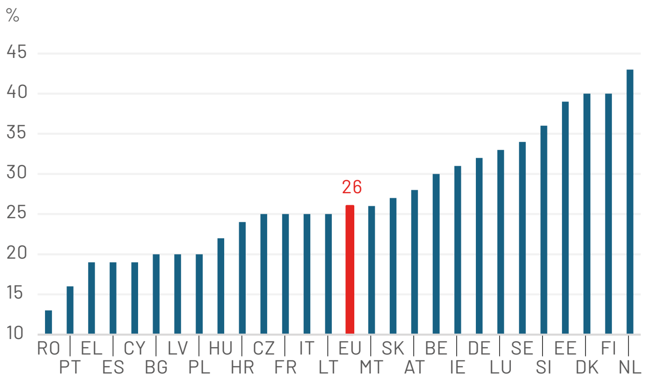


Source: European Commission. Sum of bonds and listed shares held by households relative to the sum of bonds, listed shares, cash and deposits held by households. 2021 data

This risk aversion not only limits the diversity of investment portfolios and the resilience of pension systems, but also contributes to a scarcity of early-stage funding for innovative ventures, hindering the growth of start-ups. Measures such as a revamped equity fund or debt-equity bias reduction allowance would help channel these savings into listed equities and provide solid returns for EU citizens. Learning from experience and best practices will be key to encouraging this much-needed retail investor participation. The EU needs to further develop a **risk/return culture** and education about the benefits finance brings to continue to support the EU model and its social welfare. Financial markets are a place where risks are measured, traded, managed and hedged; by contrast, too many EU regulations are out and out risk-averse;

Enhancing the currently very low level of **financial literacy** (Chart 27) could therefore simultaneously accelerate the implementation of more relaxed regulatory disposals, for the direct benefit of retail investors.

Chart 27 – Financial literacy: proportion of respondents correctly replying to 4 out of 5 questions on finance



Source: European Commission Eurobarometer (July 2023)[48].

C. ... based on a newly targeted, pragmatic agenda

In such an environment, the challenge is of course convincing households that it would be precisely in their interest to **invest in longer-term, riskier but at the same time more profitable financial instruments**. Subsequently, in order to try to progressively change this inadequate allocation of savings, EU policymakers should consider the following policy options.

1. Build a new shareholder culture

a. Enhance the **quality of information** accompanying packaged retail and insurance-based investment products. Such information is currently too complex and has a **dissuasive effect** for both the financial adviser and retail customers. The inclusion of ESG factors adds further complexity[49]. A streamlined, concise key information document, adapted to the specific features of each asset class, should be introduced: simplifying PRIIP and KID-related regulatory disposals, based on concrete evidence of **usefulness** for actual users, should be an absolute priority for the RIS.

b. Avoid initiatives that could limit access to a **human** financial adviser, especially for households with financial portfolios of limited size and complexity: these retail investors are precisely those who must be reconciled with finance as their best strategic ally.

c. Disconnect not only consumer protection and risk avoidance, but also profitability and low-cost services. Financial products, like all economic goods, have a production cost and a **distribution cost**. Such costs need to be passed on to customers in a fair, transparent and accessible way. A regulation focusing solely on a low-cost objective will exclude many asset classes and favour the development of standardised, unsuitable products that fail to cater for the wide range of preferences prevailing among retail investors.

d. Improve the financial education of retail investors while at the same time ensuring that distributors are appropriately trained. **Overprotecting** retail investors not only inhibits profitable investment opportunities but also leads some citizens, notably the youngest or most vulnerable, to resort to unregulated firms proposing highly volatile, fraudulent products, especially in digital areas abusively branded by non-cooperative jurisdictions.

48 Source: https://data.europa.eu/data/datasets/s2953_fl525_eng?locale=en.

49 There are almost a dozen sustainable finance labels in Europe. The proliferation of these labels is a source of confusion for investors, not to mention a considerable administrative burden for asset managers, who are thrown into a race for labels – all the more time-consuming and complex to manage as the distinctions increase in number and diverge from one country to another. Some funds have two or even three labels for cross-border distribution. The EU's Sustainable Finance Disclosure Regulation was designed to increase clarity but not to replace the various local labels, which had the net effect of increasing investor confusion.

→ Avoid designing consumer protection rules
on the basis of risk avoidance (Recommendation 7.b).

2. Make a **broader range** of investment products accessible to retail investors

a. Foster increased participation by retail investors in financial markets through a balanced, secure regulatory framework that facilitates access to private equity and venture capital funds, having fully informed investors of the risks and opportunities that such investments represent.

→ Increase retail investors' financial literacy
to help them independently weigh up the risks and return associated with financial products (Recommendation 7.a).

b. Ensure that the implementation of **ELTIF2** makes it possible to scale up these products, with more flexible interconnectedness between domestic investors and cross-border funds.

3. Encourage the development of long-term savings and pension products

a. Use initiatives such as national accounts rules to incentivise Member States with the lowest levels of long-term savings and pension products to develop retirement savings, including by helping them move gradually away from today's public, heterogeneous contributory pension schemes towards private, self-funded regimes, with temporary tax breaks to facilitate the transition if needed.

b. Use a review of the Institutions for Occupational Retirement Provision (IORP) directive as an opportunity to increase the cap defined for investments in alternative asset classes eligible for pension fund investment.

c. Scale up initiatives taken at domestic level to better inform companies and employees about national schemes already in place in some Member States that need to be further promoted. The failure of the Pan-European Personal Pension Product (PEPP)[50] clearly shows that national social preferences could be better served by domestic initiatives than by top-down, poorly designed products.

d. Consider nevertheless the possibility, in order to offer a concrete, simple and harmonised **savings product** in all **interested** Member States, of creating **a fully tax-free instrument** dedicated exclusively to **EU listed or non-listed shares**, with a pre-defined maximum amount. Such an initiative could be widely advertised, thereby contributing to a shift towards a risk/return, long-term investment culture and to better financial education in Europe.

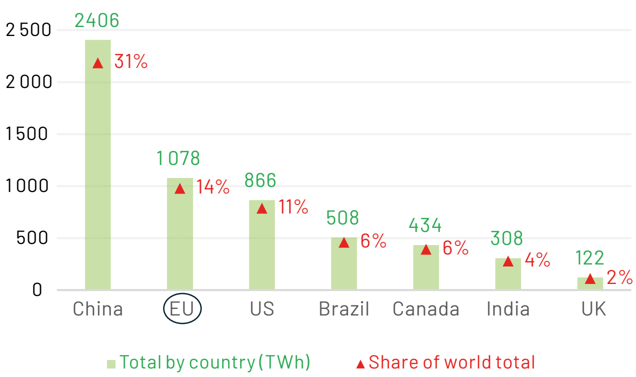
→ Propose to interested Member States the creation of a harmonised, tax-free savings product
dedicated to EU listed or non-listed shares (Recommendation 6.d).

e. Clarify regulatory disposals to better distinguish between retail and qualified investors, via a proportionate approach. Failing this, a triangle of incompatibility between return, security and scale-up will persist for savings products.

4. Consolidate the EU's leadership in sustainable finance

a. **Redesign the regulatory framework** and focus on implementing carefully detailed, concrete projects. There is a clear lack of projects in renewable energy, for example, and more generally insufficient investment in the ecological transition. While achieving a successful green transition needs additional effort, many metrics underline the growing gap between, on one hand, the investments required to keep on track to reach the Green Deal's goals and, on the other hand, the current significantly lower level of investment. The EU's share of global renewable energy production stood at 14% in 2021, for example – less than half China's 31% (Chart 28).

Chart 28 – Production of renewable energy by country



Source: IRENA. 2021 data.

50 https://www.eiopa.europa.eu/browse/regulation-and-policy/pan-european-personal-pension-product-pepp_en.

b. For the EU to remain a leader in reducing GHG emissions, it needs to **radically simplify** its ESG framework. Abstract, equivocal environmental commitments must be replaced by targeted trajectories by sector and by Member State, potentially drawing on the recent revision of the Stability and Growth Pact for public finance and based on dedicated KPIs. This could ensure more effectively that companies subject to the CSRD present a robust, auditable transition plan, in line with the trajectory applicable to their economic activity.

c. Prevent misunderstandings and greenwashing opportunities by promoting **clarity, predictability, transparency and trust**. In particular, regulatory requirements (e.g. disclosure, "do no significant harm" criteria, etc.) must remain manageable and up-to-date to be accepted and practicable.

d. Calendars should also be adjusted in a timely manner, so that before requiring companies to report certain data, the availability of said data has been guaranteed and properly regulated by a previous – not subsequent – regulation. Of course, the number of revisions to an initial text should remain limited, as changes to regulations are especially costly for financial and non-financial institutions.

e. Promoting **transparency and comparability** in the commitments made by Member States and economic activities will also help mapping where efforts still have to be made. Indeed, reporting and disclosure should not be a substitute for action. Most ESG regulations neither create more green projects by themselves nor reduce GHG emissions. Regulations should thus be **strictly fit for purpose**: the associated costs should be proportionate and should not prevent stakeholders from pursuing their business effectively.

f. Ensure **interoperability** between key jurisdictions, a level playing field and accessibility of relevant data. This includes aligning certain timings and sequencing, harmonising definitions and removing any duplications and other unintended consequences for large and international companies. Inconsistencies in the calculation of the Green Asset Ratio should be addressed, for instance, while the work to strengthen the EU Emissions Trading Scheme should continue.

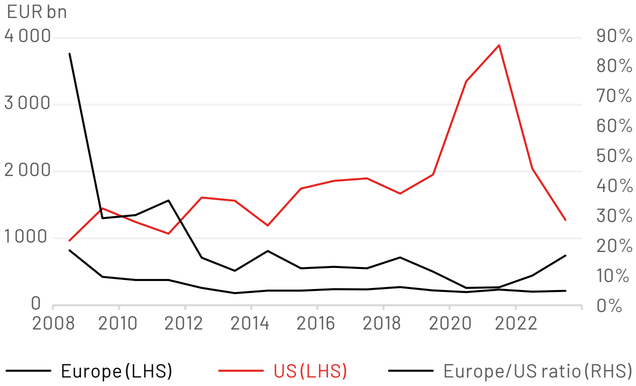
g. As a result, establishing a credible, consistent and comprehensive **roadmap** could help limit the regulatory burden and the negative image too often associated with the opportunity to benefit from a greener future. Tackling global warming without harming firms' competitiveness and profitability is indeed feasible with appropriate public and (probably mainly) private, massive but precisely targeted investment.

→ Urgently review the ESG regulatory framework
to ensure its consistency, usability and effectiveness, and restore EU leadership in this area (Recommendation 5.e).

5. Reinvigorate securitisation

a. Allow securitisation to play its key role in strengthening the capacity of the financial sector to fund the green transition by transferring part of the risks carried by banks to investors, such as insurance companies, who precisely need diversified assets in terms of risk and return. Yet, while the size of the European market was comparable to that of its American counterpart in 2008, over the last three years it has only represented **a tenth** of it on average (Chart 29).

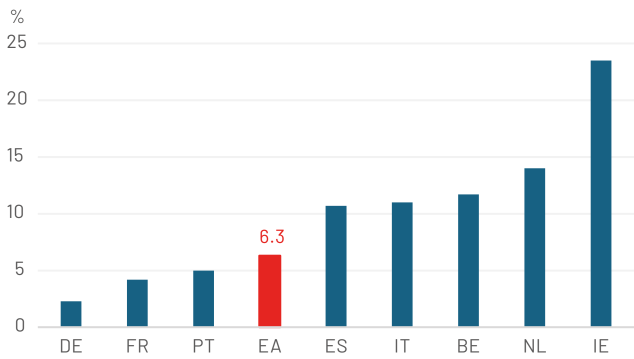
Chart 29 – Securitisation issuance



Source: AFME.

b. Enable market participants to better manage and share risks, which in turn could enable financial institutions to unlock additional lending and move towards more **market-based financing** of the economy, rather than depending mainly on bank loan after bank loan (Chart 30).

Chart 30 – Value of securitisation instruments relative to bank loans



Source: European Commission

c. Carry out an in-depth review of the applicable **regulations**, ideally in two steps; first, via an immediate downward revision of the floor applying to the senior tranches of banks' high-quality liquid assets (HQLA), in line with similar instruments and with ECB eligibility criteria, which would increase secondary market liquidity. Then, through a wholesale review of the regulatory framework based on observed performance of EU transactions, recalibrate capital charges for banks, streamline **Solvency II** disposals for a more appropriate capital treatment of securitisation products and significantly reduce reporting and due diligence burdens, which create barriers to entry for potential originators and investors.

d. Leverage the European Investment Bank (EIB) or the European Investment Fund (EIF) with a view to developing a strong EU **guarantee** scheme as an existing efficient framework to be scaled up and an alternative to the US government-sponsored enterprises Fannie Mae and Freddie Mac.

→ **Revive securitisation as a key tool**
to finance the additional investments needed and foster private risk-sharing across the EU and beyond (Recommendation 6.b).

6. Anchor **the euro** as a core international currency

a. Reinforce the common currency to better support a stronger economy: securing the euro's international role through a deeper Economic and Monetary Union (EMU) and promoting the use of the euro and euro-denominated financial instruments could help cushion the EU against extraterritorial regulations and other harmful, protectionist practices.

b. Supporting EU investment programmes, extending NextGenerationEU into a longer-lasting and targeted issuance programme and designing a new EU safe asset for the joint financing of EU common policies (as opposed to Member States' aid, which simply increases fragmentation) could raise the visibility of the EU's ambitions. It would also help deploy funds efficiently across the EU and reduce the temptation to seek subsidisation through other jurisdictions (as observed with the US IRA).

c. Design a **digital euro** to balance sovereignty considerations with promising ongoing, private initiatives, in particular the European Payments Initiative (EPI). In view of the rapid digitisation of the economy and the even more rapid growth of alternative, quasi-payment instruments, the question of a central bank currency suited to this new environment could be considered. Indeed, a detailed cost-benefit analysis assessing the added value for citizens, companies and central governments should be carried out: its impact on intermediaries must be assessed to ensure their financial stability, competitiveness and lending capacity, with the maximum amount of digital euros that customers can hold carefully set. Particular attention should be paid to the infrastructure to be put in place, notably for the offline use of a digital euro.

→ **Carry out an in-depth assessment**
of how useful a central bank retail digital currency would be for households, businesses and governments (Recommendation 5.f).

The major institutions of the Paris financial market involved in preparing this report remain at the entire disposal of the European authorities in order to plan for the rapid and effective implementation of the recommendations that it contains.

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