Deepening the banking and financial single market

Introduction

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

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

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

In the response to the Letta report, it was encouraging to see the positive reaction to securitisation. While a degree of caution is appropriate, there has been an unnecessary stigma attached to securitisation since the crisis. Perhaps the EU financial sector should be bolder when it comes to securitisation and savings. There is a general awareness that the savings system could be the protagonist of development. Savings are the engine of growth. If they are not used correctly, it will be impossible to achieve Europe's objectives. The real rationale for the Savings and Investment Union is that there is no other way to finance the transition. Without a strong mandatory contribution from the private sector and the financial sector, there will not be enough money to stimulate investment. By coincidence, the presentation of the Letta report to the European Council took place on the same day as the European Council discussion on CMU. The feeling at the meeting was that it is possible to overcome the problems in the architecture of the EU's regulatory framework. The meeting focused on the roles of the European Securities and Markets Authority (ESMA) and the national authorities. Exactly how this interaction works is a political question that will be resolved with political intelligence. In this respect, the Polish Presidency next year will be very important. There are reasons to be optimistic, but the EU financial industry also needs to be proactive. The time is now, and hopefully results will follow.

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

2. Key success factors

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

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

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

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

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

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

2.3 A competitive Europe needs competitive financial actors

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

A similar trend can be seen in trading platforms, with increasing competition from non continental players focused on the secondary market and blue chips. In February 2024, the US firm Cboe Europe had a 24% market share in European equities traded on trading platforms, which is equivalent to the whole volume traded on Euronext's primary markets. US brokers have taken an increasingly dominant role in transactions at the expense of European banks and local brokers. This shift will weaken the ecosystem, to the detriment of small and mid cap companies. This state of affairs is worrying, but Europe holds all the cards to reverse the trend.

2.4 Higher capital requirements cannot translate into more lending

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

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

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

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

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

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

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

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

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

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

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

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

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

3.2.2 Enabling the emergence of funded pension schemes

An industry representative remarked that the European agenda should be complemented by domestic efforts to tackle the challenges with equity. The success of the Savings and Investment Union will depend on member states' ability to channel savings into listed companies. The average savings rate in the EU is 13%. Europe exports savings and imports equity from the US. The first source of this leakage is the export of savings to US asset management companies, which then invest in European companies. There should be a way of converting European savings into European equity without going through BlackRock or Fidelity.

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

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

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

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

3.2.4 The overly burdensome European regulatory environment is hampering competitiveness

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

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

3.2.5 Leveraging the political will

A market expert emphasised that Europe should consider using the European Stability Mechanism (ESM) to fund defence spending. As other panellists have suggested, it is essential to harness political will. The way to finance defence is to do it together. It is important to bring people together. This approach can help Europe achieve strategic autonomy and create the conditions to finance the EU's common needs. There is reason for optimism because the political conditions are right, but it is still necessary to be proactive. All stakeholders need to push their national governments to act. If national governments do not deliver, nothing will happen. The spirit of the panel discussion shows that all the necessary conditions are there. An official agreed that everybody should start lobbying ministers, prime ministers, CEOs and presidents of industry associations. This kind of political lobbying is important, and it works.

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