European
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Forum

Conference on the Future of Europe. Contribution by the European Parliamentary Financial Services Forum.

Forewords

> The Future of Europe can only be built together, in close dialogue with all the affected citizens and stakeholders.

Right after the Maastricht Treaty was signed, the former German Chancellor Helmut Kohl brought it to the point: With the foundation of the Economic and Monetary Union and our common currency, the path to a political Union became "irreversible". Today, thirty years after the Maastricht Treaty, twenty years after the introduction of the Euro and nearly fifteen years after the global financial crisis, we still have not drawn all the lessons to achieve exactly that, a political European Union.

In this spirit, the Conference on the Future of Europe is much more than a reaction to crises. It is about rigorously implementing what we have already planned to do and what has become long overdue. It is about actively shaping a stronger Union together with the citizens, about further developing it and about making it better, so that it becomes the credible speaker of our continent in the world, more capable of acting, more democratic and more efficient in the face of the various challenges of the future – green, digital, social.

In the area of economic, monetary and financial affairs, we have come a long way. When the Covid-19 pandemic struck, we were stronger than when the last financial crisis had hit. However, despite common progress the Euro is still the only currency worldwide without a common budgetary, fiscal and economic policy. The "Five President's Report" and the "European Commission's Reflection Paper" on completing the Economic and Monetary Union still have not been fully implemented. Common projects such as the Banking and Capital Markets Union were not yet realised.

When, if not now, is the time to bring about the necessary political will to make nails with heads to finally realise a fully-fledged political European Union. The Future of Europe needs stronger European liberal democracy, no decision without the European Parliament, majority decision-making instead of blocking unanimity, an internal market without barriers and a common budget with own resources reflecting the size of the common tasks. Clearly, investing in tighter European cooperation has a high value on return. The European Parliament's Research Service estimates that alone the value added of a complete Banking Union, a stronger Capital Markets Union, and closer fiscal policy cooperation would be up to 275 billion Euros per year in economic growth.

Of course, the Future of Europe can only be built together, in close dialogue with all the affected citizens and stakeholders. Since its foundation in the year 2000, the dialogue platform European Parliamentary Financial Services Forum (EPFSF) strives to promote the integration of a single European market for financial services across national borders. As non-for-profit organization, it has organised over 250 events with decision-makers from the EU Institutions and financial industry. With this unique collection of key recommendations in the area of finance, the EPFSF provides a valuable contribution to the Conference on the Future of Europe. Now it is about implementation!

Othmar Karas,
First Vice-President of the European Parliament and Chair of the EPFSF Steering Committee

> Moving forward, we all have to work together to deliver on the EU's objectives. However, our success will also depend on the efforts and cooperation at the global level.

Since its foundation in 2000, the European Parliamentary Financial Services Forum has promoted dialogue amongst relevant stakeholders, citizens, and institutions on EU financial services policy with the objective of fostering economic growth, stability, and resilience. As strong supporters of the values of the EU, participatory democracy and an EU that generates tangible benefits for its citizens, we have welcomed the Conference on the Future of Europe from the start. Therefore, it is with pleasure that I offer, on behalf of the EPFSF, this collection of independently written articles that illustrate diverse views on the future of Europe through the lens of different parts of the financial sector ecosystem. I deeply hope these articles will further contribute to the debate.

Now more than ever, it is important that Europe be united to face not only existing challenges, such as the twin transition of sustainability and digitalisation, but also new ones, such as the war in Ukraine. This means completing the Banking Union and strengthening and integrating the capital markets, all of which should give issuers and investors access to a diverse spectrum of funding and investment solutions for their needs and foster the growth of our economic system.

The geopolitical situation has inevitably shifted the focus to imminent concerns and raised questions surrounding Europe's common priorities, both in the short and long term. At the same time, the war demonstrates the importance of the principles that had become an integral part of the European Union. By way of example, the EU's sustainability strategy continues to provide the opportunity to decrease Europe's external dependencies, while addressing the common concerns connected to the green transition. Similarly, the EU efforts towards a competitive, efficient, and inclusive financial sector in the EU continues to be critical to the ability of our economies to generate high-quality jobs in a competitive and fast-changing world economy.

Recent events, as well as future ones, will inevitably challenge EU ideals and institutions. We will have to work together to reach our goals, including the green and digital transition, the strengthening of our overall financial system, and the prosperity of our economies. The challenges which lie ahead will require the funding of a strong financial sector, which should play an active role in the debate. The EPFSF is ready to contribute to the important discussions launched by the Conference on the Future of Europe. Together, we will ensure that Europe delivers for future generations.

Wim Mijs,
CEO of European Banking Federation and
Chair of the EPFSF Administrative Committee

Executive Summary

by Wim Mijs, CEO of European Banking Federation and Chair of the EPFSF Administrative Committee

EPFSF member reflections for the Conference on the Future of Europe

This contribution represents the individual views of senior executives from financial industry members of the EPFSF. Authors respectfully make recommendations on the priority policy actions which policymakers can take to strengthen our society and economy to the benefit of citizens, governments and Europe's international competitiveness. Themes prominent in members' contributions are (i) ensuring the EU's resilience to exogenous shocks; (ii) the financing of the green transition; (iii) the digitalisation of the economy, in particular for accessing financial services; (iv) policies governing use and access to data; and (v) developing European capital markets alongside a sound and efficient banking system. The resilience of previous initiatives implemented to renew the European framework for financial services following the global financial crisis of 2008/9 has been demonstrated during the COVID pandemic – notably through the Banking Union and European System of Financial Supervision. However, the much-needed structural reshaping of European economies towards a more sustainable path remains an early work in progress.

Several contributions underline that developing and deepening European capital markets alongside a more resilient banking sector should be a strategic priority for the EU. Here authors stress that facilitating SMEs' access to finance - the backbone of European economies - and retail investors' participation should be the main targets for reform. Europe's capabilities in its capital markets and banking sector will also provide a pathway to funding for a sustainable and digitalised Europe. Some contributors ask whether the establishment of the European Recovery and Resilience Facility serves as a roadmap for further issuance of common European debt. Others underline that for growth to really become sustainable, "sustainability" should be mainstreamed across all aspects of our economies. This will require significant private as well as public funding. Authors stress that the private sector is ready to do its part. Contributions cite the immense strategic value that data will have for all kinds of endeavours. Data that is accessible, comparable, and ready to use will be an asset for both private and public sector actors and will help to empower consumers. Effective reporting, risk measurement and management, investment choices, and supervisory decision-making all heavily depend on data quality. Europe has an opportunity to establish a world class framework for data via ongoing and future EU initiatives.

Some authors focus on corporate governance and diversity as crucial elements in a more sustainable and just society. The EU has already shone a spotlight on certain shortcomings in the current approach to corporate governance. Regulation itself is also highlighted as an area where the competitiveness of the European markets can be negatively impacted. Contributors stress that regulation should be smart, targeted, proportionate – provide high levels of protection, safety and resilience - but also help foster innovation and ensure the global competitiveness of European businesses.

These contributions address some of the most critical elements for EPFSF financial industry member firms, and many of these issues will be debated in the EPFSF's work programme for 2022 and beyond. As a grouping of individual member companies and associations we welcome further dialogue on all these themes and stand ready to assist the European Parliament in its ongoing reflections on the Conference on the Future of Europe.

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01

Les problèmes centraux de financement de l’économie européenne: la forte préférence pour la sécurité des épargnants, l’exigence élevée de rentabilité du capital

By Patrick Artus,
Conseiller économique, Natixis

Les deux caractéristiques, et problèmes, centraux du financement de la zone euro sont les suivants :

- les épargnants européens ont une forte préférence pour les actifs liquides et sans risque ;
- l’exigence de rentabilité du capital pour les actionnaires est très forte.

Or, de plus en plus, l’économie de la zone euro aura besoin d’investissements à long terme (qui ne sont pas réalisés si le taux d’actualisation est trop élevé), de rentabilité faible (c’est le cas en particulier d’une forte partie des investissements dans la transition énergétique), peu liquides (infrastructures) et risqués (financement des innovations de rupture).

Comment concilier les caractéristiques des épargnants et les besoins de financement de l’économie en Europe ?

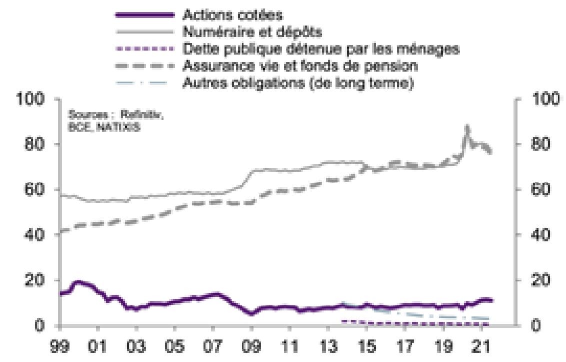
On peut envisager plusieurs pistes :

- une réforme de la réglementation des intermédiaires financiers qui favorise la transformation d’épargne courte et sans risque en investissements à long terme et risqués ;
- la création de nouveaux produits d’épargne qui permettent d’augmenter la maturité de l’épargne et la prise de risque par les épargnants individuels ;
- l’intermédiation par l’Europe de l’épargne (sur le modèle de Next Génération EU) ;
- le développement des cofinancements entre secteur public et secteur privé.

Les deux caractéristiques qui posent problème de l’épargne dans la zone euro:

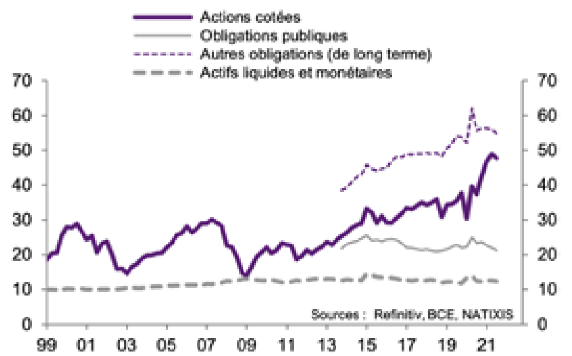
1. La première caractéristique qui pose problème est la forte préférence des épargnants individuels, de base (nous illustrons notre analyse par les données correspondant à la zone euro) pour les actifs liquides et sans risque. Le graphique 1 montre la structure de l’actif financier des ménages de la zone euro.

Graphique 1
Zone euro : encours à l’actif des ménages (en % du PIB valeur)



On voit que les actions cotées et les obligations des entreprises ne représentent aujourd’hui que 8 % de l’actif financier total des ménages.Mais il faut aussi regarder la structure de l’actif de l’assurance et des fonds de pension (graphique 2).

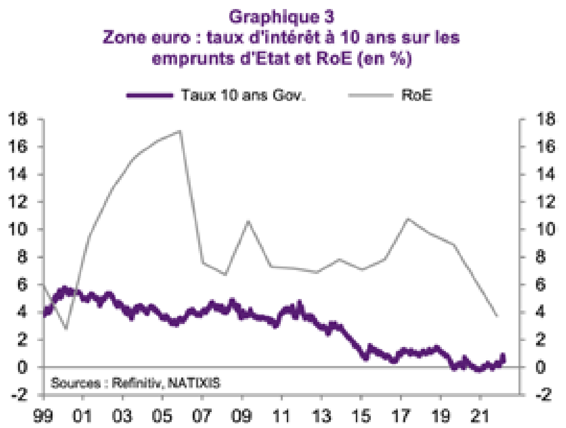
Graphique 2
Zone euro : encours à l’actif des investisseurs institutionnels (en % du PIB valeur)



On voit que les actions et les obligations d’entreprises représentent 74 % de l’actif de ces investisseurs.

Au total, les ménages européens détiennent donc 57 % de leur actif financier sous la forme d’actifs liquides et sans risque (liquidités, actifs à court terme, obligations du secteur public).

2. La seconde caractéristique qui pose problème est le niveau élevé (8 à 10 % aujourd'hui en dehors des récessions) de la rentabilité exigée du capital (de l'equity) pour les actionnaires. Le graphique 3 montre que cette rentabilité exigée de capital n'a pas suivi à la baisse, en dehors des récessions, les taux d'intérêt sans risque.



On voit donc les caractéristiques structurelles de l'épargne des Européens : elle est en grande partie liquide et sans risque, lorsqu'elle est investie en actions, la rentabilité exigée est très forte.

Cette structure de l'épargne des Européens est en contradiction avec les besoins nouveaux de financement de l'Europe
On sait que l'Europe va avoir besoin dans le futur d'investissements dans la transition énergétique, dans les nouvelles filières industrielles (électronique, matériels pour la transition énergétique, médicament…).

Les évaluations récentes montrent que les seuls investissements dans la transition énergétique (production et stockage des énergies renouvelables, réseaux électriques, décarbonation des transports et de l'industrie, rénovation thermique des bâtiments et logements) devraient représenter plus de 4 points de PIB chaque année pendant 30 ans. Ceci montre que les financements de ces investissements devront être :

- à long terme, et peu liquides (il s'agit de financer des investissements d'horizon long) ;
- de rentabilité financière souvent faible (la décarbonation de l'industrie nécessite des investissements qui changent la technologie de production, par exemple des énergies fossiles à l'hydrogène, sans accroître la production ou les profits ; la rentabilité financière des investissements dans la rénovation thermique des bâtiments et logements est faible) ;
- parfois risqués (lorsqu'il s'agit de financer des innovations de rupture, dans la production ou le stockage d'énergies vertes, dans le médicament, l'espace…).

Le problème qui apparaît immédiatement est que les caractéristiques des financements de ces investissements nécessaires diffèrent fortement de celles de l'épargne, en ce qui concerne l'horizon (la maturité de l'épargne), la liquidité, la prise de risque, l'exigence de rentabilité du capital.

Comment alors rendre compatibles les besoins de l'économie et les caractéristiques de l'épargne ?

Quels remèdes à la divergence entre les caractéristiques de l'épargne et les besoins de financement de l'économie en Europe ?

Nous voyons quatre pistes pour rendre compatibles les caractéristiques de l'épargne et les besoins de financement de l'économie en Europe.

1. Réformer la réglementation des intermédiaires financiers (Bâle 3, Solvabilité 2) pour leur permettre plus facilement de transformer l'épargne à court terme et sans risque en financements à long terme et risqués.

   Cette transformation nécessite aujourd'hui la détention de fonds propres très importants par les banques et les assureurs, ces fonds propres devant avoir la capacité d'absorber le risque de liquidité et le risque de défaut qui viennent des divergences entre l'actif (long terme, risqué) et le passif (liquide sans risque) des intermédiaires financiers.

   Mais ce modèle basé sur le rôle des fonds propres comme capacité d'absorption des pertes atteint sa limite : le niveau très élevé des fonds propres nécessaires et la nécessité de rémunérer ces fonds propres au niveau exigé par les investisseurs rendent l'intermédiation financière en Europe très coûteuse.

   Il faut donc réfléchir à modifier les règles de fonds propres, par exemple en utilisant un horizon plus long pour le calcul des risques (des stress tests). Si les actifs détenus par les intermédiaires financiers sont de plus en plus des actifs à long terme, éviter le risque de ruine à l'horizon d'un an n'a plus de sens.

2. Créer de nouveaux produits d'épargne qui permettent d'augmenter la maturité de l'épargne et la prise de risque par les épargnants individuels.

   On peut par exemple penser au développement de l'épargne retraite (création du PER – Plan d'Épargne Retraite – en France), du Private Equity en retail, accessible par les épargnants individuels), au développement de l'assurance-vie en Unités de Compte. Les produits d'épargne qui apportent une gestion des risques (couverture des risques extrêmes, évolution de la prise de risque en fonction de la situation des marchés financiers) vont bien sûr dans le bon sens.

3. Intermédiation par l'Europe de l'épargne.
   La zone euro a un excédent d'épargne dont une partie importante malheureusement s'investit en obligations étrangères, en particulier américaines.

   Il apparaît alors une possibilité : que l'Europe réalise l'intermédiation de l'épargne vers les projets d'investissement à long terme ou risqués, selon le modèle de Next Generation EU : l'Europe s'endette, en émettant de la dette ultra-sûre, ce qui capte l'excès d'épargne des Européens, puis utilise cette épargne pour financer les projets d'investissement nécessaires.

4. Développer les cofinancements entre secteur public et secteur privé.
   Le rendement exigé du capital par le secteur privé est trop élevé.
   Si le taux d'actualisation est élevé, jamais les projets d'investissement dont les bienfaits parviennent à long terme (transition énergétique, infrastructures numériques) ne sont réalisés.

   La solution est alors de développer les cofinancements entre le secteur public (États, banques publiques…) et le secteur privé, pour baisser le coût du capital avec une exigence plus faible de rendement du secteur public.

Synthèse : des pistes pour la finance européenne

Pour réconcilier une épargne des Européens largement sans risque et liquide, une rentabilité élevée exigée du capital d'un côté, et de l'autre côté des besoins de financement à long terme, illiquides, de rentabilité faible et parfois risqués, on peut penser :

- à permettre aux intermédiaires financiers de réaliser davantage de financements à long terme et risqués sans augmenter leurs exigences de capital ;
- à utiliser de nouveaux produits d'épargne qui permettent aux ménages de prendre davantage de risques (de défaut et d'illiquidité) ;
  - d'intermédier par l'Europe l'épargne ;
  - de développer les cofinancements public-privé.

Il y a donc un rôle à jouer pour les régulateurs, les gérants d'actifs et les assureurs, l'Europe, les banques publiques.

02 Is sustainable corporate governance the new black?

By Olivier Boutellis-Taft, Accountancy Europe CEO

A mindset shift on how businesses operate

Since the industrial revolution, the market economy has increased wealth, propelled goods, brought innovations and contributed to scientific progress. However, our economy is also aggravating the climate crisis, overconsumption of natural resource and biodiversity depletion, as well as growing social concerns ranging from income inequality to climate migration. This has led us to the critical situation we are in today and our entire ecosystem is in danger of collapse. The only way to stop this is to change how the economy works. This starts with the way we run businesses.

Corporate governance is instrumental to operate this change in mindset. It is not only about complying with requirements and procedures; corporate governance is about the organisation's purpose, which drives its culture. Companies' boards are responsible for defining strategic orientation. They provide leadership and steer the business' interactions within its operating context, and by extension society. From a practical business standpoint, sustainability encompasses many matters that fall directly under boards' strategic responsibility. Ultimately, integrating ESG (environmental, social and governance) in business strategy and operations is no longer only about doing good and making the world a better place: it is about staying in business.

Governments must set the tone

Making our economies sustainable is a collective responsibility. We are witnessing a steady rise in public concern as empowered customers demand companies to focus on sustainability. However, corporate governance and public engagement on their own will not make these changes happen.

Governments must strike the difficult balance between supporting the market shift to a sustainable paradigm while providing certainty and stability. In this systemic transformation, public authorities have the largest share of the responsibility. For their policies to be truly effective, they need to focus on outcomes and enforcement rather than excessively prescriptive rules.

Furthermore, the public sector in Europe accounts for a large share of the total economy, more than half in some countries. It should lead by example and be active player in the sustainability transformation.

An EU framework for due diligence

The European Commission (EC) has responded to the demand for sustainable corporate governance legislation. This February, they proposed a Corporate Sustainability Due Diligence Directive after months of delay, and several calls from stakeholders from all over Europe.

The proposed Directive aims to hold companies accountable for their human rights and environmental impacts. It plans to oblige businesses to set up mechanisms for sustainable due diligence throughout their value chains and operations. It proposes that citizens can take companies to court for not respecting the due diligence rules and companies face financial sanctions by Member States. On a global level, this is the first time an entire region is moving in this direction and for that Europe can take pride. However, more needs to be done.

Directors' duty of care

Human rights, environmental and climate objectives need to be integrated into corporate decisions. I believe it is in directors' interest to have clarity and legal certainty regarding their duties of care. Tools and standards to help companies assess their sustainability decisions are not yet fully developed and corporate directors need clarity. With their strategic role the business overall direction, the board composition and directors' experience, competences and continued professional development on sustainability matters will be instrumental to help meet the directive's objectives. Linking directors' bonuses to company's sustainability targets can also act as a good incentive.

The entire economy needs to shift

The new rules would apply to companies with 500+ employees and EUR 150+ million in annual net turnover. I am glad to see that company size has not been the EC's only criterion for preventing environmental and social harm, such as toxic waste dumping and child labour. The scope extends to companies operating in riskier sectors with more than 250 employees and a net turnover of over EUR 40 million.

However, this only represents around 13.000 companies – a mere 1% percent of all EU businesses. As the driver of our European economy, SMEs must be part of this joint effort to reach sustainability targets without being overburdened. The EC has announced upcoming guidance for smaller enterprises affected by these rules as part of larger companies' supply chains. This is a needed move but only effective if the implementation procedure follows closely with open dialogue with affected SMEs. This will help ensure the supporting mechanisms correspond to their needs.

Fight climate change

The new rules especially consider climate risks. Companies would need to have a business model and strategy compatible with the transition to a sustainable economy and with limiting global warming to the 1.5 °C target of the Paris Agreement. Fighting climate change requires radical measures and incentives, but policymakers should not forget that the Paris Agreement obliges governments. They have the prime responsibility to legislate and ensure that new legislation is enforced and effective.

Ensuring reliable data

To ensure that companies comply with human rights and environmental requirements in the new laws, the EC proposes verification by an auditor who is:

- independent from the company
- free from any conflicts of interests
- experienced and competent in environmental and human rights matters
- accountable for the quality and reliability of the audit

Businesses need to assess their procedures and internal controls so they can address adverse impacts in their operations and supply chains. Getting this due diligence verified by independent knowledgeable professionals will strengthen stakeholders' confidence in this process.

Accountants: drivers of change

In their different capacities, professional accountants play a key role at all stages of corporate governance. Good business decisions start with reliable information. As businesses change their benchmarks for success, accountants contribute by: measuring impacts, disclosing information, and adding credibility to what is reported. Auditors can add value by providing assurance on corporate governance, internal controls, and sustainability reporting.

The accountancy profession leverages its financial expertise in the field of sustainability and can help companies and governments make the right changes to transition to sustainable economies.

Value creation goes beyond financial gain. This requires corporate functions that fully integrate ESG factors with financial performance, and the board has a strategic responsibility to create them. Many qualified accountants, including those currently acting as CFOs and CEOs, have the education and skills to take up such new roles.

A trend that will stay

There is no denying that we are running out of time. The latest UN climate report suggests that we will soon reach the point of no return as many parts of the world will not be able to cope with the changing environment. Governments around the world have to step up before it is too late. Businesses and all of us will also have to play their part. Sustainable corporate governance might be one of the trendiest topics in town, but unlike most trends that fade away, it is one that will stay along.

03 Decade by decade

By Juan Cerruti,
Global Head of Research,
Santander

Europe has been built decade by decade. Every decade has had its critical years. These critical years are happening now and will undoubtedly define the future of the Union.

Recent EU initiatives that were, until recently, unimaginable are now happening at pace. We have begun to issue European debt at scale, and the war against Ukraine has led the European Union to assume new responsibilities for our common security. The need for the EU to be able to assert its strategic autonomy is ever more apparent with far reaching economic implications.

At macroeconomic level, after two years of pandemic, Europe is now facing another supply-side shock impact due to the Ukraine-Russia military conflict. According to our forecasts, that will imply in the short-run higher inflation and an economic slow-down, which will depend on the developments of the geopolitical outlook. We will feel the spill overs due to our high dependency on energy and food supplies from Russia and Ukraine. However, from a medium-term perspective, I am confident about the resilience and strength of the EU to overcome the situation and emerge even stronger.

In this process, Banks will continue playing a fundamental role in the economy by safeguarding savings and lending to families, SMEs and corporations. Today 70% of funding to companies in Europe comes from banks. Our business is, at its core, a reflection of the society in which we operate. It is no surprise that banks are at the forefront of the broader policy debate in fields such as climate change, digitalisation, and even cybersecurity.

I am passionate about the success of the European economy and the European Union as a whole. And the fact is that if we want a strong European economy, then we need strong banks. For that, we need banks that can grow, innovate, and compete on a level playing field in a digital world. Our companies' global competitiveness must be at the heart of our regulations.

Europe needs a financial sector capable of unlocking its full economic potential. We face many challenges, but there are huge opportunities that are at our hand to ensure a brighter future:

- The **Banking Union must be completed**. A European Deposit Insurance Scheme (EDIS) would allow depositors to be equally protected wherever in the EU they choose to bank. It would help to reduce the sovereign-bank link and increase financial stability for all EU member states.
- We must **finalise the reform of prudential standards** for credit institutions. The financial crisis highlighted the need to improve standards to ensure financial stability. As was tested and proved during the pandemic, banks are now better prepared to endure unfavourable economic cycles. While there is always room for fine-tuning, I believe our stability goals have now been met, and it is time now to focus again on economic growth. With much of the economy running on bank lending, the critical risk today is that banks will not be able to provide the lending Europe's recovery requires.
- **We need to create a true single market for financial services. For this, the alignment of EU national legal frameworks is indispensable**. National regulation can still force banks to have physical branches in every member state in which they operate, or meet different account opening and marketing rules, different digital ID standards, or navigate variable tax treatments for their customer accounts. If we want banks to grow, and power growth in Europe, we need to harmonise these requirements across the EU. This would enable banks and European companies to scale up and compete globally.

All the elements above will be critical to reinforce the competitiveness of European banks. These changes are needed to enable banks to finance the transition to a green and digital future on our own terms.
The European economy and its citizens are not immune to the digitisation of banking. The future composition of the financial sector has become increasingly uncertain as newcomers continue to disrupt financial services markets. Well-established companies from the digital sector such as Big Techs seek to leverage their gatekeeping roles and large user databases to provide financial services. All of them are increasingly gaining market shares, hence creating a less predictable market with financial stability, consumer protection, and privacy risks attached.

The competitive landscape is now driven by digital solutions that allow new forms of engagement with customers, services or even infrastructures. However, current regulation has been designed for the analogue world. We need revamped regulatory frameworks to ensure financial stability, to ensure that there is a level-playing field among market participants and to guarantee consumer protection. When it comes to financial services, "same activities, same risks, same regulation and same supervision" should apply.

I am convinced that data sharing – Open Data - will play a crucial role in the search for a level-playing field. A data sharing framework should be cross-sectoral and customer-centred, including data from all sectors participating in the economy (e.g. healthcare, transport, energy, public sector), and not limited to financial and banking data. Data sharing should be adjusted to the desired use cases based on the needs of customers. Just as financial data is important to new entrants and non-financial companies, non-financial data is important for the creation of new financial products and services. Reciprocity is key.

When it comes to the transition towards a low carbon economy, The EU has clearly taken a global leadership role. This agenda's objectives must be to ensure sustainable growth and job creation. Global coordination between regulators and supervisors is fundamental when defining the sustainability framework. This framework must set the right conditions and tools to enable investment. Banks have a central role to play in the journey towards a more sustainable future, but they cannot drive the transition of the economy on their own. It is the responsibility of governments to implement overarching policy frameworks that create incentives for every sector of the economy to make its contribution to the green transition.

Besides governments, the private sector must embrace its societal responsibilities too. At Santander, our ambition is to achieve net zero carbon emissions across the Group by 2050, to support the goals of the Paris Agreement on climate change. As part of our commitment, we want to mobilise our 153 million customers to go green. We have committed to mobilize EUR 120bn in green finance by 2025 and financially empower more than 10 million people. We are on track to meet both these targets.

The European Union has faced many challenges in the course of its history. The secret of our success has been our ability to turn each of them into an opportunity to reinvigorate our economic and political union. Our latest challenge – a pandemic – has proved this once again: the European authorities' response was timely and decisive. I believe, too, that the support of the financial sector has also been indispensable to soften the impact and speed up the recovery. For the future, I am convinced that collaboration between the public and the private sector will remain a cornerstone of our success.

> We may not know how the economy will look in the future, but I am sure that banks will still be playing a key role as enablers of growth and stability for our economies and societies. That is the contribution to our common good we want to make.

04

Next Generation EU: a template for further action enhancing European resilience?

by Vincent Chaigneau,
Head of Generali Insurance Management Research,
member of EFAMA

Un train peut en cacher un autre ("one train can hide another"), say the French security warnings at railway crossings. So does a crisis. The Russian invasion of Ukraine, in February 2022, came right as the 2-year-old Covid pandemic seemed to fade in Europe. The war will exert a significant drag on EU growth, via the cost of commodities (oil, natural gas, palladium, wheat, corn, fertilizers etc.), the disruption of the supply chain, the tightening of financial conditions and the negative effect on business and consumer confidence. The succession of two exogeneous shocks is a particularly fierce test of resilience, and raises two important economic questions:

First, how can the EU deliver structural answers to a geopolitical shock that has revealed an inner fragility, coming from a triple external dependency at the military, energy, and agricultural levels? Some short-term fixes are available, at the cost however of slowing sustainability progress. For instance, the reactivation of coal production, to make up for the reduced energy imports from Russia, will increase carbon emissions. Also, a looser policy on synthetic chemical inputs like fertilizers and pesticides, to quickly ramp up the EU agricultural production, will hurt biodiversity. Longer term, a greater 'triple independence' will require **heavy investments, hence substantial funding**.

This will include new pipelines and infrastructures so that liquified gas can flow to North-Eastern countries currently highly dependent on Russia, solar panels, heat pumps or increased military expenditures to reach NATO targets (2% of GDP). While some programs may be national, two strong constraints will quickly emerge: the lack of fiscal space in selected EU countries, and the need for deep coordination in activities like energy distribution, R&D, and intelligence.

Second, what are the policy options, in the near term, to mitigate the negative impact on economic growth and keep the EU economy resilient? The question has become ever more relevant since the Covid-19 pandemic has left heavy marks on the economy, not least inflation and public finances. Inflation has surged globally, including in the euro area (5.9% in February). Whatever the multi-pronged roots of then inflation shock, the war is only making it more painful. This somewhat ties the hands of central banks in the near-term: they must start to reduce the extreme policy accommodation, and even tighten policy. The ECB will act cautiously yet will not be in position to provide policy support in the face of the war-induced slowdown. Now turning to fiscal policy: Euro Area (EA) gross public debt surged to around 100% of GDP in 2021 (EC Autumn 2021), up from less than 84% by end 2019. Seven countries are above the 100% average (Greece, Italy, Portugal, Spain, France, Belgium, and Cyprus), and more exposed to debt sustainability risks. Public money spent on the pandemic has inevitably reduced the fiscal firepower into the Russia/Ukraine war.

In all, both the near-term resilience test and the longer-term structural challenges require strong EU coordinated action. With monetary policy and national fiscal policy being severely constrained, a joint fiscal answer looks necessary. This is particularly true at a time when the normalization of monetary policy is likely to push real interest rates to the upside, while the war will cause a slowdown in real GDP growth. The relative level of domestic real interest rates and real GDP growth (along with the initial level of the Debt/GDP ratio and the primary budget) is a key driver of national debt sustainability – which appears at risk in highly indebted countries. Also, the tapering and termination of the ECB QE will affect the supply-demand equilibrium in the government bond market and may lead to a widening of country spreads (hence to a rise of real rates in highly indebted countries). Let us not forget that ECB QE can be seen as stealth debt mutualisation, yet is not a permanent activity, and is in fact expected to be discontinued in 2022. To ensure financial stability in the EU, it may need to be replaced by a more explicit and permanent joint debt issuance mechanism that will act as a resilience pillar.

May Next Generation EU (NGEU) be considered as a template for the deepening of EU integration? Yes, argues a ECB Bulletin article: "NGEU could provide useful lessons for the economic governance framework and for a potential permanent fiscal capacity for the euro area in the future". NGEU was the cornerstone of the EU's fast and broad-based policy response to the pandemic. Financed by issuing a common debt, the NGEU program is worth up to €750 billion, or more than 5.0% of 2019 (pre-Covid) EU GDP, of which €390bn are grants and the rest loans over 2021-2026. NGEU was built as an exceptional and one-off response, yet it marked an impressive ramp-up of EU joint issuance. Without the Covid crisis, the EU would have been expected to issue some €10bn in 2021, to roll-over debt raised through the 2011-12 EA crisis. NGEU also had a special focus on the national investment and reform plans. It is not hard to imagine a new program that would now focus on addressing joint objectives, namely reducing the "three EU dependences". Incidentally, joint debt issuance would also boost integration between national financial systems, reduce the risk of runs on national bond markets, and help detangle the "doom loop" of interdependence among banks and local sovereigns.

Such plan however meets a major obstacle. A further broadening of joint debt issuance would require granting the EU new resources for paying back the debt. The EU budget – which is financed by own resources and contributions from all Member States – backs the NGEU borrowing, which will be paid down between 2027 and 2058. Yet for now the EU budget is a tiny fraction (about 2%) of the combined budgets of all EU countries. New resources would be needed to back a broader joint debt issuance plan. This however has historically met resistance. The lack of a more joint fiscal policy is sometimes described as the original sin, or design flaw, of the euro area: EA countries have adopted a common currency but have retained virtually full responsibility for their own fiscal policy. Broadening joint debt issuance would effectively imply a transfer of high credit credentials of Northern countries to higher indebted ones. This will require stronger assurances on spending and reform controls, as well as further progress in areas like Banking Union. The latter is "unfinished business", e.g. a common deposit guarantee is still missing. Slowness in this area reflects ongoing concerns about the sovereign-banking doom loop, which may be addressed via a reformed treatment of capital charges on sovereign debt for banks (an old discussion).

The obstacles are high, but so is the urgency to act, after the pandemic and war at the doorstep of the EU have revealed inner fragilities. The challenges at stakes – the three dependencies – are vital to the EU prosperity and security. NGEU has opened the way. A more permanent EU debt capacity would not just strengthen the European economic and financial architecture, but also benefit the region's capital markets. The well-known resistance is rational and understandable yet must be overcome for Europe to flourish. It requires a give-and-take process where each member accepts concessions in areas such as risk mutualisation, policy centralisation, and structural reforms. Of course, joint sovereign issuance cannot be the sole response to tectonic geopolitical shifts. The private sector must also provide a key contribution to EU resilience, typically via the funding of new infrastructure and green initiatives. This requires reforms in other areas, not least of the regulatory environment, e.g. a well-calibrated Solvency II revision and an adaptative taxonomy that incentivise investments towards the desired energy, agricultural and military transitions.

05 The EU should strengthen the attractiveness of its financial markets

By Thalia Chryssikou,
Chair of the Association for
Financial Markets in Europe (AFME)

The Capital Markets Union (CMU) is a generational project to support the financing needs of European citizens, enterprises and public authorities, and to strengthen EU economic competitiveness

The need to advance the project has never been more pressing. Capital markets will need to play a central role in the promotion of economic growth in the Union in the coming years and, specifically, in channelling the investment at scale to enable the green and digital transitions.

The effects of the Covid-19 pandemic and recent economic sanctions in the context of the Ukraine crisis underscore why the EU needs a strong and diversified financial system, with liquid and resilient capital markets able to withstand sudden shocks. I would argue that the need to expand the international reach and capacity of EU wholesale markets is equally important, and complementary to this goal.

There have been milestones in the advancement of the CMU. The issuance of the NextGenEU bonds is an example of what could be a game changer in scaling up EU markets and promoting the international role of the euro. Yet, EU capital markets remain fragmented and under-sized. Achieving a fully developed CMU will require perseverance and commitment at the highest political levels. As work continues across the 16 sets of actions identified in the CMU Action Plan of September 2020, I would like to reflect on what I see as the increasing importance of supporting the competitiveness of EU financial markets on the global stage.

Competitive financial markets will be key to Europe's economic strength

Financial markets in the EU – or any other jurisdiction – do not function in isolation. For the CMU to thrive in a globally competitive financial markets landscape, it is vital to pursue policies that promote the global attractiveness of EU capital markets and contribute to scaling up the Union's markets ecosystem.

Financial markets are interconnected and financial centres across the globe compete with each other. This is especially the case in wholesale markets where sophisticated investors and market participants are themselves active in multiple jurisdictions and have choices to make when it comes to deploying their capital and accessing liquidity pools.

This is why policymaking should contribute, where possible, to strengthening the attractiveness and competitiveness of EU capital markets. In turn, this will underpin current efforts to increase the capacity of EU capital markets and achieve greater strategic autonomy in financial services.

Promoting well-calibrated regulation and international cooperation

The largest and most successful global financial centres are characterised by high regulatory standards, the quality of their legal frameworks, their openness to global pools of capital and the scale of their underlying financial ecosystem.

While it is not - and cannot be - the sole driver of success, we cannot ignore that well-designed regulation and supervision plays a role in the competitiveness of financial services systems.

In the EU it is no different. To build an effective CMU, it is essential that the overall regulatory framework considers how to make market-based finance economically attractive for households, investors and businesses. And as an aside, the metrics for assessing progress on the CMU should be based on the growth of capital markets, actual finance provided or investments made, and not the number of pieces of legislation completed. The competitiveness and attractiveness of EU financial markets could also be further formalised in the mandates of the European Supervisory Authorities, alongside their existing core mandates, to ensure that they are embedded in the policymaking philosophy.

Moreover, maintaining openness and connectivity with non-EU markets is essential in continuing to build the EU's capital markets capacity. The EU should continue to champion open capital markets that allow EU participants access to international capital pools and funding opportunities while ensuring market integrity and fairness of treatment between EU firms and third country entities.

I would also like to emphasise the importance of supporting global regulatory cooperation, particularly in the areas of digitalisation and sustainability as jurisdictions grapple with common objectives and challenges. It is in the interests of European companies and investors to have standards that are globally aligned, while maintaining the EU's strong and ambitious leadership role in these areas.

Bolstering Europe's primary and secondary markets

The current EU policy agenda features major workstreams interacting with the CMU objectives and the aim of promoting EU competitiveness. The next two years will see the advancement and completion of major debates - in areas including prudential requirements for banks, sustainable finance, digitalisation and market structure, among others – with the potential to have far-reaching impacts on the European banking sector, the capital markets ecosystem and the green transition.

The EU is undertaking a comprehensive review of company listing rules to encourage more companies to list on EU public markets, particularly SMEs. As the EU competes with other global markets to attract company listings, attractive and harmonised listing rules on EU public markets are vital to support crucial access to market finance for EU companies, while retaining strong levels of legal certainty, transparency and investor protection.

Meanwhile, EU legislators are currently debating a set of major, potentially transformational proposals for Europe's secondary markets in the ongoing review the Markets in Financial Instruments Regulation. This work is critical to the promotion of globally competitive capital markets in the EU. Diverse and competitive secondary markets provide deep pools of liquidity that reduce the cost of funding for businesses and attract investors by helping them to achieve higher and more sustainable returns.

An attractive, well-regulated trading ecosystem can contribute to nurturing innovative, world-leading infrastructures and promoting enlarged pools of liquidity within the EU. I believe that the promotion of market efficiency, competition among service providers and strong outcomes for investors as well as corporate and SME issuers should guide us in this debate and encourage the EU's decision-makers to prioritise these objectives.

Time to deliver on the CMU

In conclusion, EU capital markets have many strengths to succeed in today's global landscape. These include the scale of the single market, the euro as a leading international currency and global leadership in ESG financing, among others.

It is vital for Europe to put the ultimate beneficiaries of capital markets - businesses, pensioners and savers, public authorities - at the forefront of policymaking considerations, while not compromising on our robust financial stability and investor protection principles.

> I am confident that in the coming period that EU can take significant steps towards a fully-fledged and globally-competitive CMU to support sustainable long-term growth in years to come. The objectives are within reach and the EU must find the political momentum to seize the opportunity.

06

The strategic role of European financial institutions

by Koenraad Debackere, Chairman of the Board of Directors of KBC Group N.V., member of EFAMA

A recent article in the Financial Times (Patrick Jenkins, February 22nd, 2022) summarizes multiple challenges faced by European banks (Why European bank shares are experiencing a false dawn). It fits nicely with the growing concern both within and outside the financial sector that it is time for Europe to confirm (or even rediscover) the strategic relevance of this critical sector. European strategic autonomy, as a lever for economic independence, competitive strength, and transformation will critically depend on the ability of the financial sector to finance innovative answers to major transitions.

The (Keynesian) economic support measures taken by European governments eased the balance sheets of their economic actors, including banks, during the recent pandemic. European banks' income statements and balance sheets have grown stronger, but (contrary to their American and Asian counterparts) they have on average generated a rate of return below their cost of capital. This underperformance influences Europe's economic prowess, it limits the sector's ability to attract sufficient funding to finance the investments needed, and hence, it constrains the sector's role in Europe's ambitious transformation and strategic autonomy policies.

What are the factors driving this underperformance?

The macroeconomic environment and monetary policy have put pressure on Europe's financial sector. In the last decade, the macroeconomic environment in Europe has been less dynamic than the one in the US, while the ECB's accommodative monetary policy has impacted the performance of European financial institutions. Low and even negative interest rates in the Eurozone and the flattening of the yield curve have led to sharp declines in net interest income, which still represents a little more than half of European banking income. In 2019, the net interest margin of European banks was almost 30% lower than that of US banks. Their transformation results are hampered while they have been reluctant (and for some market segments (e.g., retail) and in some countries prohibited) to pass on the negative rates to be paid to ECB to their customers. This leads to an increase in cost of financing, which is further impacted by the sizeable amounts of liquid assets European banks must hold (e.g., compliance with the LCR ratio) consisting mainly of government bonds or reserves placed with the central bank, whose return is negative. The ECB is, of course, aware of this dilemma and has (partially) remedied through mechanisms such as tiering and long- term refinancing operations (the so-called TLTRO's). While such measures are welcome and helpful, they only partially compensate the losses banks have experienced in the recent monetary environment. Obviously, this situation is evolving given the current policy adjustments announced by central banks which will, in turn, generate new unknowns.

In addition, European Financial sector faces some structural challenges as well.

Europe's banking sector is fragmented, and European capital markets are shallow. National regulations are not always aligned across Europe, transmissions of directives do diverge, and tax regimes differ. Such facts limit both economies of scale and flexibility in managing balance sheets. They also foster the persistence of overcapacity, which in turn sustains fragmentation. The incomplete European Banking Union hampers cross-border consolidation and cross border Investments. It penalizes cross-border banks given the regulatory requirements on capital and liquidity between their subsidiaries.

Banking regulation should therefore create a level-playing field across Europe. A banking sector thrives on the diversity of its business models. But, the way in which banks organize their business models should not lead to unfair regulatory consequences. The current debate on downstreaming MREL requirements, known as the daisy chain proposal, is a case in point. The setup of an institution (via Holdco or Opco) should be neutral to such requirements.

As a rule, increasing regulations are correlated with additional costs, both in terms of operational costs and capital costs. An illustrative comparison: CET1 ratios of European banks evolved from 7% in 2005 to 14% in 2019 (average). The CET1 ratio of US banks grew from 7% in 2005 to 11% in 2013 and then stabilized (average). A major framework like Basel III is applied to all banks in Europe, while in the US it is applied only to internationally active banks.

Technology dynamics related to data, digitization, and the advent of AI/ML as a general-purpose technology change and permeate the competitive landscape. Financial institutions experience an increasing number and diversity of competitors across all segments of the value chain (payments, processing, risk sharing, service distribution, products etc.). New technologies revolutionize market boundaries and landscape. Blockchain, crypto assets, digital currencies and programmable money, digital identity, artificial intelligence … are propelled to the forefront of financial service innovation. They enable disintermediation and substitution. Incumbents face unknowns and must invest significantly in technology, and the experiments and pilots it necessitates.

Central banks run pilots with Digital Currencies (CBDCs). They open perspectives on the organization of the financial system, including different options to be envisaged regarding the role of commercial banks. Assume access to the digital euro would be given to payment service providers. This would change the position of banks. And will such digital currency focus on wholesale or retail? A focus on retail is likely to increase deposit volatility, critically affecting the ALM-transformation process.

Transition challenges, especially the climate challenge, add to the digital challenges. The financial sector will play a significant role in that transition. But, expectations on their role need clarification, deeper understanding, and scientific insight.

Methodologies, taxonomies, data, indicators, impact assessments of emerging clean technologies (and their so-called Technology Readiness Levels) require significant scientific effort to underpin their validity and reliability. In the longer run transition will create significant economic opportunity. Though, in the short run, climate policy is macro-economic policy that will create important negative supply side shocks.

And now?

The above analysis signals various threats to the competitiveness of the European banking system. The two roles of banks, to transform short term liabilities into longer term assets and reduce information asymmetries based on the rich data on which to judge creditworthiness when assuming their role as a lender, are essential to the vitality and transformation of the economic systems where they operate. Trust is the cornerstone . Regulation and supervision must contain the risks of those activities. But, the advent of new players and the permeable nature of market boundaries and competition, fueled by technological innovation, lead to risks outside the present regulatory and supervisory perimeter. Financial stability and efficiency are crucial for the sector to play its role towards Europe’s strategic autonomy across a broad range of economic sectors, not in the least the funding needs of Europe’s green transformation. As Europe currently develops its industrial policy, it must consider the role of the financial sector therein. In this context the European Payments Initiative should receive proper attention.

While legal and regulatory frames must create a level-playing field for all participants, with the same obligations on data use and data sharing for bank and nonbank players. Revisit and optimize the GDPR framework based on current experiences in different economic sectors and ensure that cloud services remain accessible given the limited number of global cloud service providers. The development of a European Central Bank Digital Currency should be pursued, though without disrupting the banks intermediating role. ECB should be allowed to integrate financial stability in its monetary policy, and to enable the use of flexible collateral arrangements as an instrument in monetary policy. The European framework for banking crisis management should now be finalized and a European version of Basel should be considered to reduce the additional operational and capital costs that European banks at present incur.

Besides those critical “external” dimensions, the sector itself has the duty and the responsibility to shape their strategic, organizational, and operational future. Platform and ecosystem thinking becomes part of their business model. Technology not only drives operational efficiency but also the effectiveness of risk and compliance management. In an era of ever mounting cybercrime, technology supports operational resilience and enables sustainable cost/income ratios while guaranteeing customer centricity and proximity.

Technology, of course, brings its specific challenges. Data biases, privacy issues, misinterpretations, uninformed uses and misuses, and problematic product offerings are just a few of many points of attention. Consequently, “ethics by design” and “conduct risk” gain attention, prominence and importance.

> **Finally, it is important to conclude this brief overview with the unique contribution of talent and competence. Talent attraction, retention and development are critical for the financial sector as a whole. They should be recognized as attractive, dynamic, future-oriented employers.**

Readings on which the note has been based and developed:

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Ethics by Design (2020), World Economic Forum White

Paper. Other People’s Money (2015), by J. Kay, Profile Books.

Reinventing the European banking sector (2021), Institut Montaigne Report.

The Future of Money (2021), by E.S. Prasad, The Belknap Press of Harvard University.

07

Unleashing the power of capital to fuel Europe's sustainable and prosperous future

By Christian Hyldahl, Head of Continental Europe at BlackRock

As the Conference on the Future of Europe debates the strategic priorities for the EU, it is useful to reflect on the ambitions we have set for ourselves, and the challenges we face.

In 2019, EU leaders announced their goal to make Europe a global sustainability leader and technology powerhouse. The reform and investment needed to reshape our economies towards these long-term aims is considerable.

The current economic and geopolitical backdrop further complicates this mammoth task. While Europe is still grappling with the devastating human and economic impacts of the COVID-19 pandemic, the Russian invasion of Ukraine has sent shockwaves across Europe.

The continent is now facing an immediate humanitarian crisis unfolding at a rapid pace. The conflict has also created immense pressure to end the EU's long-time dependence on Russian gas and oil, pushing European leaders to radically shift their priorities on energy security and supply.

While these issues are front of mind for many Europeans, there are other long-term challenges that must also be met in addition to the strategic challenges of today. The gap between pension savings and Europeans' financial needs in retirement will continue to grow without deliberate, and perhaps politically sensitive, reforms.

As Europe mobilises the investment needs that will underpin the economic recovery from the COVID-19 pandemic, and meet the long-term sustainability and digitalisation aims, it will also be critical to ensure that the return on this investment is shared as widely as possible across European households.

Financing the net zero transition across the EU

Global efforts to mitigate climate change will profoundly reshape economies, rewarding those who embrace this challenge. Europe is already a leader in this debate globally, and the EU has championed green policies and strategic sustainable investments as part of the Green Deal.

The transition to net-zero greenhouse gas emissions will involve a massive reallocation of resources. Policymakers will need to balance long-term objectives with nearer-term pressures, such as the urgent need to re-think energy security and supply in the wake of the Russian invasion of Ukraine and the resulting political and economic realignment of the EU-Russian relationship.

As the economy transitions, supply and demand will shift, with the risk of mismatches, and inflationary pressures along the way. Policymaking at the EU and national level will determine how this multi-faceted transformation will play out in the long term for people and businesses across the continent.
With the right policy incentives in place, capitalism can be a powerful catalyst for positive change. Robust and integrated capital markets can put Europe at the forefront of the global net zero evolution while helping facilitate a fairer and more just transition for the communities that have been traditionally dependent on fossil fuels. But focusing solely on limiting the supply of hydrocarbons while ignoring the demand side will increase energy prices, as we have seen this winter even before the Ukraine crisis, hitting those who can least afford it.

Easily accessible capital can complement the policy aims of an orderly transition that will allow time to make the necessary investments, phase out carbon intensive activities, redeploy workers, and develop new technologies to power the net zero economy. This transition scenario should bring a manageable rise in inflation and a net gain for Europe, contributing to the sustainable and socially just future promised to EU citizens.

Leveraging financial capabilities for the benefit of EU citizens

The importance of creating a pan-Europe capital market, building long-term savings frameworks, or opening up opportunities for individual investors is rarely in the limelight. And yet these issues can strongly influence the commitment of capital to investment needs and the long-term financial prospects of millions of Europeans. Empowering retail investors with better tools to activate the money they keep in savings accounts can also be a powerful source of investment for the European economy, providing long-term funding for the EU's transformation agenda. The European Central Bank estimates that in 2021 European households held €8.8 trillion in bank deposits, with roughly 60% in current accounts, and over €3 trillion in savings accounts.

Europe's savings surplus over investment amounts to €340 billion within the eurozone alone[1]. Those who put their savings to work across capital markets had a significant gain over the last decade. For example, on average, European cross-border equity mutual funds delivered a total net return of 108% in real terms between 2010-2019[2]. Unfortunately, the absence of a widespread investment culture and the underlying poor financial education keep this potential dormant.

As the global economic and financial landscape has become more complex and exposed to geopolitical shocks than ever, no one can guarantee that the market trends from the last decade will continue without any major disruption. Despite that uncertainty, developing a strong pan-European investor base should remain one of the EU's strategic priorities to create new funding avenues for driving growth, innovation and competitiveness. The Capital Markets Union (CMU) is a vital part of this goal, ensuring that investments and savings flow freely across Member States.

The next big initiative under the CMU umbrella will be the European Commission's retail investment strategy, aiming to create the right balance between investor protection and enabling individual investors to more easily

1 Speech by François Villeroy de Galhau, Governor of the Banque de France, 30 November 2021
2 EFAMA, Reply to the European Commission's public consultation on a retail investment strategy for Europe, 3 August 2021

access capital markets to build long-term financial security beyond cash savings. The soaring inflation, which has been significantly affecting European savers, is another factor strengthening the relevance of this initiative.

Even with a modest inflation rate of 2%, the purchasing power of cash savings is reduced by almost 10% over five years and a whopping 40% over a 25-year period[3]. The CMU can help make capital work for Europeans from all walks of life, by moving their cash savings to productive investment. This shift can help to create the investment returns needed for long-term financial security.

Globalization and technology have created unparalleled choice for retail investors, but only those with a good understanding of financial risks and opportunities will be able to benefit from the investment possibilities offered by modern capital markets. According to the OECD, about half of the EU adult population struggles to understand basic financial concepts[4]. The problem is even more acute among low-income individuals, women, ethnic minorities, youth and older people. Financial literacy is key to improve financial inclusion, providing the most vulnerable groups with essential know-how that can help them make the most of their money. In the aftermath of the economic shocks triggered by the pandemic, both the public and private sectors should work together to build financial resilience among various populations, increasing equality and upward social mobility in Europe.

Financing long-term European goals while saving for retirement

The growing strain on public retirement provision systems is a long-term strategic challenge to the European social model. Household long-term savings will increasingly need to play a more prominent role in Europeans' retirement. Changes to European demographics – as Europeans live longer, they will in turn need to save more to enjoy financial security across their lifetimes – and employment trends will likely necessitate reforms where market-based privately-funded pension systems will supplement public pensions.

Effective retirement solutions that see long-term savings productively invested can also be a driver of economic growth, innovation and job creation across the EU.

Embedding financial capabilities in the Conference's blueprint for the future of Europe

The EU's ambitious sustainability and technology transformation will depend on its ability to mobilise the investments needed to transform the economy. To do this, policymakers must set out a clear policy pathway for the transition to attract private capital. This must be supported by more deeply integrated European capital markets, open to a wide range of new participants and the creation of more meaningful investment opportunities on the way to net zero.

Building up stable long-term pools of private capital will not only complement strained public resources to finance Europe's transformation, but will also ensure that the economic gains of these investments are shared more widely across Europe, and also help address Europe's looming retirement and pensions challenges.

While many of these challenges are defined as 'long-term', the need to debate solutions and move forward in addressing them is urgent. Equipping Europe with strong and broad financial capabilities will matter for EU decision-makers and citizens alike. That's why this action point warrants a prominent place in the discussions at the Conference on the Future of Europe.

3 BlackRock, Putting the capital in the European Capital Markets Union, October 2019
4 OECD/INFE 2020 International Survey of Adult Financial Literacy

08

A CMU fit for the future

by Petr Koblic, CEO, Prague Stock Exchange, member of FESE

These are momentous times for Europe, geopolitically, environmentally, and economically. If we are to secure Europe's competitiveness, through sustainable and inclusive growth, we must pick up the pace and strengthen the Capital Markets Union (CMU).

As President of the Federation of European Securities Exchanges (FESE), I reaffirm that the European exchange industry is fully invested in the furthering of the CMU. However, while progress has been made since its inception, EU capital markets remain comparatively opaque and fragmented. Barriers to integration persist and so far the equity capital structure of the European economy has not improved.

As a consequence, citizens and businesses in Europe are not able to fully benefit from the great structural set-up that European financial market infrastructures provide: facilitating access to finance for companies, providing investment opportunities, bolstering financial stability, and driving economic growth and transformation.

Exchanges bring issuers and investors together, serving the need for capital formation on primary markets and price discovery and risk transfer on secondary markets, while ensuring transparency, integrity, and investor protection. SME Growth Markets are a great example, enabling small issuers – like in my home country, the Czech Republic, and many others – to access an ecosystem with a deep and diversified investor base. However, further changes are needed to increase the attractiveness of SME Growth Markets, striking a balance between what is expected from SMEs when listing and adequate levels of safeguards and investor protection.

SMEs are the backbone of the European economy. Together they comprise approximately 99% of EU businesses, supporting growth, creating higher levels of innovation, wealth distribution and most importantly job creation. Europe must help these companies to grow by creating attractive market-based financing conditions for companies, in turn reducing the dependence on bank lending which remains a core, unmet objective of the CMU and would help to bolster overall financial stability and resilience. Of particular importance for my country, Europe needs to nurture the local and developing financial ecosystems which serve smaller companies and their investors. The enabling of easy cross-border listings and placements for issuers, and a common definition of SMEs as those that do not exceed a market capitalisation threshold of one billion euros over a 12-month period, would be two ways to help to support an increase in jobs and growth across our continent.

It further does not serve Europe's growth, autonomy or competitiveness ambitions to maintain a situation in which it is easier for European citizens and local asset managers to channel investment into opaque crypto structures, rather than into job creation and employment at home through, for example, investment in EU SMEs. We must ensure it is both prudent and logical for local and regional banks and brokers to offer EU SMEs to their clients.

Creating a more favourable environment for SMEs to list, streamlining the IPO process, bolstering transparency, and better tailoring regulation is already an objective of the EU. We must step up now with renewed purpose, back our small businesses, and invest in Europe's future.

If we are to succeed in attracting companies and investors (back) to capital markets, we need to restore trust in the efficiency, stability and transparency of the markets. While MiFID I and II have worked for blue-chip stocks, capital markets have suffered from increased regulatory burdens and decreased transparency, with the costs borne by local issuers and investors, setting back the overall integration of the CMU.

Exchanges dedicate substantial resources to maintaining the highest possible standards for accuracy and reliability, with data coming from a fair, transparent and multilateral pool of liquidity, open to all market participants under the same rules, putting trust and integrity first. This is all part of the price formation process which, predicated on transparency, creates the reference price for everyone to trade, delivers more efficient markets, and lowers the cost of capital for businesses.

However, despite the objectives of MiFID II, equity markets in the EU remain less liquid and less transparent than their US and Asian counterparts. By directing order flow away from lit markets, market liquidity is fragmented; we need to halt this trend.

Europe must also make capital markets more accessible and fair for the end-investor. The proposal in the MiFIR review to ban payment for order flow (PFOF) practices is welcome, and should be maintained: aside from its detrimental impact on competition and the price formation process, PFOF poses a clear conflict of interest by creating an incentive to direct order flow to the execution venue that offers the highest payment to the broker, not the best possible execution quality for the investor. Integrating retail investors into capital markets is nevertheless a priority, but focus should be placed on easing access to simple, cost efficient products, such as listed shares and bonds.

Above all, Europe needs a simpler equity market structure. Both exchanges and the European Commission share a vision of transparent public markets powering shared growth and prosperity. Restricting dark trading only to large orders would be an efficient step in the right direction, buttressing the quality and robustness of price formation, removing market complexity and levelling the playing field between venues, to the benefit of issuers and investors.

On the other hand, the creation of a Consolidated Tape will not in and of itself address deficiencies in market structure. As currently conceived, the proposal places the costs of the tape almost entirely on exchanges to the benefit of less transparent operators in the industry such as SIs. Only a Consolidated Tape that is not overly complex, that supports multilateral price formation and that allows investors to verify best execution will be a win for trust in and the efficiency and competitiveness of European markets.

This is a decisive moment for Europe: the decisions we take at this time will determine our global competitiveness and ability to confront the challenges of today and tomorrow. Capital markets will play a crucial role in mastering the short- and long-term economic impacts of geopolitical and public health crises, as well as in fostering the green and digital transformations. But without strategic focus now, Europe will lose ground, with the price to be paid by European citizens.

09 Europe needs a common safe asset

By Michala Marcussen,
Group Chief Economist, Société Générale

The important role of finance for a more robust economic foundation for the European Union was reaffirmed by the Versailles Declaration, which called for "creating more integrated, attractive and competitive European financial markets, enabling the financing of innovation and safeguarding financial stability, by deepening the Capital Markets Union and completing the Banking Union". Achieving this goal requires difficult decisions on public risk sharing, and reality is that outside times of crisis, it has proven hard to build consensus on just how much public risk sharing is required to underpin private risk sharing in Banking Union and Capital Market Union. Finalising Banking Union, however, requires reducing national sovereign risk on bank balance sheets. Deepening Capital Markets Union requires safe collateral. Wining reserve currency status requires deepen and liquid capital markets. Combined, all three objectives require a common safe asset of significant size.

The euro area debt crisis delivered safe financing

In the period that followed its creation in 1999, the euro area saw a significant increase in financial integration as private investors engaged greater risk sharing across member states. As illustrated by the ECB's measure of financial integration, this quickly reversed with the euro area debt crisis, that brought to light a sovereign-bank doom-loop, that pushed market to price not only higher default risk for certain sovereigns and the related member states' private debt, but also to price higher risk of a member state exiting the euro area.

The combined response that saw the creations of the European Financial Stability Facility (EFSF), the European Stability Mechanism (ESM), the ECB's Outright Monetary Transactions (OMT) and Banking Union, presented private investors with a credible framework offering safe financing for sovereigns and a credible means of supporting the banking system if need.

This increase of public risk sharing allowed the sovereign-bank doom-loop to be significantly reduced. Subsequently, the willingness of private investors to share risk across euro area member state borders increased again, which can be observed also from the ECB's quantity-based measure of financial integration, which captures volumes of financial flows across member states borders.

The Covid19 crisis proved the merits of safe financing

The Covid19 crisis did not trigger the same reversal of private financial flows as that seen during the European Debt Crisis. After an initial wobble, sovereign spreads were been well contained, thanks both to the ECB's Pandemic Emergency Purchase Programme (PEPP) and important fiscal measures taken at the European level; not least the €750bn Next Generation EU (NGEU) recovery plan. The triggering of the general escape clause of the Stability and Growth Pact, along with an easing of state aide rules, furthermore afforded governments full flexibility to respond to the Covid19 crisis with fiscal stimulus at the national level. Moreover, European banks entered the Covid19 crisis well capitalised.

Some observers argue that the euro area today has sufficient tools to manage crisis, and initiatives that involve further public risk sharing, such as a single safe asset are unnecessary, and could even bring dangers in the form of (1) fiscal moral hazard, the idea that government would be tempted by such as asset not to respect fiscal discipline or, conversely, (2) that the existence of a common safe asset could threaten the integrity of the national debt market. Numerous technical proposals for a common safe asset have sought to overcome these concerns, and while a discussion of the pros and cons of various proposals is beyond the scope of this article, the real question today is probably less on whether a technical solution exits, but more on the necessity for such an asset.

The Euro area still needs a sizeable common safe asset

A key argument favouring a common safe asset is to remove national sovereign risk from bank balance sheets and pave the way for finalising Banking Union, with single jurisdiction and a common European Deposit Insurance Scheme (EDIS). Other regulated investors, such as pension funds and insurance, also need safe assets to meet regulatory requirements. A further argument relates to Capital Markets Union (CMU), and the key role of collateral.

Analogous to the money creation that takes place in the traditional fractional reserve banking system, eligible collateral can be "reused" in the system as a liquid cash equivalent, allowing what we can term the capital markets financing multiplier to work. Central banks are a key part of this chain, as eligible collateral also gives access to central bank financing, and creates the safest and most liquid asset available, namely central bank reserves. Central Bank collateral frameworks thus sit at the heart of the financial plumbing and play a key role in determining the "safety" of a given asset used as collateral. Safe assets are thus not just for necessary for Banking Union, but also for the smooth functioning of Capital Markets Union.

It's worth keeping in mind also that deep and liquid capital markets are seen as a prerequisite for reserve currency status, and thus key also for the international role of the euro, and Europe's economic sovereignty.

Although the measures adopted at the European level in response to the Covid19 crisis were largely temporary, these offered a combined potential increase of €1.4tn for European Commission and ESM debt issuance if measures were drawn in full. The politically important point is that the Covid19 crisis marked the first time that the EU was allowed to borrow to finance budget expenditures. And despite the temporary design, the financial market perception is clearly that if faced with another similar common shock, similar European level measures would again be taken.

While adding to the stock of triple-A rated assets in the euro area, new debt issuance from the EU and ESM is still a long way from the single safe asset that Europe needs to support the joint needs of Banking Union, Capital Markets Union and the related international role of the euro.

Even setting aside considerations on outstanding issuance size, reality is that if the EU/ESM issuance were to assume the role of a genuine safe asset with preferential treatment over national sovereign bonds, be it on bank balance sheets, balance sheets of regulated investors or in ECB operations, then this could work to the contrary, and increase the risk premia on national peripheral debt. A genuine safe asset requires that national governments maintain access to safe financing. Ensuring this only for the share of national financing needs that falls within the limits set by the common fiscal rules would have the added benefit of preventing moral hazard.

Sound fiscal rules are not enough

Question is whether sound fiscal rules, ensuring that each member state had strong public finances would suffice. This was the logic of the Maastricht Treaty, with solid public finances framed by a maximum deficit of 3% of GDP and public debt of 60% of GDP, and implicit the idea that any member state exceeding these ratios would be promptly sanctioned by the financial market with a widening sovereign bond yields.

As history has shown, however, the fiscal rules, despite successive reforms, have grown ever more complex and difficult to implement. The disciplining forces of the financial markets, moreover, proved largely absent in good times and excessive in bad times. These issues are well recognised, and hope is that the ongoing economic governance review will deliver more credible fiscal rules.

Credible rules, however, are not merely a question of good design. As long as euro area government remains reluctant to share a common safe asset, investors will logically wonder why, and euro area sovereign bond markets will remain fragmented. As such, the issue of sovereign debt will remain a hurdle for the finalisation of Banking Union, the deepening of Capital Markets Union and securing a stronger international role of the euro.

10

Climate protection and banks: a fruitful liaison

Christian Ossig,
Chief Executive of the
Association of German Banks

The Russian invasion of Ukraine marks a paradigm shift for Europe and especially for Germany. Until recently, most activities in Brussels and Berlin aimed at swiftly transforming Europe into the first climate-neutral continent while maintaining its technological competitiveness. But recent events have brought Europe's security and reliance on fossil fuels to the fore. Defence budgets and investment in security are expected to rise in many European countries and Russia is now experiencing uniquely targeted and wide-ranging economic sanctions.

How will this impact Europe's environmental agenda over the coming years? Germany's government recently reaffirmed its commitments and intends to stick to its climate ambitions. In fact, the transformation will be accelerated with an energy and climate fund providing €200bn by 2026. While much of this fund was already pre-allocated, its scale and timeline alone show that energy transformation has become even more important. Europe's and particularly Germany's dependence on Russian gas and oil imports is one of the continent's main weaknesses and must be addressed without delay. While other sources of fossil fuel, liquid natural gas or even a slightly longer use of coal may solve immediate issues, it is obvious that Europe's politicians must now give even higher priority to the use of renewable energy.

Massive investments

It was always clear that the transformation into a sustainable and climate-neutral economy will require vast sums. The green transition and the development of a modern digital infrastructure, which is indispensable to successful climate action, will necessitate massive investments. The European Commission puts the figure at an additional €350bn annually. Other estimates arrive at similar sums.

But who can provide these funds? Though government programmes are currently being quickly developed, they cannot achieve the transformation by themselves, leaving large parts of the financing question unsolved. Public investment will certainly play an important role, especially when it comes to reliable transport systems, energy infrastructure and climate-neutral mobility. Furthermore, a smart funding policy can channel money into developing green technologies and thus provide essential start-up finance.

Yet too much focus on public investment and state aid is the wrong approach. While the EU has deep financial pockets, they are not bottomless. Most spending on new technologies and production processes must and will be privately financed. This is the only way to achieve a green transition.

In the coming months and years, thousands of companies will have to carefully analyse their carbon footprint and collect huge amounts of data – and many have already begun to do so. Thousands of companies will adjust their business models and invest in new climate-friendly technologies. And a lot of them will turn to their banks for help because banks provide European businesses with the bulk of their finance.

So it's no exaggeration to say that more climate protection cannot happen without banks. They have noticed for some time that the issue comes up with increasing frequency in their discussions with corporate clients. The pressure on businesses to become more climate-friendly is growing: rising CO_2 prices play a role here, as do the expectations of customers, the public and the banks. On top of that, more and more companies are subject to direct and indirect sustainability reporting obligations. But banks are feeling this pressure too because they are the ones who have to reassess the risks of their loans: they take a close look at how their corporate clients are handling sustainability and how they are preparing for future challenges. Along with climate and environmental issues, social and governance aspects also play a part. To accurately quantify risks, an immense amount of data has to be obtained from companies.

Data are becoming increasingly important

Which brings us back to the taxonomy – one of the most controversial issues of early 2022. The EU taxonomy is the centrepiece of the EU Action Plan on Sustainable Finance. It sets out which activities are environmentally sustainable, thus enabling investors to seek out such sectors and companies. Though the focus of the EU taxonomy is on large, listed companies, medium-sized companies are also increasingly coming under the spotlight: in the future, they will have to provide more detailed information on sustainability in their annual reports. More and more companies also want to know what influence the taxonomy has on lending. Banks, for their part, will have to disclose their so-called Green Asset Ratio (GAR). The GAR shows the taxonomy-aligned exposures of banks as a proportion of their total assets.

The GAR could have a far-reaching impact on reporting by banks as it allows a comparison of "taxonomy ratios". The problem – there is as yet no systematic collection of much of the data needed to calculate the GAR. In addition, certain exposures (to SMEs, for example) are excluded from the GAR numerator but included in the denominator, which makes banks look worse than they actually are.

Without doubt, the taxonomy is a valuable tool for transitioning to a low-carbon and resource-efficient economy since the defined criteria and performance thresholds show which activities are environmentally sustainable and which are not. It is nevertheless important to avoid getting bogged down in detail. It is in the nature of the project that data must be collected and evaluated and the precise evaluation criteria regularly updated. Given the sheer scale of data, however, we should not underestimate the time and effort involved: in some cases it is already out of all proportion to the insight gained. In future, therefore, the relevant sustainability data should be collected and made available centrally. This also applies to energy efficiency certificates for buildings, which banks find virtually impossible to access even though they need them for their reporting.

Enabling transition financing

The current design of the taxonomy clearly shows that its focus is too narrow. Ultimately, the entire economy will have to move towards net zero. The rapid transformation of the economy should not be hampered because businesses and banks have to spend a lot of time on complex technical screening criteria and are unable to do what is really important: embarking on and financing transition pathways. Because these are the nub of the matter. So it's important to broaden the green taxonomy into a "greening" taxonomy, meaning it should also include principles for transition financing since funds should also flow to where CO_2 is being reduced and companies are starting down the path towards climate neutrality. And here, too, practicability is hugely important.

Provided that bureaucracy does not frustrate the green awakening of the economy, the financial industry can generate enormous leverage. And these opportunities should be exploited. That's why banks should have sufficient scope for lending. Regulation should provide impetus but not overburden small banks and companies. This is why sustainable finance should become an integral part of climate policy. The EU wishes to steer the transformation through banks, recognising the importance of the financial sector for climate protection.

Agile, creative and consistent – not at the expense of security but at the expense of bureaucracy and overregulation. These are the hallmarks of a successful climate policy that will open up new opportunities. And we need to think European because what we need is a European financing architecture. That means not just a functioning banking landscape but a capital markets union which makes efficient use of the huge volume of capital potentially available in Europe. The more financial resources we can mobilise, the better it will be for the climate.

11

Financing Innovation, Diversifying Company Governance: The Key to a Sustainable and Prosperous Europe

by Viviane Reding,
Former Vice-President of the European Commission and co-leader of the Markets4Europe campaign coordinated by the EBF

More than two years ago, just as the Conference on the Future of Europe was getting off the ground, I delivered a speech entitled "A Europe fit for the next decade," in which I encouraged European citizens (especially young people) to ask the people representing them to act in anticipation of the challenges before us, "because the Europe of the future must be built now, just as today's Europe is the result of past mistakes and successes".

My call was based on decades of personal engagement in the European ideal of integration, always looking forward and building on our successes to expand peace, liberty, prosperity and justice in the EU and the world. Having pioneered real breakthroughs in the creation of a single market with concrete benefits for citizens, I was – and remain - convinced that Europe must deliver in ways that are tangible in daily life, while also dramatically improving the conditions for future generations through structural reforms. The fact that the Conference on the Future of Europe has been progressing - despite truly unprecedented challenges we have endured as humanity in the last two years – is an attestation to the resilience and relevance of the EU project.

There are no doubt very good ideas coming from every corner of Europe. At this point I want to step back and tell you about two ways in which I think we can make the future of Europe better: through better financing of innovation and through more diverse governance.

The financing that we need for entrepreneurship, innovation and sustainability

First, Europe must be a hotbed of innovation. Our innovators must be able to grow and expand on European soil, benefitting from a wide network of excellent universities and research centers, collaboration with industry and, of course, the financing they need, when they need it, and how they need it. While many things go into preparing this recipe, one ingredient that is scarce in the EU is risk capital. For this, an intricate ecosystem of funders and investors of different kinds is needed (such as venture capital, private equity, public markets for start-ups and scale-ups, financial advisors, underwriters, infrastructures, etc.). The biggest gap – by now a chronic deficiency - we face is the absence of a deep and liquid capital market, the kind that investors and companies can rely on with efficiency, breadth, and depth. Particularly troubling is the trend whereby the pie of financial markets business seems to get a bit bigger overall, but the share of EU providers of services in these markets is getting smaller. This makes the future of financing European innovation uncertain at best.

Moreover, beyond financing innovation and entrepreneurship, we need capital markets also for many other things, such as creating opportunities for savers and investors, promoting stability and risk-sharing, financing the needs of sustainability, and strengthening the EU self-governance in global competition. These challenges can only be met with more developed capital markets: a deep and efficient European Capital Markets Union is the solution to all these challenges. Just take the green bond market by itself: Having grown more than 100 times over a decade, this market shows the potential for the EU to attain a global leadership in an area that can generate wealth while doing good. But it can only happen if our successes on the political front – such as our global leadership in tackling climate change – are matched by the prowess of our financial institutions, market structures, and, ultimately, our currency.

It is with these concerns in mind that I was among the leaders of the Markets4Europe campaign more than three years ago, urging all counterparts – especially my colleagues in the national governments – to do their utmost in supporting the reforms needed - notably in insolvency systems and cross-border taxes for investors – so that the mosaic that emerges from all these systems forms a seamlessly integrated single CMU for investors and issuers. As a former Commissioner in charge of justice issues, I understand reforms in these areas are complex, but I think they are not impossible if the will is there. And it will be there only if there is wide recognition of the prize – which is nothing less than lasting prosperity for our people.

Indeed, after the pandemic, and considering all the investments we need to make for a sustainable and digitalized Europe, a functioning CMU is more important than ever. The environmental shift – both in terms of saving the climate and other environmental objectives – as well as societal needs will require investments with an unprecedented magnitude. Moreover, a functioning capital market is the best way to allow the increasing sustainability preferences of Europe's citizens to be expressed in the investments they choose. If we can invest in markets, we will finance sustainability. The digital innovations – many of which require risk capital - will certainly be of substantial help to manage the ecological actions. Taken together, all these problems will all become more manageable if we have the right financing in place. Europe's self-sufficiency in its capital markets, with its own vibrant financial centers providing the solutions needed by companies and investors around the world, will add to our prosperity and make our economies more resilient.

The CMU project is advancing. Our Markets4Europe campaign was encouraged by the ambition of many of the reforms proposed. But we are far from the final stage, and things can always fall short of expectations. I urge everyone who plays a role in this process to do their utmost to finally get this project to the finish line.

The governance that we need: diversity, equity, and inclusion

Having the right financing for innovative investments is important – but it does not guarantee that the right projects will be financed, much less get started. Money is not everything. That is why I have a second, very important piece of advice. If we want our companies to set the best sustainable business strategies and to find the best innovative projects that make the world a better place across all elements of ESG, our companies must make the best decisions, which means they must have the best governance - which brings me to the topic of diversity.

As many readers will know, I have had a certain role in stirring things up 10 years ago now when we proposed the Leadership Positions Directive (the "women on boards" proposal). The idea was to set the aim of a minimum of 40% presence of the "under-represented sex" among the non-executive directors of companies listed on stock exchanges, requiring the companies that were lagging to put in place measures to do better. And what a storm this proposal caused! While some considered what happened in the next decade a 'political deadlock', for me it was clear that the proposal caused a lively debate and triggered much national experimentation – with very promising results, as in France, for example, showing that a mandate did put in motion a spiral of greater diversity. In some ways, even some fully implemented EU proposals have not had this much impact. But, of course, the successes that occurred at the national level only proved the usefulness of setting an EU standard. So I am very happy to see that things are moving in the right direction for this proposal.

And so, they should. At this point, gender equality on boards is an idea whose time has come. Diversity at every level of a company, from management to new recruits, is a crucial element of good governance, leading to better risk management, better innovation, better alignment with stakeholders, including clients, and of course the fulfilment of that good old concept of basic human rights. And it won't stop there.

In addition to equality on boards (and in public institutions) which will get us better governance, we will need to keep going with other steps, until we get full equality in every sphere of life. Diversity – both in terms of gender and other dimensions such as nationality, race, age, and others – will make our economies stronger and our societies more wholesome.

At a time when Europe faces so many challenges, and yet also has so many opportunities to solve them, why would we not take that extra step to value and empower everyone?

> The future of Europe is bright. Now is the time to grab it.

The two ideas I have outlined here – integrating Europe's capital markets to finance sustainability, innovation, and growth on the one hand, and ensuring gender diversity and good governance in our private (and public) institutions, on the other – are two sides of the same coin. We need good ideas initiated by good companies that find the right financing and generate wealth across Europeans, while solving societal problems for future generations to come. As part of the generation of Europeans who have fought for integration, participation, and empowerment through EU tools, I know all too well that we must keep pushing for progress without taking anything for granted. Yet I also know that we are joined by new generations of Europeans who will fight with us, with an ever-stronger belief in the ideal of a free, prosperous, united Europe.

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The role of banks and capital markets to support sustainable growth

By Giovanni Sabatini, Director General, Italian Banking Association (ABI)

As the acute phase of the Covid-19 pandemic subsides, the European economy heads into a delicate 'transitional' juncture, at the end of which different scenarios unfold where citizens, companies and governments must have their say if economic growth on the European continent is to take a unified, lasting and sustainable direction.

On one hand, the need to overcome the post-pandemic recovery phase, marked by high levels of public guarantee of financing and the extension of moratoria on debt requires the phased adoption of calibrated measures to sustain businesses. On the other hand, the search for sustainable economic growth solutions in the medium to long term, further complicated by the many uncertainties relating to persistent inflationary trends, difficulties in the supply of energy and raw materials and, most recently, the impact of geopolitical factors arising from the Russian invasion of Ukraine, calls for durable and sustainable solutions.

Finding a balance between these factors will be crucial to finding the right path towards a more prosper, inclusive, and competitive Europe on the global stage. The first step is to be clear about where we are and where we want to go.

The lay of the land

At present, although the crisis caused by Covid-19 proved to be a vast challenge to sales and profitability for European SMEs, recovery started in the third quarter of 2020. The crisis did not result in the expected liquidity and solvency issues initially foreseen, mainly thanks to the extensive macroeconomic policies which counteracted the negative effects of the crisis and allowed European banks to support businesses and families with an enormous effort. However, the crisis left companies with an unbalanced 'financial debt/capital' ratio. The (appropriate) emergency measures to support corporate liquidity have had the effect of further widening the gap between corporate debt and capital. Uncertainties related to the difficulties of global supply chains, rising energy prices and the consequent impact on companies and on debt levels, add to this picture.

In this context, it is important to support companies to strengthen their capital and diversify their sources of debt so that the recovery does not come to a halt: the problem of corporate capitalization is now, more than ever, relevant, especially in view of the withdrawal of emergency measures to support liquidity.

Staying the course: navigating the twin transformation

As the European Commission rightly emphasizes, meeting the objectives of making Europe greener and more digital has become 'the challenge of our generation'. To meet this challenge, European economies will need to mobilize large amounts of capital through multiple investment channels over the next few decades. For instance, to achieve the goals set by the European Green Deal, the European Commission has pledged to mobilize at least €1 trillion in sustainable investments over the next decade, requiring an unprecedented shift in both public and private funds to finance the transition.

Having demonstrated, during the Covid-19 pandemic, to be part of the solution, European banks, in their role as lenders and capital markets issuers and intermediaries, remain strongly committed in this direction. Specifically, the banking system is deeply committed towards the implementation of three important, closely linked and mutually reinforcing EU initiatives: the Action Plan for the Capital Markets Union, the Strategy for Digital Finance and the Action Plan for Sustainable Finance.

The role of banks as enablers of sustainable growth

The development of sustainable finance requires institutions, banks, and businesses to collaborate on several fronts to enhance Europe's financial capabilities. Notably, banks have a key role to play as facilitators of the sustainable transition. However, they could find themselves squeezed between the increasing demands of regulators and supervisors and the difficulties faced by enterprises in providing the relevant sustainability data.

Specifically, certain conditions should be ensured for banks to play their role in the sustainable finance domain, including:

1. Availability of good quality ESG data from enterprises and adequate metrics to measure their level of sustainability.
2. Proportionality: impacts on SMEs should be taken into consideration and the transition should not be traumatic for smaller enterprises; in addition, sustainability reporting for smaller banks should be reasonably calibrated based on the contribution of their portfolio to the transition.

Banks are rightly scrutinized by their stakeholders on their activities to support the transition. At the same time, they should not be required to shut out certain sectors from financing entirely, especially those sectors that may currently not be well-positioned but can still move forward with the transition from an environmental and climate point of view. We are not just talking about Sustainable Finance, but also financing the transition or Transition Finance.

Therefore, it is important that the transition does not rest entirely on their shoulders, and that the regulatory framework enable all economic actors (financial and non-financial in nature) to transform their business model through a proportionate, gradual, incentive-based approach that leaves no one behind.

Finally, we should not forget that achieving the challenging environmental and social sustainability goals in Europe also depends on the ability of the capital market to channel the necessary resources from private investors to complement the public funds. That is why it will be equally important to focus on the competitiveness of European capital markets on the global stage.

Increasing the autonomy and competitivity of EU capital markets

In a post-Brexit scenario, the EU will need to assure greater autonomy and competitiveness of its financial markets whilst maintaining an open, receptive global approach. Shunning the temptation to reduce the accessibility of its markets to limit the extent of external interdependencies, the EU will have to rely on deeper, better integrated and competitive capital markets based on a stronger international role for its currency and an expanded, diverse plurality of players to strike the right balance between growth and financial stability.

This entails completing the key reforms of the CMU, but also ensuring a level playing field between European intermediaries and market infrastructures and global players. In this sense, a key example is represented by the current clearing arrangements in Europe, which are still strongly linked to the City of London. There, a sustainable solution that is part of a long-term market-driven strategy and avoids isolation of EU intermediaries as well as damages to their end-clients will have to be found.

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EPFSF contribution to the dialogue of the Conference on the Future of Europe – on sustainability

by Peter Simon, Managing Director, WSBI-ESBG

"Sustainability" is one of the key buzzwords of every corporate report nowadays. This shows not only that it is a subject of crucial importance for the future of our economy and society, but also that our businesses are aware of this fact and take note of this rightful demand. But what do we actually mean with "sustainability" and how do we avoid that it remains an empty phrase without any further action? In the following paragraphs, I will try to give you an insight into my view of the necessities for a really sustainable future economy and show you which measures are crucial to support the transformation of our economy.

To begin with, we need to be aware of which goal we are actually trying to achieve by talking about sustainability and what we mean when we speak about sustainable development and a sustainable society. Let me quote the definition introduced by Stephen Viederman, which he presented more than a quarter of a century ago: "A sustainable society is one that ensures the health and vitality of human life and culture and of nature's capital, for present and future generations."[1] I think this is an important definition for two reasons. First of all, because it emphasises the main goal of sustainable development – creating a society worth living in for us, but also for our children and grandchildren in the future. Secondly, because it clearly states that sustainability goes well beyond the protection of our environment and the fight against the climate crisis. These two topics are pivotal for our future and closely related to our understanding of sustainable development, but they need to be integrated into the transformation of our society as a whole. This definition dates from 1993, which shows that we are not starting a new discussion, but that our society is for quite some time aware of the problems we are facing, which means it is now more than ever time to act.

In my many years working at all levels of national administration, in European politics and the financial services sector, I have seen many actors and stakeholders who are taking the issue at stake very seriously. In my observation, it is especially those who orientate themselves to be responsible actors who often have integrated sustainability-related visions in their business approaches, which is essential for a more sustainable society in the future.

In my view, sustainable development is very closely connected to regional development. Strengthening local structures means also improving the resilience of our societies to external shocks and reducing our carbon footprint by assuring short supply chains and supporting local production. It also means strengthening the social fabric of our local communities, reducing the effects of rural-urban migration and protecting our traditional European societies. Only an economic system that provides equal participation for all layers of society can assure a transformation to more sustainable business models.

We have to be aware that only a thriving economy can provide the means and internal strength to adapt to the new realities inflicted by climate change. Protecting our environment and reducing the impact of global warming means adapting the business models of all actors in our economy. While big companies often have more easily the necessary capital and knowledge to change their models, many Small- and Medium Enterprises need support and advice even more. I am witnessing that many banks I know take this responsibility seriously and understand it as a crucial part of their mission. Responsible banking means being close to clients, financing the transformation of the real economy and supporting local communities.

Climate change, the protection of our environment and the fight against growing inequalities are global problems that can only be solved through a combination of local and global action. A great example of banks fighting these inequalities is the World Bank Group's Universal Financial Access (UFA) project, which defined for 2020 the goal to reach the opening of millions of new bank accounts offered by local banks. The UFA coalition partners, which make up a global member network, successfully opened 400 million accounts, thus allowing more people to store money, send and receive payments as the basic building block to cope with shocks and manage their financial lives.

1 Stephen Viederman, A Sustainable Society: What Is It? How Do We Get There? In : The George Wright Forum Vol. 10, No. 4 (1993), pp. 34-47, here p. 34.

And there have been further excellent financial inclusion initiatives by different coalitions including banks, foundations and others. Mentioning them all, would exceed the dimension of this article.

These projects show the importance of the link between global and local action to prepare and accompany the transformation to more sustainable economic models all over the globe. A successful sustainable transformation can only be assured if we have everyone on board and all actors are prepared to take their responsibility. But it is also essential that we find the right balance in legislation and regulatory requests to ensure a more sustainable development. We need to be progressive, adjust rules and move forward to adapt our economic and social model. At the same time, governments need to act proportionally and respect the different realities on the ground. Finding the right balance will be one of the most difficult challenges for local and national governments as well as supranational institutions in the coming years.

Europe has a vital role to play in this aspect. The goal of the European Commission to be the first carbon-neutral continent by 2050 is a critical step forward in the fight against climate change and in the transformation to a more sustainable global economic system. In addition to that, the traditional European economic system, based on strong and resilient social systems, should be protected and function as a role model for a more sustainable development and economic growth benefitting all the population. It is crucial to include everyone in these ambitious goals and to support grown national systems. Proportionality and responsibility are key concepts that must guide our decision-makers. Financial institutions certainly stand ready to support and help whenever they are needed.

As mentioned at the beginning, sustainability means alongside fighting climate change and the protection of our environment also an inclusive and fair economic model, respecting all the population. For a successful transformation of our global society, it is absolutely decisive to take into account the connection between a just and fair society and environmental sustainability. We cannot achieve one without the other. Only resilient and fair societies will be able to deal with the challenges of the 21st century and be ready to adjust their systems accordingly.

It is the responsibility of our generation to fill this concept with life and assure a society worth living in, respecting human life and the natural environment. A society in which everyone can develop their individual talents to the benefit of all, and a world in which it is still possible to live well for our children and grandchildren.

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An EU capital market to fund the green industrialisation

By Dr. Asoka Wöhrmann,
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One of the most important stages in the development of modern humankind was the Industrial Revolution of the 19th century. The spirit of this revolution and the inventions needed were born in Europe, and then made their way across the globe. It made the world what it is today, for better or for worse.

On the flipside, the industrialisation caused, amongst others, dangerous changes to our climate. We can only address these globally. Once again, Europe should lead the way. We are at the beginning of a green industrialisation – the next industrial revolution. It is about the climate-neutral preservation of what the industrial revolution once laid the foundation for: prosperity for more people than ever before. As a logical consequence, this green industrialisation will represent the greatest economic and social transformation in 150 years.

What is more, Vladimir Putin's war against Ukraine since February 2022 has highlighted the urgent need for Europe to cut its dependency from Russian fossil fuels. Within days, the EU shifted gear on balancing its mix of energy sources in the short term and to become independent from fossil fuels in the long run. We now move fast-forward towards net-zero – a challenge that had already been monumental before the events in Ukraine.

Capital markets union is now a vital strategic project for the EU

The fundamental ingredients to implement this great transition have not changed, whatever the timeframe. As we saw in previous waves of industrial change, the processes need open societies to spur imagination and market demand; they need science to develop innovation; and they need capital to support new investments. That is why moving forward with the EU capital markets union (CMU) is so important: Only with more market-based finance, with a deep pool of capital in an open European Union, we can make sure that innovative companies can select an affordable source of finance, and we can amass investors' money to build the new networks and technologies needed in a more sustainable economy.

The status quo – fragmented financial markets with often too small players, companies dependent on bank loans, a lack of risk capital – will only be acceptable to those who either can live with too slow a transformation or who are happy about a Europe that is dependent on foreign capital, fuel and technologies. The developments of recent years demonstrated that the EU cannot rely on the benevolence and cooperation of other great world powers to sustain its values and wealth. Effective EU capital markets are of strategic importance for our sustainable future. We can redouble our efforts for an energy transition only with an effective CMU.

Priorities for ESG regulation: data, standards, partnerships

The European Union can do much more to foster the green industrialisation. It requires reliable data to assess risk factors properly and steer capital to the most compelling opportunities in the E, S and G spectrum, and most urgently towards climate mitigation and adaptation. The change of business models will be heavily influenced by technological change. On one hand, technology plays an equally important role in finding solutions to ESG issues. On the other hand, when it comes to interpretation, information plays an important role in enabling more accurate ESG-related data. Starting with disclosure, ideally supported by standardised frameworks, time reference, over data sources and assessment.

To achieve this, a radical overhaul in corporate reporting and in the way we use data as it relates to sustainability must occur. The asset management industry can play a major role not only in analysing and processing ESG information to make proper investment decisions, but also use the role in capital markets to advocate and support the further evolvement of global disclosure frameworks. The goal must be to achieve more consistency, comparability, and more transparency in the assessment of E, S and G related information in a globally consistent manner, eventually providing a truly holistic picture of future investment opportunities. On this basis, institutional and retail investors alike can make a valuable contribution to the green industrialisation.

The path to more sustainability in our economies can only be reached if public and private stakeholders work together and create a regulatory framework that is transparent, robust and credible. This framework is evolving, and we as asset managers use our experience and market insights to enter discussions with policymakers.

Asset managers lead the way by demanding transparency and engagement

There are two main motivations for asset managers to lead such discussions: We are dependent on evolving rules for sustainability reporting which provide us tangible, standardised data on investee companies, and which enable us to provide useful information to investors and clients when it comes to our own role as a reporting entity. Secondly, we strongly believe in the effect of engagement to support the economy's transformation towards more sustainability. Asset managers also play an important role in the progression of frameworks for responsible investing. Large investors must evolve their own processes and tools, and then use their position for clear public advocacy and disclosure actions.

Along with the evolution of engagement concepts comes the requirement of reliable, consistent, and comparable information on a global scale as a prerequisite. The need for a global and consistent corporate disclosure and reporting system must be answered in due course, and it must be based on the principle of double materiality. The EU has led this way – and it needs to make sure that its standards are the basis for international standards.

To support the effectiveness of shareholders taking collective action to enforce more sustainable ways of making business, we need a legal framework that does not hinder such an engagement approach. Anti-trust rules need to be reviewed – this is for cases when if asset owners vote together at an annual general meeting (AGM) to bring in more ambitious ESG strategies in a company. In their second Sustainable Finance Strategy published in July 2021, the Commission asks supervisory agencies to look into it. Urgent legal clarification that investors' common engaging for more sustainable governance in an investee company should not count as "acting in concert" is needed.

As asset managers, we must also pursue our own transformation. This includes setting our own net-zero targets on a scientific basis – using the latest climate and energy models that provide guidance on necessary decarbonization pathways. There are many voluntary initiatives and public-private projects for this, e.g. the Net Zero Asset Managers Initiative. Engagement therefore also applies to the exchange with other companies in the financial sector as well as with politics and supervisory authorities.

If policy makers pave the way and all stakeholders collectively and step by step evolve frameworks and commit to providing more transparency, consistency and forward-looking perspectives, sustainability investing will become the new normal. A common EU financial market that allows more small savers to become investors is the fundamental precondition.

This will ensure the availability of money to transform ideas into new technologies and for laying the new networks of a green industrialisation. It is also a necessary precondition for ending our energy dependencies. With common rules on ESG reporting and on product standards, with investors being able to demand sustainable business plans, the EU can become the global hub for sustainable finance.

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