EUROZONE AND EU INTEGRATION CHALLENGES

Ensuring a viable EMU: are we on the right track?

1. 10 years on from the crisis, a great deal has been achieved, and progress is possible by the end of this year

1.1. Improvements have been made Europe-wide and in individual Member States

With some delay and after a lost decade of divergence, significant improvement was seen in the euro area as of 2010. The fiscal position of most Eurozone countries improved in 2017. All Member States, except Spain, have exited the Excessive Deficit Procedure (EDP), compared to 24 Members in in EDP 2011. The public deficit of the euro area Member States is now forecast to fall to 0.7% of GDP in 2018 and 0.6% in 2019.

Current transaction balances, which give an idea of relative competitiveness, now appear more consistent in the euro area. Since the crisis, the disparities in competitiveness have been significantly reduced. In 2016-2017, all countries in the Monetary Union except France were in fact able to achieve a balance or surplus of their current accounts.

An official noted that Europe's structures and progress towards monetary union are much better than they were 10 years ago. At the time of the fall of Lehman Brothers, Europe had a monetary union, but did not have the basis for real economic and fiscal policy co-ordination. Europe now has created the European Stability Mechanism and a much tighter co-ordination system; it has almost finished building the Banking Union, and has a more co-ordinated supervisory system and a more solid regulatory system.

Another official added that Europe has made good progress: EU legislators have advanced in their work on reducing risks in the banking sector, made some progress towards strengthening the role and functionality of the ESM and reached an important agreement on the common backstop to the Single Resolution Fund. However European countries keep exporting their domestic problems and political quarrels, holding hostage the necessary progress in order to look good in the eyes of domestic audiences. All present know that the architecture of monetary union in Europe is not complete. However Europe has delivered a number of institutional fixes and tools, designed during the crisis, and ought to be proud of that.

1.2. A window of opportunity for improving the resilience of the EU economy and tackling weaknesses in the euro area architecture has opened

After a decade of poor economic performance and increased divergence, economic fortunes have improved significantly in recent years. The euro area is enjoying a sustained expansion with growth well exceeding potential, albeit moderating, increasingly supported by vigorous investment and improving job creation. This favourable environment provides a unique window of opportunity for improving the resilience of the EU economy and tackling weaknesses in the euro area architecture.

However, an official noted that the process is not complete, and now is a good opportunity to make progress; Europe should not wait until the next crisis to realise what it should have done. The official's country is engaged with a number of other Member States to achieve a breakthrough by the end of the year.

Another official stated that he has been waiting impatiently for a Franco-German consensus about how Europe can go further in many areas. Every quarter, the official's country has repeated its message about fiscal capacity and fiscal rules, and the completion of the Banking Union. All these issues are very important, especially the Banking Union, and Europe needs to be honest about whether it can go further, or whether it needs to wait for another political cycle.

2. Priority areas for further ensuring the viability of the Economic and Monetary Union

2.1. The importance of Member States doing their homework

Reducing vulnerabilities whilst enhancing the capacity to absorb shocks and reallocate resources will require comprehensive structural reforms. Implementing structural reforms at the domestic level with a view to achieving a steady convergence towards resilient economies is fundamental for improving the functioning of the EMU. These internal adjustment efforts in the Eurozone become even more urgent with the long-term drag of ageing populations and higher projected pension expenditure. However, in one official's view, European countries shy away from reforms. This official noted that they often repeat a message about the importance of countries doing their 'homework' and being fiscally disciplined. Their own country has growth of 4% and record unemployment. This country is nonetheless fully committed to the rules of the Eurozone.

2.2. A Monetary Union cannot work without fiscal discipline

It is difficult to make progress towards a fiscal union as long as existing rules have not been met by all Member States. An official noted that Europe's agenda is already set: it needs to complete the Banking Union, strengthen the ESM, and build a credible stabilisation function that can help to tackle asymmetric shocks. Politics, however, are holding back progress: Europe does not have a political union, and aiming for an economic union without a political one means that it is difficult to accept basic economic truths such as spill-overs and asymmetric shocks.

Europe's finance ministers are now working on their budgets for next year; it will not be easy for them to convince their cabinet and coalition colleagues of the importance of achieving a balanced budget and decreasing debt, particularly in the context of the political cycle. However, it remains important to enforce agreed EU rules, although where there is widespread dissatisfaction with the rules, or with issues such as the output gap, it is important to change them, rather than just talking about doing so.

2.3. Completing the Banking Union

The Chair notes that improving and completing the Banking Union would foster a more effective allocation

of resources across the Eurozone, help to achieve a better diversification of risks thus contributing to private risk sharing across the EU. An official stated that Europe needs to develop a common deposit insurance system and a solid European Stability Mechanism. Europe has been working on some of these issues for years, and it should be possible to reach a compromise and an agreement on them by the end of this year. Agreeing on a date for the backstop, and possibly bringing this forward, would represent good progress.

Another official added that they are reasonably sure that Europe will be able to complete the Banking Union, although the Austrian Presidency will need to be clever in reconciling the proposal from the European Commission with all of the pillars of the Franco-German paper.

2.4. Correcting the current disequilibrium in the monetary union

The Chair explained that the pattern of euro area rebalancing that predominantly relies on 'adjustment in weaker countries' is not sustainable either politically or economically. The symmetry of economic adjustments should also be a priority focus. Lack of solidarity and an unjustified mistrust towards countries with lower productivity will indeed feed populism in Europe and undermine the cohesion of the euro area. In addition, lasting and excessive current account surpluses are not sustainable within a monetary union because they result in effect in creating currency advantages for the best performing countries. This is true also at the international level, as illustrated by the recent complaints of the US administration. Symmetric economic adjustment both in deficit and surplus countries is therefore a prerequisite for a durable rebalancing in the euro area. He asked the ministers if there must be a symmetrical adjustment mechanism to prevent a long-run excessive balance of payment surpluses or deficits.

An official noted that there will inevitably be another crisis, but Europeans should not adopt the mind set that they are never in a good phase; the present time is a positive moment. Building the monetary union or the European project in general should not be seen as a means of shying away from national obligations. Countries need to carry out structural reforms, ensure fiscal stability and address their system imbalances, although it will be impossible for all countries to have a zero current account deficit, a zero current account surplus, or zero public deficit. However, these different cyclical moments should not be magnified to the point at which they become a source of instability. The official noted that her country has seen real wages fall, child poverty return and inequalities grow, and any country that can avoid going through a similar process in future, by avoiding high deficits and imbalances, should do so.

Another official added that their country went through a very painful experience in the 1990s, involving hundreds of thousands of people being fired and structural losses in the labour market. However, that painful period is now over, and the official's country remains committed to the enforcement of agreed rules.

Responding to a question from a participant regarding whether the central issue is not imbalances between countries, but rather imbalances between rural and urban areas and the service and manufacturing sectors, an official stated that it is always necessary to begin analysing Europe-wide imbalances on a national level. In this official's country, private household debt has reached double digits over the past two to three years, and their central bank has recently introduced macroprudential measures to deal with this dynamic, which is another example of countries 'doing their homework'. Individual countries are responsible for themselves, and need to deliver at the national level before doing anything else.

Another official agreed that the issue of imbalances within countries is an important one; in particular, the difference between the countryside and cities is noteworthy, and politically significant, in most of the countries of Europe. Although Europe takes the regional level into account to some extent, it is important to look at this issue more, as well as the individual level. It should be borne in mind that, the more equal societies are, the more stable their growth.

2.5. A central fiscal capacity for macro-economic stabilisation

2.5.1. The current proposal of an embryonic fiscal capacity is a positive development

The EU Commission has proposed that a European Investment Stabilisation Function linked to the EU budget would complement existing instruments at national and European levels to absorb large asymmetric macroeconomic shocks in the euro area and countries participating in the European Exchange Rate Mechanism (ERM II). It would represent an embryonic Central Fiscal capacity. The EU budget would guarantee back-to-back loans of up to €30 billion (about 0.2% of euro area GDP in 2021). The loans would be available to Member States experiencing a large asymmetric shock and complying with strict eligibility criteria for sound fiscal and macroeconomic policies.

Responding to a question from a participant about how officials regard this proposal, one official stated that their country supports embryonic efforts to create a fiscal capacity. It is better to make progress than to reject a good proposal because it falls short of perfection. Another official stated that their country feels the same way about the Commission's proposal.

2.5.2. A Europe-wide unemployment insurance scheme is an attractive option

An official stated that they would not want to make clear their preferred option for how fiscal capacity should be dealt with; expressing a preference might make it difficult to reach an agreement. It is unacceptable to take the view that, for instance, a 15% unemployment rate represents the equilibrium rate of unemployment; it is extremely important to increase output and GDP growth, and reduce the rate of unemployment. In the official's country, one of the most important fiscal automatic stabilisers is unemployment insurance, as it has a very high unemployment rate and unemployment has been a major source of imbalance through expansionary and recessionary phases. If Europe aims to increase its stabilising capacity, unemployment insurance is an obvious means of doing so.

An official added that certain preconditions need to be met before these types of transfers can take place, including commitments to rules, fiscal discipline and responsibility; in this way, the threat of moral hazard can be mitigated. However, the nations of Europe should not forget that asymmetric shocks exist, or that countries have promised their citizens that the 2008 crisis will not be repeated. Fiscal capacity will inevitably form part of the architecture for delivering on this promise.

Restoring capital mobility in the euro area

During the decade from 2000 to 2010, there was a high level of capital mobility within the Eurozone but it mostly resulted from inter bank funding which supported the financing of inefficient investments (e.g. in real estate bubbles, sub optimal business ventures and infrastructure projects notably in Spain, Italy, Portugal, Ireland and Greece) and which contributed to massive current account deficits. The 2011-2013 sovereign debt crisis halted the circulation of capital flows around Eurozone and EU countries.

Since then, financial flows between the Eurozone countries have declined; there has been a fall in cross-border loans in the euro area. The share of the government bonds held by non-residents has dropped. Investors' and banks' portfolios have increasingly become national following the sovereign debt crisis. Member States with excess savings (Germany and the Netherlands in particular) no longer finance investment projects in lower per-capita-capital countries (Spain, Italy, Portugal, Greece). Indeed the euro area exhibits from a savings surplus of more than €300 billion or 3.5% of GDP in 2017, which is no longer being lent to the other euro-area countries but to the rest of the world excluding the euro area.

Developing cross-border financial flows within the euro area is essential. The true objective of a currency area is that savings should flow to finance the most productive investments throughout the currency area. Indeed in a monetary union, the elimination of currency risk allows savings from the countries that have a high level of per capita capital (Germany, Netherlands, France) to finance investment in the countries with lower per capita capital and higher marginal productivity of capital (for example Spain, Italy, Portugal). Income convergence therefore normally stems from the transfer of savings from high per capita income countries to low per capita income countries. But, as mentioned above, these transfers have been considerably reduced in 2008-2010.

To restore the capital mobility between the Eurozone countries, the confidence of the countries with savings surpluses in the solvency of the other countries 'governments and banks must be restored. The prerequisite for reducing regulatory barriers to capital flows is that legacy issues, including high levels of NPLs in some individual banks, must be addressed and the risk reduction legislative package must be adopted, including an NPL prudential backstop to prevent the future accumulation of excessive NPL stocks as problems like this hold back the political trust required to move forward quickly. To address this point, Europe must trust and strengthen its institutions such as SSM and SRB and empower them further to continue their programmes. Since it is understandable that some national authorities are concerned about the possible financial stability implications of for example future waivers for capital, such concerns need to be addressed.

1. Asymmetric imbalances between euro area countries are unsustainable

1.1. Asymmetric adjustments in countries with persistent and large current account imbalances hinder capital mobility in the euro area

An official underlined how the euro area has been characterised by very large and persistent competitiveness gaps between countries, which is one of the main obstacles to overcome. Since the crisis, the recent history of Europe has featured 'not very good adjustment', which means that not all countries have adjusted. More countries are now running surpluses, but the adjustment in Europe has not been appropriate because the countries with large deficits have adjusted their current accounts by reducing domestic absorption; essentially, they have undergone output contractions, labour shedding or higher unemployment. There has been less change in the large surplus countries. In terms of how adjustment should ideally work, within a currency union there must be periodic real exchange rate realignments.

These real exchange rate realignments are not happening in the correct way in the currency union. There are ways to do real exchange rate realignments. One is by differential inflation rates or differential wage growths. This means seeing higher inflation and higher nominal wage growth in the countries which are performing well. One helpful aspect is the ECB's very accommodative policy. In particular, the ECB is focused on its euro area price stability objective and is not overly concerned about inflation developments in specific countries. That is very important, because it allows real exchange rate alignment through nominal differential inflation rates. However, most of this adjustment must come from the real side and emerges from real factors. The ECB's inflation objective cannot achieve the real exchange rate realignment the euro area needs. In terms of these real factors, labour productivity has a lasting effect on competitiveness adjustments. Labour shedding and wage reductions should not be used to perform adjustments in the future. To give one example, these competitiveness gaps are widening further. Productivity in German manufacturing has grown by over 30% since 2000, but in Italy it grew by only 8%. With similar wage growth in Italian and German manufacturing, German competitiveness has far outpaced Italy's. Unfortunately, the structural reforms essential to raising productivity have actually slowed in many of the economies which need them.

A public representative highlighted an important macroeconomic issue. Implicitly, many governments in Europe are favouring export led growth over growth based on domestic demand. The current tensions between the EU and the US demonstrate that this might cause backlashes.

1.2. Capital flows are not going inside the south of the euro area

An official suggested that one of the most striking observations about capital flows in Europe since the advent of the euro is that foreign direct investment emanating from the northern European countries has gone east rather than south. Competitive gaps are only one explanation, however. The lack of structural reforms and low investment is reflected in one very worrying measurement: before the advent of the euro, per capita income levels between the original 12 members were converging but since then they have essentially diverged. Real income levels per capita are not converging, which is quite worrying. As a result of the fact that the newer Member States which have joined the euro subsequently are characterised by fewer structural rigidities, per capita incomes in these countries are rising and converging with the incomes of other countries, even though the process has been slow. The official wondered whether they were focusing disproportionately on countries with lower per capita incomes in the south of the euro area, noting however the existence of the Macroeconomic Imbalance

Procedure. This framework encourages countries like Germany to address their excessive fiscal or domestic surpluses. However, it does not have much force and it has not been applied very often, but there is some mechanism for symmetric adjustment.

There are two issues with capital flows. First, if Germany or any other of the surplus countries did more to rebalance its policy-mix and raise their domestic demand, the question arises whether this would benefit the south of the euro area. The IMF doubted this, because there is no way to show definitively that these positive spill overs are stable, robust and always flow in one direction. More importantly for capital mobility, the counterpart of the German current account surplus is its exports of domestic savings. There is no way to engineer an outcome which mandates that Germany's domestic savings being exported must go to the south of the euro area. This is the real challenge: to relate adjustment in the currency union to capital mobility. In fact, if Germany's current account surplus were to adjust to a lower level, it would necessarily lead to lower capital outflows from Germany, which would not help the south either.

The official queried whether the Banking Union has facilitated more capital mobility. Unfortunately, cross-border banking flows in the euro area have declined. In 2008, cross-border banking flows within the euro area amounted to approximately €2 trillion. In 2017, this figure was €1.3 trillion. The creation of the SSM and the SRM has not reversed this decline. By contrast, capital flows in the form of portfolio equity and bond flows within the euro area declined during the financial crisis and have now stabilised, but they have not declined as much as banking flows. Risk sharing fosters both stability and convergence within monetary unions. And without that, it becomes much harder to make high rates of growth sustainable.

2. Despite the implementation of the Banking Union, the banking markets remain highly fragmented; in addition, the Capital Markets Union project fails to deliver on its promises

2.1. The national ring-fencing policies of capital and liquidity clearly fragment the banking markets and keep retail banking integration low

An industry representative felt that Europe went through a difficult crisis in 2008 and 2009. Many of the participants at Eurofi had shared a dream, which was to make the eurozone stronger, more resilient, and quicker to react to shocks and finance rebounds. This dream was especially shared by those in the banking sector. The industry thought that Ministers, the ECB and the European Commission would make this dream a reality through the development of the Banking Union. So far, a substantial amount has been achieved, including the creation of the SSM and the SRF. At an earlier panel at the conference, potential risks were discussed, including a potential slowdown in the economy, a potential crisis, political tensions, populism and anti European sentiments. Two very serious opportunities have been missed, however. First, the system remains massively fragmented, and there is increasing support for fragmentation. There is a fragmentation of capital, liquidity and bail-in instruments. The industry representative expressed surprise that it is possible to speak of 'internal MREL' in the euro area. The SRB must surely be against this notion. There should not be any fragmentation of bail in able liabilities. To some EU Institutions, this is apparently normal, however. This idea seems to contradict the European ideas of private risk sharing with this and the efficient allocation of resources and capital. The shared dream of Europe has not been implemented, and the eurozone is not sufficiently strong because of this fact.

The industry speaker felt it is extremely difficult to reallocate assets when the situation in Europe is so fragmented. In Europe, this is a 'chicken and egg' question. Europe is not like the US in terms of the role of capital markets. In Europe, the banking industry has a key role in allocating resources across businesses and territories. The promise of the euro is to do this at the level of the eurozone. Fragmentation happens endlessly, because there is national bias. When there is national bias, choices are made in different ways. Europe should reduce fragmentation and avoid this outcome; then capital will be allocated in a better way. The other very important aspect here is trust, namely blind trust, especially between home and host supervisors. However, trust among supervisors is very important for the future. If there is trust in Europe, measures will be developed and decisions made on a step–by–step basis. This area does not need excessive regulations; it requires more decision making.

The time has come for political leaders to trust the institutions they have created. The time has come to trust the Single Supervisory Mechanism (SSM) and the Single Resolution Mechanism (SRM). European nations should not act at the national level, adding constraints to their common institutions. This would not be difficult and should be done, not next year but now. Ms Nouy of the SSM has indicated that moving for transnational banking groups to a branch based model over a subsidiary model could reduce fragmentation, but this demonstrates how Europe has reached a point at which it is having this kind of debate and is not able to fix it. It is important to solve these problems before the elections to the European Parliament.

2.2. The level of securitisation in Europe is lower than before the crisis due to an inappropriate regulatory framework

An industry speaker underlined that securitisation is very important. Some of Europe's savings should go to securitisation and reduce the pressure on banks' capital to allow them to fund the real economy. In the US, the capacity to sell assets and use capital in fresh ways lies at the core of the US banking sector's capacity to rebound. There are plenty of buyers of assets in the US, but this does not work in Europe. The level of securitisation in Europe today is lower than before the crisis. The industry representative expressed incredulity at how this is possible. If there were a crisis, banks would not have the capacity to inject more capital to support the economy. If there were a crisis, the industry speaker felt that the industry would suggest that regulations are overly tough and ask regulators to relax them. The US did this, but it did this during a period of growth. In any event, regulations are a positive factor. The problem here is in fact the lack of securitisation. The industry representative questioned whether regulators and supervisors would prefer to face a political debate about relaxing regulations or simply establish an efficient and well functioning securitisation system.

2.3. Legacy issues, including high levels of NPLs in some banks, must be addressed and the risk reduction legislative package should be rapidly adopted

An official felt it is important to consider what is happening in both the Banking Union and the Capital Markets Union. Europe has been very slow to overcome the banking crisis. 10 years after the crisis, there are still countries and banks with high levels of NPLs. The total number of NPLs in the system is not an issue, however; the capital numbers for the system are high. The problem exists in a fairly small number of banks, but this holds back the political trust

required to move forward quickly. To address this point, Europe has created the SSM and the SRB, which is a huge step forward. Europe must trust these institutions and, if necessary, empower them further to continue their programme. These projects will only move forward if strong European institutions drive them.

Secondly, it is essential to finalise the legislation which is already being developed in order to reduce risks. Ideally in December, and undoubtedly before the next set of European elections, Europe must drive forward the banking package currently in the trialogue: the NPL package, the agreement on the introduction of the common backstop for the Single Resolution Fund and the agreement to bring it forward before 2024. It is a short period of time, but the EU has a very able Presidency, so all industry participants should focus on closing these issues by the end of the year.

2.4. Too little progress on building the Capital Markets Union

An official suggested that the most difficult part of this debate is connected to the need to move forward on the Capital Markets Union. This is the prestige project of the Commission. There has been little progress in legislation and very little progress in actual activities in the markets. For instance, according the report of the ECB on financial integration, only around 30% of debt securities and 20% of equities are held by investors in other countries.

After the Banking Union dossiers have been closed in December, prior to the start of the next Commission, all industry participants must think about what must be done on the CMU. An official noted that according to the long perspective the elements to work on should also include difficult issues such as insolvency issues beyond bank insolvency law and tax. Only after one year of consultations France and Germany agreed on a common position paper on the CCTB-Directive-proposal. This demonstrates that considerable progress is possible. More cooperation in this area could become a nucleus to illustrate a way forward on how to tackle the more difficult issues.

2.5. The misallocation of capital is a result of the policy environment

A public decision maker felt it is important to address the supply side of the economy, rather than what is seen today in terms of the focus on the construction sector and other relatively unproductive sectors. This question concerns the allocation of capital. The misallocation of capital is a result of the policy environment. This official queried why more capital is invested in real estate than infrastructure, as an example. Additionally, in relation to Capital Markets Union this question raises the question of contributing to standardisation. Infrastructure finance is a good example of this. Many investors and firms want to put money into the green economy, but it is very difficult because it is not standardised. There can be an asymmetry of information and substantial governance problems. Yet a considerable amount of money in savings flows into real estate. The industry seeks to standardise and create new asset classes. This problem is not caused because there is a demand for this from savers. The capital markets also drive efficiency by the creation of new categories and through providing information on governance and similar topics. It is curious that so much money is in real estate, which will probably be the source of the next crisis.

3. Potential solutions to restore capital mobility within the euro area

3.1. Achieving symmetric adjustments in countries with large current account imbalances

An official returned to the comments made by another official about how adjustment would function in an economy with full employment such as Germany's. As a full employment economy, Germany cannot increase its imbalances by spending even more money. The official noted that the necessary changes are happening. The problem of rebalancing Germany in favour of domestic demand is being addressed, but capital is flowing into construction and other sectors of the economy which are not necessarily the most productive. Europe's overall productivity issues are well known, but this issue also exists in Germany in areas such as services, infrastructure and energy. Another official shared the observation made by a previous official that the quantum and the speed of structural reform in Europe are insufficient. Additionally, this official agreed that it is unclear whether raising demand in Germany would benefit the countries within the eurozone that need this. Considering current wage growth in Germany, the basis for change is there. However, there is a lack of sufficiently deep and fast moving structural reform in all parts of the eurozone, which is also true for Germany. On infrastructure, the official advised that one key constraint is a lack of sufficient government planning capacity to deploy capital.

A public representative explained how this question involves the decisions of people or firms to invest in particular countries. The majority of the problem is not a lack of investments in some countries within the European Union; it is a lack of capital. There is a problem of demand in investment. Credible demand for investments can be undermined by non functioning labour markets, insufficient skills bases, an absence of infrastructure and general mistrust in the stability of the economy. These are the key elements that must be improved and restored. If the situation improves in the countries showing this kind of deficiencies, even if local financial systems do not function perfectly, people will find a way to bring capital. The only way to reach a more balanced situation is through structural reforms which will improve the competitiveness of the economy. An official agreed with the Central Bank official's central point. In a full employment economy such as Germany's, there is a strong opportunity for reforms. It is essential to expand the potential for growth. This can be achieved via things such as increasing female labour force participation, which the German government is already addressing, or by conducting infrastructure investment. The official reiterated that it is hard to identify whether positive spill overs would occur to southern Europe or the rest of the euro area.

3.2. Completing financial integration

3.2.1. Creating an enabling environment for pan European banks in the Banking Union

A public decision maker outlined several obstacles that hinder the fungibility of capital and the liquidity of banking groups. First, a number of national options and discretions are hindering the practical application of cross-border liquidity waivers within the Union. While such waivers are explicitly allowed by the CRR, and already contain prudential safeguards, so far the ECB has received almost no application for their use from the banks it supervises. An important reason for this lack of applications is the existence of national large exposure limits on intragroup exposures in several European countries. These limits prevent institutions in these countries from transferring liquidity within the group in a flexible manner and thus represent practical obstacles to the use of liquidity waivers. Effectively, they are hindering the free flow of liquidity in the Banking Union and should be harmonised further.

Second, the proposal to have cross-border capital waivers within the EU was not taken forward in the on-

going review of the CRR, which is a missed opportunity. Such waivers would be consistent with the establishment of the SSM and the Banking Union and help to support the free flow of capital across the Union. On the one hand, it is understandable that some national authorities are concerned about the possible financial stability implications of the proposal. On the other hand, such concerns could be addressed in the future by making the waivers subject to additional prudential safeguards, and by putting in place appropriate transition arrangements subject to the planned further progress on the Banking Union.

Third, the major progress we have made in our Banking Union needs to be recognised also in the international regulatory framework. For example, the G-SIB framework currently penalises cross-border transactions within the Banking Union by attaching a higher systemic risk score to banks with more of such transactions. This goes against the very rationale of the Banking Union, as it reduces the incentives for cross-border transactions and risk diversification. The international regulatory framework should recognise the progress that has been made in the Banking Union and exclude intra Banking Union positions from the cross-jurisdictional indicators in the G-SIB methodology.

Fourth, there are also some resolution related aspects that warrant further consideration. In particular, the allocation of internal MREL has turned out to be an area of tension between national jurisdictions. Jurisdictions with a foreign bank subsidiary prefer to have a high pre-positioning of internal MREL to ensure an orderly resolution of its local subsidiary. However, this implies a certain degree of ring-fencing to the detriment of the foreign parent bank. The compromise reached by Member States in the Council only allows internal MREL to be waived if the resolution entity and the subsidiary are located in the same Member State, neglecting the fact that so much has been achieved in terms of joint supervision and resolution among euro area countries. Therefore, it should also be possible to use guarantees to replace internal MREL and allow for more flexibility in the allocation of resources within the Banking Union. Of course, to install confidence it will be important to have adequate safeguards in place, including there being no legal or practical impediments to the provision of support by the parent to the subsidiary, in particular when a resolution action is taken.

3.2.2. A common liquidation regime for pan-European banking groups

An official considered that, in comparison with the banking system in the United States, there is one key element missing in Europe: a unified code of insolvency. Europe cannot wait until insolvency law is harmonised. Europe must focus on the elements of bank insolvency law which have a close, if not direct, connection with resolution, where further harmonisation is necessary. That is a very important element not only for the management of groups and facilitating resolution but also for addressing the waiver issue.

3.2.3. Finding a compromise between speed and ambition

Considering the range of possible solutions, the public representative felt that many things could be done. In many cases, it is possible to find a compromise between speed and ambition. While achieving a Banking Union and CMU are within Europe's reach, the public representative opined that these may exceed Europe's grasp. It is important for Europe to understand what the purpose of restoring capital mobility is. Europe should not be happy with simply restoring an active interbank market. In fact, this issue is about divergence between the countries within the European Union. Even in a fully functioning market, not all banks are the same.

Conclusion

The public representative felt there are three important things for Europe to focus on. First, policymakers, representatives from public authorities and industry figures should 'do their homework' in respect of national politics and structural reforms. Secondly, trust must be restored not only between supervisors but between top level policymakers and the people within countries, because trust is disappearing. Finally, Europe is not working cooperatively. Many different types of institution are operating in this area and hoping that everything will simply work out. Different participants must trust each other, be more cooperative and do their homework. An official noted that this demonstrates what an industry speaker indicated: defragmentation is possible, but without major changes it will not be well allocated.

Enhancing cross-border risk sharing and capital allocation in the Eurozone

In an effective Banking Union, there should no longer be any distinction between home and host supervisors for banks operating across borders. The possibility of 'national bias' playing a part in regulation or supervision should be eliminated.

However, the EU legislative prudential framework does not recognise transnational groups at the consolidated level, but as a sum of separate subsidiaries, notably due to the insufficient trust of Member States vis-à-vis the institutional setup of the Banking Union. Consequently, the Banking Union represents a source of costs for the significant supervised entities in terms of contribution to the Single Resolution Fund, local prudential requirements and additional compliance costs. Although these costs are to a large extent results of the higher prudential requirements for banking - including cross-border activities as a consequence of the financial crisis - they have produced only limited beneficial effects on banking integration, notably due to the national ring-fencing policies of capital, liquidity and bail-in instruments that - while addressing justified concerns by host Member States - clearly fragment the banking markets and impede the restructuring of the banking sector.

An official opened the discussion and underlined the general agreement in the sector that greater investment is required in Europe, that savings should be used in the best possible way across the borders, and that financial stability would increase with some private risk sharing. There is currently more fragmentation in the banking market than was the case before the financial crisis. This is not merely a regulatory problem but is also a matter of trust. There are significant differences across the borders within the European Union, the single market and the Banking Union with the distinction between home and host supervisors.

1. The deepening fragmentation of EU banking markets is worrisome

1.1. The domestic bias of the EU banking regulatory framework and the absence of a common insolvency regime impact the profitability of EU banks

An industry representative expressed disappointment at the fact that the fragmentation of the financial system in Europe has not been addressed, and noted that the fragmentation is not due to banking regulation, but rather due to highly political elements. The profitability of the banks within the Eurozone is damaged by the fact that liquidity, subordinated debt and capital are still fragmented and that a great deal of energy is being expended to locate these fragmentations and to argue the case for a consolidated approach. The resistance to consolidation seen in many host countries is not easy to understand with the resolution mechanism now in place under the aegis of a single institution as well as the establishment of the colleges of supervisors and the principle of 'no creditor worse off'.

An official cited the lack of a pan European business model as being a key issue of concern. This is exemplified by the German banking sector where the post-crisis reaction has been to retreat very substantially to its domestic market. The German market has a substantial external surplus that translates into an excess of savings. From a macro-economic perspective, a banking sector that is very domestic will always have a "passive überhang", which is a great deal of deposits that are very earnings-challenged on the asset side. As such, the aggregate return on equity (ROE) in the German banking system is not ideal. There is a growing realisation that, in a country like Germany that is global and export-oriented and that has a very strong and demanding corporate sector in terms of the financing capabilities that it requires, it is not beneficial to have a banking sector that is earnings challenged and that struggles to build a business model that can allow the finance sector to be more expansive and to grow at a pan-European level. Then the speaker described some examples to illustrate the current fragmentation in the banking area.

An example of a regulatory obstacle, which goes some way to explaining the current fragmentation, is in relation to the G-SIB (global systemically important banks) score. When a French bank acquires an Austrian or Belgian bank, for example, it is treated very similarly in its capital charges as if it were buying a bank in Kazakhstan or Colombia. The current banking package attempts to address this issue but much more needs to be done. Moreover local capital and liquidity constraints are very serious issues and must be addressed very strategically, particularly in light of the need for a level playing field between America and Europe.

A significant obstacle to the unification of the resolution mechanism exists in the form of differing insolvency regimes between Member States, which undoubtedly leads to very plausible and credible concerns in the host countries. The concept of 'no creditor worse off' is plausible and strong, but applying it to a plethora of national insolvency regimes where many Member States are still resisting harmonisation will lead to great difficulty in fostering real unified capital and liquidity mobility.

The official also noted a particular issue whereby banks are willing to act 'European' when things are working well but become very domestic during moments of crisis. This essentially means that the banks are withdrawing financing precisely when that financing is required.

Another public decision maker noted that greater political will and compromise is key in order to find the necessary solutions to these issues. Ministers of Finance, as opposed to Ministers of Justice, should be involved in fostering the harmonisation of the insolvency regime at the EU level.

1.2. Addressing the home/host issues in the context of the completion of a fully fledged Banking Union

A speaker emphasised that the completion of the Banking Union will solve the fragmentation issue at the European level and will facilitate better cross-border consolidation. A particular issue in this regard is the European Deposit Insurance Scheme (EDIS), which is crucial for host countries in substantially reducing the risk of local taxpayers being exposed to losses when a consolidated transnational bank fails and the host country has to compensate the depositors of its domestic subsidiary. It is also necessary to remove the present risks of transforming subsidiaries into branches. Both home and host countries face downside financial stability risks in this regard. With large banks, the home country may be unable to cover deposit claims in other Member States, especially when a large entity has headquarters in a small home jurisdiction.

An industry representative stressed, however, that addressing the home/host issue should not be postponed until the completion of a fully-fledged banking union as it could take 'centuries' to wholly harmonise models and legal systems across Europe. He continued by saying that consideration needs to be given to defining the minimum political package that would be needed to overcome the question of confidence between host countries and banks as well as, to a certain extent, between countries and the European institutions. Ultimately, however, this is not a question for the private sector.

In terms of the political landscape, an official encouraged Germany and France, in particular, to develop quickly a consensus on the issues raised above as history shows that, when Germany and France agree on something, there is a chance that the rest of Europe will follow suit. Steps have already been taken in this regard, for example concerning: the German position on the common backstop, where there has been no demand for any kind of automatic sovereign debt restructuring; the Meseberg paper that was signed with France; and the decisions that were made both at the Economic and Financial Affairs Council (ECOFIN) Eurogroup and the head of state level in terms of fast-tracking the common backstop, which is a very significant step towards addressing the sovereign bank nexus.

2. Two possible solutions exist to moving forward: an unconditional financial solidarity among the different entities of transnational EU banks and the transformation of subsidiaries into branches

There are two possible optional solutions to moving forward. One is a branchification approach and the other is a banking group support approach.

The branchification approach arises from the fact that the current European legislative framework allows transnational banking groups to transform their subsidiaries into branches. This approach would create 'de facto' unconditional group support for branches and would ensure equality of treatment of creditors of the same ranking regardless of geographic situation. In addition, it would not require any prior harmonisation of multiple national insolvency laws since the Directive of 4 April 2001 has established a common liquidation regime whereby the liquidation of bank branches is managed under the regime of the parent company.

The banking group support approach is predicated upon the notion that the level of own funds and the

creation of MRELs have considerably increased the solvency of EU banking groups, which means that they should be able to deal with any difficulties that their subsidiaries run into within the Eurozone. This outright group support should be based on EU law and enforced by EU authorities. This commitment is the key condition for the banking groups who wish to define prudential requirements at the consolidated level.

2.1. Nordea Bank: a successful example of branchification

An industry representative outlined the experience of Nordea Bank in its approach to branchification. As of 1 October 2018, Nordea's headquarters will move to Helsinki, which will mean that the bank will operate within the Banking Union. It is the largest bank in the Nordic region, with a balance sheet of approximately €600 billion, and is the result of a merger of Norwegian, Finnish, Swedish and Danish champions that took place roughly 20 years ago. It is therefore not a single country bank that has expanded but rather a creation of four countries coming together, all of which are small liberal market economies with a disproportionate number of large multi-national companies and each with a different position in the single market.

The bank was created 20 years ago because of the realisation that these small open-market economies would need a strong bank that could not only support these societies but, in particular, support the large multi-nationals when they expand and become more global. Nordea's vision has always been to operate as one bank with one operating model, which requires an appropriate legal structure that reflects the business, and a business model and that can help implement new regulatory requirements.

As a result, Nordea branchified the bank in January 2017. Sweden remained the parent territory with Finland, Denmark and Norway becoming significantly sized branches of the Swedish bank. It was then recognised that, as far as the Banking Union is concerned, Nordea would only be able to remain competitive if the regulations that it implemented were stable, predictable and fostered a level playing field, and that a single country regulator would never be able to fully respond to a multi-national, cross-border bank of Nordea's size. It therefore made the decision last September to move its headquarters from Stockholm to Helsinki, which essentially means that Sweden becomes a branch and Finland becomes the parent bank. This will reduce the bureaucracy that would otherwise arise with multi-jurisdiction subsidiaries and will help drive a single operating model to implement forthcoming regulation. It is hoped that Nordea will now achieve what it initially sought: predictability, stability and a level playing field to enable competition.

2.2. Unconditional group support as another possible way forward

An industry representative highlighted that branchification is difficult for a variety of reasons, notably in the countries in which there is a desire to associate local partners. An alternative, therefore, that could be further investigated, might be found in support within the banking group that wishes to operate in an integrated way. This being said, the industry representative stated that it would be highly unlikely for a bank in the Eurozone to allow one of its subsidiaries in another participating Member State to fail. As an example, Crédit Agricole recapitalised its subsidiary, Emporiki, during the Greek crisis six years ago. Crédit Agricole took this measure because it was considered to be the bank's 'duty' to do so.

An official considered whether the sector needs to go beyond the 'solo approach' in the Banking Union and perhaps invent some guarantees and some more predictability in the way that a bank can help a subsidiary based in another country. Another official acknowledged that guarantees from a bank's headquarters would help to eliminate the uncertainty but noted that those guarantees should be based on EU law and should be universal. While 'soft law' can be important in this regard, it is not enough when it comes to the issue of trust, which instead requires strict legal frameworks. This point was also emphasized by a public decision maker.

Conclusion: rebuilding trust

It is essential to consider transnational banking groups of the euro area as unique entities from an operational, regulatory and supervisory perspective, and not as a sum of separate subsidiaries if the fragmentation of the banking markets in Europe is to be addressed.

To ensure such an objective, it is necessary to tackle the root cause of domestic ring-fencing practices which, in general, lies in the concern that, should a banking group face difficulties, the parent company would repatriate liquidity and capital to the detriment of subsidiaries in other jurisdictions. This lack of trust between national authorities is one of the most damaging legacies of the recent financial and sovereign debt crises. Measures such as the Meseberg paper may present a significant step forward from a technical point of view but there is still the question of how many people in the street actually understand, for example, what MREL is. To rebuild trust in Europe, the sector has to go beyond the technical questions. Acceleration is required in order to convince citizens that change is coming, as opposed to getting bogged down in negotiating approaches between different countries.

Optimising the Banking Union

1. Not completing the Banking union would be a great mistake

A public decision maker stated that an analytical argument not to complete the Banking Union would be difficult to make. There should be quick agreement among the panel that, following the enormous growth of the financial sector since the Economic and Monetary Union (EMU) came into being in 1999, it was a conclusion of the crisis that a genuine Banking Union was a missing element in the EMU. Steps have been taken to the extent that there is a Single Resolution Mechanism (SRM) and the Single Supervisory Mechanism (SSM), but it is incomplete, which begs the question of how and when the Banking Union can be appropriately finished.

1.1. The euro area economy and the European banking industry are resilient

An official advised that asking why the Banking Union is necessary is important to keep the broader picture in mind. First, the Banking Union is a core part and an essential element of the EMU, which is still unfinished

business. Financial stability was the neglected child in the Maastricht talks of 1990-91 and this will be corrected by completing the Banking Union. That is the main reason why the European Commission suggested pushing forward with the Banking Union in 2010-12 and why an agreement was made by the Member States and the European Parliament in the summer of 2012. Significant progress has already been made since it was agreed in 2012. The Single Supervisory Mechanism, established under the auspices of the ECB, has successfully unified and overhauled the supervision of euro area banks. The Single Resolution Mechanism has given the authorities improved powers to intervene in failing banks.

Second, the economic starting point for euro-area reforms is relatively benign and positive. There is a more political genesis, but the economic context is benign. Growth is strong and solid, and the economy has been in recovery mode since 2013. The ECB's policies have contributed to the turnaround. Reforms in euro-area Member States and better economic and financial governance at the EU level have made the euro-area economy more resilient. There is no return to the unsustainable old normal pre-2008 economic and monetary policy; instead, there is a progression to a new normal equilibrium, characterised by stronger regulation, the utilisation of macroprudential policies and a substantial evolution of monetary policy. Such a context should favour further a strengthening of the institutional basis of the Banking Union, particularly in the areas of banking resolution and deposit insurance.

An industry representative noted that the European banking industry is more resilient than it was 10 years ago and the Core Tier 1 ratio is around 11% on average. The SSM and SRM are in place, although elements are still missing. In order to solve the current stalemate, it is necessary to look at the European banking structure and at questions that cannot be solved by the European Insurance Deposit Scheme (EDIS) proposal such as ring-fencing policies across cross-border business which include the free flow of capital and liquidity.

1.2. Where the Banking Union stands following the Council's conclusions on a roadmap to complete the Banking Union (June 2016)

A public decision maker noted that there is a question about where the Banking Union stands following the 2016 Council Conclusions on a roadmap to complete the Banking Union. The banking package is in the trialogue. At the same time, that differences remain became clear from the European Council's discussions in June on the desired degree of risk reduction necessary before moving to EDIS. This is nothing special in Europe. The division of responsibilities to decide on which level certain competences, correct powers and forms of risk-sharing should be brought exists in federal societies such as Europe and in the US. It comes back to striking the right balance between liability and control. The jurisdictional level that bears the consequences of decisions will want a say in discussions.

1.3. Safeguarding the credibility of EU institutions is essential

An official turned to the current situation as perceived from an outside rather than an inward-looking perspective. Banks are in global competition and are strategic assets for the continent. Continued discussion of the Banking Union is puzzling. It is important to consider what that means for a normal EU citizen and whether permanently talking about the Banking Union can convince them. Without minimising the institutional achievement, when the idea of the Banking Union was developed in 2012, it was with political impetus on the future of the EMU and a Banking Union to tackle serious sector-limited issues. Forgetting the big picture could end up creating overwhelming differences.

However there is good news. It is positive for business to benefit from a large market with a cross-border vision. It is positive for the banks that are already cross-border; it can even be good for German savings banks that are in the markets for good. Savings exist in some countries due to the well-functioning Single Market and because companies benefit from a larger space. The financial sector must have the same non-fragmented analysis.

'Step-wise' is confusing. Last year, the European Parliament had two years of work on EDIS behind it. It is not fair to put the blame on them, as it is not their fault, but heads of state and government were proclaiming the Banking Union as a positive for outside investors who could know that things are functioning well because of the SSM and the EBA. If promises made at this level are not fulfilled and delivered, given that the Commission made an initial proposal on EDIS in 2015 and a second in 2017, common ground to safeguard the credibility of the political institutions of the EU is essential.

1.4. Trust is built through actions

An official advised that trust is built through actions, not words or beautiful horizons. The examples given illustrate that, for a truly European Banking Union, national governments should understand that the national banking system can no longer be seen as a sort of appendix for national public-policy goals and only that. If that becomes visible, it will create trust among depositors in certain countries that they should also be relaxed about guaranteeing deposits in other countries and banking systems, where there is no longer the national interference that has, unfortunately, characterised European banking for a long time.

1.5. It is in the German interest not to be seen as the ones imposing a vision or system, but as the ones listening to others

Another official noted that if the argument that Germany is two-thirds or one third of the eurozone population is always used as a justification for its system being the right one, something will be destroyed. A solution must be found which respects the fact that German savers need to be protected and that no one wants to destroy anything. It is also crucial to be aware of other Member States with other structures. It is in the German interest not to be seen as the ones imposing a vision or system, but also as those listening to others.

There are facts and figures that could help to find a common ground on efforts to clean up banks elsewhere, and it is hoped that this could be adopted quickly, as time is running out. Going into the next Parliament will be more complicated. Europe is a good combination of 'big' and 'small' Member States and it is important to build something that is sustainable.

2. Improving the EU resolution framework is a priority

2.1. Balancing liability and control in the Banking Union

A continuous discussion in the EU concerns the division of responsibilities between Member States and the European level. One guiding principle is that competences tend to be allocated to the European level if economies of scale and spill overs between Member States are large, and if differences in local circumstances and preferences are small.

Another principle is the balance between liability and control. The level that bears the consequences of

decisions (financially or otherwise), will also want a say in them, for example via policy coordination. These principles are central in the debate on the completion of the Banking Union. Before the financial crisis, banking supervision and crisis management were national. Liability and control were aligned, because EU countries themselves faced the consequences of the failure of a bank under their supervision. Yet the crisis showed that this situation was unsustainable. With the establishment of the Banking Union, the EU was given the responsibility for supervision (via the SSM) and resolution (via the SRM) of large banks. According to a public decision maker, still, the Banking Union currently remains a mixture of European and national elements. In terms of control or policy coordination, the SSM and SRM are responsible for bank supervision and resolution, but bank liquidation will still be executed by Member States under national law. In terms of liability, the European level now bears part of the cost of bank failures via the single resolution fund (SRF) and possibly the ESM-instruments for (in) direct bank recapitalization. It can also impose losses on the private sector via bail-in. Yet an important part of the costs still lies with Member States, because the SRF's public backstop is still in development, because deposit guarantee schemes are national and because national central banks provide emergency liquidity assistance (ELA).

So, the Banking Union is not finished yet. Tensions and discussions may arise as Member States are still partly liable for bank failures while the decisions on supervision and resolution are made under European control.

There are good reasons to complete the Banking Union, along the lines of the roadmap agreed by the European Council. Proposed measures include a public backstop for the SRF and EDIS. Streamlining liquidity provision under resolution is also being considered. The right balance between liability and control is key. These elements all imply more public risk-sharing in EMU as liability for bank failures in other countries is shared at the European level. These measures should therefore be accompanied by sufficient European control over these risks. This is why risk-sharing should be preceded by sufficient risk-reduction.

2.2. Aligning national insolvency regimes with the EU resolution framework in order to avoid a better treatment in liquidation than in resolution

An industry representative agreed that the Banking Union is part of a bigger project. It can be interpreted in two ways: not to focus so much on the Banking Union or taking the Banking Union as a precondition or an element of credibility for the whole approach and purpose. There is a common rulebook with several pitfalls, but it is essentially a common rulebook with common supervision. Other elements remain mostly national. In resolution, there is the mix of common decision-making, the SRM and the SRF, but insolvency remains national. This creates an inconsistency that potentially generates serious problems, which is the work that remains to be done and must be taken seriously.

On resolution, the idea was to make an exception when there is a legitimate public interest to be protected; otherwise, the general case would be insolvency. However, insolvency remains national and, in many cases, inconsistent with the spirit of the European resolution approach. How cases in some countries have been dealt with is remembered. The principle of no creditor worse off than in liquidation could be infringed.

A second issue is being serious about the capacity of capital instruments to effectively absorb losses and be truly subordinated when cases come. It could not be the case that senior debtholders are treated better than in resolution, as could happen depending on the national insolvency rules. Differences remain, including in Spain, Portugal and Cyprus. It is possible to pinpoint a number because the Single Resolution Board has done this analysis. It is public and shows the important differences that should be taken into account.

The aim should be at least for a common legal framework of resolution when it comes to insolvency law and to align it fully with the resolution framework, first ensuring that additional Tier 1 and 2 capital truly absorb losses and remain always the most subordinated classes of credit. It should also be clear that this principle of no creditor worse off should be respected in all cases. Finally, it would be a helpful element of discipline to avoid or limit the discretion that authorities have to decide which bank goes into resolution and which into liquidation. This could be avoided if there is an ex-ante communication of which institutions are systemic and connected to the public interest, and which are not.

This proposal is difficult because there is always an element of arbitrariness and it could also be time dependent; in any case, limiting discretion when qualifying an institution as deserving of resolution or liquidation is key. The harmonisation of these regimes is difficult. Those who look at the EU from the outside, like the International Monetary Fund (IMF), for instance, have proposed a common regime for bank liquidation, giving more powers to the SRM and this proposal is worth considering.

An official considered that the European Commission is specialised in working in the electrical power field between Germany and France, and between the German and French economic philosophies, which are at the heart of the European idea. The Commission will have to continue to do that. The Banking Union must be seen as a comprehensive entity, with resolution and diversity instruments intertwined in ensuring financial stability and the enhanced confidence of depositors in the banking system. Both are almost equally important for financial stability. A well functioning, effective resolution regime is an essential condition for credible bail-in rules. Bail-in rules that compensate for bail-out practices need an effective resolution regime to be credible in practice. The fiscal backstop for the SRM is at least as important as EDIS in ensuring that the taxpayer's purse is not used to handle a banking crisis.

3. A pragmatic way forward towards EDIS

3.1. All depositors should enjoy the same level of protection in the euro area

An industry representative advised that a fully mutualised EDIS is essential to genuine monetary union, because money is not only banknotes. One €50 banknote is worth the same in Athens, Berlin and Madrid, but that does not work for deposits. Consequently, genuine monetary union does not exist. The latest commitment was to have full fungibility of money, where the value of deposits should be the same regardless of location in the Union and the risk profile of the bank. The principle is to disentangle the sovereign and the banks. The only logical conclusion if this principle is accepted is that it is a must. Otherwise, the link is retained.

It is difficult to think in these terms due to emotions, which cannot replace logical arguments. There is a system that people know, so it is desirable to add belts and braces, but starting at the national level and not moving from there. Doing that misses a number of advantages of

having a fully mutualised EDIS on top of other elements of the Banking Union functioning well. The possibility of creating a true market for bank deposits across the Union is missed and with it opportunities for investment where investment is more profitable and attractive. It always creates a suspicion that, when difficulties come along, there will be a capital flight to sovereigns that are perceived to be stronger, because of savings, tradition or low debt, for example, or perhaps the TARGET2 balance is inflating, which a country does not like particularly, and so on.

To prevent moral hazards, contributions to this fund must be based on the risk profile of the institution, not the country. Many feel protected now because the sovereign is strong. This connection is understandable, but this is not in doubt, although the benefits of doing otherwise are different. Even the private sector is aware of an impact study done by the ECB in April on EDIS's impact in terms of response and cross-subsidisation, which is an important issue that is confused with solidarity. Solidarity has nothing to do with EDIS. It is an insurance mechanism, not one for producing transfers from one banking system to another in a systemic way. This is what the ECB says will not happen with a mutualised EDIS. The April study is good. If reinsurance gets stuck in the middle, paradoxically, there will be more transfers between banking systems.

However, it is important to remember that, if single money is desirable, that is both bank money and physical central bank money, each euro needs to be equally protected, given the risk profile of banks across the Union. This is achieved only by having the four pillars operating fully, on a mutualised basis and as mutualised as they currently are, with: regulation; supervision; an ambition for a common scheme on resolution and liquidation; and deposit protection.

3.2. A solution on EDIS must consider the diversity of banks, which requires a mix of remaining national DGS in combination with a European layer

An industry representative referred to the past and the statement of the four presidents at that time, when the third pillar of the Banking Union consisted in the Deposit Guarantee Scheme Directive (DGSD). Consequently, the statement that there is no common EU-level framework for depositor protection is nonsense and altogether wrong.

The optimisation of the third pillar should be in the focus, taking into account that there are questions which cannot be solved even by EDIS. These include ringfencing and problems around the free flow of capital and liquidity within banking groups. It should be borne in mind that liquidity floors and restrictions on group waivers are applied by the SSM and not only by the National Competent Authorities (NCAs). EDIS would not solve these questions, although they are solutions which would be more efficient than EDIS.

The diversity in the European banking industry was mentioned as being a major merit of the European financial landscape by the Committee on Economic and Monetary Affairs (ECON) of the European Parliament and the Economic and Financial Affairs Council (ECOFIN). The Commission's EDIS-proposal not only negatively affects the diversity of the European banking structure, it ultimately is destroying it. This is because Institutional Protection Schemes (IPS) which are relevant for almost half of all euro area banks and cover 20% of all assets, would no longer be workable. Provisions in the DGSD allowing for alternative measures are also important for countries like Italy as they acknowledge another form of diversity: the existence of highly concentrated banking markets, which is important for France. A solution to the discussion on EDIS must consider this diversity and requires a mix of retaining national systems, maybe in combination with a European layer. The aforesaid statement is meant to be a description of the current situation. Besides, the ECB paper mentioned previously is in many aspects flawed and completely neglects the danger of contagion in a single centralised deposit protection system.

3.3. More trust and stability in Europe requires building on existing trust and national DGS and adding at the EU level a mechanism that works and is acceptable to everybody

A public representative advised that initial discussions about making Europe stronger focused on the Banking Union. For deposit protection, looking back into the history of the story, only about 20% of each national fund is to be voluntarily exchanged between Member States, in case it is needed. This was the endpoint of the Commission's proposals for DGS. The Parliament and Council released this and it was not questioned for some time, until the Five Presidents' paper came out (June 2015), without speaking to anybody with an idea on the topic, without having a political discussion and with no political legitimacy. Five presidents found the definition of deposit insurance to be fully fledged mutualisation. This was never questioned again, and that was a mistake.

The aim is the same. The normal European person was mentioned, and people must be able to trust that deposits are safe. The promise made to the outside world of a Banking Union and what happens if it is not delivered was also mentioned. The promise is to give stability to the eurozone and to the EU concerning the question of topics, so it is crucial to be less dogmatic and more pragmatic, and consider what is needed to earn people's trust. Fully-fledged mutualisation does not give trust to people. The normal person wants to know that there is something above if a bank fails. Everyone, including the Germans, must realise that there are countries where people no longer trust national systems. This is a matter of fact. A Banking Union must accept this and find European answers. Something must be built at the European level.

It is intellectually poor to start at an endpoint because five presidents once thought that this could be a good idea without questioning whether it must be the endpoint or if there are other ways to reach the same level of trust. If something is delivered to European citizens at the European level which imparts the feeling that something in Europe can save their money if their bank or national system fails, they will be interested in nothing else. A system which helps to ensure liquidity helps avoid catastrophe, even in a problematic situation, as demonstrated by the Commission's impact assessment produced after the legislation.

To rethink this absurd mechanism: the endpoint was given first and the Commission had to write a proposal for legislation coming to this endpoint. Then Parliament turned to their obligation to write an impact assessment. What is usually the first step happened after the last point, and an impact assessment was written, with one mistake, which can be found on page 33 or 34: a graphic and explanation which was not deleted from the honest impact assessment, showing that a reinsurance system gives as much stability in 99.3% or 99.5% of cases as a fully-fledged, mutualised system. The Commission made an honest impact assessment before deleting anything that did not fit with the five presidents' expected result.

Returning to this point, being pragmatic means considering actions that work. Having national DGSs in the future and adding something at a European level

which gives protection without endangering trust in existing systems will find broad majorities all over Europe. It would be interesting to conduct research into the IPSs in Germany. In years of conversations with people from the system and different organisations, no system is more trusted than the IPSs. The reason is always the promise that everyone will be rescued, no matter what happens. Germany has more deposits than 15 of the other 19 Eurozone Member States. It has the same amount of deposits as France and Italy combined, and two-thirds of covered deposits are in the IPSs. Any European system which weakens the trust of these German deposits weakens the trust of European citizens in that system. Creating more trust and stability in Europe requires building on existing trust and putting something on top that works and is acceptable to everybody.

3.4. A reinsurance scheme seems the consensual way forward

The Chair noted that several proposals have been made on EDIS, with an official Commission proposal on the table. Since then, the Commission has made a series of suggestions to amend the proposal and distinguish between liquidity assistance in a first phase and loss-coverage in a second, with conditionality. Some banking sectors are promoting the idea of an ex-post funded system. A recent Eurofi/Centre for European Policy Studies (CEPS) paper promoted a European Reinsurance Fund. A reinsurance scheme can be beneficial and protect creditors across the Union, notably in cases of multiple bank failures. There is no guarantee that even strong schemes existing in certain Member States can withstand that, and it may be that, whatever the exact shape, a more unified system can do a better job even for those Member States.

An official noted that elements of compromise exist. A reinsurance scheme should be hoped for at this stage. The full mutualisation of risk seems politically not realistic, at least for the time being, so the solution could be based on reinsurance principles. The models presented in the background notes are good starting points and there should be some flexibility as to how to find a practical, pragmatic and functional solution. Finally, this indeed matters to the real economy, and to consumers and citizens. Numbers and macroeconomic figures are important but popular psychology and animal spirits also play a role. There must be momentum shown in EMU completion, to enhance citizens' confidence in the foundation of the euro.

Another official agreed that time can be spent on conceptual discussions around whether completion of risk-sharing is needed or not. From a pragmatic standpoint, the promise to be delivered on is that every European depositor will have their money back within seven days in a bank-default situation. Interim solutions may well focus on liquidity sharing, such as reinsurance or the Dutch situation of a credit-line-exposed arrangement with banks that can double the size of the fund overnight if needed, to satisfy the requirement of certainty of payout being equal everywhere in Europe and the first requirement. If moving from liquidity-sharing to loss-sharing is largely symbolic, then maybe 10 or 20 years from now it will be a non-event, rather than spending time and energy on what is somewhat a theoretical discussion.

An industry representative advised that the EDIS discussion highlights a remaining problem with the link between banks and sovereigns. A large fund would help in the case of a local or national shock that depletes national funds and the national DGS is unable to pay out. That could have happened in a Portuguese case with regard to the insolvency of Banco Popular's subsidiary, where the fund was lower than the payout amount. Fortunately, it did not, but it highlighted the situation.

In that situation additional funds could be helpful, but the systemic financial crisis at the European level could not be covered by any EDIS in the world. That is not something that EDIS is needed for, nor is it the purpose of EDIS or any DGS. Therefore, the DGS could be permitted to borrow from all other European DGSs in case of liquidity stress, to solve this issue of local depletion of funds. Mandatory lending could be a good starting point for a fruitful discussion.

Enhancing supervision and resolution in the Banking Union

1. A common supervision: a work in progress which requires a single rulebook

The Single Supervisory Mechanism (SSM) has merged the 19 national approaches into one single supervisory system. However without a common regulation, the EU supervision cannot treat banks equally and this opens the door to regulatory arbitrage and distorts competition. The single rulebook is currently not truly single and European supervision is still a work in progress.

1.1. The single rulebook is not truly single

The single rule book is not a truly single comprehensive regulatory framework for banking activities which makes supervision less effective and efficient. The legal framework underpinning banking activity in the euro area remains fragmented. A regulator stressed that enhancing supervision can and has to be driven forward at various levels. The first is regulation itself, where not one single-rulebook situation has been completed, not only due to options and national discretions (ONDs) but a few issues have at least been insufficiently harmonised in the level-one legislative texts. That said, on the regulatory level, if Europe chooses the path of applying a single rulebook across the whole banking industry, which the US has not done, the natural and necessary counterpart is a healthy degree of proportionality. That is a logical counterpart to having a single rulebook; otherwise, it runs into massive level playing field problems: small banks versus big banks; small risk versus big risk. Those two elements are inseparable.

1.2. Despite the elimination of a number of options and discretions by the SSM, there are still national options and discretions (ONDs)

A regulator noted that the majority of ONDs have been sorted out, in that they will expire within the next 12 to 18 months[1]. That is a step forward but, before each OND is disqualified, it is important to recognise that some are triggered by differences in national legislation which are not connected to financial regulation, such as tax law, insolvency law or, possibly most importantly, national accounting standards. The world cannot be saved through the lens of financial regulation alone. To the extent that any particular bank has to comply with accounting standards, a

certain level of ONDs is not only legitimate but necessary. It is not a black-and-white situation. Driving forward for the next three to five years, as has been done for the past five ones, should lead to optimism over an ever-more harmonised Banking Union.

An official agreed that progress has still to be made towards a unified legal basis. State-of-the-art common data collection and supervisory judgement can exist but when national specificities prevent a decision according to a European approach, then equal treatment cannot be delivered. National specificities may require different national rules, but many ONDs have nothing to do with accounting or national legal specificities; rather, they are rooted in different traditions. As a result, many different rules must be applied to the same topic, depending on the jurisdiction where the supervised bank is located.

1.3. European supervision: a work in progress

There is now a transparent and homogenous application of the Supervisory Review and Evaluation Process (SREP) but discrepancies between national supervisors and the SSM are still to be dealt with. A regulator advised that the Banking Union started with 28 or 19 different traditions of supervision and types of application, depending on whether the EU or only the Eurozone is counted. To a large degree, that is still the reality; this is fact, not criticism. Such practices must be continuously and vigorously aligned, as they can differ even when based on the same piece of regulation. This process is strongly driven and rightly so by the SSM, which is a game-changer and a quantum step ahead since November 2014. However, realistically it will still take years to align practices. Efforts to focus on a more consistent application of supervision should never be reduced.

1.4. Uniform criteria for assessing the same issues

This applies equally to significant and less significant institutions. The ECB has gradually been setting guidelines for various areas of regulation. An industry representative stressed that cooperation between the institutions is generally appreciated. It is getting better by the day and there is progress every year. However, there are four points to raise according to a representative of the industry:

• First, if there are shortcomings in individual areas that should not have consequences for all the institutions. New rules are not required for an individual problem. Individual failures should be dealt with individually for each bank concerned, as part of the Supervisory Review and Evaluation Process (SREP).

• Second, The ECB is currently working on internal capital adequacy (ICAAP) and liquidity (ILAAP) assessment processes, to set the same standards in these areas. These activities are important for internal risk management and highly appreciated. But more transparency is desirable. It is important to understand more about, for example, what comprises capital surcharges and similar issues.

• Third, is the importance of stress test. This exercise is expensive, and time consuming for banks and requires some improvement. In particular, it would be appropriate to strike an adequate balance between quantitative banking supervision, which is essentially based on the evaluation of huge amounts of data, and more qualitative supervisory practice, which focuses on the assessment of the individual risk situation. Even if digitalisation and rapid developments in the IT sector open up new possibilities for the monitoring process, largely automated processes seem less suitable for qualitative supervisory practices.

The final point is the need to more closely interlink regulatory and supervisory authorities in the future in order to improve financial stability. Communicating at an early stage - and therefore improving cooperation - avoids excessive administrative workload for banks and makes it easier to plan requirements.

An official noted that the ECB is more transparent than any national supervisor has been. Perhaps there are some exceptions here and there, but many papers on ECB supervisory policies are available on their website. A common supervision also requires further efforts from banks, supervisors and regulators to reduce the remaining stock of non-performing loans (NPLs), especially in countries where the NPL ratio remains high. A regulator noted that this point is somewhere between regulation and supervision. An important example is NPL portfolios. These are not an individual-country problem but a European one, as are the profitability and cost of capital. Europe must ensure its competitiveness on a global scale. Next to general comments on regulation and supervision, there are major specific issues which deserve a strong focus.

A regulator noted that making EU banks more profitable is necessary but unfortunately it cannot be just instructed. It must be done. Other than that, there has been a long list of important issues, and all of them are legitimate. Risk reduction is a key challenge, because it is there and is on the books. It is a reality. If that is not addressed, everything else becomes even more of a problem. Risk reduction would be the key thing, not because the others are unimportant but because that is the true entry point.

2. Further harmonising the supervisory toolbox and achieving a common culture of supervision

2.1. Creating European teams for onsite inspections

The SSM has harmonised the main tool of banking supervision: the SREP. In the SREP, the SSM analyses each bank's business model, its governance, risk management, and risks to capital and liquidity positions. But the supervisor's toolbox comprises other instruments, which need to be improved. Onsite inspections at banks are one example. In some countries, the preparation takes time, while the actual inspection is quite short, while in other countries, it is the other way round. This makes it difficult to coordinate and create international teams for on-site inspectors.

A Central Bank official agreed that more cross-border onsite inspections are required and the SSM strives to increase the number of cross-border on-site missions. Since the SSM and the ECB do not have a great deal of on-site inspectors, recruiting national onsite inspectors would allow more cross-border onsite inspections. The success of this initiative will largely depend on the number of on-site supervisors the national authorities are willing to make available.

2.2. The ECB cannot create a common culture of its own. National Competent Authorities (NCAs) should continue to contribute

A Central Bank official noted that a common culture of supervision within the SSM also needs to be pushed forward. A fully-fledged common culture requires a truly unified legal basis, harmonised administrative practices - (e.g. for the SREP, the treatment of NPLs, stress tests, the ICAAP, the ILAAP) – and time and cooperation. Indeed, staff from 19 countries and 26 authorities has to be persuaded to leave their cultural comfort zone and align how they think, assess and act. She added that when a supervisor has worked according to a specific national regime for 25 to 30 years, it takes time to get accustomed to the European view. It is important to convince people every day.

Therefore, the SSM has, for example, established a rotation scheme for members of the Joint Supervisory Teams. This too will help to spread a common culture. At the same time, it helps to avoid supervisory capture. It also fosters exchange between supervisors from across the euro area, bringing them together in many different working groups to devise training manuals and supervisory guidance. But the official confirmed that the ECB cannot create a common supervisory culture by itself. National authorities must embrace the European idea and seize the opportunity to contribute to a new, common supervisory culture. They must let more of their staff come to the ECB, for a while at least. Let them work in a European environment and carry this culture back to their home countries.

Furthermore, the idea of a European supervisory culture should be reflected in how banks are dealt with. For example, national reporting requirements should be dropped to avoid double reporting and disburden banks; instead, the aim should be for a single European reporting framework.

To sum up: a common supervisory culture is emerging, but it still needs to be nurtured and nudged. It will take time but this European culture in supervision emerges more and more from year to year.

The Chair stated that there is a point around the words, 'transparency', 'culture' and 'trust', namely the human relationship around supervision and resolution. It should be enhanced and should improve with time, because there is solid ground. It already has improved. Europe is on the right track, but whatever can be done to foster this common culture is important. In summary, this common culture is not only between national and central supervisors and resolution authorities, but also between the industry and the supervisors, such that everyone understands the aims of the other. As a supervisor, the industry understands that strong supervision is necessary for fostering the resilience of the European banking system. Transparency and dialogue will help to achieve this common understanding. This is near to day-to-day practice, so many different stakeholders can contribute to foster this common culture.

An industry representative stressed that a major lesson is the change in culture in the banks, the degree of which should not be underestimated. It is a primary responsibility of the banks to make sure that they are more resilient and better prepared. Of course, nobody wants to think about their own death, but the responsibility exists to be prepared for all situations. Cooperation with regulators and supervisors is important so that common objectives can be shared.

3. Achieving a unified framework for bank resolution for addressing the fragmentation of banking markets within the EU

3.1. The home/host supervisors for banks operating across borders have not been suppressed and the possibility of 'national bias' playing a part in regulation or supervision should be eliminated

3.1.1. The EU resolution framework is a work in progress, but the EU banking market remains fragmented

An official noted that the European banking market remains fragmented, and the lack of capital and liquidity mobility within banking groups impacts bank profitability. There is a solution to this problem: the IMF in its Euro Area Financial Sector Assessment recommends a unified and transparent framework for bank resolution in order to ensure that banks are not treated differently across jurisdictions. The SRM delivered a substantial upgrade in a short period in operationalising the new bank resolution framework. However, actual bank interventions over the past year or so show that the framework remains fragmented. So far, only one bank was resolved according to the new EU resolution framework and just a few others were handled by national bank-liquidation regimes following decisions by the SRB.

An industry representative stressed that for a European bank, the more European regulation and supervision, the better, while recognising that host regulators have important responsibilities in their countries. The more progress is made on the path of uniting Europe from a financial point of view, the better. The continuous attempts to insert discretionary national deviations into EU law should be considered critically. There are for instance elements of local requirements that increasingly take precedence over the requirements of the whole group (e.g. internal MREL). He noted that pools of funding and liquidity that are currently trapped due to regulatory constraints should also be tackled to allow for an efficient cross-border use of solvency and liquidity buffers throughout banking groups in the Eurozone. Europe creates its own inefficiencies because each subsidiary maintains idle buffers to prevent a local regulatory breach. And, even more concerning, is the fact that in the area of resolution we run the risk of inefficient and costly requirements at solo entity level in the Banking Union.

He considered that the flipside of that is the advantage provided by a transnational banking group. Pan EU Banks could manage balance sheets more efficiently. A larger pool of liquid assets would be available for all the constituent entities within the group, managed from a single source and able to be deployed as needed when a crisis occurs. Nobody knows when it will occur, so all those levels should always exist at all localities, rather than at a single point.

Another industry representative confirmed that a well-functioning, integrated financial system needs competitive and profitable pan EU banks. In this perspective, it is of paramount importance to achieve a consistent implementation of the Banking Union, to address notably the sovereign-bank doom loop and remove national discretions and the remnants of ring-fencing. Euro-area banks must diversify and not be overly linked to one single economy. Having strong and genuine euro-area banking groups addresses two points: efficient capital allocation and the cost of capital. An important lesson from the previous crisis is that, in times of crisis, foreign banks tend to pull back. Therefore, it is important to be mindful of not being too dependent on non-euro-area banks. More needs to be done to advance integration in Europe. Brexit and rising protectionism make it even more important. There is a cost to fragmentation: it took the eurozone twice as long as the US to recover from the crisis. Achieving the Banking Union and ensuring its single nature to the fullest extent means removing national discretion and the remnants of ring fencing critical for creating strong pan-European banks.

The Chair noted that profitability is in the hands of the market and is gained day to day with the business. What links it to regulation is the possibility of using the Banking Union to have sound diversification impacts between the EU and the Banking Union, which will normally lead to increase profitability. Again, it is a structural issue, so obstacles and the way around them in supervision and resolution must be identified. An industry representative stressed that whether banks in Europe are public or

private, big or small, national or pan-European, they must be able to earn money, be profitable and be competitive with American and other banks. Then resolution and other issues would not be a problem.

3.1.2. Balkanising everything will achieve nothing

The home/host issues have become most important. Moving from a going concern into the question of gone concern is a matter of trust to be fostered and enhanced by having 'skin in the game' or underlined by contractual or capital arrangements. That balance is still to be found because on the supervisory side, the rulebook must be finalised and some of the national elements somehow weeded out. However, at the same time as implementing a rulebook called Bank Recovery and Resolution Directive (BRRD) and the SRM Regulation (SRMR), legislators began work on version numbertwo. This is another issue to be considered.

A regulator noted that harmonising how liquidation is dealt with is of importance. Something that can be done without any regulation is to be ambitious at achieving that banks are truly resolvable, including the building up of needed MREL. For the moment, this is the only measure to avoid the further divergence of home and host authorities. It is important to prove it works and to ensure everything that can be done has been done in order to have a resolvable bank, while considering also profitability 'Balkanising' everything will achieve nothing.

An industry representative wished for a reduction in fragmentation and an avoidance of trapped liquidity and capital within the Banking Union. It is better to make sure that banks do not slowly die in good health but that they are profitable, resilient and competitive with an efficient allocation of capital.

3.2. Priorities for achieving a unified framework for bank resolution

3.2.1. The capacity for early intervention and advanced resolution planning must be strengthened

An official considered that the framework and capacity for early intervention and advanced resolution planning must be strengthened. To give a very concrete example, authorities need to be able to preschedule the resolution weekend when a problem bank is intervened and resolved, with minimal disruption to others.

An industry representative noted that supervisors and supervised entities have a common objective, which is to avoid the death of a bank. Supervision is about ensuring that it never has to happen, so that the market is reassured that it will not happen and that it works. In that common objective, there is more that connects and binds than divides, even if there may be differences of opinion from time to time on interpretation. Supervisors and supervised entities should find more common ground in this.

3.2.2. Completing the Banking Union (EDIS, backstop to the Single Resolution Fund (SRF)) is necessary

An official noted that a well-funded resolution fund with an appropriate backstop is needed, as well as funded national deposit-insurance schemes and a European deposit-insurance scheme (EDIS) to underpin national schemes. Another one stressed that EDIS is on the horizon but is part of the home/host equilibrium. Without an EU solution, we create the excuse for host authorities to take extra precautions because, otherwise, it falls on their system, he said.

3.2.3. Loss-sharing agreements in state aid should be aligned with the BRRD

An official advised that the priority is to reduce uncertainty about the treatment of creditors, with a focus on loss-sharing arrangements and discrepancies between state-aid rules and the BRRD. Loss-sharing arrangements in state-aid rules should be aligned with the BRRD, subject to the introduction of a financial-stability exemption which allows the relaxation of bail-in requirements to reduce contagion in a crisis. The exemption should be used only in times of severe euro area or country wide crisis and be subject to strict conditionality and governance arrangements.

A regulator advised that this is not the only issue. The current framework does not come out of space, but evolved from a system that existed. The de facto resolution authority was the European Commission's DG Competition, which set up rules for state-aid in cases of need. Now, the system has the BRRD and SRMR on the one hand, alongside a state-aid system to be applied, with a different history and a different target and aim. The time has come to align it. There is a good reason for that because even the Banking Communication[2] includes a sentence that it is in place until a resolution regime exists, so it must now be addressed. It does not need to be removed, but it should be aligned. There will always be a need to have optionality. Financial stability is at risk and is the biggest open door that it will not be possible to close. Financial stability is fundamental to finding a solution.

3.2.4. Addressing the home/host concerns in resolution

An official noted that the financial-stability interests of both home and host authorities must be carefully balanced. European institutions and national authorities have established collaborative processes for dealing with a stressful situation. The priority is to ensure the feasibility of resolution strategies for cross-border groups with domestic systemically important banks. This requires consistency between the resolution strategy and the amount and location of loss-absorbing capacity.

3.2.5. Clarifying the issue of liquidity in resolution would also strengthen the credibility of the bank crisis management

A regulator noted that a credible tool to address the risks of banks having insufficient liquidity following resolution actions is a missing piece in the puzzle. Liquidity might be the constraining factor after the weekend, even on Monday morning, because market trust must be built up again regarding the bank's solvency and viability. Therefore, a bridge into liquidity might be required.

At the same time, the work on liquidity issues has been enhanced. First and foremost, it is for resolution-planning and preparation of the institutions to make sure that there are adequate safeguards to keep the bank liquid, including collateral. Second, while easily said, timeliness of intervention is key. It is easy to be hesitant when it is time to jump in. At the same time it is challenging to take action early. Safeguards are meant for purpose. Refusing to use them, is as if you tell a patient not to spend their remaining money on the doctor, because it will be needed for the funeral.

This speaker added that even with all precautions, a liquidity facility for resolution is required. As everyone acknowledges, even when the SRF has a backstop and could provide liquidity, that is not what it was designed for, it would end with a small-to-mid-sized bank and not address a larger one. The fund having skin in the game is crucial so that the resolution scheme is trusted. This concerns pure liquidity, so one can forget about when liquidity was the substitute word for equity. However, more cannot be done and the issue of who should provide that liquidity returns. The discussion always goes in the direction of the central bank because fostering a bank in resolution and sovereign nexus by saying, 'That is for the government,' is to be avoided. A solution is needed because ending with

a resolved but illiquid bank on Monday morning is in no one's interest. The better a solution can be framed upfront, the less likely it is to be needed.

An industry representative noted that one important lesson from the crisis is that the issue is not often solvency, but liquidity. Probably the most important thing that remains to be built in case of resolution is a temporary public-sector backstop which allows the restoration of market trust, given that it is not only solvency that drives market access. It takes time to restore trust and have access to the market, so this missing piece is probably critical.

3.2.6. Achieving more predictability in the EU crisis management framework

The treatment of bank failures at the EU level is not sufficiently predictable. The decision to resolve, governed by EU rules, or to liquidate, regulated by national insolvency laws, relies on the SRB's assessment at the EU level of whether public interest is at stake, which depends on whether the functions performed by the failing bank are critical and whether the failure has a significant adverse impact on financial stability. Defining and agreeing on what constitutes a 'critical function' is an area of importance. While significant progress has been made in the collection and analysis of data, some important gaps exist between home and host authorities. Such divergence in understanding undermines cooperation and trust between national supervisory authorities. Moreover, the notion of public interest produces different outcomes depending on the level of the jurisdiction for similar banks, for example, whether European, national or regional.

An official stated that, on the application of the public-interest test, the SRM test focuses on the Banking Union and national levels. The European Commission, in its application, also considers the subnational level. More deference should be given to the SRB's judgement on this issue. The bottom line is that a unified banking market in the euro area requires the building of trust in the European bank resolution framework. There has been important progress, but more predictability and transparency is needed.

3.2.7. A more unified liquidation and insolvency regime is essential

An official stated that there are 19 insolvency laws in the Banking Union and 27 or 28 in Europe. This counterfactual is the core system to unwind a bank. Basic rules have not yet been harmonised. Earlier, an official said that this is a long stretch and an uphill battle. Another official also wished for more ambition and to move away from 'going-concern' issues towards 'gone-concern' issues. A more unified way of dealing with liquidation and insolvency is essential. It is impossible to get an insolvency law on a European level as such, but perhaps there can be a kind of module in the insolvency or liquidation law for banks that are active internationally or in Europe where all creditors are treated the same.

A public decision maker considered that the SRB should have an administrative liquidation tool which allows it to appoint a liquidator and commence proceedings. This would be especially useful for larger or cross-border banks that do not need full-scale resolution. The SRB should be able to apply this tool to all banks within its remit, mainly the so-called significant institutions, as well as other euro area banks deemed systemic at the time of failure. This tool would be especially useful for ensuring that cases involving cross-border banks are dealt with at a euro area level, facilitating necessary coordination and a level playing field. The tool could be applied by itself or in combination with other resolution tools, including an effective sale-of-business tool, and should be underpinned by a harmonized creditor hierarchy.

An industry representative advised that, while lessons are drawn from the previous crisis and implemented reforms that make the likelihood of failure lower, with instruments in place, the next time will be different. The previous crisis is always prepared for, but each crisis is different, often in quite an unexpected way. As a chief risk officer in a previous role, it is critical to think about other risks and now there are new risks to be addressed. That means having flexibility and creating the tools, and a mind-set of, 'Whatever it takes'.

Banks are less likely to fail, but a crisis could have other origins. There are three examples: first is the growing importance of shadow banking, which is of systemic importance. Second, markets can have very sudden movements in the current context of the significant increase in the size of shadow banking, but it should also be considered that banks will probably play less of an amortisation role in case of a sudden correction, precisely because of all the regulations in terms of capital equity as well as market-making. It is important to be cognisant of the fact that maybe the probability of a crisis is reduced but the magnitude of shocks could be quite big, and the channels of contagion to the broader economy less predictable. Finally, the new competitive landscape must be considered, as large tech companies will play a key role in providing financing. It is a challenge for financial regulation in terms of consumer protection and financial stability and a level playing field for the banks. Cyber is another type of risk which could have sudden repercussions that must be anticipated and addressed.

An industry representative summarised that Europe needs to keep the momentum in building the Banking Union. More European and market union is needed, with the objective of having not only more resilience but also more competitive banks that support growth and contribute to the resilience and recovery of the economies in the case of a crisis.

The Chair noted that, given that this is Eurofi, the convergence of the views towards the need for greater European integration and the suggested way of enhancing supervision and resolution by deepening integration is probably not a surprise. He also stated that there is a need for a simplification of the regulations. Some ask for an end to new ones; others for a cleansing of the old ones. Even in terms of data collection, 'Clean the past and concentrate on what is new.' He concluded that the backstop for resolution should be completed alongside, in some way or another, EDIS, which might not go all the way forward, but allows it to continue and deepen integration. The one issue that goes to level one is that the legislators have to come with propositions and ideas.

I. European supervisors identified 175 ONDs available under EU law, 130 of them have been suppressed and are now applied in a uniform way across the euro area.

II. The Communication sets out the updated EU crisis rules for state aid to banks during the crisis from 1st August 2013. It replaces the 2008 Banking Communication and supplements the remaining crisis rules. Together, they define the common EU conditions under which Member States can support banks with funding guarantees, recapitalisations or asset relief and the requirements for a restructuring plan.

Reviewing the operation of the ESAs

1. A more active role for the ESAs in developing supervisory convergence

1.1. Supervisory convergence is not starting from scratch and the positive role the ESAs play in the creation and implementation of common rules for financial services should be widely recognised

A regulator emphasized that without effective supervisory convergence, there is no level playing field and a growing risk of diverging rules affecting the degree of investor protection and market integrity between Member States. Consistent application of the rules is a prerequisite to mitigate the threat of market fragmentation. It should facilitate cross-border activities and economies of scales. He stated that supervisory convergence is not starting from scratch; it has been an increasing process. The issue is whether more needs to be done or whether more tools are needed to accelerate convergence. If passporting activities in the EU are expected to increase dramatically in the future around the CMU, impeccable supervisory and enforcement convergence is needed. There are only two ways to make progress when it comes to convergence: either by transferring direct supervisory powers to a European Authority (the SSM way) - which would make sense for cross-border and wholesale market activities - or by reinforcing the convergence tools of the European Authority. Since there is little appetite for the first solution (despite the fact that it has been done for CRAs and TRs with no major opposition), all efforts should concentrate on the convergence powers.

According to another official, the ESAs are good to have. However the assumption underlying the legislative proposal of the EU Commission seems to assume that the ESAs are insufficient and ineffective, which is fundamentally wrong. They do a terrific job, including sitting on boards of supervisors, working groups, teams and taskforces. It happens every day and is tremendous proof of European collaboration.

1.2. A single rule book is crucial to ensure convergent supervision

A regulator noted that the ESA review is underway. The European rulebook on convergence is essential to ensuring that harmonised EU regulation translates into convergent supervision. ESAs must play a prominent role in improving instruments for convergence, a key priority in the ESA review and reform process. ESAs need more resources and independence. They should assume a stronger role in peer reviews to enhance convergence, as they are key to that process.

1.3. A convergent supervisory approach is crucial to preserve financial stability

A regulator stressed that important topics for the ESAs, which have not formed part of the review process, include anti-money-laundering (AML) and terrorist financing. Against a backdrop of recent experience in the European financial system, especially the banking system, there is a prominent role for the ESAs, the European Banking Authority (EBA) and the Level 3 Committees on this important cross-sectoral issue. Resources and competences must be concentrated, especially in coordination. If national authorities are not effective, the competence to intervene will be key. This does not mean transferring all competences to a European level, but there is a case for a stronger role for Europe, to be played predominantly by the ESAs.

1.4. Mediation procedure should be used for the efficient and timely resolution of disputes among National Competent Authorities (NCAs)

A regulator noted that supervisory convergence is the bare minimum. The entire panel is involved with ESMA, so it is not a vote for eliminating national market regulators but about sitting them at a table that makes more sense. For many securities issues, that is European, not national. The work done nationally is nearly irrelevant, as the relevant work is appropriately done at ESMA. There may be some national implications or fiscal side. Diversities that come with economics or with tradition are fine, but supervisory convergence is the minimum, A regulator highlighted an interesting situation over the last 12 to 18 months, of four important people working at the European level moving to the national level. Committed Europeans are taking the decision to make Europe from the national level, which makes sense. It should be attempted, while not denying obvious and necessary economic and supervisory integration.

1.5. The ESAs should assume a stronger role in inspections to enhance supervisory convergence

A regulator advised that the focus must be on enhancing existing tools to foster convergence. Level 3 is currently guidelines, opinions and Q&As, which are important for implementing regulation in detail but have limited effectiveness. There is room to improve and enlarge the scope for 'comply or explain' for Q&As in order to ensure their consistent understanding and implementation. Conversely, there is the issue of enlarging the scope of peer reviews to check how Level 3 is implemented in each country, led by ESMA with a team of NCA experts. It is important and achievable, and it is hoped that an agreement could be found on it.

A regulator noted that NCAs do not always consciously violate European rules or fail to follow European practices. Reviews often uncover different practices, and the issue concerns defining common European practice. European market participants have a right to be treated equally, irrespective of where they are supervised, so there is room for ESA executives to have a stronger role. All countries and NCAs must have equal rights. ESA governance does not have to be changed for peer reviews, if parts of the industry are not transferred to their direct control. More support should gradually be given to the ESAs executive parts. Such reviews should be made more transparent, accompanied by follow-ups, and feed into reviews of legal acts.

The Chair highlighted a proposal that does not use the term 'peer review'; but proposes that senior ESA staff with associated NCAs on a voluntary and rotating basis should review and inspect NCAs. Where the quality threshold of a NCA is low, it is more efficient to have an ESA inspection than one from another Member State. The Chair asked whether this might not be easier than sending in the BaFin too late as in Greece. A regulator considered that even this new set-up can be too late. There is no guarantee of being in time. The proposal is appreciated but has been heavily revised since the original proposal. That demonstrates that the discussions over the past six months had not been in vain, which is good. It shows a paternalistic attitude, stating that 15 out of 27 countries may not be up to the job. That can be said but is difficult in the EU, and caution is advised. Regulatory framework discussions are driven by a belief that only little guys in little countries are misbehaving, which is a profoundly difficult proposal.

A regulator noted that anything which is not realistic and not meaningful can be dropped so that the accent is placed on supervisory convergence and the aspect of appropriate governance. Convergence is the critical issue and progress must be made on it. It is possible to be brutal and rude about a supervisory-convergence peer review. If someone is not working well, there is no problem having a name and-shame with the person's name and the name of the national supervisor. That is why sufficient tools are needed.

A regulator advised that reviews should assess not only the consistency but also the efficiency of supervisory outcomes performed by NCAs. The appropriate governance is perhaps not a new executive board, for which there is little support. Beefing up the current management board with highly qualified experts is not interesting.

1.6. Enhancing the role of the ESAs towards third countries is urgent

Entrusting the ESAs with the responsibility for monitoring the regulatory and supervisory practices of third countries is even more relevant because of Brexit. The monitoring of third country equivalence has a significant loophole to be closed. Entrusting the ESAs with monitoring it is wise and should be done.

A regulator noted that colleagues have a great mandate on everything to do with third countries. Being pragmatic means looking at outsourcing and the delegation of key functions, while ensuring that ESMA plays a crucial role in the details, whatever happens with third countries' relationships. This may make ESMA successful as a single-entry point and makes a great deal of sense.

2. Stumbling blocks for achieving a political compromise on the ESAs review

2.1. Realism is essential to achieve a compromise

A regulator noted that the ESA review must be finalised under the current European Parliament mandate, but realism is essential to achieve this. All parties could identify proposals where there is a possible compromise. No deal would be the worst-case scenario. It may be a surprise or shock to state, even without political legitimacy, that there is no consensus and no majority on several new direct supervisory powers for ESA.

A problem faced by the current proposals is a reoccurring objective of implementing a copy-and-paste of the Banking Union. Supervisors specialised in consumer protection do not work in the same way as prudential supervisors. Retail products are not the same in the different EU countries. Germany has a strong, self-regulated, excellent identity of structured products. In Italy, retail investors buy bonds. France, the Netherlands and Austria offer other kinds of products. This may be because national tax systems are not the same, but it is also about distribution. In the Netherlands, investors use pension funds and life insurance. In Belgium, Undertakings for Collective Investment in Transferable Securities (UCITS) are preferred. It is not only about language; different countries have different priorities. There is no competition between initiatives proposed by the EU and national legislation, just because there is nothing in the pipeline at the EU level.

In such a context, supervisory action must be fine-tuned to ensure an appropriate level of supervision. Without political legitimacy, it is possible to redraft a proportionate compromise to see where each authority (EU or national) is best-placed. It is not a competition between NCAs, which are strongly involved in the functioning of ESAs. It is important to consider which authority is best-placed to supervise the harmonised and the national. The discussion must be between wholesale and retail markets. There is no problem with wholesale or third-country as even benchmarking is for ESMA. But knowledge and experience of retail markets is national and their supervision should remain national.

2.2. Mistakes to be avoided

A regulator considered that, with few exceptions and contrary to their name, the ESAs are not supervisors. They are regulatory harmonisers and facilitators with a mandate to promote convergence and practical supervision, which is supported. However, as a practitioner and pragmatist, he stated that EU legislators should not create overlapping areas of competences and new complicated processes but should instead ensure that they are able to make more effective use of the powers they already have. Turning to the areas of competence of the ESAS, he agreed that the increased importance of third country relations and passporting should be elevated to a European level. But it is insulting to assume that a peer review to promote supervisory convergence is diminished by having representatives of NCAs participate, which is part of the proposal that should be changed. The proposal has fundamentally flawed assumptions and consequences.

A regulator explained that the Commission should review and redraft to achieve something more modern. Resources are not available to engage in processes which overlap and create a bureaucratic 'monstrum.' It is about not creating processes which a cynic would call typically European, with overlapping competencies that are not thought through. Given the example of the Single Supervisory Mechanism (SSM), either they do it or national regulators do. That is right. Many current Commission proposals are unclear and are sort of both, which does not work. Establishing EBA as an operational supervisor next to the SSM is also ridiculous and not thought through. It is not anti-European to call for a pragmatic process review. Products that are inherently European, with an obvious benefit to elevating them to European level, should be. But the legislative proposal is flawed and not worth concluding on.

2.3. No consensus for asking ESMA to approve all prospectus

A regulator advised that the impression of criticism without proposals should be avoided. If there is momentum towards compromise, issues for which there is no consensus can be dropped, such as direct supervisory powers to ESMA for prospectus, as these are not meaningful. Nobody understands asking ESMA to approve a prospectus and then have to go back at national level for local investors who are not interested in prospectuses.

A regulator considered that a prospectus on a national topic is national. But it is not clear why a prospectus on a non-national topic should have no European validation. Time may be needed to move it, as the system works and should not be destroyed for something that does not work. It may be gradual, but is worth thinking about.

2.4. A consensus on a fundamental modification of the governance structure is very difficult

A regulator stressed that the governance of the ESAs and ESMA must be reviewed and some sort of executive body introduced. Another one added that it is important to fine-tune current governance and enable delegation to an independent internal committee of each ESA. This internal committee can be set up rapidly and be composed of a majority of non board of supervisor members, such as three rotating board-of-supervisor members and four ESA executives. It would steer the various peer reviews at

staff level, take independent decisions on the outcomes, such as follow-up action, and prepare other supervisory-convergent decisions in the current framework. Those are interesting, realistic proposals where progress can be made in supervisory convergence, which is the main issue.

A regulator noted that more supervisors than academics and experts are needed because the job involves numerous standing committees and stakeholder meetings. Most are people from the industry, experts and academics. Supervisors are also important. Another regulator disagreed. The regulator offered to qualify the statement. On the question of increasing the level of academics or other advisors at board level, the answer is 'no' because few regulatory bodies have a strong inclusion of and impact from academics and that is a good thing. There is a thin line between asking for advice from experts and infringing on democratic decision-making. That should not be forgotten. Maybe it is somewhat old-fashioned to believe in democracy, but academics have no democratic legitimacy to make decisions. Delegating too much to academic or seemingly expert circles gives away too much decision-making to other people. Expert knowledge is positive and should be embraced, which is done and is good. There should be more sensitivity to the thin line between real decision-making processes and advices. That is blurring it.

3. Achieving the right balance between EU and national supervision

3.1. The main distinction to be made is between wholesale (B2B) and retail (B2C) markets

A regulator stressed that when reviewing the European System of Financial Supervision, it is essential to ensure the right level of supervision. The main distinction to be made is between wholesale (B2B) and retail (B2C) markets. Wholesale securities markets are more integrated and are regulated mainly at European level, so a case can be made for a strengthened supervisory role for ESMA in some areas (e.g. data service providers under MiFID II). ESMA has already been granted supervisory powers for credit rating agencies and trade repositories, and has a natural role to play as regards select B2B activities of a similar nature.

By contrast, retail securities markets are less integrated. NCAs are therefore best placed to supervise the compliance of retail products with the applicable legislation. NCAs have developed expertise in the applicable legislation, understand the language, and, thanks to their proximity to the local market, have a good view of the products sold there, are close to local investors and understand their preferences and vulnerabilities. Transferring supervisory powers over retail products to the ESAs ignores the existence of local ecosystems and risks leading to less efficient supervision. A division of supervisory responsibilities between the ESAs and the NCAs in some domains could result in losing the overall picture needed to grasp all risks at local level.

Another regulator agreed that market regulatory issues are increasingly becoming cross-border. Cross-border problems require cross-border solutions. Therefore it is necessary to think beyond personal interests to see what is appropriate for EU investors and best for capital markets.

3.2. Maintaining supervision at the domestic level seems necessary for consumer protection

A regulator highlighted a fear is that there would be a downgrading of consumer protection if nothing changes in the drafting of the current proposal. Customer protection is spoken about frequently, at ESMA, EIOPA or EBA level, but the scope of ESA's mission statement is smaller than what is done at a national level. Measures that ensure an appropriate level of customer protection make up around 60% of the domestic mission statement. There is no competition between initiatives proposed by the EU and national legislation, because nothing is in the pipeline at the EU level. Therefore, for consumer protection supervision should be maintained at the national level.

3.3. Increasing supervisory powers of the ESAs on cross-border activities where there are strong synergies at the EU level

Regulators as a network should consider how best to organise addressing important market problems to make their strength visible, transcending the centralisation/decentralisation debate to consider the best place for activities within the network. Mutual accountability is key; not centralisation versus decentralisation. The current network is restrained in terms of resources, capabilities and other aspects. The response is about how to deal with it, where to find the people to oversee it and why the 27 should be thinking about it. There is a query over what 26 other colleagues are thinking and why it is being done in 26 different places. He added that this does not make sense from a network perspective, so logic should be applied. If the national link is strong and local logic is needed, and if there is a strong link to national markets for NCAs, it should be kept at the national level. If that link is weaker, with principally European business, a fully-integrated market and cross-border problems, moving to the European level should be considered. If the Commission 's proposals are examined in that light, it is fine to think about prospectuses, the ESRB and benchmark regulations and to move that to an ESMA level with mutual accountability.

A regulator advised that further proposals would include market abuse. This is difficult to supervise in one country due to things taking place in one part of the Euronext market compared with others. Colleges and other aspects can overcome it, but a proliferation of markets where people can trade will make it increasingly more difficult, so organisation is important. The basic principle is to respect the size and shape of the risk or problem. If that is done through the analytical framework, it will produce something logical, although it might not be in fashion at that point. Fashion is not as important as providing value for the people of Europe.

A regulator stressed that an integration process needs an economic approach to make sense. The next decade will be one of securities, as the last has been one of banking-supervision integration. There is no difficulty in agreeing, even if it looks like disagreeing, with looking at the issues one by one. If they are taken like that: benchmarks are not national, neither is data-gathering, nor is CCP. Everything is European if reviewed in this way. The Commission's proposal anticipates what will happen in the next 10 years. If anything, it is too forward-looking, but it struck the right chord. A second point that could facilitate agreement is that, if the next decade is one of securities, it is worth focusing more on ESMA, which is where more integration is needed. Otherwise, strange things happen, such as licensing European products nationally, which creates discomfort among authorities, for good or bad reasons. This inevitably leads to a wrong set of incentives. It encourages a race and the acceptance of undesirable compromises in the battle to be quickest.

A regulator emphasized that there are places in the network where things can be done better. Benchmark regulation is one example. Prospectuses are coming under fire, and certain issues could be done better if taken at a

European level. Market abuse could be dealt with more efficiently and with less complexity at a European level. In terms of a proposal like financing reporting, these are markets that should be considered European. It should be possible to combine national and European pride and do what is best for the people.

There are many ways to address the issue of outsourcing the substance of delegation. The current proposal looks bureaucratic and has been addressed by an ESMA opinion but could be included as a guideline or as something to comply with or explain. Reviews of implementation could occur every two or three years. There are always solutions to make progress in that respect and it must be done.

An agreement on centralising data-gathering would be excellent for the industry as they would be bothered less. A point not in the Commission proposal is for an Erasmus for NCA personnel and board members.

Financing and investment challenges in the CESEE Region

1. Funding and investment needs in the CESEE (Central, Eastern and South Eastern Europe) region

1.1. The existence of a significant investment gap

A market observer emphasized that the CESEE region has recovered from the crisis and enjoys relative economic stability and prosperity. However, there is a persistent investment gap in the region. This is apparent in the low level of capital stock, which is approximately 50% of the average EU level and it is below 30% in certain CESEE countries, an official pointed out. Before the crisis, investment was an important factor in the region's growth, but after the crisis, investment ratios plunged across most of the countries except Macedonia, Poland and Estonia for country specific reasons. While the pre-crisis investment level may have been unsustainable, a comparison of current levels of investment with benchmarks indicates a significant lack of investment. Assessments conducted by international financial institutions (IFIs) such as the EBRD have estimated a shortfall of investment of about 3 6% in comparison to peer countries. They also show that the current investment dynamics in the CESEE region will not be sufficient to maintain the region's share of capital in relation to GDP and to close the investment gap in a gradual way, assuming a reasonable growth pattern. Maintaining capital to output levels would require the closure of an investment gap equivalent to 4% of the region's GDP.

In terms of composition, this gap is more pronounced in the private sector, because EU funds mainly target the public sector. There are nevertheless significant needs for infrastructure investment in the region and beyond, according to the IMF, the market observer pointed out. In the CESEE region, Turkey, Russia and Central Asia, there is an estimated total of €1.3 trillion in infrastructure needs. A proposal to build a European 'silk road' has also recently been made, offering a considerable potential for growth and employment with expected relocations of production sites to the region and further economic integration.

The official emphasized that the problem of investment is not only a question of quantum, but also of quality. There is a clear underrepresentation of research and development and innovation projects in the region compared to the wider Europe and this gap has increased since the crisis. Surveys also show that CESEE firms generally and service firms in particular need to upgrade their machinery, equipment and ICT in order to boost productivity and thereby also create sustainable growth rates for the future. An IFI representative added that skills and human capabilities for innovation need improving in the region. In a recent EIB study, 80% of CESEE firms suggested that the availability of skills is their biggest constraint. The outward emigration of skilled people is a significant issue but it is difficult to formulate a policy response to this. It is hard to establish the correct level of resource to put into education and training at the EU level. There could however be a balance in terms of how to manage resources and skills at the European and national levels and links between universities and the private sector also need developing.

1.2. Main funding needs of CESEE businesses

An official explained that firms in the CESEE region can be classified in three broad categories: large firms funded by foreign capital; so called semi private companies partially state-owned; and micro, small and medium sized enterprises. The third group is the vulnerable one, as these smaller companies are mostly dependent on bank financing, which is costly and collateral demanding. No significant funding needs have been identified concerning the other two categories of companies. Large firms are usually subsidiaries of large European or international groups and have direct credit lines with their parent companies and semi private companies operating for instance in the energy sector usually have sufficient capital resources on their balance sheets.

An official agreed that the largest share of finance constrained companies are SMEs, particularly those in the micro segment, which accounts for roughly 90% of SMEs across CESEE. The difference between large companies and SMEs is apparent in the success rate for loan applications. Even interest rates are estimated to be roughly 200 basis points lower for large companies than for smaller ones. The investment and financing gap is therefore not only the consequence of financing conditions but it also reflects other structural conditions which cannot easily be changed.

2. Supply of funding in the CESEE region and main drivers

2.1. Supply of bank financing

An industry representative believed that the supply of banking activities is appropriate in the region, with adequate liquidity and competitiveness across the different countries. There has been a certain recovery of the corporate market since the crisis with a growth of loans (+4.9%) and deposits (+5.4%). There are also strong improvements on NPL ratios across all countries. In addition, more capital could be secured in the future for companies through public private partnerships (PPPs). Some countries such as Turkey have made great progress on this already and others such as Poland, the Czech Republic and Slovakia could experience significant benefit from PPP schemes. However, banking activities are affected by the stringent requirements that regulators have imposed

and further impacts are expected from the ECB monetary policy and the progressive normalisation of interest rates. Issues such as volatility in Turkey and sanctions in Russia are making some international financial players more cautious also. The industry representative highlighted that the CESEE region is below penetration in GDP terms for loans and deposits, which indicates potential for growth. For example, CESEE countries have an average loan to GDP ratio of 47% (down from 53% in 2013) while markets such as Germany and Italy have reached 89% and 106%. The decrease in recent years is due to deleveraging and the elimination of NPLs.

An official noted that although the banking sector is profitable in many CESEE countries a large number of banks still conduct very conservative business targeting households and mortgages. They are not inclined to move into riskier segments such as SMEs or micro companies. An IFI representative emphasised the difficulty for banks to lend on the basis of intangible assets. This is a problem given the need for firms in the region to develop their innovation capacity, which requires more intangible investments.

A market observer underlined that financial markets generally have recovered in the region following the crisis, but interest rates have been too low given the modest capital stock compared to the euro area.

2.2. The small size and fragmentation of capital markets

An industry representative stressed that capital markets in CESEE are at an early stage of development. The aggregate size of all of the pension funds, insurance assets and retail funds in the entire CESEE region which counts 11 countries is approximately the same as that of Austria. Similarly, the aggregate value of the asset management industry in these countries is approximately one fifth of the investment assets of the top three pension funds in the Netherlands. The issue is that financial players need to handle 11 different supervisors and regulatory regimes. Another industry representative underlined that the ratio between corporate bonds and the total liabilities of companies in the region is only a few percentage points, compared to 11% in the US and 4% in the rest of Europe. Additionally, because of MiFID II, international brokers are closing their equity research departments, which is also causing a negative effect in CESEE.

2.3. Saving is improving but mainly focused on traditional saving products

In order to close the investment gap in CESEE, an important factor is developing the wealth and savings of its citizens, an official stressed, because a stronger focus is needed on domestic resources. The model of financing investments in the CESEE region has had to change since the crisis with a reduced dependence on external financing. The saving rate is growing but recent IMF estimates suggest that domestic savings across the region still lag significantly behind the benchmark saving rates of economies that have migrated from middle to high incomes.

An industry representative stressed that retail saving trends are positive in the region. A recent survey indicated that 80% of citizens in some CESEE markets consider it important to save. Saving rates across the region have increased by +10% to +35% over the last few years depending on the countries[1] and the average amount put aside is growing[2]. The problem however is the way in which people are saving. Savings accounts are the main option and only a few people consider life insurance and capital markets as a possibility. These savings are not generating enough return for wealth to develop, particularly in the current low rate environment, and sometimes the yield is even below the rate of inflation. This can be explained by the motivations for saving, which are mainly to put a financial back up aside for emergencies and to finance the acquisition or the renovation of a flat, but pension provisions also need tackling with an increasingly ageing population.

Another industry representative agreed that it is not the absolute savings rate which is important, but rather how savings are invested. From the industry's perspective, there is a lack of money going into securities and funds. A very significant proportion of savings (50 to 70%) sits in cash holdings even for private bank clients, compared to an average of 20-25% in Western Europe for these customers. In addition, while it is positive that the savings rate in the region is growing, it remains relatively low compared to countries such as Austria or Germany. Additionally, the capital base remains lower.

3. Main objectives for developing capital markets in the CESEE region

3.1. Improving financial education and incentives to foster retail investment

Several panellists emphasized the importance of developing financial literacy and a proper savings culture in order to foster retail investment in the CESEE region. The financial education level in the region is very low, an industry representative stressed. A worldwide financial literacy study by S&P showed that only one third or one fourth of people interrogated in CESEE can answer simple questions concerning interest rates and the diversification of investments[3]. Developing financial education is essential otherwise long-term savings will mainly remain in current and savings accounts and will not be properly invested, thus creating no extra wealth. This deserves a specific workstream in the Capital Markets Union (CMU) action plan, which is not the case at present. Another industry representative suggested that financial literacy could be enhanced through both education and technology. Technology now allows for far cheaper and more efficient ways to educate end investors, providing them with tools such as robo-advisors which can help them plan for their retirement based on the savings they already have, their future revenues and their objectives. The first industry representative added that the level of financial education of SME managers and entrepreneurs also needs improving. There is the ELITE programme for example developed by the LSE Group, through which selected SMEs are trained in the perspective of an IPO or a bond issuance. In Romania there is also "Made in Romania", a programme which selected the 50 top companies in the country and supports them. Similarly, developing the level of financial education of the media should be encouraged. An official concurred that the financial education of companies needs improving. National promotional banks can play a crucial role here.

The need to put in place appropriate incentives to foster investment in capital markets was also pointed out. An industry representative suggested that the most effective stimulus, though unfortunately the most difficult one to implement for political reasons, is the use of fiscal incentives. In the US, the capital gains of low income citizens were not taxed previously, although the tax rate has now increased to 20% similarly to the EU. Another issue to be tackled is the alignment of the fiscal treatment of equity and debt financing, as proposed in the CMU; this is possible to achieve as the experience in Belgium has shown. Additionally, best practices should be shared between EU governments regarding incentives for capital market investing.

3.2. Developing Pillar 2 retirement systems

An industry representative considered that retirement systems are the most powerful lever to develop capital markets. Generally speaking, there is a direct correlation between the level of development of capital markets and the existence of a proper capital funded Pillar 2 scheme. These schemes can contribute to address the needs related to ageing population, while also developing a significant pool of capital that can be invested in the local economy. Local stock exchanges and insurance companies can play an active role in this process. In most countries in CESEE, Pillars 2 and 3 systems are at early stages of development. Unfortunately, in some prominent countries which have developed growing capital funded systems, there has been a tendency to revert to a 'pay as you go' system.

There are different best practices worth considering. Whether this is a defined benefit or defined contribution scheme, it is essential to introduce workplace structures which reach a large part of the population. If this is combined with auto enrolment, it can make a sizeable difference. The Pan European Pension Product (PEPP) proposed by the Commission in the context of the CMU could support this evolution. Smaller markets and countries often benefit the most from such pan European products, which allow financial institutions to reach multiple markets of a relatively small size in a more profitable way.

3.3. The need for a more homogeneous legal and regulatory framework

An industry representative stressed the importance of a homogenous legal and regulatory framework for developing capital markets in the region. Ultimately, the closer the alignment between individual country standards and the EU rulebook is, the easier it will be for pan European initiatives to assist the development of investment capital in the region. This is a very important objective as Europe moves into the next phase of the Capital Markets Union. Consistent standards indeed facilitate the development of investment offerings for retail clients across multiple smaller markets, whether this is for retirement solutions or retail investments. There is still a relatively diverse set of rules regarding investments across different CESEE markets. Even in well established and common regimes such as UCITS, some countries maintain specific record keeping requirements for example. In respect of future EU pension initiatives such as PEPP, the region should aim to align closely with EU standards. Otherwise, it will be more difficult for regional, EU and international providers to give the local investment base access to adequate solutions.

An official suggested that structural obstacles to investment in the regulatory environment need identifying. All countries should screen their regulatory environment and consider whether it creates obstacles for the development of new financial instruments that could be attractive for issuers and investors. One of the working groups of the Vienna Initiative is helping countries in the region in their screening processes and providing guidelines on how to remove obstacles. Another official agreed that improving and stabilising the legislative framework in the region is essential. CESEE economies will continue to require external financing in the mid term, which means that predictability for investors is crucial. An industry representative emphasized the need for stronger collaboration between national authorities to improve the legal and regulatory environment in the region.

3.4. Developing and integrating local capital markets

Several panellists stressed that further developing and integrating local CESEE capital markets and their infrastructures is essential. An official noted that there have been several attempts to integrate stock exchanges in the region in order to increase volume and liquidity. This is however a challenging task that requires focused effort from both public and private stakeholders. Another official agreed with the importance of developing financial market infrastructures in the region and felt there is potential for fintech, especially with crowdfunding and ICOs to contribute to bridging the financing gaps in the CESEE region. Some issues however need addressing, such as money laundering and consumer protection.

The official also mentioned that the European Commission in the context of the Structural Reform Support Programme (SRSP) is providing CESEE countries with help to develop their capital markets. An industry representative remarked that this support is provided at the request of national governments. However, it should also be possible for the private sector to request support directly from the EU if the local government is not willing to ask for it. Some of these funds could for example be used to offset the costs of listing SMEs, which is happening in Poland for example. Indeed, according to a recent survey performed by the EBRD, the principal barrier to finance for SMEs is the cost of listing on regulated capital markets (e.g. the fees paid to lawyers and listing entities).

Another industry representative suggested that the region needs central bank programmes to support the repurchase and issuance of financial instruments. In addition, there should also be partnerships between issuers and institutional investors. Several interesting initiatives have been observed in the region. For example a covered bond purchase programme similar to what the ECB has done has been undertaken in Hungary by the local central bank in order to support the purchase of paper from local mortgage banks and support the mortgage market. An interesting strategy has also been implemented since 2016 in Bulgaria for the development of capital markets through a Council for the Development of the Capital Market.

Impacts are also expected from the CMU, an industry representative mentioned, but the CMU will not solve all the region's problems. The CESEE region needs to set its own key performance indicators and take bold measures of its own. The region must develop its own equity research capacity, because nobody is really active in the brokerage environment in CESEE. While there are large regional banks in CESEE, for whom the development of the region is critical, their main core activity is often not investment banking. The larger international banks do not do trading and investment in the CESEE region, because it is not a core business.

4. Changes in the role of IFIs in the region

IFIs such as the EIB and the EBRD play a major role in the financing of the CESEE region economy. An IFI representative explained that the EIB, previously focused on the provision of cheap long-term funding, is changing the way it operates in the region and is moving towards using new kinds of products covering different financing needs and instruments. The EIB is working in the area of venture capital and private equity. The EIB's Investment Facility is probably the biggest venture capital fund in Europe, investing in funds that operate in the region and also providing investment expertise, which is an aspect that needs developing. The EIB is also contributing to developing the link between banks and innovative firms, with a scheme providing banks with a first loss guarantee on portfolios of loans to growing SMEs and innovative firms. This allows banks to take more risks (e.g. regarding

intangible investment) than they otherwise would have taken. Another example is a pool of banks in Bulgaria that are investing in innovative start up companies. An official mentioned that the funds provided by the IFIs are in theory a possible source of funding for SMEs, but the requirements imposed are often too burdensome administratively and for the IFIs these financing projects are too small. An official remarked that the IFIs have also attempted to introduce instruments to produce a catalytic effect on domestic institutional investors, but this has not been particularly successful. Greater focus is needed on this segment, because the investor base is key for the development of capital markets.

Improving the usage of EU funds and the technical capabilities of Member States in terms of planning and prioritising projects are other objectives that the IFIs are contributing to. In the CESEE region, there has been considerable dependency on EU funds for infrastructure investment, but approaches need to change. CESEE countries need to take more of an initial stake in these projects and more projects should be developed with financial instruments that may optimize the use of financial resources. This requires advisory and technical knowledge regarding how to plan and prioritise projects, and how to use these new financial instruments. In addition, although there is a better allocation of EU funds, a large proportion of them still go into traditional areas such as transport infrastructure; there is a need to direct more funds towards other areas that may foster growth in the region such as innovation, technological transformation and the development of skills. The EU proposal to re bundle many of the previous programmes into the InvestEU programme seems appropriate and there are on-going discussions about how this mechanism should function. The EIB is also working on several other programmes, such as a programme to support 'smart cities' which is particularly relevant in the CESEE region, where cities are relatively small and need support in the planning of their digitalisation and interconnectedness projects. An official welcomed the general intention to undertake further pooling of projects across the region, noting the potential of initiatives such as the EIB's 'smart cities' programme. When it comes to the use of new financial instruments, Europe must ensure there is a level playing-field between European institutions and national promotional banks. A further issue that CESEE should consider, the IFI representative suggested, is how to position itself in the context of the negotiation for the Multiannual Financial Framework. Given the resources that will come into CESEE, the region should consider how to define and prioritise its policies for the future.

An industry representative encouraged the IFIs to undertake further work on capital market development. The region needs support to foster the listing of SMEs, identify anchor investors for SME IPOs and stimulate secondary trading on the capital markets. National capital market strategies that are being addressed in the context of the Vienna initiative are also important. Several other actions that could help to improve capital market financing in the region were proposed by the industry player. One would be for the EIB or EBRD to provide seed capital for the development of a regional ETF. Employee stock option plans are another possibility, in order to bring private individuals to the market. Further suggestions include developing equity research at the regional level; developing corporate governance; implementing a capital market development fund in conjunction with a sovereign investment fund; and increasing media cooperation and investor education.

1. +10% in Austria, 35% in Romania, roughly 20% in Slovakia, almost 10% in the Czech Republic, and there has been positive growth in Hungary.

2. It was €76 per month in 2012 and €83 in 2016; it is €91 in 2017.

3. One of the questions in this survey had asked participants to consider a situation in which they needed €100, asking them to decide whether it was preferable to pay back €105 or €100 plus 3%. This question was followed up by a question about whether to diversify their investment or keep 'all of their eggs in one basket'. Results in other EU countries: one out of two Austrians gave the correct answers to three out of four questions. In France, the results were the same. In Italy, one out of three people answered correctly. In CESEE, the figure was one out of three or one out of four. In the UK, it was two out of three.

Priorities for further developing financial markets in the CEE region

1. Changes needed in the funding model of the Central and Eastern Europe (CEE) region

1.1. Changing the growth model of the CEE region

An IFI representative stated that there has been sound post-crisis cyclical recovery in the region but, at the same time, there are reductions in the forecasts for potential growth and an extension of the timeline for the completion of the economic convergence process. This means that the region will have to evolve its growth model. The pre crisis model involved a great deal of foreign investment into labour intensive industries and a great deal of portfolio capital coming through foreign-owned banks, which will probably not continue. There will likely need to be greater emphasis on domestically driven productivity growth, local innovation and skills development.

Infrastructure will remain a significant priority but there will need to be a greater focus on how to finance not only tangible assets, like manufacturing plants and infrastructure, but also intangible assets and innovation, particularly in the services sector.

1.2. CEE economies mainly rely on bank financing at present

An official emphasized that the CEE region is bank-centric with most businesses relying mainly on bank funding and there is at present a financing gap in the region. Stricter bank regulation plays a role in this situation as banks find it harder to finance smaller, riskier enterprises because of relatively low returns. Levels of private equity and venture capital investment are well below what is seen in more developed countries and they are mainly focused on the larger economies of the region.

An industry representative stressed that many people do not realise the scale of the problem that this situation causes in the CEE region in particular. In Europe 75% of financing comes from banks and 25% from the capital market and in the CEE region the ratio is 90% / 10%. In the US it is the opposite, 75% of financing coming from the capital markets. Therefore any change in banking regulation has a substantially higher impact on the

financing of the economy in the EU than in the US, where companies can rely on capital markets as an alternative. EU banks are very strictly regulated and controlled because of their importance for the EU economy and in order to avoid any further taxpayer bail-out. This has made banks much safer but is limiting their ability to contribute to the funding of the economy.

Another official remarked that the ultra-low interest rates over recent years and the dependence on bank financing have not encouraged corporate bond issuance even for well-established enterprises and access to finance is scarce for small and medium enterprises and for start-ups.

There is, however, no 'magic formula' to resolve the current financing gap via bank financing, the first official believed. The companies that are currently non-bankable could benefit from some consolidation and economies of scale, thereby creating some synergies that could make them more prone to bank financing. But the long-term goal of governments should be to shift the focus away from traditional industries and support the development of more innovative, technology intensive and high growth industries.

1.3. Encouraging a rebalancing of financing in favour of capital markets

The panellists were in favour of a development of capital markets in the region, which is also an objective in the rest of the EU in line with the Capital Markets Union (CMU) initiative.

An official emphasized that certain countries in the CEE region, such as Romania, are trying to improve their position in the field of capital markets. As of 2017, stock market capitalisation out of GDP stood at 19% in CEE compared to 45% for the Eurozone and 146% in the US[1]. Romania aims to be close to 30% stock market capitalisation out of GDP by 2023, helped by new listings of private and state enterprises. The main goal of Romania's strategy is to overcome the frontier market status and obtain an emerging market status. This will increase the visibility of the Romanian capital market to, in particular, international investors, many of whom are subject to asset allocation constraints, and it will allow them to diversify their portfolios. The Romanian authorities also have a project for setting up sovereign funds to develop and finance profitable and sustainable investment projects in various economic sectors. One of the benefits of this financial instrument is to support Romania's efforts to achieve the emerging market position for the domestic capital market by increasing its liquidity following the listing on the Bucharest stock exchange of the companies in this sovereign fund portfolio.

An industry representative noted that regrettably the EU CMU project is taking longer than expected to materialize. The issue is that Europe has not set itself an appropriate goal in this regard. Europe's aim should not be to copy the US but to have a balance between bank and capital market financing, recognising that it is a more debt and social oriented society than the US. Before the CMU is a reality, which might take many years, further thought should also be given to the ways in which banks may replace some of the functions of a capital market in financing e.g. start-ups and innovation and the measures needed to facilitate this.

2. Facilitating the access of companies to the capital markets

An official stated that it needs to be easier for companies to access capital markets but that will not be a simple task and will take a few years to achieve. Companies tend to prefer debt and from a business perspective, debt financing is cheaper than equity financing, but there are limits to that. Also, generally, a company that does not have access to bank financing will not have access to capital markets either, via equity or debt, almost creating a 'catch-22' situation. A certain number of issuer and investor-related factors also create obstacles. Listing is still perceived as complex, expensive and intimidating by many companies, even with proportionality rules and regulatory exceptions. In addition, SMEs are riskier than larger corporates, which makes it hard to market them to retail investors, and institutional investors might not have an interest in small tickets. There is also still a negative perception from institutional investors when it comes to corporate governance in the region.

Developing trading and clearing infrastructures and connecting them across the region could create additional liquidity and attract more investors. Alongside traditional exchanges, it is also important to create innovative SME trading platforms with simplified listing rules. Crowdfunding is also an opportunity to further explore as it has worked well in the past.

In addition, from a policy perspective, governments should continue proposing attractive start-up and SME financing programmes, and tax exemptions within the state aid rules, the official emphasized. This will help SMEs to grow. Governments should also foster innovation as innovative companies are more attractive to investors and will have better access to capital markets. In the CEE region, many of the companies that are currently listable are owned by governments. A privatisation wave of those companies could provide an additional boost to capital markets and attract investors.

Another official stressed that companies need to develop a better understanding of the functioning of capital markets and of the responsibilities and advantages this type of financing involves. The Romanian Government is fully committed to support this process by working together with the industry participants.

3. Encouraging more active engagement of investors in the capital markets

3.1. Addressing financial literacy and investment culture issues

An official highlighted that the CEE region lacks a financial culture. Experience of the capital markets is much lower than in more developed countries and government policy should play a bigger role in addressing this.

An industry representative agreed that Eastern Europe does not have a capital markets culture and stressed that there will be no improvement without the support of politicians. Politicians in the region should stop criticizing and putting off investors, calling them speculators or capitalists. They also need to realise that the problems associated with pension, life insurance and social insurance systems and with wealth building are the result of a lack of capital markets. People living in the CEE region are all at a disadvantage now vis à vis those who live in countries where capital markets and pension funds are more developed because in the CEE region there are few attractive investments.

Ultimately, it is a question of culture, the industry speaker considered. However, only two countries in Europe have a real capital market culture: Switzerland, which has never been in the EU; and the UK, which is about to leave it. France and Germany are now supposed to be the basis for the future CMU but the CEE region should also create its own capital markets and sell itself as a region that is open for capital markets. The individual CEE countries are too

small for this endeavour; therefore a capital market culture needs to be developed at the regional level. Transparency and financial literacy are pre-requisites and the CEE has neither, so they need enhancing. Consideration needs to be given as to how this can be done. For example awareness about capital markets should be developed in schools. Products should only be sold to those who understand them, in order to avoid reproducing one of the causes of the previous financial crisis. The work of the EBRD and the EIB is to be commended in this regard, but politicians also need to push for developing a capital market culture.

3.2. A balanced approach to the different investor segments

An IFI representative highlighted the importance of addressing the diverse needs of the investor base with appropriate instruments and investment solutions. A key point is that there is no one-size-fits-all solution or generic policy on the demand side that could help each country to develop all the different investor segments at the same time. This is because there is a very diverse set of issues. A successful demand side policy also requires constant fine-tuning in order to avoid blind spots in the approaches to these issues.

Different investor segments have very different expectations. Market-makers need to hold inventory to trade and meet end-investor needs. Pension funds target assets with much longer maturities. Asset managers tend to invest in very liquid assets that can be valued on a daily basis. International investors have different needs from local investors because they put a strong focus on currency and interest rate hedging instruments. Retail investors seek access to a range of products that allows them to generate returns in a more protected environment.

Governments should develop a balanced approach to these different investor segments because overreliance on one of them in particular can raise stability issues. Over-reliance on international investors without a domestic investor base, for example, can lead to instability when international investors withdraw from these markets. It is not a coincidence that the countries that have been successful with the development of their capital markets are the ones that have tackled the different dimensions of the investor-base. Croatia and Romania provide very good examples of holistic approaches to the reforms needed for the development of capital markets. They both have a contributory pillar to pension funds, which form a significant part of the investment base, and they have been taking steps to enhance clearing, settlement and trading links. The reclassification that Romania is aiming for from frontier market to emerging market status in order to encourage inward investment is also an appropriate objective. The EBRD and the Commission are working with CEE countries on developing these approaches. The secondary market also needs to be developed. How dormant accounts, which is an issue linked to the process of privatisation, are dealt with is very important in this regard.

3.3. Developing appropriate incentives

An official stated that governments should develop attractive tax structures to bring investment funds in for incorporation into the CEE region. Improving the governance rules in the region is also very important as it would allow investment funds to allocate more funds into the region.

Another official highlighted that Romania has simplified account opening and the registration procedures for foreign investors, as well as the conformity requirements for corporate events and proxy-voting. Draft regulation has also been developed aimed at improving the registrar activity of the central securities depository and capital market entities interested in setting up a central counterparty have been identified. In addition, the possibility for Romanian issuers to be listed on external markets has been extended.

4. Changes in the approach of IFIs and promotional banks in the region

An IFI representative stated that there will need to be a greater focus on financing intangible assets in the CEE region, particularly in the services sector. This is not something that the IFI community, the promotional banks or the commercial banks are used to financing. Adapting to these new needs requires a change in the business models of promotional banks in particular. The EIB will have to focus more on advisory services and technical advice, and is co-operating very closely with the EBRD on this. More focus will also be needed on the corporate side in terms of corporate innovation and corporate investment, beyond the traditional infrastructure-related activities. The EBRD has done more on the corporate side in the past than the EIB, but there are countries that are not served by the EBRD and that the EIB will need to assist.

The nature of the EIB's financing instruments will also need to change in order to support the new needs of the CEE region. At present it carries out large-scale debt financing of significant infrastructure projects alongside structural funds and also off-balance sheet financing through PPPs (public-private partnerships). An expansion of PPPs is needed in certain CEE markets. More focus also needs to be given to equity financing. The EIB primarily provides equity financing indirectly through its subsidiary, the European Investment Fund (EIF), and there are some good examples of setting up funder funds in individual countries and regional funds to support the development of venture capital and private equity in the region. More of this is needed. The EIB will need to take direct equity stakes itself on the corporate side, which it does not do at present, unlike EBRD. The EIB does however undertake venture debt that carries equity risk, but which does not dilute the original shareholders. That product is working extremely well in Western Europe and it needs developing much more in Eastern Europe.

The EIB will also carry out more local currency financing in all the markets. Traditionally, it has funded the banks and they have passed low-cost funding on to the SME sector. Now, however, the banks are no longer short on funding but short on capital. The EIB will therefore need to issue more products to banks in order to allow them to lend to SMEs that do not have collateral. This will be a significant requirement in a more innovation driven economy. The SME initiative, which essentially is a risk-sharing mechanism that the EIB carries out with the local banks in order to allow them to lend uncollateralised, has been a great success in some CEE countries. The EIB will expand this quite significantly. In addition, the EIB is supporting new securitisations, particularly in Poland. It has worked very well in supporting the first securitisations of leasing receivables, consumer loans and so on as the anchor investor with a number of other stakeholders. The EIB has also fostered the first local currency hybrid bond in Poland, which is a new product for the Polish utility sector.

1. CEE capital markets (bond and stock markets) are equivalent to 78% of GDP compared to 340% in the UK and 350% in the US (A. Treichl – Views Eurofi Magazine September 2018).

Priorities for the next EU Commission

1. Strong political debate should be linked to policy alternatives

A public representative noted the importance of establishing a link with the work that is being done now in the financial integration area and that the European Parliament hopes to conclude as soon as possible in the next political and legislative cycle. Lively political discussions that are not disconnected from real policy choice are important in order to regain the trust of citizens. Real alternatives need to be brought to the public arena.

However, in such discussions, a unified pro European front against populist nationalism would be unhelpful as it would simply give populism a great deal of space. Instead, pro-European forces should foster lively and strong debate on possible alternative options before building legislative consensus. It needs to be made clear to citizens that the choice is not purely between Europe or no Europe but that there are different possible choices with different possible balances in terms of policy choices, social bases and so on.

These debates, while being highly political, should also be strongly linked to policies. The capacity to link politics and policies should be the key element of a European Commission that can successfully conclude, rethink, relaunch, broaden and streamline a number of policies. A good starting point is to build up a common agenda and a lively political debate, and to mobilise stronger democratic consensus and support in order to make politically impossible things possible as a result of acquiring legitimacy through having been part of an open and clear democratic debate at the European level.

An expert noted that belief in the EU amongst European citizens is highly correlated with the economy. The EU will fail unless it generates long-term sustainable growth, jobs and fairly distributes the benefits of that growth to all segments of society.

2. European authorities need to set out a holistic investment strategy

A public representative argued that the key headline going forward should be 'investment for growth'. European authorities need to be able to explain to citizens what a comprehensive investment strategy would look like. Jacques de Larosière previously commented on this point, stating that European authorities need to be able to, in a streamlined and comprehensive way, put together and combine areas that seem largely disparate. Instead of bureaucratically distinguishing between elements such as the Capital Markets Union (CMU), the Banking Union, investment routes and the Macroeconomic Imbalance Procedure, European authorities should be able to have a more comprehensive vision in which they clearly set out the goals and use all the tools that they have in a synergistic way.

There is currently a paradox in the private side of an excess of savings that are taken away from Europe as opposed to being channelled into investment for growth. This is an issue that cannot be addressed by a single piece of legislation but, rather, should be at the heart of a number of areas. The Banking Union and the CMU are not separate things; there cannot be a CMU without a strong and integrated Banking Union. This should be a holistic concept. There is also the investment and the capacity to bring public and private together. There is a problem of asymmetries and imbalances.

The role of the social dimension also needs to be considered. If one cannot imagine a fully-fledged transfer union with great redistribution or if one cannot realistically imagine fining Germany for having a current account surplus and instructing an individual to pay, things will not move forward. Internal demand and internal wages must be boosted in countries with persistent excessive surpluses. It is also the philosophy of Europe's social market economy to benefit from a stronger social Europe that is neither fully public nor fully private but that utilises a combination of tools. Europe cannot retrench itself in a global market. It needs a combination of financial, political and social elements, and this combination should be presented in a visible design that is simultaneously ambitious and realistic.

The chair expressed support for this holistic approach, stating that the segmented approach that has 'plagued' the current political cycle has seen a lack of coherent explanations, a lack of deadlines for action delivery and a lack of a tripartite political agreement between the European Council, the European Parliament and the European Commission. The holistic approach may not be an easy one but it could be a very powerful way of driving Europe forward.

3. Europe faces an institutional problem

A public representative highlighted three points. The first is that the three pillars of the Economic and Monetary Union (EMU), the Banking Union and the CMU have been considered from the point of view of within the EU. This is finished, not only because of Brexit but also because of the outcome of what has been delivered.

Second, as outlined by Jacques de Larosière, Europe needs to be careful because the rest of the world will not tolerate it failing to fix its internal problems. In such a case, they will 'destroy' the euro.

Third, the original intention of the CMU was to convince the UK to stay within the EU. This obviously has not worked but the CMU remains and needs to be considered in a completely different way because it now has to tackle the Brexit issue, which was not foreseen at the outset. The whole logic of the CMU is therefore inverted. This, however, does not weaken the need for a CMU but instead makes it even more important. It might have once been a measure to keep the UK on board, but it has now become a cornerstone of financing the European economy.

As stated earlier by Jacques de Larosière, new challenges are obliging European authorities to face issues that are threatening the euro. Europe may not be able to deliver to the level of ambition that Jacques de Larosière is calling for during this mandate, but this will need to be the first target for the next Commission. The financial market cannot be fixed without fixing the EMU.

As a result of the above, Europe faces an institutional problem. The new Commission will find itself in an international environment that is much more hostile to the EU. Europe believes in soft powers whereas the rest of world does not. Instead, they believe in an alignment of interest, which they know how to define and to express, and for which they have the leadership willing to fight. Europe will not be in a similar position unless it believes that the euro and its internal market, including in financial services, is of the essence.

The public representative suggested the appointment of an EU Finance Minister that would be able to speak for the EU in discussions with world leaders. Jean-Claude Juncker

has been in such discussions on trade issues but does not have a mandate over the EU's economic landscape. Such an appointment may not occur before the next Commission but should nevertheless be strongly considered.

The chair expressed agreement with much of the above comments, noting however that not all problems should be dealt with by way of institutions, which sometimes tends to be a European reflex.

A public representative stressed that now is not the time to rebuild the entire institutional setup of the EU. The current Commission does not have the best track record in terms of overcoming national positions, which has caused problems in relation to, for example, the euro area stabilisation function and the European Deposit Insurance Scheme (EDIS). The European authorities will need to convince everyone to overcome different national starting points. Understanding the perspectives of other Member States is one thing but European legislation cannot be predicated solely upon, for example, the regime of the Sparkasse. Instead, the Banking Union needs to be looked at with the three pillars that were previously promised.

4. The European authorities require the best talent but there is a concern of conflicting competencies

The Chair stressed the need for having the 'top people' in the Commission, which can allow the EU to achieve a great deal. Whoever takes over the finance portfolio has to be 'top class', with a project that is agreed trilaterally with a very fixed deadline and delivered, in order for Europe to attain a powerful position on the world stage. The Parliament also has an important role here. In addition, clarity of roles is required as too often there have been conflicting, overlapping competencies within and amongst the European authorities.

A public representative highlighted that a commonality between the single market and the single currency is a clear distribution of competencies. There can be both shared and exclusive competencies but shared competencies must be fully embedded in a governance system that clarifies who does what and who controls what. Problems occur when there is confusion as to what is European and what is national. In this sense, the focus should not be on institutions but on a clear vision.

Nevertheless, it is important to know the institutional and political framework. There will never be full harmonisation of economic policy, because this does not exist in any federal state; the budget cannot be controlled at the sub-federal level. This is an issue of size and differences. It is also important to learn the lessons of what Europe has been able to do well and to try to, mutatis mutandis, use this strength to open new policy areas and to build up this consistency in vision that is required to address very clear problems.

5. The single market and single currency are 'precious' assets

A public representative maintained that, while having quality people in post is important, the EU's main assets are the single market and the single currency, which have performed well against two powerful shocks. The Brexit negotiations have highlighted that preserving the integrity of the single market is more readily achieved not by infighting within and amongst institutions and Member States but by being united with an accumulated institutional culture and the political capacity to manage these 'precious' assets. Belief in those assets will allow Europe to better manage its negotiation with the UK, as demonstrated by Mario Draghi in relation to the single currency.

Another public representative concurred that the single market and the single currency are 'worth fighting for' and highlighted three dimensions that will need to be at the top of the next Commission's agenda in order to do so: the fight against inequality amongst Member States and within Member States; climate risk and environmental, social and corporate governance (ESG) criteria; and cyber risk, which should not be seen as merely a technical side issue.

6. Europe must implement the tools that it develops

A public representative stressed that the tools that have been created to deal with various issues must be used rather than simply spoken about, as has been the case with the Macroeconomic Imbalance Procedure and the single resolution fund. This resolution fund took years to be built but it is never mentioned as a solution when there is a crisis in a European bank. European citizens are told that issues have been identified and that tools have been created, but this is not then delivered upon. If Europe has the tools, it should dare to use them.

An expert agreed that instruments should be used and that rules should be applied rigorously. If European authorities set themselves deadlines, they must deliver to those deadlines. Otherwise, public confidence in the European authorities will be undermined.