FINANCIAL SECTOR ADVISORY CENTER (FinSAC)

Getting the financial sector reform priorities right

MAY 22-23, 2024 | VIENNA, AUSTRI

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Finance, Competitiveness & Innovation
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Keynote address

Europe's Long March

From national financial systems to integrated EU financial policy

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Jean Monnet's Handwritten Note - Spring 1952

Nous ne préserverons la paix que si nous faisons l'Europe.

Europe – Histoire

Marché unique

Monnaie unique

Fédération

(We can only preserve peace if we make Europe.

Europe – History

Single Market

Single Currency

Federation)

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Internal Market for Regulated Industries

- Regulation shapes markets
- Thus, internal market framework ultimately drives policy integration
  - Regulatory harmonization: directives → regulations → single rulebook
  - Supervisory integration: soft coordination → binding mechanisms → central authority
- But old habits die hard
  - Myriad public and private interests with stake in national status quo
  - EU-level governance is experimental, can fail
- Transitions often, but not always, driven by emergency

Monetary Union

- Banks create money; financial system transmits monetary policy
- Gradual discovery process
  - Bank-sovereign vicious circle not clearly diagnosed until 2009 (IMF on Ireland)
  - Even though other monetary unions had been there earlier
    - Supranational supervision in Eastern Caribbean 1983, West Africa 1990, Central Africa 1993
- "While a banking union is desirable at the EU level, it is critical for the euro" (IMF, June 2012)

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Slow Start of EU Financial Services Policy

- Limited legislative activity
  - Treaty of Rome: unanimity on banking matters
  - Segré Report 1966: vision of an integrated financial system
  - But only modest initiatives in rest of 20th century (e.g. banking directives)
  - Finance largely left out of Single Market effort in late 1980s
  - Maastricht negotiations result in enabling clause Art. 127(6) TFEU, with condition of unanimity
- Soft coordination initiatives
  - 1957: Conference of Insurance Supervisory Services (→ CEIOPS → EIOPA)
  - 1964: Committee of Governors (central banks → ECB)
  - 1972: Groupe de Contact (bank supervisors → CEBS → EBA)
  - 1978: Banking Advisory Committee (CBs + supervisors + finance ministers + Commission)
  - 1989: Securities Commissions Chairs' Informal Group (→ FESCO → CESR → ESMA)
  - 1990: Banking Supervisory Sub-Committee (to the CoG → ECB's Bank Sup. Committee)

■ Catalyst #1: Inception of the Euro (late 1990s / early 2000s)

- "Pre-emptive" national banking consolidation in the 1990s
- Legislative agenda: Financial Services Action Plan 1999
  - Holistic vision covering the entire financial sector
  - Implemented in the 2000s + Accounting Regulation of 2002
  - Tommaso Padoa-Schioppa's vision of "single rulebook" 2004
- Further soft coordination (Lamfalussy): CESR 2001, CEBS & CEIOPS 2004
- Transformative market infrastructure consolidation 1999-2003
  - Formation of today's Deutsche Börse Group, LCH.Clearnet, Euroclear

Catalyst #2: Financial & Euro Area Crisis (2007-2017)

- Further steps towards single rulebook + binding cooperation in 2009 (Larosière)
- Comprehensive failure of national banking supervision
  - Market integration created perverse incentives driven by banking nationalism
- Banking sector fragility endangering sovereigns
  - Ireland, Portugal, Spain, Cyprus, Slovenia, Italy
  - Unsustainability of bailout promise tilted balance towards more market discipline
  - Prospect of European-level bailouts ("ESM direct recapitalization") triggered demand of European-level supervision
  - Then backtracking on ESM direct recap, substituted by Single Resolution Mechanism
- ECB / European banking supervision (in place November 2014)
- Single Resolution Board (in place January 2016)

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Catalyst #3: Rising Confrontation with Russia (since 2014)

- Euro area enlargement in the Baltics (2010-2014)
- String of scandals in 2018 led to integrated AML framework
  - AMLA to be established this year, direct supervisory authority ca. 2027
- Increasing salience of EU financial sanctions
  - Including EU decisions involving financial infrastructures: e.g. SWIFT, Euroclear
- Greater awareness of need for pooled (financial) firepower
  - “Monetary union, the capital markets union and the banking union complement each other and strengthen the European single market. It is worth our while striving to complete them. The single market is not just a driver of prosperity. It also gives us a position of strength from which to advocate for our European values and interests. This is becoming ever more important in a changing world. A world that has seen growing discord and conflict, and is potentially heading towards a multipolar order. Europe is our chance to ensure that we can determine our own future, even in a world like this. Let’s take that chance.” (Joachim Nagel, speech at 23rd German Banking Congress, 23 April 2024)

Target Destination in Sight?

- Acceptance of principle of EU financial policy, but multiple diverging interests
- Capital Markets Union
  - Paradox of EU sequence: retail banking policy integrated, wholesale markets not
  - Initiated 2014 (pre-Brexit context), but few if any achievements
  - Revival of discussion in 2024
- Unfinished banking union
  - Extended "second phase" negotiation started in 2015, reached deadlock in 2022
  - Roadblocks: risk-sharing (e.g. deposit insurance), bail-in, sovereign exposures
- Insurance still mostly under national frameworks

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