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EBF Paper

Open Strategic Autonomy & Market Access

EXECUTIVE SUMMARY

We publish this paper with the hope of contributing the European banking sector's view to an important public discussion around OSA and market access.

We start by recognizing that, despite the explicit inclusion of financial services in these discussions, there still remain **a number of important questions** that are **unclear.**

Without claiming to resolve all open questions, we set out to provide high-level answers to two key questions:

- What is the **role of banks** in the OSA debate and what is the **optimal contribution** of the European banking sector to the EU's OSA goals? To what extent is a **sector-specific approach** needed? (Section 2)
- Which **policies would boost** the banking sector's contribution to the EU's goals in relation to OSA? (Section 3)

With regard to the first question (*What is the role of banking in OSA and how different is it from other sectors?),* we conclude that:

1. The **banking sector** will make a **positive contribution to the EU's open strategic autonomy** as an employer and catalyst of innovation, as well as a financier of the economy and notably the sustainable transition and digitalization.
2. **OSA should be applied to banking in a nuanced way**, taking into consideration the geopolitical context and approach to financial services regulation regarding a given country where banking services are provided from. This should be done along with an understanding of how banking services provided by firms based in and outside of the EU play an important role in helping the EU achieve its policy priorities, such as the twin transitions.
3. The various roles played by banks in the economy are important **separately and cumulatively**, and this makes the banking sector a particularly important part of the OSA debate.
4. The **essential functions of banking**, provided by banks which are based in the EU and in third countries, that are critical to OSA are:
    - Transmission of monetary policy;
    - Management of risk in the economy;
    - Efficient allocation of capital;
    - Provision of financing to households, companies and governments[1][i];
    - Management and functioning of payment services;

[1] The EU recognizes the significant amount of resource that will be required to fund these transitions. For instance, according to the Commission, additional annual investments of over €620 billion will be required to meet the Green Deal and RepowerEU objectives. Furthermore, it said that by far the greatest part of this would have to come from private funding. Given this, we believe that the EU having access to capital and investment provided by firms in third countries is important, as they, alongside the EU based financial sector, can play an important role in funding the transition and helping the EU achieve its objectives in this area. Yet, there is a risk that the current approach to OSA in the financial sector could make this more difficult, as third country market access in financial services is reduced.

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- Provision of investment opportunities to investors/households (including investor protection); and
- Contribution to vibrant local/regional ecosystems and financial centres.

5. Given these functions, the EU should acknowledge the **European banking sector as a strategic industry in the context of the OSA discussion** and embed it clearly within the scope of its strategic autonomy objectives, subject to the full consideration of factors referred to above which make the banking sector's access to global markets vital for its functioning, as well as ensuring that EU/EEA market participants have access to international capital markets.
6. There are **three different attributes** that the banking sector must have to carry out the role described above: **access to capital (supply and demand), profitability (competitiveness), and resilience (ability to endure crises).** The EU's OSA goals require banks that can raise and distribute funds in the economy to its best uses, profitably and in a highly resilient manner.
7. The factors that shape the ability of the banking sector to contribute to OSA can be **affected by both OSA policies and other sectoral policies**. Ultimately, any EU policy impacting the banking sector's capacity to contribute to the EU's OSA goals (and more generally, the EU goals) should be evaluated in terms of its impact on the banks' access to high volumes of supply and demand for financing, their access to specialized expertise and professionals to deliver solutions for their clients, banks' (pre- and post-tax) profitability, and the banking sector's resilience to fulfil its functions.
8. It should be recognized from the outset that achieving strategic autonomy in relation to banking will require understanding the **specificities of banking and how they relate to the concepts of autonomy**. Moreover, what makes finance different in terms of the inter-connections between the underlying factors that shape its contribution to OSA goals should be recognized and lead to a more nuanced approach in how OSA is applied to it, especially with regard to the balance to strike on the autonomy of the sector. Certain policies that would seem to bolster OSA in banking could be counter-productive if they undermine the banks' access to the tools (e.g. capital or expertise provided by firms both inside and outside of the EU) they need to carry out their functions. That is why a sector-specific approach is useful.

With regard to the second question (*Which policies would boost the banking sector's contribution to OSA?*), we conclude that:

- First of all, **a sector-specific and nuanced approach** is needed to strike the right balance and avoid unintended consequences.
- To augment the banking sector's contribution to OSA, it is necessary to:
  - Boost the **competitiveness** of the EU/EEA banking sector;
  - Define an **external approach** that takes into account **the specificities of the sector**; and
  - Implement **other policies that complement** these policies.

Taking these one by one, boosting the competitiveness of the banking sector requires:

- Making **regulation more efficient** in the EU (to lower the regulatory drivers of the cost of capital of EU/EEA banks & improve profitability);
- Embedding a "**competitiveness test**" in the EU's financial sector policies; and
- **Reducing the fragmentation** of the Single Market in financial services.

Drawing "the external boundaries of the Single Market in financial services" (i.e. the terms under which firms based in third countries and those which are EU-based have access to each other's markets) needs to happen through a **sector-specific, nuanced approach** which ensures both a level playing field and adequate access to capital, expertise and business opportunities at the same time. In particular, we recommend:

- A transparent and predictable process taking into account the values of third countries, particularly those which share many of the same values as the EU, including in their approach to financial services and its regulation i.e. "friendly-shores".
- Assessing and considering the possibility of granting market access for specific and selected 3rd country institutions from friend-shoring jurisdictions, based on a lighter (but still material) equivalence regime.
- Providing for conditions to increase EU/EEA investors', issuers' and market participants' access to international capital markets and also the other way around (reciprocity).
- Identifying and removing financial sector related barriers to European companies investing in 3rd countries.
- Recognizing the benefits of EU/EEA firms' access to third country markets and the important role financial services institutions outside of the EU play, alongside those in the EU, when providing capital to the EU/EEA and market participants.
- Avoiding unintended complications for EU/EEA companies.

Finally, other policies — which may require further investigation — could possibly complement the above approaches, namely:

- The establishment of a European safe asset.
- The strengthening the international role of the Euro.
- The establishment of EU sovereignty over European Payments.
- The achievement of EU Digital Sovereignty.

We hope that this paper will offer a useful clarification of key questions that have to be addressed in the public debate in relation to how banks can best contribute to the EU's OSA goals and market access considerations.

SECTION 1: INTRODUCTION

1.1 What is OSA?

The concept of "**strategic autonomy"** is defined as the capacity of the European Union to act autonomously when and where necessary. The inclusion of the **"open"** qualifier is based on the view that the openness of the EU economy in general is beneficial and is not in contradiction with autonomy. It signifies that autonomy should not be seen automatically as equivalent to self-sufficiency in a protectionist sense.

OSA is closely related to "**market access"**, which is the process through which entities outside the EU[2] are given access to EU/EEA markets, usually subject to rules set out in the specific legislation concerning the equivalence criteria and/or the sectoral sections of the bilateral trade agreements. Market access in turn is related to outgoing business conducted by EU-based entities. Both concepts are related to the outside boundaries of the EU Single Market.

1.2 How does the financial sector/banking sector appear in this debate?

Having started in the areas of security and defence, OSA has expanded to economic and financial issues in the last few years. In **January 2021**, the EC published a **communication** with the aim of asserting an increasingly leading role in global financial and economic governance. According to this communication, the EC is committed to strengthening the EU internally by further reinforcing the Single Market and completing the Banking Union and the capital markets union, and by proposing steps aimed at strengthening the international role of the euro, enhancing efficiency and ensuring the resilience of EU/EEA financial market infrastructures and payment solutions, as well as improving the EU sanctions framework and the EU/EEA's resilience when faced by unjustified unilateral extraterritorial sanctions imposed by third parties.

The financial sector was also prominent in the **Council's 2022 conclusions** on open strategic autonomy of the European economic and financial sector. Conclusions were drawn taking into consideration the dramatic changes in the contemporary geopolitical context, highlighting even more the need of achieving the EU's strategic autonomy, while preserving an open economy. In its conclusions, the

Council focused on:

- Strengthening the international role of the Euro;
- Achieving a strong, resilient and internationally competitive European financial sector able to serve the economy and avoid risk arising from excessive reliance on third-country financial institutions and infrastructures;
- Shielding and strengthening the resilience of financial market infrastructure;
- Developing an effective mechanism for managing sanctions;
- Increasing and improving cooperation with partners.

Despite the explicit inclusion of financial services in these recent discussions, there still remain **a number of important questions** that appear to be **unclear in the policy debate**.

[2] For the purpose of this paper, the EU is, in the relevant context, used in the meaning of the internal market and the European Economic Area. Iceland, Liechtenstein, and Norway have full access to the internal market while adhering to the EU aquis and being subject to the supervisory single handbook.

1. **Is the banking sector a "strategically critical sector" in the OSA context?** If so, where does this importance come from? And to what extent is it "just like any other sector" when we look at the basic concepts of OSA such as self-sufficiency and resilience?
2. **What are the best ways to boost the banks' ability to contribute to the EU's OSA?** Given the ways in which banking benefits and influences OSA interests, what are the tradeoffs and different objectives to balance when optimizing the sector's contribution to the EU's OSA?

We feel that not enough open discussion occurred on these questions, while implicitly certain choices were made. For example, OSA has been applied in a uniform manner across a whole range of industries, whether that be gas, microchips or the financial sector. Importantly, OSA has generally been synonymous with an effort to increase self-sufficiency and arguing in favor of using policy tools to reduce the purchases of products or services from outside the EU/EEA to do so. For instance, Commissioner Mairead McGuinness said in 2022 that the lessons regarding the situation the EU faces in terms of UK clearing and Russian energy are the same, even though the sectors and geopolitical contexts characterizing them are entirely different.

1.3 The purpose of this paper

It is not the ambition of this paper to resolve all of the question that are open in this debate; neither do we think that a full public or private sector consensus exists in the EU on some of these questions. However, as the representative of the **European banking sector**, with members representing private commercial banks in the EU/EEA/EFTA and UK, we believe the EBF is well placed to put forward the perspective of European banks on **two key questions** framing this debate:

- What is the **role of banks** in the OSA debate and what is the **optimal contribution** of the European banking sector to the EU's OSA goals? To what extent is a **sector-specific approach** needed? (Section 2)
- Which **policies would boost** the banking sector's contribution to the EU's goals in relation to OSA? (Section 3)

Section 4 will summarize the recommendations.

As some of the analysis inevitably relates to EU financial sector policies, we provide some of the technical details in the annexes.

SECTION 2: THE ROLE OF BANKS IN OSA AND THE OPTIMAL CONTRIBUTION OF THE EUROPEAN BANKING SECTOR TO THE EU'S OSA GOALS

To outline how banking can best facilitate the OSA goals of the EU, we should first look at the channels through which banks typically contribute to public goals relevant to OSA and the attributes banks must have to fulfil these functions.

2.1 Through which channels does banking contribute to OSA goals?

The following essential functions of banking are critical to OSA:

- Transmission of monetary policy;
- Management of risk in the economy;
- Efficient allocation of capital;
- Provision of financing to households, companies and governments[3ii];
- Management and functioning of payment services;
- Provision of investment opportunities to investors/households (including investor protection); and
- Contribution to vibrant local/regional ecosystems & financial centres.

In other words, the EU's OSA goals require banks that are able to transmit the ECB's (and national central banks') monetary policy, manage risks in the economy, intermediate in terms of lending and capital markets between demand and supply of capital, meet the financing needs of governments and companies of all sizes and meet the needs of savers, and contribute to the vitality of financial centres that attract talent and knowledge to the cities hosting them.

Looking at these functions and their impact together, we can assert that **the EU should regard the European banking sector as a strategic industry** due to its central and multifaceted role in the economy and embed it clearly within the scope of its strategic autonomy objectives. However, as will be explained further below, the banking sector's ability to contribute to OSA depends critically on a nuanced and sector-specific approach, in particular with regard to the sector's access to global markets. In other words, autonomy in banking should not translate to protectionism or interruption of long-standing commercial relations with partners that are similarly regulated, because that would not be to the benefit of the EU/EEA and its market participants.

Looking at banking more closely, we can see that all of the roles played by banks in an economy are important separately and cumulatively, and that this makes the banking sector a particularly important part of the OSA debate. First of all, banks are ***key enablers* of the EU's OSA-related goals in other sectors**, especially in relation to the EU's autonomy in technological innovation and its ability to reach its climate-related goals. This is not only about financing; it is also about providing non-financial services. Certain activities of the sector, particularly those related to the provision of specific services (such as investment banking, M&A, etc.) to European companies considered strategic, have a particularly strategic aspect. More broadly, in this enabling role, banks provide the financing needed

[3] The EU recognizes the significant amount of resource that will be required to fund these transitions. For instance, according to the Commission, additional annual investments of over €620 billion will be required to meet the Green Deal and RepowerEU objectives. Furthermore, it said that by far the greatest part of this would have to come from private funding. Given this, we believe that the EU having access to capital and investment provided by firms in third countries is important, as they, alongside the EU based financial sector, can play an important role in funding the transition and helping the EU achieve its objectives in this area. Yet, there is a risk that the current approach to OSA in the financial sector could make this more difficult, as third country market access in financial services is reduced.

for sustainability investments, enable risk capital for digital innovators, and carry out many other services that are needed by the companies and households. Without the banking sector's financing of these investments, the EU's goals of the twin transition cannot be achieved.

At the same time, the financial/banking sector is a **strategically critical sector** in the OSA debate ***in its own right***, i.e. not only as a contributor to the autonomy of other sectors. This is because banks are employers in a knowledge-intensive, value-creating sector with strong links to local and regional financial centres and the network of companies and localities they serve. All of these functions increase the value-added in the GDP and augment the vibrancy and resilience of the EU/EEA economy.

Hence, we believe **the EU should regard the European banking sector as a strategic industry** in the context of the OSA discussion and embed it clearly within the scope of its strategic autonomy objectives, subject to the full consideration of factors referred to above which make banking sector access to global markets vital for its functioning, as well as ensuring that EU/EEA market participants' have access to international capital markets.

In other words, while banking should be seen as a critical sector within the OSA debate, it should be recognized from the outset that achieving strategic autonomy will require understanding the specificities of banking and how they relate to the concepts of autonomy.

2.2 What are the attributes needed for these functions?

Given the functions described above, which underlying factors could strengthen (or weaken) the banking sector's capacity to fulfil them?

In our view, there are **three different attributes** that the banking sector must have to carry out the role described above: **access to capital (supply and demand), profitability (competitiveness), and resilience (ability to endure crises).** In other words, the EU's OSA goals require banks that can raise and distribute funds in the economy to its best uses profitably and in a highly resilient manner. Looking at these attributes more closely, we can analyse the drivers behind the strength of each attribute (and how they may interact):

- The banking sector's **access to high volumes of supply and demand** for financing (both for credit financing and capital market intermediation), which is itself linked to:
  - Ability to benefit from scale (cross-border activities and integration);
  - Ability to access international pools of capital;
  - Ability to exercise international presence and play a role in helping EU/EEA companies expand to other regions across the world;
  - Ability to play a role in the strengthening of business and trade relations between; EU/EEA and other regions in strategic areas that are relevant for the EU to maintain its position in the international context;
  - Volume of capital ready to be invested in the EU/EEA;
  - Ability to also attract funding in competition with zero-risk central bank money;
  - Volume of corporate demand for credit and access to capital markets.
- The banking sector's **access to specialized expertise and professionals to deliver solutions for their clients:**
  - Ability to put together the right expertise needed for different regions, sectors, and client types;
  - Ability to attract knowledgeable professionals to work in the banking sector;

- Ability to access specialized services located outside the EU as partners, such as those needed by high-tech issuers.
- The banking sector's (pre- and post-tax) **profitability**, which is itself linked to not only the quality of management but also factors beyond their control:
  - Tax policies;
  - Cost of capital for banks, itself influenced by their attractiveness to international investors;
  - Ability to benefit from scale (cross-border activities and integration);
  - Optimal level of regulation that enables, and does not constrain, financing capacity and does not create excessive compliance costs;
  - Capacity of banks to raise new capital from the markets for recovery purposes.
- The banking sector's **resilience** to fulfil its functions, which is shaped by:
  - The ability of regulatory policy to achieve stability without creating excessive; compliance costs and without hindering the ability of banks to lend and invest;
  - Autonomy of the sector in terms of technology, know-how, etc;
  - Economy-wide factors that absorb or amplify cyclical changes.

These factors, which are essential ingredients that shape the ability of the banking sector to contribute to OSA, can be affected by both OSA policies and other sectoral policies. Ultimately, any EU policy impacting the banking sector's capacity to contribute to the EU's OSA goals (and more generally, the EU goals) should be evaluated in terms of its impact on the banks' access to high volumes of supply and demand for financing, their access to specialized expertise and professionals to deliver solutions for their clients, banks' (pre- and post-tax) profitability, and the banking sector's resilience to fulfil its functions. In other words, certain policies that would seem to bolster OSA in banking could be counter-productive if they undermine the banks' access to the tools (e.g. capital or expertise) they need to carry out their functions. That is why a sector-specific approach is useful. We will look at this issue more closely below.

2.3 In what ways is banking similar to - and different from - other sectors, and looking at "friendly- shores"

It is clear that many of the above-stated factors are inter-related, and there are important trade-offs to be made, and potential unintended consequences to avoid, suggesting that a nuanced approach may be best to take into account the specificities of banking. Given the diverse nature of the EU/EEA and global economy, with industries ranging from car manufacturing to energy production to financial services, quite often the characteristics of one industry will not apply to another. And even if they do in the broader sense, there are likely to be subtleties and nuances in that given area which are prevalent to one industry and not the other. Therefore, while certain trade-offs might have been studied carefully in other sectors, arguably the financial sector will benefit from a nuanced approach even more than other sectors. To some extent, such a nuanced approach has already been suggested for banking[4]. In our view, getting this nuance right requires looking at the **totality of the factors** that optimise the banking sector's ability

[4] The 2022 EBA report draws a nuanced conclusion (October 2022 EBA report on EU dependence from non-EU entities): "In the above-mentioned Commission Communication, the EBA was tasked to take a closer look into EU's dependency on third-country financial services providers. The EBA analysis concluded that: "Considering the high degree of openness of the EU economy and the benefits from international risk-sharing -the exposures give no raise to concern at the aggregate level. That said, the EU financial system shows some reliance on services provided by non-EU entities, such as payment and settlement services and investment banking activities, therefore the development of competitive EU based capacity may reduce the dependency and could prove to be beneficial in the medium term."

to facilitate the EU's OSA goals, i.e. **access to high volumes of supply and demand, access to expertise, profitability,** and **resilience.**

For example, complete openness to the outside world would maximise the volume of capital available to invest within the EU/EEA (and the investment opportunities available for EU/EEA investors) but could potentially undermine self-sufficiency/resilience. Conversely, a search for absolute self-sufficiency could come at the expense of the EU/EEAs financing capacity and access to expertise.

In this respect, looking at the financial sector in particular, we see access to global markets as an important characteristic of the sector. Many financial services are provided from firms based in 3rd countries into the EU, particularly from the US, UK, Switzerland and Japan. At the same time, firms in the EU are also a major exporter of financial services into 3rd countries, supporting clients alongside local firms providing their own services *(please see Annex 1).* Moreover, there is a high level of specialization in various financial centers which are inter-connected, and which benefit one another. The multiple jurisdictions in which global and regional financial centers exist share many of the same values as the EU, and they also have a like-minded approach to financial services and its regulation, e.g. the US, UK, Switzerland and Japan all have well-regarded regulatory standards in financial services. The adherence to a high level of common standards can be expected to continue, thereby ensuring robust compliance with global regulatory (prudential) standards and robust supervisory frameworks that achieve the same goals vis-à-vis market integrity, investor protection, market efficiency, etc.

That is why, when looking at the level of the EU banks' interaction with 3rd country counterparts/markets, it is useful to take into account the need for access to these markets by EU institutions, as well as the capital (and expertise) EU/EEA market participants are able to access from firms based in 3rd country jurisdictions with common standards and shared geopolitical and economic objectives (i.e. "friendly-shores"), as this directly benefits the sector's ability to function and serve the EU economy.

Yet, as explained in Section 1, OSA currently approaches financial services in the same way as it approaches energy independence; the latter of which follows Russia's invasion of Ukraine. In this instance, the financial and the energy sectors not only have significantly different characteristics to one another, but the geopolitical context which they operate in are entirely different as well. More broadly speaking, a sector-specific approach seems to be the only way of generating a positive impact on the banks' ability to contribute to OSA.

SECTION 3: HOW TO BOOST THE BANKING SECTOR'S ROLE IN OSA

3.1 Adopting a sector-specific, nuanced approach

As suggested by the above analysis, the banking sector has to be viewed with a high degree of nuance in the OSA debate, with a sector-specific approach that recognizes both its special role as an enabler of the OSA in other sectors which it finances, requiring access to international capital flows and expertise, and also the importance of the sector as a critical sector in its own right. Moreover, as outlined in Section 2.3, the sector is different from other sectors in many aspects, which calls for a careful consideration for trade-offs and unintended consequences of policy options.

When designing policies that are intended to boost the OSA in the banking sector and ensuring that EU/EEA market participants can benefit from having access to international capital markets, we should take into account sector-specific factors such as:

- The volume of capital flows and expertise to serve banking sector clients;
- The location of specialization in the EU and in 3rd countries;
- The benefits of reciprocal access between the EU and 3rd countries; and
- The level of alignment of core principles and practices between the EU and the "friend shores".

In simple terms, if the EU wants to reach strategic autonomy and economic security, it needs **strong, competitive banks** able to **finance sustainable and dynamic growth**. This happens at a time when more financing is needed to overcome geopolitical, environmental and digitalization challenges. At a time when growth is needed the most, the competitiveness of our banks and their ability to deliver for their clients should be a key goal of EU policies.

In the next three sub-sections, we go into more detail on how to boost the banking sector's contribution to OSA. We believe that this goal has three components:

- Boosting the competitiveness of the banking sector;
- Defining an external approach that takes into account the specificities of the sector; and
- Other policies that complement these policies.

3.2 Boosting the competitiveness of the banking sector

In addition to a sector-specific, nuanced approach advocated above, we also recommend that policies – both in the context of OSA and more generally – place due emphasis on the underlying international competitiveness of EU/EEA banks' business environment. While market access rules may be easy to change through EU decisions, the banking sector's global market share in the various segments of financial services is primarily shaped by the competitiveness of their business environment. Hence we need an approach that focuses on the underlying factors that drive competitive advantages and disadvantages for EU/EEA banks.

In our view, the best way of achieving this is by:

- **Making regulation more efficient in the EU (to lower the regulatory drivers of the cost of capital of EU/EEA banks & improve profitability);**
- **Embedding a "competitiveness test" in the EU's financial sector policies; and**
- **Reducing the fragmentation of the Single Market in financial services.**

It is suggested to initiate a high-level dialogue to formulate a shared vision for the future of the European sector as a key strategic actor, and to define concrete actions aimed at supporting the global competitiveness of the European financial sector. (Please see 3.2.2.)

3.2.1 Making regulation more efficient in the EU

The regulatory reform designed after the Global Financial Crisis, the implementation of which will be finalised at the end of the transitional arrangements of Basel III, has contributed to building up resilience in the European banking system. The prudential regulatory and supervisory framework is significantly more robust; however, it has grown too complex, an unintended consequence of the reform. Regulatory complexity brings about burdensome compliance and supervisory processes which constitute an important driver of inefficiency for banks. The excessive complexity of Level 1 and Level 2 regulation increases compliance costs, requires more resources than necessary from banks and supervisors, and undermines the understanding of investors.

The prudential regulation should be simplified going forward in the context of recovery of the European banks' competitiveness. At the EBF, we believe that there is room to reduce the regulatory complexity while keeping the same level of robustness.

A review of the framework is required to minimize the double counting and redundancies, eliminate inconsistencies and make the framework more efficient. This would maintain current levels of financial stability while simultaneously boosting investment activity (e.g. for the green and digital transformation) and further enhancing the role of banks as the beating heart of the economy.

While market valuations in the EU are generally lower for many different sectors (partially to be explained by the level of development of the EU capital markets), there are specific reasons for the valuation gap in the banking sector. These valuations are arguably conditioned by an extremely **complex regulation,** too complex to understand for the investors of banks (e.g. taxes, limits to dividend distributions). The **fragmentation of the EU banking market** does not help either.

As one important example of a regulatory area where the complexity might hamper business opportunities, **sustainable finance** will play a key role in banks' competitiveness and ability to get international business. A lot will depend on implementation, for example whether transition activities can be financed. The EBF advocates for a clear setup of transition pathways by economic sector and activity that can let banks assess the risk of every exposure and client, therefore assign capital in a commensurate manner with the backing of official benchmarks.

Separately, global convergence among taxonomies and sustainability reporting standards in various jurisdictions are essential to maintain EU leadership and competitiveness in sustainable finance and to avoid market fragmentation. The EU currently is in the lead of the development of a sustainable finance framework, but financial markets are global and therefore it is essential to achieve common ground and convergence to enable global capital flows and ensure level playing field for EU companies. The EU is to work closely with international authorities and standard setters.

The proposal and adoption of new sets of legislation targeting sustainable finance should be refrained. The new political cycle should carefully undertake an impact assessment of the legislation adopted to date, to assess whether it is contributing to the ultimate objective of the framework, which is to promote the financing of the transition of the economy.

3.2.2 Embedding a competitiveness test in the EU's financial sector policies

To achieve an open, strategically autonomous and prosperous economy, it is important to ensure that the **attractiveness** of EU financial markets (including Capital Markets) and the **competitiveness** of their participants remain a cornerstone of the EU's financial strategy. Attractiveness and competitiveness considerations need to be integrated into every aspect of the legislative work of the Union in relation to financial services and markets, to account for the diverse needs of EU/EEA investors and corporates to raise capital, invest and hedge risks. If one were to reflect this role in the regulatory and supervisory work of European authorities, one could better support the financial/ banking sector in its "enabler role", for example, by ensuring that, for each envisaged evolution of the regulatory framework, the impact on the attractiveness of EU financial services and capital markets and on the competitiveness of EU/EEA market participants is systematically assessed, alongside the current assessments of the impact on investor protection, financial stability and market integrity. To ensure that competing priorities are managed properly, a "Do Not Significantly Harm (DNSH) principle" could be applied, by reference to the principle applied for the green transition. It should be recalled that the European Economic and Social Committee proposed such a test in its answer to the CMU action plan.

Impact assessment undertaken for every single regulatory field should rest on three pillars:

- Ex ante impact assessment
- Ex post impact assessment, in order to know how the regulation works in reality and spot potential unintended consequences
- Cross-sectorial impact assessment in order to understand the impacts in other industries

Including considerations of attractiveness, competitiveness and growth as secondary statutory objective for selected European authorities (first and foremost the European Supervisory Authorities). It is noted that this approach has recently been adopted in the UK, for the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA).

3.2.3 Reducing the fragmentation of the Single Market in financial services (Banking Union and the Capital Markets Union)

An important factor for boosting competitiveness is the ability of financial sector participants to reach scale. Unfortunately, both the Banking Union and the Capital Markets Union fail to provide European actors with the full potential of the Single Market. That is why any attempt to boost the competitiveness of EU/EEA banks in the OSA context should also include efforts to complete these unions.

- **The completion of the Banking Union**

The establishment of the Banking Union is a significant achievement for the EU. However, the Banking Union is incomplete, with ongoing political and regulatory challenges that impede the development of cross-border banking business models. A key unaddressed aspect is the third pillar of the Banking Union. Simultaneously, resolving the home-host debate is crucial. Lack of progress in the third pillar of the BU – as well as the limitations on capital and liquidity movement within the Banking Union are a source of fragmentation and act as structural barriers to bank consolidation across the Eurozone and the development of a single capital market. Banks, as key players in capital markets, face restrictions that prevent them from operating freely across the Euro area. The banking sector still faces significant barriers due to the absence of liquidity waivers and the higher risk-weighted assets for cross-border subsidiaries. Recognizing the Banking Union as a single jurisdiction is essential for reducing

fragmentation and simplifying the existing overly complex framework. In a fully functional Banking Union, there should be no distinction between home and host supervisors, and "national bias" in regulation and supervision should be eliminated.

A complete Banking Union is therefore an important step in advancing a Single Market in financial services, that is likely to increase the investor base and therefore the access to funding of European companies, while at the same time allowing the free flow of funding. Such a unified market cannot be created without the support of non-bank financing, and this is why it is important to revamp the discussion of the Capital Markets Union (CMU).

- **The establishment of a strong Capital Markets Union**

Despite two European Commission action plans, EU capital markets remain both fragmented and underdeveloped. The lack of progress across both of these two dimensions prevents larger companies to lower their cost of capital, innovative firms to access risk capital, small and medium-sized enterprises to grow, and investors to access the full range of investment opportunities. As a result, the EU does not have the size or depth of a capital market commensurate with the size of its economy. As we have argued elsewhere, in order to integrate and to develop the EU's capital markets , the EU should renew its efforts to remove cross-border obstacles in the EU/EEA and encourage Member States to deepen their local markets through policies that grow the demand and supply of capital. A separate but related challenge is that the EU does not have the kind of securitization market that other developed markets have which act as a bridge between credit and capital markets. Overcoming the challenges mentioned above is relevant for the OSA debate as well, because the CMU is a crucial element for the long-term success of an EU strategy, reliant on a strong, integrated financial capital market as well as on a digital transition. By growing and unifying its capital markets, the EU will also become more attractive and open to foreign investors.

For this to happen, the CMU project must notably:

- **Be part of the priorities of the next Commission,** both in terms of the further removal of cross-border obstacles and development of national and regional markets;
- **Re-visit the policy on securitization in order to revive the EU securitization market**, which will act as a bridge between capital markets and credit, enable EU banks to free up capital and liquidity and provide new funding to the EU economy, especially for small scale investments that are needed. A genuine CMU would mean building a sufficiently large securitization market, allowing banks to raise liquidity and unlock additional lending.
- **Recognize the role of banks as important actors in the capital markets, namely through recognition of their role as service providers and intermediaries of issuers and investors**. By looking at other jurisdictions with stronger capital markets, such as the US and the UK, which have strong banks;
- **Support the promotion and strengthening of European emissions trading**.

3.3 Defining an external approach that takes into account the specificities of the sector

While the policies defined in 3.2 should boost the competitiveness of the EU/EEA banking sector, an internal-looking lens is not enough to enhance banks' ability to contribute to OSA. Like any EU sectoral policy, the external boundaries of the Single Market in financial services also carry an immense importance in determining its competitiveness. In fact, many components of the competitiveness of the

sector are intricately reliant on its access to capital and services worldwide and its ability to operate internationally.

By the terms "**the external boundaries of the Single Market in financial services"** we refer to the **terms under which** entities outside of the EU, and the EU-based entities, have access to each other's markets. In line with our points in section 2, we recommend a **sector-specific, nuanced approach which ensures both a level playing field** and adequate access to capital, expertise and business opportunities at the same time.

There are two different business scenarios to take into account: **outgoing** and **incoming** business:

- **Outgoing business** can be described as EU firms exporting financial services to the rest of the world. This happens both as a result of the expansion strategies of EU banks and also as a result of the underlying commercial business carried out by EU banks' corporate clients outside the EU. These strategies are in turn closely linked with OSA. The global dimension of the European private sector is critical for EU relevance in the world, both from an economic and geopolitical point of view.
- **Incoming business** can be described as firms based in 3rd countries, such as the US, UK, Switzerland and Japan, providing services into the EU. This reflects firms based in these third countries providing capital, investment and/ or expertise to EU financial sector firms or EU corporate clients or investors.

Clearly, there must be coherence and consistency of the principles underpinning these two scenarios. Rather than being isolated from each other, these two kinds of business often have commercial links either at the level of the financial sector counterparts or the clients served or both. More importantly, both kinds of interactions generate benefits for the EU/EEA economy which must be taken into account when looking for the right approach to the external boundaries of the EU Single Market in financial services, and therefore how OSA is applied to the banking sector.

Benefits can be summarized as follows:

- Looking at outgoing business, one sees other benefits. **Diversification and globalization** are fundamental pillars of many European companies that have expanded into Africa, Asia and Latin America. Cross-border investment favors diversification, which helps businesses to provide more stable results and be more resilient. Companies are powerful agents of European economic influence and soft power projection. They make a significant contribution to the local communities and real economy in the market where they operate by promoting economic growth, facilitating entrepreneurship, investment, and trade. **The international presence of EU/EEA banks plays a major role in helping EU/EEA companies expand to other regions across the world, supporting EU standing in the international context and ultimately making them more competitive and resilient.**
- Looking at incoming business, **having an open approach to cross-border financial services from the rest of the world provides the EU, its businesses and consumers with a broad range of service offerings from which market participants can choose**. This allows for increased competition and broadening of choice which, together, often lead to a price reduction of available services. Moreover, cross-border trade flows also contribute to the EU/EEA's deep and dynamic banking, financial and capital markets, which support investment in the rest of the economy. Capital and investment provided by firms based in 3rd countries, alongside those based in the EU, play an important role in helping the EU achieve many of its policy priorities which will require significant levels of capital and investment. The extent to which the EU can benefit from such cross-border

financial services trade heavily depends on the level of 3rd country financial services market access to the EU. More specifically, it depends on the ability of firms based in 3rd countries to provide services to clients in the EU, thus ensuring that market participants in the EU can access capital and investment from outside of the bloc.

However, there are **challenges** that must be faced when drawing the external borders.

For the outgoing business, again the benefits from helping international business of banks and their clients should be balanced against other needs such as the **level playing field** in the EU and **coherence** of the regulatory framework. Therefore, it may not be realistic to expect that EU banks' international business with non-EU entities is fully exempted from the rules applicable to EU/EEA clients, but it is also not desirable to have a full extra-territorial ambition. It is necessary to balance the need for a **comprehensive coverage** of rules with the need to take into account the **geographic specificities** of the business done by the 3rd country-based clients of EU banks.

For example, from a sustainability regulatory angle, it is important to acknowledge the different needs and starting points of developing countries when dealing with the green transition. The EU's sustainable finance framework, which was designed with the conditions of the EU in mind, and is not easy to implement even in the EU, is not well-adapted to the conditions (the economic activities, the financial sector infrastructure and ecosystem, capacities of the private sector and local counterparts) in most 3rd countries in the world. Applying the same regulatory scrutiny to this business of EU banks would endanger the competitiveness of European players against local peers who are not subject to the same requirements.

For the incoming business, the benefits of openness cannot justify unlimited access for any country. It must be ensured that any open approach taken is compatible with the **level playing field** between EU and non-EU financial actors, the **competitiveness** of EU financial actors or the **coherence of the EU regulatory environment** (i.e. for investor protection or market integrity). This means that determining the level of access of financial actors of non-EU 3rd countries to EU financial markets (and EU clients) will need to be linked to factors such as the level of consistency of the regulatory standards applicable in these 3rd countries and the nature of the mutual access between jurisdictions.

Prudential and resolution requirements stand as another example of areas in which European regulation is limiting the ability of European banks to conduct business in other jurisdictions. Finding the right approach would allow EU/EEA market participants (i.e. EU/EEA based businesses) to benefit as much as possible from capital and investment from 3rd countries.

Putting these two scenarios (incoming & outgoing business) together, we believe that **the external boundaries of the EU Single Market in financial services** should be drawn based on the following principles:

- **A transparent and predictable process:** It is important to establish a transparent, consistent and predictable EU equivalence regime. Indeed, it is in the interests of the EU to provide EU/EEA market participants with a system to support their strategic planning and long-term decision-making processes and strengthen their global competitiveness.
- **Recognizing shared approaches with "friendly shores":** As explained in section 2.3 and again in this current section above, there is a broad range of 3rd countries applying different approaches to financial services and their regulation. In this respect, it is important to acknowledge that, those countries that have similar regulatory and supervisory cultures, often applying a similar level of standards in terms of regulation, supervision and enforcement, do merit a different approach when access decisions are made, reflecting their closeness to the EU. This will enhance the positive

impact of such decisions, and ensure more scrutiny and the potential for more restrictions is focused on those 3rd countries that are farther away from the EU norms.

- **Assessing and considering the possibility of granting market access for specific and selected 3rd country institutions from friend-shoring jurisdictions, based on a lighter (but still material) equivalence regime.** Following on the point above, the alignment of key principles and values in the regulation and supervision of financials services between the EU and key "friendly shore" jurisdictions should be taken into account when designing market access and reciprocity arrangements, and could possibly be the basis for granting market access for certain institutions.
- **Providing for conditions to increase EU/EEA investors', issuers' and market participants' access to international capital markets and also the other way around (reciprocity).** For example, this goal could be achieved through further inter-operability for globally active banks, based, whenever available, on agreed global standards; targeted regulatory relief, and mutual recognition and reciprocal access.
- **Identifying and removing financial sector related barriers to European companies investing in 3rd countries.** This would increase competitiveness of EU-headquartered firms and enable key projects such as the European Commission Global Gateway, channeling investment to emerging and developing countries to support the green transition.
- **Recognizing the role firms based in third countries play, alongside those in the EU, in providing capital and financial services in general to the EU/EEA and market participants.** This would help to ensure that the EU/EEA households, companies and governments have access to the capital and financial services that they need (such as for the EU to achieve its twin transitions).
- **Avoiding unintended complications for EU companies:** We recommend a careful assessment of unintended consequences of the EU legislation in financial services on EU companies that are the clients of EU banks operating in 3rd countries. Potential extraterritorial impacts should be properly assessed in the drafting process of EU legislation. More precisely, both ex ante and ex post assessments of the impact of EU legislation on operations of EU businesses in 3rd countries should be carried out.

These principles should be helpful in balancing of the different objectives we outlined earlier in this section, and should help the EU maximize the advantages from cross-border financial services trade.

3.4 Other policies to remove obstacles and boost capacity

Other potential policies - which may require further investigation - are summarized below (and included in greater detail in Annex 2):

- **The establishment of a European safe asset** which would play a role in the European Union's capacity to finance its investment needs. Beyond the regulatory reforms needed for the CMU, European governments, as shareholders of the EIB, could also rely on this public bank to sponsor (in the form of a guarantee) a safe assets structure, which will have a AAA rating and will allow the attraction of investors to fund the purchase of securitized real estate loans originated in European countries. It would create a private reference asset classes and bolster the development of EU capital markets.
- **The strengthening of the international role of the Euro** through the use of the euro as a transaction currency voluntarily would be more preferable approach to current proposals focusing on mandating the use of the euro for invoicing imported goods.
- **The establishment of EU sovereignty over European Payments**. National solutions have to be protected as they could evolve towards a pan-European payment solution. A digital euro (on the central bank's balance sheet) is not necessarily needed to secure strategic autonomy – and

could even have the opposite effect on the EU banking sector's ability to contribute to OSA goals – if not properly designed.

- **The achievement of EU Digital Sovereignty.** We recommend giving customers the freedom to make decisions on the access and use of their data across sectors ; enabling the financial sector to reap the benefits of a horizontal data sharing framework and easily take up new technologies and develop digital innovation (AI, cloud, DLT, crypto assets) through a robust EU digital operational resilience framework (DORA); consistency with the international level, ensuring fair competition, reducing the prudential burden for the non-core business of regulated entities and adequately regulating new entrants; and regarding cyber risks, responsibilities to be shared among other participants/agents.

SECTION 4: CONCLUSION

In conclusion, the **banking sector should be a critical partner in the debate around OSA and market access** into and out of the EU. A nuanced, sector-specific approach that boosts the competitiveness of banks domestically, while also drawing the external boundaries of the sector in a way that optimizes its benefits, will ensure long-term solutions that enable the banking sector to both

- Efficiently intermediate the supply and demand of capital flows, needed by the EU economy and
- Contribute to the EU's OSA goals.

These contributions will be made possible by the banking sector being both a key enabler of OSA goals in others sectors which it finances, but also in its own right as a major employer and catalyst of a vibrant, innovative, value-creating economy.

ANNEX 1: STATE OF OPENNESS AND INTERCONNECTIVITY OF THE EU ECONOMY

The EU is the largest exporter and importer of services in the world. The importance of the EU's trade in services has grown significantly in the past decade, with the value of exports and imports of services equalling 13.2% of EU GDP in 2021. Taking extra and intra-EU trade in services together, the EU represented 30% of the world's trade in services in 2021.

- With a specific focus on financial interdependencies, the euro area is characterized by a high degree of financial openness (See Chart 29). Not only is the euro area more financially open than the US and China, but it is also more financially open than the average open advanced economy as shown in the chart 29 below (specifically panel a). Over the past decade external asset and liability positions have averaged almost 480% of GDP in the euro area, compared with 320% in the US and 170% in China.
- The euro area is also home to a number of investment hubs (Belgium, Ireland, Cyprus, Luxembourg, Malta the Netherlands, France and Germany) whose importance has increased since the global financial crisis.
- The EU's main FDI partners are other advanced economies, in particular the US, the UK and CH. Together, they account for almost 60% of EU inward and outward FDI stocks. FDI exposures between the EU and its main partners are concentrated in the services and manufacturing sectors. In particular, the financial services sector attracts the largest volumes of both inward and outward FDI positions (see chart 32).

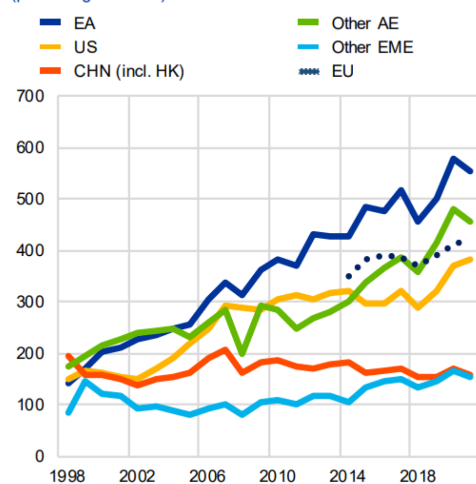
5

Chart 29

The euro area is more financially open than most of its partners and is home to major investment hubs

a) External financial asset and liability positions in the euro area and other major economies

(percentage of GDP)



b) External financial asset and liability positions in financial centres

(percentage of GDP)

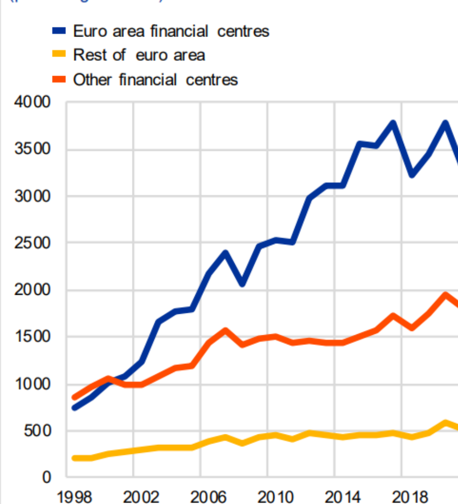


Chart 32

Inward and outward FDI positions, by sector of economic activity

(percentage of EU GDP, average stocks, 2015-19)

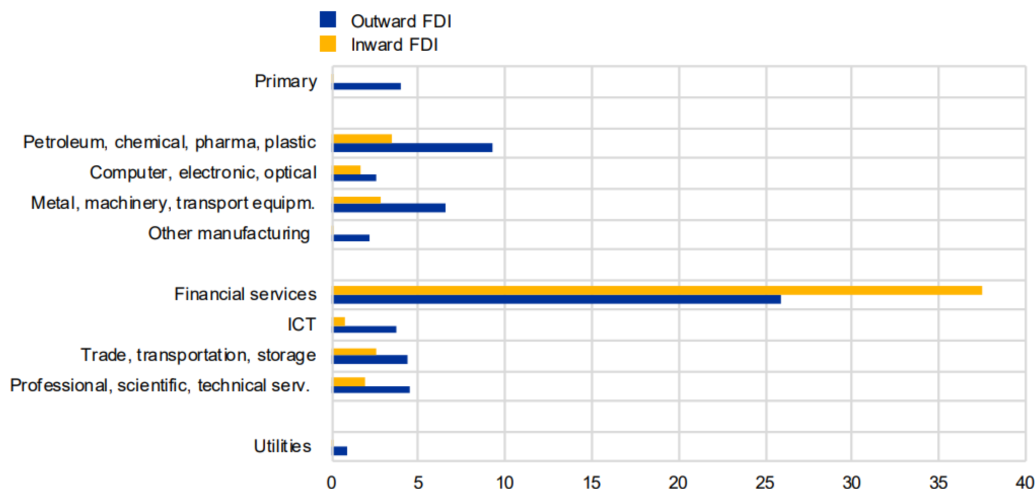
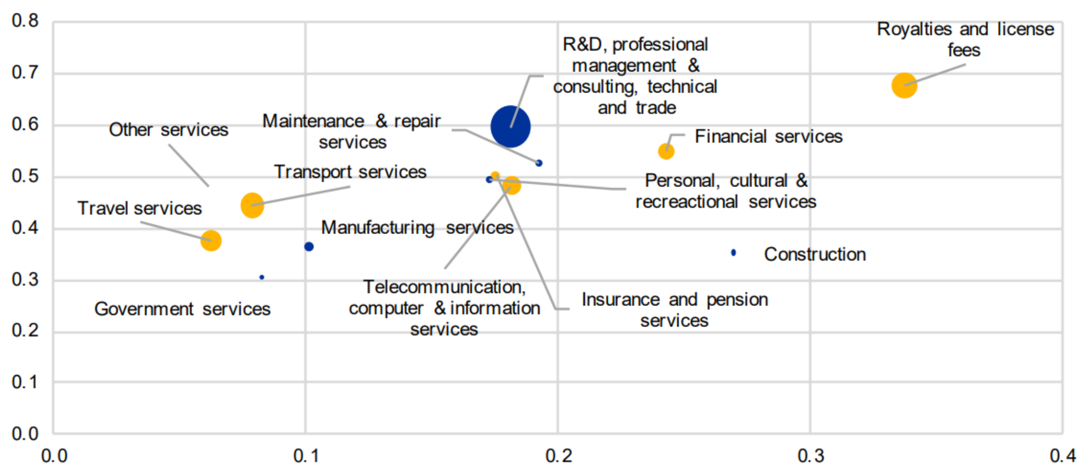


Chart 15

Concentration and scarcity of services imports in the EU (2019)

(x-axis: Herfindahl-Hirschman Index (CDI1); y-axis: scarcity of extra-EU imports (CDI2))



ANNEX 2: OTHER POLICIES

- **The strengthening of the international role of the Euro**. The international role of the Euro could be strengthened by setting positive incentives to the use of the euro as a transaction currency voluntarily. This could stand as a more preferable approach if compared to current proposals focusing on mandating the use of the euro for invoicing imported goods: indeed, the latter practice would likely increase transaction costs and make trade less efficient. A stronger international role of the Euro would also require the elimination of deficiencies in market depth, market volume and integration of EU financial and capital markets and the strengthening of potential growth and economic dynamism in the EU. This could be achieved through better economic policy coordination and by setting clear economic policy priorities for innovation and investment. In this way, the Euro would become more attractive as an investment currency and as a transaction currency.

- **The establishment of European Payments solutions**. Effective payment services are considered vital for the strength of the respective currency. As a result, sovereignty of payments has a direct impact on the economic sovereignty of the national economy and its public and private actors. In this sense, it is important to highlight that the different Member States have created their own national solutions. We are of the view that these national solutions have to be protected as they could evolve towards a pan-European payment solution. A digital euro (on the central bank's balance sheet) is not necessarily needed to secure strategic autonomy. A cross-border instant payment solution could probably handle this aspect just as well. Moreover, under certain circumstances (in particular if the deposit base of banks is undermined), the digital euro could even have the opposite effect on the EU banking sector's ability to contribute to OSA goals, if not properly designed.

- **The achievement of EU Digital Sovereignty.** EU digital sovereignty is vital to the ability of EU businesses and organizations to innovate. Equal considerations should be given to providers and users since the users of IT services and success-critical digital technologies depend on adequate competition among providers. Banks, as users of numerous IT services, have experienced this for years. It is therefore important to establish a competitive EU IT provider landscape, especially in the areas of cloud IT. This would be in support of the achievement of sovereignty over infrastructure which can only be achieved through strong EU expertise in the area of cybersecurity. The potential for data-driven innovation in all sectors of the economy is significant. The same applies for the financial sector. Financial institutions are already delivering new services, products and experiences to their customers and data is a key element for this. The sector has gone through the introduction of mandatory data sharing with third parties under the revised Payment Services Directive (PSD2), and organizations are still grappling with the lessons learned from this experience (e.g. the impact that a lack of incentives for all market participants has).What is now needed to see an opening up of interfaces in all industries, such as big tech, since promoting a cross-industry exchange of data is critical to European data sovereignty. This includes the freedom of customers to make decisions on the

storage, processing, access and use of their data at any time. Among other things, this will enable banks to better respond to customer needs and to modernize and thus significantly improve their risk management.

- In the wider digital context, the EU should enable its financial sector to reap the benefits of a horizontal data sharing framework and easily take up new technologies and develop digital innovation (AI, cloud, DLT, crypto assets). This should be done through a robust EU digital operational resilience framework (DORA).
- In order to enable the Digital Transformation of the financial services industry, EU authorities need to ensure that the regulatory framework for EU financial services is consistent at international level, ensures fair competition, reduces the prudential burden for the non-core business of regulated entities and to adequately regulates new entrants.
- Regarding cyber risks, differently from what happens today, responsibilities should be shared among other participants/agents.

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[i] The EU recognizes the significant amount of resource that will be required to fund these transitions. For instance, according to the Commission,[i] additional annual investments of over €620 billion will be required to meet the Green Deal and RepowerEU objectives. Furthermore, it said that by far the greatest part of this would have to come from private funding. Given this, we believe that the EU having access to capital and investment provided by firms in third countries is important, as they, alongside the EU based financial sector, can play an important role in funding the transition and helping the EU achieve its objectives in this area. Yet, there is a risk that the current approach to OSA in the financial sector could make this more difficult, as third country market access in financial services is reduced.

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