François Villeroy de Galhau: The consequences of Brexit for the French and European financial sectors

Speech by Mr François Villeroy de Galhau, Governor of the Bank of France and Chairman of the Autorité de contrôle prudentiel et de resolution (ACPR), at the ACPR conference, Paris, 23 November 2018.

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Ladies and gentlemen,

I am delighted to welcome you along with Bernard Delas to this new conference organised by the ACPR, which this morning will focus on the consequences of Brexit for the financial sector. This issue is admittedly constantly evolving in line with current events... I welcome the agreement that was reached between the European negotiators and their British counterparts last week and we all hope that it will pass through the stages to come and ultimately be finalised. However, in a context that remains uncertain, we must be cautious: even if we hope to avoid it, we must also be ready for a possible no deal scenario. The ACPR and the Banque de France are preparing for this eventuality to ensure the smooth functioning of the financial system. That will be my first point and for that reason I will discuss it using the conditional. I would then like to look beyond Brexit to see how we can transform some of today's difficulties into opportunities for the future and build a more integrated "financial Eurosystem".

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I. In the short term, effectively manage the risks of Brexit

As part of their tasks, the ACPR and the Banque de France closely monitor two main types of risk associated with the prospect of Brexit: those that could threaten financial stability and those that could undermine customer protection. It is important to avoid the cliff-edge that would arise from a No Deal Brexit. The economic consequences would naturally be far more serious for the United Kingdom than for the rest of the European Union. At this stage, our analysis, like that of the ECB, which as you know jointly carried out an in-depth technical study with the Bank of England, has not identified any major risks to financial stability. In the words of Mr Draghi: "It would really take an extraordinary amount of lack of preparation to materialise the financial stability risks that might come from a hard Brexit.[1] The clearing of interest rate derivatives nevertheless deserves particular attention, as the UK clearing houses have a virtual monopoly in the sector. In the event of a No Deal Brexit and without taking any specific measures, this could represent a systemic risk. Therefore, should it unfortunately be necessary, we support the solution adopted by the European Commission to temporarily recognise the equivalence of the UK legislative framework under EMIR 1 and to authorise the United Kingdom's clearing houses to continue providing clearing services to European financial institutions until EMIR 2 comes into effect. But this would obviously have to be a temporary solution, for a period of no more than a year or so, and would also have to be tied to a strict timetable for the adoption of EMIR 2. We now hope that the European institutions manage to finalise this "security clause" as soon as possible.

Our primary focus of attention today would then concern the protection of customers that have taken out contracts with UK firms, particularly in the insurance sector. It is of course the responsibility of the insurance industry itself to actively prepare for the consequences associated with the loss of EU passporting rights. And the majority of the major players have taken the necessary steps. Some of them have already been granted authorisations by the ACPR which is also currently assisting more than 50 institutions from all sectors with the relocation of their activities. But we are keeping an especially close eye on the small and medium-sized players, particularly the smaller investment firms, as well as electronic money and payment institutions.

An ACPR study conducted in July 2018 found that only 24% of investment firms and 22% of electronic money and payment institutions operating under the freedom to provide services regime wished to obtain authorisation by the end of 2018.

We must therefore be ready to deal with situations where UK firms may not have already transferred their activities. In this respect, it would clearly be preferable to have European legislation to ensure that every relevant issue is dealt with in a harmonised manner. However, if need be, and as a backstop, the enabling legislation adopted by the Senate and coming before the National Assembly on 10 and 11 December would allow us to take the steps in France to secure legal protection for households and companies. We would therefore suggest the introduction of a tailored transition regime that, for the run-off management of contracts, allows UK firms to continue the activities they initiated under the European passport, provided that they submit a liquidation plan to the ACPR. We hope that these transitional rules will be incorporated into the ordinances and that they will confer similar powers to those existing under EU passporting rights upon the ACPR. This would be the trade-off for the continuity thus provided.

II. Beyond Brexit, building a financial Eurosystem

Clearly, Brexit is, and will remain, bad news not only for the United Kingdom, but for Europe as well. But to a certain extent it can also represent an opportunity to restructure the European financial system. We have an effective monetary Eurosystem consisting of the ECB and the 19 national central banks; we have the legal framework for a single financial market and – in part – a Banking Union; we have an exceptional savings capacity – one of the highest in the world – with an annual flow of EUR 400 billion in euro area financial savings in the second quarter of 2018.[2] However, as yet we do not have a "financial Eurosystem", made up of stronger and pan-European financial institutions and shared market infrastructures. Let's be clear: there will not be a single City for the continent, but rather an integrated polycentric network of financial centres, with specialisations based on areas of expertise. A polycentric system of this nature can function, as illustrated by the United States: New York's financial centre is favoured by corporate and investment banks, Chicago's financial centre handles futures, while Boston specialises in asset management.

Paris is well qualified to become the "market hub" of this new European constellation. Our capital hosts four of the euro area's eight global systemically important banks, the top life and non-life insurance sector and asset management industry, one of the leading bond markets and the largest continental commercial paper market with NEU-CP. It is also the biggest private equity investor in continental Europe. In addition, the French financial authorities, including the Banque de France and the ACPR, are working together to facilitate the dissemination of sound and safe financial innovations and to foster the scaling up of sustainable finance. Moreover, Paris offers the leading source of highly qualified financial services personnel. Consequently, many global banks have already decided to transfer the majority of their market activities to Paris.

This new system will require a single rulebook implemented in a harmonised manner. And we are close to achieving it in the banking sector, but we are not quite there in the insurance sector. It is thus necessary to further strengthen the role of the European supervisory authorities, and France supports – although it remains a little too alone in doing so – the Commission's proposed reform of the ESAs. For example, EIOPA must be allowed to create, at its own initiative, cooperation platforms to better supervise entities whose activities mainly involve cross-border transactions performed under the freedom to provide services regime. EIOPA's role as a neutral mediator in the internal model approval process at group level must also be reinforced, without giving it direct power in the approval process, which would undermine its neutrality.

This “financial Eurosystem” will also require shared infrastructures within the Union capable of offering services beyond the confines of the euro area: examples such as T2S and TIPS, the new interbank instant payment settlement system, both multi-currency services, show us that it is possible. We must also deal with the question of private monopolies in the clearing sector. We must ensure that critical key players do not become “too big to fail”. Of course, by its very nature clearing is an activity that generates major economies of scale, and thus encourages concentration. But greater competition is absolutely necessary to stimulate financial innovation. Fortunately, LCH SA will centralise repo transactions at the beginning of 2019. More generally, we would like to see the development in Paris of an enhanced and extended clearing services offering in the area of interest rate derivatives.

More broadly, Brexit represents an opportunity for Europe to effectively transform its own savings, in order to enhance its ability to finance the real economy: what I call the Financing Union for Investment and Innovation. This involves better steering the euro area’s abundant savings to absorb shocks within the euro area more effectively and to meet investment and innovation needs in fields such as digital technology, energy transition and the equity financing of SMEs. In practice, the creation of a true Financing Union requires the acceleration of the Capital Markets Union and the completion of the Banking Union. The second pillar on the resolution of failing banks is more important still than a possible common deposit guarantee scheme. And it is essential to remove barriers for pan-European banks. This was the policy agenda of the Franco-German declaration in Meseberg in June 2018: but I insist on the urgent need to make it a reality today. The response to Brexit should be the economic and financial strengthening of the euro area: if we remained mired in technical nit-picking with self-satisfaction from some, disparagement from others, and distrust on all sides, we would not only have missed an opportunity, we would, collectively, have failed in our duty.

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I would like to conclude on that note. The unity demonstrated by the EU27 in their Brexit position, behind their negotiator, Michel Barnier, who has done a remarkable job, has been impressive. And everyone now better appreciates – at least in the sense of what they would miss – all the advantages offered by our Europe and our common market. This political desire to “protect” must now unfold into an ambition to “construct”, to build a more effective Europe. Thank you for your attention.

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[1] European Central Bank press conference, 25 October 2018.

[2] Four-quarter cumulative flows.