François Villeroy de Galhau: How to develop a "financial Eurosystem" post-Brexit

Closing remarks by Mr François Villeroy de Galhau, Governor of the Bank of France, at theEurofi High Level Seminar 2019, Bucharest, 5 April 2019.

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Ladies and Gentlemen,

It is a pleasure to be in Bucharest today to conclude this Eurofi High Level Seminar. I am grateful to D. Wright and D. Cahen for offering me the opportunity to give this keynote speech... but perhaps less grateful about the theme they asked me to address: "Opportunities for developing EU autonomy in the financial area post-Brexit". We are still faced with great uncertainties, and Brexit is and remains bad news, not only for the United Kingdom, but also for Europe. This unchartered territory has nevertheless the merit of making one thing very clear: it costs dearly to leave the single market. So we are still hoping for the best, but we have to prepare for the worst: a no-deal Brexit and all the risks it implies. This will be my first point today. Then, your theme obliges us to look ahead, beyond Brexit: Europeans should use the demands created by the current context to build a more integrated "financial Eurosystem", and add some pillars to Europe's financial sovereignty.

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I. Preparing for the risks

It has been – first and foremost – the responsibility of the financial industry itself to prepare for the consequences of Brexit, starting with the loss of EU passporting rights. Supervisors both at national and European levels have encouraged and monitored the implementation of contingency plans. Up until now, most major players have taken the necessary steps, but some concerns linger regarding the preparedness level of the smaller players, particularly electronic money and payment institutions. On the other hand, public measures have been taken to deal with the specific risks of a no-deal Brexit that could threaten financial stability or consumer protection. The temporary and conditional recognition of British CCPs should prevent cliff-edge effects, as well as temporary waivers on mandatory clearing and bilateral margin exchange for a limited category of products. Member states have also adapted their domestic regulations or are planning to do so. In France, legislation has been enacted ensuring contract continuity for cross border activities and an extended access to UK settlement systems.

II. Building a financial Eurosystem

Let me now turn to the heart of my topic. The unfortunate reality is that Brexit leaves us no other choice: we must now reshape the European financial system and develop its autonomy. The euro area can already build on strong assets: an effective monetary Eurosystem, the legal framework for a single financial market and essential components of a Banking Union. However we do not, as yet, have a "financial Eurosystem", made up of stronger pan-European financial institutions and market infrastructure. 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.

Starting with the **Banking Union**, its success depends on the completion of a robust resolution mechanism, probably even more than a full common deposit insurance scheme. Regarding the backstop of the Single Resolution Fund, in the interests of financial stability, we should consider

extending the maturities on the credit lines. But we will not achieve an effective and profitable Banking Union without cross-border consolidation in Europe: there are still too many roadblocks and not enough cross-border restructuring. Compared to the US market, the European banking sector remains fragmented: the market share of the top 5 European banks amounts to 20%, compared to more than 40% in the US. So we should aim to create a “single banking market”, as recently proposed by Annegret Kramp-Karrenbauer, where genuine pan European banking groups could operate more effectively and better face foreign competition. On top of that, banking integration makes banks more resilient as it reduces their exposure to asymmetric shocks which leads to enhanced risk-sharing and a better allocation of resources. A useful step towards forming genuine pan-European banking groups could be to lower capital requirements of European subsidiaries, while safeguarding their financial position through credible cross-border guarantees provided by the parent company, which could be triggered both in normal times and in crisis situations. This would be based on European Union law and enforced by European Union authorities.

I add the obvious, on bank regulation: it is now desirable that we stabilise visibility on total capital requirements, adding up from various origins. The smooth transposition of Basel 3 is part of this clarification, including the implementation of the output floor only at consolidated level within the European Union: if not, we will have introduced a new obstacle to cross-border activities within Europe.

Together with the Banking Union, a genuine **Capital Markets Union (CMU)** is essential to strengthening financial integration in Europe: we advocated it strongly with Jens Weidmann, President of the Bundesbank, in a joint paper published yesterday, and it will be a key topic of today’s informal Ecofin, thanks to the Romanian Presidency. Despite some recent achievements, progress on this topic is proving difficult and slow. Let us finally move on from a rhetorical consensus in principle to concrete headways, notably on instruments, access to finance for SMEs, and supervision.

In this respect, I welcome the progress achieved on a Pan-European Personal Pension Product (PEPP): this product is portable across member states and offers consumers a wider range of investment opportunities. We should also make progress towards the harmonisation of insolvency regimes. It should facilitate cross-border investment.

One of the most challenging issues of the CMU is to provide cheaper and easier access to equity for SMEs in order to support their growth. Equity financing is a key driver of innovation: it is better suited to the uncertainty and offers long-term returns associated with innovative projects. The euro area is seriously lagging behind in this respect: equity only accounts for 80% of GDP, compared with 122% in the United States.

Integrated capital markets also require effective supervision. Here again, milestones have been reached thanks to the outcome of the recent review of ESAs towards enhancing their role. Concerning the supervision of financial markets, ESMA will as a first step contribute to furthering convergence of supervisory practices. Yet in the longer run, the scope of its direct supervisory powers should be expanded starting with the supervision of wholesale markets. Regarding the insurance sector, a particular attention was paid to strengthening the supervision of cross-border activities through EIOPA. I welcome also the enhanced EBA role on AML-CFT issues, an area where progress in the European framework is absolutely needed.

Finally, the Capital Markets Union needs robust market infrastructure. Thanks to EMIR II, Europe has given itself powers – via ESMA – to directly supervise **third country** CCPs which have a systemic footprint vis-à-vis the EU. This being said, EMIR II is not the end of our journey. Much more needs to be done regarding either the role of the ECB or ESMA’s prerogatives over **EU CCPs**.

Both the Banking Union and the Capital Markets Union are the key components of what we call with Jens Weidmann a genuine “Financing Union for Investment and Innovation”: this idea is a way of better channeling our abundant resources – our EUR 340 billion savings surplus in 2018 – towards the concrete needs of the European economy: the energy transition, SMEs’ equity or digital innovation. This unified branding has the merit of highlighting the purposes of this Union to the general public: investment and innovation, or in other words the financing of the future.

III. Some pillars of a European financial sovereignty

In the longer run, we should build three key pillars of the future European financial sovereignty. First of all, the EU needs to strengthen its position as rule maker through enhanced **equivalence regimes.** Brexit has given new momentum to this topic: a comprehensive reassessment of current equivalence regimes is essential given the scope of the relationships between the EU and the UK. Beyond the issue of Brexit, the review of equivalence regimes also provides an opportunity to improve them. There is a need for greater transparency in the procedure for granting equivalences, within a comprehensive institutional framework. The monitoring and control of equivalence decisions could also be improved by granting more power to ESAs, and by providing the European Commission with more gradual options through flexible tools in the case of regulatory divergence: for example, temporary, partial or conditional lifting of equivalences.

The second pillar of European financial sovereignty concerns the efficiency of **retail payments and market infrastructure**. Regarding retail payments, while the Single Euro Payments Area (SEPA) has proved to be successful, further convergence is still needed in response to the growing influence of major third countries’ firms in payments solutions. In order to preserve our sovereignty, a European strategy for retail payments would be necessary, with a view to (i) addressing market fragmentation and promoting unified European-based solutions, (ii) improving the protection of payment data and (iii) encouraging European players to take part in the current concentration in retail payments. Regarding infrastructure, the European System of Central Banks shouldered its responsibilities in strengthening European post-trade integration, notably through the Target2Securities platform. In the coming years, the set-up of a unified collateral management platform operated by the Eurosystem will be another key step directly contributing to an effective Capital Markets Union.

Moving on to the third pillar, the **international role of the euro** is a key component of our European financial sovereignty. After a significant rise, the international use of the euro has declined since the financial crises of 2008–2012 and remains limited in comparison with the dollar. The US dollar is a clear advantage in the exercise of American power, while China cares about the internationalisation of the renminbi. A larger use of the euro would help to protect our businesses against foreign exchange risks or legal disputes abroad. In this regard, the concrete measures identified by the European Commission in December are particularly relevant. The development of fully unified European instant payment systems, integrated capital markets, and the possible creation of a safe euro-denominated asset should among others contribute to the international expansion of the euro.

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At this critical time, let me conclude with verses from *Othello*: “To mourn a mischief that is past and gone is the next way to draw new mischief on”. In modern English it means: “when you lament something bad that’s already happened, you’re setting yourself up for more bad news.” Making the best of such a misfortune as Brexit is the surest way to overcome it. Our collective response to Brexit should be the further integration of Europe: if we remained mired in technical nit-picking with self-satisfaction in some quarters and attacks from others, and distrust on all sides, we would not only have missed an opportunity, we would, collectively, have failed in our duty. Thank you for your attention.