REBUILD

Working Paper

Financial Union

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Abstract

This Chapter elaborates on the rationale and contours of a European Financial Union. It examines the main measures taken in the banking and financial sectors during the pandemic and discusses the state of play of Banking Union and Capital Markets Union and the challenges lying ahead to reach a European Financial Union. Banks mitigated the impact of the pandemic through increased lending – which was facilitated by supervisory and regulatory flexibility. Financial markets were relied upon since the start of the pandemic after monetary policy interventions, and in the EU recovery. The chapter argues that is essential to complete the Banking Union and develop the Capital Markets Union at the core of the Financial Union, for two main reasons: first, to raise and allocate resources efficiently in the real economy, and second, to enable the green, digital, and social transitions (economic and social policies). In this regard, NGEU measures and related policies boost the Financial Union as an even more compelling and pressing EU policy priority.

Keywords: Financial Union, Banking Union, Capital Markets Union, NGEU, markets, funding

1. Introduction

The state of the EU's economy after the Covid-19 pandemic is well illustrated by two elements, i.e. the debt issuances and the reliance on the banking sector. Firstly, the EU will soon become the fifth largest debt issuer in the EU,[2] as the debt of the EU will reach nearly 900 billion euros by the end of 2026 (combining the EU recovery programmes, green investments, and Ukraine's support). However, the bonds are not as attractive as Member States' bonds for a number of reasons. The supply of bonds remains insufficient to trade, which makes them less liquid, and increases their price. The development and deepening of markets are therefore essential to improve liquidity and make the supply attractive for investors, and channel funding to key EU policies for the next generations. Secondly, the banking sector was used countercyclically during the Covid-19 pandemic, providing a shock absorption function. Contrary to the global financial crisis, banks did not represent the problem but part of the solution to support the economic recovery, with much larger capital

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[2] Ian Johnston and Mary McDougall, 'EU Becomes "Real Player" in Debt Markets but Faces Investor Scepticism' *Financial Times* (12 October 2023) <https://www.ft.com/content/85ed3082-483a-4637-b755-41844ed0c95f> accessed 12 October 2023.

and liquidity buffers when the Covid-19 crisis unravelled.[3] Banks were further enticed to provide their critical functions to the real economy through the ease of prudential requirements and mitigation measures adopted by the European Central Bank (ECB) in its prudential supervision competence.[4]

This Chapter elaborates on the rationale and contours of a European Financial Union. It examines the main measures taken in the banking and financial sectors during the pandemic and discusses the state of play of Banking Union and Capital Markets Union and the challenges lying ahead to reach a European Financial Union. This introductory section gives a first glimpse at each element.

A European Financial Union remains a heavily incomplete project despite its political conception in the 2015 Five Presidents' Report to complete the Economic and Monetary Union (EMU).[5] While the Banking Union (BU) has been a reality for ten years, the EU still lacks a proper functioning Capital Markets Union (CMU),[6] authorities with further responsibilities and powers at EU level for financial supervision, and a fully harmonised regulatory framework.[7] Despite a major achievement with the BU to build a 'genuine' EMU, there is little progress in market integration with fragmented markets along national lines. In other words, ten years after the establishment of BU and several decades of free movement of capital, we cannot benefit from a European integrated banking market nor European financial markets. We still observe a home bias in investors' portfolios, a domestic bank-sovereign dependence, and different funding costs across the euro area.[8]

The measures taken during the pandemic have been instrumental to allow the EU's economy to rely on the banking and financial sectors. On the banking side, these included not only capital relief, liquidity and operational measures but also supervisory flexibility and soft

[3] EBA, 'Thematic Note - Preliminary Analysis of Impact of COVID-19 on EU Banks EBA/REP/2020/17' 5 <https://www.eba.europa.eu/sites/default/files/document_library/Risk%20Analysis%20and%20Data/Risk%20Assessment%20Reports/2020/Thematic%20notes/883986/Thematic%20note%20-%20Preliminary%20analysis%20of%20impact%20of%20COVID-19%20on%20EU%20banks%20%E2%80%93%20May%202020.pdf> accessed 5 February 2024.

[4] Andrea Enria, 'Flexibility in Supervision: How ECB Banking Supervision Is Contributing to Fighting the Economic Fallout from the Coronavirus' (*ECB Banking Supervision*, 27 March 2020) <https://www.bankingsupervision.europa.eu/press/blog/2020/html/ssm.blog200327~abd2a8244b.en.html> accessed 1 April 2020.

[5] Jean-Claude Juncker and others, 'Completing Europe's Economic and Monetary Union' (2015) 10–2 <https://www.ecb.europa.eu/pub/pdf/other/5presidentsreport.en.pdf>; Emmanuel Mourlon-Druol, 'History of an Incomplete EMU' in Fabian Amtenbrink, Christoph Herrmann and René Repasi (eds), *The EU Law of Economic and Monetary Union* (Oxford University Press 2020) <https://oxford.universitypressscholarship.com/10.1093/oso/9780198793748.001.0001/isbn-9780198793748-book-part-3> accessed 29 July 2021.

[6] See parts III and IV in Federico Fabbrini and Marco Ventoruzzo (eds), *Research Handbook on EU Economic Law* (Edward Elgar Publishing 2019); Paul Craig and Menelaos Markakis, 'EMU Reform', *EMU Reform* (Oxford University Press 2020) 1428–36 <https://oxford.universitypressscholarship.com/10.1093/oso/9780198793748.001.0001/isbn-9780198793748-book-part-51> accessed 29 July 2021; IMF, 'Background Note on CMU for Eurogroup' <https://www.imf.org/-/media/Files/News/Speech/2023/imf-background-note-on-cmu-for-eurogroup.ashx>.

[7] Juncker and others (n 4) 10–2.

[8] Spanish and Italian businesses with higher funding costs than German and French, see European Council, 'The Future of European Capital and Financial Markets' (19 October 2023) <https://www.consilium.europa.eu/en/policies/future-of-eu-capital-markets/> accessed 10 January 2024.

measures to restrict dividend distributions.[9] In particular, the new terms of the ECB Targeted longer-term refinancing operations (TLTROs) III provided long term funding to banks at attractive conditions to support credit supply. Moreover, capital and financial markets had a fundamental role after the quick activation of unprecedented monetary policy measures by the ECB, and other major central banks, in terms of assets purchases programmes first with the extension of the existing Assets Purchase Programme, and then, under the Pandemic Emergency Purchase Programme (PEPP).[10] The bond's issuances from the European Commission to finance the recovery plan and the approved 27 NRRPs in grants and (where applicable) in loans also relied upon markets, including a substantial part of NGEU Green Bonds.[11]

I argue that the compelling necessity for a Financial Union has been boosted by the NGEU framework. It is paramount for the EU and its Member States to raise and allocate public and private resources to public policies, such as the ones prioritised under NGEU, and sustained in the long run for the next generations. A Financial Union would level the playing field across the financial and banking sectors and help channel Europeans' savings into the real economy, insofar as 'EU's stock market capitalisation is less than half that of the United States, in percentage of GDP, and also lower than that of Japan, China and the United Kingdom'.[12] This illustrates the EU economy does not rely enough on financial markets. Though, financial and capital markets can be used to channel private and public funding, by offering competitive and diversified sources of investment and funding. Their functioning and Union-wide existence will support investment, innovation, which will ultimately contribute to European growth and competitiveness by boosting the EU's position as an investment location, and its real economy.

This Chapter is structured as follows. Section 2 frames the contours of the Financial Union by using an economic approach and examining the main EU policy proposals put forward after the financial crisis. Section 3 discusses the roles of banks and financial markets during the Covid-19 pandemic and examines the supervisory and regulatory measures to rely on them and handle market volatility. Section 4 examines the state of play of the BU and CMU and the main challenges ahead and rationale to reach a European Financial Union. Section 5 concludes.

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[9] Andrea Enria, 'How European Banking Supervision Can Help Fight the Economic Consequences of the Coronavirus Outbreak in Europe' (*ECB Banking Supervision*, 1 April 2020) <https://www.bankingsupervision.europa.eu/press/interviews/date/2020/html/ssm.in200401~c19a2ad1ed.en.html> accessed 4 February 2024; Giovanni Bassani, 'Of Viruses, Economic Crises and Banks: The European Banking Union and the Response to Covid-19' (2021) 32 European Business Law Review <https://kluwerlawonline.com/api/Product/CitationPDFURL?file=Journals\EULR\EULR2021016.pdf> accessed 4 February 2024; Brunella Bruno and Filippo de Marco, 'European Banks' Response to COVID-19 "Quick Fix" Regulation and Other Measures' (2021) PE 695.460 Study requested by the ECON Committee; Antonella Sciarrone Alibrandi and Claudio Frigeni, '12. Restriction for Bank Capital Remuneration in the Pandemic: A Lesson for the Future or an Outright Extraordinary Measure?' in Christos V Gortsos and Wolf-Georg Ringe (eds), *Financial Stability amidst the Pandemic Crisis: On Top of the Wave* (European Banking Institute 2021).

[10] See Chapter 3 in this volume.

[11] See Chapter 21 in this volume.

[12] European Council Press release, '"Channeling Europe's Savings into Growth" - Op-Ed Article by European Council, European Commission, Eurogroup, ECB and EIB Presidents' (9 March 2023) <https://www.consilium.europa.eu/en/press/press-releases/2023/03/09/channeling-europe-s-savings-into-growth-op-ed-article-by-european-council-european-commission-eurogroup-ecb-and-eib-presidents/> accessed 10 March 2023.

2. Contours of the EU Financial Union: *economic approach and EMU grounding*

The Financial Union designates a specific economic approach and understanding of the interplay of the real economy with the banking, capital and financial markets, and a view on what public and private capital can do to support public (economic) policies, in particular with the transitions. This subsection shortly describes the economic rationale behind the Financial Union, and the key institutional creations (and reforms), which are at its core.

From an economic approach, a working Financial Union (with integrated markets and single banking and financial systems) would facilitate monetary policy transmission and preserve the singleness of the currency (i.e., the depositors' confidence in the public money function).[13] Moreover, the EU is a bank-based economy, which relies on banks as providers of liquidity and credit, and not so much non-bank financial institutions.[14] The EU economy needs to rely more on capital and financial markets while keeping risks monitored and managed, in the direct line of the policy proposals put forward since the global financial crisis (GFC). Beyond the distinction between bank-based and market-based financing, shadow banking has developed after the GFC in an attempt to circumvent newly adopted banking regulation. However shadow banking has been progressively more regulated[15] but remains under an imperfect patchwork of supervisory and regulatory frameworks, despite warnings from the central banking and supervisory community.[16] It is a pressing challenge for the future Financial Union as discussed in section 4.

Since the GFC, major institutional and regulatory reforms aimed at ensuring risks taken by banks and financial institutions are better controlled, assessed and managed. This significant shift led to a new European supervisory architecture created under a sectoral supervisory model with three European Supervisory Authorities (ESAs) and the European Systemic Risk Board (ESRB), which altogether belong to the European System of Financial Supervision (ESFS).[17] This internal market-wide system already existed when the BU was first announced politically as a building block to reach a 'genuine' EMU.[18] The inception of the BU[19]

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[13] Juncker and others (n 4) 11.

[14] In contrast, the US is a market-based economy Joost V Bats and Aerdt CFJ Houben, 'Bank-Based versus Market-Based Financing: Implications for Systemic Risk' (2020) 114 Journal of Banking & Finance 105776.

[15] Agasha Mugasha, 'Securing Effective Regulation of the Shadow Banking System' (2018) 29 European Business Law Review 497.

[16] Andrea Enria, 'The Role of Banks in Mitigating Systemic Risks Arising in the Non-Bank Financial Sector' (ECB conference on counterparty credit risk, Frankfurt am Main, 20 June 2023) <https://www.bankingsupervision.europa.eu/press/speeches/date/2023/html/ssm.sp230620~ecce24f124.en.html> accessed 10 January 2024.

[17] Jennifer Payne, 'The Institutional Design of Financial Supervision and Financial Stability' in Fabian Amtenbrink and Christoph Herrmann (eds), *EU Law of Economic & Monetary Union* (Oxford University Press 2020); Sophie Vuarlot-Dignac and Eugenia Siracusa, 'The European System of Financial Supervision and in Particular the European Securities and Markets Authority' in Federico Fabbrini and Marco Ventoruzzo (eds), *Research Handbook on EU Economic Law* (Edward Elgar Publishing 2019).

[18] Herman Van Rompuy and others, 'Towards a Genuine Economic and Monetary Union - Four Presidents' Report' (2012).

[19] Pedro Gustavo Teixeira, *The Legal History of the European Banking Union: How European Law Led to the Supranational Integration of the Single Financial Market* (Hart Publishing, an imprint of Bloomsbury Publishing, 2020); Danny Busch and Guido Ferrarini (eds), *European Banking Union* (Second edition, Oxford University Press 2020); Dalvinder Singh, *European Cross-Border Banking and Banking Supervision* (Oxford University Press 2020); Christy Ann Petit, 'Differentiated Governance in the Banking Union: Single Mechanisms, Joint Teams, and Opting-Ins' (2022) 2022 7 European Papers - A Journal on Law and Integration 889; see Part III in Federico Fabbrini and Marco Ventoruzzo (n 5).

followed the ESFS, with the creation of the first pillar the Single Supervisory Mechanism (SSM) in 2014, and the second pillar the Single Resolution Mechanism (SRM) in 2015. However, it remains incomplete, and with several shortcomings in the resolution framework, and a non-existing third pillar – the European Deposit and Insurance Scheme (EDIS).

The CMU initiative launched in 2015 targets not only capital and financial markets, but also company reporting and auditing.[20] CMU has its foundations in the Single Market for Capital but remains, for now, inexistent and was part of the European leaders' rhetoric to complete the EMU post-financial crisis.[21] Brexit had a dual effect on the CMU project – slowing it down first before rebooting it – with the City of London outside of the EU regulatory and supervisory frameworks.[22] As will be discussed below, the post-pandemic recovery shows the fundamental role of the markets for financing the green and digital transitions. In the real economy, financial markets are used for savings, credits, holding cash, which leads to increasingly marginalise the banking sector. It is a trend at the international level, which reaches the EU. Nearly half of global financial assets are held by non-bank financial institutions (NBFIs), therefore outside the banking system[23] with its shortfalls in terms of prudential regulation and supervision (see section 4). The EU economy could rely more on capital and financial markets with the appropriate regulatory and supervisory framework. The integration of bond and equity markets would favour cross-border (private) risk-sharing in the EU, also ensuring a shock absorption function.[24]

The ESFS has evolved since its creation in 2011, with more powers for EBA and ESMA (see also section 4), but it remains far away from an integrated system of supervision,[25] applying (not fully) harmonised regulation. Right before the pandemic, the review of the ESAs strengthened supervisory convergence in 2019 but it represented limited progress, following incremental changes.[26] While we observed a further centralisation and granting of additional powers (EBA in the Anti-Money Laundering (AML) system of enforcement / ESMA with a direct responsibility for benchmarks and data-reporting services providers), the ESAs review failed on ESAs governance changes which could have made their decision-making more European.

[20] For a very detailed account, see Danny Busch, 'Capital Markets Union' in Federico Fabbrini and Marco Ventoruzzo (eds), *Research Handbook on EU Economic Law* (Edward Elgar Publishing 2019) <https://search.ebscohost.com/login.aspx?direct=true&db=nlebk&AN=2284009&site=ehost-live> accessed 9 January 2024; and earlier, Nicolas Véron and Guntram B Wolff, 'Capital Markets Union: A Vision for the Long Term' (2016) 2 Journal of Financial Regulation 130.

[21] Juncker and others (n 4).

[22] Christy Ann Petit and Thorsten Beck, 'Recent Trends in UK Financial Sector Regulation and Possible Implications for the EU, Including Its Approach to Equivalence' (European Parliament 2023) Publication for the Committee on Economic and Monetary Affairs, Policy Department for Economic, Scientific and Quality of Life Policies PE 740.067.

[23] The share of the NBFI sector is 47.2%, see FSB, 'Global Monitoring Report on Non-Bank Financial Intermediation 2023' (2023) 7 <https://www.fsb.org/wp-content/uploads/P181223.pdf>.

[24] Juncker and others (n 4) 12.

[25] There are some hard constitutional constraints, in particular stemming from the Meroni doctrine, see Maria Patrin, 'Meroni Behind the Scenes: Uncovering the Actors and Context of a Landmark Judgment' (2021) 6 European Papers - A Journal on Law and Integration 539; Nathan De Arriba-Sellier, 'The Brexit Reform of European Financial Supervision: Lost in Transition?' (2019) 30 European Business Law Review 695.

[26] For ESMA, see Niamh Moloney, 'Institutional Governance and Capital Markets Union: Incrementalism or a "Big Bang"?' (2016) 13 European Company and Financial Law Review <https://www.degruyter.com/view/j/ecfr.2016.13.issue-2/ecfr-2016-0376/ecfr-2016-0376.xml> accessed 6 August 2018.

Nevertheless, a cross-sectoral improvement lies in the forthcoming Single Rulebook for AML next to the revised AML Directive 6,[27] and a forthcoming EU AML Authority (AMLA). AMLA will have responsibilities within an integrated system including national supervisors for the financial sector AML/CFT risks, a supporting role for non-financial sectors, and a coordinating role of national Financial Intelligence Units to curb money laundering and counter the financing of terrorism.[28]

Overall, these institutional creations (or ongoing project) – the ESFS, the BU, the CMU, the AMLA – help to locate actors responsible for enforcing the EU Single Rulebooks (in Banking, Financial and Capital Markets, AML Regulation), which give, albeit imperfect, normative and institutional foundations for the emergence of a Financial Union.

3. Use of the banking and financial sectors during the Covid-19 pandemic

At the start of the pandemic shock, the ECB adopted several measures to ensure the banking sector plays its function of banking intermediation to support the economy, from households to small businesses and corporates. Along the monetary policy package adopted in March 2020,[29] ECB Banking Supervision adopted several measures the same month, as regards capital, liquidity, and operational relief measures to liberate additional capital and ensure lending to the real economy.[30] The EBA also called European supervisors to apply flexibility in the prudential framework and in their supervisory approaches.[31] These measures benefited from the existing regulatory flexibility under EU Banking Regulation, as well as from some regulatory interventions called 'quick fixes'. These measures and regulatory interventions are examined in turn and followed by other measures taken to handle market volatility and rely on (integrated) markets.

3.1.Supervisory and regulatory flexibility

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[27] European Parliament, 'Deal on a Single Rulebook against Money Laundering and Terrorist Financing' (*European Parliament*, 18 January 2024) <https://www.europarl.europa.eu/news/en/press-room/20240117IPR16880/deal-on-a-single-rulebook-against-money-laundering-and-terrorist-financing> accessed 8 February 2024.

[28] Council of the EU, 'AML: Council and Parliament Agree to Create New Authority' <https://www.consilium.europa.eu/en/press/press-releases/2023/12/13/anti-money-laundering-council-and-parliament-agree-to-create-new-authority/> accessed 8 February 2024; Christy Ann Petit, '16. Anti-Money Laundering' in Miroslava Scholten (ed), *Research Handbook on the Enforcement of EU Law* (Edward Elgar Publishing 2023).

[29] Philip Lane, 'The Monetary Policy Package: An Analytical Framework' (*ECB Blog*, 13 March 2020) <https://www.ecb.europa.eu/press/blog/date/2020/html/ecb.blog200313~9e783ea567.en.html> accessed 13 March 2020.

[30] ECB, 'ECB Banking Supervision Provides Temporary Capital and Operational Relief in Reaction to Coronavirus' (*ECB Banking Supervision*, 12 March 2020) <https://www.bankingsupervision.europa.eu/press/pr/date/2020/html/ssm.pr200312~43351ac3ac.en.html> accessed 5 February 2024; ECB, 'ECB Banking Supervision Provides Further Flexibility to Banks in Reaction to Coronavirus' (*ECB Banking Supervision*, 20 March 2020) <https://www.bankingsupervision.europa.eu/press/pr/date/2020/html/ssm.pr200320~4cdbbcf466.en.html> accessed 5 February 2024; see also Bassani (n 8) 450; see section 4 for Banking Union measures, 'EU/EA Measures to Mitigate the Economic, Financial and Social Effects of Coronavirus - State-of-Play 8 March 2021' (2021) PE 645.723 EGOV In-depth analysis.

[31] EBA, 'EBA Provides Additional Clarity on Measures to Mitigate the Impact of COVID-19 on the EU Banking Sector' (*European Banking Authority*, 31 March 2020) <https://www.eba.europa.eu/publications-and-media/press-releases/eba-provides-additional-clarity-measures-mitigate-impact> accessed 6 February 2024.

First, on 3 March 2020, the ECB addressed letters to the CEO of all the significant banks to stress the importance of contingency strategies at a time the pandemic was described as 'potential'.[32] In other words, banks rely on continuity planning in their governance, and prepare for adverse scenarios, here represented by the spread of the Coronavirus. Then, the ECB adopted supervisory flexibility measures on 12 March 2020,[33] which included, among others, capital relief as well as operational relief with adapted deadlines and processes (extended for six months to release regulatory burden, e.g. postponed on-site inspections). A week later, the ECB provided further supervisory flexibility to mitigate credit risk,[34] notably in the evaluation of banks' strategies to reduce past Non-Performing Loans (NPLs) and for the loans under public guarantees that could become non-performing, so that they could benefit from moratoriums and public guarantee schemes (see hereinafter).

Furthermore, the ECB adopted a recommendation on 27 March 2020 for banks to suspend or limit the distribution of dividends at consolidated level and then extended to banks' share buybacks.[35] This measure, although not legally binding, aimed to incentivise banks to refrain from using their released capital to remunerate managers with variable remunerations and shareholders with dividend distributions.[36] In EU Banking Regulation, this measure has a direct effect on capital adequacy frameworks and the capital position of banks, which was expected to allow EUR 30 billion of additional capital to be kept within the banking system[37] and providing additional resources to lending activities. A measure that was considered by the then-Chair to the Supervisory Board, Andrea Enria, as 'entirely appropriate from the point of view of social corporate responsibility.'[38] These recommendations were applicable until 30 September 2021.

Beyond prudential measures, the supervisors – both the ECB and the EBA – also recommended banks to use the available regulatory flexibility around capital buffers in accordance with existing secondary law (regarding the Pillar 2 Supervisory Guidance (P2G) banks could operate below the level of capital in P2G, and so could they for their capital conservation buffer (CCB), liquidity coverage ratio (LCR), and could adapt the capital

[32] Andrea Enria, 'Contingency Preparedness in the Context of COVID-19' (3 March 2020) <https://www.bankingsupervision.europa.eu/press/letterstobanks/shared/pdf/2020/ssm.2020_letter_on_Contingency_preparedness_in_the_context_of_COVID-19.en.pdf> accessed 5 March 2020.

[33] ECB, 'ECB Banking Supervision Provides Temporary Capital and Operational Relief in Reaction to Coronavirus' (n 29).

[34] ECB, 'ECB Banking Supervision Provides Further Flexibility to Banks in Reaction to Coronavirus' (n 29).

[35] Recommendation of the European Central Bank of 27 March 2020 on dividend distributions during the COVID-19 pandemic and repealing Recommendation ECB/2020/1 (ECB/2020/19) 2020/C 102 I/01 2020 [OJ C 102I]; see also EBA, 'Statement on Dividends Distribution, Share Buybacks and Variable Remuneration' (*European Banking Authority*, 31 March 2020) <https://www.eba.europa.eu/sites/default/files/document_library/News%20and%20Press/Press%20Room/Press%20Releases/2020/EBA%20provides%20additional%20clarity%20on%20measures%20to%20mitigate%20the%20impact%20of%20COVID-19%20on%20the%20EU%20banking%20sector/Statement%20on%20dividends%20distribution%2C%20share%20buybacks%20and%20variable%20remuneration.pdf> accessed 6 February 2024.

[36] Bruno and Marco (n 8) 23; Sciarrone Alibrandi and Frigeni (n 8).

[37] Enria, 'Flexibility in Supervision' (n 3).

[38] ibid.

composition of capital instruments under Pillar 2 beyond common equity tier 1).[39] All in all, it was expected that this could represent a capital relief of EUR 120 billion of Common Equity Tier 1 (CET1) capital, which could finance up to EUR 1.8 trillion of lending.[40]

Finally, the EBA gave further guidance to European prudential and anti-money laundering (AML) / Countering the Financing of Terrorism (CFT) supervisors, with the key objective to safeguard the integrity of financial markets. It called for flexibility in supervisory reporting adapting the assessment of Pillar 3 disclosures,[41] and stressed at the same time, the necessity to maintain effective AML/CFT systems to mitigate banks' financial crime risks and to adjust AML/CFT supervision to the Covid-19.[42] Finally, it is worth mentioning that the EBA decided to postpone the 2020 EBA EU-wide stress tests.[43]

3.2.Regulatory interventions

The European legislators conducted regulatory 'quick fixes', under an urgent review, by amending the Capital Requirements Regulation (CRR) with entry into force already in June 2020.[44] These corresponded to capital-enhancing measures in order to allow banks' lending and loss absorption. They relaxed prudential supervision as regards certain banks' exposures, which reduced the risk weights, and relaxed accounting standards. Following international agreement in the Basel Committee for Banking Supervision, the legislators allowed a delayed implementation of International Financial Reporting Standard (IFRS) 9, to mitigate its impact on own funds. The transitional arrangements were granted additional two years, which exempted banks from having significantly higher loan loss provisions, and therefore released additional capital.[45] Moreover, the legislators anticipated the application of certain measures, such as the supporting factor for lending to Small and Medium Enterprises (SMEs) and infrastructure sectors, which were put into place ahead of schedule. They grant a more

[39] ECB, 'ECB Banking Supervision Provides Temporary Capital and Operational Relief in Reaction to Coronavirus' (n 29); EBA Press release, 'EBA Statement on Actions to Mitigate the Impact of COVID-19 on the EU Banking Sector' (*European Banking Authority*, 12 March 2020) <https://eba.europa.eu/eba-statement-actions-mitigate-impact-covid-19-eu-banking-sector> accessed 17 March 2020.

[40] ECB, 'ECB Banking Supervision Provides Further Flexibility to Banks in Reaction to Coronavirus' (n 29).

[41] EBA, 'Statement on Supervisory Reporting and Pillar 3 Disclosures in Light of COVID-19' (*European Banking Authority*, 31 March 2020) <https://www.eba.europa.eu/sites/default/files/document_library/News%20and%20Press/Press%20Room/Press%20Releases/2020/EBA%20provides%20additional%20clarity%20on%20measures%20to%20mitigate%20the%20impact%20of%20COVID-19%20on%20the%20EU%20banking%20sector/Statement%20on%20supervisory%20reporting%20and%20Pillar%203%20disclosures%20in%20light%20of%20COVID-19.pdf> accessed 6 February 2024.

[42] EBA, 'Statement on Actions to Mitigate Financial Crime Risks in the COVID-19 Pandemic' (*European Banking Authority*, 31 March 2020) <https://www.eba.europa.eu/sites/default/files/document_library/News%20and%20Press/Press%20Room/Press%20Releases/2020/EBA%20provides%20additional%20clarity%20on%20measures%20to%20mitigate%20the%20impact%20of%20COVID-19%20on%20the%20EU%20banking%20sector/Statement%20on%20actions%20to%20mitigate%20financial%20crime%20risks%20in%20the%20COVID-19%20pandemic.pdf> accessed 6 February 2024.

[43] EBA Press release (n 38).

[44] Regulation (EU) 2020/873 of the European Parliament and of the Council of 24 June 2020 amending Regulations (EU) No 575/2013 and (EU) 2019/876 as regards certain adjustments in response to the COVID-19 pandemic 2020 (OJ L).

[45] Recital 12, ibid; Bruno and Marco (n 8) 20–21.

favourable treatment of certain exposures to SMEs and infrastructure in order to incentivise the banks to continue.[46]

Other measures had a direct impact on bank lending, and in particular the flexibility granted in the prudential and accounting of moratoria and Public Guarantee Schemes (PGS).[47] Moratoria on loans payments and PGS were adopted at national level to relieve debtors temporarily while the lockdowns significantly blocked most business activities. Moratoria helped to keep businesses that were solvent but temporarily illiquid out of bankruptcy. The lockdowns affected some viable businesses for which cash flows were temporarily suspended. Moratoria and PGS fostered direct increase in lending insofar as supervisors had also decided to increase supervisory flexibility towards the treatment of such loans.

3.3.Measures to handle market volatility and rely on (integrated) markets

In banking supervision, with a link to financial markets, the ECB adopted a temporary reduction in capital requirements for market risk,[48] in reaction to high levels of volatility on the financial markets. This measure aimed to keep banks providing market liquidity and their market-making activities. At national level, some national securities regulators temporarily banned short selling instruments to cope with stock price volatility and instability in capital markets, after a positive ESMA Opinion.[49] This measure is contested as to its effect on bank stability and could even be counterproductive.[50] It was in place only for a short period of time.

Later in 2020, the Commission put forward a 'Capital Markets Recovery Package' to boost investments in the EU real economy and the re-capitalisation of companies, and ensures additional capacity for banks, through targeted amendments to capital market rules, in particular securitisation, the CRR, MiFID II and the Prospectus Regulation.[51] These targeted amendments were exceptional in nature, and for some, announced as temporary. However, I

[46] Recital 19 Regulation (EU) 2020/873 of the European Parliament and of the Council of 24 June 2020 amending Regulations (EU) No 575/2013 and (EU) 2019/876 as regards certain adjustments in response to the COVID-19 pandemic.
[47] Bruno and Marco (n 8) 16–18, see also the NPLs prudential backstop, temporary prudential filter, regulatory treatment of public debt and leverage ratio.
[48] ECB, 'ECB Banking Supervision Provides Temporary Relief for Capital Requirements for Market Risk' (*ECB Banking Supervision*, 16 April 2020) <https://www.bankingsupervision.europa.eu/press/pr/date/2020/html/ssm.pr200416~ecf270bca8.en.html> accessed 7 February 2024.
[49] ESMA, 'ESMA Issues Positive Opinions on Short Selling Bans by Austrian FMA, Belgian FSMA, French AMF, Greek HCMC and Spanish CNMV' (*ESMA*, 15 April 2020) <https://www.esma.europa.eu/press-news/esma-news/esma-issues-positive-opinions-short-selling-bans-austrian-fma-belgian-fsma> accessed 8 February 2024.
[50] Luca Enriques and Marco Pagano, '16. Emergency Measures for Equity Trading: The Sase against Short Selling Bans and Stock Exchange Shutdowns' in Christos V Gortsos and Wolf-Georg Ringe (eds), *Financial Stability amidst the Pandemic Crisis: On Top of the Wave* (European Banking Institute 2021) 550–2; Gianfranco Siciliano and Marco Ventoruzzo, 'Banning Cassandra from the Market? An Empirical Analysis of Short-Selling Bans during the Covid-19 Crisis' (2020) 17 European Company and Financial Law Review 386.
[51] European Commission, 'Coronavirus Response: How the Capital Markets Union Can Support Europe's Recovery' (*European Commission DG FISMA*, 24 July 2020) <https://finance.ec.europa.eu/publications/coronavirus-response-how-capital-markets-union-can-support-europes-recovery_en> accessed 7 February 2024.

concur with scholars who considered that such exceptional measures will produce long-term effects[52] in line with the overall, still pending, CMU construction.

Indeed, the CMU project is taking new grounds. The parallel NGEU funding strategy on financial markets seemingly reinforces the rhetoric around CMU and its completion. In the words of Valdis Dombrovskis, Executive Vice-President for an Economy that works for the people: 'Capital markets are vital to the recovery, because public financing alone will not be enough to get our economies back on track.'[53] Therefore, the CMU relaunch, culminating with the latest 2020 CMU Action Plan and following packages discussed hereinafter, stems directly from the pandemic economic measures,[54] and NGEU policies implications.

In the longer run, as the fiscal measures and support from the government are being lifted, the continued support of banks through lending remains essential. Yet, the interest rates' environment has raised and still raises issues for borrowers. Beyond the uncertainty of this macroeconomic environment, both the BU and CMU remain incomplete, which raise several challenges.

4. State of play and challenges ahead

The objective behind the Financial Union is to build integrated European markets. This requires the completion of the BU, the rebooting of the CMU, and to address transversal challenges that touch both banks and financial institutions.

4.1.Banking Union completion and market integration

The first supervisory pillar and second resolution pillar of the BU were successfully implemented but with outstanding shortcomings in the Single Rulebook and the EU resolution framework.[55] The adoption of the third pillar has been stalled since 2015 despite several rounds of trimming the EDIS proposals to satisfy divergent interests across Member

[52] Filippo Annunziata and Michele Siri, '17. Fixing the Core of EU Capital Markets Legislation during the Pandemic: Temporary Exercises or Long-Term Path?' in Christos V Gortsos and Wolf-Georg Ringe (eds), *Financial Stability amidst the Pandemic Crisis: On Top of the Wave* (European Banking Institute 2021) 565.

[53] European Commission Press Release, 'Making Capital Markets Work for Europe's Recovery' (*European Commission - European Commission*, 24 July 2020) <https://ec.europa.eu/commission/presscorner/detail/en/ip_20_1382> accessed 7 February 2024.

[54] Federico Fabbrini, 'The Legal Architecture of the Economic Responses to COVID-19: EMU beyond the Pandemic*' (2022) 60 JCMS: Journal of Common Market Studies 186.

[55] Andreas Witte, 'The Application of National Law by the ECB, Including Options and Discretions, and Its Impact on the Judicial Review' in Chiara Zilioli and Karl-Philipp Wojcik (eds), *Judicial Review in the European Banking Union* (Edward Elgar Publishing 2021) <http://www.elgaronline.com/view/edcoll/9781800373198/9781800373198.00025.xml> accessed 29 July 2021; Ioannis Asimakopoulos and David Howarth, 'Stillborn Banking Union: Explaining Ineffective European Union Bank Resolution Rules' (2022) 60 Journal of Common Market Studies 264; Michael Schillig, 'BRRD/SRM, Corporate Insolvency Law and EU State Aid - the Trifurcated EU Framework for Dealing with Banks in Distress' in Gianni Lo Schiavo (ed), *The European Banking Union and the role of law* (Cheltenham, Edward Elgar, Elgar Financial Law series 2019).

States, still divided between risk reduction and risk sharing.[56] In short, Member States are not ready to move to full European liability. A European deposit insurance scheme would increase the resilience of the banking sector and act as a single fund (upgrading the currently limited national deposit guarantees of up to EUR 100,000 per deposit, as per the EU Deposit Guarantee Scheme (DGS) Directive). The Eurogroup met in inclusive format in June 2022 with the intention of adopting a new work plan towards the completion of the BU, including EDIS. This failed and the focus shifted instead to a phased approach, with principally the review of the framework for bank crisis management and national deposit insurance.[57]

The CMDI review, with the April 2023 package, would achieve a better framework for resolution and crisis management,[58] as well as provide depositors with a more effective safety net, relying on industry funds through built up national funds. As the initial BU political project, the co-legislators generally aim at ensuring an orderly resolution of failing banks and to minimise the costs to EU taxpayers. In particular, the objectives of this review are to fix some of the prior shortcomings in the procedures and rules, from early intervention, Failing or Likely to Fail and the related Public Interest Assessment, until insolvency or resolution, and, put simply, to move away from the say ‘resolution is for the few, not for the many’.[59] Observers have raised concerns about the resolution of smaller institutions,[60] with consideration for the regional impact of their potential failures, and the status of national DGSs. In this regard, the proposals elaborated some specific solutions for mid-sized banks. And, while the expansion of the scope of resolution goes hand in hand with a sound safety net and review of common deposit insurance, it does not equate to capture all smaller banks which would still benefit from DGS alternative measures.[61] The Daisy Chain Regulation

[56] Agnès Bénassy-Quéré, ‘Reconciling Risk Sharing with Market Discipline: A Constructive Approach to Euro Area Reform’ 24; Craig and Markakis (n 5) 1433; Pedro Gustavo Teixeira, ‘The Future of the European Banking Union: Risk-Sharing and Democratic Legitimacy’ in Mario P Chiti and Vittorio Santoro (eds), *The Palgrave Handbook of European Banking Union Law* (Springer International Publishing 2019) <https://doi.org/10.1007/978-3-030-13475-4_7> accessed 30 September 2019; Giuseppe Boccuzzi, ‘The Third Pillar of the Banking Union: The Pan-European Deposit Guarantee Scheme’ in Giuseppe Boccuzzi (ed), *The European Banking Union: Supervision and Resolution* (Palgrave Macmillan UK 2016) <https://doi.org/10.1057/9781137555656_6> accessed 29 July 2021.

[57] ‘Remarks by Paschal Donohoe Following the Eurogroup Meeting of 16 June 2022’ (16 June 2022) <https://www.consilium.europa.eu/en/press/press-releases/2022/06/16/remarks-by-paschal-donohoe-following-the-eurogroup-meeting-of-16-june-2022/> accessed 30 June 2022; ‘Eurogroup Statement on the Future of the Banking Union of 16 June 2022’ (16 June 2022) <https://www.consilium.europa.eu/en/press/press-releases/2022/06/16/eurogroup-statement-on-the-future-of-the-banking-union-of-16-june-2022/> accessed 30 June 2022.

[58] Christos Gortsos, ‘A Reform of the CMDI Framework That Supports Completion of the Banking Union’ (2023) PE 741.493 In-depth analysis, European Parliament Economic Governance and EMU Scrutiny Unit; Emilios Avgouleas and others, ‘Reform of the CMDI Framework That Supports Completion of the Banking Union’ (2023) PE 741.516 In-depth analysis, European Parliament Economic Governance and EMU Scrutiny Unit.

[59] ‘Eurofi Article by Elke König - A Centralized Administrative Liquidation Tool for Banks | Zagreb, April 2020’ (*Single Resolution Board*, 24 April 2020) <https://www.srb.europa.eu/en/content/eurofi-article-elke-konig-centralized-administrative-liquidation-tool-banks-zagreb-april> accessed 8 February 2024.

[60] Concetta BRESCIA Morra, Alberto Franco Pozzolo and Noah Vardi, ‘Completing the Banking Union: The Case of Crisis Management of Small- and Medium-Sized Banks’ (2023) PE 741.514 EGOV In-depth analysis; SRB, *Small and Medium-Sized Banks: Resolution Planning and Crisis Management Report for Less Significant Institutions in 2022 and 2023.* (Publications Office 2023) <https://data.europa.eu/doi/10.2877/275060> accessed 8 January 2024.

[61] Anneli Tuominen, ‘Reforming the Crisis Management Framework – a Bridge over Troubled Water?’ (*ECB Banking Supervision*, 16 October 2023)

already amended the resolution framework in 2022 to ensure loss absorption and recapitalisation (amending the Capital Requirements Regulation (CRR) and Bank Recovery and Resolution Directive (BRRD) as regards own funds and eligible liabilities, multiple-point-of-entry resolution strategy, total loss-absorption capacity), while the CMDI legislative proposals are still under discussions to amend the BRRD, the SRM Regulation and the DGSD.

Moreover, the doom loop with an interdependence between banks and their sovereigns could be addressed by transitional measures, like the Regulatory Treatment of Sovereign Exposures (RTSE) discussed for some years to set some large sovereign exposure limits, but did not lead to concrete outcomes.[62] Policymakers are seeking to find a balance between on the one hand the holding of sovereign securities by banks and on the other, the role that banks represent in terms of shock absorption.[63] Therefore, in the BU, the bank-sovereign nexus is yet to be addressed. In this regard, proposals to diversify the banks' balance sheet, i.e. the Sovereign Bond-Backed Securities and a European Safe Asset, are being discussed without a successful outcome so far.[64] EU bonds were qualified as a 'safe asset' or at least the NGEU programme as an opportunity to create a supranational, euro-denominated safe asset.[65]

The BU completion is, furthermore, hampered by the absence of a functioning common backstop, which is also harmful for the credibility of the European resolution framework. Indeed, in December 2023, the Italian Parliament decided to vote against the ratification of the revised ESM Treaty. Without the ratification from all Member States, the ESM cannot provide the common backstop to the Single Resolution Fund (SRF).[66] In other words, the amount available for resolution at the SRF remains insufficient (at EUR 77.6 billion),[67] should a major cross-border bank fail, and to date, the ESM credit line under the backstop cannot be tapped after an SRF depletion.

It is striking that there has been almost no progress in market integration in the BU since its inception. In other words, the BU is not seen as a unique domestic market in which banks have a real 'EU footprint'[68] with a cross-border nature. Two observations can be made. First,

<https://www.bankingsupervision.europa.eu/press/speeches/date/2023/html/ssm.sp231016_1~b030e53ecb.en.html> accessed 9 November 2023.

[62] J Deslandes and Marcel Magnus, 'Which Supervisory or Regulatory Treatment of Banks' Exposures to Sovereign Risks?' (2019) PE 624.434 EGOV Briefing <https://www.europarl.europa.eu/RegData/etudes/BRIE/2019/624434/IPOL_BRI(2019)624434_EN.pdf> accessed 8 February 2024.

[63] See foreword by Rolf Strauch, Christos V Gortsos and Wolf-Georg Ringe (eds), *Financial Stability amidst the Pandemic Crisis: On Top of the Wave* (European Banking Institute 2021) XV.

[64] J Deslandes, C Dias and M Magnus, 'Are Sovereign Bond-Backed Securities ("SBBS") a "Self-Standing" Proposal to Address the Sovereign Bank Nexus?' (2018) PE 624.405 EGOV Briefing.

[65] Rebecca Christie, Grégory Claeys and Pauline Weil, 'Next Generation EU Borrowing: A First Assessment' (2021) 22 Bruegel Policy Contribution; Tilman Bletzinger, William Greif and Bernd Schwaab, 'Can EU Bonds Serve as Euro-Denominated Safe Assets?' (2022) 2712 ECB Working Paper Series <https://data.europa.eu/doi/10.2866/84563> accessed 9 February 2024.

[66] See Chapter 5 in this volume.

[67] SRB Press release, 'Single Resolution Fund Grows by €11.3 Billion to Reach € 77.6 Billion' (*Single Resolution Board*, 5 July 2023) <https://www.srb.europa.eu/en/content/single-resolution-fund-grows-eu113-billion-reach-eu-776-billion> accessed 8 February 2024.

[68] Andrea Enria, 'European Banking Supervision: Taking Stock and Looking Ahead' (Analysis Forum – Milan, Milan, 27 September 2023) 7.

the mergers and acquisitions in the banking sector are mainly domestic-market oriented,[69] which exacerbates the concentration of national markets. Second, banking groups do not opt for branch structures nor provide cross-border services directly.[70]

Several scholars engaged on the impasse in completing the BU.[71] . Of the incremental, real, and cosmic deals proposals developed by Beck et al. in 2022 to complete the BU, the first route seems the path currently undertaken through the ongoing crisis management and deposit insurance review. As they wrote, the completion of the BU is necessary but not sufficient to create a single market in banking.[72] I consider this policy challenge very much linked to the CMU.

4.2.Rebooting the Capital Markets Union

CMU is still a patchwork of manifold regulatory acts today. Regardless of this incomplete status, the relaunch of initiatives is paramount to support the functioning of the EU Single Market for Capital.

The CMU initiative was launched by the 2015 CMU Action Plan. Several legislative files followed, such as for: simple, transparent, and standardised securitisation; Prospectus Regulation; Collective Investment Funds; Pan-European Pension Product; Covered Bonds; Crowdfunding; Investment firms; European market infrastructure. However, as a patchwork of regulatory measures, they did not and could not embody a coherent, institutionalised, and credible Union for capital markets, which remained fragmented. The CMU project was kept alive through interim reviews, studies, and reports, until the CMU 2020 Action Plan.[73] Since the pandemic, the Commission stressed the importance of capital markets to support the EU recovery and released two packages to ensure better data access and revamped investment rules (November 2021), and on clearing services, corporate insolvency rules harmonisation and listing rules (December 2022).[74]

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[69] Anna Gardella, Massimiliano Rimarchi and Davide Stroppa, 'Potential Regulatory Obstacles to Crossborder Mergers and Acquisitions in the EU Banking Sector' (2020) 7 EBA STAFF PAPER SERIES <https://www.ssrn.com/abstract=3749447> accessed 6 February 2024.

[70] Mathias Hoffmann and others, 'Banking Integration in the EMU: Let's Get Real!' (*VoxEU*, 10 January 2019) <https://voxeu.org/article/banking-integration-emu-let-s-get-real> accessed 21 January 2019.

[71] Thorsten Beck and others, 'Completing the Banking Union: Economic Requirements and Legal Conditions' [2022] CEPR Policy Insight 13; European Central Enria, Andrea, 'Of Temples and Trees: On the Road to Completing the European Banking Union' (Institut Montaigne, Paris, France, 17 May 2022) <https://www.bankingsupervision.europa.eu/press/speeches/date/2022/html/ssm.sp220517~e33713d293.en.html > accessed 18 April 2023; Jacopo Carmassi and others, 'Completing the Banking Union with a European Deposit Insurance Scheme: Who Is Afraid of Cross-Subsidisation?' [2018] ECB Occasional Paper Series 57.

[72] Beck and others (n 70) 10.

[73] 16 between 2016 and 2021 as documented by European Commission, 'Studies under the Capital Markets Union (CMU)' <https://finance.ec.europa.eu/capital-markets-union-and-financial-markets/capital-markets-union/what-capital-markets-union/studies-under-capital-markets-union-cmu_en> accessed 7 February 2024; see also High Level Forum, 'A New Vision for Europe's Capital Markets - Final Report of the High Level Forum on the Capital Markets Union' (2020) <https://ec.europa.eu/info/sites/info/files/business_economy_euro/growth_and_investment/documents/200610-cmu-high-level-forum-final-report_en.pdf> accessed 10 June 2020; European Commission, 'CMU 2020 Action Plan: A Capital Markets Union for People and Businesses' (*European Commission*, 2020) <https://ec.europa.eu/info/business-economy-euro/growth-and-investment/capital-markets-union/capital-markets-union-2020-action-plan_en> accessed 15 November 2021.

[74] European Commission, 'CMU: Commission Adopts Package to Ensure Better Data Access and Revamped Investment Rules' (25 November 2021)

Overall, in 2023 the Commission streamlined the CMU initiative around three key objectives which are clearly directly related to NGEU policies and the EU economic recovery: (1) Support a green, digital, inclusive and resilient economic recovery by making financing more accessible to European companies, (2) Make the EU an even safer place for individuals to save and invest long-term, (3) Integrate national capital markets into a genuine single market.[75]

Recently, significant steps have been made to foster more integrated capital markets. Capital markets will benefit from an increased market transparency (e.g., with European Single Access Point, benchmarks, and listing). The following gives further elements on three important developments to ensure an enhanced and functioning clearing system, European stock exchanges and some amendments of capital markets legislation. This overview is not meant to be exhaustive considering the sprawling nature of EU financial and capital markets law.

First for the clearing system, European Market Infrastructure frameworks (with the EMIR first adopted in 2012) have reached a new step to make clearing more attractive and resilient in the EU – an objective that gained even more salience after Brexit.[76] The increase of clearing infrastructures and offer within the EU, with an enhanced supervision, aims at safeguarding financial stability and contributing to EU strategic autonomy (see also Chapter 21 in this volume). Indeed, clearing in the EU is significantly reliant on third-country Central Clearing Counterparties (CCPs).[77] The Council and the Parliament reached a provisional political agreement on EMIR and clearing-related proposals on 7 February 2024.[78] In sum, the review would lead to improve clearing services procedures, rules, as well as the supervision of EU CCPs and require certain market participants to have an active account at an EU CCP (subject to a Joint monitoring Mechanism). It would strengthen the coordinating role of ESMA in emergency situations, but with still a significant reliance on national authorities.[79] Overall, the goal is to make clearing services and EU CCPs more efficient and

<https://finance.ec.europa.eu/publications/capital-markets-union-commission-adopts-package-ensure-better-data-access-and-revamped-investment_en> accessed 7 February 2024; European Commission, 'CMU: Clearing, Insolvency and Listing Package' (7 December 2022) <https://finance.ec.europa.eu/publications/capital-markets-union-clearing-insolvency-and-listing-package_en> accessed 7 February 2024.

[75] With 16 legislative and non-legislative actions, see European Commission, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions a Capital Markets Union for People and Businesses-New Action Plan 2020 [COM(2020) 590 final]; on the green financing, see Daniel Gros and others, 'How Can Covid-19-Influenced CMU Initiatives Help Diversify SME Access to Finance While Promoting a Greener Economy?' (2022) PE 703.360 Publication for the Committee on Economic and Monetary Affairs, Policy Department for Economic, Scientific and Quality of Life Policies, European Parliament <https://www.europarl.europa.eu/RegData/etudes/STUD/2022/703360/IPOL_STU(2022)703360_EN.pdf> accessed 7 February 2024.

[76] Petit and Beck (n 21) 57–59.

[77] ibid 60–1.

[78] Council of the EU, 'CMU: Council and Parliament Agree on Improvements to EU Clearing Services' (7 February 2024) <https://www.consilium.europa.eu/en/press/press-releases/2024/02/07/capital-markets-union-council-an-parliament-agree-on-improvements-to-eu-clearing-services/> accessed 7 February 2024.

[79] ibid.

competitive.[80] Yet, the ambition might clash with the reality and difficulty to build a fully European CCPs ecosystem (from the perspective of the operators' capacity/appetite and the supervisory/regulatory architecture).

Second, regarding stock exchanges, the listing package, expected to be adopted in 2024, is supposed to foster access to financing, in particular for SMEs, and make EU public capital markets more attractive by alleviating some administrative burdens in the listing process, while ensuring market integrity and investor protection.[81] This is in line with the policy objectives underpinning the significant financing needs behind the transitions post-pandemic recovery.

Third, capital markets legislation was significantly reviewed in particular investment services and financial markets activities (with the Directive and Regulation on Markets in Financial Instruments, MiFID II and MiFIR) and investment funds (with the Directive on undertakings for collective investment in transferable securities (UCITS) and Directive on Alternative Investment Fund Managers (AIFM)) for which the co-legislators reached provisional agreements in mid-2023.[82] The commonality is to ensure transparency, the competitiveness of EU financial markets, and aim to integrate better capital markets into a single market, while safeguarding financial stability.

Finally, the more recent policy impetus is centred on the future of 'European capital and financial markets'.[83] A political agreement is expected at the 2024 Euro Summit to identify the political priorities,[84] which could lead to a bolder strategy to accompany the rise of a coherent, institutionalised and credible CMU (with potential legislative initiatives after the 2024 European Parliament elections by the new European Commission).

4.3.Transversal challenges

Transversal challenges designate cross-sectoral challenges for both banks and financial institutions and the related regulatory frameworks. In EU banking and financial regulation, we observe a trend to pursue some simplification (also supported by digitalisation), the removal of red tape, with a consideration for proportionality (e.g. see the Basel III implementation with the CRR3 and the CRDVI).[85] Furthermore, the cross-sectoral dimension relates to EU policy goals reinforced after the pandemic, such as reaching net zero industries, increasing EU's competitiveness and autonomy in technology and trade (e.g. diversification of supply chains). This subsection examines the challenges and developments related to

[80] European Parliament, 'Deal to Make the EU an Attractive Clearing Hub While Addressing Sectoral Risks' (*European Parliament*, 7 February 2024) <https://www.europarl.europa.eu/news/en/press-room/20240205IPR17406/deal-to-make-the-eu-an-attractive-clearing-hub-while-addressing-sectoral-risks> accessed 7 February 2024.

[81] Council of the EU, 'Listings on European Stock Exchanges: Council and Parliament Agree on New Act' (*Council of the EU*, 1 February 2024) <https://www.consilium.europa.eu/en/press/press-releases/2024/02/01/listings-on-european-stock-exchanges-council-and-parliament-agree-new-act/> accessed 7 February 2024.

[82] Issam Hallak, 'Amendments to MiFID II and MiFIR' (2023) PE 733.546 EPRS Legislation in progress Briefing; Issam Hallak, 'Amendments to AIFMD and UCITSD' (2023) PE 729.321 EPRS Legislation in progress Briefing.

[83] European Council (n 7).

[84] Two plans were already announced for a repo facility and a market for futures derivatives to support the deepening of capital markets and the attractiveness for the investors.

[85] Also applicable for capital markets law, see Annunziata and Siri (n 51) 566.

NBFIs, the insurance sector, the green and digital transition, as well as the governance and institutional structures for a Financial Union.

Such strategy requires to rely not only on banks, but also non-bank financial institutions. NBFIs, also sometimes called ‘shadow banks’,[86] are increasingly taking up activity also in the EU to finance the real economy. The share of the NBFI sector in the euro area doubled from 15 trillion euros in 2008 to 31 trillion euros.[87] In the last years, policymakers have stressed the role of banks to mitigate the systemic risks NBFIs represent, in particular by improving the way banks assess and manage the risks attached to their non-bank counterparties, i.e., counterparty credit risks.[88] In the context of the Covid-19 pandemic, the increased attention turned to non-bank financial risks when the start of the pandemic triggered the ‘dash for cash’[89] in March 2020. In sum, regulators and policymakers[90] seek to understand better how the traditional banking sector interact with NBFIs and to improve the identification and reporting of banks’ exposures to NBFIs.[91] A new Report from the European Commission elaborated on the systemic risks NBFIs represent and their interconnectedness with banks, and more generally the EU macro-prudential framework.[92]

In the same vein and beyond the banking sector, EU legislators reviewed the regulation and supervision of insurance. They agreed on Solvency II rules and most importantly, there was a significant breakthrough with a new framework for the recovery and resolution of insurance firms (Insurance Recovery and Resolution Directive (IRRD) similar to what exists for banks).[93] The objective behind the amendments of Solvency II rules is to ensure more funds

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[86] The NBFI sub-sectors include insurance, pension funds, hedge funds, money market funds, real estate investment trusts and funds, finance companies, broker-dealers, structured finance, trust, captive financial institutions and money lenders, central counterparties, see FSB (n 22) 75.

[87] Enria, ‘The Role of Banks in Mitigating Systemic Risks Arising in the Non-Bank Financial Sector’ (n 15); also part of the implementation of the Basel III, see EBA, ‘The EBA Publishes Roadmap on the Implementation of the EU Banking Package’ (14 December 2023) <https://www.eba.europa.eu/publications-and-media/press-releases/eba-publishes-roadmap-implementation-eu-banking-package> accessed 8 February 2024.

[88] Enria, ‘The Role of Banks in Mitigating Systemic Risks Arising in the Non-Bank Financial Sector’ (n 15).

[89] Viral V Acharya and Sascha Steffen, ‘The Risk of Being a Fallen Angel and the Corporate Dash for Cash in the Midst of COVID’ (2020) 9 The Review of Corporate Finance Studies 430.

[90] Laura Noonan, ‘EU Regulators to Probe Links between Banks and Non-Banks’ *Financial Times* (3 January 2024) <https://www.ft.com/content/c7239712-fc92-48ec-8438-dafd108bbb44> accessed 9 January 2024; Laura Noonan and Katie Martin, ‘Regulators Turn up Heat on Shadow Banks after Market Blow-Ups’ *Financial Times* (29 September 2023) <https://www.ft.com/content/bcaaa173-9538-4e26-a657-223ee0bf1c0e> accessed 1 October 2023.

[91] Commission Delegated Regulation (EU) 2023/2779 of 6 September 2023 supplementing Regulation (EU) No 575/2013 of the European Parliament and of the Council with regard to regulatory technical standards specifying the criteria for the identification of shadow banking entities referred to in Article 394(2) of Regulation (EU) No 575/2013 2023 (OJ L).

[92] European Commission, ‘Report from the European Commission to the European Parliament and the Council on the Macroprudential Review for Credit Institutions, the Systemic Risks Relating to Non-Bank Financial Intermediaries (NBFIs) and Their Interconnectedness with Credit Institutions, under Article 513 of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on Prudential Requirements for Credit Institutions and Amending Regulation (EU) No 648/2012’ (European Commission 2024) COM(2024) 21 final <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=COM:2024:21:FIN> accessed 30 January 2024.

[93] European Parliament, ‘Deal on Updating the EU’s Rules Regulating the Insurance Sector’ (13 December 2023) <https://www.europarl.europa.eu/news/en/press-room/20231212IPR15865/deal-on-updating-the-eu-s-rules-regulating-the-insurance-sector> accessed 8 February 2024; Issam Hallak, ‘Insurance Recovery and Resolution Directive’ (2023) PE 739.273 EPRS Legislation in progress Briefing.

are channelled to the EU economic recovery post-Covid, as well as in the context of the European Green Deal and digital transformation, with a reduction of the cost-of-capital rate and reserve insurance firms must hold.

In terms of the green and digital transitions,[94] the financing needs are enormous. As stressed by EU institutions' presidents: 'the lion's share will need to come from private capital'[95] while public investment has a role in setting the overall policy direction and giving right incentives to private capital (including through Multilateral Development Banks such as the European Investment Bank and National promotional banks). The EU green transition relies on a substantial amount of new regulation and initiatives at EU level in the banking and finance field,[96] and in the context of international standards.[97] The reviews mentioned above in EU Banking and Financial Regulation all took on sustainability concerns, and the intent to incentivise banks and financial institutions play their role. Furthermore, the digital transformation of the banks' business models and their management of IT and cyber risks[98] happens in the context of the wider EU development and regulation of the Digital Single Market.

The last challenge in setting a Financial Union relates to its governance model and institutional structures in accordance with EU primary law. As observed above, we have manifold institutions and agencies in the BU and ESFS, who cooperates with each other, try to reach supervisory convergence and common approaches in their application of the EU Single Rulebooks (albeit with a differentiation between BU-wide and internal market-wide). The Financial Union would require, by following Treaty provisions that heavily constrained the current architecture,[99] to create another twin concentric circle with a dual nature. Moloney suggested a euro-area Financial Union, within a wider CMU.[100] On the one hand, a core Financial Union could correspond to BU-wide (i.e., BU and CMU as applicable to euro area and BU participating Member States), and on the other, an EU-wide CMU based on EU Single Rulebooks. In such a case, the Financial Union would be, as for the Banking Union, a possibility for non-euro area Member States to join as 'participating Member States'. They would be by default part of the CMU with common rules and (sectoral) institutions that are single capital market wide.

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[94] See Chapter 11 in this volume.

[95] European Council Press release (n 11).

[96] Iris HY Chiu, Lin Lin and David Rouch, 'Law and Regulation for Sustainable Finance' (2022) 23 European Business Organization Law Review 1; Danny Busch, Guido Ferrarini and Grunewald, *Sustainable Finance in Europe* (2nd edn, Palgrave Macmillan 2024) <https://link.springer.com/book/9783031536953> accessed 9 February 2024; Armin Steinbach, 'The Greening of the Economic and Monetary Union' (2022) 59 Common Market Law Review <https://kluwerlawonline.com/api/Product/CitationPDFURL?file=Journals\COLA\COLA2022028.pdf> accessed 9 February 2024.

[97] See the work by the Network for Greening the Financial System in particular.

[98] ECB Banking Supervision, 'Supervising the Future of Banking: Navigating the Digital Transformation - Blog Post by Elizabeth McCaul, Member of the Supervisory Board of the ECB' (*The Supervision Blog*, 10 March 2023) <https://www.bankingsupervision.europa.eu/press/blog/2023/html/ssm.blog230310~d91c37f468.en.html> accessed 10 March 2023; Thorsten Beck and others, 'Three Scenarios for the Financial System in 2030 - Will Video Kill the Radio Star? Digitalisation and the Future of Banking' (2022) 12 Reports of the Advisory Scientific Committee - ESRB <https://www.ssrn.com/abstract=4012413> accessed 4 April 2023.

[99] Federico Fabbrini, *Economic Governance in Europe : Comparative Paradoxes, Constitutional Challenges* (Oxford University Press 2016).

[100] This has also been thought of as inner layer and outer layer, see Moloney (n 25) 397–8.

5. Conclusions

In order to pursue and achieve the green and digital transitions, as well as other social and economic policies, it is essential to complete the BU and relaunch the CMU. They will form together the Financial Union, provided they rest upon a coherent institutional, regulatory framework, embraced by the institutional investors, banking and market actors, as well as the non-bank financial institutions. However, the NGEU framework for the EU recovery and the funding of structural reforms post-Covid-19 have put constraints on public budgets with major investment needs.[101] Against this background, this chapter argued that the compelling necessity for a Financial Union has been boosted by the NGEU framework.

Banking, capital and financial markets are fundamental to raise public and private capital and allocate resources to funding for reforms. A single market for capital and banking will also ensure cross-border flows, funding for SMEs and innovation, which contributes to growth and the real economy. The transformation of the EU in a more balanced bank and market-based economy may take time considering the manifold evolutions necessary at institutional and regulatory level, and from the institutional investors and market actors' perspectives (i.e., among others, in terms of behaviour, credibility and acceptance of the market actors themselves).

The post-financial crisis reforms brought us a more reliable and sound banking sector, better capitalised and with liquidity to withstand shocks, as it did at the start of the pandemic, when it provided its critical intermediation function to the real economy. As the chapter examined, several measures were adopted to guarantee this role and safeguard financial stability. First, policymakers and the co-legislators acted swiftly and significantly to make sure banks continue to provide such function and liberate capital for funding to keep lending to borrowers. Second, EU level actions were also reinforced by national measures, for instance the moratoria on loans payments and PGS. Third, financial markets were key in the EU bond issuances, a nascent European 'safe asset' albeit with a temporary nature.

The chapter elaborated on the legislative evolutions in EU banking and capital markets law. These evolutions ultimately show deeper, ongoing transformations that have been accelerated by the EU recovery policy agenda. Indeed, regulatory interventions were initially made in an emergency with quick fixes but were followed by more substantial reviews in EU Banking and Financial Regulation – for some already in the pipeline but accelerated by the pandemic effects (among others, and as illustrated, the CRR/CRD, the CMDI review, the Solvency II rules, the IRRD, the AML package).

Overall, in the ongoing EU banking and finance transformation, we can find several policy objectives at the interplay of EMU deepening strictly and, more generally, addressing some transversal societal challenges. As the chapter discussed, on top of technical dimensions and the overarching objective to build integrated and stable European markets, the regulatory changes take on transversal challenges and an intergenerational agenda propelled by NGEU. When examining EU Banking and Financial Regulation, one can attest of the rapid and substantial changes to facilitate and foster an economic recovery in the EU with a significant care for sustainability, the green and digital transition.

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[101] See in this volume, Chapters 4 and 17.

Such regulatory developments and approaches happened along the adoption and implementation of NGEU policies and measures. In the post-pandemic economic governance, other financing needs add up to the EU recovery funding programmes, not only the massive EU green investments but also the financial support for Ukraine.[102] This is why the current review of the regulatory apparatus should sooner than later be joined by a more ambitious institutional overhaul – where the Financial Union indeed becomes a compelling EU policy priority.

[102] See Chapter 22 in this volume.