bankenverband

Strengthening Europe's sovereignty

Position paper of the Association of German Banks

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Summary: how to strengthen European sovereignty

The European Union faces the once-in-a-century task of asserting itself – as a community – politically, economically and socially in a world of global competition. Europe's economy will remain dependent in this process on open and secure world markets to unfold its strength. But for Europe, too, competitiveness and strategic direction are interrelated. The EU financial market has a key role to play in ensuring Europe's economic success, competitiveness and sovereignty. This applies especially to capital markets union, economic and monetary union – including the role of the euro – digital sovereignty and European payment systems. At the same time, political union must be moved forward in order to safeguard Europe. This includes a common foreign policy.

We welcome, in this context, the European Commission's communication of 19 January 2021 ("fostering openness, strength and resilience"), which addresses this issue and underscores the strategic relevance of strong financial markets. In our view, however, the communication and the actions it proposes do not go far enough. The communication takes insufficient account of important prerequisites like political unity, material foundations and interrelationships such as foreign and security policy resources, and sovereignty over the digital transformation and payments. Below, we set out our position on the question of how European sovereignty can be strengthened.

1. Political sovereignty

- The European Union – like any political community – needs sovereignty in order to ensure its security and prosperity and to safeguard its interests in a world of global competition.
- So political sovereignty is neither a question of prestige nor an end in itself. It means global heft and a **seat at the global table**, **not isolationism** or disengagement. And this applies both to international negotiations and institutions and to bilateral relations. Political sovereignty therefore only makes sense if it **offers solutions**.
- The EU will continue to base its prosperity on the deep **global integration** of its economy. As global economic relations are contested, it is becoming increasingly important for the EU to play an active and strategic role. It must do so, on the one hand, to establish and uphold multilateral rules and, on the other, to better protect against political or economic pressure from third parties ("weaponizing interdependence", "economic coercion").
- **Transatlantic cooperation** remains the most sensible anchor for the EU. Europe's security remains dependent on US commitment, and this goes not only for securing transport routes and access to raw materials but for much else besides. What is more, the close integration of both sides' economies and financial sectors continues to benefit Europeans, too, and should not be put at risk. Further fragmentation of markets is not in Europe's interests.
- The EU cannot remain neutral or on the sidelines in the face of the growing **rivalry between China and the US**. Instead, as in past decades, it must position itself where possible in the framework of transatlantic cooperation.
- The EU has yet to realise its potential as a single actor in international institutions. This continues to apply to the UN, but also to supranational financial policy institutions such as the Basel Committee, the Financial Stability Board or the International Monetary Fund.
- To strengthen its sovereignty and role in international relations, the EU – like any political community – needs to fulfil the **material prerequisites** to do so and have a coherent **strategic orientation**. This is only possible with realistic guidelines and staying power. "Actionism" will not prove helpful.
- A key precondition for protecting the European and thus the German economy is that EU member states do not allow themselves to be divided and ruled. Unfortunately, it is still far too easy to disunite the EU – in the face, for example, of calls by third parties to boycott individual countries. The EU is a market with strong purchasing power and a productive investment location with almost 450 million citizens. When the EU speaks with a single voice on foreign trade policy, this carries weight and is not ignored by third parties.
- Crucial to the **long-term success** of an EU strategy is that it thinks beyond foreign trade policy and takes a holistic view of the various aspects of the economy and foreign policy as a whole. This requires a **strong, integrated financial and capital market** as well as a **digital strategy** that includes sovereign payments processing, cybersecurity, and platform, infrastructure and data sovereignty. The goal should be to avoid further asymmetries, i.e. unilateral dependence on third parties. Mutual dependencies, on the other hand, are a natural part of the global economic system.
- The financial sector is of strategic relevance to Europe's sovereignty. A strong financial market is an essential – though in itself insufficient – prerequisite for Europe's sovereignty.

This means, conversely, that the financial market is by no means Europe's only potential weak point and open door to outside influence. Classical defence capability and **political unity** remain prerequisites – asymmetries or dependencies in this area cannot be counterbalanced by economic strength alone.

- For Germany and the EU, it is as true today as it has been for many decades that **rigorous multilateralism** is in their own geostrategic interest. Multilateralism means stable partnerships, institutions and rules-based action, both within and outside the EU. It does not mean shifting ad hoc coalitions with those who are currently like-minded.
- It continues to be the case that the EU economy – be it in the absence of other power resources in European politics – is dependent on a stable international legal framework. Its central principles include the rule of law, mutual market access (reciprocity), data protection, the protection of intellectual property, the liberalisation of currencies and the free movement of capital.

2. A strong capital markets union

- It remains crucially important for Europe to substantially expand its economic strength and be prepared for future challenges.
- This includes the development of a deep, efficient and integrated capital market (capital markets union, CMU) against the backdrop of a strong internal financial market in the EU (key action 1 of the Commission's communication). The European financial market must be made more **competitive**, as well as **more attractive and open** to foreign investors, in particular.
- The Association of German Banks therefore welcomes both the action plan on capital markets union of September 2020 and the reform and modernisation of European **energy and commodity markets** proposed in the communication of January 2021. We consider it especially important to target the promotion and development of euro indices and benchmarks as well as trading in euro-denominated financial instruments, including derivatives (key action 2). These measures, and the CMU project as a whole, should not focus on operators of trading venues alone but must take account of banks as service providers and intermediaries of issuers and investors – and thus as important actors in the capital market. Otherwise, the development potential needed to strengthen the European economy will be severely limited. Unlike trading venue operators, which bring together securities trades placed by investors without taking on any risk themselves, banks perform a wide range of valuable tasks: from issuing and bilateral and multilateral trading, to securities settlement, custody and servicing, often deploying their own capital and assuming risk in the process. Generally speaking, strong capital markets, such as the US and UK, have **strong banks**.
- We support the planned promotion and strengthening of European **emissions trading**. As in energy and commodities trading, the goal here should be to establish an efficient and internationally competitive European market (key action 5).
- Our association welcomes the announced establishment of a working group to discuss the desired reduction of euro-denominated interest rate derivative exposures to central

counterparties in the United Kingdom (**UK CCPs**) and the transfer of some of these exposures to the EU. The German banks recognise the need for action given the temporary nature of the current equivalence decisions and are already addressing this issue and the associated challenges in depth. They are prepared to actively support work in this area. It will be important to carefully analyse the considerable challenges and economic implications and to find solutions that will ensure the international competitiveness of European banks and the European financial market. In particular, it is vital to avoid restricting EU access to international capital markets. With this in mind, our association recommends an incentives-based approach, combined with further standardisation of the European regulatory framework and targeted regulatory relief. This is the only way to ensure the necessary supply of liquidity (key action 8).

- A transparent, consistent and dependable **EU equivalence regime** will give the European single financial market strong support. It is in the interests of the European Union to provide EU market participants with a system to support their strategic planning and long-term decision-making processes and strengthen their global competitiveness.

3. Role of the euro

- In principle, the operational prerequisites for a **reserve currency** in the EU are met. The primary starting points for strengthening the international role of the euro (key action 3) should, however, be twofold:
  1. The remaining deficiencies in the **market depth**, **market volume** and integration of European financial and capital markets (including in derivatives) should be eliminated.
  2. The potential growth and economic dynamism in the EU and euro area should be strengthened. Greater **economic dynamism** could be achieved above all through better economic policy coordination (including further steps towards fiscal integration) and by setting clear economic policy priorities for innovation and investment.
- With a strong focus on these two developments, the euro would become more attractive both as an **investment currency** (also for outsiders) and a **transaction currency** (especially for global trade in goods, commodities and foreign exchange), thus gaining in influence overall. The role of the euro as a reserve currency in the international monetary system could be strengthened, thereby counteracting existing or future dependence.
- We do not share the expectation that the “Next Generation EU” and SURE programmes will make the EU one of the world’s largest issuers of **sovereign bonds** and that this will strengthen the position of the euro. These issuances may indeed lead to a more liquid euro capital market. But the higher level of debt will only succeed in helping to strengthen the euro if the funds raised are used of to strengthen economic stability. For this to happen, the funds will need to be deployed first and foremost for forward-looking purposes which will above all support structural change in the areas of climate protection and digitisation. There is insufficient guarantee that this will be the case as things stand. Since the funds are raised at European level, the EU would also need to be given an extensive say in how these funds are spent in member states.

- Status as an international reserve currency presupposes a stable and economically dynamic **currency area**. The euro area is still incomplete, however. There is particular room for improvement in economic policy coordination and joint strengthening of growth potential (including structural reform). We therefore need a serious discussion of the necessary coordination and integration measures (such as fiscal union, harmonisation of tax regimes, strengthening of the European Parliament) and a corresponding development of the EU in this direction.
- It is only the **attractiveness** of the European economy (see two primary starting points above), and not technical measures, that can significantly strengthen the euro as a transaction and investment currency. We are critical of proposals that would “mandate” the use of the euro for invoicing imported goods, for instance. Such measures are likely to increase transaction costs and thus make trade less efficient. The more preferable approach by far would be to set positive incentives to use the euro as a transaction currency voluntarily. These include large and deep financial markets in the EU (including foreign exchange markets), as well as good prospects of economic stability, which will ultimately reduce the risk of unexpected exchange rate swings.
- Furthermore, some key obstacles are not adequately addressed by the Commission communication. This applies especially to:
  - uncertainty about the **stability** of the euro area. In the financial and sovereign debt crisis, the financial and political stability of the EU was called into question. This experience has not been forgotten.
  - The difficult dynamics of recent years (Brexit, political/constitutional rifts between some central eastern European states and the rest of the EU, tensions between southern and northern Europe) are likely to further diminish the stability of the EU and thus the chances of the euro assuming the role of a reserve currency.

4. Digital euro

- A digital currency (key action 6) is necessary to offer suitable payment methods for servicing an economy partially converted to blockchain technology. Documentary transactions in export financing are going digital, for example, and need digital means of payment to fully exploit the efficiency gains.
- The one-way dependence of the European economy on a digital currency controlled by another region of the world, such as the US or China, or even by private corporations, would weaken Europe’s sovereignty. Conversely, to strengthen Europe’s sovereignty in a world of global competition, a digital euro must be developed that can hold its own alongside other digital currencies.
- As a central bank digital currency, the digital euro would remain embedded in the global monetary and financial system (with the US dollar a strong reserve currency). Banks would continue to operate as intermediaries. Here, too, isolationism or the creation of a parallel system will serve no useful purpose.

5. Digital sovereignty

- "Digital sovereignty" means Europe's aspiration and ability to become more independent in the digital world. Digital sovereignty can be understood in the sense of both protective mechanisms and active instruments aimed at promoting digital innovation.
- A European Commission report on media sovereignty (of March 2019) stresses that the **power of global tech companies** that put data appropriation and valuation at the heart of their strategy while not always abiding by European rules and fundamental values constitutes a major political challenge for Europe. In 2019, the European Parliament also expressed deep concern about the security threats associated with the growing technological presence of China in the EU and called for possible action at EU level to reduce this dependence.
- The private banks agree that the EU must create a true **digital single market** as the basis for achieving this. The coronavirus pandemic has demonstrated just how important a digital single market is. A coherent European legal framework for digital services is a first step in this direction.
- Europe's digital sovereignty is vital to the **ability** of European businesses and organisations **to innovate**. Equal consideration should be given to providers and users since the users of IT services and success-critical digital technologies depend on there being adequate competition among providers. Banks, as users of numerous IT services, have felt this for years. It is therefore extremely important to establish a competitive European IT provider landscape, especially in the area of **cloud** IT, and to actively promote European IT cooperation projects, such as the German government's **GAIA-X** initiative to create an open data infrastructure. These initiatives will help to gain **sovereignty over infrastructure**.
- A related issue is the development of **secure technological infrastructures** (such as 5G) and a **digital euro**. Although Europe has a sovereign and efficient payments infrastructure with its payments system based on the SEPA standard, this is under threat from initiatives such as Facebook's Libra (now renamed Diem). To introduce a programmable euro and meet the needs of industry in the Internet of Things (IoT), on the other hand, it will be essential to have an efficient telecommunications network. True digital infrastructure sovereignty can, moreover, only be achieved through strong European expertise in the area of **cybersecurity** because this will dominate future security policy issues.
- Data lie at the core of value creation in the digital economy and are a strategic production and competitive factor. The financial industry has supported the principle of **data sovereignty** with the Europe-wide opening of interfaces in payment systems since the introduction of second European Payment Services Directive, or PSD2 for short. This is currently a one-way opening, however, to the disadvantage of the financial industry. We now need to see an opening up of interfaces in all industries, such as big tech, since promoting a cross-industry exchange of data is critical to European data sovereignty. This includes the freedom of customers to make decisions on the storage, processing, access and use of their data at any time. Among other things, this will enable banks to better respond to customer needs and to modernise and thus significantly improve their risk management.
- **Decision-making sovereignty** in the digital world is becoming increasingly dependent on expertise in the field of artificial intelligence. Entire business models and even state actions

are based more and more on the evaluation of huge amounts of data by complex algorithms. COVID-19 has already shown that decisions based on the use of advanced AI systems can deliver considerable benefits in terms of combatting pandemics. The US and China are currently at the forefront of AI research and development. A lack of European expertise in this area may have devastating consequences for European sovereignty, as technologies will have to be bought blindly without any real possibility of scrutiny. Even today, a full reconstruction of every decision may not always be possible when advanced AI methods such as neural networks are used. Yet the ability to understand the source and rationale of decisions and recommendations made by autonomous systems and, if necessary, influence them is important both for individuals and for companies and industries. A sense of proportion will be needed if decision-making sovereignty is to be established vis-à-vis big US and Chinese technology firms while avoiding the imposition of excessive regulation on European providers such as banks.

- In the interests of **platform sovereignty**, there is a need to counter market distortion resulting from the gatekeeper function of large online platforms by revising the regulation of digital services and modernising competition law. Banks are particularly affected as they already encounter large online platforms as competitors in some areas but at the same time depend on cooperating with them, such as on the expansion of cloud technology in banking IT. Banks are becoming especially dependent on platforms to acquire new customers: the customer journey usually starts with providers like Google. The banks are getting left behind here because they are gradually losing their customer interfaces. A digital European identity network in the form of a public-private partnership between all industries and governments could act as a counterweight to identification solutions offered by large platforms. But an enormous dependency and loss of interface can also be observed when it comes to existing customers, as experience with Apple Pay, Samsung Pay and Google Pay makes clear.
- Digital sovereignty should be achieved not by trying to copy existing strategies in other countries but by Europe setting its own forward-looking priorities and following its own path. This **European path** should feature values and standards like trust, openness, a high level of data protection and smart governance. Time is short, however: digitisation is not subject to a linear innovation process; it is exponential, and top priority should be given to acting without delay.

6. Sovereignty over European payments

- The importance of electronic payments has grown considerably with the increasing digitisation of economic activity and consumer behaviour. At the same time, it has become a key that unlocks other business models – some of which extend far beyond traditional banking and finance. The growing dependence on mostly US payment providers and tech companies has made banks and their customers vulnerable in this strategic field. This applies, in particular, to retail payments both at actual cash registers in shops and in e-commerce.

- In addition, effective payment services within an economic area are considered vital for the strength of the respective currency. As a result, sovereignty of payments has a direct impact on the economic sovereignty of the national economy and its public and private actors.
- Sovereignty certainly does not mean relying solely on European products and technology – the international networking of value creation in payments should not only be considered a dependency, but also the result of successful partnerships that are in the interests of private and corporate customers. Sovereignty in this context means being able to (co-)determine rules for these partnerships that are in line with European needs and interests.
- So there also needs to be a **strengthening of European offers**. The banking industry has already achieved a lot in this area, for example its development of a standardised SEPA procedure for instant payments. The task now is to further develop this preparatory work into payment solutions that are both convenient for businesses and consumers, and can be used throughout Europe. German banks are tackling this challenge on several fronts. The most ambitious example here is the European Payments Initiative, where institutions from a number of member states are aiming to create joint payment solutions for cash registers in shops and for e-commerce.
- Political, legislative and private sector measures to strengthen European sovereignty over payments must grasp their interactions with other aspects of digital sovereignty – and at the same time see them as an opportunity. Particularly when it comes to retail payments, the service attributable to payments in the narrower sense is increasingly dependent on additional technological components. The most obvious examples are consumers' mobile devices (smartphones, etc.) which are included in the added value. At the same time, payments and the data generated from them enable other digital business models that may also have an impact on areas of society and the economy beyond the financial sector and can generate added value.
- With its Retail Payments Strategy, the European Commission has presented a potential roadmap for future regulation of the European payments sector. While the banking industry shares this goal of strengthening European offers and thereby European sovereignty, choosing the required instruments to achieve it will need some careful thought. Placing a one-sided burden on the banking industry, as occurred with PSD2, and technological overregulation will thwart this policy objective. The same applies to further price-setting restrictions in payments. Rather, it must be about allowing banks to "scale up", at least in terms of partnerships and generating viable business models and economies of scale with these partnerships to finance large investments.

7. Protecting the European economy

- *Economic coercion* is a collective term currently used to describe – usually without much differentiation – various forms of economic policy pressure put on the EU and its economy from very different third parties. They range from China's boycotting of products from individual EU countries (e.g. to stifle criticism) to extra-territorial US sanctions that also affect the EU and its economic operators.

- In structural terms, banks and other financial market actors are closely integrated into the international financial system, which is strongly influenced by the US market and the US dollar. As a result of this **integration**, European banks can act globally and thus support their domestic economies on the world stage: they benefit from it, but are nevertheless dependent on it. US sanctions usually start here, i.e. with the financing of (sanctioned) transactions via banks. However, this interdependency cannot simply be shut down with legal or technical measures. In addition, a number of conflicts have shown that banks and investors are by no means the only potential "gateway" for external pressure. Sanctions also work directly via the companies and political officials involved.
- For globally active banks, it is a matter of acting **within the framework of international law**, including sanctions regimes and strict anti-money laundering (AML) and countering the financing of terrorism (CFT) legislation. The accusation that banks are "overcompliant", that their interpretations of these rules are overcautious (to the detriment of the companies or projects being financed and therefore to their own clients), is unfounded. For banks – and their anti-money laundering compliance officers who are personally liable in these matters – the process of deciding which businesses can be financed within the existing legal framework is a complex one and the conclusion can leave them legally responsible.
- Against this background, there are discussions on strengthening the **EU's Blocking Statute** (key action 15). This would not resolve the dilemma that banks are subject to conflicting legal requirements from various jurisdictions, but rather exacerbate it. On the contrary, the policy objective must be to standardise EU and US sanctions regimes and to counter the growing trend towards extra-territorial effects and claims of validity that go too far. The high standard of internationally applicable AML/CFT regulations ought not to be weakened, but further strengthened in its implementation.
- Due to the exclusion of an individual (sanctioned) state from **SWIFT**, its role and political constellation are also being discussed (though this is not addressed in the communication). However, SWIFT is part of the globally networked and multilaterally organised financial system and remains fundamental to the EU market. The joint interests of the EU and the US have priority here. SWIFT is part of the solution for the European economy, not part of the problem. In this context, there can be no autonomous institutional solution limited to the EU.
- European banks and companies can only be expected to resist external calls for boycotts, for example, in the sense of the EU's Blocking Statute, if they receive effective and complete support and protection from European policymakers and the legal situation allows them to do so without consequence.
- In terms of a European response to third-party measures, it might be helpful to create a **European agency** (key actions 10 and 11) to act as a centre of competence for sanctions issues, but also for investment protection controls. This would help shape European opinion on these matters and would support the strategic direction of the EU with analysis and information, and install a specific contact person at EU level, both for European businesses and for the corresponding foreign authorities.