THE EUROPEAN RECOVERY IN 2021

Enabling the European financial sector to support a digital and sustainable recovery

MARCH 2021

European Financial Services
Round Table

The European Financial Services Round Table (EFR) was formed in 2001. The Members of EFR are Chairmen and Chief Executive Officers of international banks or insurers with headquarters in Europe. EFR Members believe that a fully integrated EU financial market, a Single Market with consistent rules and requirements, combined with a strong, stable and competitive European financial services industry will lead to increased choice and better value for all users of financial services across the Member States of the European Union. An open and integrated market reflecting the diversity of banking and insurance business models will support investment and growth, expanding the overall soundness and competitiveness of the European economy.

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European Commission President **Ursula von der Leyen**, 17 September 2020

"The Recovery and Resilience Facility is at the very heart of NextGenerationEU. It is our key tool to turn the immediate challenges presented by the coronavirus pandemic into a long-term opportunity. Member States need clear guidance to ensure the Facility's € 672 billion is invested both for Europe's immediate economic recovery, but also for long-term sustainable and inclusive growth."

European Commissioner **Mairead McGuinness**, opening remarks ECON Committee 25 January 2021

"Our main objective this year is to ensure we have an open, strong and resilient economic and financial system, based on solid market infrastructures. A strong economic and financial system will be based on completing the Banking Union and developing the Capital Markets Union."

"We will review Solvency II to make sure the regulatory framework remains fit for purpose, and to allow the sector contribute to the recovery, the Capital Markets Union and the Green Deal."

European Commissioner **Thierry Breton**, 15 December 2020:

"The EU is pushing for stronger and competitive capital markets, so that businesses and investors can reap the full benefits of the single market. We have already established the building blocks of a CMU and now we have to reflect and consult on how to take this flagship project forward."

A. INTRODUCTION

The year 2021 will have a strong focus on the continuation of addressing the COVID-19 pandemic - with the vaccination program and other health measures - but most certainly also with a great emphasis on taking the necessary measures to address both the human and socio-economic consequences. A coordinated response from the authorities in 2020 has already successfully mitigated the economic impact of COVID-19 and we would like to congratulate the European Commission for its major role in this e.g. suspension of state aid rules and the stability and growth pact, the Capital Requirements Regulation (CRR) quick-fix, the Capital Markets Recovery package, its role in developing the European instrument for temporary Support to mitigate Unemployment Risks in an Emergency (SURE) and the NextGenerationEU.

Concerning the economic outlook for 2021, on 20 January 2021 the International Monetary Fund has raised - amid exceptional uncertainty - its earlier prediction for global economic growth this year from 5.2% to 5.5% and 4.2% in 2022. During the press briefing IMF Chief Economist Gita Gopinath stated that the strength of the projected recovery varies significantly across countries and that China and the US are well ahead of the euro-area.

For the European recovery, the EU has adopted in December 2020 the EU's long-term budget and the recovery plan NextGenerationEU, which should help repair the economic and social damage caused by the coronavirus pandemic and which aims to lay the foundations for a modern and more sustainable Europe that post-COVID-19 will be greener, more digital, more resilient and better fit for the current and forthcoming challenges.

The EFR Members support these goals of economic and social recovery as well as the important policy topics of the digital and the sustainable agenda. The financial sector will also play its role in the recovery. While the crisis is not finished yet and 2021 started with a lot of challenges, the EFR is also looking to the future and to the lessons of the crisis. We think that there is a significant opportunity for policymakers and the private sector to work together on solutions to help our economy emerge stronger. Those include helping companies to rebuild their balance-sheets through greater access to capital markets for both debt and equity, educating our small to medium-sized corporates of the many financing options available and, more broadly, promoting financial education and literacy. All of the EFR institutions invest significant time and resources in financial education and literacy programmes and the current crisis illustrates the importance of those programmes and also the need to re-double our efforts on that front.

In its recent Paper *The European economic and financial system: fostering openness, strength and resilience*[1], the European Commission has stated that "a well-functioning financial sector is not only key for providing financing and investments for the European economy; it is an important steppingstone for EU businesses and citizens to thrive globally. Crucially, it is also instrumental in providing strong incentives for innovation in the digital economy, and for driving the green transition, as outlined in the European Green Deal." Furthermore, The European Commission stated that "Overreliance on non-EU banking could create problems in times of financial market disruption. The market share of EU investment banks has been falling over the last 15 years, both globally and in the EU. In times of financial crisis, non-EU banks may choose to reduce their presence in the EU and to focus on their domestic market. This could hamper the access of EU companies and Member States to capital-market funding, risk management solutions or other financial services, and could compromise the liquidity or even solvency of EU financial counterparties."

1 Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions, Brussels, 19.1.2021 COM(2021) 32 final.

We fully endorse these statements by the European Commission but note that the extent to which the European financial sector can play its role in the recovery and in the European economy will depend also largely on policy proposals and decisions that will affect the financial sector.

In this report we address the issues that are important for the European Commission's agenda and we make recommendations on how to address various topics concerning the prudential agenda, the sustainable finance agenda and the digital agenda.

The EFR attaches importance to a sound financial regulatory and supervisory framework. Given the important role of the European financial sector in financing the European economy, it is vital that there are no unnecessary legal or regulatory restrictions in this regard. Regulation needs to concentrate on transparency and stability in financial markets, ensuring a European as well as global level playing field and supporting the European financial industry as a central player in the European economy.

Given the paramount importance of the European recovery plan and the envisaged role for the financial sector, there must be a shift towards growth-supporting measures and not towards non-risk sensitive regulations. It is time to look holistically at the current regulatory frameworks and determine whether it suits what Europe needs to support economic growth and its competitiveness. Similarly, all new rules must work consistently and coherently to support the growth objective. For instance, the current review of Solvency II offers an opportunity for a targeted evolution of the framework to ensure that it is well placed to support the European political objectives, in particular the transition towards a greener economy and the economic recovery plan, while maintaining strong policyholder protection and further improving financial stability. Furthermore, Europe must seek to drive such discussions at international level. The diversity of business models and markets at global level and across the EU should be preserved. It has been acknowledged by different sources and regulators that diversity supports financial stability rather than compromises it.

The EFR is strongly supportive of the EU's sustainable finance agenda and the financial sector should be considered a partner in delivering the EU's climate commitments. It is noted that while the financial system is an important element in the economic transformation, it is only one component of the European economy. Policy actions should therefore be balanced between the financial system and broader economic actors.

Digitalisation and the entry of new players in financial markets can bring positive effects in terms of competition, increasing efficiency and extending the reach of financial services to cover previously underserved populations. It is important to ensure equal digital competition by effectively applying the principle of "same activities, same risks, same regulations", shifting towards an activity and risk-based approach. It is important to review the regulatory and supervisory frameworks for validity outside of the mere regulated financial sector.

The Members of EFR wish to reiterate their unwavering commitment to continue to support the European economy and their clients as we collectively face and strive to alleviate the economic consequences of this pandemic. Therefore, the EFR Members and their institutions stand ready to play their role in the European economic recovery. The recommendations given in this report will enable the financial sector to play this role.

B. SUMMARY OF MAIN ISSUES AND KEY RECOMMENDATIONS

In order to enable the European financial services sector to support the European Recovery, the European Financial Services Round Table gives the following key recommendations.
Full details are given in the Section C of this report.

GENERAL PRINCIPLES

Regulation should be aimed at transparency and stability in financial markets, that ensures a European and global level playing field, and that is supportive of the European financial industry playing a central role in financing of the European economy, to the benefit of all parts of society.

Cooperation and coordination at global level is vital for the EU. The EU should ensure that measures taken in the EU do not create global competitive disadvantages for the European financial sector. Furthermore, open EU borders should be ensured to be attractive for international (financial) institutions.

KEY RECOMMENDATIONS

1. Financial Services contributing to EU competitiveness in the digital geo-economical context

While welcoming DG FISMA's Digital Finance Package and the broader EC's Digital Strategy, some pressing issues need to be addressed so that the financial services industry will be able to contribute its full potential to the EC's overarching goal of digital strategic autonomy.

1. Fair competition in a digitally transformed market should be ensured (incl. access to infrastructure and data focusing on cross-sectoral approaches). The prudential rules for banks should be revised to reduce the burden of prudential regulation for non-core businesses within regulated groups. Globally consistent regulatory frameworks are necessary to keep Europe attractive as global hub for innovation.
2. An evolution is necessary from open banking to a cross-sectoral approach to user data sharing for the benefit of European consumers and businesses. Regulatory clarity is needed for crypto-assets and a careful consideration of the implications and opportunities of CBDCs (Central Bank Digital Currencies).
3. A coherent risk-based approach is needed for a resilient digital financial ecosystem, incl third-party risk management (e.g. Cloud Service Providers). Autonomy in payments should be achieved through pan-European market-led initiatives.

2. Making the European prudential framework fit to support the recovery

Bold and targeted measures are needed to enable that sufficient funding for the European Recovery will become available.

4. Regulatory regimes need to be fit for purpose.
   - The implementation of the final Basel III reform should be decided after a thorough impact assessment taking into account the impact of the health crisis and should avoid triggering any significant increase in capital requirements. This requires to take into account European specificities, exercising national discretion regarding operational risk (setting ILM=1) and including a pertinent solution to the output floor. The implementation of Basel III should furthermore be fully aligned in timing and in substance with other jurisdictions ensuring a fair level playing field.
   - The European Commission needs to work on removing Regulatory barriers among Member States of the Eurozone and on facilitating further integration of financial services, so that more economic integration will be stimulated and that the European recovery can be supported adequately.

- In order to cope with the sudden increase in the targeted amount of the Single Resolution Fund, the SRB should use its regulatory discretion to authorise banks to make up to 30% of their contributions in the form of Irrevocable Payments Commitments.
- The review of the Solvency II framework should result in a prudential framework that, while remaining robust, allows the European insurance industry to play a greater role in financing the European economy and in particular financing the energy and technological transition.

5. Prudential regulation should be applied by extending the activity- and risk-based approach to other parts of the regulatory framework that still remain entity-based. Regulatory obstacles that might hinder the uptake of technological innovation in the financial sector should be eliminated.
6. The Capital Markets Union should be speeded up setting a true reviving of securitisation. An equity culture should be built in Europe. Institutional investors should have incentives to hold more equity. There should be a focus on initiatives that will help mobilise the large and unproductive reserves of private savings. A common framework for insolvency should be developed.
7. Public-Private Partnerships (PPP) are essential to face new risks. For example, it is crucial to make every effort to find a solution that through the PPP mechanism can provide pandemic or multiperils insurance protection, in particular for small and medium-sized enterprises (SMEs).

3. Supporting the European sustainability agenda

The financial sector has a key role to play in mobilizing the required capital to deliver on the policy objectives under the European Green Deal. Policy actions should be balanced between the financial system and broader economic actors since the financial sector is only one component of the European economy. While the financial sector has no problem today in financing sustainable projects or investments that are investible and bankable, the problem the financial sector faces is that there are not enough investible sustainable projects in Europe and that a pipeline of sustainable investments is needed.

8. A more robust and consequent mechanism is needed to change behaviour in the real economy in the area of production and consumption via carbon pricing. This will allow to further leverage sustainable investments.
9. Political leadership is needed to trigger investment, finance and achieve the transition. Europe should aim to arrive at common standards with the US. The financial services industry can only play its role as effective as the political framework allows that to do. Policymakers should drive the transition to a low carbon economy. Governments will have to increase their commitment and accompany the necessary transition, and collaboration of private and public sector is of the essence.
10. As the accounting of activities eligible to the taxonomy will be one of the key metrics to monitor the shifting towards a carbon-neutral economy, it is essential that this tool takes into account activities in transition. Hence, the EU taxonomy for sustainable investments should be completed with a transitional approach in order to incentivize as much as possible all activities/sectors to embark on a decarbonization path.
11. The current data gap as well as the need for availability, comparability and reliability of ESG data need to be addressed. Otherwise, the integration of ESG Risks into risk management and supervisory approach and Stress testing might prove challenging for financial institutions due to a lack of reliable ESG data and ESG scenarios.
12. The societal dimension, the ‘S’ in the ESG agenda should also be properly addressed to support workers in the digital transformation process, regarding re- and upskilling and both on a financial security and mental well-being level.

C. MAIN ISSUES TO BE ADDRESSED SO THAT THE EUROPEAN FINANCIAL SERVICES SECTOR CAN PLAY ITS ROLE IN THE EUROPEAN RECOVERY

1. Financial Services contributing to EU competitiveness in the digital geo-economical context

1.1. Financial Services: a strategic sector for EU's competitiveness

The post COVID-19 economy will be more digital than ever, and Europe needs the right public policies to catalyse innovation and help the economy recover as quickly and sustainably as possible. A competitive financial sector is key to support the recovery and the autonomy of the entire European economy. To achieve that, financial services firms must be able to compete fairly in digital markets.

The EC has an opportunity to build the required foundation with its Digital Finance Package, as well as the initiatives stemming from the cross-sectoral Digital Strategy, such as the Data Governance Act (DGA), the Digital Markets Act (DMA) and the upcoming Data Act. Acting now will make markets more competitive, empower users and open up more opportunities for European firms on a global scale.

Digital transformation is based on the convergence of various underlying technologies, and produces geo-economic shifts and sectoral transitions that all influence existing financial services. Therefore, a future-proof regulatory framework needs to be able to address upcoming changes and newly created products in a holistic manner. At the same time, the regulatory and political environment must foster innovation and entrepreneurial initiatives of the private sector to empower the European economy in the global context.

Among the core principles for a regulatory framework enabling Financial Services' contribution to EU's competitiveness the EFR welcomes in particular the following priorities identified in the Digital Finance Strategy:

- **Removing obstacles** to the uptake of technology in finance and the promotion of the Single Market;
- Assessing the **impact of BigTechs** in finance and adjusting the regulatory and supervisory perimeters to capture new players with the capacity to impact financial stability (e.g. significant crypto assets, critical technology providers);
- **Creating a fair competitive** environment, e.g. via measures to ensure fair access to digital platforms for all financial service providers.

1.2. Main relevant policy areas enabling innovation and competitiveness for the European financial market

In the following paragraphs, the EFR would like to inscribe the main relevant policy areas in a conceptual framework that would enable innovation and competitiveness for the European financial market in a safe and secure manner. The EFR therefore differentiates 3 conceptual areas of attention: "above the glass" (of a digital screen, through which clients interact with any digital services, i.e. all digital customer facing aspects, improved, personalised user experiences, innovative products and services), "below the glass" (referring to technologies that work below the surface, that make the former happen, such as infrastructures, efficiency and security elements) and "frame of the glass" (the enabling context):

1. **"frame of the glass"** – the indispensable context:

- **Ensuring fair competition** in a digitally transformed market, including fair access to relevant technological infrastructure and data;
- **Revision of prudential rules for banking groups** not only to adequately regulate the new entrants, but also to reduce the burden of prudential regulation for non-core businesses within regulated groups, to be able to innovate at speed;
- **Globally consistent regulatory frameworks** to avoid the risk of reducing the attractiveness of Europe as a global hub for innovation, compared to other jurisdictions, potentially isolating the EU from a global market of innovators.

2. **"above the glass"** – new user experiences:

- Evolution from sector-specific data interventions, such as **open banking, to a cross-sectoral approach to data sharing** for the benefit of European consumers and businesses;
- **Creating legal and regulatory clarity and international alignment for crypto-assets,** and a careful consideration of the implications and challenges of CBDCs (Central Bank Digital Currencies).

3. **"below the glass"** – the underlying technology to make it happen, in an efficient and secure way:

- **Implementing a coherent risk-based approach for a resilient digital ecosystem** which does not restrict access to innovation while ensuring minimum security requirements for all actors in the financial services value chain, including third-party risk management (e.g. Cloud Service Providers);
- Driving **autonomy in payments** through pan-European market-led initiatives.

1. The frame of the glass

Fair competition with platforms

In the broader context, the EFR supports the EC's work to ensure that digital markets remain open to competition and innovation. Clear rules and enforcement priorities for large online platforms must address imbalances in the digital economy and ensure all firms can compete on an equal footing.

As proposed in the Digital Markets Act (DMA) and to address anti-competitive dynamics, it is paramount that clear ex-ante rules prohibit certain practices (e.g. self-preferencing) for platforms acting as gatekeepers. This will ensure that digital markets remain fair, competitive and contestable. We support the EC's intention to limit regulatory action to the very few large platforms with a market-gatekeeper role, rather than affecting the platform business model itself.

This new framework should guarantee fair access to platforms, including app stores and communication technologies that are part of operating systems, and should give platform users (individuals and businesses) effective portability tools to be able to move or share their data and multi-home. This would help to reduce lock-in effects and encourage wider innovation. This would also solve partially the data issue addressed in the point below, which is common in all gatekeeping contexts.

In complement to the ex-ante regulation proposed in the DMA, it is of particular importance to ensure active enforcement of the competition policy framework.

Prudential rules for banks

The consolidated application of prudential requirements implies that financial institutions' subsidiaries conducting the same activities as BigTechs or FinTechs (e.g. consumer lending, e-money, payment services) face an additional layer of requirements on top of those that are relevant for the activity in question. This leads to several competitive disadvantages for the companies launching technology innovative solutions being part of banking groups, vis-à-vis non-financial entities or non-EU companies. Authorities should consider how to limit the negative implications of prudential consolidation, advancing towards more activity and risk-based regulation – consistently applying the principle of "same activities, same risks, same rules".

Including new players into the regulatory and supervisory perimeter is an important step towards enforcing this principle, in line with the recent Financial Stability Institute recommendations[2] applying for example the same AML / CTF requirements to BigTechs and FinTechs that offer financial services. However, it is only one side of the coin, as it should also apply to better target prudential requirements for financial institutions on the actual risks stemming from their activities. Especially in the context of non-core banking activities, regulatory requirements regarding capital, corporate structure, use of technology, and workforce remuneration are not proportionate and create competitive disadvantages for banks, ultimately reducing innovation.

Therefore, the ESAs' report on the value chains, platformisation, and mixed activity groups - in response to the EC's call for advice as part of the Digital Finance Strategy - should explicitly outline how the proportionality principle embedded in financial regulation could be more consistently applied within banking groups to reduce the duplicated burden.

Globally consistent regulatory framework

The EC should bear in mind that the EU financial sector is part of a globally interconnected market. A globally consistent regulatory framework is therefore critical for maintaining financial stability and protecting end users, to address gaps in supervision across jurisdictions that could create systemic vulnerabilities. Any European development on the regulation of innovative technologies should be coordinated with the ongoing global risk assessments or initiatives (e.g. G7/G20, FSB, BIS, IOSCO) and adhere to global standards in order to maintain interoperability.

Moreover, following the example of the DLT pilot scheme, the testing of innovative technologies across multiple jurisdictions should be accelerated in the EU. Efforts should focus on facilitating knowledge sharing between regulators and a wider network of market participants, and on a joint work on policy and regulatory requirements applied to innovative technologies, ensuring they are safely implemented. In this regard, we recommend for the EC to support global initiatives such as the BIS Innovation Hub and the Global Financial Innovation Network (GFIN) or similar initiatives.

2. Above the glass

Open Finance and Data

Any efforts on data access and sharing should follow a cross-sector approach to avoid deepening the competitive imbalance that follows from the asymmetric data access obligations introduced by PSD2 for banks. The forthcoming Data Act, to be developed before the open finance proposal, should put this cross-sectoral approach to data access into practice.

2 FSI Paper on Fintech regulation: how to achieve a level playing field, 2 February 2021.

In a citizen and customer-centric approach, users should have greater control over their data and be able to share it with market participants under an appropriate cross-sector framework, respecting database property protection rules. The DMA takes a first step in that direction by rebalancing current asymmetries. In that regard, further alignment and consideration of country-specific laws and EU laws is necessary to ensure a safe and efficient functioning of data sharing initiatives.

New rules for data intermediaries (as in the DGA) should facilitate the provision and use of these services, but refrain from prescribing particular business models, and allow consumers to choose between porting their data via an intermediary or directly from one firm to another.

These approaches would result in increased opportunities for European consumers and businesses to thrive in the data economy.

Specifically for "Open Finance", it will be important to avoid a direct copy-across of the PSD2 framework to other financial services and products and ensure that a thorough review of the existing framework is undertaken in order to remedy and prevent unintended side effects. It will also be important to ensure that any potential open finance framework takes a holistic approach to relevant players, regardless of them being financial entities, and that it is coordinated in timing and extent with other initiatives, such as the EU data strategy and governance framework, the upcoming Data Act and the DMA.

Data policies expand the ecosystem of providers that users can use to access financial services. In this context, rules regarding responsibilities and liabilities must be clearly defined between the different participating players. For example, it must be considered how and where to assign liability for a data breach from a third party and for the resulting harm to users.

Crypto-assets and CBDCs

The EFR welcomes the EC's proposal to clarify the classification and regulatory treatment of different types of crypto-assets and the proposal for a DLT infrastructure pilot regime. The former is in general consistent with the principle of "same activity, same risk, same regulation". However, we would welcome some clarity on the treatment of Decentralised Finance (DeFi) within the EU.

The publication of the ECB Report on a digital euro (October 2020) is an important milestone in the central bank exploration of the opportunities and challenges of Central Bank Digital Currencies (CBDCs). The potential issuance of a CBDC requires a careful analysis of the concrete needs it aims to cover, its viability and the effects it may have on financial intermediation, financial stability and monetary policy. In this regard, we welcome the attentive approach of the ECB, whose report rightly identifies some key principles that a "digital euro" should follow: i) avoiding its use as a form of investment and the associated large shifts from bank deposits, ii) creating synergies with private payment solutions, and iii) relying on supervised payment providers for the provision of user-facing services and the development of new business models.

Moreover, we believe that the ECB's exploration phase should analyse regulatory and legal risks, in particular: i) Data privacy, where private data could potentially be exposed to those holding the digital money, especially in the case of retail tokens; ii) Cybersecurity, where the introduction of a "digital euro" would present a completely different cyber resilience challenge for the Central Bank (although cyberthreats are already part of the current payment, clearing and settlement risks); and iii) the AML/KYC risks associated with the use of a "digital euro", that could require further AML due diligence procedures.

We invite authorities to also explore the possibilities to enhance the efficiency and the effectiveness of supervision, embedding supervisory and monitoring frameworks directly into the system.

And finally, before the ECB decides to issue a CBDC, it should be very clear what a CBDC can contribute that is not already covered or can be covered by market-led payment solutions.

3. Below the glass

Digital Operational Resilience

The EFR welcomes the intention to create a strong and robust EU digital operational resilience framework via FISMA's DORA proposal. The suggested framework for **cyber threat information sharing** is a particularly positive step towards building cyber and threat intelligence. In this same context the EFR is working on establishing a circle of trust mechanism for strategic incident information exchange.

Harmonisation of ICT risk management and incident reporting requirements across the financial sector have been a long-standing demand from sector participants and are an important step towards achieving efficiency gains and providing authorities with a clear, overarching picture of ICT-related risks by financial services. For this to become reality, the DORA proposal will have to be **outcome-focused and risk-based**, instead of expanding existing guidance from critical to all ICT-related contracts and processes. There should be enough flexibility in the framework in order to ensure business models and group structures are able to effectively improve resilience, avoiding divergent or duplicative requirements.

In the medium term, the EFR supports the establishment of an EU hub for major ICT-related **incident reporting**, that could help avoid multiple reporting lines. However, given the sensitivity of the information that would be centralised there, it will be essential to ensure the necessary safeguards and protections. Given the overlap of incident reporting under DORA and horizontal regulation (e.g. NIS), the EC should also consider the role that a non-financial authority, such as ENISA, could play in establishing that single reporting hub. This EU Hub should build trust progressively among Member States and also support national authorities. This could be achieved in stages, initially establishing a central reporting and coordination hub in each Member State with a consistent roll-up reporting scheme from national mechanisms to the EU hub.

Greater **transparency** of cyber-related incidents should be fostered by making anonymised data available. Currently, the data publicly available at EU level is very limited. The information sharing mechanism should be improved to allow a continuous exchange of information between authorities and the private sector. The cyber (re)insurance underwriting community should also be granted access to incident reporting data (on an anonymous basis), given the important role of insurance in promoting cyber resilience.

Given the **global nature** of both finance and the risks posed by cyber-security, it will be imperative that the DORA regime ensures interoperability with other systems established in other jurisdictions. The regulation should as much as possible make use of existing international definitions and standards and should be aligned with widely implemented cyber security frameworks such as NIST CSF and ISO 27001.

On **third-party risk management**, the EC should not introduce too prescriptive provisions aiming at concentration risk, as it could restrict access to innovative technology. In particular, mandatory multi-vendor strategies might not reduce, but may even introduce additional operational risk.

Together with mandatory contract termination requirements this would create a barrier to innovation and resilience. Additionally, responsibility and accountability must be clearly allocated between financial institutions and the respective third-party providers, with oversight for DORA naturally resting with the relevant EU entities and supervisory authorities. Furthermore, the interaction between DORA and existing sectoral guidance (EBA/ESMA guidelines) as well as horizontal legislation (NIS Directive/NIS2) in relation to ICT third-party risk needs to be clearly delimited in order to create a coherent framework.

Streamlining and **simplifying outsourcing and delegation procedures** is another important step towards facilitating the use of third-party ICT services. The desired result can only be achieved via a combination of measures with **focus on proportionality**:

- a risk-based approach towards the application of requirements, focusing on material ICT arrangements and in line with the existing outsourcing framework that recognises the different risk levels of arrangements, e.g. intra-group arrangements;
- an effective and efficient direct oversight framework that does deliver added value instead of duplicating compliance effort;
- support for collaboration in form of pooled audits;
- the promotion of standard contractual clauses to streamline negotiation processes with CSPs and to facilitate cloud switching;
- the development of certification schemes that demonstrate that TPPs meet the expected level of risk mitigation and resilience for both supervisory authorities and financial institutions.

With an **appropriate oversight** framework the burden of compliance, currently borne by financial institutions, would be shared with ICT providers. Specifically, the EFR considers that EU companies would greatly benefit from a European approach proposing minimum requirements for cloud providers, such as cloud reversibility to reduce the risks of provider lock-in.

Overall, the EC should **focus on operational resilience outcomes with a non-prescriptive and risk-based approach**. These fundamental design aspects can facilitate interpretation and future implementation, through a more standardised, future-proof and proportionate approach that shall avoid unnecessary compliance efforts.

Autonomous European payments & value-added infrastructures

We welcome the authorities' support of the European Payments Initiative in the **European Retail Payments Strategy**: an industry project to improve customer choice and experience in e-payments.

Its successful development requires the involvement of providers from more countries, but is equally dependent on regulatory certainty and stability, particularly with regards to the business model. Therefore, it is important to avoid introducing new regulatory obligations that would divert funds from innovation to compliance.

Apart from creating an infrastructure independent from international schemes for Europe, such an initiative would also help strengthen the international role of the Euro.

New payment solutions are also an opportunity to develop EU-wide **digital identities**, which are presented in the EC's Digital strategies as a key enabler of the digitisation of the sector and the overall economy. If an effective digital identity framework were to be comprehensively introduced, the potential benefits are vast. A digital identity framework, enabling firms to efficiently and securely prove a consumer's identity online, without the need for physical documents, would likely provide a significant boost for innovation across the economy, while simultaneously reducing fraud levels and costs that industry currently incurs to manually prove consumer identities.

1.3. EFR Recommendations

Pending policy issues to ensure FS contribution to EU's digital strategic autonomy

EFR welcomes FISMA's Digital Finance Package and the broader EC's digital strategy.
Building on it, the EFR considers that there are some pressing issues that need to be addressed by current and upcoming policy and legislative proposals.
Only then will the financial services industry be able to contribute its full potential to the EC's overarching goal of digital strategic autonomy.
To achieve this the EFR has compiled key recommendations in the main relevant policy areas for digital innovation and competitiveness in Financial Services:

- Regarding the indispensable context ("frame of the glass"):
  - Ensuring fair competition in a digitally transformed market (incl. access to infrastructure and data, focusing on cross-sectoral approaches);
  - Revision of prudential rules for banks to reduce the burden of prudential regulation for non-core businesses within regulated groups;
  - Globally consistent regulatory frameworks to keep Europe attractive as global hub for innovation.

- Regarding new user experiences ("above the glass"):
  - Evolution from open banking to a cross-sectoral approach to user data sharing for the benefit of European consumers and businesses;
  - Regulatory clarity for crypto-assets, and a careful consideration of the implications and opportunities of CBDCs (Central Bank Digital Currencies).

- Regarding the underlying technology and infrastructure ("below the glass"):
  - Coherent risk-based approach for a resilient digital financial ecosystem, incl. third-party risk management (e.g. CSPs);
  - Autonomy in payments through pan-European market-led initiatives.

2. Making the European prudential framework fit to support the recovery

2.1. Background

The EFR supports regulation that:

- is aimed at transparency and stability in financial markets,
- ensures a European and global level playing field, and
- is supportive of the European financial industry playing a central role in financing of the European economy, to the benefit of all parts of society.

The COVID-19 pandemic has added complexity to the global scenario, and so we need to set a safe road through issues arising from megatrends such as climate change, geopolitical instability, financial volatility, low Interest rates, aging of populations, and cyber risk. In any future legislative proposal, market participants will need regulatory certainty to plan long-term investments and incorporate the need for business change. The regulatory framework should be stable, changing only if it will demonstrably benefit consumers, investors and the economy.

We encourage policymakers to design rules to unlock the benefits and the opportunities that digitalisation offers for consumers.

2.2. Risks and opportunities

Ambitious and timely measures by the ECB, national regulators and governments have helped overcoming the economic consequences of the health crisis.

As economies return to normality, and support measures are withdrawn, corporate balance sheets will be registering total debt representing 140 % of GDP. Addressing the financing needs of the economy in the medium term will require the support of the financing sector. It will also require adaptation of the prudential framework, which showed some design flaws and lack of flexibility in calculation and calibration in stress-conditions.

Prudential Framework to be adjusted

Much has been accomplished during the last decade to ensure that Europe, and the world, have a much more resilient banking sector. Greater robustness has been and will continue to be a critical element to allow the financial sector to respond to the challenges that lie ahead. The EC's prompt action in proposing the prudential quick-fix to help the flow of credit helped protect the European economy at the outset of the pandemic, but more needs to be done to adapt the prudential framework to the economic situation, to address its unintended procyclicality and to ultimately achieve regulatory stability after many years of constant changes. In particular:

- **Implementation of Basel III:** Given its significant impact, implementation should not proceed without an updated impact assessment taking into account the latest numbers and COVID-19 effects on bank balance sheets. Without it, and given markets expect banks to meet the expected capital increase upfront, implementation could harm financing. We believe it is critical to respect the political commitment to avoid a significant increase in capital requirements. The EU proposal should therefore be delayed until the evolution of the pandemic is more certain and its structural impact on the economy becomes more manageable.

There is a risk that asset deleveraging, driven by higher capital requirements for banks, could negatively affect the recovery, putting the European economy at a [further] competitive disadvantage versus other parts of the world. For all of these reasons, we suggest:

- A postponement of the transposition of the Basel III agreement and the publication of any draft of the Capital Requirements Regulation (CRR3) at least until the impact of the pandemic on the European economy is clear and recovery is on track.
- The flexible implementation of the framework to take into account European specificities. These include in particular:
  - the output floor, both as regards the application at the consolidated level, the implementation as a backstop using the parallel stacks approach, and the maintenance of existing solvency and MREL ratios based on unfloored RWA as regulatory reference;
  - the credit risk treatment of corporates without external rating (unrated), which is the majority of European corporates;
  - the maintenance of the SME and infrastructure supporting factors, as well as of the Credit Valuation Adjustment (CVA) exemptions;
  - the credit risk treatment of mortgage and commercial real estate lending;
  - the capital treatment of specialised lending, which will play an important role in the financing of the recovery, the green new deal and digitalisation;
- In addition, the operational risk framework should be applied making use of the Basel discretionary powers and setting the internal loss multiplier at one.

- **Standardized Approach of Counterparty Credit Risk (SA-CCR):** in line with the recital in the EC's Capital Markets Recovery Package of 24 July 2020, we call on the Commission to review the SA-CCR before June 2021 "in the context of the economic recovery after the COVID-19 pandemic", to avoid the detrimental impact that "overly conservative SA-CCR" may have on the availability and cost of financial hedges to end-users. Among others, design and calibration issues (the alfa factor was calibrated in 2005) and the international level playing field should be considered. In keeping with the spirit of the recital, we ask SA-CCR to be reviewed as an amendment of CRR2 as, otherwise, the solution would come too late, once the problems that the recital aims to avoid will have already occurred and cannot be solved.

- **Non-Performing Loans (NPLs):** as the timing of the recovery remains uncertain, it is appropriate to allow banks to cope with the expected increase in non-performing loans in a way that does not harm the economy and avoid foreclosures or fire-sales where possible. To do that, the adjustment of Loss Given Default in case of massive NPL disposals should be extended up to 2024, the Pillar 1 CET1 provisioning requirements should be delayed or raising to 5% the Net Present Value (NPV) threshold that triggers the classification of forbearance measures as distressed restructuring. The European Commission Action Plan on NPLs is a good starting point but still falls short in some aspects, especially in supporting own bank NPL workout and the role of banks in purchasing NPLs, both of which are objectives it acknowledges as useful. In addition, the underlying NPLs of NPL securitisations should be clearly excluded from the Pillar 1 NPL backstop.
  The EC is putting forward «quick wins» such as mandatory reporting and the use of European Banking Authority (EBA) templates for NPLs, creating an EU data hub that would serve in theory as a better use of multiple existing data sources. This will increase the compliance burden on banks, with limited benefit in the absence of more meaningful reforms.

- **Contributions to the European Resolution Fund:** The aim of the European Resolution Fund was to create a fund of € 55 billion. Monetary policy, household savings and the reluctance of consumers to spend

money have however led to a high increase in banking deposits, as a result of which the required banks' contributions to the Fund will be now reaching a € 75 billion level. Therefore, at a time that the financial sector should support the European recovery, the banks have to deal with an extra burden of locked-in capital that cannot be used.
We call on the Single Resolution Board to use its regulatory discretion to authorize banks to make up to 30 % of their contributions in the form of Irrevocable Payments Commitments which are collateralized by cash and not deductible from equity.

- The European Commission needs to work on removing Regulatory barriers among Member States of the Eurozone and on facilitating further integration of financial services, so that more economic integration will be stimulated and that the European recovery can be supported adequately.

- The proposal in the Action Plan for the use of precautionary recapitalisations (as provided for in the Bank Recovery and Resolution Directive - BRRD) for banks in difficulty because of the health crisis but deemed solvent, acknowledges the limitations of BRRD but raises obvious concerns over the come-back of the classical bail-out with state aid.
In the context of the BRRD some discussion is taking place whether to broaden the scope of the usability of the DGS fund.
In our view, we should stick to the initial principles of the resolution and liquidation framework. Taking into consideration the generally acknowledged European banking consolidation needs, ailing small banks need to be liquidated. The regulatory framework should be designed and calibrated in such a way that medium sized banks that are able to raise MREL should be resolved if they appear viable, otherwise they should be liquidated as the smaller banks.

- **Moratoria and EBA guidelines:** The EBA Guidelines on legislative and non-legislative moratoria on loan repayments, published in the early phases of the pandemic, provided significant flexibility as well as certainty on the application of the regulatory framework to various forms of payment moratoria taken by EU banks to support their obligors. In December EBA decided to re-activate the Guidelines on moratoria by introducing a new deadline to apply the moratoria of 31 March 2021 replacing the previous date of 30 September 2020.
In addition, relief measures implemented locally by jurisdictions may have different timings, given that the pandemic may have evolved differently. We would suggest more flexibility be granted in terms of the period of application (i.e. allowing valid interpretations of the rule instead of fix dates for all jurisdictions), provided that the general spirit and criteria of the Guidelines are respected.

- **Lessons learnt from COVID-19 crisis:** we support the review of the Basel agreement to mitigate its unintended pro-cyclicality. Particularly important is reflecting on the usability of capital and liquidity buffers when needed. The current crisis has shown that, under the current framework, banks are not willing to use their buffers given the restrictions on dividend distributions that its usage implies, and, even more important, the "fully loaded" market view that penalises the need to replenish the buffers after usage. Another significant topic is the reflection on the pro-cyclicality of the current framework of expected credit loss provisioning.

Financial Markets Union.

Looking forward it is more important than ever that scarce financial resources are allocated efficiently and effectively within Europe to (a) avoid a post-pandemic economic shock resulting in structural dead-weights

– or 'zombie' firms -that drag the recovery, and (b) to support the digital and green transitions. Now, it is more urgent than ever that Europe advances towards a truly Financial Markets Union, with determined steps being taken to conclude the **Banking Union** and the **Capital Markets Union (CMU)**. Today's fragmented financial market prevents banks and capital markets from taking full advantage of scale economies (key in the digital transformation) and imposes costs to European citizens and companies that cannot access a truly diversified and deep pan-European funding market.

Further integration of the EU banking sector and finalization of the **Banking Union** is the only answer to national responses we see in each and every crisis, and this pandemic is no exception. Whereas we welcome the unified and more harmonised response at EU Regulatory, Supervisory and Monetary level, we also experienced very fragmented initiatives from local governments and local supervisors (e.g. banning intragroup dividend distribution). This type of issues, combined with a regulation which still suffers from several local peculiarities, limits the support that banks can offer to the absorption of the shock and, most important, to the reboot of the economy post COVID-19 crisis. A fragmented Banking System is also by definition less efficient, less transparent hence less investable from a shareholder perspective. When an investor has to choose between banks that can act swiftly across geographies and banks that are limited by local constraints, then the choice is easy and mirrored in the market valuations of American and European Banks. In a nutshell, our recommendation is to eliminate remaining national discretions that allow ring-fencing of capital and liquidity by host authorities and proceed with the integration of the EU financial market.

In particular on **CMU** we welcome renewed efforts to identify and remove barriers to its efficient functioning. The recently agreed capital markets recovery package will streamline elements of the capital raising and investment process, but more will be needed. Going forward, we would also recommend:

- A complete review of the securitisation framework, where transactions are still lagging far behind those of comparable jurisdictions such as the U.S. Securitisation, is a safe way to provide capital relief in banks' balance sheets and open up investment opportunities. The current capital treatment, including NPL and synthetic securitisation, does not encourage transactions by either originators or investors. In view of the 2022 legally-mandated review and the experience gained so far in the post-2008 framework, a review on the basis of the EBA advice is needed.

- That the Markets in Financial Instruments Directive (MiFID) Review in 2021 supports further deepening of European capital markets by continuing to ensure robust competition among firms and trading venues, to benefit investors and the broader EU economy. This should also include ensuring that sophisticated investors with strong capital market expertise have the means to access a wider range of capital market investments, thereby broadening the investor base for smaller companies that want to grow.

- To strengthen their capacity to finance the EU's corporate sector, European capital markets must remain open and accessible so that Europe's global banks can channel the necessary investment into the EU while ensuring a level playing field and maintaining the integrity of the Single Market.

- To encourage banks intermediary activities and avoid significant capital increase for market making activities in a context of a global level playing field. For that, several prudential issues linked to CRR3 need to be addressed:
  - Target the implementation of the Fundamental Review of the Trading Book (FRTB) in a consistent way, replicating the U.S. adjustments as much as possible;

- Address various design and calibration issues to prevent significant capital increase;
- On CVA preserve the European exemption from holding capital against CVA risk on Corporate derivatives exposures and ensure the ongoing reforms of CVA does not unduly penalise certain activities (hedging of interest rate risk or currency risk by non-financial counterparties);
- Providing for an appropriate prudential treatment of long-term SME equity investment by banks in the implementation of Basel III;
- On Net Stable Funding Ratio (NSFR), ensure that short-term market making and equity market facilitations are not penalised with long-term funding requirements, particularly where the prudential risk does not merit such a course of action. Specifically, the EBA should accelerate the CRR2 mandated review into the NSFR treatment of securities held as a hedge for derivatives transactions.

Securitisation

The EC is required to present a report reviewing the functioning of the Securitisation Regulation to the Council and Parliament by the end of 2021. EFR has been at the start of the Prime Collateralised Securities (PCS) initiative in 2012 (an industry-led, non-profit project to develop a label for high quality securitisations which meet best practice in terms of quality, transparency, simplicity, and standardisation) and supports a relaunch of securitisation in Europe to support the European economy. Securitisation has continued to exhibit subdued volumes for a number of reasons. Below we detail key items we believe the EC should focus on to further improve European securitisation markets.

1 Recalibration of Securitisation Risk Weights

Whilst the new securitisation framework brought many improvements, it also included a significant increase in capital requirements, with senior risk weights (RWs) more than doubling. This increase is mainly caused by a higher RW floor as well as by the use of a more conservative RW formula driven by the introduction of a "p" factor.

The EC should review current RW calibrations, with a view to better aligning them with the underlying risk profile. This is particularly important for senior tranches, with calibration improvements enabling a significant increase in securitisation issuance, allowing for greater levels of funding for SMEs.

2 Harmonisation and Simplification of the Significant Risk Transfer (SRT) Process

SRT is a key capital management tool used by many European banks, with recent growth in issuance by smaller banks as well. By transferring risk outside of the banking sector via securitisation, issuers are able to free up capital to be recycled into new lending.

Currently, the regulatory review process for SRT is largely unharmonised and lacks transparency in how key decisions are made. Whilst the industry acknowledges improvements in recent months, it is key to continue to develop the process, building on the EBA's recent SRT report. An agile, efficient SRT process can greatly increase the certainty of use of this tool in Europe, further improving the functioning of securitisation markets.

3 Securitisation Treatment Under Liquidity Coverage Ratio (LCR) and Solvency II

Recent regulatory changes have helped to significantly harmonise securitisation regulation within Europe. However, there remain rules where the treatment of securitisations is not in line with the associated risks, nor the treatment of comparable instruments.

Most importantly, the EC should review the following:

- LCR – Qualifying STS securitisations should be upgraded to Level 2A within the framework, whilst the ability for non-STS securitisations to qualify as High Quality Liquid Asset (HQLA) should also be considered. It should be noted that the treatment of covered bonds within the LCR is currently more advantageous, despite the highly similar risk profiles;
- Solvency II – Similarly, the treatment of securitisations for insurers is not aligned with the risk profile. Particularly, the calibration for senior tranches is more punitive than for direct investments in underlying assets, despite the credit enhancement and greater liquidity.

4 Better Targeted Disclosure Framework

The industry is highly supportive of the new disclosure requirement included within the Securitisation Regulation, viewing it as an extension of existing reporting practices. However, the lack of a differentiation on the so-called "ESMA-templates" used between public and private transactions is problematic.

The templates have been designed with funding/cash securitisations in mind and are not suitable for private transactions (e.g. SRT, Asset-Backed Commercial Paper -ABCP). Many large, private-transaction investors have made it clear that the templates do not provide the information they require, and, consequently, are not considered by investors. The initial setup and ongoing costs to comply with these templates is significant and extremely burdensome for originator banks to deal with.

Solvency II: long-term savings and long-term sustainable investments

The long-term focus of the insurance business model and the corresponding long-term investment strategies make the insurance sector well placed to support Europe's recovery from the crisis and its transition to a sustainable economy. The insurance sector can contribute massive investments into sustainable, green assets sourced from long-term life insurance, while providing green financial products to consumers. However recent proposals for a review of Solvency II should not put an unwarranted challenge to this natural economic fit.

Solvency II is strongly supported by the insurance industry and the framework has proven its value since it was implemented in 2016, in particular during the current COVID-19 crisis. However, the framework is excessively conservative and probably the most conservative globally. As such, any further increase in capital requirements and/or volatility would drive the industry towards an excessive de-risking of its asset portfolios, potentially driving an exit from asset classes that form a large part of the green asset universe and reallocate to essentially government bond type asset classes. This would, in turn, drag down policyholder returns on long-term savings and pension products as well as further constrain industry's ability to offer these products to address the pension gap in Europe resulting from an ageing population. Should the Solvency II review introduce increased artificial volatility and more procyclicality, this may additionally jeopardise the stabilization typically provided by insurers to financial markets in times of crisis.

In contrast, a targeted evolution of Solvency II can support the political priorities for the development of the EU, while ensuring a high level of policyholder protection and financial stability. Unnecessary changes to the framework and those changes, that would increase the level of volatility and inhibit the ability of the industry to support the political objectives of the Solvency II review, should be avoided. Instead, a targeted evolution by maintaining proven elements (e.g. extrapolation) and removing unfounded conservativism in some elements (e.g. volatility adjustment and risk margin) can help to increase insurers' sustainable investment capacity, and to increase risk coverage capacity. This would support the real industry in its digital transformation and in mastering the recovery from the current crisis, but – equally important – providing protection to individuals and businesses including against emerging challenges posed by climate change.

2.3. EFR Recommendations

1. **Regulatory regimes need to be fit for purpose.**
   - Bank capital available and European banks' competitiveness support the growth of the real economy, the transition to a green economy and capital markets development. The political agreement was that the implementation of the final Basel III reform should avoid triggering any significant increase in capital requirements or international unlevel playing field, and the implementation should be faithful to the political mandates (G20, European Parliament, ECOFIN).
   - The implementation of the Basel III reform should be decided after a thorough impact assessment taking into account the impact of the health crisis. Furthermore, European specificities should be taken into account, including a pertinent solution to the output floor and operational risk frameworks.
   - The implementation of Basel III should furthermore be fully aligned in timing and in substance with other jurisdictions ensuring a fair level playing field.
   - In order to cope with the sudden increase in the targeted amount of the Single Resolution Fund, the SRB should use its regulatory discretion to authorize banks to make up to 30 % of their contributions in the form of Irrevocable Payments Commitments.
   - Regulatory barriers among Member States of the Eurozone should be removed and further integration of financial services should be facilitated to stimulate more economic integration and to support the European recovery adequately.
   - The review of the Solvency II framework should result in a prudential framework that, while remaining robust, allows the European insurance industry to play a greater role in financing the European economy and in particular financing the energy and technological transition.

2. **Prudential regulation should be applied** by extending the activity- and risk-based approach to other parts of the regulatory framework that still remain entity-based. Regulatory obstacles that might hinder the uptake of technological innovation in the financial sector should be eliminated.

3. **For the development of European capital markets**, it is necessary to speed up the Capital Markets Union setting a true reviving of securitisation. An equity culture should be built in Europe. Also, institutional investors should have incentives to hold more equity. There should be a focus on initiatives that will help mobilise the large and unproductive reserves of private savings. A common framework for insolvency should be developed.

4. **Public-Private Partnerships (PPP) are essential to face new risks.** For example, it is crucial to make every effort to find a solution that through the PPP mechanism can provide pandemic or multiperils insurance protection, in particular for small and medium-sized enterprises (SMEs). The drastic economic impact for SMEs, and especially micro and small enterprises, has been visible right from the start of the pandemic. They have been strongly affected by the current crisis and the subsequent Non-Damage Business Interruption (NDBI) losses.

3. Supporting the European sustainability agenda

3.1. Background

The COVID-19 pandemic has demonstrated the potential of environmental and climate issues to inflict enormous damage on the economy. COVID-19 has its roots in the environment, with a virus moving between animal and human populations. Climate change threatens to create many more economic shocks (desertification for example), increases the risk of viruses moving into human populations, only some of which can be anticipated. This is a reminder of why it is so important that tackling climate change and promoting sustainability is one of the main underlying themes across all EU policymaking, to build an economy that is more durable, resilient and contributes to the fight against the future risks posed by climate change and other Environmental, Social and Governance (ESG) issues.

The financial sector is one of the key parts of this, playing a dual role as a provider of finance to the businesses and technologies that will make this new sustainable economy a reality, as well as being the channel between passive savings and productive investments in the economy. As more information is collected and disclosed about the ESG profile of financial products, investors will have greater scope to invest in line with their preferences. Over time, this should influence the investment activity in the real economy, with finance becoming easier to obtain if it supports sustainable economic activities. Ultimately, this will help drive a more sustainable economy, where climate-friendly behaviour becomes the norm.

This is the goal but complex policy decisions need to be made in the short and medium term to make it a reality. Through its 2018 Sustainable Finance Action Plan, the EU has led the world on determining how to incorporate sustainability considerations into the financial system. The EU should build on this strong foundation for its 2021 Renewed Sustainable Finance Strategy and focus on the missing pieces as well as increasing impact. Much progress has been made in adapting the financial system to make ESG aspects more identifiable, including through the Taxonomy Regulation[3] and new disclosure requirements. However, a priority complementary action is to generate relevant data in the real economy so that it can be reported by financial firms. Presently, there is a mismatch between the information that financial firms are being asked to report and the data that they can obtain from the real economy. It is furthermore, necessary that the EC, which has a head start, will have a dialogue with the (new) American administration to arrive at common standards.

As demand for ESG products increases, so will demand for compliant and financeable sustainable projects. Presently, due to a lack of investible sustainable investments or projects in Europe, investors are driven towards the relatively few projects that can be classified as green or environmentally sustainable. This presents the risk of herd behaviour but is also a missed opportunity because the substantial demand for green investment is not being spread evenly across the economy. Policymakers should focus on how to increase the visibility of prospective projects so that there is a much greater diversity of supply of green investments, and use the tools they have (e.g. public) for that purpose.

In this context, it is also of utmost importance that the 2021 Renewed Sustainable Finance Strategy has a strong focus on financing the transition. While it is a necessary first step to have a common, science-based understanding of what can be considered as sustainable economic activity – as an ultimate goal, it is even more important to facilitate companies to get there. It is time to shift the focus from green financing towards transition financing. A broad transformation of the real economy is needed in order to reach climate neutrality by 2050.

3 The Taxonomy Regulation was published in the Official Journal of the European Union on 22 June 2020 and entered into force on 12 July 2020.

Finally, the limit to what can be achieved through regulation of the financial sector alone needs to be adequately taken into account. While regulation can be helpful through standardisation, incentivisation and pricing of negative externalities (e.g. carbon emissions pricing), it can also act as a source of disincentivising friction by creating an excessive and complex reporting and compliance burden. Achieving the appropriate proportionality is critical if the EU wants to see new technologies and companies develop within the Single Market. As financial services are at the heart of the economy and fully committed to making it more sustainable, action targeting the sector alone is not sufficient to change the economy. Putting a price on carbon or requiring real economy firms to calculate and disclose their carbon footprint will be hugely impactful in changing behaviours.

Sustainable development is both a challenge and an opportunity for the financial sector, which is going to finance a large part of the investments required and is framed for managing risks through its different businesses (insurance, market, creditworthiness assessment).

3.2. Risks and opportunities

Carbon pricing

Financing rapidly the transition to a carbon-neutral economy is required to ensure that global warming stays below 1.5C. Climate change is creating both physical risks (e.g. damage resulting from climate related extreme weather events) and transition risks (e.g. changes to energy policies, disruption of existing business models through technological transition, liability/reputational issues), all of which may impact the value of assets and investments.

Transition risks occur as society attempts to move to a lower-carbon future. Transitioning to a low-carbon global economy will be potentially disruptive, especially for the carbon-intensive industries we all rely on for essential services. However, sustainable economic growth is benefic with the creation of opportunities and jobs in specific, low carbon sectors of the global economy. As such, a fair and just transition, respecting the needs and livelihoods of people in regions and segments of the economy that are most affected will need to be balanced against the imperative to decarbonize.

Financial intermediaries are regarded as enablers of the green transition and will act as channels for the allocation of capital to sustainable economic activities. What are to be regarded as sustainable activities, and how they are disclosed, is currently being specified in three pieces of legislation that form the bedrock of sustainable finance: the Taxonomy Regulation, the Sustainable Finance Disclosure Regulation (SFDR) and the Non-Financial Reporting Directive (NFRD). In practical terms – the obligations introduced to promote sustainable finance consist principally of a classification system, non-financial reporting requirements and disclosure obligations on sustainability impacts. The political importance of the EC's Sustainable Finance Package, albeit justified, has resulted in a bewildering array of ESG related requirements, which are myriad and closely interrelated but distributed across different pieces of legislation. Accordingly, requirements related to ESG can be difficult to navigate. The Taxonomy, the SFDR and the NFRD – while separate – are interdependent with multiple cross-references and links to one another. This results in sometimes overlapping, conflicting and unclear requirements.

While the financial system is an important element in the economic transformation, it is only one component of the European economy. Policy actions should therefore be balanced between the financial system and broader economic actors.

The financial services industry can only play its role as effectively as the political framework allows it to do. The EU Green Deal is a first move but policymakers should go further to drive the transition to a low carbon economy:

- Climate scorecards show that it is unlikely that the dramatic shifts necessary to avoid the most draconian scenarios can be achieved.
- The Global Risks Report 2020[4] identified environmental issues as the top 5 risks in terms of likelihood, so awareness is there. Yet the energy transition is still too slow. Critical policy decisions – like imposing a carbon tax to change pricing dynamics in the long-term – are dragging or being implemented half-heartedly.
- A clear roadmap for the progressive phasing out of fossil fuel subsidies is needed. Economies based on fossil fuel usage for the past 125 years must be transformed. Policymakers should price externalities correctly, such as through a realistic CO_2 price for emissions and diminishing gradually the explicit and implicit subsidies for fossil fuels. The financial sector needs clarity on the regulatory, tax and investment strategies for the next 10, 20 and 30 years.

Carbon pricing not only significantly contributes to steering economically relevant behaviour and related financial flows in the right direction, it also significantly contributes to minimizing the risk of undesirable regulatory interventions. It provides for a robust valuation methodology that allows to compare and benchmark risks emanating from climate change with other risks emanating from other sources. This allows to set quantifiable objectives, review the progress towards goal achievement and establishes comparability between peers and across sectors.

EFR supports the international and European initiatives focused on promoting sustainable finance policies and a progressive transition to a carbon-neutral economy. Climate change and other ESG factors will have an impact on financial service companies, both as investors and as underwriters.

However, we would like to emphasise two issues:

- The financial sector is willing to finance sustainable projects or investments that are investible and bankable. The problem we face is that there are not enough sustainable projects to finance in Europe. We need a pipeline of sustainable investments, and the European public administrations, which control 45 % of the European GDP through public expenditures, have a key role to play, as underlined by ECB President Christine Lagarde during her 8 February 2021 appearance before the European Parliament plenary session.
- More work on the Taxonomy Regulation could be undertaken to better take into account the transformation pathways of companies, i.e. currently "harmful" activities switching to "neutral" and ultimately sustainable business. Moreover, additional activities which might enable the transition to a greener economy (e.g. nuclear energy) should be thoroughly assessed. We equally see a pressing need to enhance availability, comparability and reliability of ESG data on which financial institutions' disclosure and risk assessment is based upon. The integration of ESG risks into stress testing might otherwise prove challenging for financial institutions due to a lack of reliable ESG data and ESG scenarios. From a banking perspective, we would support a dedicated ESG Supervisory Review and Evaluation Process (SREP) approach focused initially on Business Model and Governance, while a full-integration to be developed over time in line with new methodologies and considering that the Social and Governance factors analysis is in its early stage. From an insurance perspective, we acknowledge

4 World Economic Forum, 15 January 2020.

scenario analysis as a tool to assess climate-change related uncertainties. In this context, we consider qualitative scenario analysis better suited for the assessment of climate risks than quantitative stress tests, which do not reflect the substantial uncertainties inherent in projections over decades. Furthermore, we believe that it is important to use a consistent set of climate change scenarios and to allow for the recognition of (undertaking-specific) management actions over time in order to gain meaningful insights for product and risk management.

Sustainability reporting

One of the most important challenges this year on sustainable finance is the availability, reliability and comparability of sustainability data. The sustainable finance framework implies an outstanding need of additional data related to the exposures of companies to sustainability factors. This data is essential to help the financial sector reorient capital flows towards sustainable activities and align portfolio to sustainability targets as well as assessing financial risk that could be arising from climate risk factors. This will also be a prerequisite to comply with the various reporting requirements that the financial sector is liable for and ensure market integrity and confidence of investors and other stakeholders (supervisors, NGOs, citizens, etc.) in the new EU regulatory framework.

As such, EFR is highly supportive of the EC's ambition to overhaul the NFRD in order to incorporate further ESG considerations both sector-agnostic and sector-specific and widen its scope with a relevant proportional approach.

With this in mind, we express the strongest wishes that the forthcoming EU regulatory framework will (i) take into great consideration the timeframe mismatch in the implementation of financial sector's new reporting requirements, (ii) ensure that the NFRD review will give rise to consistent harmonised standards for both financial institutions and non-financial companies and (iii) reinforce data reliability namely through appropriate regulation of data providers and ESG rating agencies:

(i) Various EU regulations that require new non-financial reporting from the financial sector are expected to apply before the finalization of NFRD revision or in the same time of companies' obligations to report on taxonomy alignment. We believe that risks arising from this timeframe mismatch should not be underestimated as, beyond legal risk around the accuracy of the data, it could undermine the investors' confidence in this reporting and more globally in the EU legislative framework on sustainable finance. All EU non-financial disclosure regulations should be aligned – in terms of timeline as well as content. To ensure consistency in the implementation of the reporting framework, attention should be paid to incorporate into the upcoming NFRD revision companies' indicators mirroring properly information required from the financial sector under the Sustainable Finance Disclosure Regulation, the Taxonomy Regulation, the Benchmark Regulation and under the forthcoming revision of the Pillar 3 disclosures.
Moreover, in order to steer sustainable investments successfully and to facilitate a broad transformation towards a carbon-neutral economy, companies in scope of the NFRD should be mandated to disclose climate-related KPIs (based on greenhouse gas emissions) which inform on core business transformation and allow for application in global portfolios. This should include forward-looking statements and targets as well as specific KPIs for key sectors, which would complement the rather static Taxonomy assessment.

(ii) A high degree of integration and connectivity between financial and non-financial reporting is essential as both types of information are required to evaluate a company's development, performance and position. In this context, we support the establishment of a centralised, open access, free of charge (EU) data register, as envisaged under the European Single Access Point (ESAP). While a real necessity to reduce fragmentation, the scope, information coverage, governance and business model of ESAP should be defined and agreed with all stakeholders. EFR fully supports the work undertaken so far by the European Financial Reporting Advisory Group's (EFRAG) multi-stakeholder European Lab Project Task Force (PTF) which has made a comprehensive inventory of existing regulatory and voluntary standards on non-financial reporting as well as high-level recommendations. We believe EFRAG would be the best positioned to be entrusted with the development of harmonised and common EU non-financial reporting standards. EFR is also of the opinion that any common standards should be well-fitted to the specificities of EU companies. However, EU initiatives on non-financial reporting should, if possible, aim for a high degree of international convergence. While we welcome the NFRD review, we believe that, ultimately, only an international convergence of non-financial reporting can achieve a high degree of availability, consistency, comparability of non-financial data. We would welcome the development of an international standard under the umbrella of the International Financial Reporting Standards (IFRS) Foundation to ensure consistency between reporting requirements and to leverage synergies. In order to achieve these two goals- a standard well-fitted for EU actors and international harmonisation- a proper integration of the EU standards setter in the governance of this international common standard will be necessary.

(iii) A proper regulation of data providers and ESG rating agencies will be key to ensure data reliability as they are playing an increasingly important role. EFR believes this framework should address the issue of transparency and comparability of methodologies, proper governance and supervision as well as the access to those services under reasonable commercial practices.

Prudential regulation to enable sustainable finance

Today, there is no doubt that climate risk and other environmental risks may impact the financial system stability. As such, integrating those risks driver into the risk management framework becomes increasingly important.

In that context EFR applauds various initiatives in that field such as the essential work of the Network for Greening the Financial System to provide a harmonised supervisory toolbox to define risk management mechanisms, and the extensive analysis provided by EBA in its recent discussion paper[5].

However, as also described above key challenges still need to be addressed with respect to methodologies and data availability and reliability. Those challenges apply also for the prudential regulation.

In this regard, the following recommendations could be made:

- A progressive approach should be adopted when considering the integration and supervision of ESG risks into risk management. While methodologies are still being explored, the industry is more mature regarding climate transition risks than physical risks, others environmental risks and social risks. The progressive approach should also allow reflecting the data gap that should be improved with the EU regulatory initiatives as well as international initiatives.

5 Discussion Paper on management and supervision of ESG risks for credit institutions and investment firms EBA/DP/2020/03 (3-11-2020/3-02-2021).

- In the same vein, considering the work in progress on methodologies and data, climate stress testing should not be expected to provide in near term the same type of outcome as standard supervisory stress tests.
- The prudential regulation should not be deviated from its role to safeguard financial stability and the resilience of the financial sector. Hence adjusted prudential treatment should be only envisaged for green assets where a lower prospect of financial risk related to the ESG factors can be demonstrated on a forward-looking basis. Capital requirements must always reflect the financial risk of underlying exposures. In this regard, the timeframe to consider prudential treatment of green/brown assets should be consistent with this prerequisite as well as the need to be coordinated with international initiatives.

Furthermore securitisation could play an important role. As stressed by the CMU report of 10 June 2020 of the *High Level Forum set up by the European Commission (HLF)*, EFR is convinced that the revival of the European securitisation market, will be critical to enable European banks *"to free up their balance sheets"* and review their capacity to distribute credit towards activities/companies that need it the most, including sustainable activities and companies that need to finance their transition. In this regard, EFR is supportive of HLF recommendations to put forward a series of targeted, prudentially sound amendments to improve the EU securitisation framework.

The social 'S' aspect of the ESG debate

The current policy debate regarding sustainability is very much focusing on the environment related aspects and these are being dealt with primarily in this report. Less attention so far is given to the societal dimension, the 'S' in the ESG agenda. EFR has analysed recently in more detail consequences and impact of digitalising the economy on the labour market and on workforce[6]. Policy recommendations were offered which address this part of the agenda.

Digital transformation has multiple impacts on the EU workforce, many of which are positive, allowing for new opportunities and increased flexibility, e.g. enabling remote working, which has been a great asset in the COVID-19 situation and could become a regular form of work for a large share of employees. But there are also some that need our attention. Firstly, the discontinuation of certain jobs and the creation of new ones, for which different (technological) skills are needed. Secondly, the shift in employment relationships towards increasing 'atypical' work forms, such as platform work. Thirdly, at least in part related to digital transformation, the increase in mental health issues. Technological advancement and related expectations cause stress and anxiety, e.g. the perceived requirement to be online available 24/7.

Much can be done on the industry's side to support workers in the digital transformation process, regarding re- and upskilling and both on a financial security and mental well-being level. EFR Members are committed to do their part as employers of around 2.03 million people worldwide. Also, as providers of (retirement) saving and income protection products, they are striving to make their services fit for purpose for the changing environment.

However, action is also needed on the policy side to prepare society for this new era and ensure the legal environment and public policies in a larger sense (such as education and health systems) are also fit for purpose. Those needs are even reinforced by the COVID-19 crisis as transformation is likely to accelerate.

6 EFR Paper on the Impact of Digital Transformation on Labour, June 2020.

Realizing that competence in the addressed policy areas lies primarily with the Member States, we suggest considering the following policy measures on EU level to support the respective policy agendas of Member States:

- Awareness raising: increase awareness of the challenges related to digital transformation of the workforce, and solutions to address them, both on a private and public level with EU citizens, companies and national policy makers;
- Best practice exchange: facilitate the exchange of policy and company best practices to address abovementioned challenges amongst Member States;
- Sustainability Principles: enable and incentivize companies to incorporate sustainability principles and be transparent about this, in this context mainly in the 'S' (social) area of ESG, including, for instance, sustainable work policies, possibly through EU regulation in the area of non-financial reporting;
- Link to EU co-funding: EU co-funded Member States' initiatives in the areas of employment, (mental) health and education should integrate measures to address the challenges caused by digital transformation.

3.3. EFR Recommendations

EFR Members believe that embedding green policies and promoting social cohesion can be a catalyst for economic growth, as well as having a positive impact on people and the environment. And we believe the financial sector has a key role to play on promoting sustainable policies. Climate change and other ESG factors will be present and have an impact beyond the pandemic.

Support packages can create a more equitable society, prioritise the (mental) health for all people, and produce a net environmental benefit. The unprecedented fiscal stimulus and economic support packages assembled by governments under the EU impulsion also provide a unique opportunity. Not only would this enable the EU to recover from the pandemic, but it would promote economic growth, expand the labour force and deliver social benefits. The EU's promise of a €1.8 trillion stimulus package to rebuild a post COVID-19 Europe that is "greener, more digital and more resilient" could tackle the economic, societal and social challenges.

Indeed COVID-19 has exposed many underlying inequalities be they economic, social, racial or gender-based. The current policy debate regarding sustainability is very much focusing on the climate-related and environment aspects and these are being dealt with primarily in the policy landscape. The societal dimension, the 'S' in the ESG agenda should also be properly addressed to support workers in the digital transformation process, regarding re- and upskilling and both on a financial security and mental well-being level.

The pandemic reminds us that we still have much work to do to close the information, protection, funding and investment gaps. This will require synergies from the public and private sectors to achieve the best outcome possible.

In this regard, the financial sector has a key role to play in mobilizing the required capital to deliver on the policy objectives under the European Green Deal by contributing to the funding of the transition to a carbon-neutral, climate-resilient and resource-efficient economy, as a complement to public money.

Implementing a set of consistent sustainability targets ensures that ambitions and commitments are followed by tangible actions. We advocate for a more robust and consequent mechanism to change the behaviour in the real economy in the area of production and consumption via carbon pricing. This will allow to further leverage sustainable investments.

In addition, a holistic/legislative and inclusive approach would be beneficial:

- Political leadership is needed to trigger investment, finance and achieve the transition. Europe should aim to arrive at common standards with the US. The financial services industry can only play its role as effective as the political framework allows that to do. The EU Green Deal is a first move but policymakers should go further to drive the transition to a low carbon economy:
  - The financial system plays a role to ensure that the transition is as fair and as inclusive as possible. In that respect, governments will have to increase their commitment and accompany the necessary transition, and collaboration of private and public sector is of the essence.
    As the accounting of activities eligible to the taxonomy will be one of the key metrics to monitor the shifting towards a carbon-neutral economy, it is essential that this tool takes into account activities in transition. Hence, the EU taxonomy for sustainable investments should be completed with a transitional approach in order to incentivize as much as possible all activities/sectors to embark on a decarbonisation path.

- The integration of ESG Risks into risk management and supervisory approach (SREP) and Stress testing might prove challenging for financial institutions due to a lack of reliable ESG data and ESG scenarios. Therefore, the following data-related issues should be addressed:
  - **Data gap:** A progressive approach should be adopted when considering the integration and supervision of ESG risks into risk management. While methodologies are still being explored, the industry and authorities are more mature regarding climate transition risks than physical risks, others environmental risks and social risks. The progressive approach should also allow reflecting the data gap that should be improved with the EU regulatory initiatives (upcoming NFRD revision, central data base) as well as international initiatives. In this last regard, we would support a dedicated ESG SREP approach focused initially on Business Model and Governance, while a full-integration to be developed over time in line with new methodologies and considering that the Social and Governance factors analysis is in its early stage.
  - **Availability, comparability and reliability of ESG data:** There is a pressing need to enhance availability, comparability and reliability of ESG data. This data is essential to help the financial sector reorient capital flows towards sustainable activities and align portfolio to sustainability targets as well as assessing financial risk that could be arising from climate risk factors. This will also be a prerequisite to comply with the various reporting requirements that the financial sector is liable for and ensure market integrity and confidence of investors and other stakeholders (supervisors, NGOs, citizens, etc.) in the new EU regulatory framework. In this regards EFR supports the setup of a Central Database of ESG information to which listed corporates should mandatorily send their ESG data.
  - **International Convergence:** EU initiatives on non-financial reporting should be considered in the context of international convergence and harmonisation. This will notably require the proper alignment of the EU standards setters as only an international standardisation can lead to a high degree of comparability of non-financial data.

- **Implementation timeframe:** Considering the lack of ESG data and the mismatch between reporting requirements of financial sectors and reporting requirements for non-financial institutions, EFR would welcome for a reasonable implementation timeframe when the EU Commission will define the implementation measures on the taxonomy alignment reporting for financial institutions. Most of all, it will be critical to take into account data gap on SMEs and retails clients when considering disclosure requirements.

- The current policy debate regarding sustainability is very much focusing on the environment related aspects and these are being dealt with primarily in this report. The societal dimension, the 'S' in the ESG agenda should also be properly addressed.

ANNEX I: EFR VISION

The European Financial Services Round Table (EFR) was formed in 2001. The Members of EFR are Chairmen and Chief Executive Officers of international banks or insurers with headquarters in Europe.

EFR Members believe that a fully integrated EU financial market, a single market with consistent rules and requirements, combined with a strong, stable and competitive European financial services industry will lead to increased choice and better value for all users of financial services across the Member States of the European Union. An open and integrated market reflecting the diversity of banking and insurance business models will support investment and growth, expanding the overall soundness and competitiveness of the European economy.

Increased fragmentation as a result of the post-crisis regulatory response underlines the need to safeguard the single market and to protect the level playing field. The EFR therefore strongly encourages national governments and the EU institutions to continue their efforts to create a truly single market for wholesale and retail financial services, which will play an essential role in providing long-term financing for the economy in Europe. Furthermore, strong market discipline is essential to ensure fairness and alignment of interests of the financial sector and the rest of the economy towards serving the citizens of Europe and the world.

The integration of financial markets does not stop at the EU's borders – markets are increasingly global. EFR Members therefore encourage both national and European leaders to establish internationally consistent and coherent financial regulation and supervision and to support and promote free and open markets throughout the world.

As of March 2021, EFR Members' companies combined represent

- Around 968 million customers[7]
- Around 2.03 million employees
- EUR 22.34 trillion total assets
- EUR 17.36 trillion assets under management

7 Please note that double counting of customers may occur.

EFR Members - March 2021

Jean Lemierre
EFR Chairman and
Chairman BNP Paribas

Denis Duverne
EFR Vice-Chairman and
Chairman of the Board of Directors
AXA

Paul Achleitner
Chairman of the Supervisory Board
Deutsche Bank AG

José Antonio Álvarez
Chief Executive Officer
Banco Santander

Oliver Bäte
Chairman of the Board of Management
Allianz SE

Lorenzo Bini Smaghi
Chairman
Société Générale

Cesare Bisoni
Chairman of the Board of Directors
UniCredit Group

Philippe Brassac
Chief Executive Officer
Crédit Agricole SA

William Connelly
Chairman of the Supervisory Board
Aegon NV

George Culmer
Chairman
Aviva

Sir Howard Davies
Chairman
NatWest Group

Michael Evans
Chairman
M&G

Gabriele Galateri di Genola
Chairman
Assicurazioni Generali S.p.A.

Nigel Higgins
Chairman
Barclays

Antonio Huertas Mejías
Chairman and CEO
MAPFRE

Walter Kielholz
Chairman of the Board of Directors
Swiss Re Ltd.

Michel Liès
Chairman of the Board
Zurich Insurance Group Ltd

Urs Rohner
Chairman of the Board of Directors
Credit Suisse Group

Steven van Rijswijk
Chairman of the Executive Board
and CEO ING Group

Carlos Torres Vila
Chairman
BBVA

Mark Tucker
Group Chairman
HSBC

Björn Wahlroos
Chairman
Sampo Group

Axel Weber
Chairman
UBS

ANNEX III: ABBREVIATIONS

ABCP	Asset-Backed Commercial Paper
AML	Anti Money Laundering
BIS	Bank for International Settlements
BRRD	Bank Recovery and Resolution Directive
CBDCs	Central Bank Digital Currencies
CET1	Common Equity Tier 1
CMU	Capital Markets Union
CRR	Capital Requirements Regulation
CSP	Cloud Service Providers
CTF	Counter Terrorist Financing
CVA	Credit Valuation Adjustment
DeFi	Decentralised Finance
DGA	Data Governance Act
DGS	Deposit Guarantee Schemes
DLT	Distributed Ledger Technology
DMA	Digital Markets Act
DORA	Digital Operational Resilience Act
EBA	European Banking Authority
EC	European Commission
ECB	European Central Bank
EFR	European Financial Services Round Table
EFRAG	European Financial Reporting Advisory Group
ESAs	European Supervisory Authorities
ESAP	European Single Access Point
ESG	Environmental, Social and Governance
ESMA	European Securities and Markets Authority
EU	European Union
FISMA	Directorate-General for Financial Stability, Financial Services and Capital Markets Union
FRTB	Fundamental Review of the Trading Book
FSB	Financial Stability Board
GDP	Gross Domestic Product
GFIN	Global Financial Innovation Network
HQLA	High Quality Liquid Asset
HLF	High Level Forum
ICT	Information and Communications Technology
IFRS	International financial Reporting Standards
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
ISO 27001	International Organisation for Standardization requirements concerning Information Security Management
KPIs	Key Performance Indicators
KYC	Know Your Customer
LCR	Liquidity Coverage Ratio
MiFID	Markets in Financial Instruments Directive
MREL	Minimum Requirement for own funds and Eligible Liabilities
NDBI	Non-Damage Business Interruption
NFRD	Non-Financial Reporting Directive
NGOs	Non-Governmental Organizations
NIS	Network and Information Systems
NIST CSF	National Institute of Standards and Technology – Cybersecurity Framework
NPLs	Non-Performing Loans
NPV	Net Present Value
NSFR	Net Stable Funding Ratio
PCS	Prime Collateralised Securities
PPP	Public-Private Partnerships
PSD2	Payment Services Directive 2
PTF	Project Task Force
RW	Risk Weights
SA-CCR	Standardized Approach of Counterparty Credit Risk
SFR	Single Resolution Fund
SFDR	Sustainable Finance Disclosure Regulation
SME	Small and Medium Enterprise
SREP	Supervisory Review and Evaluation Process
SRT	Significant Risk Transfer
STS	Simple, Transparent, and Standardised Securitisation
SURE	The European instrument for temporary Support to mitigate Unemployment Risks in an Emergency
US	United States of America

European Financial Services
Round Table

EFR – European Financial Services Round Table (asbl)
Rond Point Schuman 11
B-1040 Brussels
Belgium

Tel: +32 2 256 75 23
Fax: +32 2 256 75 70
secretariat@efr.be
www.efr.be

Siège social
Avenue Marnix 23
B-1000 Brussels
Belgium
RPM BXL 0861.973.276