DEAR READER,

By the time you read this publication exploring issues relating to European Union banking regulation, a policy cycle changeover will be under way in Brussels: The previous European Commission is standing down, and the new one is in the process of being set up. This executive body will not be in an easy situation at its launch. In 2014 the European Union may have started to recover from the crisis that started in 2008 – financial discipline was better and the overall balance of the economy had tentatively started to improve (the EU's average budget deficit decreased from 6.6% in 2009 to 2.9%, albeit at the cost of an increase in debt from the 2009 figure of 74% to 87%) – but most of the member states were still dealing with the serious negative consequences on their real economies, such as slow growth (2009: −4.3%, 2014: 1.7%) and high unemployment (2009: 8.9%, 2014: 10.2%). The austerity measures, while genuinely necessary, slowed down the recovery, so Europe was slower to find its feet again than other regions of the world. The competitiveness problems, meanwhile, remained. The Commission President *Jean-Claude Juncker* wanted to boost development with his plan for the EFSI (European Fund for Strategic Investment), with the aim of stimulating the economy and creating new jobs through investments. The upturn got under way and now, five years down the road, Juncker is ending his term in office with an EU that – despite the worsening political problems – is indisputably in a better state economically. Growth is slowing down again (now averaging 1.4%), but unemployment has dropped to 6.3%.[1]

A growing number of experts, however, are warning against complacency as the clouds are already gathering for the next crisis. What is more, with respect to many issues there has been no progress for many years: Not all the building blocks of the Banking Union are in place, and the Capital Markets Union remains an unfulfilled desire. Meanwhile, the fiscal pillar of the euro area has yet to be constructed; and when it comes to the triad of research, development and innovation, as well as digitalisation, we are plodding along behind America and Asia. The public mood demands a transition to the green economy, while powers outside the EU are far from committed to complying with the Paris Agreement or making new undertakings on the reduction of carbon-dioxide. So far, there are no answers to the question of how we can access sufficient quantities and quality of goods and energy and keep industry on the continent while setting an example

1 Source of the data in this paragraph:
https://ec.europa.eu/eurostat/databrowser/view/sdg_17_40/default/table?lang=en

to the world with our environmental awareness. The *Ursula von der Leyen* Commission, therefore, will have its work cut out for it, and will need all its balancing abilities to be successful.

This publication gives an account the financial challenges of the cycle ahead, while also providing an overview of the regulatory developments of recent years.

The current tasks for the sector are summarised by *Levente Kovács*, Secretary General and *Péter Vass*, Deputy Secretary General of the Banking Association, in their study examining the processes from the banks' perspective ("*Current challenges in the regulation and activities of the financial sector in the European Union, 2019–2024*").

It's crucial for us to understand the lessons of the financial crisis that started in 2008. We cannot afford to make the same mistakes again. Ten years ago, we had no effective EU regulations or supervisory body. The financial system had to be transformed, the serious problems had to be fixed and fundamental flaws had to be remedied. *Mária Móra* explores these issues in detail in her study entitled *"Ten Years after the Crisis – Thoughts on the Reform of Financial Regulation"*. This essay outlines how bank failures can be managed without risking the safety of the system or spending taxpayers' money, how financial supervision was solidified, and how the banking sector's capital position was strengthened.

After the financial crisis, numerous regulatory reforms were effected to stabilise the operation of the EU's banking sector with the aim of restoring confidence in the financial system. Although the tightening of regulations lowers the probability of a future crisis emerging or deepening, the banking sector continues to face many challenges. The exceptionally low interest rates and the strict capital and liquidity requirements profoundly affect the banks' profitability, and this is a factor that endangers stability in the long term. Low profitability can be seen as the most serious threat to the European banking sector, because banks afflicted with it tend to shrink. *János Müller*, Chief Advisor of the Banking Association, examines the newly established and expected future institutional and regulatory environment for the operation of the European and Hungarian banking sectors in his essay entitled *"The Building of the European Union's Financial System"* likewise *László Seregdi*, supervisory advisor at the Regulation Department of the National Bank of Hungary (*"What can the European Union expect from the application of the final Basel III guidelines?"*). Although the reforms have led to a more stable and flexible financial system with the banks better capitalised than before the crisis, the remaining risks still need to be managed and we must keep pace with the latest technological and economic developments.

The whirlwind technological changes and the lightning spread of innovative financial solutions also jeopardise the banks' situation from several angles, because

they make it possible for new competitors to poach their customers with cheaper services. These technologies can undermine the stability of the system; it is important for the rules to apply to these new actors as well, to stop them operating outside the law. In addition to these, many other new challenges (threats?) have arisen, including cyberterrorism or the emergence of cryptocurrencies, the potential impacts of which are hard to predict.

Although technological advances have tested the adaptability of financial intermediaries many times in the past, the latest innovations are radically changing the way in which financial services are provided.

In the interest of boosting the European economy and improving the competitiveness of the banking sector, we should be reaping the benefits of financial technology and hold our own in the global competition and in the changing digital world. We need to leverage the opportunities inherent and technology-driven innovations. Besides the threats discussed above, the new buzzword "FinTech" (short for financial technology) also carries massive opportunities: It is capable of cost-effectively linking the European markets and local ecosystems. It both encourages innovation within the EU and forces the banking sector to evolve, while also strengthening the international competitiveness of the EU's capital market. We need to step up to the plate, therefore, both in Brussels and here at home.

The recent money laundering scandals also pose a serious challenge for the banking sector. These have led to more vocal calls for stricter supervisory control of the anti-money laundering system. There is certainly scope for improvement in the efforts to combat money laundering and terrorism financing, but it would be good to resist the pressure from Brussels for a new institution to be created for this purpose. Instead, the emphasis needs to be placed on better working by the authorities of the members states, coupled with close cooperation between the member states and the institutions of the EU.

The transition to a green economy is certainly putting banks to the test. The increasing focus on sustainability criteria, as well as the need to adapt to the EU's taxonomy for sustainable activities, also poses a major challenge for the financial institutions.

I'm also counting on the sector's expertise when it comes to educating customers. Promoting financial awareness and improving financial literacy are of key importance, and it is also in the credit institutions' best interests for consumers to live within their means and be capable of understanding and expressing their needs, and choosing the services that are best-suited to them, amidst all the rapid changes. The financial attitudes and habits of citizens need to be shaped so that families are better prepared to safely navigate financial issues.

On top of all these tasks, the banks also face challenges from the real economy and political factors. As I mentioned at the beginning of this foreword, growth is slowing in the global economy, and especially in EU. In its global economic outlook of April 2019, the IMF forecast global GDP growth of 3.3% in 2019, and 3.6% in 2020. The European Commission's autumn 2019 economic forecast, meanwhile, predicts growth of only 1.4% in the EU as a whole in 2019, 2020 and 2021. And this is to say nothing of such uncertainty factors as trade threats, wars or Brexit, which also have a negative impact on the EU's growth. The financial sector and money markets are certain to react sensitively to these.

The EU needs to respond to the economic slowdown without delay. The initiatives already launched must be carried through to completion. The Banking Union needs to be completed. In relation to this, there is still much work to be done in the interest of establishing the European Deposit Insurance Scheme. Completing the Capital Markets Union is critical for ensuring a competitive European business environment and mobilising investments. What is more, this is a Single Market-related project that could ensure equal access to financing for small and medium-sized enterprises (SMEs) across Europe. SMEs have a key role in both the European and the Hungarian economy, as they make up 99% of businesses and provide two thirds of jobs in the private sector. Helping them to secure funds is essential for achieving better economic performance and improving competitiveness.

Identifying how best to uphold Hungarian interests in the thick of all these challenges is a test for people, governments and banks alike. Nevertheless, I am confident that through good cooperation we will find the answers that help us to boost Hungary's economic convergence and prosperity. By exploring the problems and putting forward suggestions, this publication inspires us to work together. Thanks are due to the authors.

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