

PIFS

Program on International Financial Systems

Symposium on Building the Financial System of the 21st Century:

An Agenda for Europe and the United States

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Final Report

SYMPOSIUM ON BUILDING THE FINANCIAL SYSTEM OF THE 21ST CENTURY: AN AGENDA FOR EUROPE AND THE UNITED STATES

The 23rd Europe-U.S. Symposium of the Program on International Financial Systems was held at the headquarters of Santander Bank in Madrid, Spain from June 3-5, 2025. Participants discussed the implications of tariffs for the global economy and international finance, prospects for expanding access to private and public capital markets in Europe and the U.S., international financial regulatory divergence with regard to climate policies and Basel III, and the digitalization of the financial system.

Topic 1: The Implications of Tariffs for the Global Economy & International Finance

In Topic 1, participants discussed the implications of tariffs for the global economy and international financial system. They emphasized the high degree of uncertainty about when and to what extent the U.S. would impose tariffs on its trading partners, how those trading partners might retaliate, and what the short- and long-term effects would be on trade patterns and economic efficiency. Many agreed that, however the tariff threats and negotiations would be resolved, this was an important inflection point in the global economy and potentially for U.S.-Europe relations.

Rationales for U.S. Tariff Policy

Participants identified several rationales that had been put forward by the Trump administration for its tariff policies, including as a revenue source, as leverage to dismantle unfair foreign trade practices, as a tool of industrial policy, and as a means of rebalancing the global economy.

Advocates of the administration's tariffs emphasized that they should be understood as part of a larger growth strategy that also included tax cuts, deregulation, and more energy production. They argued that, as a whole, the growth strategy was highly pro-business and pro-investment. Trade policy would offer further incentive for firms to invest in the U.S., as previous advantages to outsourcing would be removed. Thus, tariffs would be a tool of industrial policy, encouraging both domestic and foreign firms to shift more industrial production to the U.S. Some participants were skeptical that there would be sufficient skilled labor supply for large-scale increases in industrial production or that businesses would have the confidence that tariffs would remain in place long enough to make investment worthwhile. However, advocates of the economic agenda expressed confidence that its supply-side measures would incentivize increases in both labor supply and investment.

There was some disagreement about whether tariffs were a useful source of revenue. On the one hand, advocates argued that tariff revenue could be used to offset some of the tax cuts proposed by the administration. Many participants were skeptical, however, pointing out that in order to raise significant revenue, tariffs would have to be set so high that they would lead to reductions in trade volume, thus limiting the ability of tariffs to be a major revenue source for the U.S. Several also argued that, while the administration had also spoken of tariffs as an alternative to taxes on Americans, in reality tariffs were simply another form of tax that would most likely be born by U.S. consumers and businesses.

A key issue about the various rationales for tariffs was who would pay for them. Since tariffs are collected on imports, the direct payment is made by the importing firm; however, there was debate about who would ultimately bear the cost—the importing firm, consumers (through price pass-through), or the exporting firm (by reducing prices to stay competitive). Some participants argued that the dependence of foreign manufacturers on the U.S. market and the lack of viable alternatives meant that they would be forced to lower their prices and bear the cost of the tariff.

Some suggested that the optimal tariff for the U.S. would be in the 10-15% range, significantly higher than it had been for decades. To the extent that foreign producers

lowered their prices to compete in the U.S. market, tariffs would effectively mean that foreigners would subsidize the reindustrialization of the U.S. economy. Others argued that there was good evidence that in previous tariff hikes under the Biden and first Trump administrations, either importing firms or consumers had paid the bulk of the tariff. Moreover, since tariffs would be much higher and more pervasive this time around, they argued that price pass-through was inevitable as imports declined while demand remained.

An alternative explanation was that the threat of high tariffs was a tactic to force trading partners to take seriously long-standing U.S. complaints about their own trade and investment barriers to U.S. imports or their subsidies to exports to the U.S. While many of these complaints were focused on China and some other developing economies, administration officials had also identified a variety of discriminatory measures imposed by the EU, including tax policies like the Digital Services Tax, as well as enforcement actions against U.S. tech companies and financial institutions. If that were the primary explanation, it would imply that trade barriers could be eliminated through negotiations, which would lead to a net positive effect on the global trading system.

A third explanation was that tariffs were a necessary step in reversing global imbalances, in which the U.S. was forced to run trade deficits with the rest of the world to absorb other countries' excess production and provide a market for their subsidized goods. Administration officials had argued that this system hollowed out American industry and could eventually erode the credibility of the dollar; thus, they argued that it was essential to reduce those imbalances and that tariffs could be a powerful tool to do so. A number of participants were skeptical, however, arguing that the overall U.S. current account deficit reflected the fact that U.S. demand for goods and services exceeded the economy's capacity to produce them. They argued that, regardless of tariffs, the U.S. current account deficit was likely to get even worse in coming quarters as the Trump administration's stimulative tax policies took effect, expanding demand for both consumption and investment.

Finally, some participants focused on geoeconomic strategy as a rationale for the tariffs. They cited concerns over dependence on China for many manufactured goods, as well as China's growing technological strengths. Moreover, the non-market nature of the Chinese economy and the symbiotic association of many companies with the government or party was seen as unfair competition to U.S. firms. Reshoring was thus both politically and economically justified, even if it were to cause short-term pain. Moreover, many participants anticipated that in its bilateral trade negotiations with other trading partners, the U.S. would demand those economies also curtail their economic reliance on China, particularly when it came to supply chains in technologically critical products.

These different rationales implied different endgames. If the reason for tariffs were for negotiating leverage or to reduce imbalances, it could be expected that they would be reduced if the policy were successful (although, as noted, there was considerable skepticism that

imbalances could be eliminated through trade policy). If the goal were to reindustrialize the U.S. or to decouple from China, it seemed likely that tariffs would last for much longer.

Most participants anticipated that higher U.S. tariffs were likely to last, with an average rate of over 10%. Moreover, many expected that other countries would also raise trade barriers either bilaterally in response to the U.S. tariffs or in order to pursue their own industrial policy goals or to prevent import surges due to trade diversion from U.S. markets. This would reduce the potential benefits of tariffs to U.S. producers. It also implied reductions in global trade and potentially a reordering of global supply chains. At the extreme, it could result in a return of Cold War-style economic blocs centered on the U.S. and China (and perhaps another centered on Europe).

Trust and Uncertainty

Participants expressed concern over the unpredictability of U.S. actions and their potential effects on the global trading system. One element of this was trust. They noted that the imposition of tariffs by the U.S. appeared to be violating international agreements, including commitments made under the WTO and FTAs. Indeed, it was noted that the new administration had even violated commitments that had been made under the first Trump administration, including the U.S.-Mexico-Canada Agreement (USMCA).

Supporters of U.S. tariff policy argued that the U.S. was not violating those commitments, due to misbehavior by trading partners. Claims of misbehavior spanned a variety of economic and political situations, including non-tariff barriers to trade (NTBs), currency misalignment, intellectual property theft, and illegal movement of drugs and people across borders. Thus, the tariffs were reciprocal in nature. They also argued that the President's trade actions were in compliance with U.S. laws and the authority delegated by Congress, including the executive's right to designate national security or economic emergencies.

Many participants found these claims to be specious. They noted that there was no provision made in any international agreement to impose across-the-board tariffs on countries without specific findings of violations or prior consultations with trading partners. Moreover, no clear justifications for the levels of tariff had been made beyond a claim that all bilateral trade deficits should be eliminated. Participants also pointed out to the aggressive and often threatening rhetoric expressed by the President and other administration officials, including toward some of America's closest allies. Finally, many saw the insistence on bilateral negotiations and threats to punish coordinated responses by trading partners as a rejection of the basic principles of all trade agreements since the 1930s.

These participants saw the U.S. tariff policies not only as a violation of international obligations, but also as a significant breach of trust. With even Trump's own first-term accomplishments such as USMCA being violated, they asked whether it would be possible to trust any agreement with the U.S., even if common ground were to be found for mutually acceptable terms. While for many trading partners there was likely to be no realistic alternative to striking new bilateral deals with the U.S., major economies like China and the EU were expected to push back hard.

Moreover, it was argued that many economies would seek to reduce their dependence on the U.S., both economically and politically.

Beyond concerns that lack of trust would make trade deals harder to achieve and could also take a toll on U.S. global political influence, participants universally worried about the increased uncertainty in the global trading system. While they welcomed the various tariff delays to date as potentially positive signs that tariff levels would be lower than threatened and that the U.S. was willing to negotiate with partners and listen to businesses' concerns, they also noted that it was impossible to make informed decisions about investment, production, or sourcing. Given questions about whether the U.S. would honor or revise the agreements that would eventually be made, participants predicted a dampening effect on investment both domestically and internationally.

Participants noted a variety of sources of uncertainty in both U.S. trade policy and the global trading system. Many participants expressed frustration that there was no transparency or clear administrative process by which the U.S. government was making decisions about tariffs. Not only did many participants find the justifications for across-the-board "reciprocal" tariffs by country to be murky and lacking economic rationale; they also complained about the seemingly *ad hoc* decision making about which products and trading partners would receive temporary exemptions from declared tariffs or which ones would be subject to additional levies or restrictions. While the Trump administration appeared to value this ambiguity as a tool for making the best bilateral deals with trading partners, participants argued that it was highly disruptive for global supply chains and investment decisions.

There was also considerable uncertainty about how the rest of the world would respond to U.S. tariffs and negotiating demands. While the first of the bilateral trade deals had recently been announced with the UK, it was noted that this was a framework agreement and specifics remained publicly unavailable. With a dozen or more negotiations with major trading partners yet to be completed—or in some cases even begun—companies and investors remained in the dark about how trade with the U.S. would be impacted. One question on some participants' minds was whether there was a first-mover advantage to countries seeking agreements. The Trump administration had suggested this was the case and it was noted that there were a number of countries that seemed to be trying to get in early. A number of participants suggested that this was short-sighted, however. They argued that, for many countries, a wait-and-see approach would be wiser, so that they could get a better understanding of the administration's bottom line. Perhaps more importantly, participants wondered about the feasibility of collective action by some group (or groups) of trading partners. While the U.S. had threatened partners not to coordinate a common front for trade negotiations, some participants argued that major trading partners like the EU, Canada, Mexico, Japan, and South Korea could benefit by doing so. Whether they would make such an attempt or how it would work was seen as very much up in the air.

Two other uncertainties also weighed on participants' minds concerning the trade negotiations. One was the extent to which bilateral agreements would include provisions for U.S. trading partners to restrict trade, investment, and intellectual property transfers with China. A number of participants predicted that such restrictions would be a major sticking point for Asian economies

that were at least as dependent on China as on the U.S., but even for the EU and UK, the economic and foreign policy implications of having to choose between China and the U.S. would be profound. Second, many participants expressed concerns that trade frictions could spiral out of control. Would tariff hikes be "one and done," or would the world experience a replay of the early 1930s, with Smoot-Hawley-level U.S. tariffs sparking waves of retaliation that could damage the entire world?

Global Economic Effects

Confidence in economic forecasting was inevitably impaired by the uncertainty created by the U.S. tariff announcements and negotiations. Several participants stated that their organizations had sharply lowered their expectations for economic growth both domestically and globally once they saw the size of the tariffs announced on April 2 ("Liberation Day"), but had since revised those forecasts upward somewhat in response to the U.S. decision to postpone many tariffs pending negotiations with trading partners. Nonetheless, forecasts for economic growth, global trade, and inflation were all gloomier during the time of the Symposium than they had been before the April 2 announcement.

In the short run, a number of participants predicted slower growth in the U.S. and Europe, as well as mixed results in terms of inflation. U.S. growth prospects were seen as stronger than in Europe, due to continuing strong innovation and productivity growth, the relatively low trade exposure of the U.S. economy, and fiscal policy. While some elements of the administration's economic plan, including tariffs and restrictive immigration policies, were seen as negative, the Trump administration's fiscal and regulatory policies were seen as highly stimulative. Still, most participants predicted slower growth, albeit not necessarily a recession. While few were prepared to predict a recession based on current information, it was understood that there could be further economic shocks arising from global political or economic issues—not to mention trade policy retaliation by major trading partners that could set off a tariff spiral. Most participants agreed that U.S. inflation was likely to rise—not only due to price pass-through from tariffs, but also because fiscal stimulus was being applied procyclically at a time of full employment and with an immigration crackdown that would likely lead to labor shortages in low-skilled sectors like agriculture and hospitality. In contrast, some participants anticipated that there would be little impact on prices in the U.S., arguing that there had been no indications of inflation so far in the tariff imposition or in past experiences over the past decade, and that supply-side policies would increase domestic labor supply even while immigrant labor was likely to decline.

Participants expected somewhat different effects for Europe than for the U.S. Reduction of exports to the U.S. would be a damper on growth, as would any global disruptions of supply chains. Given Europe's higher trade dependence and lower growth trajectory than the U.S., many cautioned that it would be hit harder than the U.S. and that growth in both the EU and UK would be lackluster at best. Some felt that recession was likely at some point in 2025. With regard to prices, there was considerable uncertainty on two points. One was the extent to which supply chain disruptions would constitute a supply shock that could raise prices on many goods. The other was about how various economies and governments would respond. Some participants argued that excess supply in China and elsewhere in East Asia would flood European markets and lead to lower global prices in tradables, which would have deflationary consequences.

Others anticipated that European governments would act to stem higher imports from China due to trade diversion from the U.S., which would limit that effect. Overall, many anticipated modest short-term deflationary effects in Europe and other non-U.S. economies as a result of the U.S. tariffs.

Of all the non-U.S. economies, China was seen as best positioned to ride out the storm. While some companies would see declines in demand and profits, China's large domestic markets and fiscal capacity, as well as its indispensable position within many supply chains and product areas, would make it less vulnerable. Moreover, given the size of its markets and its centrality in many global supply chains, China would be in a position to retaliate against U.S. tariffs with sustained high tariffs and other import restrictions of its own, damaging the prospects for U.S. firms to supply the market. Longer term, some participants argued that this would be an opportunity for China to further develop indigenous technological capabilities and make itself less dependent on the U.S. and Europe. It was noted that Chinese companies, with the support of the government, had already started responding to concerns over availability of advanced semiconductor chips by dedicating resources to producing their own.

In terms of long-term impacts, many participants expected that global trade would likely decline. One reason was political. Beyond the direct impacts of U.S. trade policies, they predicted loss of trust in trading partners would make reshoring and friend-shoring more prevalent. They noted that national security concerns had already become much more salient for many governments and corporations in recent years, and argued that this concern would only continue to grow as they acted to reduce their dependence on foreign economies that might put up new barriers—possibly even leading to a new economic Cold War between China and the U.S. Another reason was uncertainty about whether supply chains could be reconstituted even if countries outside of the U.S. were to reaffirm their commitment to trade openness. Filling missing nodes within supply chains would likely take time and add to the costs of goods. Restrictions on transfer of intellectual property could further complicate the task and raise costs for some products.

Some participants also raised the question of how global imbalances would be affected by U.S. tariff policies. While one of the Trump administration's justifications for tariffs was in order to reduce the overall U.S. current account deficit, a number of participants argued that the overall deficit reflected macro variables like savings and investment and therefore could not be eliminated by attacking each bilateral deficit. If that were the case, they asked, how would the U.S. react? They worried that lack of progress on current account deficit could easily lead to further tariff increases by the U.S., which would exacerbate the effect on global trade.

Long-term effects were seen as likely to vary by country as well. As noted, some participants anticipated that the U.S. would get a productivity boost from reshoring and would benefit from improved terms of trade by imposing an optimal tariff in the 10-20% range. If so, this could further expand the already-growing wealth gap between the U.S. and European economies. Others anticipated greater inefficiencies and higher costs for the U.S. economy, weakening growth prospects for the long term. For Europe and most other countries, it was expected that declining trade and less efficient supply chains would reduce long-term growth. Economies that were highly dependent on trade with the U.S., like Canada, Mexico, and many East Asian economies, would be hurt unless they succeeded in securing good trade deals with the U.S.

While much of the discussion in Topic 1 focused on goods trade and the impact on the real economy, there was also some discussion of financial services. Some participants were hopeful that the disruptions to trade would not bleed into finance. They noted that for the most part, finance was not governed under the same global and bilateral agreements that governed international trade. Moreover, they noted that finance did not fall directly into the key justifications for the Trump tariff policies, such as reindustrialization and reduction of global trade imbalances. Some also noted that the Trump administration had been encouraging about foreign investment in the U.S., which made it important to keep the U.S. investment climate welcoming. The administration had also been positive toward other concerns of the financial services industry and had stated its intention to keep U.S. capital markets globally competitive. Other participants were skeptical of the notion that finance would not be negatively affected by trade measures. One reason was that finance tends to follow the real economy; as trade and interdependence declined between the U.S. and other economies, financial services would necessarily be adversely affected. Also, some participants noted that the U.S. would not necessarily be able to confine competition to its preferred areas—in other words, retaliation for tariff increases could take any number of forms, including reduced cooperation in finance (e.g., in negotiations over substituted compliance, approvals for foreign participation in domestic markets, etc.) as well as reduced political or military cooperation. In other words, frustration and loss of trust in the trading realm could be broadened across a host of other functional issues.

Opportunities and Challenges for Europe

While the U.S. tariff policies and the likelihood of a fragmentation of the global trading system were seen as clearly negative for Europe from an economic perspective, some participants argued that there could be a silver lining if the crisis could serve as a catalyst for more effective economic and political actions by Europeans themselves.

A number of participants noted that several previous rounds of EU institutional expansion, including movement toward banking union, establishment of the European Stability, and the creation of the Single Resolution Mechanism, had been prompted by crises that changed the political and economic calculus of members. Since the reelection of President Trump in the U.S., it was argued, European countries had already made rapid changes to defense spending and to intra-European defense cooperation, which had long been elusive, in order to reduce concerns about possible U.S. disengagement from NATO. With the reality of U.S. trade policy now apparent, these participants argued that movement on key economic policy issues had become more likely.

Discussion focused on three elements of integration. One was the completion of remaining pillars of the European Banking Union, especially the creation of an EU-wide deposit insurance scheme. Second was progress toward the proposed Savings and Investment Union (the successor to previous proposals for the Capital Markets Union). Both EBU and SIU were meant to support productivity and growth in the EU by reducing fragmentation and inefficiencies in the European financial system that was keeping Europeans' vast pool of savings from being channeled into investment. Third, some participants argued for the importance of vastly expanding EU-issued bonds, which could be used to deepen EU financial markets while also supporting infrastructure

and other projects that would advance the objectives of integration, climate transition, and technological development.

While many participants agreed that these actions could be beneficial to the EU economy as well as with the claim that crisis was often a precondition for major advances in EU integration, some remained pessimistic that these developments would actually occur. Several questioned whether the crisis was big enough to sweep aside longstanding political objections, particularly within smaller economies to SIU or among fiscally conservative countries with respect to risk-sharing. They noted that even the Global Financial Crisis and the Euro crises that followed had been not had a transformative effect on European cooperation. A number of participants also noted that, in addition to the widely recognized challenge of competing national interests, there was rising populism within Europe that was increasing skepticism over integration and the supranational authority of the EU. As in the U.S., they argued, populist political parties were suspicious of solutions that seemed to cede political decision making to technocrats in Brussels.

Some participants saw additional opportunities for Europe that did not necessarily involve deeper EU integration. In particular, they suggested that the global dominance of the U.S. dollar could be threatened if foreign investors lost their confidence in the U.S. government or its financial markets. Several argued that faith in the ability or willingness of the government to pay its obligations could be in question. Not only did they see the Trump administration's fiscal policy as likely to significantly increase the already historically high debt-to-GDP ratio, but statements by the President and some of his allies made some worry that the U.S. might choose not to honor its debt to at least some bondholders. Similarly, some raised concerns over taxation or equal legal treatment of foreign investors, including based on longer-term trends of U.S. use of financial sanctions against even major economies. If the status of the U.S. dollar or attractiveness of U.S. financial markets were to be threatened, several participants argued that that the Euro and European markets could benefit by offering predictability, transparent adherence to rules, and non-discrimination against foreigners. As one participant put it, "safety could be the new sexy" for investors.

Some participants argued that the UK was particularly well-positioned to benefit if investors were to sour on U.S. financial markets or the dollar. They pointed to London's longstanding position as a global financial center that was known for the quality of both financial services and regulation. Moreover, they saw the UK as more nimble than the EU, as it could adapt policies and innovate unimpeded by EU policymaking and legislative processes. With the UK also apparently first in line for a comprehensive trade agreement with the U.S., it could also promise greater certainty to investors and potentially serve as a bridge between the U.S. and EU.

Future of the Global Trading System

Finally, participants discussed the future of the global trading system. Many agreed that the Trump administration's imposition of high tariffs and preference for bilateral trade agreements, as well as its suspicion of a rules-based multilateral system and global integration, would mean fundamental changes to the shape and governance of global trade. Few participants appeared to believe that the new world of tariffs was a passing fad.

One key question was what would happen to the WTO. Participants expressed mixed opinions. Some argued that the U.S. rejection of a number of its obligations under existing international trade law, in addition to previous actions to weaken the Dispute Settlement Mechanism, would essentially mean the end of the WTO. Without a U.S. willingness to accept and enforce rules, there would be no way to prevent countries from following their own policy preferences and interpretations, including by using the same national security and domestic industrial policy justifications that the Trump administration (as well as the previous Trump and Biden administrations) had used to subvert multilateral principles. Moreover, U.S. abdication of support for the WTO and global rules would leave the field to China, which had for decades been a source of instability in the global trading system by abusing rules, flooding global markets, hollowing out industries in its trading partners, and accumulating large-scale macro imbalances. Thus, they foresaw a global trading system plagued by beggar-thy-neighbor trade and industrial policies as well as use of market power by major economies.

Other participants were less pessimistic. Several pointed out that the WTO had long been an imperfect overseer of the global trading system. Indeed, the organization was already in the midst of reform discussions on a variety of issues, including trying to improve the efficiency of decision making and to clarify the status and rights of emerging economies. A number of participants argued that the WTO had been particularly ineffective at dealing with the challenges to global rules posed by China, and that it was not just the U.S. that was frustrated by the situation. They noted that the Trump administration had quickly appointed a representative to the WTO and had remained actively involved in the reform negotiations, which they took as a sign that the U.S. was not abandoning the organization. Similarly, the claim by some U.S. officials that its tariff policy was primarily a means of eliminating unfair trade practices in other countries raised the possibility that the current crisis could be the impetus for serious negotiations to create a fairer and more stable trading system that would reduce global imbalances. Finally, several participants noted that most actual progress in WTO-governed trade negotiations since the failure of the Doha Round had come in the form of plurilateral agreements among self-selected groups of economies, such as the International Technology Agreement and Government Procurement Agreement. Such plurilateral agreements could be a means for willing member-states to continue rules-based trade cooperation even without U.S. participation.

Some participants argued that there could be a special role for Europe in rebuilding a global trading system that did not necessarily include the U.S. They envisaged a new set of agreements among states that valued the predictability and fairness of a rules-based system. In such a system, the EU's reputation for predictability and consistency based on transparency, rules, and procedures could be the new anchor for like-minded states including economies such as Japan, Canada, and South Korea, among others. Several argued that the first step to such a new system would be a comprehensive trade agreement between the EU and the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP, which already included Japan, Canada, Australia, Singapore and the UK, among other like-minded economies, and was considering South Korea). They argued that a EU-CPTPP agreement could cover the bulk of global non-U.S., non-China trade, particularly in high-end goods and services.

A final question on the global trading system was whether the world was headed toward a system of more-or-less exclusive trading blocs. Some participants pointed out that the U.S. and other

countries had been making moves toward partial decoupling from China for at least a decade, with a focus on high-tech and other critical supply chains, and that the Trump administration had made clear that economic security was a major driver of its trade policy. Indeed, there had been some indications that U.S. bilateral trade agreements with third countries might include provisions against trade and/or intellectual property transfer with China. Meanwhile, China had made clear its intention to resist U.S. trade pressures, including by increasing its tariffs on U.S. imports and also by increasing restrictions on exports of rare earths and other critical materials. These efforts at decoupling could easily put other economies, including European ones, into the position of having to choose between the U.S. and China as trade partners, which would have enormous economic and political implications. Participants recognized that Asian economies like Japan and South Korea would be put in a particularly difficult position if were forced to choose among economic clusters based on supply chains, markets, and political affinity. Some participants argued that fears of exclusion from U.S. markets and Chinese domination would make the prospects of EU-CPTPP cooperation much more attractive to CPTPP members, raising the feasibility of such cooperation as an alternative to exclusive trading blocs.

Topic 2: Expanding Access to Private and Public Capital Markets

In Topic 2, participants discussed how to expand access to capital markets. For the U.S., the focus was on whether and how retail investors should be able to invest in private markets. For Europe, participants discussed challenges in both public and private markets.

Why Private Markets?

Participants noted the rapid development of private equity and credit in the U.S. as an important phenomenon. Europe was also experiencing growth in its private markets, albeit more slowly. Many saw the shift as benefiting investors, companies, and the economy as a whole.

A number of participants noted that investments in private markets had received higher returns in recent years than those in public markets. Moreover, private markets experienced less volatility in part because values weren't determined by daily trading. Participants argued that private markets allowed investors to better manage their investments based on their own maturity and risk preferences. For investors with long-term objectives who did not require liquidity, like life insurers and retirement savers, private equity and credit were seen as a natural match. Moreover, since decision makers were directly representing the interests of investors, they argued that the direct ownership structure of private equity ensured that managers' and owners' interests would be aligned, leading to a complete focus on shareholder returns. Regulation was another reason for the attractiveness of private markets, as participants noted that regulatory burden, reporting requirements, and costs of compliance had increased the costs to companies of going or remaining public. For a number of participants, the compliance costs of issuing equity publicly came with few benefits—they argued that many of the reporting requirements and their frequency, for example, did not provide the kind of information that investors needed to judge the performance of their investments.

Private markets were also seen as providing useful benefits to companies. To start, participants noted that most companies were unable to access public markets due their size, newness, or business model. For such companies, having an alternative to bank loans was seen as essential, especially as banks in the U.S. and Europe had become more conservative and credit-constrained due to capital and liquidity regulations. Private markets could provide risk capital to allow for corporate growth and innovation at each stage of companies' development, depending on their financing needs. Importantly, both private equity and private credit could support longer-range objectives, relieving management from having to satisfy markets whose time horizons were much shorter. With regard to private credit, participants noted that companies of all sizes might prefer to borrow on private markets rather than from banks or through bonds even if private credit was more costly, because private credit offered greater speed and flexibility. In addition, a number of participants noted that many family-held companies preferred private over public markets to ensure that they retained control over the company and to maintain confidentiality about their financial positions and investment strategies.

Finally, many participants argued that expanding private markets could provide important benefits to economies. By increasing returns to companies and investors, they could support more investment and innovation. In Europe especially, where bank lending remained a dominant form of financial intermediation, private markets were seen as a useful avenue for mobilizing savings. Moreover, the faster decision making in private markets raised the possibility of reducing transaction costs and thus allowing companies to move swiftly to take advantage of new opportunities and technologies.

At the same time, participants agreed that private markets had drawbacks as well, including lack of liquidity and less information. Also, some participants questioned whether private markets would continue to outperform public markets. As the amount of funds pouring into private markets continued to increase, they argued that it was likely that new investment opportunities would be less attractive as the quality of deal-flow decreased and competition bid down returns. In private credit, a number of participants raised concerns about covenant-light lending and willingness to lend to riskier borrowers, which could lead to higher risks in a downturn. The resilience of private markets had not been tested in such a situation, and some participants worried that failures in the private credit market could potentially be transmitted throughout the financial system through counterparty risk. The risk of contagion was one that macroprudential supervisors were wary of.

Rise of Private Markets in the U.S.

For the U.S., where private markets had risen particularly rapidly and provided significant benefits for investors, participants discussed two main issues: why private markets had become so attractive to investors and companies, and whether and how private assets should be made available to retail investors.

In the U.S., private markets were seen as essential to small- and medium-sized enterprises (SMEs), not only in the form of venture capital and private equity takeovers, but also increasingly in the credit space. With banks having reduced their lending and risk profiles significantly over the past two to three decades due to both changes in business models and the effects of prudential regulations, SMEs had become quite reliant on private lenders.

Many larger companies had also shown a preference for private over public markets. Going or staying private was seen as attractive by these companies partly because the costs of listing publicly had gone up due to regulation and shareholder lawsuits; at the same time, some of the benefits of public markets, such as enhanced credibility and access to lower-cost funding, had declined over time with the growth of a comprehensive private financing ecosystem. It was argued that tech companies in particular preferred to fund themselves through private equity and credit, in order to enable investments in R&D and production capacity that could take years to pan out. By not having to worry about short-term share price fluctuations, they could concentrate on executing their business plans. For both large and small firms, private credit was seen to offer more flexible terms and speedier decisions on loans; in many cases, these benefits could outweigh higher interest rates even if they could obtain cheaper financing through bank credit or bond issuance.

Several institutional factors supported the rise of private markets in the U.S. As noted, one factor was rising costs in the public markets and banking sector, including both costs of compliance for public companies as well as capital charges and liquidity constraints in the banking sector. In contrast, the more lightly regulated private markets offered cost advantages. Participants also noted the prominence of life insurance companies in U.S. private credit. The long time horizons and stable capital bases of insurers were seen as a good match for longer-term loans and investments that did not have to be marked to market, and the higher interest rates associated with private credit also increased the returns on such investments. Importantly, this was only made possible by regulations that gave insurance companies the flexibility to invest in private credit; in the EU, in contrast, Solvency II effectively barred insurers investing in private credit, slowing the growth of private credit there.

Participants discussed at length proposals to make private assets more accessible to retail investors. Currently, individuals in the U.S. could only qualify to invest directly in private markets by meeting wealth or experience criteria that were only achievable for a small minority of households. These criteria had been put in place to protect retail investors, since private assets were seen to carry significant risks for investors that did not exist in public markets. In particular, the long lock-in period for most closed-end funds and the lack of deep and liquid secondary markets was seen as potentially hazardous for small investors who might need to exit their positions quickly. Moreover, the lower disclosure and absence of market prices raised questions about unsophisticated investors' ability to judge performance and values.

While recognizing the importance of investor protection, many participants were not convinced that these regulations were in the best interest of retail investors. Noting that private assets had been achieving higher returns than public assets over an extended period, they worried that retail investors were being locked out of the most lucrative and least volatile areas of U.S. capital markets. In other words, they felt that retail investors were actively being disadvantaged by regulations meant to protect them. There were also serious questions about the appropriateness of those regulations. Some participants noted that wealth minimums did not ensure that investors were actually sophisticated, and argued retail investors should also be able to qualify by passing a test that demonstrated their understanding of the risks and mechanics of private funds. Perhaps more fundamentally, a number of participants pointed out that retail investors already had ready access to much more complex and volatile financial products, including crypto assets, derivatives, margin trading, and highly leveraged ETFs via simple-to-use phone apps. It seemed hard to justify caution only about private assets when retail investors could take on so many other kinds of risks already.

Many participants anticipated that U.S. regulators would be increasingly open to granting retail investors' access to private assets, both for the reasons noted above and because of the change of administration. Thus, there was discussion about how best to provide such access, while also increasing liquidity and ensuring that investors understood the particular risks of private assets before locking into them.

One possibility for balancing access to private assets with investor protection was indirect investment through other investment products, such as investment funds or annuities. These funds would be publicly traded and provide liquidity. But this could still raise pricing issues due

to the difficulty of valuing private assets within a fund. Several participants suggested that employees could be offered access to private assets through their direct contribution pension schemes such as 401(k) plans, arguing that the longer time horizons for retirement savings made such plans the perfect vehicle for retail investors to benefit from private markets. Others were more cautious, arguing that retirement plans were precisely the vehicle that should be most highly regulated for investor protection. These participants were also suspicious of allowing crypto assets or margin trading in retirement accounts although the scope of permissible assets could be separately determined..

Other suggestions focused on increasing the liquidity of private assets. A number of participants noted the rise of secondary markets for private equity and credit, and argued that this trend should be encouraged. Although they recognized that there could be dangers to investors in terms of pricing and the depth of secondary markets, they argued that the benefits of greater liquidity would outweigh those risks and legal obstacles. There could also be complications created by the ways in which limited partnerships were structured, which might need to be resolved or clarified by regulation. Some participants argued that the best way to improve liquidity and pricing would be through tokenization. Tokenization could increase liquidity by allowing fractionalization and simplified trading and settlement. Since many participants anticipated that tokenization would rapidly increase in importance in the financial system, this could be a practical way of pricing and trading any number of illiquid assets, including private equity and credit, real estate, and even artwork and collectibles.

Public and Private Markets in Europe

Turning to Europe, participants discussed both public and private markets, both of which were seen as inadequately developed. The EU in particular still had a highly bank-based financial system, which participants saw as problematic for the region's economy. They worried that the vast pool of European savings was locked up in low-yielding deposits at banks, which were unable for both cultural and regulatory reasons to provide the risk capital needed for innovation, productivity growth, and the green transition. Participants agreed that Europe's massive savings should be used to fund its massive public and private investment needs, but that so far its capital markets had not done so effectively.

Public Markets

Many participants agreed that public markets in the EU were not meeting their potential. They noted that markets remained fragmented and often illiquid. Fragmentation was seen at multiple levels, including among trading venues and in government debt markets. While the introduction of consolidated tape for equities would be helpful in improving price discovery and efficiency, fragmentation of trading venues reduced efficiency and liquidity of markets. It also tended to reinforce regional and national biases, slowing the progress toward integration and reducing cross-national diversification within the EU. Government debt markets also remained fragmented on a national basis, preventing the emergence of a large and liquid default risk-free EU-wide bond market and Union-wide yield curve.

Participants also pointed to the lack of development of securitization markets as a serious problem for European finance. They saw securitization as important for several reasons. One was to help develop bond markets in general. Also, they saw asset-backed debt to be an attractive investment. Perhaps most important, securitization was seen as an essential way to expand lending to companies by allowing banks to reduce their balance sheets and expand their own lending, and also by providing a mechanism for banks to originate more lending for securitization purposes. Thus, a number of participants identified securitization as an important option for shifting savings into investment.

Participants expressed some frustration with the progress of securitization, which several characterized as "low-hanging fruit." While recognizing that the EU had made efforts to expand securitization in recent years, they noted that securitization in the EU was still quite limited, in contrast to the U.S. and UK. Despite liberalization efforts and rhetorical support for securitization, practical challenges remained in place. Several noted that EU-regulated products were currently limited to mortgage-backed securities (MBS); while MBS could be an important way of moving assets off banks' balance sheets and supporting the housing market, they did not contribute to other major goals, such as increasing funding for SMEs. Also, many participants criticized Solvency II for restricting insurance companies' participation in asset-backed securities markets, even though in many ways ABS were ideal products for insurers.

Private Markets

Private markets in the EU were seen as even more underdeveloped than public markets. Participants noted that the vast majority of EU companies were SMEs and relatively few were able to mobilize funding through equity or bond issuance in public markets. Thus, they saw a hole that private markets could potentially fulfill, if regulations and investor preferences would allow it.

Participants pointed to several regulatory restrictions on the growth of private markets. One of these was strict restrictions on access by retail investors. To be qualified as a professional investor (and therefore eligible to invest in private assets) required a combination of wealth, experience, and knowledge that was seen by participants to be excessively complicated and non-standardized. Institutional investors also faced restrictions on the type of private investments they could access. For example, pension funds and UCITS were only allowed to invest in listed securities; single, transparent, standardized (STS) securitizations; and regulated funds. Meanwhile, in stark contrast to the U.S., Solvency II prevented insurance companies from operating in private markets, effectively trapping long-term funds in low-yielding investments. In other words, EU regulations had severely restricted the investor base for institutional investors as well as retail investors. Many participants found these restrictions to be frustrating, and urged that they be eased.

UK markets were seen more positively by participants. In particular, London offered one of the world's most highly developed public markets, with a full range of deep and liquid markets in domestic and international equities, bonds, asset-backed securities, and derivatives. However, participants recognized some real challenges in the UK public markets. For example, Brexit had led to the removal of some trading clearing back to the EU. Also, the number of listed companies

on the London Stock Exchange had plummeted, falling by about one-third over the last decade. This decline resulted from a combination of companies shifting their listings abroad, dropping secondary listings, and going private, but was definitely seen as evidence of the reduced attractiveness of UK capital markets. However, London had retained its key role in global corporate bonds, Eurobonds, and sovereign bonds, which it had sought to advance with further innovations such as creating International Securities Market, with its lighter disclosure requirements for professional investors. Participants saw more potential for private markets in the UK than in the EU, although they agreed that it still lagged behind the U.S. Positive signs included a supportive regulatory regime as well as the ability to use trading venues such as PISCES to trade securities (such as collateralized loan obligations) based on private assets in addition to public and asset-backed securities.

Creating an "Investor Mentality"

While much of the discussion in Topic 2 focused on regulation and institutions, many participants argued that the fundamental challenge in Europe was the lack of an "investor mentality." Savers in most European economies preferred to hold their savings in banks or life insurance rather than investing in capital markets, despite the existence of a variety of investment products including Undertakings for Collective Investment in Transferable Securities (UCITS) and Long-Term Investment Funds (LTIFs) in the EU and Long-term Asset Funds (LTAFs) in the UK that would allow them to invest in diversified portfolios of securities that would provide higher yields. Even in the UK, where modern capital markets had originated and evolved over hundreds of years, participants noted that the share of households that owned securities was quite low.

Participants raised several hypotheses for why European households chose to be savers rather than investors. One important explanation was low risk tolerance, as seen not only in where they chose to park their financial assets but also in surveys that consistently showed wealth preservation to be the top priority for households. Some participants argued that this tendency was reinforced by financial regulations that overemphasized retail protection at the expense of returns. Unlike in the U.S., where the notion of a trade-off between risk and return was well understood by the public and emphasized by financial institutions, several participants described investment literature in both the EU and UK as emphasizing the possibility of losing money, rather than the probability of gaining higher returns.

One reason put forward for low risk tolerance had to do with households' experiences with financial investment. Compared to the U.S., European returns in both equities and bond funds had been relatively weak, which might lower Europeans' willingness to accept risk. Also, with the exceptions of Sweden and the Netherlands, defined-contribution pension systems were not widespread in Europe. Even the superannuation schemes in the UK were relatively limited. In contrast, the majority of employees in the U.S. were enrolled in defined-contribution systems in which they had at least some degree of responsibility over the management of their own retirement funds. By being forced to take such responsibility, U.S., Swedish, and Dutch households had developed experience with financial investment that changed their risk preferences.

Participants also discussed what could create an investor mentality. One suggestion was to increase the availability and reach of defined-contribution pension options, which would give households more experience with investments, albeit within guardrails. In addition, many participants noted that the younger generation was increasingly comfortable with the idea of investing due to the ease of app-based investing. While some participants felt nervous that so many young investors had dived straight into crypto assets and complex financial instruments like options, thanks to the ease of the apps and the allegedly addictive "gameified" nature of some of them, they agreed that it could contribute to the development of an investor mentality that could help to advance European capital markets and contribute to economic growth. Finally, participants agreed that more and better investor education was needed, both by governments (e.g., in informational materials on pension and superannuation) and by financial services providers.

Topic 3: International Financial Regulatory Divergence – Climate Policies and Basel III

In Topic 3, participants discussed the prospects and potential consequences of international financial regulatory divergence, particularly between the U.S. and EU. Participants agreed that in many ways, regulatory cooperation since the Global Financial Crisis had contributed to the stability and resilience of global and domestic financial systems, and expressed the view that it was important to maintain the strong points of the system. However, in recent years, diverging assessments of the costs and benefits of Basel III had led to differing approaches to designing and implementing the Basel End Game, although there was still considerable consensus regarding the principles at stake. There was much more divergence among countries with regard to climate-related financial regulation. The EU had been particularly assertive in addressing climate change through financial regulation. In contrast, climate-related financial regulation in the U.S. had been consistently less assertive and more piecemeal. The new Trump administration was seen as hostile to the climate agenda, including in financial regulation, exacerbating tensions between the U.S. and EU on such issues.

Basel III and the Post-Crisis Reform Agenda

Participants agreed that post-Global Financial Crisis financial regulatory reforms had contributed to the stability and resilience of the global financial system. They noted that banks and financial markets had performed well despite a variety of serious challenges, including most recently the COVID-19 epidemic and the Russian invasion of Ukraine.

However, participants raised concerns about the costs of some reforms, as well as divergence in their implementation. In particular, the implementation of the Supplementary Leverage Ratio (SLR) was criticized by many participants as restricting bank lending without actually improving banks' resilience. While some participants saw it as a necessary way of preventing banks from gaming internal models and taking on too much risk, others argued that the SLR was creating negative consequences for banks and financial markets. A particular concern about its implementation in the U.S. was what participants saw as its negative effects on the Treasuries market. Several argued that, at a minimum, Treasuries should be exempted from SLR limits. More generally, participants noted that the SLR had been designed to be a backstop to ensure banks were sufficiently capitalized. However, it had moved to the front lines of regulation, becoming a binding constraint on some large banks' balance sheets and weakening the principle of risk-based capital requirements. Beyond the SLR, a concern expressed by some participants about the U.S. implementation of post-crisis reforms was the stringency and non-transparency of stress tests on major banks. It was argued that it was likely that the Fed would make changes to address those concerns following the appointment of Michelle Bowman as vice-chair for supervision.

Much of the discussion in Topic 3 focused on implementation of the final version of Basel III (Basel End Game). While some jurisdictions, such as Japan, had fully completed their implementation of Basel End Game, the U.S., EU, and UK were still in the process of doing so. Moreover, some key elements of the Basel End Game remained under debate in those

jurisdictions, particularly in the U.S., where pushback from the banking industry and legislators had already led regulators to scale back some of their initial plans to raise capital requirements in the fall of 2024. With the election of President Trump and the appointment of a number of new banking regulators, Basel End Game rules were still being reconsidered. Meanwhile, in both the EU and UK, concerns about the competitiveness of domestic financial institutions and about the need for more lending to improve productivity and innovation were adding to debate about the final shape of Basel End Game implementation.

For the U.S., a number of participants emphasized the importance of not creating higher capital requirements, as had been proposed in the original Basel End Game proposals. However, discussion focused especially on the issue of "tailoring," or differential implementation of regulations. Participants supported the idea of restricting Basel requirements to large and systemically important banks, while having a lighter hand on smaller banks. America's many small banks were seen as essential to supporting the economy, since so many regional companies and SMEs were dependent on bank lending; moreover, their business models were much more simple than major banks. However, questions remained as to the size thresholds for which banks would be subject to the full Basel End Game requirements.

For the EU, much of the discussion focused on simplification of regulations. There was a general consensus that capital rules were excessively complex. Participants argued that the capital stack was too complicated and varied among banks and across national borders. They noted that different authorities set different buffers without much coordination and that, moreover, micro- and macroprudential functions were carried out by various authorities. This created significant regulatory burdens that did not contribute to greater financial stability. However, this did not necessarily imply a call for deregulation or for lower capital requirements. Indeed, here were mixed opinions about whether EU capital requirements were excessively stringent, with some arguing that high capital requirements were choking off lending and others countering that EU requirements were no higher than in other jurisdictions. There was also some opposition to the notion of tailoring bank regulation by size. Some participants argued that it would be a good thing to reduce demands on small banks. In contrast, others argued that, while documentation requirements and frequency of reporting could safely be reduced for small banks, all banks should meet the same capital and liquidity standards regardless of size.

In the UK, participants anticipated that the long-delayed Basel End Game provisions would include elements of both simplification and tailoring. It was emphasized that rules on recalibration of capital standards would have to be capital-neutral, which was seen as important since the UK had tripled bank capital requirements in the decade following the Global Financial Crisis.

Participants observed that in all three jurisdictions, bank regulators were increasingly thinking about banks' international competitiveness and their broader economic impact, rather than just on maximizing microprudential goals. This discourse was apparent not only in the U.S., where the Trump administration was focused on removing supply-side obstacles to rapid economic growth and was responsive to banks' concerns about overregulation. In the EU, the Draghi Report had sensitized economic policy makers to the need to funnel the continent's vast savings into productive investment in innovation and infrastructure, and participants sensed that

competitiveness concerns were becoming more prominent in banking and financial regulation. In the UK as well, concerns over lackluster economic growth and declining competitiveness had also influenced the formulation of banking and financial regulation. Perhaps as a result, many participants saw divergence between the U.S. and Europe on Basel III to be relatively limited and largely technical in nature since both sides were concerned about having too-high capital requirements.

Climate-Related Financial Regulation

Climate-related financial regulation was another story. Participants saw large and growing differences between the U.S. and EU approaches and warned that such divergence could significantly raise costs for internationally-active financial institutions and complicate the task of global regulatory cooperation.

In the U.S., climate-related financial regulation had already been in dispute before the 2024 election. Financial institutions and many legislators had pushed back against proposed reporting requirements and incorporation of climate risk into bank stress testing. Bank regulators including the Fed had issued guidance for banks' management of climate risk, but compliance was voluntary and there was no equivalent to the European Banking Authority's Pillar 3 reporting standards. The Fed had also engaged in research and discussions of how to integrate climate risk into CCAR stress testing, but this had never been implemented. The SEC had issued a rule to require Scope 1 and Scope 2 emissions reporting for all listed companies (including banks) in 2024, but it had been stayed by courts and then by the SEC, and after President Trump's election the SEC had announced that it would no longer defend the rule in court. Thus, there was no specific federal regulation of financial institutions' climate risk, other than using existing securities laws to require material disclosures or to prevent false statements and greenwashing. Participants anticipated that under the Trump administration, climate-related financial regulation would not occur, and even research and discussion of climate risks by regulators would be discouraged.

One striking element of U.S. financial and climate regulation was the considerable variation at the state level. Some states, such as California and Massachusetts, had been quite forward-leaning on climate issues. In addition to requiring disclosure of emissions and risk, several states had mandated that state agencies work only with financial institutions that met their reporting requirements and that pension funds prioritize ESG investments. In contrast, some other states had mandated that state agencies and pension funds not do business with financial institutions and funds that applied certain ESG-based exclusions. Furthermore, Texas and other states had boycotted asset managers complying with other states' ESG requirements and sued a variety of major asset managers for violating anti-trust laws by avoiding investments in coal. As a result, asset managers and banks in the U.S. were finding themselves potentially whipsawed by conflicting requirements of doing business in different states.

Meanwhile, the EU remained forward-leaning in climate-related financial regulation. Most prominently, this included reporting requirements for all firms and banks, following the EU Taxonomy. Moreover, supervisors required banks to consider climate risk in their business strategies and risk management, including stress testing. There was also continuing discussion of

whether and how to incorporate ESG or climate lending requirements in banking regulation, as well as how to incorporate climate risk into supervisors' stress testing models. Moreover, pension funds were required to incorporate ESG and climate risk in their investing strategies, and regulators strictly enforced rules against greenwashing for all firms and investment products. While there had been some efforts to simplify and streamline climate reporting, participants agreed that the EU commitment to climate-related financial regulation was a firm one that contrasted severely with the current U.S. approach.

The UK was seen as also favoring rules to ensure accurate reporting and consideration of climate risks for firms and financial institutions. However, its approach was characterized as less legalistic or prescriptive than that of the EU, concentrating on developing principles and on cooperation with financial institutions to improve assessment and management of climate risks for their loans and investments. It was argued that this approach reflected both the traditional principles-based approach of UK financial regulators and the high degree of uncertainty about how to measure and manage climate risk.

Overall, the divergence between the U.S. and Europe (particularly the EU) on climate-related financial regulation was large and growing. This raised significant challenges of compliance for internationally-active financial institutions, which could face conflicting regulations between the EU and U.S. and even among states within the U.S. that would raise compliance costs and potentially place them in violation of the laws of some jurisdictions in which they operated in order to comply with the rules of others. Some participants warned that this divergence also threatened international financial regulatory cooperation, which had been built on the premise of common standards and substituted compliance across jurisdictions.

Prospects for International Cooperation

Some participants were gloomy about prospects for international cooperation. They pointed to growing divergences between EU and U.S. regulators and legislators on issues ranging from climate to crypto assets to financial competitiveness as straining the post-crisis cooperative frameworks in financial regulation. Several argued that the election of President Trump in the U.S., as well as concerns over slow growth in the EU and UK, were further tipping the scales away from valuing international cooperation and financial stability in favor of increasing the competitiveness of domestic financial institutions and markets. This raised the prospect for some participants of a race to the bottom that could gut prudential regulations and possibly invite financial instability in the future. At the least, regulatory divergence would make compliance more difficult and more expensive for internationally-active financial institutions, contributing to fragmentation and inefficiency.

Other participants were more optimistic. They argued that there was actually much less divergence than there appeared to be. They noted that international financial regulatory cooperation had always operated on the basis of broad agreement on principles and standards, which were applied domestically based on the economic and political conditions of each jurisdiction. Despite more aggressive rhetoric from the Trump administration, they argued that U.S. regulatory and supervisory agencies continued to support existing international standards, as did U.S.-based financial institutions. Although they anticipated that the U.S. would emphasize

competitiveness in its application of financial regulation, they noted that it had long been the case that major jurisdictions including the U.S., EU, and UK had adapted global standards to suit their own needs.

For many participants, the major question for international cooperation (as opposed to complying with international standards) was how to address divergence in climate policies (where there are no international standards) between the U.S. and Europe. The EU's firm commitment to leading the world toward more climate-friendly financial regulation could collide with U.S. rejection of efforts to incorporate climate risk into financial regulation. Some participants worried that either the EU or U.S. could be tempted to manipulate their approvals processes for substituted compliance in order to exert political pressure on other jurisdictions to change their policies. Thus, participants urged regulators to resist this temptation and to continue to cooperate on the basis of agreed standards and apolitical evaluations of other countries' financial regulation and supervision.

Topic 4: The Digitalization of the Financial System – Cyber Resilience and Crypto Assets

In Topic 4, participants discussed the digitalization of the financial system. Discussion focused in particular on stablecoins and digital infrastructure. Participants addressed a variety of questions on those issues, including how to enforce anti-money laundering rules, the resilience of digital asset providers, and how to ensure that digitalization would not endanger financial stability.

Use-Cases for Blockchain

Participants agreed that there were multiple possible use-cases for blockchains in financial services. While much attention had been paid to the use of distributed ledger technology (DLT) in the context of bitcoin or other native digital assets, participants recognized several other actual or potential uses.

One major use-case was tokenization. The most well-known and commonly-used tokens to date were stablecoins, which are digital assets designed as a means of payment or settlement, for which the issuer is obligated to convert coins for a fixed amount of money. In principle, however, any type of asset could be represented by a digital token and traded directly and instantaneously. A number of participants argued that tokenization of equities could make trading cheaper and more efficient; moreover, the ease by which tokens could be fractionalized offered new opportunities for retail investors to take positions in a variety of financial assets, potentially including illiquid assets like real estate and collectibles.

Participants also saw potential for the use of blockchains, whether permissioned or permissionless, in improving the efficiency, speed, and accuracy of financial transactions. They noted that existing payments, settlement, and clearing infrastructures were built on the foundation of complex legal and institutional systems dominated by banks—for example, international payments relied on a web of correspondent banking that added costs and time to every transaction. Blockchain-based payments offered the opportunity to bypass these complex and expensive systems.

Not all participants were enamored of the use of tokenization and blockchain-based payments and settlements. Some worried about the financial stability implications of instantaneous trading. Many also raised questions about the effects of anonymity on core concerns of financial regulators, such as anti-money laundering and terrorist financing, not to mention the difficulty of clawing back funds that were mistakenly transferred.

The Emerging U.S. Regulatory Framework

Participants agreed that after years of lagging the EU on digital assets regulation, the U.S. was now moving quickly to establish regulations that would enable the growth of digital assets. In addition to issuing his own meme coins, President Trump and many of his supporters had championed crypto assets during the 2024 campaign, and his election heralded major changes in how U.S. regulators would approach both digital assets and wider use of blockchains in financial

activity. Previously, there had been no legislation to regulate digital assets, leaving wide gaps in regulation. While the SEC and CFTC had sought to step into that void, their actions had been legally contested and in some cases had been at odds with each other, with the SEC acting particularly aggressively to stifle the growth of crypto assets and exchanges. Moreover, the SEC had presided over the failure of FTX. The new administration, together with supporters in Congress, had prioritized legislation to create a regulatory framework for digital assets, which appeared to be progressing quickly. Meanwhile, the new leadership in the SEC had significantly shifted its stance from restraining the spread of crypto to encouraging innovation by stepping back from its enforcement policy of claiming that the offering of many crypto assets violated securities laws.

At the time of the Symposium, Congress was considering two sets of legislation. FIT21, which had been passed by the House but was still in committee in the Senate, would clarify regulatory responsibilities for tokens, intermediaries, and exchanges. Meanwhile, the House and Senate were advancing two bills to regulate stablecoins (STABLE and GENIUS Acts, respectively), which were expected to be merged soon and voted on as early as late summer. While the timing and contours of comprehensive digital assets regulation were in question, participants agreed that passage of stablecoin legislation appeared imminent. The emerging U.S. regulatory framework for stablecoin would definitively remove stablecoins from regulation as securities, would require federal and/or state licensing, and put in place strict reserve and transparency requirements. However, for the time being, interest payments would be prohibited. Meanwhile, the proposed CLARITY Act, which would create a comprehensive regulatory framework for digital assets and trading, was moving toward initial mark-up in the House.

Looking to the future, participants anticipated that digital assets would increasingly be incorporated into the mainstream U.S. financial system. While a variety of existing financial institutions were already offering digital assets through funds or ETFs, regulators were expected to enable banks and other financial institutions to custody digital assets, accept deposits from digital asset providers, and manage payments using blockchain applications and stablecoins. However, one type of digital asset that was expressly <u>not</u> part of the emerging crypto ecosystem in the U.S. was central bank digital currency (CBDC). The Trump administration had issued an executive order in January 2025 to prohibit the issuance of a digital dollar and several legislative proposals had also been put forward; even if legislation against CBDC did not pass, the Fed was on record as saying it would not issue a digital dollar without express approval from Congress.

While U.S. regulation had so far been piecemeal (albeit rapidly accelerating), the EU had passed comprehensive regulation of digital assets in 2023, in the form of the Markets in Crypto-Assets Regulation (MiCA). MiCA provided a framework for the regulation of all digital assets, from stablecoins to meme coins as well as crypto exchanges, addressing investor protection, market integrity, and financial stability. While many specifics were still in development and some participants described the current implementation of regulations as "piecemeal," MiCA rules were already in place for stablecoins and offered a clear road map for regulators, issuers, and exchanges. Participants noted euro-denominated stablecoins were growing in number and usage and that many traditional financial institutions were also entering the space—in fact, Société Générale was the second stablecoin issuer to obtain a license in the EU. Meanwhile, the ECB

was moving forward with plans for a digital euro, with the expectation that stablecoins and CBDC would coexist in the payments ecosystem.

Despite the EU's lead in passing crypto legislation, some participants argued that the U.S. was likely to move more rapidly in some respects than the EU. They argued that, once enabling legislation was in place, U.S. regulatory agencies could move more rapidly than the European Commission in devising and introducing rules. In the meantime, they could also provide exemptive relief for companies to experiment with novel digital assets or blockchain applications. For example, some argued that tokenization of traditional financial instruments could advance rapidly, with trading of "wrapped" tokens (which allows for trading across multiple blockchains while storing the original asset in a secure vault or with a custodian) potentially beginning as soon as 2026.

Stablecoin Regulation and Financial Impact

Many participants agreed that stablecoins were a particularly important area of digital assets to get right. Global circulation of stablecoins had exploded, growing from about $25 billion in 2020 to $250 billion by 2025, and according to some forecasts stablecoin market cap had the potential to reach $1 trillion in 2026, and to continue to grow quickly in coming years. While stablecoins were initially used only for moving money in and out of crypto assets, advocates of stablecoins predicted a much wider set of use-cases, including remittances, payments, and cash management, albeit this could be impeded if no interest could be paid on stablecoin holdings. For many young and/or unbanked people, stablecoins could be used as a substitute for bank accounts. As noted earlier, stablecoins held the prospect of cheaper and faster payments that could avoid the expense and complication of correspondent banking, which could be particularly important in cross-border payments where transactions costs via legacy systems were relatively high. While stablecoins would not replace the existing range of payments options, many participants anticipated that they would be one component of a heterogeneous payments system.

Given the importance of stablecoins in the digital assets universe and potentially more broadly in the financial system, participants argued that it was essential to get regulations right. They saw the issue of backing as an especially important issue for regulators. While stablecoin issuers claimed that their tokens were fully backed by cash reserves, many participants argued that this could only be guaranteed by clear regulations, transparency, and strong supervision. Otherwise, they argued, stablecoins were essentially unregulated money-market funds, which could be a means of financial contagion in a downturn. Maintaining par value in a crisis would depend on both the liquidity and the quality of funds, since stablecoin issuers would not have access to either central bank liquidity backing or insurance schemes. Some participants pushed back on criticisms of stablecoin reserve holdings, arguing that stablecoins were fully backed by reserves, unlike banks, which operated on the basis of fractional reserve. Indeed, it was noted that the only reason that Circle lost money during the U.S. bank failures of 2023 was that it had been forced to hold part of its reserves in banks, including Silicon Valley Bank. The same risk existed in Europe, where MiCA required stablecoin issuers to hold 30% of reserves in banks. Other participants were skeptical of the claim that stablecoins might be safer than traditional banks—they noted that traditional banks were heavily regulated, closely supervised, participated in deposit insurance schemes, and had access to central bank emergency liquidity. Since stablecoins

did not have access to deposit insurance or central bank liquidity, they argued, it was all the more important to have strong regulation and supervision in place rather than just relying on market discipline.

Participants also discussed whether stablecoins would be a vehicle to avoid anti-money laundering and know-your-customer laws. Criminal use of the banking system was already a major challenge, but a number of participants worried that stablecoins could be used for anonymous transactions. A number of participants argued that this need not be a problem. Responsible stablecoin issuers were already exercising due diligence in determining which blockchains they would work with, and regulation could require that, just as it did for banks. Some participants also argued that even seemingly anonymous blockchain transactions were seldom actually anonymous, as authorities could in many cases identify owners through on-ramps and off-ramps, although others countered that this was more difficult in practice if a user were sufficiently careful. Some also noted that it would be difficult to claw back payments that had been made in error or as part of a crime, or just due to mistake.

One additional concern regarding stablecoin regulation was the possible impact on financial stability. As stablecoins became a larger asset class and more important in the payments system, some participants worried that they could become an avenue of contagion in a financial crisis, as money-market funds had proved to be in 2008. Proponents argued that this concern was overblown, since stablecoins were fully backed by cash or cash-equivalent reserves. For economies such as the U.S., where regulations were likely not to allow stablecoins to pay interest, there would be even less incentive for issuers to take risks on quality or liquidity. Some participants remained skeptical, pointing out that even well-designed regulations and effective supervision were susceptible to surprises and crises—while currency-backed stablecoins had so far performed admirably under stress, that was no guarantee that they would do so under different circumstances or as they became a major part of the payments system.

Participants also discussed concerns about currency stability, since stablecoins could potentially affect the money supply by enabling rapid inflows and outflows of domestic currency. Alternatively, widespread availability of stablecoins could allow for *de facto* dollarization in economies with high inflation, reducing central banks' ability to manage the money supply. While this was plausible for developing economies, several participants rejected claims that the proliferation of stablecoins would weaken the international role of the dollar, pointing out that the vast majority of stablecoins tracked the dollar; indeed, they argued that if anything, the U.S. decision to promote digital assets and put in place regulations would strengthen the role of the dollar.

Digital Infrastructures

A final set of questions surrounded the resilience of digital infrastructures. Participants noted the rising reliance of financial services on a relatively small number of tech firms to provide data storage, secure communications, cyber security, data analytics, and artificial intelligence services. This raised several questions, including how to ensure that such tech firms met the high standards required for data privacy, accessibility, and security in the financial services industry. While primary responsibility would necessarily be held by the financial institutions managing

investors' accounts, a number of participants added the reassurance that tech firms were communicating and cooperating with regulators and supervisors to ensure that they were contributing to the function and integrity of the financial institutions for which they were providing services.

Some participants also raised the question of concentration risk, noting the small number of firms that were providing the bulk of information services in the financial industry. Others argued that such concerns were misplaced. They pointed out that there was enormous physical diversification and redundancy in the actual data centers and communication nodes that were handling financial data, ensuring that problems in one or even multiple locations operated by a particular company would not interrupt access to data. Finally, there were issues of the appropriate market structure for trading digital assets, a subject addressed by MiCA as well as by pending legislation in US.

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