

COMPETITIVENESS OF THE EU BANKING SECTOR



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Closing the gap: strategies to boost the profitability of European banks

The profitability of European banks has been fairly high across the board in the last couple of years, mostly thanks to the increase in interest rates. This follows several years where profitability was a pressing concern, particularly in the context of an international environment that presents numerous challenges. Factors such as the high segmentation of the banking system across national markets, varied national regulatory practices and competition from fintechs and other financial and non-financial firms complicate the landscape for European banks. Progress towards a European Savings and Investments Union (SIU) is crucial to preserve the competitiveness of the EU banking sector. In particular, actions that banks themselves could be undertaking should boost profitability, and hence their competitiveness.

From a regulatory and supervisory perspective, the EU banking sector is well regulated and well supervised – and resilient, as proven during the 2023 banking turmoil and as confirmed by successive stress test exercises. The uneven implementation of Basel III regulations across jurisdictions will impact mostly on the wholesale markets. While the EU started to apply the standards from 1 January 2025, except for the market risk rules, other major jurisdictions have not implemented yet, leading to distortions in the international level playing field and competitive disadvantages to EU banks in their trading activities. This unlevel playing field not only distorts the global financial system, but also creates inefficiencies in the banking sector and generates regulatory arbitrage likely causing risks to financial stability.

The EU has already delayed by one year the implementation of the Basel III market risk framework, until 1 January 2026. This was complemented by several supervisory steps coordinated by EBA. The European Commission is currently consulting stakeholders to gather their views on possible further steps in relation to market risk. Similarly, the European Commission is proposing to address banks' international level playing concerns in relation to liquidity requirements, by proposing to render permanent the currently transitory treatment of short-term securities financing with financial customers for the calculation of the net stable funding ratio, and will propose a review of the rules applying to securitisation, including prudential requirements in this area for banks later this year.

In addition to addressing regulatory and economic challenges, there is a pressing need for European banks to embrace digital transformation and innovation. Banks should be encouraged to invest in digital infrastructure and to prioritise initiatives that foster innovation within the banking sector. European banks can, thus enhance their efficiency, lower their operating costs, ultimately boosting their profitability.

Despite the very significant progress in banking regulation and supervision – with the single rulebook and with the ECB now supervising banks in the 21 Member States taking part in Banking Union, banking markets are still somewhat organised across national lines. This in part reflects national

differences in markets – for instances mortgage practices are not uniform across the EU, in part out of tradition, in part in response to tax and regulatory requirements. Also, retail markets remain organised often along national lines, also reflecting consumer laws. As a result, the banking sector has not been able yet to reap the benefits of the Single Market, also because the regulatory and supervisory framework itself is imposing to meet all prudential requirements at all levels – parent and subsidiaries.

Progress towards a European Savings and Investments Union is crucial for EU banks' competitiveness.

Banks have been extremely prudent in scaling up, in part because their profitability was scarce for a period, in part because the progressive build-up of capital required by the implementation of Basel standards took precedence over external growth. It is urgent that this process of scaling-up the banking sector is allowed to continue, as the EU financial systems needs large banks present across the EU. Cross-border mergers are even more necessary for the development of the Single Market and for the success of the SIU; they are essential for enhancing efficiency of banking operations and optimize resource allocation within the EU. This consolidation not only strengthens the competitiveness of banks in the EU but also serves as a critical step toward achieving a true Single Market in banking, where optimised cross-border capital and liquidity allocation can provide consumers with better services and products.

In conclusion, by prioritizing regulatory harmonisation and focusing on preserving an international level playing field, promoting cross-border integration, streamlining regulatory frameworks, and embracing innovation, policymakers can contribute to the growth and the competitiveness of European banks.



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European banks: Too weak to compete?

Banking sectors across Europe show a wide variety in terms of profitability. Despite the fact that banks are operating in a relatively similar regulatory framework there are visible differences either in the level of the profitability ratios or their permanence over time.

The returns of European banks have improved over the past two years, but it should be considered rather in the long term so that the whole financial or economic cycle is covered. The current improvement is an evident advantage, as the profits enhance banks' capital. But since it is caused by currently high interest rates it can be assumed that the higher profitability will not be permanent.

There are several points of attention when analysing the European banks' return after the global financial crisis. There is a group of European countries with a relatively high and stable banks' return, including Nordic countries, Belgium and the Netherlands. Another one is the group of the CEE countries with more volatile ROE ranging from satisfactory to high levels. There is also a group, including South European countries and Ireland, where profitability is volatile and reaching negative levels in problematic years. The fourth group consists of countries with

stable but relatively low profitability, mainly Germany and France.

The EU banking sector is too diverse to find one specific solution to catch up with US banks in terms of return. The profitability of banking sectors from the first two groups also indicates that there is no common obstacle that prevents European banks to be highly profitable.

There are, however, some conspicuous issues, which need to be considered. The first one is that stability is more desirable than excessive variability which is connected with risk. That is not only the matter of taking suboptimal decisions due to uncertainty, but also the possibility of state interventions. Above-average returns may lead to rhetoric related to excessive burdens borne by borrowers, and further – to extraordinary measures (e.g. windfall tax, credit moratoria) being taken or imposed by states. Such interventions may adversely affect the banks' profitability.

The second issue concerns the profitability level. Very essential is the ability to generate adequate level of net interest margin. This depends however on the economic environment, possibility to invest funds in high-margin products, cost of financing and liquidity. Another way to enhance profit is the cost discipline. Many EU banking sectors, including the Polish one, have improved it over the last few years. Taking care of asset quality is also extremely relevant to avoid material fluctuations of return during the economic cycle.

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Talking about the profitability and competitiveness of European banks, an important issue arises: would giving the SSM and the SRB effective powers to define the allocation of capital, liquidity and MREL resources within cross-border banking groups, and thus abandoning the 'solo approach' be beneficial to European banks' competitiveness?

In this context it should be noted that host countries may be concerned that capital and liquidity could be transferred to parent entities, thus draining subsidiaries of resources and making them more vulnerable to external shocks.

While discussing an integrated approach to regulation and supervision of transnational banking groups, it

is therefore of utmost importance to provide safeguards which would properly address host countries' concerns. Certain prerequisites for starting further discussions can be identified.

Firstly, inclusion of the host countries in the decision-making processes of such centralised supervision would be absolutely needed.

Secondly, in the pan-European supervision model, when a financial crisis occurs, the ECB's financial aid resources should be accessible also to banks from the non-euro area.

Thirdly, we can hardly imagine a pan-European supervision without a European Deposit Insurance System. Without EDIS, possible consequences of centralised supervisory decisions would be borne by local DGSs, which would not be acceptable.

Fourthly, further harmonisation of certain substantive regulations remains one of the prerequisites. Currently, significant differences in national regulations (including insolvency laws) would make uniform or coordinated supervision of transnational banking groups a rather difficult task.

Fifthly, effective cooperation and exchange of information between the SSM, SRB and NCAs would be crucial. Formal arrangements and safeguards guaranteed in the EU law seem to be necessary, especially those pertaining to dispute resolution, but ultimately it is the mutual trust and quality of working cooperation that really matters.

Lastly, a clear division of competences between the European supervisor and the national ones would be vital. It would be necessary to eliminate overlaps and areas of no-man's-land, and to properly manage conflicts of interests. Effective transparency mechanisms should be provided by all means.



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A strong European banking sector is key to strengthening Europe's sovereignty and strategic autonomy and to financing Europe's investment needs

In these new geopolitical times, Europe is rightly giving priority to ensuring its sovereignty and strategic autonomy. The investment needs to achieve these imperatives are vast – The Draghi report assesses the additional investment needs at EUR 750-800 billion per year by 2030. And these figures do not include the recently announced huge investments needed to bolster Europe's defence capacity. Confronted with these circumstances, the new Commission has set out an ambitious mandate placing competitiveness and the reduction of excessive dependencies in critical sectors as the central drivers of its agenda over the coming years.

It should go without saying that the financial industry is indeed a critical sector, and that the European banking industry stands ready to support this ambition. Our ability to do so, however, is hindered by some limitations of the EU financial regulatory framework.

In order to address the challenges to the competitiveness of European investment banks, three key levers are decisive.

Unlocking the securitization market

The Commission has announced a legislative proposal to review the Securitisation Framework by Q2 2025. This is most welcome, and a favorable review is to be expected, given the growing political support for Europe to have a strong securitisation market. Indeed, the Noyer, Letta, and Draghi reports have all pointed to securitisation as an important tool to contribute to the EU's competitiveness and its financing challenges. A return to issuance levels as seen before the financial crisis could progressively generate, as per Christian Noyer's estimates, an additional private financing per year of € 250 to 500 bn.

To make significant progress, the priorities for the industry are to unlock barriers for both issuers and investors. For banks that means in particular recalibrating prudential capital requirements. For investors such as insurers this would require adjusting Solvency II capital charges to re-incentivize them to return to the market. In addition, reducing barriers to market entry such as issuers' disclosure and investors' due-diligence requirements would be essential.

Ensuring a level playing for European investment banks, in particular regarding market risk

Last year, to preserve the global level playing field for internationally active European investment banks in respect to their trading activities, the European Commission postponed the implementation of FRTB by one year. The Commission indicated at the time that some major jurisdictions had yet to finalise their rules or communicate on their timelines for implementation. Today the reality is that the US Basel 3 endgame proposal is at a standstill, with implementation unlikely to start before 2027/2028, while the UK and Canada have also deferred Basel adoption.

In light of these developments, the best and simplest option to prevent any further erosion of the level playing field with third country investment banks is to defer the implementation of FRTB by an additional year.

Backtracking and preventing over-regulation and gold plating

The new Commission has pledged to deliver an unprecedented simplifica-

tion effort to improve Europe's competitiveness, with a first Omnibus series of measures related to the sustainable finance regulatory framework published at the end of February and others in the pipeline. This is therefore the right time to reconsider other existing and proposed financial regulations by applying a simplification and competitiveness filter.

In this regard, the simplification drive must also involve careful analysis of what other jurisdictions are doing or are likely to do. The US for example has a stress capital buffer which simplifies several micro and macro prudential objectives. Also, in view of the recent policy directions enunciated by the new US administration, it may opt for a soft and capital-neutral application of Basel III, while simplifying certain requirements in the area of stress tests or the supplementary leverage ratio. Europe should take close heed of these developments and adjust its stance accordingly.

The simplification mandate should be in Europe an opportunity to simplify and adjust the MREL requirements along the lines of the TLAC framework. Indeed, MREL is a European creation which supplements and overlaps the global TLAC framework standard established by the FSB. Adapting MREL rules in this way would significantly reduce the administrative burden for both resolution and competent authorities as well as for banks, be more understandable for investors, and improve EU banks' competitiveness. It should imply also the reduction of the P2R to avoid double accounting with Pillar 1, as has been decided in the UK in September 2024.

Lastly, to put in place the Savings and Investments Union, which the Commission has correctly identified as a horizontal enabler to achieve the sovereignty and strategic autonomy goals, it will be important to cancel or deeply reassess the Retail Investment Strategy proposal which in its present form would not be conducive to achieving the objectives of the SIU.



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Seizing the moment to foster pan-European banking

For all the justified attention to enhancing capital markets and creating a Savings and Investments Union, bank lending remains important to the Eurozone economy, with about half of business debt coming from a bank balance sheet. Such high reliance demonstrates two things. One, the importance of making available alternative means of funding to business. And two, the importance of maintaining a liquid and reliable bank funding channel. These two do not contradict each other. To the contrary, a well-functioning, strong banking sector operating across the EU is a pre-condition for flourishing capital markets.

The increasing policy attention to banking sector competitiveness is a welcome development. It is tempting to compare EU banks to their US peers. In doing so, we note that the EU single supervisory system is in place and works well. In addition, there is ample competition and EU banks have liquidity and willingness to support the economy. Yet it is a sobering fact that before 2008, the market cap of the largest Eurozone banks and their US counterparts were in the same ballpark. Today, the market cap of the largest US bank matches that of the 10 largest Eurozone banks combined. The prolonged negative monetary policy rate environment in the Eurozone has contributed to multi-year lacklustre bank profitability until just a few years ago.

And while EU bank profitability has recovered, several EU member states levy bank-specific taxes. Sometimes, these taxes are related not to profitability, but to balance sheet size, adding a procyclical element. Such taxes are draining banks' capacity to strengthen their balance sheet, extend credit, and maintain capital and dividends. Given that bank investors impose a certain cost of equity, bank taxes also risk banks pricing themselves out of market vis-à-vis competitors not subject to them.

A further clear difference holding back EU banks is the single US market versus Europe's fragmented banking and capital markets, from cultural, language, tax, bankruptcy, regulatory and supervisory perspectives. This also prevents EU banks from gaining scale. Such scale is increasingly needed to absorb costs that are predominantly fixed in nature. This applies in particular to technology outlays, in e.g. retail banking, payments, and financial markets. The more volume and clients a bank has, the better it can amortise those costs.

Yet despite these issues, I would like to take a "glass half full" perspective. Experience teaches us that in the most difficult of times, Europe comes together and takes breakthrough decisions. Indeed we currently witness a willingness among policymakers to consider options that were in the "unthinkable" domain until not too long ago.

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One of the most pressing issues we see at this stage, is the complexity of the EU's capital requirements framework, and the degree of regulatory discretion built into it. Partly as a result of this, EU banks maintain higher capital ratios than their US counterparts.

In addition, the EU framework features more buffers stacked on top of each other, not least macro-prudential ones. The buffers are particularly complex as many EU member states now impose high O-SII buffers, "positive-neutral" Counter-Cyclical Buffers, and sector-specific Systemic Risk Buffers or RWA add-ons that have a similar effect. We believe the best way forward is to lower cumulative requirements for banks. In particular the macro-prudential framework should be simplified and structural components should be

removed. In addition, a mechanism would be welcome to assess and remediate excessive buffer cumulation and overlap. An overarching goal should be to improve predictability of the whole framework.

Other priorities should include removing obstacles to cross-border liquidity and capital flows within banking groups and improving transferability between national DGS funds. These would further support EU banking sector consolidation.

The EU's simplification agenda is an important and welcome initiative. A systematic review of the regulatory framework in search for burden reduction opportunities should extend beyond ESG to cover all regulation.

Meanwhile, European banks themselves continue to free up capital, by e.g. optimising client portfolios, models and improving data quality. An instrument that can further help here is securitisation. The administrative burden for originators and investors could be reduced by streamlining due diligence and reporting requirements. Further steps towards standardisation and simplification would also help.

The positive sum of these policy actions will be bigger than its parts. For example, steps towards Banking Union create more opportunities for pan-EU consolidation. Larger, consolidated European banks are in turn better placed to make full use of a vibrant European securitisation market, to put their capital to maximum use for lending. Let us take this opportunity and allow a self-reinforcing positive cycle to develop in Europe.



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Resilient banks are key to foster European competitiveness

Over the last decade, EU bank resilience has achieved unprecedented level thanks to regulatory and supervisory efforts. Today, EU banks' capital levels are high, liquidity and bail-in instruments are ample, and credit is flowing into the EU economy. Meanwhile net profits remain close to all-time highs, which showcases that EU banks are strong and resilient.

Yet, the situation is more nuanced in contrast to US banks, who have generally been even more profitable over the last six years. This performance was supported by higher NII and NIM amid structurally higher US interest rates, and higher fees and other income has generated elevated return on equity and assets. However, cost efficiency paints a more mixed picture with rather sticky costs at EU banks. Regarding asset quality, the average cost of risks is only marginally higher than US banks over the same period. Finally, EU banks have been losing market share in certain market segments over the past decade or so, which may cause concern about EU strategic autonomy.

But again, a combination of shifting geopolitics, structural factors and

economic headwinds puts EU banks at new crossroads. In this context, recent reports urged the EU to act to preserve its strong and competitive position. EU banks must play a key role in this endeavour.

Against that backdrop, three priorities should shape the EU banking sector going forward.

Fostering global regulatory coherence and completing the EU single market

Since its inception, the EBA has promoted regulatory consistency and coherence at international and EU level. Looking at the EU sector, it is clear regulatory efforts have paved the way towards more robust and resilient banks.

The EBA is maintaining its efforts towards EU-wide Basel III implementation by delivering the mandates conferred by the legislators in a transparent, predictable and accountable manner. Such contributions meaningfully enhance international compliance and preserve a proper functioning of the European and global financial systems.

Beyond this, the EU must build a ESIU to unlock the full potential of the financial sector. In the current framework, banks can already allocate their capital across borders to growth-generating sectors. Greater cross-border banking would allow both consumers and businesses to access a broader range of financial services.

Finally, remaining gaps in the resolution regime need to be closed to strengthen the EU's ability to manage failing banks.

A holistic view of financial regulation and supervision

The EU and EBA prioritise implementation, delivery and supervision, and in this new regulatory cycle, we must view the current EU financial framework holistically. Its development over time responded to important considerations that led to successively or simultaneously strengthening of micro and macroprudential supervision, resolution, AML, consumer protection, and conduct. The current juncture offers an opportunity to assess whether the framework's overall design, implementation and impact are as intended and whether they bring sufficient efficiency. However, this does not mean deregulation.

The EBA works on ways to simplify undue regulatory burdens on banks, while maintaining financial stability and protection. Since its inception, it has focused on harmonised EU reporting and disclosure to support financial activities in a single market. It is now integrating prudential and monetary policies to

reduce the costs for stakeholders while addressing the needs of supervisory authorities. The intermediate step towards such integrated reporting is to facilitate data sharing which is currently being reported.

Boosting resilience to new challenges

Delivery with concise and clear mandates is also key to make banks future-proof to embrace opportunities and counter climate and digitalisation risks.

Now is the time to assess the framework's design, implementation and impact for efficiency.

To remain globally competitive, EU banks should accelerate efforts to further transform their business models to embrace new challenges. Current high profitability should be an opportunity to increase investment in digitalisation and in management information systems, to improve efficiency, revenue capacity and resilience.

Digitalisation affects bank business models and impacts competition, bring new opportunities, but cyber and ICT related risk and data security are by far the biggest drivers of operational risk for banks. According to an EBA risk survey, more than half of banks noted that they had been victim of at least one cyberattack in H1 2024. To protect against such risks, the ESAs are operationalising the framework on ICT risks and operational resilience.

In addition, enhanced risk management capabilities are needed to prepare for a shifting geopolitical landscape and transition to a more sustainable economy. Recent flooding and wildfires are forceful reminders that physical risks put strain on banks' balance sheets.

Going forward, Europe needs to balance all these priorities to ensure the resilience, preparedness and competitiveness of EU banks.



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The need for a shared diagnosis on the competitiveness of European CIBs

While most sectors of the European economy face the competitive challenges posed by the U.S., the relative decline of European CIBs over the last decade has been particularly sharp. Between 2014 and 2024, the number of European players in the top 15 largest M&A advisors in the EMEA region went down from five to only two. Similar downward trends can be seen in other highly strategic markets, such as equity and debt underwriting or trading activities, where European banks have lost market-shares even within their domestic markets.

The grounds to this competitiveness gap between U.S. and European CIBs are probably a mix of external and internal factors. They may include for instance differences in domestic macro-economic environments, diverging risk-appetite and innovation dynamics, as well as different cost structures. Some will also point to the role of securitization in helping U.S. universal banks optimize their balance sheet.

Regardless of which explanatory factors come on top, it is not for regulators to suggest specific remedies or strategies to reverse this trend, which by nature is an industry matter. However European

policymakers should be part of this discussion too, as they can contribute to improving the business environment and ensure that European players benefit from a levelled playing field.

In this regard, the first priority is to prevent any further deterioration of the situation. Although CRR3 came into force on January 1, 2025, the Basel III Endgame has yet to be transposed or implemented in the United States, and significant uncertainty remains about if and how it will be adopted. The United Kingdom has also decided to postpone its own set of rules, which exacerbates the situation for EU banks.

Certain banking activities are particularly sensitive to international competition and potential regulatory disparities, with market activities being among the most affected. Fortunately, in anticipation of the uncertainties surrounding the transposition of Basel III in the United States, EU legislators have equipped themselves with the means to respond to all possible scenarios.

Regarding the capital requirements applicable to market risks (Fundamental Review of the Trading Book – FRTB), which are a focal point of transatlantic competition issues, the European Commission has been empowered to postpone the entry into force of the new rules by delegated act for up to two years. This authority has already been exercised once, resulting in a one-year postponement to January 1, 2026.

The question of a further one-year postponement will need to be addressed promptly and this should be the right thing to do as we still lack clarity on the US/UK landing zone. Additionally, the Commission must propose a new delegated act providing measures to mitigate the quantitative and operational impact of Basel III on market activities for a period of three years, in line with another possibility opened by CRR3.

But regardless of what other jurisdictions do when it comes to Basel III, other significant steps can be taken immediately in order to help European players grow within their domestic market and participate in an efficient Savings and Investments Union. While US top-tier CIBs have expanded globally out of a deep, integrated domestic market, our European banking sector remains much fragmented along national lines, which prevents European institutions from reaching similar economies of scale and hinders their capacity to service their SMEs and corporate clients on a fully European basis. Part of this fragmentation is market-based and relates for instance

to the lack of standardization in banking products and client demand. But other aspects are regulatory by nature and could be reversed more easily, such as the current constraints on liquidity and capital management within paneuropean banking groups or overly cautious securitization rules. Besides integration, our banking sector would also benefit from a revamp of the European regulatory and supervisory framework, which has become overly complex for the industry. Streamlining regulatory requirements, in particular those derived from technical norms published by the EBA or the ECB, could be another material improvement of our environment. Now that European regulation and supervision have reached maturity, withstanding the past years' macroeconomic and financial shocks robustly, a simpler landscape would yield benefits for all, without sacrificing in any way the high standards for financial stability.

All these issues are pressing ones, which should be addressed through an informed, fact-based debate among public stakeholders. The Draghi and Letta reports have laid the ground by stating that financial markets and banks are part of the needed European effort on competitiveness. Now is the time to deep-dive into the banking competitiveness chapter: what the EU lacks is a shared diagnosis on the strengths and weaknesses of its banks, and on which actions to take looking forward. Some have recently suggested that the European Commission should bring forward to 2026 the publication of its report on the European banking sector, mandated by CRR3, and that it should include a dive into competitiveness issues into this analysis. We should all stand ready to contribute to this reflection.