IMPROVING THE COMPETITIVENESS OF THE EU BANKING SECTOR

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Competitive EU banks: the entry door to a competitive economy

The European Union stands at a critical juncture, as it has been losing ground to the US in economic competitiveness: over the last 25 years, GDP per capita has increased by 25% in Europe, compared with 38% in the US[1]. Yet, the EU's openness to international cooperation and its robust and credible regulatory framework remains key assets for global attractiveness in a time of high geopolitical and economic uncertainty. The current context offers a window of opportunity to close the gap. The 2024 Letta and Draghi reports, along with the EU's 2025 Competitiveness Compass, provide strategic guidance by calling for deeper integration of the EU single market, the completion of the Banking Union, and more efficient capital allocation.

To up its game, the EU must have more competitive banks, better integrated markets and smarter innovation financing.

First, improving bank competitiveness is a necessity. Indeed, the profitability of EU banks has improved but remains below US and UK peers, judging, for example, by the consistently lower profitability indicators of French banks since 2021[2]. Amongst the top 10 banks generating the bulk of investment banking fees in Europe, there are only 3 SSM banks, accounting for 29% of these fees while US banks bring in 55% of investment banking revenues[3].

One of the most pressing issues is cross-border consolidation: EU banks remain too fragmented. Although we have achieved single supervision and resolution, the Banking Union remains incomplete with many hurdles to free flow of funds. This limits economies of scale and the capacity to finance large-scale digital and climate transitions. We now have a decade of experience in assessing consolidated risks within banking groups; it is time to promote confidence and fully play the "size card", by encouraging cross-border mergers, in particular through removing regulatory and prudential ring-fencing and granting cross-border liquidity and capital waivers at individual level.

Regulators should also keep an eye on the global level playing field, based on a faithful and timely implementation of Basel III in all jurisdictions, the only way to ensure financial stability and bank resilience. This also means ensuring that activities subject to high competition are not hampered by EU-specific goldplating and benefit from regulatory predictability. It is crucial for EU strategic autonomy to nurture EU-based global players in corporate and investment banking activities. This should be kept in mind when implementing the forthcoming market risk reform (FRTB) or dealing with other issues such as trade finance.

In addition, the current simplification effort can provide an additional breath of fresh air, if it preserves compliance with Basel standards and avoids the deregulation trap. We believe there is room to eliminate a number of costly, EU-specific complexities and rigidities in capital, supervisory and reporting requirements.

Beyond competitive banks, the whole financial sector should also drive its investments towards the competitiveness of EU firms and in particular innovation. Our challenge is that EU capital markets are still underdeveloped: the pool of capital is lower in the EU (two to three times GDP) than in the US (six times GDP)[4], preventing the efficient allocation of a European annual savings surplus of around €300 bn.[5]

Reversing this situation requires making the Savings and Investment Union a reality by unifying banking and capital markets to support growth. The EU Commission's proposal for revitalising the securitisation market is a welcome step in this direction, contributing to deepen capital markets and potentially enabling banks to free up capital for further lending and investment – whilst maintaining the safeguards that had been put in place after the 2007-08 crisis.

As it is not necessarily the banks' role to partake in every form of financing, such as venture capital, other financial actors will have to step in to fill the gap. However, some existing provisions in banking prudential standards could be leveraged, such as the favourable, Basel-compliant treatment of publicly-supported equity financing. The Commission has just opened a public consultation to operationalise this potentially powerful measure to incentivise banks to invest in strategic sectors.

All in all, the EU has many tools and resources at its disposal to become a global and competitive leader.

1. *Financial services: The European mysterious gap | Banque de France*
2. *Source: N° 172 : La situation des grands groupes bancaires français à fin 2024 | Autorité de contrôle prudentiel et de résolution*
3. *Financial services: The European mysterious gap | Banque de France*
4. *Source : Oliver Wyman, 2024 European-Capital-Markets-Report.pdf*
5. *Source : Banque de France, 2024 The challenge of strengthening European financing for start-ups | Banque de France*

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Improving the competitiveness of the EU banking sector

In the post-pandemic period, European banks' profitability has remarkably improved. In 2023 and 2024, their return on equity (RoE) stood above 10% and their return on assets (RoA) hovered around 0.7%. These compare favorably with the sector's 10-year averages of 6.2% and 0.4%, respectively. Price-to-book valuations have also improved, now on average reaching 1, thus reducing the gap with US banks. During this period, the equity prices of EU banks have outperformed significantly the general index, and investors have shown strong interest in banks' credit risk.

This improved situation has been primarily attributed to external factors. Higher policy interest rates enabled banks to increase their net interest income. The sector also contained its expenses, despite significant global inflationary pressures, and sustained good asset quality and low cost of risk, despite elevated geopolitical risks and the energy crisis.

As policy rates decline and interest margins are reduced, bank profitability may again come under pressure. To mitigate this, banks have been diversifying their revenue streams, focusing on non-interest income channels. However, elevated macroeconomic uncertainty heightens credit risks and given the historically high share of IFRS stage 2 loans, the cost of risk might rise.

Profits have helped banks maintain their robust capital position despite distributing record-level payouts in 2024. In August 2025, EBA's EU wide stress test results confirmed that the sector remains resilient, also in a severe scenario. A well-capitalised and profitable sector not only underpins financial stability but also facilitates economic growth by facilitating finance to investment-seeking households and corporates. However, in an increasingly competitive global environment, amidst rising geopolitical and geoeconomic risks, EU banks also face heightened third-country competition.

Although any performance comparison across regions require caution, current profitability levels of EU banks fare well vis-à-vis their global competitors. Recent IMF data show that EU banks' profitability is above that of banks in the UK (9.1% RoA and 0.7% RoA), Switzerland (RoE 7.0%, RoA 0.5%) and Mainland China (RoE 8.1%, RoA 0.6%), and just behind that of banks in the US (RoE 11.2%, RoA 1.4%), or Hong Kong and Japan (both with RoE of 11.7%).

Despite this, the EU banking sector still faces challenges. This relates to the EU's potential growth which suffers from structural inefficiencies and market fragmentation. Completing banking and capital unions in Europe should help unlock some of this potential and allow banks to further diversify their portfolios and income by targeting ancillary services areas.

Another source of challenges lies in European banks' need to further improve their operational efficiency and complete their digital transformation. While EU/EEA banks have advanced notably in this area, indications are that banks in other regions tend to have integrated new technologies more rapidly, which gives them a competitive edge. While this involves considerable upfront costs, this offers long-term benefits for efficiency and customer engagement. This also helps tackle competition from new players in digital banking and FinTech.

The removal of market fragmentation hurdles should help the sector to consolidate further. Market consolidation would in turn facilitate investment in digital transformation. This virtuous circle would enhance financial stability, creating a resilient banking sector that can support the economy through the cycle. Banks would increase their lending capacity, allowing them to finance large-scale infrastructure and commercial projects (e.g. the EU strategic priority for Security and Defence) and to drive technological investments, supporting innovation and green financing for a sustainable growth of European economies.

European banks show strength but must improve efficiency and address market fragmentation.

In the post-pandemic landscape, European banks have showed strength in terms of profitability, capital position, client and investor confidence. To fully unlock their potential, policymakers and market participants must accelerate efforts toward completing the Banking and Capital Markets Union, creating an environment in which EU banks can thrive and compete globally. Banks also need to keep working on improving the efficiency of their operating models. A strong, well-integrated, and forward-looking European banking sector is not just an economic imperative - it is a strategic necessity for securing long-term financial stability and prosperity across the region.

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Profits, resilience, and the competitiveness of the EU banking sector

European banks have seen modest profit gains recently, but they still lag behind major international peers. US and large non-EU banks consistently report higher returns on equity. Reasons include business models, market scale, and regulations. Also, differing macroeconomic and social environments play an important role.

Firstly, many European banks have a stronger orientation toward retail and traditional lending. In contrast, global competitors have invested more aggressively in corporate and investment banking, which tends to offer higher margins.

Secondly, the European market is often more fragmented than, for example, the US market. This fragmentation limits the ability of banks to achieve the economies of scale seen in some of their international competitors.

Thirdly, European banks have traditionally operated under a stricter regulatory framework than many of their international counterparts. Although reforms over the years have improved their overall performance, these banks continue to face higher compliance and operational costs. Their culture tends to be more risk-averse which slows down innovation and cost reduction.

There is a vast academic literature documenting the above observations.

What I would like to add to this discussion are two points. First, that focusing on banks' profitability alone distracts attention from their long term resilience. Second, that cultural factors, most importantly attitudes of market participants toward risk, matter not only for banks but also for regulatory and supervisory policies.

Let me start with the first point. As supervisors we put emphasis on adaptive efficiency of banks – their ability to cope with shocks, rather than focusing only on short-term allocative efficiency reflected in their profits. Thus what is particularly important for us are future risk adjusted profits. And here Schumpeter's enduring observation helps: *"A system—any system, economic or other—that at every given point of time fully utilizes its possibilities to the best advantage may yet in the long run be inferior to a system that does so at no given point of time, because the latter's failure to do so may be a condition for the level or speed of long-run performance"*. There is always a trade-off between short run allocative efficiency (profit maximization) and long run adaptive efficiency (long-horizon resilience). Hence the rationale for regulatory and supervisory actions. Somewhat provocatively one may even say that lower profitability of European banks (within reasonable limits, of course) might be acceptable if it leads to greater resilience of the banking sector to shocks. A system that only rewards profit may forego resilience. And in our quest for competitiveness and profitability, we should also ask ourselves the question, how much of long term resilience are we willing and prepared to sacrifices for the benefit of profitability or competitiveness.

As for the second point regarding cultural environment of economics systems, including banking one, I would like to note that various formal arrangements of financial systems and norms regulating participants' behaviour are hugely impacted by societal attitudes towards risk. And these attitudes are different between the US and the UE, as documented in an insightful paper published in 2018 in the *Quarterly Journal of Economics* by A. Falk and his co-authors, entitled 'Global Evidence on Economic Preferences'. They show that Western European societies are more risk averse than the US society is. As for Poland, my country falls somewhere between risk neutrality and risk aversion. As supervisors act on behalf of society, we cannot ignore societal economic preferences. There needs to be alignment between formal rules and informal norms, including risk preferences, since only then there is a base for a strong and stable economic development, including of the banking sector. However, formal rules, regulations, and supervisory practices can create an incentive structure which can – in the long term – influence choices of market participants.

A system that only rewards profit may forego resilience.

To conclude, in order to make banks more resilient we should focus both on making them well managed institutions capable of withstanding external shocks but also we should focus on the quality of broadly understood environment in which they operate. It is to strengthen and deepen the European common market, the source of the most important advantage of the European economy in a world torn by uncertainty. Fighting the fragmentation of the European common market, including its financial system, is to mitigate one of the reasons of why the UE banks have lower profits than their US counterparts. Another topic is the need for a broad public debate and a possibly wide social consensus around acceptable level of risk in the financial market, in particular in the banking sector.

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Competitive European banks are key for European growth and strategic autonomy

"Europe has many economic strengths, but must act now to regain its competitiveness and secure its prosperity", the European Commission rightly states in its Competitiveness Compass. The European economy has been lagging behind in terms of productivity growth and innovation; besides, the geopolitical context and the rising trade war highlight the need to focus on the EU's strategic autonomy, of which competitiveness and growth are a prerequisite.

One central piece of the competitiveness puzzle is the banking sector, itself not spared by the global struggles. The return on assets ratio (RoA) of European banks has been on average much lower than US banks' (0.4% against 1.1% in the last decade), as has been the price-to-book ratio.

There are several priorities to improve competitiveness in the banking sector.

The prudential framework needs a precise assessment in regard of the level playing field.

Regulatory divergence has become a reality: the United States have postponed their own application of Basel 3.1, with uncertainty on the timing and content. The UK's PRA has also postponed its application calendar and called for adaptations. Canada has decided last February to freeze its output floor at its current level; the output floor remains a real concern in terms of European banks competitiveness as long as other jurisdictions don't apply it.

Europe has many cards in its hands to increase competitiveness.

Beside this global outlook, specific prudential parameters are likely to impact European banks' competitiveness. A key example is specialised lending (SL), which helps make progress towards the Green Deal's goals. Yet, the application of CRR3 input floors on Loss Given Defaults (LGD) prevents from discriminating the risk of the transactions. It makes the best transactions too expensive, and might push some institutions to finance riskier deals, and ultimately reinforce the market share of non-banking sector. The EBA report expected by mid-2026 on this topic should be the opportunity to review these floors, at least for the best transactions, based on historical recovery rates of more than 20 years.

Lastly, Europe continues to bear the cost of its fragmented banking sector. Internal MREL requirements, an overly complex macroprudential framework, and other regulatory inconsistencies add layers of burden and complexity. This fragmentation increases operational costs, reduces efficiency, and ultimately weakens the competitiveness of European banks.

The securitisation reform needs to be fit for the challenge of reviving the market.

Securitisation has been identified by the Draghi and Noyer reports in 2024 as a key means for the banking system to recover financing capacity. Securitisation is critical in the context of Basel 3 ramp-up. It supports increased lending, particularly to corporates and SMEs. For example, asset-backed commercial papers (ABCPs) can accelerate the cash conversion cycle, providing quicker access to liquidity for SMEs that are part of large corporate value chains.

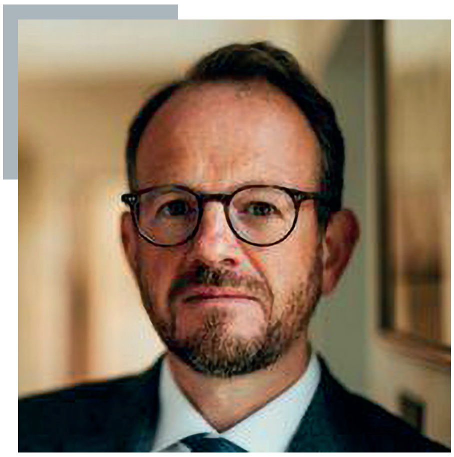
The June 17th securitisation package must be at the level of the Commission's political ambition to bring dynamism back to this market. Though very welcome, it risks falling slightly short of what is needed to drive real change. For this, some work remains to be done on the calibration of parameters for capital requirements, especially for corporates and mortgages, on the conditions for a more liquid market through LCR rules, and on the due diligence and reporting rules that should not discourage investors.

Competitiveness should be put at the heart of considerations during the legislative process.

The 'Less is More' report proposed several recommendations. Namely, it is critical that a competitiveness assessment be performed for each new regulation, to assess potential detrimental effects on European markets and positions. Legislators, namely at level 2, should be granted an objective of competitiveness to some extent, with financial stability naturally remaining the primary objective.

Simplification is essential. The simplification initiatives launched by the EBA and ECB are welcome. This is all the more necessary as supervisory requirements seem to increasingly rely on soft law publications, often leading to growing expectations, higher costs, and greater administrative burdens. A more proportionate, risk-based approach grounded in materiality and enabling mediation should prevail. This would help to avoid gold-plating and unnecessary costs.

To conclude, additional levers could be explored to enhance competitiveness. Completing the Banking Union and establishing the Savings and Investment Union remain key milestones for the future. In the end, a more competitive banking sector means a more efficient allocation of capital, more innovation in financial services as well as better access to credit for firms and households that can support growth.



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Securing Europe's future: Why Basel transition rules matter

The EU is experiencing economic stability, marked by controlled inflation and falling Central Bank interest rates. Despite recent geopolitical and internal shocks, our financial system remains resilient, thanks in large part to robust bank regulation and supervision - a point highlighted by the IMF in its July 2025 FSAP report. Today, European banks are broadly recognised for their support of the economy following a 15-year period of regulatory reform.

From the political and historical perspectives however, Europe is facing several simultaneous and important challenges, including those related to climate change, migration, technological transformation, and shifting geopolitical dynamics. Addressing these macro challenges will require bold changes in approach at the micro level. Without such action, the EU's global competitiveness could be at risk.

The European Commission has estimated that around €1.2 trillion annually will be needed to support the EU's transition towards a green, digital, and secure future, with a notable portion designated for defence. Europe's banks will be called upon to support this transition, combined with funding from the public sector, despite increasing budgetary constraints. Initiatives like the Savings and Investment Union (SIU) aim to boost capital markets funding over time, but in the medium term, bank lending will remain the primary source of capital for the European economy.

Despite expected strong demand and available credit, lending rates remain elevated. In May 2025, the average interest rate for corporate loans stood at 3.5%. This rate is comparable to levels seen in 2011 during the sovereign debt crisis, although current economic conditions differ. Rates also vary among Member States, with some exceeding 4%, influenced by factors such as loan duration, corporate ratings, and collateralisation.

Lending rates sit at the intersection of monetary policy and financial regulation, shaped by the relationship between Central Bank rates and the equity banks must hold to fund loans - commonly reflected in the Common Equity Tier 1 (CET1) ratio. The CET1 ratio determines how much capital a bank must maintain relative to its risk-weighted assets, serving as a key measure of financial strength and regulatory compliance. European supervisors report that the average CET1 ratio for banks stands at 15.9%, a figure broadly accepted by investors and analysts as a marker of financial resilience

Yet, European banks remain less profitable than their international peers. Strategic steps are needed to enhance competitiveness and ensure banks can continue supporting the EU's transition to a green, digital, and secure future.

Sustainable profitability is essential - not only to attract investor interest and secure equity funding, but also to enable future initiatives such as digitalisation. Regulatory capital requirements for European banks are set to increase in coming years, prompted by the introduction of the Output Floor under the Final Basel III reform, scheduled from 2025 to 2030. This change will necessitate more equity to fund existing loan levels. Consequently, European banks may need to adjust their lending rates to maintain cost coverage and consistent profitability in accordance with supervisory expectations. This adjustment comes at a time when affordable bank funding is considered as key to unlocking the resources needed to tackle Europe's challenges.

However, this outcome is not predetermined. The EU's implementation of Basel III includes transitional arrangements to moderate capital requirements for highly rated corporates, mortgages, risk-hedging instruments and securitisations. These transitional measures were approved by EU co-legislators in 2024 in response to concerns that the Basel Committee on Banking Supervision's (BCBS) original framework might otherwise result in higher capital requirements for certain loans, are based on policy objectives relating to access to finance and align with political mandates issued by the G20, ECOFIN finance ministers, and the European Parliament.

Reflecting specific characteristics of the European banking sector and aligning with trends in other major jurisdictions, these transitional arrangements that would otherwise expire between 2029 and 2032, could be extended and renewed by the European Commission. For these reasons, ongoing evaluation of their appropriateness is warranted and welcomed but clear and timely regulatory guidance will be essential to ensure banks can continue to support Europe's transformation while maintaining financial stability.