SIMPLIFYING EU FINANCIAL REGULATION

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Simplification – a joint goal albeit difficult to jointly achieve?

The current financial services' regulatory and supervisory framework of the EU has just very recently brought to proof several times that it is able to ensure financial stability even in critical periods. The COVID-19 pandemic, rising energy prices and inflation, the Russian invasion of Ukraine, the international banking turmoil in 2023 and, most recently, the conflict in the Middle East have all put our economies under stress. However, EU banks largely managed to remain in a sound condition which in turn enabled them to continuously finance the (real) economy during these challenging times.

Undoubtedly, this satisfactorily stable banking environment is the outcome of many regulatory and supervisory measures which have been taken during the past 15 years as well as the corresponding and comprehensive efforts of the banking industry to steadily improve since the Great Financial Crisis. Once again, it became absolutely evident that a broad and substantial regulatory framework is key to ensure the soundness and resilience of EU banks and financial stability in the EU (while, for the sake of completeness, it should not remain unmentioned at this point that banks have also benefitted from the strong monetary and fiscal responses of EU Member States to past shocks, in particular during the COVID-19 pandemic).

Consequently, there seems to be a broad consensus of all involved parties that resilience of EU banks should by no means be weakened but that, at the same time, there is an urgent need for action to strengthen the global competitiveness of the EU financial industry. Thus, the common objective is „simplification, not deregulation". But what does this mean concretely?

Well, some first immediate and important steps have already been taken by the European Commission (and the EU co-legislators): The application of the new prudential requirements for market risk (Fundamental Review of the Trading Book - FRTB) has been deferred for a second time very recently to secure international level playing field, amendments to the CRR have been adopted as regards the treatment of securities financing transactions under the NSFR, and further amending proposals to mitigate regulatory pressure, in particular regarding the recently introduced "ESG-framework", are cumulated in several so called "Omnibus"-Directives, which are currently negotiated by the EU-legislators.

Furthermore, several additional initiatives are on their way or have already been finalized (non-exhaustive list): The ECB has established a "high level task force" on simplification which shall develop proposals to simplify the banking rules by the end of 2025. The European Supervisory Agencies are committed to increase their respective efforts and to play their part in simplifying the regulatory framework and in reducing administrative (reporting) burdens. Moreover, a lot of valuable content should be expected from two reports mandated by the CRR 3: Until 2028 at the latest (but most probably earlier), the European Commission will assess and report the overall situation of the banking system in the single market and on the appropriateness of the Union regulatory and supervisory frameworks for banking and, until 2027, the EBA is expected to prepare a report assessing the overall prudential framework for small and non-complex institutions (i.e. the "principle of proportionality"). Equally important as a basis for progress are the numerous elaborations and reports contributed by academics and/or the industry, as for instance, just to name one of them, the so called "Less is more"-report published in February 2025 and prefaced by Jacques de Larosière.

> **In order to simplify financial regulation, there is obviously no "silver bullet".**

In order to simplify financial regulation, there is obviously no "silver bullet". As current financial regulation is characterized by a very high degree of complexity and granularity, identifying concrete areas which are suitable for further simplification will not always be simple. However, it is absolutely feasible to successfully fulfil this important task if we acknowledge that it will require serious and continuous dedication of all involved stakeholders, comprehensive and constructive work, and the willingness to perform complex analyses of the current status quo of the legal framework. But first and foremost, a successful completion of the project to simplify regulation will strongly depend on the readiness to incorporate all relevant sources and ideas into the discussion. This means in particular to discuss in detail – and in an open and unbiased way – input resulting from relevant activities of the European Commission, the ESAs, the ECB, other authorities and Member States but as well respective contributions forwarded by the banking industry, academics and other financial law professionals.

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Towards simpler, more proportionate and consistent EU financial regulation

Over the past two decades, the EU has built a comprehensive regulatory framework for the financial sector, covering prudential, market, anti-money laundering and sustainable finance areas. While this architecture has strengthened the resilience of the system, it has also introduced significant complexity, duplication of responsibilities and interpretative difficulties. While stability and security has improved, market competitiveness and efficiency have suffered. Current regulatory framework can hinder innovation, limit market access and place a disproportionate burden on smaller players.

Moreover, it has a direct impact on economy. For example, European capital markets remain fragmented, underdeveloped, and less attractive to investors than the competitors from the US. This undermines the economic growth as nearly 45% of euro area investment fund assets, according to the ECB, were allocated outside the EU in 2023. This alone highlights a persistent preference for deeper, more integrated markets abroad.

EU policymakers are aware that it is time to react, and in fact the work has already been initiated both by the current European Commission and the Council presidencies. Policymakers are aware that simplification cannot mean "mechanical" simplification by rashly reduction of number of legal acts or provisions – we need smart deregulation, which reduces complexity without sacrificing stability. While the task at hand is very complex, there are several design challenges that need to be addressed.

First, the main barriers to effective simplification stem from the structural features of EU regulation. The system of legislative tiers in the EU, i.e. the multi-level legislation of level 1, 2, and 3, was a reasonable response to the need for flexibility and speed, but in practice it has also led to a stratification. Levels 2 and 3 acts - besides being too many and too detailed - sometimes extend the scope of regulation beyond the original mandate of Level 1. This stratification is ripe for a review in three areas:

•the scope of delegation: substantive content should be placed directly in the primary legal text and the mandates given to the European Supervisory Authorities should be clearly defined therein,

•the sequencing: level 2 texts should be known by the market participants at a time when they are working to adjust their businesses to legal requirements stipulated by the Level 1 texts

> **We need smart deregulation, which reduces complexity without sacrificing stability.**

•the number of level 2 and 3 measures should be reduced.

Second, broader participation and transparency, including input from market participants and national authorities in the regulatory process would enhance legal clarity. This should be implemented not only in regard to Level 1 legislation but also to technical standards and ESA guidelines, whereby public consultations, impact assessments and feasibility studies relating to these acts should be disclosed.

Third, insufficient coordination when it comes to regulating various financial sector aspects, such as ESG and MiFID II, AML and CRD, leads to duplication of compliance requirements and unclear points of competence. The efforts on the EU level to identify and address redundant or duplicative requirements are already ongoing. A more horizontal and interdisciplinary approach, involving supervisors, financial institutions, and other relevant stakeholders from adjacent sectors would be more effective. Such cross-sectoral coordination mechanisms should also be strengthen within the European Commission and the ESAs to oversee consistency between regulations both on the EU and national levels.

Fourth, when creating regulatory framework, the impact assessment should be strengthened, especially in two areas. Cumulative Impact Assessment as a mandatory element of the legislative process could be carried out, not only ex ante for new acts, but also ex post for sets of existing regulations. This evaluation should also took into account how new laws impact competitiveness in general and how they will influence the operations of small and medium-sized enterprises.

Finally, we need to the conception of any new legal proposal. Laws should be drafted with the customer, or investor, in mind. Legal complexity leads to cumbersome services and products. Filling in lengthy questionnaires or ticking of boxes, be it in the MiFID, ESG or KYC areas, puts off potential users and investors, does not fulfill the original purpose and creates political backlash.

Simplification is not an end in itself, but a tool. It does not mean compromising on system safety – on the contrary, it means greater transparency, effectiveness, and resilience in the long term.

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A European approach to simplification in the financial sector

Over the last fifteen years, the EU legislative corpus grew in significant numbers. There have been at least 370 new laws in each of the past five legislative terms, with an increase of 14 % to 16 % from each term to the next, with the sole exception of the Juncker term, where the rate of new production decreased by 24 % (Marcus JS,2024). Logically, the production of European standards in the financial services sector (banking, financial markets, insurance) did not follow a different path, neither at the level 1, nor at levels 2 & 3. The last fifteen years saw the development of a very complex, resource consuming, volatile and sometimes non-operable set of rules which tried to indirectly maintain the spirit of the Lamfalussy process as it has been thought back in 2001.

Let us be clear. The EU's decision to regulate financial services more stringently after the 2008 crisis was a necessary and prudent move. The global financial crisis exposed significant vulnerabilities and weaknesses in the financial system, highlighting the need for robust regulatory frameworks to prevent future crises. The EU's proactive approach to financial regulation has not only restored confidence in the financial system but also laid the foundation for a more stable and attractive single market. With the finalisation of Basel III in sight, coupled with the key steps achieved on, to mention a few, EMIR 3.0, MiFIR, MiFID or Solvency II, it is now time for the EU to come up with a serious, holistic and ambitious plan for simplifying financial services regulation.

Simplification in itself is far from being simple, especially in financial services. This is why we need a fully-fledged European approach to simplification. Such a European way to implement simplification in financial services doesn't mean a prioritization of deregulation. Rather, simplification could go with an optimisation of the current rulebook by making its current functioning and implementation much more efficient. As underlined by the Draghi and Letta reports, the extent to which regulatory simplification could act as a key lever for European competitiveness cannot be ignored anymore nor dealt with file-specific contingent add-ons.

Many steps have already been taken on this matter. On one hand, co-legislators are striving to simplify the current Retail investment strategy and FiDA proposals. On RIS, it is crucial to continue simplifying the text which all in all remains very complex. Further work is needed especially on the various tests created or made more challenging and demanding by the current proposal, especially on the customer journey. On FIDA, all stakeholders now recognize the complexity of the text and the necessity to avoid undue burden on the financial sector. Both sides of the coin need to be taken into account and, for open finance to be a success, FiDA needs to be deployed in a way that meets effective market demand on the data users' side while limiting the significant market adjustment costs for data holders.

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On the other hand, DG FISMA has started reviewing a list of technical norms that could be postponed. While this review is in principle welcomed, it risks becoming yet another file-specific contingent initiative falling short of what's needed to meet the simplification targets. We can also mention the task-force the ECB has assembled or the sectoral projects undertaken by the EBA, ESMA and EIOPA whose sectoral focus will bring valuable insights on what would be needed but overall, all miss the holistic lenses needed to really address the issue.

Therefore, the European approach to simplification in financial services regulation cannot be limited to files currently under discussion nor level 2 & 3 improvements. Now, more than ever, we need level 1 simplification. What is being done on sustainability reporting is a good example of the constructive mindset colegislators have adopted, and should be confirmed in the swift finalization of the Omnibus legislation. Furthermore, an additional simplification effort for the digital sector is also underway. We do not see any reasons as to why the financial sector would be left alone from this horizontal endeavour.

On the banking front, work is already on the way ahead of the Commission's 2026 report on the competitiveness of the EU banking sector. In that regard, priorities should be simplifying the multiple capital requirements for banks, as well as removing barriers to cross-border banking integration, including waivers for local liquidity and capital requirements. Along with targeted simplification of existing rules, we should also look into how we can simplify the rule-making process within our Banking union, in order to make sure that future rules do not add excessive administrative costs or go beyond the spirit of level 1 texts.

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Simplification via 28th regime

The European Union was founded by treaty and animated by regulatory bodies, with all its vaunted achievements effected via law and regulation. Europe, by virtue of its history, has a penchant to perceive regulation as an answer rather than a problem. And indeed there has been a snowball effect in EU financial regulation and supervision that continues and we are at the center of it: 25% of Delegated Acts in the Union as of September 2023 concerned financial stability and financial services. A snapshot of the challenges:

- 431 legislative texts over the 2019-2024 period have added to the 378 legislative texts written between 2014 and 2019.
- The 1,000 page CRR3/CRD6 banking package additionally assigns 139 mandates to the European Banking Authority including 60 new mandates for technical standards and 29 for guidelines.
- Level 1 texts are often ambiguous. This results in the delegation of significant issues to Level 2 acts, which should in theory only address technical details and should not imply strategic decisions and policy choices. This Level 1 ambiguity also leads to inconsistent interpretations and applications across Member States.
- Furthermore Level 2 rules often end up being published close to, or after, the application date. Without any assurance of a non-enforcement period, financial firms require predestination for timely regulatory compliance.
- Meanwhile the European Supervisory Authorities (ESAs) have become quasi-legislative bodies, being both drafters and interpreters of regulations through layers of soft law. Soft law (Level 3 in the form of guidelines and Q&As generally) is often treated as de-facto binding by supervisors, leading to the enforcement of highly specific requirements with a vague legal basis.
- On the topic of supervision, the Single Supervision Mechanism (SSM) views "intrusive" financial supervision as part of their mission statement. They have increased their supervisory fees by 145% over the past decade to EUR 680 mm.
- Within J.P. Morgan, we clearly see the impact of the SSM budget and mandate, with the ECB having approximately double the hours of time spent in supervisory meetings than the United Kingdom relative to both bank assets and revenues.

This unwieldiness and complexity are specific to the European Union and arguably are a consequence of the compromises resulting from seeking to preserve cherished local banking institutions in 27 countries while pursuing an ever closer union.

> **Measures for regulatory simplification include changes that align to practical commercial reality.**

Some incremental and modest measures for regulatory simplification include changes that align to practical commercial reality. Regulatory compliance should be considered relative to Level 1 texts with the industry given minimum implementation periods to adhere to new Level 2 and Level 3 texts. Level 2 and 3 acts, including supervisory expectations, should have pre-litigation remedies, and be drafted with more inclusive and transparent consultation and impact assessments. The European Commission's commitment to reduce reporting obligations by 25% should be fully implemented, as well as the 'one in one out' principle that was announced. Supervisors should need to explain how any supervisory expectations beyond regulatory requirements are proportionate to observed financial risk.

How can the monumental and complex European regulatory machine be simplified in a more radical manner? Perhaps by being repurposed: the creation of a 28th regime, as suggested in the Competitiveness Compass, for corporate and insolvency law could provide the foundation for pan-European capital markets. There is no political mandate nor desire to homogenize European financial services, but there is real determination to encourage the scale for European financial institutions that enables international competitiveness. Attempts to create an EU banking union to date have been hobbled by the national consequences of pan-European legislation, which also results in a thicket of national transposition differences for any financial institution that wishes to utilize their EU passport. European countries would benefit from paring back EU financial regulation to more principles-based prudential standards aligned with the Basel Committee on Banking Supervision, and allowing National Competent Authorities to supervise and simplify their own domestic banking regulation whilst maintaining alignment with those international standards. Allowing sizeable pan-European banks to opt in to a new 28th regime instead of being subject to national laws would be a groundbreaking means of simplifying the EU financial regulatory landscape. This two-tiered system would promote both vibrant domestic European banks that are responsive and reflective of their local communities, and leverage the rule-making capabilities of the EU to provide the regulatory framework for internationally competitive European banks.

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Simplification through principles-based legislation and regulation

It is obvious that our banking system is exponentially more robust than it was fifteen years ago and therefore equally clear that simplification is not and cannot be about a general weakening of standards. That needs to be stated at the outset.

What simplification needs to address is the proliferation of rules that pose a challenge to industry, regulators and supervisors alike, and that in many cases do little to reinforce the solidity of an already robust financial ecosystem.

There are undoubtedly changes that can be introduced to the Lamfalussy structure to improve its functioning and to create more regulatory certainty, in particular in ensuring final Level 2 rules are available well before implementation dates. Certainly, greater efforts should be made to adhere to existing Better Regulation principles, including that Member States should refrain from "gold-plating". The core of the debate, however, needs to be about what the system is trying to achieve rather than the minutiae of how it is set up. In chasing a Single Rulebook we have ended up with an excess of rules, often not actually applied in a uniform manner. The EBF has highlighted, for example, that the 2024 Banking Package consisted of approximately 1,000 pages and conferred 139 mandates to the European Banking Authority (EBA) for drafting technical standards and guidelines. This compares to 500 pages and 62 mandates for the 2019 Banking Package. Should we not instead be striving for a more principles-based framework?

The current approach seems to focus on prescriptive legislation which needs to be complied with. On-site inspections by regulators test whether (a) there has been compliance, (b) whether the compliance by a bank has led to proper risk management. But if the main objective of prudential regulation is risk management, should we not have more principles-based legislation and regulation which allows the banks' executive teams to manage effectively, with supervision focused on substance and material risks rather than line by line reviews, and the variety of tools at disposal of regulators, such as inspections, applied proportionately?

The maturity of a prudential regulation system advances when it goes from a rules-based, compliance-with-rules approach, to a principles-based, step-back from the detail approach. This is not easy as it requires less enforced compliance and more judgement. It also needs to recognise the diversity of bank business models – and be proportionate to them, not penalise any given business model, but appropriately judge whether they are being implemented and managed in a risk-conscious way.

The proliferation of rules poses a challenge to industry, regulators and supervisors alike.

If this approach is embraced, simplifying the framework or even withdrawing legislation becomes easier – you are shifting the burden from process to people. It is not without risks, but deserves to be debated particularly in light of the evident maturation of the regulatory framework.

Another important aspect is a comprehensive overhaul of reporting requirements. There is duplication and surfeit of data supply to multiple layers of regulators. A bank's reporting universe is vast and has been expanded massively by the new climate and environment reporting requirements.

A start has been made in this area with the ESG Omnibus proposals but these do not always target the most critical areas. For examples, it should be recognised that for many organisations, sustainability is managed at a group level, with strategies, targets, risk management and transition planning occurring primarily at the Group level. To this end, we strongly support the approach of the International Sustainability Standards Board (ISSB) and call for the option to report at the top-level of consolidation. Climate and environment are, after all, global concerns. We are all tasked with doing our part to protect the planet and encourage the transition. There are also obvious questions about using the taxonomy as a disclosure framework and the appropriateness of applying rules such as the CSDDD to the financial sector.

Shifting to a simpler, more principles based, framework is not something that will be achieved overnight. It requires a robust analysis of what are the core standards essential for financial stability, then a focus on principles-based regulation and avoid being overly prescriptive. It also raises questions about the sharing of data between supervisors and the division of responsibilities between EU level and national bodies.

Done correctly, simplification improves the experience of industry, supervisors and clients alike without undermining the broader regulatory objectives of investor protection, financial stability, and sustainability. It is worth discussing.

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A sharp focus on policy goals is key to delivering simpler regulation

The EU is a regulatory superpower. This can be a source of strength. Harmonising rules across member states underpins the single market and simplifies firms' cross-border compliance.

In financial services, the recent trend in the EU has been towards much more harmonisation. Legislation (Level 1) is complemented by technical standards (Level 2) and guidance (Level 3). This helps to provide certainty for firms, but too many prescriptive rules also create a significant compliance burden.

The Digital Operational Resilience Act (DORA) is a good example. While it will deliver an important upgrade to firms' operational resilience, firms are required to complete more than 90 data fields for each third party ICT provider, much of which has to be requested from vendors. I am sure that a case can be made for each data point in isolation. But the reality is that individually they will not deliver equal value to supervisors; while the cumulative cost for firms will be higher than for a more targeted data set.

Moreover, legislative proposals are not always sufficiently well connected to evidence-based objectives. This can impede the legislative process and lead to sub-optimal outcomes.

For example, the proposed Financial Data Access (FiDA) Regulation, which aims to promote data-driven open finance, is not supported by a sufficiently rigorous assessment of actual client demand and use cases. EU legislators have rightly scrutinised these aspects of the proposal. Without major changes, this legislation risks mandating unnecessary and expensive private sector investments to establish IT infrastructure that will potentially not be utilised.

To take another example, the most noteworthy measures proposed under the EU Retail Investment Strategy focus on consumer protection and lack a clear linkage to the stated goal of improving retail investor participation in capital markets. Legislators need in particular to address MiFID II rules that currently prevent sophisticated clients with capital markets expertise from accessing a broader range of capital markets products.

Fortunately, the limits to the effectiveness of ever-increasing regulatory productivity have been recognised by EU policymakers, as the US has embarked on a significant deregulatory agenda, while the UK has adopted a renewed emphasis on regulation supporting competitiveness and growth.

Effective regulation demands a disciplined focus on outcomes, with proportionality at its core.

In this regard, the EU simplification agenda will be absolutely key in allowing firms to refocus resources from compliance towards financing growth and Europe's strategic investment needs. We welcome the focus on 'Omnibus' packages to simplify the rulebook, starting with sustainability reporting, as well as the simplification and burden reduction initiatives of the ECB Task Force and the European Supervisory Authorities.

But a focus on simplification is easier to agree in principle than to deliver in practice. Europe has a highly complex policymaking process with multiple stakeholders; and it takes time to deliver change.

If that change is to be achieved, it is important not just to look at simplifying existing rules. Effective regulation demands a disciplined focus on outcomes, with proportionality at its core. New rules need to be better calibrated, avoiding over-specification at the outset. This does not necessarily mean deregulation, but it should mean smarter, more streamlined rules that facilitate less burdensome compliance.

In practical terms, this means focusing closely on what regulation is setting out to achieve, with particular emphasis on:

Thorough impact assessments that deliver clear answers to a problem statement that Level 1 legislation is designed to solve for;

Ensuring Level 1 legislation limits and prioritises Level 2 mandates to the minimum necessary to deliver the policy objectives, setting clear boundaries around what those mandates are required to deliver, while ensuring that new Level 1 obligations with Level 2 dependencies only take effect after a realistic amount of time and avoid delegating politically contentious points to Level 2;

A more proportionate and outcomes-oriented approach to Level 2 rules and Level 3 guidelines. European Supervisory Authorities should provide clear explanations as to how proposed Level 2 rules reflect the mandates outlined in Level 1 legislation, with a focus on options explored and rationale for the proposed approach, including a specific analysis of the impact on regulatory burden and competitiveness;

A more structured dialogue between European Supervisory Authorities and the industry, not limited to feedback on Level 2 proposals but on an on-going basis, could facilitate greater understanding and better rulemaking outcomes.

Delivering better regulation will inevitably involve more discipline around policy goals and potentially trade-offs between objectives. And for this sort of approach to work, it needs to be supported by all stakeholders. We in the industry stand by to support policymakers in this endeavour.