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Consolidation and securitisation – what the EU's banking sector needs now

Despite recent progress witnessed in European markets, they remain less profitable than their international competitors. This gap is most evident when comparing European banks to their US counterparts, which have achieved a higher average return on equity since the end of the financial crisis. Part of this disparity stems from different interest rate environments. European banks' balance sheets continue to bear the scars of the ECB's prolonged period of accommodative monetary policy, which kept financing costs low but created a sustained drag on net interest income.

The broader economic context also plays a role: the US economy has consistently outperformed the Eurozone, creating more investment and lending opportunities that boost bank profitability. However, the profitability gap also persists due to structural issues within the European banking system. Addressing these challenges requires completing the Banking Union and transforming the EU's securitisation market to tackle some of the fragmentation that undermines sector performance.

European banks currently lack the global scale needed to compete effectively. The European banking landscape remains dominated by regional banks and national champions, with few truly pan-European institutions and global players. This fragmentation makes it difficult to compete against larger international banks and limits operational efficiency. Moreover, European banks rely more on traditional lending activities that remain on their balance sheets, while their US peers tend to generate higher returns focusing on higher-yielding exposures, as well as through a greater participation in investment banking and trading activities.

While mergers and acquisitions are often cited as a solution to Europe's scale problem, execution has proved challenging. Over the past year, a wave of domestic consolidation has begun in fragmented banking markets, but various deals have encountered political resistance, despite compelling economic rationale. The failure to execute these domestic mergers appears detrimental to the EU banking sector's competitiveness.

The incomplete Banking Union and less developed Capital Markets Union appear to be additional hurdles. Without these frameworks, merging banks cannot fully realise revenue synergies or extract cost savings, limiting their ability to achieve meaningful scale.

Finishing the Banking Union, establishing a European Deposit Insurance Scheme and removing barriers to cross-border consolidation, would address the fragmentation and drag on European banking. These reforms would enable banks to pursue consolidation opportunities that create genuine value.

The EU needs to develop further private capital financing capabilities.

The Capital Markets Union is a critical piece of the puzzle. The EU needs to develop further private capital financing capabilities and reduce banking intermediation while expanding the use of securitisation and other risk transfer mechanisms. Currently, European banks are hamstrung by structurally limited use of securitisation. The EU securitisation market operates below its potential and fails to contribute sufficiently to economic growth or capital market development. This underutilisation is a missed opportunity.

Securitisation offers unique advantages. It enables risk transfer from bank balance sheets through investments with different risk profiles, allows increased lending without requiring expensive additional bank capital, facilitates the transformation of bank balance sheets from 'brown' to 'green' assets, provides simultaneous financing for numerous EU SMEs, and supports ECB monetary policy as well as corporate and sovereign financing during economic stress. The European Commission's recent proposals to revitalise the EU's securitisation framework represent progress in the right direction, but bolder steps should be taken during the negotiation process.

Finally, the simplification agenda is also part of this equation. Despite the current efforts that are being pursued by the European Commission, which we support, simplification in the financial services sector should consider the strains put on the sector beyond reporting requirements. Banks in Europe face a significant number of regulatory transformational projects today. The implementation of DORA, SEPA IPR, and the significant changes coming in under Article 21c of CRD6 consume precious resources and bandwidth within banks. This is happening at a time of significant incremental geopolitical and climate related risks, as well as technological transformation given the advent of AI. All will require large investments to ensure consistently safe operational and cyber security.

With all this in mind, it is clear that decisive action is urgently needed to deliver meaningful results for Europe's banking sector and broader economy.