Improving the competitiveness of the EU banking sector

1. A persistent competitiveness gap with the United States

The competitiveness of European banks improved in 2023 and 2024, but it remains below that of their US counterparts mainly due to economic and structural factors.

1.1 European banks are resilient and increasingly profitable

1.1.1 European banks are performing well despite geopolitical fragmentation

An industry speaker underlined that sustainable profitability is essential to attract investors and finance strategic initiatives such as digitalisation. The profitability of the banking sector has improved in recent years, with EU banks performing comparably to their US counterparts. They have maintained momentum despite falling interest rates and declining net interest income, illustrating their resilience to current geopolitical and macroeconomic headwinds, including tariff policies and growing political fragmentation.

A Central Bank official concurred, noting that the European banking sector has made significant progress over the past decade. Ten years ago, it was in a fragile position with very high levels of non-performing loans (NPLs). The sector proved its strength during both the Covid crisis and the market turbulence of March 2023. However, the leading institutions in terms of market activity remain US-based.

1.1.2 Profitability and resilience alongside continuing structural dependencies

A Central Bank official stressed that matching the profitability of US banks would require replicating the US regulatory environment, which would not be appropriate for the EU. EU banks are currently close to record profitability, with return on equity exceeding 10%. Sustaining this performance requires continued focus on cost management, customer relations, product offerings and innovation. Banks must also keep investing in digitalisation, the green transition and infrastructure to preserve long-term profitability.

The EBA recently completed its 2025 stress testing exercise, covering 64 banks representing 75% of EU banking sector assets. The results showed that the sector would remain resilient even in the event of capital losses exceeding €500 billion. Combined with the current profitability levels, this suggests that the sector's overall health is robust.

Nonetheless, several structural dependencies persist. There are concentration risks in areas such as cloud services and infrastructure, which are largely provided by major US firms. EU payment systems and card schemes are also closely tied to US markets. Moreover, EU companies rely heavily on external investment banks, capital pools and non-bank financial intermediaries for capital market intermediation. These dependencies represent a vulnerability for the sector.

1.2 Economic constraints and persistent structural gaps

1.2.1 Europe trails the US in growth and profitability

The Chair reminded participants that the EU economy has been steadily losing ground to the United States. Over the past 25 years, GDP per capita has risen by 25% in Europe compared with 38% in the US. The profitability of EU banks remains below that of their US and UK counterparts. Even in wholesale financial markets, where European financial integration is most advanced, European banks are not the main players. Only three banks under the Single Supervisory Mechanism (SSM) rank among the top 10 fee-generating investment banks in Europe.

A Central Bank official noted that the strength of US capital markets expands the addressable market for US banks and enables them to reach greater scale, giving them a clear competitive advantage over their European peers.

1.2.2 Size matters: advancing the single market to bridge the competitiveness gap

A public representative argued that strengthening the competitiveness of the European banking system should be a central objective for the European Commission and Parliament. Achieving this requires scale. The creation of a genuine single banking market must be treated as a political priority. Yet in recent months, the Commission has shown limited ambition to advance this agenda. While it may be possible to trade off competitiveness and stability in the short term, this balance is unsustainable in the medium term. Consolidating the single market remains the most effective way to enhance the competitiveness of the European banking sector without undermining financial stability.

An industry speaker strongly endorsed these remarks, emphasising that completing the single market in banking is fundamental for Europe's competitiveness.

1.2.3 Profitability is determined by economic strength and scale, not tweaks to prudential regulation

A Central Bank official underlined that the performance of the banking sector reflects the strength of the underlying economy. This was the key finding of a report by Oliver Wyman for the European Banking Federation (EBF) in 2023.

A regulator noted that European banks likely face a heavier regulatory burden than U.S. peers, but the issue should not be oversimplified. Two main roots were identified: over-complexity of rules, which calls for simplification but is hindered by a lack of trust among market actors and member states; and stringency of prudential requirements, which reflect political and social choices rather than purely technical considerations.

The current framework has successfully prioritized stability and crisis prevention, arguably more than in the U.S., but this raises the question of whether society now seeks a rebalancing between stability and competitiveness. Broader values such as economic sovereignty may also need to be considered, as building strong, profitable banks is essential for the Union's resilience. This could imply greater acceptance of risk in the banking sector.

Simplification remains a priority and is relatively easier to achieve, while broader deregulation is more complex, rooted in cultural and political factors.

2. Structural and regulatory factors are undermining scale

Regulatory complexity, internal barriers and fragmentation within the EU are holding back the growth and competitiveness of European banks.

2.1 A heavy and fragmented EU regulatory framework

2.1.1 The complexity of regulation and the EU's internal barriers are undermining bank competitiveness

An industry representative agreed that European banks face a heavier regulatory burden than their global competitors. A recent study commissioned by the EBF estimated that discretionary decisions by European and national supervisors increase EU banks' common equity tier 1 (CET1) requirements by €273 billion — an increase of over €100 billion in the past three years — despite the resilience of the European banking system during this period.

Several factors explain this additional burden. First, the regulatory framework itself is excessively complex, with a macroprudential system characterised by a "millefeuille" of buffers. Second, persistent internal barriers continue to limit the cross-border circulation of capital and liquidity. The output floor introduced under Capital Requirements Regulation 3 (CRR3) has added a new layer of restriction. These national and prudential barriers fragment the European banking sector, increase costs, reduce efficiency and weaken competitiveness.

2.1.2 Market fragmentation and prudential complexity are limiting scale

A Central Bank official observed that the EU regulatory framework is more intricate and detailed than the US system. According to SSM assessments, capital requirements for large European banks would actually be higher under the US framework. The EU system reflects its specific institutional structure, marked by national differences within the euro area. The use of directives has contributed to fragmentation in the application of EU rules, affecting banks' products, services and client markets, and ultimately limiting scale. To address this, regulations should be preferred over directives.

Differences in underlying rules have led to a variety of supervisory practices across member states. Greater harmonisation therefore requires more detailed and consistent supervisory approaches. Achieving scale is essential for competitiveness, both in financial services markets and within the banking sector itself.

A public representative highlighted that there are two distinct types of complexity in the EU regulatory framework. The first stems from market fragmentation: national barriers, macroprudential rules, supervisory practices and the lack of a common deposit insurance scheme. The second reflects the EU's prudential approach, which diverges in certain respects from Basel standards. Ultimately, the absence of a single market is the core reason for the competitiveness gap. Internal barriers and lack of scale significantly increase the complexity of operating in the EU. Efforts to simplify regulation should therefore focus on reducing the complexity arising from this incomplete single market.

2.1.3 Overcomplex rules and lack of trust restrict EU banks' competitiveness

A regulator noted that while European banks likely face a heavier regulatory burden than U.S. peers, this is not the sole reason for the profitability gap. Scale and economic structure are decisive factors, and internal trade barriers within the Union act as a significant constraint. Facilitating cross-border consolidation is essential, as banking is inherently a business of scale.

The speaker cautioned against deregulating the prudential framework, which has ensured resilience and stability during recent crises. However, some concerns raised by the private sector are valid: reporting obligations have become excessively burdensome, and the impact of non-financial regulation, such as rules on AI and data protection, should also be considered, given their influence on productivity.

An industry speaker added that part of the regulatory burden arises from extensive requirements on transaction reporting, supervisory data and cross-border compliance. In some cases, EU banks face overlapping and duplicative obligations with limited added value. Streamlining the framework — as envisaged in the ongoing European Securities and Markets Authority (ESMA) consultation — would enable market participants to focus more on innovation, client service and strategic development.

2.2 Divergent implementations of Basel III: a competitiveness handicap for EU banks

The Basel framework has a significant impact on competitiveness. Rules on software capital, for instance, illustrate how regulation can penalise investment in digitalisation. An industry speaker noted that investors are not fully recognising or rewarding the performance of EU banks. This is not primarily due to cost structures or business models, but rather to the regulatory requirements they face. The average CET1 buffer in Europe stands at 470 basis points, meaning EU banks hold 4.7% more capital than required by their risk profiles in anticipation of the Basel III output floor. By contrast, the UK is adapting its framework, and the US appears to be moving towards deregulation. While the European framework is robust, US simplification has freed up around €100 billion of CET1 capital, giving US banks greater flexibility. Although sustainable profitability is vital for resilience, Basel III rules effectively penalise traditional balance-sheet lending, which remains the main channel for financing growth in Europe.

An industry representative underlined the distinct characteristics of the European banking sector and stressed that Europe should avoid "gold plating" its rules. The postponement of the Fundamental Review of the Trading Book (FRTB) is a welcome step, and the prudent valuation framework should also be reconsidered, as it can reduce capital ratios by up to 50 basis points. Specialised lending — critical for Europe's climate transition — is constrained by input floors on loss given default (LGD) under CRR3. These parameters prevent banks from adequately distinguishing between risk profiles, thereby limiting financing for projects that are in fact less risky.

An industry speaker further highlighted that under the EU framework, investments in software and digital client applications incur a 50% capital deduction, whereas in the US the deduction is zero. As a result, digital investments by EU banks are 50% more costly. This requirement is not mandated by Basel. Since digitalisation and AI investments strengthen resilience and bring wider economic benefits, such capital charges risk leaving European banks reliant on outdated systems. In turn, this diminishes their resilience and reduces the value delivered to businesses and citizens.

2.3 Global competition and the level playing field

An industry speaker stressed the importance of ensuring that global financial institutions operate on a genuinely level playing field. Enhanced cooperation between local and regional regulators is needed to ensure comparable prudential requirements across jurisdictions.

A Central Bank official explained that US banks providing loans to European households or companies must comply with European standards. With the forthcoming Capital Requirements Directive 6 (CRD6), additional restrictions will be imposed on the direct provision of banking services from the US to the EU. This will have competitive implications, as US banks seeking to compete in core banking will need to meet EU requirements. It should also be noted that the Basel Committee currently considers the EU to be partially non-compliant with Basel III, a factor that needs to be considered when discussing further complicates the global competitive landscape.

3. Strategic simplification and regulatory adjustment

3.1 Strategic simplification, not deregulation, will drive competitiveness

Competitiveness must not be confused with deregulation. Simplification is about making targeted strategic adjustments while maintaining resilience and assessing the cumulative regulatory impact. The Chair stressed that strengthening the competitiveness of EU banks and financial markets is essential for a more competitive European economy. However, this is not a deregulation agenda. Beyond capital requirements, the EU framework is marked by costly complexities, an incomplete banking union and insufficient cross-border consolidation.

An industry speaker agreed that simplification should focus on intelligently adjusting the regulatory framework rather than dismantling it. European banks currently intermediate only 30% of the European bond market, raising concerns about strategic autonomy and the control of European debt trading. The European Commission should consider whether this situation is sustainable and resilient and examine how targeted regulatory changes could help without undermining financial stability. The aim is not to replicate the US framework. As demonstrated in March 2023, the EU banking sector has performed well under its current robust rules. However, this is an opportune moment to address the technical constraints that affect European banks' competitiveness relative to their international peers.

A Central Bank official emphasised that complexity can be reduced without weakening resilience. The SSM intends to adopt a more risk-based supervisory approach, focusing annual assessments on selected priority areas rather than covering every topic each year.

An industry speaker noted a broad consensus that EU regulation is overly complex, both in absolute and relative terms. Yet there is no comprehensive understanding of the cumulative impact of this complexity. A structured assessment is needed, starting with baseline capital requirements, then examining the effects of national fragmentation, internal barriers and Level 2 measures. Only once the cumulative impact is understood can meaningful discussions on simplification take place.

3.2 Streamlining the Regulatory Framework

A Central Bank official highlighted that reporting requirements offer clear opportunities for simplification. Introducing multiple regulatory changes within a single year places an excessive cost burden on the industry; grouping changes together would facilitate implementation. Additionally, Level 2 and Level 3 texts — drafted in the aftermath of the global financial crisis — could be simplified and clarified, as concision was not their original focus. Using regulations rather than directives would help reduce fragmentation.

However, the most powerful driver of competitiveness lies in the development of capital markets. Equity financing is better suited to riskier economic activities. As long as the EU economy remains heavily reliant on bank financing, it will struggle to support these activities at scale.

3.3 Adapting supervision and leveraging technology

3.3.1 Supervision must be simplified, proportionate and risk based

An industry representative stressed the need for proportionate, risk-based supervision anchored in materiality. Excessive administrative burdens can arise when supervisory expectations go beyond existing regulatory requirements. The intensity and frequency of supervisory engagements should reflect the size and business model of each institution.

The Commission is expected to publish a report on the banking system in the single market in 2026. This report should not exclude discussions on issues such as gold plating and the level playing field, as these can materially constrain competitiveness. Ambitious reform of securitisation is also essential. The Commission has already put forward a promising proposal, which will play a key role in advancing the Savings and Investments Union (SIU).

3.3.2 Overcoming scale constraints through technology

A Central Bank official pointed out that Europe's slow population growth limits banks' ability to expand their customer base through traditional means. This underlines the need to "work smarter". Digitalisation, automation and AI tools can offer solutions for both the industry and supervisors by improving cost efficiency. The lower the cost of supervision, the more effectively it can be conducted.

The AI Act is now in force. The ECB has conducted a high-level analysis of potential conflicts between banking regulation and the AI Act and has not identified any significant obstacles so far. These technologies could therefore support both supervisory effectiveness and industry adaptation to scale constraints.

4. Competitiveness as a policy objective

4.1 Balancing resilience, competitiveness and strategic autonomy

Europe needs to reassess the balance between resilience and profitability, and place competitiveness at the core of its regulatory framework to safeguard strategic autonomy. A regulator underlined that it is still unclear whether there is sufficient political or societal willingness to recalibrate this balance. In the short and medium term, a trade-off exists between stability and competitiveness. Policymakers and public authorities must engage in an open and transparent discussion with stakeholders about the extent of long-term resilience they are prepared to trade in favour of profitability and competitiveness.

Given the evolving global context, other strategic considerations may also need to be factored in. To ensure Europe's economic sovereignty, the development of large-scale financial institutions may be necessary. Such institutions require adequate profitability and competitiveness, which may entail accepting a higher level of risk within the banking sector.

An industry speaker stressed that regulation can only safeguard European strategic autonomy if it simultaneously mitigates risks and enables banks to compete globally. The regulatory framework for cryptoassets is a case in point: if it is not enhanced, clients may shift to jurisdictions where they are less protected. A more immediate way to strengthen competitiveness would be to extend TARGET2 operating hours, thereby increasing European market independence. As the US moves towards deregulation, the competitive gap is likely to widen. Without action, the EU risks losing strategic autonomy in financial services.

An industry representative added that competitiveness objectives should be more explicitly embedded in the EU regulatory framework. This could involve incorporating competitiveness into regulators' mandates, as in the US and the UK, or conducting systematic competitiveness assessments for new regulations.

4.2 Simplification alone will not close Europe's competitiveness gap

A public representative observed that some stakeholders equate "competitiveness" with "simplification". In reality, simplification is only one component of a broader competitiveness agenda. The banking sector has significant scope for improvement in this area.

While it is reasonable to reduce administrative burdens and to simplify regulation within the current framework of the incomplete banking union, genuine progress depends on addressing the fragmentation of the single market itself. Simplification of the single market remains a critical step towards closing Europe's competitiveness gap.