

Leveraging the role of banks in the SIU

The role of banks in the development of the Savings and Investment Union (SIU) lies at the heart of the broader debate on Europe's growth, competitiveness and financial resilience. While Europe has traditionally relied on a bank-based financing model, there is growing recognition of the need to further develop capital markets in order to better support innovation, scale-up financing and long-term investment.

In this context, discussions highlighted both the structural differences with the United States and the challenges Europe faces in mobilising its substantial pool of savings more effectively. Rather than opposing banks and capital markets, panellists emphasised their interdependence within a more integrated financial ecosystem. Achieving this balance, however, requires addressing persistent market fragmentation, improving regulatory proportionality and enhancing the overall attractiveness of European financial markets.

Particular attention was given to the need to unlock the large volume of deposits held on bank balance sheets and to develop deeper and more efficient securitisation markets. At the same time, strengthening financial literacy and broadening investor participation were identified as key enablers of a more dynamic investment culture.

1. Europe's financing model at a turning point

This first part sets the scene by examining the structural characteristics of Europe's financing model and the evolving role of banks within the SIU, highlighting key challenges in comparison with the United States.

1.1 From bank-based finance to capital markets: europe's financing gap and the changing role of banks

The Chair observed that Europe is lagging behind the US in terms of productivity and financing innovative companies. Historically, Europe has relied on banks to finance the economy. Through a predominantly house bank system, large European banks held stakes in industrial firms, provided loans and were deeply involved in their operations. Banks acted as industry partners, managing and supporting companies extensively.

In contrast, US banks were prohibited from holding shares in non-financial companies and interstate banking was banned. This meant that robust capital markets were needed as an alternative. During the financial crisis, Europe was criticised for its universal banks, particularly in light of the 2012 Liikanen report, which criticised these banks for proprietary trading and shareholding. This led to a transformation in banking regulations across Europe. There is some irony in the fact that banks arguably performed better when engaging in riskier activities.

1.2 Europe's financing model at a crossroads: why European banking champions matter

A regulator stated that there is some validity in the notion that global players often engage in market-related activities, which emphasises the necessity of a level playing field for such operations. It is crucial to redefine the role of banks in relation to markets, since markets do not operate in isolation. Entities need to facilitate access, provide liquidity and ensure market functionality. However, juxtaposing markets and banks is misleading due to the substantial synergies between them. The relationship between these two components of the system needs to be examined, as well as whether regulation poses an issue. There is doubt as to whether proprietary trading represents market servicing.

European champions are needed who are capable of servicing the European market. European banks currently account for less than half of market activities in Europe. While there should not be complete dominance, there is potential for improvement. In the event of disruption, the European market must continue to function effectively based on its resident actors.

1.3 Strengthening SME financing: the complementary roles of banks, capital markets and public intervention

A Central Bank official agreed with the view that banks and capital markets should not be viewed as isolated entities in competition with each other. What is needed is the development of an integrated ecosystem that effectively supports companies' financing needs. Within this framework, banks will continue to hold substantial influence, reflecting Europe's historical and cultural predisposition towards banking. It is not feasible to change this attitude in a short timeframe, so banks need to play a prominent role. Nevertheless, it is important to simultaneously incentivise capital market growth.

The challenge lies in effectively fostering this dual approach. Banks must play a more prominent advisory role, particularly with regard to small and medium-sized enterprises (SMEs). While SMEs transitioning to capital market financing may initially disrupt banking interests, this should ultimately lead to economic growth in the longer term. This expansion would generate increased revenue for banks as the overall size of the economy grows.

The state plays a pivotal role in developing less mature markets, acting as both a regulator and a product developer. Stock exchanges have the potential to enhance the appeal of the capital market by offering educational initiatives, networking opportunities and competitive global market entry strategies. The underperformance of Central and Eastern European markets compared to Western Europe further underlines the urgency of these efforts. Hungary has introduced convertible loans and employee share ownership schemes to support SMEs, with instruments that are fully market-based and do not rely on public guarantees.

1.4 Strengthening Europe's banking model: integration, competitiveness and financial sovereignty

An industry representative emphasised the structural, cultural and social differences between the European and American financial models, highlighting Europe's reliance on a robust yet more fragmented banking system. Developing an integrated financial system tailored for Europe is vital. European banks are losing market share across various profit segments, which underlines the importance of Europe supporting its banking champions. Banks play a vital role as partners within the economy. Universal banks finance households, SMEs, and corporations, while offering market services that connect European savings to investments.

Growth and competitiveness must be incorporated into regulatory mandates, as demonstrated by recent UK initiatives. The prudential framework must be amended to better support lending activities. A 'European preference' must be adopted to strengthen European actors and ensure financial security across the region. Proportionality should be based on actual risk rather than size. Size-based proportionality fails to accurately identify risks, and could increase fragmentation and undermine consistency within a single rulebook.

2. Unlocking financing capacity: regulation, markets and instruments

This second part focused on the regulatory, market and financial instruments that could help mobilise savings, enhance competitiveness and support the development of deeper capital markets in Europe.

2.1 Enhancing competitiveness and proportionality in EU banking regulation

An official stated that there are areas in which Europe could take inspiration from the US. It is vital that discussions take place on a level playing field. It is also important for Europe not to neglect its existing responsibilities.

2.1.1 Strengthening proportionality in EU rules

An official commented that proportionality is a central issue in the discussions, and European regulations could improve in this area. Basel III is implemented uniformly across all European banks, whereas in the US it is only applied to large, internationally active banks. Proportionality should benefit both large and new companies, and access to market is crucial.

2.1.2 Bridging the gap with the US and mobilising European savings

An official observed that the recent announcement by Michelle Bowman of the US Federal Reserve regarding the recalibration of capital requirements for major US banks requires Europe to respond competitively in order to establish an equitable playing field. There are concerns that Europe is losing market share to its American

counterparts, particularly in the market-based sector. Structural changes have been seen in Europe, focusing on the banking union (BU). The 2022 Eurogroup statement on advancing work on European banking structures should be revisited.

Past reports such as Draghi's have highlighted Europe's lag in productivity and investment regarding the notion of consolidating larger banks. Private investment must be mobilised due to a significant outflow of finance to the US, estimated at almost €300 billion. Banks need to do more to mobilise the approximately €11 trillion in dormant savings and need to consider how they can better support and contribute to financial interests. If the EU wants to complete the BU, then more is needed on the principle of proportionality, including the Basel III compliance agreement.

2.2 Bridging the EU-US Gap in banking: capital markets, regulation and small banks

2.2.1 The role of deep capital markets in US bank performance

A Central Bank official expressed their appreciation for the idea presented. A frequently overlooked factor in European discussions is the numerous small community banks in America that facilitate 60% of SME financing. Recent US adjustments to capital requirements impacting community banks suggest strategic financial shifts. Under the recent proposal of the Basel III endgame, the smallest banks are expected to experience a 7.8% reduction in capital demands, while regional or medium-sized banks will see a 5.2% decrease. The largest banks, or globally systemically important banks (G-SIBs), will receive a 4.8% reduction. Comparative analyses from institutions such as the Basel Committee on Banking Supervision (BCBS) and the European Banking Authority (EBA) indicate that US G-SIBs have historically faced higher capital requirements than European banks.

US banks remain significantly ahead in terms of absolute profit levels. Impact studies have shown that regulation was not the main reason for the profitability of US banks. Instead, their success is attributed to the broader and deeper US capital markets. This environment has facilitated a potential growth rate advantage of 20% for the US over a 15-year period. Europe needs regulatory reform to cut unnecessary bureaucracy without sacrificing stability. The ECB's task force's promotion of capital stack simplification is commendable.

2.2.2 The case for a European small banking regime

A Central Bank official suggested introducing a small banking regime similar to those in Switzerland, the UK and the US, which would focus on small, non-complex credit institutions (SNICs). Strengthening the SNIC regime and encouraging small banking frameworks could simplify and bolster SME financing. While red tape needs to be reduced universally, there are potential benefits for the real economy from an opt-in small banking regime.

The Chair surmised that establishing a small banks regime might be a potentially pivotal factor in enhancing the financing of substantial economic segments, particularly SMEs in Germany and Austria. Such a regime

would be crucial in optimising the efficacy of the European banking sector.

The Central Bank official agreed with this but noted that it is one facet of a larger picture. The Commission's proposal to develop a SIU is vital. Learning from the best practices and successful examples of countries such as Sweden is crucial. Sweden's pension schemes play an important role in providing funding to support SMEs, alongside dedicated SME stock exchanges. Capital markets need to be opened up to SMEs, particularly during periods of growth

An industry representative said that she did not support the approach of a dedicated small banking regime, because it was a question of risk rather than size.

2.3 Mobilising European savings: the role of securitisation and market integration

2.3.1 Addressing balance sheet constraints to unlock bank deposits

An industry representative stated that their bank is familiar with the complex regulatory environment influenced by the Single Supervisory Mechanism (SSM). There is a need for an evolved ecosystem that would expand the current architectural framework where banks would continue to play a pivotal role. Capital markets also play an indispensable role in supporting the banking sector.

European banks hold substantial cash reserves on their balance sheets, but mobilising these savings raises a fundamental balance sheet constraint ('double-entry issue'), as deposits are assets on banks' balance sheets and require mechanisms such as securitisation to effectively recycle them into investments. A robust system is needed to channel these savings into productive investments.

It is crucial to simultaneously focus on structural measures and enhancing financial education. 55% of US adults are considered financially literate, which is considerably higher than the 18% observed in Europe. This shortfall highlights the importance of improving financial education across Europe, which is vital for fostering informed and mature market participation.

There is a stark contrast between the comparatively small and fragmented European securitisation market and the US market. At approximately \$15 trillion, the US market vastly overshadows the EU's €1.2 trillion, despite the regions having closely aligned GDPs when evaluated based on purchasing power parity (PPP).

2.3.2 Developing a deeper and more integrated securitisation market

An industry representative stated that the US banking sector has an advantage in recycling balance sheets, driven by an originate-to-distribute model that facilitates ongoing lending by enabling stock shifts. This points to the necessity of introducing regulatory amendments to improve securitisation encumbrances, potentially starting with adjustments to accounting practices relating to mortgage servicing rights on regulatory balance sheets.

The Chair acknowledged the importance of securitisation in enhancing the role of banks, as it provides a valuable means of recycling banks' balance sheets and directing them towards more productive activities. However, simply having banks trade securitisations among themselves may not be sufficient to revive the market. In addition, the role of non-bank investors, including insurers and investment funds, was highlighted as critical to creating sufficient demand for securitised products.

2.3.3 Broadening the investor base

An industry representative agreed that broadening the sources of demand could improve the market. It is important to look beyond traditional bank transactions and incorporate wider market players, such as investment funds, in order to create robust demand. However, the fragmented nature of the European market is a cause for concern. Standardising processes could pave the way for a deeper, more integrated market with larger pools of securitised assets. Such standardisation would enable assets to be bundled more effectively, making them more attractive to investors.

Significant divergences persist across Member States, for example in foreclosure timelines, ranging from around six months in Denmark to up to four years in countries such as Ireland or Slovakia, limiting the scalability of securitised assets.

The Chair agreed that it was necessary to harmonise the regulatory frameworks governing securitisation. The hope is to establish a cohesive regime across the 28 member states to streamline rules. While the current proposal does not fully achieve this, there is a willingness to discuss potential improvements further.

2.4 Lessons from Canada's approach to SME financing: balancing stability, proportionality and competitiveness

An industry representative emphasised the importance of achieving international coherence through globally agreed frameworks. Canada has a dual regulatory system involving both federal and provincial regulators. Standardisation is essential for effective risk management and cross border operations. However, there is also a need to balance this with competitiveness.

Canada's approach aims to maintain stability while fostering competitiveness. The Canadian securities regulator has launched a pilot scheme requiring smaller venture issuers to report their finances twice yearly, with the aim of reducing compliance costs and enhancing SME competitiveness. Canada's prudential regulator is consulting on capital adequacy requirements, proposing lower risk weights for corporate SME exposures to boost lending capacity while maintaining alignment with Basel. The goal is to ensure a level playing field, maintain market integrity and align with international rules while keeping domestic market competitiveness in mind. In addition, Desjardins channels household savings into local SMEs and cooperatives, illustrating how domestic savings can be effectively mobilised to support the real economy.

Canadian regulation is fairly harmonised with the international rules. The speaker's firm complies with

Basel III and has very strong capital and liquidity ratios, far above the minimum standards. However, international coherence is key. The representative further highlighted financial literacy as key to individuals' informed decision making and to channeling household savings into the productive economy.

3. Towards a fully integrated and resilient financial system

The final part of the discussion explored the conditions required to build a fully integrated and resilient financial system in Europe, including regulatory convergence, cultural change and a renewed approach to securitisation.

3.1 Building an integrated financial system in Europe: beyond fragmentation and towards a true single market

An industry representative emphasised their company's global presence, its strong ties with Europe, and its commitment to regional growth and investment. While banks are essential conduits between savers, companies, and capital markets, they are hampered in their effectiveness by a fragmented regulatory environment. For the SIU to be resilient and successful, a balanced financial system is required that incorporates banks, intermediaries, and institutional investors in complementary roles.

3.1.1 Addressing regulatory fragmentation through harmonisation

An industry representative commented that addressing fragmentation issues is the responsibility of regulators and legislators, who can create a unified regulatory framework to ease these challenges. Addressing fragmentation requires a combination of tools. This includes further harmonisation of national rules, where possible, as well as optional frameworks, for example, an optional 28th regime that can support cross-border activities. More broadly, reducing duplication in the regulatory framework, for example by merging the Minimum Requirement for Own Funds and Eligible Liabilities (MREL) and the Total Loss-Absorbing Capacity (TLAC) requirements, and ensuring that competitiveness is considered in policy design were highlighted as important elements to improve market integration.

Banks should engage constructively with policymakers, provide clear insights into regulations that hinder market integration, and offer concrete data and real-world examples. This involvement helps to illustrate the benefits of a unified market approach via seamless cross-border service provision.

3.1.2 Driving integration and cultural change: the role of policymakers and banks

An industry representative highlighted that Europe needs a cultural shift towards a more pan European approach, moving beyond national silos and supporting deeper integration through a more consistent application of rules across the Union. Leadership must come from EU

policymakers. While national perspectives remain important, there is a need, in certain areas, to move towards more European approaches where this supports the functioning of the single market. At the same time, this also requires a shift in supervisory mindset – away from compliance-focused approaches and towards a more proportionate, outcomes-based approach. Banks also have a role to play as partners to policymakers, helping translate this more European, outcome focused approach into practice.

3.2 Strengthening the Banking Union and revitalising securitisation: a shift from regulation to fundamentals

An official emphasised the importance of maintaining unity within the BU, a principle that has been safeguarded since its inception, and of ensuring consistent safety and resilience across institutions, regardless of their size, business models or regulatory frameworks. It may be challenging to achieve similar levels of financial literacy in Europe without pension reforms, since Americans are naturally incentivised to actively engage with market dynamics due to their pension system.

There is a need to revitalise securitisation in Europe in order to catch up with the US. Regulators play a critical role in improving due diligence and reporting practices. The benefits of securitisation must be extended beyond concentrated financial centres and groups to encompass broader participation from more banking groups and regions.

A regulator disagreed that national authorities lack a European perspective. While aspects such as mortgage frameworks should be harmonised, it is crucial to be strategic about what is harmonised. Financial markets do not function in isolation, but are supported by banks, and are closely tied to society and the economy. Rather than designing the perfect securitisation product, it is important to ensure that products which meet people's needs are available.

While it is necessary to expand the investor base around securitisation, there should not be excessive focus on the origination and structuring phases. Although the regulatory aspect of securitisation has received significant scrutiny, greater attention should be given to the underlying economics of securitisation transactions.

The discussions highlighted that strengthening the role of banks within the SIU requires building a more balanced and integrated financial system. Unlocking Europe's financing potential will require combining stronger capital markets with a well-functioning banking sector, supported by proportionate and coherent regulation. Key priorities include mobilising savings more effectively, deepening securitisation markets, and reducing fragmentation across member states. Fostering financial literacy and broadening the investor base will be essential to sustain long-term market development. Delivering on the SIU will depend on a collective shift towards a more European approach, to ensure that banks and capital markets can jointly support growth, innovation and financial resilience.