Q&A

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European competitiveness: the who, what, why, and how

As the EU advances the Market Integration & Supervision Package (MISP), how should policymakers think about selecting initiatives to pursue for the EU competitiveness agenda?

The MISP legislative file, aimed at further integrating EU capital markets, can be a catalyst for the EU's competitiveness agenda. Better-integrated markets can help channel savings more efficiently across borders, broaden liquidity, and ultimately lower the cost of capital for EU companies and reduce the costs of investing for citizens.

Delivering these objectives and furthering EU competitiveness should therefore be thought about relative to EU companies and consumers. Policymakers' limited bandwidth should be focused on reforms with a clear, evidence-backed impact on end-user outcomes.

There is a risk of mis-characterizing competitiveness to hijack the competitiveness agenda. For example, there is a proposal to reopen old arguments on equity market structure – with the ink barely dry on the latest update of the trading rulebook and no indication that these changes have worsened market functioning. Claims that price formation is broken or weakened require robust evidence and nothing today points in that direction. A one-size-fits-all approach to equity market structure is not the answer to investors' needs, which differ by size, urgency and liquidity. Regulation should not narrow the set of execution options available to achieve best execution for end investors – an oligopoly is not competitive because it is large, and removing investor options manifestly does not encourage competition.

On the other hand, reforms to the post-trade framework is a good example of where there is a clear opportunity for improvement to further European competitiveness. The EU post-trade landscape remains structurally fragmented across jurisdictions – creating operational complexity and avoidable expense. AFME has highlighted that settlement fees in European central securities depositaries (CSDs) are, on average, 65% higher than in North America. The current regulatory framework is highly fragmented and structured along national lines. Progress in harmonising settlement rules and facilitating connectivity and interoperability will materially lower costs and improve investor outcomes.

In summary, 'cui bono?' is the principal filter through which the MISP policymakers should set the EU competitiveness agenda.

Would giving the European Supervisory Authorities (ESAs) a competitiveness mandate enhance the attractiveness of EU capital markets?

'Competitiveness' is a banner under which policy is pursued rather than being a policy itself, and many different strategic actions could be taken under its aegis. Some of these actions are poor strategy. For example, competitiveness should not mean lowering prudential standards to a level which raises financial stability concerns. Equally, 'competitiveness' should not become a guise for introducing protectionist measures that do not benefit markets or investors. 'Competitiveness' should instead focus on adopting a more risk-based approach, streamlining rules and reducing bureaucracy.

So let us say there is a clearly defined objective of making regulation and supervision more efficient whilst retaining their effectiveness, a definition of competitiveness that would have broad support. Accountability then becomes critical because without accountability, there is no mechanism to ensure that the mandate is executed in a manner aligned with the intent.

How will the ESAs report on their delivery against a competitiveness mandate? To whom would the ESAs report their delivery, and would there be any obligation on the ESAs to respond to feedback? How would the financial sector be involved and what would be measures of ESA success? Would there be a template submission for the agencies against defined metrics, or would that be viewed as too intrusive and bureaucratic?

To return to the original question, a competitiveness mandate will not enhance the attractiveness of EU capital markets. However actions taken by the agencies that are inspired by a competitiveness mandate may enhance the attractiveness of EU capital markets. It is all about the execution, and I would recommend that the execution of any competitiveness mandate is not left to blind trust and faith.

Will supervision play an important role in improving the competitiveness of the EU banking sector?

Yes, supervision is an essential component of delivering the ambitious enhancements to competitiveness envisaged by the European Commission in its recent banking competitiveness report. As the report highlights, many of the benefits of the forthcoming changes to the banking framework will hinge on supervisory authorities changing their culture to focus on risks that matter most for financial stability, rather than continuing a zero risk tolerance culture. Without this change, supervision will continue to stifle banks' ability to deploy financing efficiently to the real economy.

The supervisory authorities can do much of the work to deliver cultural change unilaterally. Adopting a more tailored supervisory model, with greater regard to banks' specific risk profiles and operating models, and refraining from prescriptive supervisory expectations that exceed prudential requirements, are actions that they can take now. Similarly, authorities can prioritise staff training and adopt new recruitment criteria to ensure that staff are equipped with the right skillsets to conduct risk-based supervision and make judgement calls about risk materiality.

However, as with all well-run public bodies, the best way to ensure that the supervisory authorities deliver this culture change will be through clear legal mandates and accountability. Accordingly, the SSM Regulation should be reviewed and the European Commission should publicly consult on the legislative changes to be made to deliver a risk-based, transparent, and more accountable supervisory framework. Key aspects of this review and consultation would be embedding restrictions on the SSM's ability to promulgate "soft law" through its supervisory guidance, requiring thorough consultation and cost-benefit analyses when designing essential guidance, and creating a clear and less onerous process for challenging SSM supervisory decisions.

The EU has acknowledged that its regulatory framework has become too burdensome. Is the current reform push the right way to genuinely simplify it?

It is encouraging that the EU acknowledges its regulatory framework has become overly burdensome. However, there is a risk that reforms will focus primarily on easing the burden on smaller institutions while leaving larger firms with essentially unchanged requirements. Rather than an appropriate adjustment to scope, this would implicitly recognise that the burden on the whole system is overly complex and costly without actually addressing it. Proportionality decisions in banking should reflect not only size and complexity, but also the underlying risk profile and nature of activities performed.

Applying proportionality to supervising smaller entities without sufficient regard to their risk profile may inadvertently increase financial stability risks. The United States has a bifurcated regulatory regime based on the size of banks, and its recent experience offers a cautionary lesson. Rollbacks of post-crisis rules eased requirements for smaller institutions, softening annual stress tests and the penalties for poor performance. This lighter oversight left such banks more vulnerable, and in 2023 Silicon Valley Bank collapsed abruptly after a rapid deposit outflow, triggering broader turmoil and several other bank failures—an episode regulators later characterised as a failure of both supervision and management.

The lesson: reducing requirements based on the size of the institution without sufficient regard to risk can become a source of systemic instability. The corollary is that a burdensome regulatory environment should be tackled for all, instead of creating a two-tier compliance framework that provides incentive for European banks to stay small.