COMPETITIVENESS OF THE EU BANKING SECTOR

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Global competition between EU and US banks: root causes and opportunities

In the aftermath of the great financial crisis, the Euro area banking sector went through significant changes. Capital level and liquidity profiles improved considerably, thanks to updated regulatory frameworks (i.e. implementation of Basel III reforms) and a new supervisory framework (Banking Union and Single Supervisory Mechanism-SSM). Indeed, the SSM banking sector proved to be resilient against the effects of COVID-19 pandemic, since institutions entered that dramatic phase stronger than in the past.

However, SSM banks suffer from structurally lower profitability in comparison with the US banks. SSM banks' Return-on-Equity in third quarter 2022 stood at 7.6%, compared to 13.1% in the US[1]. This weaker performance has been reflected in their valuations, with price-to-book ratios and market capitalisation of SSM banks well behind US peers.

There are several reasons explaining this gap in competitiveness:

1. Euro area growth has been slower[2] than US one. This was also reflected in monetary policy, with the ECB that kept rates down longer than the US Federal Reserve, putting pressures on banks' interest margins;

2. Prevailing bank business model in Europe implies, in principle, the retention of loans on the balance sheet until full repayment, given also a less developed capital markets. In contrast, US banks can leverage on large and developed capital markets for their lending business, employing the originate-to-distribute model, where loans are securitised and transferred to the financial market;

3. European banking sector is less concentrated than the US one. SSM banks have generally shown less appetite for cross-border M&A operations; this means that banks in Europe face higher competitive pressure than US peers, with an additional impact on pricing. Indeed, despite efforts towards establishing banking union, the SSM banking sector remains segmented along national lines and barriers to cross-border consolidation with capital or liquidity ring-fencing still exist. Therefore, SSM banks cannot fully exploit economies of scale and risk diversification;

4. SSM banks show larger management buffers above capital requirements than US peers. In particular, European banks are typically concerned with market stigma, rating downgrades and distribution restrictions; therefore, they usually decide to hold significant management buffers, which are expensive.

5. Regulatory pressures and supervisory intrusiveness are perceived to be very high for SSM banks. Indeed, despite the application of the proportionality principle, actual differences between large and small banks are not perceived very material from the regulatory nor from the supervisory standpoints. For example, CRR and CRD frameworks are applied to all banks and regular stress test exercises are conducted on all significant institutions (by EBA and ECB) and on the majority of less significant institutions (by National Supervisory Authorities); on the contrary, in the US, mid-sized banks are treated preferentially under liquidity and capital requirements and do not participate to annual CCAR (Comprehensive Capital Analysis and Review). However, it seems to rather represent one strong point for the SSM banking sector: Silicon Valley Bank (SVB) demise has showed that financial crises can start with institutions of all sizes and we need to remain vigilant on the whole financial sector, in order to preserve financial stability.

As the SVB case demonstrated, the presence of a comprehensive deposit insurance is crucial and, unfortunately, the Banking Union still lacks its third Pillar. However, in a crisis event, the activation of the European deposit insurance scheme could help restore confidence and head off financial contagion.

In addition, at European level, we still lack well-developed capital markets.

Finally, financing digital and green transition will play a decisive role in the global competition. SSM banks are reviewing their digital strategies, but seem to be still one step behind US peers and competition from non-banks is particularly aggressive. Differently, the transition to a greener economy represents a big opportunity for EU banks, as this will require enormous amount of long-term investments, to be channelled to those projects bringing the most value added to both environment and investors. European regulators and supervisors are devoting a lot of effort from the very beginning and the SSM banks may be better prepared than international peers. This is a strategic opportunity to catch in order to preserve competitiveness.

[1] ECB and Bankregdata.com data.
[2] In the period 2007-2021, US GDP rose by 1.6% per year on average, compared to 0.6% in the Euro area (Eurostat).

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Making the Banking Union a reality

The launch of the Banking Union in 2014 was a powerful response to the Great Financial Crisis. The establishment of the EU single rulebook, the set-up of the single supervision mechanism and resolution framework have enhanced resilience and confidence in the European financial system. However, the European integration of banking services remains unfinished. Real progress is slow despite some political ambition: Banking groups continue to be fragmented along national borders; funding differentials for banks across the European Union and the bank-sovereign nexus persist.

The creation of the Banking Union delivered in shoring up resilience of banks. Supervision has been enhanced and made more uniform across banks. Banks are better capitalised, managed, and governed. However, the banking union still falls short in terms of fostering a genuine European single market. Cross-border banking activity in the European Union has not recovered since its significant drop during the Great Financial Crisis. In fact, the share of EU/EEA banks exposures (loans and advances and debt securities) towards counterparties in other EU/EEA countries has stubbornly remained stable since 2014, at around 24% in 2021.

Equally, banking sector consolidation never reached pre-crisis levels in terms of M&A transaction number and volumes. In 2020, there were 19 major M&A transactions involving EU Banks (up from 13 in 2019) with a total value of EUR 10.8 bn (EUR 5.6 bn in 2019)[1] in contrast with a total value of USD 95 bn for M&A activity in the US in 2020.

The fundamental rationale for the Banking Union never changed. On the contrary, the adverse macroeconomic headwinds are an acute reminder of the need for a pragmatic and swift path towards completing the Banking Union. Tightened monetary conditions challenge business model viability, especially for banks which were built for the low-rate environment. As rates started to gradually increase last year, banks first saw their profitability rise with net interest income and interest margin gains. But repeated rate hikes have impacted valuation of financial assets and expectations of potential deterioration of credit quality.

As a result of changing rates, bank deposits have become more sensitive to interest rate differences and susceptible to be moved at short notice. This may impact duration sensitive business models in particular. This sensitivity is heightened by digitalisation and instant communication technology which can easily accelerate this quest for deposit yield.

Adverse macroeconomic headwinds are a reminder to swiftly complete the Banking Union.

The Banking Union was to enhance trust in European banks. On the regulatory side, we have built the Single Rulebook and strengthened supervision. Those achievements are put to a test regularly by the EBA through its stress test exercises. Our 2023 exercise covers an increased number of banks[2] and uses a particularly severe scenario with assumptions for both interest rates and inflation. The adverse scenario puts banks to the test of high and persistent inflation and interest rates and a severe GDP contraction, ultimately focused on solvency concerns.

A consistent and effective framework for managing banks in distress is a precondition for further integration and for avoiding national ring-fencing when problems arise. It is important to push progress on a more comprehensive and efficient set of resolution tools for smaller and medium-sized banks. Beyond that, a strong resolution framework requires us to clarify and harmonise the public interest assessment and banks' insolvency rules as well as to introduce more flexibility and effectiveness for the deployment of resolution funds. The Commission's upcoming proposal should address these issues.

Progress on risk reduction is widely acknowledged. However, advances on risk sharing remain rather elusive. As long as the European Deposit Insurance Scheme (EDIS) is stuck at the finishing line, the only pragmatic and swift way forward is to resort to the minimum common denominator. This entails the harmonisation of the use of DGS resources in resolution to ensure clear and consistent access conditions as depositors' trust is contingent on having those funds accessible without lowering the level of protection.

Recent volatility in the market and subsequent developments highlight the need to advance swiftly in completing the banking union. With the Basel III negotiation in final stages, co-legislators have the opportunity to advance on pragmatic use and effective implementation of cross-border liquidity and capital waivers. In addition, the banking landscape has changed since the inception of the banking union due to the entrance of new digital players and service providers. This offers the unique opportunity to finalise the banking union alongside the development of a level for new players and technologies.

[1] EBA Risk Assessment of the European Banking System, December 2021.
[2] 70 banks in 2023 compared to 50 banks in 2021.

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European Banking Union needs a Big Bang

The world today is desperate for price stability and once again deeply concerned about financial stability. The EU is shaken by the war in Ukraine and still trying to come to terms with the consequences of BREXIT, the fallout from the pandemic crises and the challenges from a looming global climate crisis. Bold steps are needed to deliver growth and stability globally.

The EU as a single market is not fully integrated, especially for services, including finance. To a financial services provider wanting to serve clients across the region, the EU appears more like a conglomerate of 27 different markets, each with its own regulator plus a 28th European-level regulator on top. While we have seen the establishment of the Single European Payments Area and a nucleus for a banking union, significant friction and fragmentation remain. European banking needs a Big Bang overhaul now.

Creating new rules for cross-border lenders is vital. As a result of financial fragmentation, hundreds of millions of EU consumers, businesses, and the bloc's overall economy are not reaping the full benefits of the single market. More financial integration would not only benefit consumers and the economy, it would also pave the way for long-overdue consolidation in European banking and help to deliver more uniform transmission of monetary policy. This would break the vicious circle linking banks and sovereigns that lay at the heart of the euro area sovereign debt crisis in 2010. And it would add stability today if this consolidation is achieved in a proactive orderly process as opposed to improvised reactive crisis management.

To speed up the very slow pace of organic integration and consolidation, we need a regulatory Big Bang. To reshape the European financial sector it is time to now introduce a fully-fledged EU banking framework for cross-border banking groups. I've made these suggestions before, but they are worth repeating.

Such a framework would rest on five key pillars. Cross-border banks would be subject to EU rather than national law, including for their contracts. This would allow EU banks to exploit significant economies of scale and operate much more efficiently using a single platform. Today, that is hampered by differences in national anti-money laundering requirements, and mortgage rules. EU-wide lenders would only be supervised by the EU Single Supervisory Mechanism, rather than national watchdogs. This would free cross-border banks from differing prudential rules, allowing a free flow of capital and liquidity within banking groups. Harmonised regulation will also make it easier to harness new technologies, such as digital identity measures, which are key to the fight against financial crime.

Only an EU single market for financial services will prevent looming financial stability risks.

Cross-border banks would be able to provide a full suite of banking services across all 27 countries using a single International Bank Account Number code. Today, some consumers and businesses cannot transfer money across national lines because of discrimination against foreign Iban codes. This has paralysed competition and innovation in cross-border payments. And innovative services, such as mobile wallets, are primarily offered at national levels. The EU's "free movement of people" principle should be accompanied by the "free movement of funds", with no barriers and with no additional charges to consumers.

Cross-border banking groups would be subject only to a single EU bankruptcy framework, leading to more consistency in dealing with bank failures. Today, only the largest banks are subject to EU rules if they fail; others are dealt with under national rules. These are often inconsistent with each other, including on key issues such as state aid rules. Creating a single administrative tool for bank liquidation, as proposed by the EU's Single Resolution Board, could be a first step.

Last, but not least, these changes would alleviate most remaining concerns about risk sharing, paving the way towards a common EU deposit guarantee scheme. This would strengthen the credibility of deposit insurance and, again, reduce the bank-sovereign vicious circle. A single common deposit insurance programme would be an additional safeguard and will make sure that customers from different member states benefit from the same level of protection. Regulators and European policymakers have a simple choice here: wait for the next accident to happen and react then or act now. Never before in recent years has the potential benefit of a proactive legislation and regulation been higher for the EU than now.

Only a regulatory Big Bang would provide the nucleus of a proper single European market in financial services, a decisive advantage for consumers, banks and the economy as a whole. There is no better time than now.

Creating a truely single market for financial services would enable the EU to not only prevent a deepening of financial stability concerns, it would lay the foundations for managing the multiple intertwined crises we face today in a stronger and more united way than before.

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How the EU can reap the benefits of a single market for banking activities

For consumers that are not familiar with the institutional landscape composed of the SSM, the SRB and the SRF, the idea of a European banking « union » is not a very tangible one. Most banking services, from payments to mortgages or to retail investment, are still being provided to them by national players. According to the ECB, about only 1% of European credit is distributed on a cross-border basis.

Of course, banking is not the only fragmented industry in Europe : telecom, transportation or utilities also operate with a significant domestic bias. But such industries have their own specificities, they rely on heavy physical infrastructures and they have often been deemed critical in some way or the other. It is hard to argue that in the 21st century this should still be the case of banking too. On the contrary, there is a strong economic case to have more paneuropean banks: geographical diversification in assets and liabilities would increase the stability of banks; such banks could contribute more to the private matching of excess savings and financing needs across Europe, which would benefit the growth potential of Europe.

But even more striking is that, in the case of banking, legal steps like the 1993 single banking licence and passporting had opened up cross border opportunities long before the inception of the banking union agenda, and had actually led to more formation of crossborder activities before this agenda was launched rather than since then.

So why does the European banking sector still resemble a mosaic of national markets and what can we do about it?

The usual policy answer would be to stress the need for completing the banking union, starting with the review of our crisis management framework, which is under way and should help reduce overcapacities, and at a later stage for agreeing on a form of European depositor insurance that would equalize the protection of covered deposits across the European Union.

But it is likely that none of these two files can actually be a silver bullet. In fact, prior progress of the banking union agenda was actually associated with a retrenchment of cross-border banking activities rather than the other way around.

The real solution might lie elsewhere, and be closer to business considerations than institutional ones.

On the revenue side, the lack of standardization of retail products makes it harder for banks to sell the same product to other countries' customers in the EU, and undermines their capacity to refinance these assets via non domestic investors, through securitization or asset sale.

The real solution might be closer to business considerations than institutional ones.

On the cost side, there is insufficient synergy potential between EU countries of operation: for example, rules on taxation, insolvency and consumer protection are all very much governed by national laws and not harmonized, which in turn does not allow to scale the cost of compliance at EU level.

These two elements suggest that it only makes sense in terms of business to develop a cross border retail activity when it can immediately reach a critical mass in each concerned MS. This means cross border organic growth is not an option, and leaves it to relatively large - and more complex - M&A deals.

Such deals have arguably been difficult to see coming in the past few years because of depressed sector profitability and valuations, as well as constant increase in capital intensity because of regulatory reforms. The recent paradigm shift with rising rates that support - at least over the medium term - profitability and valuations could however change that outlook.

This is less true for corporate and investment banking (CIB) activities, where platforms are European and global in nature. But even for these activities, since they require mere size of the balance sheet (but for advisory) and are structurally more volatile in revenues, it is difficult to conceive that large CIBs could thrive outside of a larger group active in retail too.

All in all, one cannot see a complete set of credible policies that would erase with certainty all hurdles to paneuropean banking business. Some of these hurdles can also even be cultural, like when local and regional banks keep thriving within some countries. It can only be a long process, steered by business initiatives taking advantage of market opportunities and only facilitated by more crossborder-friendly regulations regarding asset and liabilities management on the back of the stronger solidarity created by the integrated crisis management regime that is now in force.

We should get back to basics, when it comes to the banking union agenda.

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A competitive banking sector in the EU – an objective to pursue

Developing a more competitive economy has been one of the long-standing political priorities of the EU. The banking sector is at the core of such an objective, given its role in the financing of the economy, the transmission of monetary policy and, more recently, sustaining the EU climate targets. Nevertheless, EU banks have suffered from a chronic competitiveness gap with other international markets. This competitiveness gap can be attributed to both cyclical and structural factors.

Cyclical factors, such as weak economic growth and a double-dip recession at the beginning of the last decade, have proved to be a constant headwind for the profitability of EU banks. Monetary policy has also played its part, sustaining a long run low interest rate environment, which only now is changing. While this has supported banks' funding costs and indirectly helped to address non-performing exposures, low rates in the euro area have led to a significant contraction in the net interest margins of banks, which is critical to profitability.

Structural factors have also impacted EU banks' competitiveness. Overcapacity and fragmented domestic banking markets continue to hold back EU banks from realising economies of scale, resulting in higher average cost-to-income ratios and insufficient size to compete effectively with international peers. While we have already seen considerable progress in banking consolidation within single Member States, particularly in those markets that were historically less concentrated, such as Italy or Spain, there are still several barriers to cross border consolidation.

With cyclical factors turning the tide (or arguably remaining outside of direct control of legislators), the EU should focus on addressing these structural factors, doubling down on existing initiatives to address the causes of fragmentation and overcapacity in its banking sector.

Credibility, consistency and competition are objectives EU regulators should pursue to enable a genuine single market and allow banks to deploy their capital, and ultimately lending capacity more effectively. In order to achieve these, we share a few ideas.

First, cross-border mergers within the Eurozone banking sector have been almost absent so far, notwithstanding the benefits of having the Single Supervisory Mechanism. The completion of the Banking Union, and a solution on a deposit insurance scheme in particular, are the obvious missing pieces. Recent global market turmoil around financial institutions should be the necessary incentive to restart the dialogue.

Credibility, consistency and competition are objectives EU regulators should pursue.

Second, pending a (difficult) political agreement on the deposit insurance front, regulators and supervisors could still work on addressing the current barriers in the form of capital and liquidity ring-fencing within cross-border banking groups. The current CRR3/CRD6 package offers a great opportunity to tackle the problem, for instance with regard to the level of application of the output floor in the 2017 Basel agreement and the potential extension of capital/liquidity waivers within the Banking Union. Concerns from host countries could be addressed by expanding group-wide resolution requirements and increasing supervisory cooperation. Designing a regulatory environment that could favour the establishment of branches instead of more complex subsidiaries would also play an important role.

Third, further harmonisation of local tax, insolvency and anti-money laundering frameworks would also help increase commercial synergies, whose relatively small size is one of the main hindering factors to cross-border deals in the banking sector. Some of these issues will admittedly require several years to get resolved. However, authorities should further build on initiatives such as the Capital Markets Union or the EU strategy for retail investors.

Finally, the standardisation of capital requirements and macro-prudential tools at EU level would also reduce complexity and uncertainty due to differences in local prudential requirements. This includes national discretions around capital buffers such as systemic risk charges for other systemically important institutions or countercyclical capital buffers, which also impact the calculation of the capital haircuts for minority interests in case of mergers.

Achieving a coherent banking market across the EU would significantly enhance the efficiency of the financial banking system. In turn, this would contribute to address the relative shallower depth of the EU capital market and allow the EU to fully seize the opportunity presented by its early leadership in financing the transition to net zero. One of the more recent examples is the adoption of the corporate sustainability reporting framework, as increased ESG reporting will provide visibility of banks' broader ESG engagement but also seek to ensure transparency, accountability, and comparability of the corporate sector in its entirety.

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When rethinking regulation

We are not in 2008. Many checked their calendar after the collapse of Silicon Valley Bank (SVB) to make sure we hadn't gone back in time. We haven't, and it is worth noting why.

Since the Global Financial Crisis, banks have taken major steps to enhance their resilience. They have three times more capital and liquidity ratios are well above the mandatory minimum. The collapse of certain banks responds to a very specific issue linked to bad risk management. No amount of capital or liquidity can save us from every bad business decision.

Like banks, the EU has been very active and ambitious on different fronts. Despite things moving faster in the EU, there is no time or place for complacency and we should all help achieving more.

As it reviews its regulatory framework, the EU should consider striking the right balance between financial stability on the one hand and growth and competitiveness on the other. The work has started as the European Commission will introduce competitiveness checks. Furthermore, the Commission has released a communication with key areas for competitiveness; financial services comes on top.

The EU can be very ambitious, even more if it strategically allows businesses to use their strengths. A few examples:

First, in banking, a review of current capital requirements and supervisory processes, including how rules are implemented, could provide capacity for additional banking lending (€4-4.5 trillion; Oliver Wyman's: "The EU banking regulatory framework and implications"). Additional lending could also support the financing of the green and digital transitions, and more generally investments in strengthening the competitiveness of the EU economy.

Furthermore, despite the setup of a single resolution authority and fund, and the improved authorities' ability to respond to future banking crises, there are still obstacles to cross-border bank mergers within the Eurozone. This prevents banks from realizing scale or synergies across markets. Post-SVB, it is even more urgent to finalize the Banking Union with an EU-wide deposit insurance scheme. A single market in retail financial services is needed to provide scale and enhance competitiveness.

Businesses can help the EU bringing growth, innovation and competitiveness.

This will also help jump-start the Capital Markets Union. Insolvency rules and other fragmentation on disclosure, consumer protection and compliance, hamper cross-border investment and dampen funding from outside. This happens at a time when more financing is needed to overcome geopolitical, environmental and digitalization challenges.

Second, it is essential that the sustainable finance regulatory framework is defined in a way that enables the transition of all economic sectors and actors. Europe has taken a decisive role in the sustainability agenda, leading with ambition and encouraging other jurisdictions to act as well. Given the depth and speed in which the regulatory framework has been developed, we encourage policy makers to reflect on the progress achieved to date. As a priority, they should aim to achieve as much alignment and harmonisation as possible across jurisdictions, to avoid fragmentation and support the competitiveness of businesses.

Last but not least is innovation and technology. Financial services are already digital, but to make sure businesses can innovate and reap all the potential benefits of technology and digitalization, regulation and supervision should be simple and future-proof, based on principles and guidelines that allow rules to match the pace of innovation.

In the case of data, there are unexploited opportunities. The data economy should be customer-centric and cross-sectoral. The combination of data from different sectors holds the greatest potential for delivering new services and experiences for people and businesses. In the case of financial services, non-financial data is important for the development of new better financial products and services, fulfilling the needs of people and business.

For all these reasons, we need to strike the right balance between risk and growth. Other countries like the UK are taking steps, discussing with its private sector how to achieve the best possible outcomes. The US has passed the Inflation Reduction Act, which offers financial incentives to support the green transition. A significant law, which will have an effect on EU competitiveness. These are reasons for the EU to pursue broader aims, focusing on boosting its structural competitiveness.

The EU should be a single market for goods and services that enables people, businesses and communities enjoy the benefits of scale, of free movement and democracy.

In the end, I did check my calendar. We are in 2023. However, we should start looking into the future, into what the EU can do during the next political cycle: to review how rules effectively work and how they are implemented; to define a sustainability framework that enables the green transition; and to allow businesses to innovate. The EU must never lose sight of the goal, growth, and all the potential it holds.

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Europe needs more funding through capital markets to improve competitiveness

Europe needs more funding through capital markets to improve competitiveness

Europe faces longstanding challenges, intensified by the war in Ukraine, inflation and financial market volatility. Geopolitical tensions are elevating, and Europe is still too dependent on other nations for commodities and energy. At the same time, Europe has considerable strengths: strong education, deep expertise and innovative skills in key industries, particularly related to fighting climate change.

For Europe to achieve its growth potential, it requires a framework that enables its institutions to compete effectively. This calls for major targeted investments, including:

1. **Accelerate the European green energy transition:** Reaching net-zero will require € 28 trillion investment in the next 30 years.
2. **Diversify global supply chains to reduce reliance on specific countries:** European corporates will have to source critical inputs from a smaller pool of suppliers, while building up strategic reserves.
3. **Increase defense spending to address geopolitical realities:** Annual spending will need to increase by around $ 100 billion versus 2021.
4. **Catch-up on digitalisation and new technologies:** Europe leads in only 2 out of 10 key transversal technologies (Artificial Intelligence – AI, quantum computing, cloud). Without improvement, European companies would miss out on a value-added opportunity of € 2-4 trillion a year by 2040.

The financial sector plays a crucial role, because 70% of funding in Europe is provided by banks. In the U.S., this is reversed. Bank lending capacity is determined by capital requirements, which constrain banks' capacity to fund the necessary investments. Recent bank failures have also demonstrated the need to reduce the economy's reliance on bank funding, as this creates risk concentration. European governments are also constrained by high debt.

In parallel, the EU capital market is still smaller than in the U.S. with 14% versus 42% of global market share. Europe is fragmented along 27 national markets. Due to Brexit, the EU lost around a third of its capital market, and gained a competitor with deep liquidity.

Key measures for an integrated, open and liquid capital market to address Europe's challenges.

Short-term steps

The current landscape creates new momentum for an integrated, open and liquid European capital market that can secure prosperity for companies and citizens. EU policymakers have one year left to deliver progress ahead of May 2024 European Parliament elections. Focus on three measures can provide tangible support:

1. Securitisation is indispensable to diversify funding sources and finance the green transition. The European market for securitised assets represents 8% of eurozone GDP, compared with 47% in the U.S. One reason is that the Basel and EU regulatory treatment of securitisations lacks risk sensitivity, with the capital treatment making it unattractive for banks and insurers. The U.S. has not implemented the relevant Basel framework. <u>Action</u>: Progress needs to be made in 2023, via the ongoing Banking Package, for targeted reduction to capital charges, so that change is seen in early 2025.
2. Proposed measures for strategic autonomy, such as the review of the EU clearing framework could penalize European banks and drive business to non-EU markets. Careful consideration should be given in the legislative process to determine how to protect EU liquidity providers/market makers competing internationally. <u>Action</u>: While supporting more clearing on the Continent, European banks should be allowed to service non-European clients where the client wants to clear. This would allow them to remain competitive with US and UK peers.
3. The retail investment strategy should empower participation in capital markets: Potential introduction of an inducements ban in the sale of investment products will drive retail investors to more risky asset classes or away from capital markets, creating an advice gap as already apparent in the UK which introduced such a ban in 2014. <u>Action</u>: Make disclosures clearer. Knowledgeable investors should be able to choose from a broad range of products. A full ban of inducements should be avoided.

Long term changes

Policymakers should consider broader challenges such as demographics and a low growth potential, and how they can be prioritised by specific reforms, including on capital markets. Progress and reform will come with tradeoffs, but this will benefit the EU overall. The regulatory framework must not undermine access to global liquidity. There are a number of areas to address:

1. **Lack of flexibility of EU regulatory framework creates disadvantages:** Extraterritorial application impacts EU bank competitiveness. Adjustment to international standards and more flexible equivalence assessments are needed.
2. **More consolidation of market infrastructures:** EU equity capital markets are only 25% the size of the US, however, the EU has 3 times as many exchange groups, 18 central counterparties (CCPs) and 22 central securities depositories (CSDs), as opposed to 1 each in the U.S. Further consolidation creates deeper liquidity pools, making it more attractive for investors to invest in Europe.

These policies would permit Europe to build on its strengths while adapting its weaknesses, leading to higher living standards, a better climate and long-term growth.