

# Competitiveness of the EU banking sector<sup>1</sup>

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Ugo Bassi welcomed attendees and introduced the panel on the competitiveness of the EU banking sector. The critical objective of the discussion is to identify policy priorities, means, instruments, and tools needed to tackle the profitability gap that European banks are encountering within a challenging international environment, characterised by an unlevel playing field.

Interest rates in Europe are structurally lower than those in the US, which severely impacts profitability. There are increasing economic and fiscal divergences manifesting across Europe, illustrating the paradox of having a single supervisor while national authorities still opt to impose capital liquidity requirements, thereby restricting the operations of pan-European banking groups.

Several governments are hesitant to endorse cross-border mergers and often express a preference for ensuring that local savings finance local investments. The European Commission is preparing a global report on the banking sector, which will incorporate all suggestions that are deemed relevant. There needs to be an emphasis on the importance of focusing on solutions, while facilitating an open exchange in pursuit of concrete strategies.

Ugo Bassi asked Aurelio Maccario and Tanate Phutrakul to give their views as industry representatives.

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## 1. Seizing the moment to foster pan-European banking competitiveness

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Aurelio Maccario stated that every crisis brings an opportunity, and it is clear that there is the willingness to move forward with cohesion in a very structured way. The European banking sector is currently in a very favourable position, marked by notable strength, resilience, and robust capital and liquidity levels. Europe also now has a strong regulatory framework, with a single supervision that allows it to move in a joined up way

There are three pivotal areas that can significantly enhance the sector's competitiveness. The first is a swift conclusion of the regulatory framework, underscoring that while Capital Requirements Regulation III (CRR3) is already in place, a timely decision on the Fundamental Review of the Trading Book (FRTB) is still pending. Different stakeholders have varying opinions on the issue, but independently finalising the regulations will showcase Europe's capacity to determine its own regulatory future without waiting for rulings from other jurisdictions. Initiating regulatory clarity will allow banks to plan with greater certainty.

There is also a need to simplify the securitisation framework and to make it more market-friendly. This simplification will serve multiple purposes, primarily enabling banks to liberate portions of their balance sheets to better support the real economy during crises, while simultaneously generating capital. Since the great financial crisis, European securitisation default rates have remained impressively low, with an average of just 1% which is in stark contrast to the 4% of defaults seen in the US. However, despite this, Europe is still trailing behind regions such as the US, UK, Australia, and parts of Asia, indicating that there is a clear opportunity for improvement.

Aurelio Maccario concluded by reiterating the critical nature of pursuing operational simplifications while adhering to the regulatory principles established over the last decade. Central banks and regulators are taking steps to ease the implementation of regulations without altering the overall regulatory framework itself, ultimately aiding in the competitiveness of the sector

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## 2. Three critical areas where scale is lacking: technology investment, wholesale banking, and cross-border diversification

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Tanate Phutrakul highlighted the resilience and robust supervision of the European banking system, which has successfully navigated through several recent crises. The current economic challenges are 'known unknowns', showing that the sector is well-prepared and profitable, with strong returns on equity being evident in its operations. Banks have weathered significant events, including the COVID-19 pandemic, the geopolitical ramifications of the Russia-Ukraine war, and the challenges posed by the collapses of Silicon Valley Bank and Credit Suisse. Despite these difficulties, there is a comparative strength and profitability of European banks. However, there is a concern around the scale at which European banks operate compared to their American counterparts. The market capitalisation of the largest 10 European banks does not match that of the largest American bank, pointing to the need for improved competitiveness.

He identified three critical areas where scale is lacking. The first is technology spend, to prevent cyber security or to prevent cyber crime, to make sure to digitise, and to make sure that banks' payment systems are secure. That takes a significant amount of investment and cannot be done with a sub-scale banking platform. 30% of ING's spend is on IT.

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1. Although the conference was held under the Chatham House Rule, the speakers of this session agreed to be identified by name in this summary.

The second area of scale that needs to be improved is around wholesale banking, in particular financial markets. European banks are too reliant on American competitors. The regulatory regime needs to be improved in order to enable European players to be able to effectively compete in the wholesale banking space. The notion of a regional wholesale bank does not work; a bank is either global and providing wholesale banking clients in Europe with a global footprint, or it is not actually able to compete effectively over time.

The third aspect around scale is that banks need to be able to diversify. Indeed, banks need geographic diversification across European countries to mitigate local downturns and support profitability.

Tanate Phutrakul concluded by emphasising three objectives: ensuring a free flow of liquidity and capital among European subsidiaries of groups like UniCredit and ING, simplifying the macroprudential capital regime, and creating a framework that reduces the cost and complexity of cross-border mergers, thereby enabling further European banking consolidation.

Ugo Bassi noted that some of the issues that have been mentioned are very well known, and others are more hidden. Ugo Bassi asked Jacek Jastrzębski for his views.

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### 3. Is Europe willing to accept slightly more risk to enhance competitiveness and profitability?

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Jacek Jastrzębski agreed with previous statements that Europe has been able to build a resilient, strongly capitalised, liquid banking sector. Europe has become the world leader in stability, which is particularly true for the banking sector. However, this success has come at the cost of competitiveness and growth.

While regulators have prioritised financial stability, this has limited European banks' profitability compared to global peers. A fundamental question must now be addressed: is Europe willing to accept slightly more risk to enhance competitiveness and profitability? This is an open question which requires a deep discussion with all the stakeholders.

In the US only around 35 banks are subject to their equivalent of resolution procedure. There are various reasons for this approach. He noted cultural differences between Europe and the US regarding the acceptance of business failures and bankruptcies. In Europe we sometimes believe bankruptcy should be avoided at almost all costs in Europe, whereas in the US bankruptcy is part of business life. Of course there are also other factors, including potentially fewer concerns about public aid in the US, which means that the remainder of distressed situations in banks – i.e. those not subject to the US-equivalent of resolution – can be dealt with in a more flexible manner without the public aid concerns that Europe has.

There is also the underlying issue of fragmentation. European banks are unable to achieve the economies of scale that are available to their US counterparts

because of the fragmentation of European markets. Due to fragmentation, Europe is actually imposing tariffs on itself; internal tariffs in Europe are the equivalent of roughly 110% of external tariffs on services. It is not only about a harmonisation of financial regulation, but also about a genuinely single market.

European banks are traditionally strongly focused on retail and traditional corporate lending. The margins that can be achieved within traditional banking are lower than what can be achieved in advanced corporate investment banking businesses, which is also a source of explanation of the different level of profitability and of the different level of competitiveness between European banks and their global counterparts.

We are in a moment where maybe we should reconsider our approach to the perfect balance between stability on one hand and competitiveness and profitability on the other. If we come to the conclusion that the level of stability which we have aimed for so far comes at a cost which is too high in terms of competitiveness and profitability, we may decide to readjust or recalibrate our approach. Supervisors are happy to take part in this discussion, but it cannot be done if they and the regulators are the only ones who carry the risk. There needs to be a wider public debate around the level of risk that will be accepted. All stakeholders – and the general public – have to be aware and also very blunt and open about it that there may be some sort of a trade-off – and that increasing competitiveness (also through deregulation) may increase risk. And there must be a wide consensus around such a recalibration or readjustment.

Policymakers and regulators should consider facilitating banks' engagement in new business areas like private equity and venture capital. In Poland, regulators are working with financial institutions to encourage investments in innovation, dual-use technologies, and early-stage ventures, which could boost both banking competitiveness and broader economic performance.

Ugo Bassi asked Gabriel Cumenge and François-Louis Michaud to provide their views.

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### 4. The key issue is the capacity of European banks to finance growth, particularly for corporates and SMEs. A more competitive and integrated corporate and investment banking (CIB) sector is critical for the EU's economic autonomy and industrial strategy

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Gabriel Cumenge highlighted a focus on the competitive dynamics within the corporate sector. There is concern over the competitiveness of European banks in serving the market, particularly regarding their role in financing corporates and small and medium-sized enterprises

(SMEs). The outlook looks bleak in the sector, evidenced by the decline in the market shares of European banks in favour of their US counterparts in these transactions.

A robust competitive banking environment is needed, to support both growth and the geopolitical autonomy of European companies. In conversations with larger corporates, there is a clear expectation that banks should be able to service projects beyond European borders, necessitating a competitive, globally-focused European banking sector. There is great importance in the forthcoming European Commission report, as it will be pivotal in assessing the current environment and will determine where improvements could be made. The Single Supervisory Mechanism (SSM) has been a regulatory success, but there is a disparity in market shares between European and American banks, and this persists despite a strong regulatory framework.

Simplification needs to be addressed, with a significant responsibility for regulators and co-legislators. Level 1, level 2 and level 3 practices need to be addressed, as well as supervisory practices. There is not an entire trade-off between competitiveness and financial stability; in Europe there is room to manoeuvre around simplifying, being more risk-based and risk-oriented. It is not about increasing the risk but giving the banks more room to manoeuvre. There is a fine balance that has to be found.

A level playing field is a positive thing. FRTB will be the key issue, but all regulations will need to be examined when Europe is clear on what the US will do. If there is a push in the next two years to simplify and to be more competitiveness-oriented then regulations can be examined, but a change of culture is required. Change is needed on the way the new regulations will be done in the future. The 2009 de Larosière report will need to be re-examined, as well as the whole European architecture of how the norm is produced, how it is implemented, and with what mandate.

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## **5. Assess whether the structure and implementation of the EU regulatory framework is delivering the desired results. To take stock of existing rules and identify areas for streamlining or rebalancing. A system-wide review, involving all key stakeholders to calibrate the overall regulatory burden across different dimension**

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François-Louis Michaud observed that panellists seem to agree on the matters at hand. Care is needed that what is actioned is not a trade-off between efficiency and stability, as the two issues need to be combined. The change should not be led by a push for deregulation or losing the standards that have helped Europe to navigate the crises and shocks it has been through in recent years. Checks are needed for strengths and efficiencies. The picture for

strengths is extremely positive, as evidenced by what has been seen over the last 10 years. Banks have been able to collectively navigate a series of very dangerous exogenous shocks of all kinds with no damage. Results from EBA stress tests showed banks holding more than 10% Common Equity Tier 1 (CET1) during different scenarios. Credit distribution on the whole has been dynamic in the EU over the past decade, and that is despite a significant buildup of regulation. There is 40% nominal origination of credit. For SMEs as a whole it is 90%, and it is 65% for commercial real estate.

Despite the significant buildup of regulation and increase in supervisory intensity, credit origination has been dynamic. There are eroding market shares for European banks in certain EU areas. To a certain extent, the EBA interprets the question as one of strategic autonomy, rather than the competitiveness of the banking sector as a whole. The EBA and the Commission have delayed the implementation of FRTB to ensure there is a level playing field. There is also a scale of size effect. After the great financial crisis, EU banks have been very quick to merge in order to obtain the size that allows them to operate on a much larger scale, but that consolidation and integration has not been seen within the EU. There are still a great deal of frictions in the single market to facilitate the type of size that is needed. Europe also lacks mechanisms like securitisation that could increase the size of the balance sheets and also provide instruments for banks to originate more dynamically.

The second big issue is the accumulation of needed rules, such as micro, macro, anti-money laundering (AML) and conduct. The financial regulation framework is being added to, with new authorities being introduced at both national level and EU level. Everybody is performing their role very well, but they have their own agendas, so cooperation may not be entirely well-organised between entities and organisations. Capital requirements, liquidity requirements, reporting requirements and inspections takes time and money for banks.

François-Louis Michaud advocated for pausing the rebuild, as Europe has acquired the strengths it needs as a whole and they have been positively tested. It is now a good time to check whether Europe has the design it wants for the entire financial regulation, whether it is executed on an ongoing basis in terms of the cooperation amongst all authorities and their mandates, and whether it is sufficiently coordinated.

The third question is whether the outcome is as expected in terms of the overall impact on the sector, such as the reporting burden and the time that is spent with a firm. Work is ongoing around what can be streamlined or rebalanced. In terms of the reporting burden, Europe has harmonised to a significant degree, which is a positive because it should simplify the work of the institutions, provided that national regimes are not kept in place and that Europe does not have supervisory authorities that keep adding to the burden on an ongoing basis. The correct balance needs to be found between what has been harmonised and what is still required. There might also need to be a focus on convergence, and how this harmonisation is working in practice within the EU.

The topic of calibration is difficult, as it focuses on the desirable level of capital requirements or burden in general for the system as a whole, taking into account all the dimensions that have previously been mentioned, such as micro, macro and AML. Europe does not currently have the right place for that, because nobody is really in charge of it. There is no real forum for discussing those issues, which have multiple dimensions; governments have an interest in it, but so do micro supervisors and macro authorities. It is not an easy institutional issue or architectural issue to solve, but it is one that is very much needed.

François-Louis Michaud concluded by stating that there are a significant number of commonalities. Everyone agrees on the situation, and that adjustments and improvements can be done, but it should also be clear that it is not a game of deregulation. The work needs to build on the strengths that have been acquired. It has taken a significant amount of effort for Europe to reach the point that it has, and that should not be traded for easy gains. The system needs to be made more efficient as a whole. The EBA is committed to that, and will be contributing to what DG FISMA will be proposing.

Ugo Bassi noted that it was a challenge to draw a conclusion on the diagnostic issues and potential solutions, due to the strong consensus that has been demonstrated

among the participants. There has been a clear agreement on the necessity for regulatory simplifications, but simplification efforts could invoke further legislative needs. There is a critical role of enhancing cross-border banking operations and developing proposals in important areas such as securitisation, banking union, and establishing a European Deposit Insurance Scheme (EDIS).

There is also the apparent complexity of achieving regulatory progress, particularly when systematic bureaucratic barriers overshadow the regulatory aspirations. There is an importance of sustained communication between the Commission and all stakeholders, both within the public and private sectors, as they navigate suggested reforms or enhancements to the banking framework. While discussions might appear straightforward, implementing effective changes requires considerable collaboration and a commitment to facilitating a more competitive and robust banking environment for Europe as a whole.

Jacek Jastrzębski expressed optimism about the trajectory of developments in financial markets, given the vibrant discussions that have been taking place. It reinforces the belief that it is an exciting time to be part of the financial community and to co-shape the evolving landscape of the financial market.