

Diversity in the EU banking system

The panel explored possible improvements to the EU's financial regulatory framework regarding different banking models, in particular mutual, cooperative and deposit-taking banks, as well as new market entrants. This was followed by a discussion of the supervisory framework in both the Single Supervisory Mechanism (SSM) and non-SSM contexts, including how supervisors across Europe can more effectively recognise the diversity of business models.

The discussion showed that a diversified banking system strengthens the resilience, inclusiveness and financing of economies. To preserve this diversity, proportionate regulation, supervision and impact assessments are needed to ensure fairness without overburdening smaller institutions.

According to policymakers, over-simplification of rules based on bank size could jeopardise financial stability and depositor confidence. Industry leaders indicated that one size does not fit all, and there should be simpler, but no less prudent, rules for smaller institutions. They also called for a regulatory pause to reassess the complexity of EU banking rules, and for a test to ensure that any new legislative proposal enhances European competitiveness and sovereignty.

1. A diverse banking system for greater resilience, inclusion, and economic financing

1.1 The need for EU regulation and supervision to support banking diversity

The Chair observed that recent sessions had reached a consensus on the importance of maintaining banking diversity to meet the varied needs of stakeholders across Europe. Banks throughout the EU must offer tailored services to individuals, small and medium-sized enterprises (SMEs), large corporations, and start-ups - serving both technologically adept younger clients and those less familiar with digital tools. Achieving such inclusivity depends on the availability of diverse business models.

1.2 Resilience through diversity in financial systems: the BPCE example

An industry representative suggested that there was broad agreement among stakeholders about the benefits of diversity in financial systems, noting that diversity increases resilience. Uniformity creates systemic vulnerability, as it can lead to collective failure. Co-operative banks were born out of the need for individuals to access financial services previously denied to them. These banks were designed to enable people to save and borrow, and over time they developed into large networks like BPCE. Co-operative banks now

represent around 65% of the French banking market and are consolidated into three major groups. Their growth has been driven by grassroots demand, creating networks with thousands of branches.

Large branch networks based on genuine proximity to territories are often criticised for inefficiency, but customers continue to value them. French co-operative banks predominantly offer fixed-rate mortgages, which is unusual in other countries. The banks take on the interest rate risk themselves, funding themselves through non-fixed rate deposits and capital markets. This model demonstrates a form of diversity as it is different from practices in other jurisdictions, but it is no less stable. Co-operative banks are well capitalised and have historically shown resilience in times of crisis. Applying uniform benchmarks to institutions with fundamentally different models risks misinterpreting diversity as an aberration rather than a strength. The real challenge is to recognise and appreciate the value of specific approaches.

The Chair asked whether the approach of the single supervisor unintentionally disadvantages such banking models by comparing them to inappropriate peers. An industry representative responded that supervisory outcomes are closely linked to how the single supervisor conducts its assessments.

1.3 Desjardins in Canada: success through adaptive regulation and cooperative European inspiration

An industry representative explained that Canada is trying to learn from what is happening in Europe, although it also feels pressure from America and has to find a balance there. The Canadian financial landscape consists of five or six major international banks, approximately 100 smaller co-operatives and credit unions, fintech companies, and Desjardins, which is a significant co-operative financial group with about CAD 470 billion in assets and 54,000 employees. Desjardins operates mainly under provincial regulation in Quebec, with its insurance activities under federal oversight and wealth management supervised at both levels.

Any regulatory approach should prioritise consumer protection and systemic stability. Founded 125 years ago to serve French-Canadian communities underserved by Anglophone banks, and inspired by the BPCE and Raiffeisen models, Desjardins benefits from a collaborative relationship with its provincial regulator. The Autorité des marchés financiers (AMF) looks at everything in Europe and around the world. Desjardins wants to be regulated by the best standards while building a strong relationship with its regulator.

There are four key aspects of this success. First is the provincial regulator's significant influence on federal regulators, which involves open debate. Second is adaptability such that the regulator is able to accommodate and adapt to Desjardins' unique role, particularly in providing services to remote regions

where other banks have no presence. The regulator balances stabilising Desjardins in the ecosystem while accepting the need for Desjardins to ensure that are financial services in certain regions of Quebec and elsewhere in Canada. Third is consistent communication through regular, monthly meetings that. Fourth is ongoing efforts towards harmonisation between federal and provincial regulations, which the regulators are working on extensively. There is both a strong relationship with the regulators, but they nonetheless regulate Desjardins like any other systemic co-operative, and that is what Desjardins wants because it wants to be compared with the best of them.

1.4 The custodian model: emphasising asset servicing and its stabilising role in finance

An industry representative highlighted that much of their firm's business is focused on asset servicing, which is the custody and administration of institutional clients' assets. The firm connects banks by looking at their administrative processes, primarily in securities servicing. The firm's P&L is therefore less dependent on products that generate interest income. Instead, the model relies heavily on commissions on assets under management and involves handling extremely high volumes due to low margins on custody and administration fees. As a result, the firm is designated a global-systemically important bank because it moves large volumes and sits on many assets.

Custody banks play a stabilising role within the industry and protect investors. Aspects such as lending or deposit-taking are different for custody banks. Lending, for example, is mostly intraday, overnight, to provide clients with a line of credit to facilitate their processes. The stabilising effect of this model is essential for the industry. There should be sufficient flexibility within the regulatory framework to take account of the specific characteristics of custody banks. The current capital framework is an example of where there custody bank specificities ought to be better reflected. In particular, capital rules that treat lending to regulated investment funds, including EU UCITS, as exposures to unrated corporates. This 'one-size-fits-all' approach unfairly restricts custody banks' ability to provide lines of credit to EU UCITS and other regulated entities, often required to accommodate day-to-day operational needs.

2. How regulation and supervision need to evolve to preserve diversity

2.1 Canada's principles-based regulation: ensuring consistency through dialogue and coordination

An industry representative commented that the strongly principles-based regulatory approach in Canada can in effect become rules-based at the implementation level. To address this, there are quarterly discussions with senior regulators to ensure alignment and to escalate concerns about the translation of principles into rules. These meetings have allowed for verification that both sides are speaking the same language, leading to cooperation and even simplification.

Proportionality is not just about a common language. It is also about harmonisation across different regulators, which requires a significant investment of time and effort. In 2019 the International Monetary Fund (IMF) presented a report that advocated increased federal-provincial co-operation in Canada. If banks and co-operatives do not understand, then that generates another risk in the country, because some will not apply the rules. The IMF's involvement therefore provided external pressure for greater accuracy and collaboration, thereby mitigating the risks arising from misunderstanding or non-application of regulations.

2.2 Proportional regulation and impact assessments to support fairness for small institutions

2.2.1 SSM's commitment to more effective and proportional supervision

A Central Bank official stressed that equivalent activities with similar risks should be subject to the same rules. However, proportionality can be achieved through both regulation and supervision. The SSM already applies a proportionate approach, using risk profiles to determine the scope and frequency of assessments. Sustainability assessments are conducted annually, while other areas may follow multi-year cycles.

Proportionality also applies to reporting requirements, so that smaller or less well-known banks are not overburdened with complex obligations. Governance is particularly challenging for small banks, where board responsibilities may be unclear or less rigorously applied. While governance standards must be maintained, expectations of board structures should differ according to the size of the institution.

In some cases, smaller institutions may not be able to afford dedicated staff for functions such as anti-money laundering (AML). Compliance responsibilities should be distributed across mixed teams to ensure effectiveness. Recovery plans for smaller banks could be assessed less frequently, provided they follow consistent principles for similar activities and risk levels.

A supervisor noted that there is considerable diversity in the European banking system and the intention is not to stifle this or to create a single bank under a single supervision. Supervisory efforts include benchmarking for all institutions. The SSM itself is benchmarked against other supervisors, such as the Office of the Superintendent of Financial Institutions (OSFI), to identify areas for improvement.

Proportionality is already embedded in the current framework, which distinguishes between less significant institutions (LSIs) and significant institutions (SIs). The allocation of resources also varies at the national level. Even among LSIs, the level of market activity and complexity varies.

During the 2008 financial crisis, business model type was no guarantee of immunity from impact, and banks across all sectors were affected, including banks from the co-operative sector, whatever nation they were from. There have been banks with enormous crises, and specialised lenders and universal banks are also not

immune from crises. Business models must be respected, but they have to be understood and managed by the board and CEO of the bank in question. The focus for supervisory bodies remains risk management, which is assessed through annual evaluations.

An industry representative reiterated the importance of a risk-based approach to supervision, also in the context of evolving supervisory expectations such as those related to climate and wider sustainability related risks. Climate and other sustainability related policies must recognise that custody banks cannot influence client ownership of specific assets, or more specifically the 'decarbonisation' of such assets.

2.2.2 Neutral and flexible regulation with benchmarking to ensure proportionality and respect for bank diversity

A Central Bank official stated that, despite some commonalities, each bank has unique characteristics. While comparative benchmarking is valuable in this context, regulators and supervisors must remain neutral across all business models. This neutrality extends to avoiding favouring or hindering any particular model. Regulation must not create barriers to entry or sustainable operation. In order to ensure that banks are sustainable and viable, benchmarking is a useful way of making comparisons, but the specificities of each bank should not be forgotten.

When benchmarking, it is also important to know whether proportionality applies. If a comparison of a group of banks shows that certain requirements are difficult for all of them to meet, this may suggest that the regulation or supervisory practice is not appropriate for that type of bank. It therefore helps to identify what simplifications are needed.

A bank's sustainability goes beyond profitability and includes risk strategies, risk assessments and the ability to adapt, which are important to take into account when benchmarking. Benchmarking serves as a useful tool for determining proportionality by identifying areas where regulation may be inappropriate or in need of adjustment. In addition, the assessment of banks relative to others needs to be considered over a longer period than a single year in order to take into account cyclical factors and unforeseen events. There is therefore a need for flexibility in the application of the rules, but this implies no favouritism and no interference with business models.

2.2.3 The importance of impact assessments in regulation

A Central Bank official affirmed that impact assessments are essential, though that is a complicated area. Such assessments are already conducted for new regulations. However, the European Commission is not the only actor; the legislative process also involves the European Parliament, the European Council, the European Banking Authority (EBA) and the SSM.

Stakeholder consultations are conducted during the development of regulations and when implementing technical standards, to understand the concerns of the banking sector. Balancing the interests of different types of banks when testing the solutions prepared by

the Commission is a major challenge in the development of regulations. For instance, the statement of one small cooperative bank showed that it had a high Liquidity Coverage Ratio (LCR) and a high Net Stable Funding Ratio (NSFR). However, the figures were not relevant for its day-to-day management. The Commission should use the results of the impact tests, while recognising the complexity of accommodating different banking models.

2.3 The risk of oversimplifying rules to financial stability and depositor trust

A supervisor highlighted that there is extensive talk about simplification and deregulation. There are potential inconsistencies that may necessitate legislative adjustments, but the comprehensive review by the European Commission in 2026 will be waited for before conducting a full stocktaking exercise. Maintaining financial stability and depositor protection are paramount. Differing rules based on size could incite instability as depositors seek what are perceived to be safer institutions. Such an approach should not be encouraged, because it is not completely understood.

European citizens expect uniformity and equal treatment. There were instances in 2008 when discrepancies in deposit guarantees between countries prompted depositor flight from some banks, because they were considered to have less protective deposit guarantees. That should not be repeated. Simplification efforts should not compromise sector resilience, particularly given current uncertainties. Some rules are complex, and that is true both for banks and supervisors. The capital stack, for example, is difficult to follow clearly. However, it could be simplified without going into the level of capital.

The European banking sector is well-capitalised with a good level of liquidity. The aim is to maintain the high level of protection for the banking sector while maintaining the level of activity over the next decade.

The Chair indicated that simplifying regulation could reduce granularity, potentially hindering supervisors' ability to enforce proportional rules. Any such changes must be based on sound, risk-based assessments. Moreover, simplification could spark debate over increased supervisory discretion and its impact on maintaining a level playing field across the EU's integrated banking market. The development of the single rulebook was intended to promote consistency, especially for cross-border banking operations. This also raises the question of the extent to which European oversight should be strengthened in response.

2.4 One size does not fit all: simpler, not less prudent, rules for smaller institutions

An industry representative explained that his article proposed a three-step approach. National Association of German Co-operative Banks (BVR) represents a network of around 670 independent cooperative banks in Germany. Although these institutions have an average asset size of around EUR 1.5 billion, which is significantly smaller than Europe's largest banks, they remain collectively profitable. This refutes the argument that

success depends on large, consolidated entities. Co-operative banks meet the needs of their customers and continue to maintain branch networks where there is demand for physical banking services.

A single set of rules for all banks, regardless of size or structure, does not reflect diversity. The EU has made progress through initiatives such as the single market, single rulebook, single supervision and single resolution framework. However, these frameworks can conflict with the need to preserve diversity.

The proposal in the article has three main elements. The first is a moratorium on new regulation. The second is a holistic review of existing frameworks. The third is the development of a dual rulebook approach. Since the introduction of the single rulebook, it is estimated that one new regulatory measure has been adopted per day, and a significant piece of legislation, such as a Regulatory Technical Standard (RTS) or Implementing Technical Standard (ITS), has been adopted about every 10 days. Smaller banks struggle to keep up with this barrage of regulations.

Europe has undoubtedly made significant progress since the 2008 financial crisis, but inconsistencies have emerged. For example, there are inconsistencies between the Capital Requirements Regulation (CRR) and the European Commission's proposals on crisis management and deposit insurance (CMDI). The finalisation of Basel III, which is included in the EU's CRR III package, imposes unnecessary administrative burdens on smaller banks. BVR banks use the standardised approach to calculate RWA, and the finalisation of Basel III does not change the amount of RWA, it only adds to this administrative burden. Some positions would increase and some would decrease, but when netted the number remains the same, but nonetheless the change in approach has to be implemented. An Institutional Protection Scheme (IPS) is in place and is working well for the group of small, homogeneous banks, but they still have to put in place recovery plans. While this is beneficial, it represents a significant ongoing cost for institutions already covered by the IPS, so it is simply an additional burden.

A differentiated regulatory framework with two different sets of rules, one for large international banks and another for smaller institutions, would reflect practices

in other jurisdictions, such as the United States, Asia and the United Kingdom. The case of Silicon Valley Bank (SVB) is significantly different, as its size of USD 250 billion far exceeds the size of the banks in the BVR network. Post-Brexit, the UK is developing a 'strong but simple' framework for smaller banks.

2.5 A regulatory pause to reassess EU banking rule complexity and introduce a financing economy test

An industry representative suggested that given diversity is widely acknowledged to be beneficial, the European Central Bank (ECB) and European public authorities should actively encourage it rather than maintain a position of neutrality with respect to business models. The SSM has been a major success over the past decade, but adaptation may be necessary given its increasing complexity over that period, with many hundreds of regulations published. There should be a shift toward a simpler rulebook, as already requested by co-operative banks and the Federation of Banks. Central bank governors of several large European countries also call for a pause in regulation to allow for reassessment. A less-for-more approach, or a stop and reassessment of regulation, should be utilised.

There is a shared interest, between public authorities and banks, in maintaining financial system solidity. Public authorities want banks to be resilient. A weak economy undermines the possibility of resilience. Therefore, any new regulation should be tested for its potential impact on the common goal of financing European economies, ensuring it does not hinder economic growth.

The Chair acknowledged the consensus on the essential nature of diversity within Europe. Supervisory practice and regulation should be distinguished: the SSM focuses on implementing existing regulations rather than creating them, as regulatory changes require action by institutions such as the EBA or in Brussels. Major ongoing events are creating significant challenges for Europe. Despite being well-prepared for various crises, continuous improvement of the system remains vital - a goal to which the discussion has contributed.