6. EU FINANCIAL SECTOR: COMPETITIVENESS, SIMPLICITY, DEREGULATION?

Santiago Fernández de Lis
Head of Regulation, BBVA

"Everything should be made as simple as possible, but not simpler".
(Albert Einstein)

1. INTRODUCTION

Financial regulation follows long cycles that are mostly explained by financial crises and their impact on the policy-makers' balance between efficiency and financial stability goals. The 1929 crisis triggered a regulatory tightening that lasted until the 1970s, when a deregulation trend started, culminating in (and arguably contributing to) the global financial crisis of the late 2000s. We are now in a regulatory tightening phase that has lasted more than 15 years. Some voices are already calling for deregulation, arguing that the balance moved too far in the direction of financial stability, at the cost of reducing efficiency in the financial sector and limiting its contribution to economic growth and its ability to innovate. As a side effect of the regulatory tightening we observed a rechannelling of financial flows to non-bank financial intermediaries, including some segments that are little or not regulated at all, such as cryptoassets. It remains unclear whether, when and where a new trend in the direction of deregulation will materialize.

In this context, the second Trump presidency and the watering down and delay in the implementation of Basel III in the UK and the US (where it might even not be adopted) has triggered a debate in the EU on the desirability of a regulatory pause, simplification or correction. The Draghi and Letta reports have contributed to this debate, fueled by the awareness of the subdued economic performance of the EU as compared to the US, also reflected in much worse results in the Stock Exchange over recent years, including in banks' market value.

This article addresses several related questions: Is it time for a deregulation cycle, or for a regulatory pause or simplification? Where is it more likely to materialize? What are the implications for international regulatory coordination and the Basel standard setting process? Is excess regulation behind the worse performance of the EU economy, Stock Exchange and financial sector as compared to the US or are there other reasons? Is regulation to blame for the lack of digital champions in Europe? To the extent that regulation explains, at least partly, the European underperformance, what can be done to correct it?

The main conclusions are as follows: (i) fragmentation of the theoretical single market is probably the most important factor in explaining EU banks underperformance as compared to US banks, together with environmental and structural factors, but regulation is also playing a role; (ii) the EU regulatory activism (especially in new fields) is mainly attributable to the EU Commission desire to avoid inconsistent national regulations; (iii) the restrictive bias of EU regulations is mainly a result of the recent proliferation of new regulatory and supervisory agencies with narrow mandates that compete among themselves (and also with some pre-existing national agencies) in terms of orthodoxy, thus creating uncertainty on the part of financial institutions; (iv) the EU would benefit from an explicit inclusion of competitiveness objectives in the mandates of some agencies, in particular the Single Supervision Mechanism (SSM), in line with the recent UK reform, and from a strengthened accountability of the agencies; (v) the simplification exercise initiated in the EU should be ambitious and go beyond the current focus on the climate change area and simplification of SMEs reporting; (vi) the impact analysis of regulations should be strengthened, putting more clearly the burden of the proof on the need to regulate. Some specific recommendations and lines for action are included in the final section.

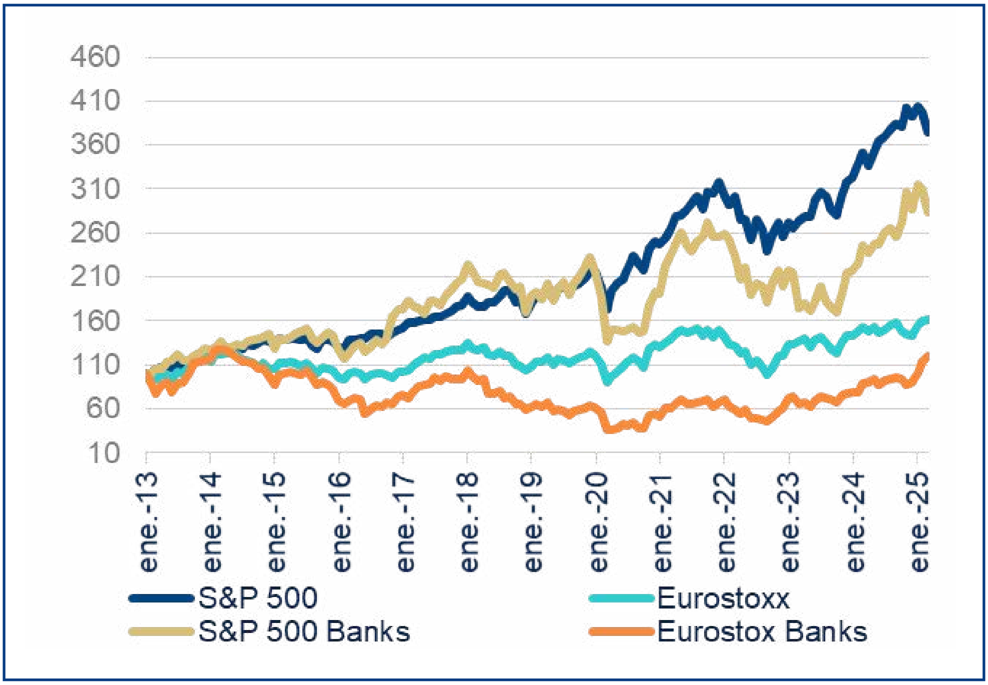
2. DOES REGULATION EXPLAIN THE UNDERPERFORMANCE OF EU VS US BANKS?

The EU Stock Exchange has underperformed US markets over the last decade, as can be seen in chart 1. The EU banking sector also underperformed its US counterparts over recent years, which almost doubled the results of EU banks in local currency and more than doubled it in US dollar terms.

Some private sector stakeholders have argued that the EU banks' underperformance is mostly related to an excessive regulatory burden[1]. This was recently acknowledged by the Governors of the central banks of Germany, France, Italy and Spain in a letter to the President of the European Commission. According to this view, there is a perception that the EU may be imposing stricter requirements than those established by international standards or applied by other jurisdictions. This perception has been reinforced by the recent debate surrounding the finalization of Basel III, already approved in the EU but considerably relaxed and postponed in the UK, and which appears to be moving in a similar direction in the US, where it might not be implemented at all following Trump's election.

[1] See for example https://www.eacb.coop/en/studies/eacb-studies/less-is-more.html

Chart 1: Stock Exchange indices in US and the EU: overall and banks.



Source: Bloomberg.

However, this contrasts with the fact that the Basel Committee considers the EU "materially non-compliant" with risk-based capital standards, whereas the U.S. is considered (so far) "largely compliant". It is important to take into account that the Basel agreement is limited to internationally active banks, with the implication that Basel overlooks the fact that the US applies the standards only to a handful of big banks with overseas operations, whereas the EU applies them to all banks. In fact, the crisis of some U.S. regional banks in the spring of 2023 has been largely attributed to more lenient regulation and, above all, supervision of medium and smaller entities, which fall outside the scope of international standards.

Overall, financial regulation in the EU is harsher than in the US in some aspects but looser in others:

- In the field of prudential regulation, the US follows a much stricter policy for Global Systemically Important Banks (GSIBs), but it is significantly looser for the rest of banks, in application of the principle of proportionality, whereas in the EU most regulations apply to all types of institutions, big and small. US banks benefit from lower minimum regulatory capital ratio requirements as a result of a simpler capital buffer structure. Both US and EU systemic banks are subject to GSIBs buffers. But on top of that US banks have only stress capital buffers, whereas EU banks are subjected to O-SIIs buffers (for domestic systemic banks), systemic risk buffers, countercyclical buffers and pillar 2 buffers. EU banks are also subjected to Minimum Required Eligible Liabilities (MREL) whereas in the US loss-absorbing debt is absent, except for GSIBs (in the form of Total Loss Absorbing Capacity, TLAC, which also affects EU GSIBs).

- European banks benefit on average from a more risk sensitive and granular approach to calculate risk-weighted assets (RWA) due to the more intensive use of internal models, which leads to lower RWA density and consequently a lower leverage ratio and volume of capital in absolute value for a given size. This has been partly corrected by the introduction of the output floor in the recent finalization of Basel III, which will be introduced gradually in forthcoming years. There is scope of the EU to move further towards the of the standard approach in the calculation of RWAs.
- Regarding consumer protection, in the US it depends crucially on who runs the Consumer Financial Protection Bureau (CFPB). Democrat administrations typically appoint stricter Directors whereas Republican administrations appoint Directors that are less aggressive in their policies[2]. In the EU consumer protection is mostly a national (or even regional) competence, although some directives harmonize certain aspects at EU level. The swings in the US administration and the heterogeneity in the EU make it difficult therefore to compare US and EU regulations in this field.
- The US has a harsher regulation on anti-discrimination & fair lending (although this may change with the Trump-2 administration) as well as on consumer redress (with the possibility of class actions).
- In the area of payments, the EU regulations on PSD-2 and Open Banking were more pro-consumers than in the US, and are now in the process of additional tightening with PSR and FiDA, respectively. In the US the attempts to introduce Open Banking regulations have not succeeded so far.
- Privacy laws are stricter in the EU with the General Data Protection Regulation (GDPR), although it is not specific to the financial sector. The same can be said as regards Artificial Intelligence, with the AI Act.
- On cybersecurity and operational resilience, the EU regulation (DORA) is stricter.
- On Anti Money Laundering (AML) the EU regulation has been reinforced with the 6th Anti-Money Laundering Directive (6AMLD) and the new Authority (AMLA) that is creating a more unified EU framework. The US Bank Secrecy Act (BSA) and PATRIOT Act have strong enforcement, but the fragmented structure sometimes reduces effectiveness.

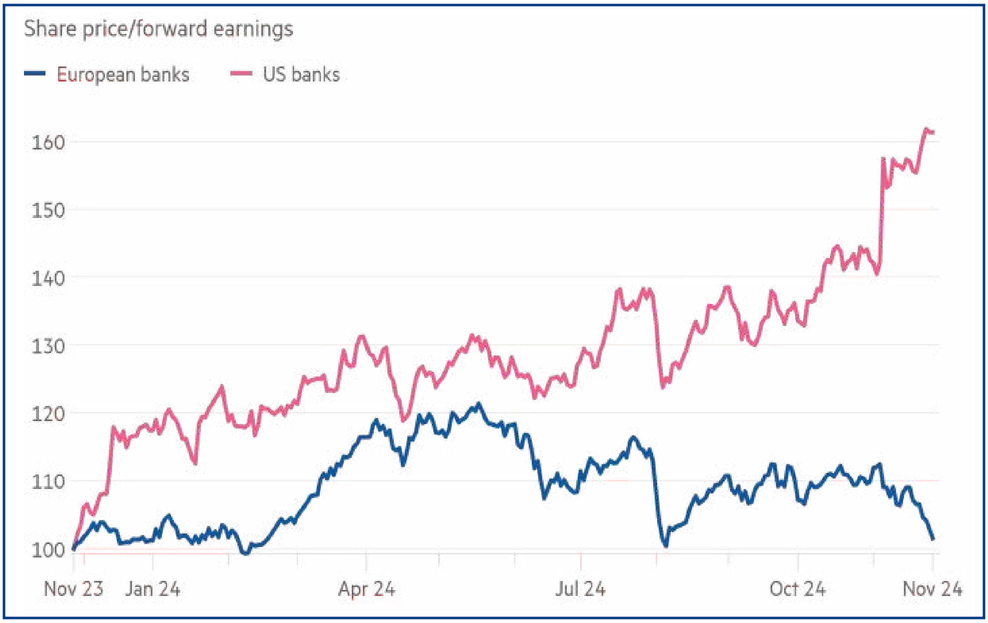
One may conclude from the above that, although there is not a clear-cut pattern as regards the degree of tightness of financial regulation across both sides of the Atlantic, overall the EU regime is probably harsher. But this does not imply that regulation is the

[2] On February 11, 2025, President Trump appointed Jonathan McKernan as Director of the CFPB, who is expected to significantly reduce the activity of the institution and soften its policies.

main reason for the worse market performance of EU banks in the Stock Exchange. Other factors considered together seem more important:

- The macroeconomic environment, with higher growth and interest rates in the US, is probably a key factor. When comparing Price to forward Earnings ratios, US banks clearly outperformed EU banks systematically in the recent period (see chart 2). This suggests that the markets expect this outperformance to be maintained in the future.

Chart 2: The valuation gap between US and European banks has widened.



Source: Bloomberg.

- Fragmentation is a key factor. The EU is a very fragmented market, with an unfinished banking union and banks that remain largely national. In the US, although there is some state level segmentation for smaller banks, the big players have a US-wide dimension. In the list of the ten biggest banks in the world by market capitalization there are no EU banks and five US banks.
- Regarding the business model, US banks have a larger turnover of their loan portfolio, with a lower dependence on retail mortgages, and a higher deposits' base and less proportion of debt securities. US banks' net interest income is driven by higher asset yield and lower funding costs than Eurozone banks.
- Partly as a result of the faster turnover of their balance sheet, NPLs are structurally lower in the US than in Europe. The US clean-up process of NPLs is faster. The Cost of Risk is more volatile in the US.
- Overall, efficiency is worse in Eurozone banks than in the US. The lower weight

of operating expenses as a percentage of total assets in Europe is more than offset by the lower capacity to generate revenues in the EU[3].

- Public sector support also favors US banks, in particular in the mortgage market. The Government Sponsored Agencies, Fannie Mae and Freddie Mac, allow the transfer of US banks mortgage lending risk, freeing up their balance sheet and using the proceeds to fund new mortgages. In contrast, in the EU state aid rules are very strict, as a mechanism to ensure a level playing field in the (theoretical) single market. A paradoxical outcome of this is that securitizations in the US have managed to overcome the stigma of being the origin of the 2007-08 Global Financial Crisis, whereas in the EU (where the problems with this market were comparatively minor) the same international standards almost killed the securitizations market, despite the efforts of several subsequent regulatory reforms.

All in all, it seems clear that the better behavior of US banks in the Stock Exchange is explained mostly by environmental and structural factors rather than regulation, although regulation may be playing a role as well. Furthermore, there are certain features in the EU regulatory framework that may introduce a restrictive bias, as will be explained in section 3 below.

3. THE RESTRICTIVE BIAS OF EUROPEAN REGULATION

The Global Financial Crisis revealed profound failures in financial regulation and supervision and led to a reassessment of the regulatory architecture in the EU. At the same time, one of the solutions to the crisis —the Banking Union— required the creation of new institutions at the European level that overlapped to a certain extent with national agencies (none of which was discontinued, to my knowledge). To avoid the conflicts of interest of regulators having multiple objectives, the trend was to set up agencies with a single clear task: microprudential, macroprudential, conduct, resolution, consumer protection, payment systems, lending in resolution, deposit insurance… This proliferation of institutions, duplicated at EU and national level (and in some cases also at the Eurozone level), is making the EU regulatory architecture increasingly complex.

These new institutions are still in the process of establishing their credentials and scope of action: the European Banking Authority (EBA), which develops secondary regulation and ensures its consistent application; the Single Supervisory Mechanism (SSM), which directly supervises significant entities; the Single Resolution Mechanism (SRM), which ensures that larger entities have adequate resolution mechanisms; the European Systemic Risk Board (ESRB), which harmonizes macroprudential policies, are some of the institutions created in the last 15 years. This proliferation complicates

[3] See Resti et al (2025): How have European banks developed along different dimensions of international competitiveness? https://www.europarl.europa.eu/RegData/etudes/IDAN/2025/764380/ECTI_IDA(2025)764380_EN.pdf

coordination, especially in crisis resolution, and may lead to stricter application of standards, as these new authorities seek to establish their roles and scope of action. And probably more importantly, the lack of track record of these new institutions creates uncertainty on the part of financial institutions, which do not have a benchmark for their policies and therefore react also in a conservative way in their internal control policies, to avoid rule breaching.

The European Supervisory Authorities (ESAs), such as the EBA or the European Securities and Markets Authority (ESMA), have been developing level 2 regulations in recent years, which develop technical aspects of EU Regulations. They also develop level 3 regulations through Q&A processes to clarify their application. As this regulation gains prominence, this may also introduce a restrictive bias, partly because the experts drafting level 2 and 3 regulations tend to be those who negotiated and agreed the international standards in the first place, and may have a natural inclination toward a more orthodox interpretation than the legislators who drafted the level 1 regulations.

Another source of complication is the coexistence of institutions at the Eurozone and EU levels, in particular the SSM vs EBA. This implies that level 2 regulation is developed by an institution which is not the supervisor, contrary to what happens in the US or the UK, where both functions coincide in the same institution. The EBA is a relatively small institution that coordinates policies of supervisors that include a giant agency (the SSM) under the umbrella of the ECB, which is probably the most independent central bank in the world. In normal circumstances the regulatory role of the EBA should have been carried out by the SSM/ECB (in analogy with the UK and the US), but the peculiar configuration of the Eurozone (which does not include all EU members) explains this duplicity. The implications of this situation for democratic accountability will be discussed in section 6.

All the above-mentioned factors may introduce a conservative bias in EU financial regulation. Additionally, the absence of a common fiscal capacity in the EU, combined with strict regulation limiting state aid, means that some segments of the financial system lack public guarantees as in the U.S., with the result that similar regulations can have harsher effects in the EU due to the absence of public support. The above-mentioned case of Fannie and Freddie support to US securitizations is paradigmatic. Another example is the absence in Europe of a liquidity mechanism for resolution, which makes crisis management more rigid and potentially costly, and could trigger bank runs, undermining depositor confidence.

4. DIGITAL REGULATION: A BRAKE ON INNOVATION?

As mentioned above, the European Union tends to be a first mover in regulating new industries, new risks, or new technologies, particularly in the digital field. The General Data Protection Regulation (GDPR) adopted in 2016 set standards for privacy protection that later became a global benchmark imitated in many jurisdictions. The Digital Markets Act (DMA) and the Digital Services Act (DSA), both adopted in 2022, were also pioneers in regulating BigTech activities and their implications for competition. The EU was also the first major jurisdiction to regulate crypto assets in 2023 (through the Markets in Crypto Assets regulation, MiCA), and Artificial Intelligence in 2024.

One reason for the EU Commission to act relatively early in regulating new areas is to avoid a proliferation of potentially inconsistent national regulations. In this regard, the EU would benefit from greater clarity "ex ante" in the delimitation of national vs. EU competences in regulation, which is particularly complicated when applied to new fields like digital identity.

The EU regulatory process is slow and lengthy. On average it takes between 4 and 5 years from the initial proposal to implementation. Some recent examples are MiFID (6.5 years), DORA (4.5 years), MiCA (4 years) or PSD2 (4.5 years). In the digital field these delays imply that by the time the new regulation is applied the underlying reality has changed and often requires a new twist in regulation or refinements in level 2 and 3 legislations.

At the same time, there is concern about the lack of European digital champions compared to the impressive emergence of BigTechs in the US and China. The coincidence of these trends has led to suggestions that the underdevelopment of BigTechs in Europe may be due to excessive or premature regulation. More broadly, beyond the digital field, excessive regulation has often been blamed for the lack of dynamism in the EU economy compared to the "laissez-faire" approach of the US, especially in areas where innovation is a key component of success.

According to recent literature[4], it remains unclear whether excessive regulation penalizes digital EU firms. Other factors seem to play a more prominent role in explaining the lack of digital champions, such as fragmentation of the internal market, underdeveloped capital markets (especially for start-ups), punitive bankruptcy laws and restrictive immigration regulations, which limit talent attraction. Regarding the failure in the scaling-up of start-ups, labor market regulation setting relatively high severance payments is often also mentioned as a limiting factor. If the ratio of success of start-ups is between 10-20%, the temporary hiring of employees is incompatible with strong severance payments in case of failure. In other words, over-protective labor market regulation in the EU is incompatible with a strong innovative ecosystem[5].

Instead of Europe lagging in digital champions because of excessive regulation, the causality may well run the opposite way: the fact that the EU has fewer Bigtechs may explain its more restrictive regulation and antitrust policies in the digital field, since consumer protection is given a more prominent profile vis-à-vis foreign digital champions.

As a positive aspect of the European rush to regulate anything new, it has been argued that it is helping Europe to become a global standard setter, which favors Euro-

[4] Anu Bradford (2024): "The False Choice Between Digital Regulation and Innovation" (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4753107)

[5] Olivier Coste (2022): "Europe, Tech and War", https://www.amazon.com/Europe-Tech-War-Oliver-Coste/dp/B0BN2CZCHL

pean firms when competing abroad, because they play with home rules (the so-called "Brussels effect"). This might be true, but it depends crucially on whether foreign regulators adopt EU standards or develop more lenient local rules. In the field of banking, for instance, there is certain evidence that EU banks, being under EU laws in their activities overseas because of consolidated regulation and supervision, compete with stricter rules than their local competitors in many emerging economies, in what we may call "self-defeating extraterritoriality".

In the field of financial services, the asymmetry of EU data sharing regulation like Open Banking and more recently Open Finance (under discussion in the Financial Data Access Regulation, FiDA) implies a competitive disadvantage for banks, in the sense that specific financial sector regulations impose more demanding data sharing rules vis-à-vis non-financial players than horizontal regulations affecting all sectors. This approach penalizes EU banks vs non-EU Bigtechs. This is probably an unintended consequence of policies aimed at enhancing competition in the financial sector. The implementation of the Digital Markets Act, DMA, which develops rules for data sharing for gatekeepers, may attenuate this asymmetry.[6]

In the new regulatory frontier on Artificial Intelligence, the AI Act imposes more demanding requirements on AI systems in order to mitigate potential negative impacts in citizens' health, security and fundamental rights, reflecting also the EU concern with privacy and intellectual property protection. Although the AI Act approach is in line with European values, its interaction with previous regulations like GDPR complicates the use of AI in many fields and is leading some of the main AI players like Meta and Apple to declare that they will not deploy global AI systems in the EU, or will delay their implementation. The underlying problems point to GDPR requirements like the limit in the consent on the use of data by consumers to one specific purpose, or the data minimization principle, which are incompatible with the nature of AI systems. This restriction in the adoption of new technologies in the EU (which anyway has very little domestic capacity to develop such systems) may put EU companies and consumers at a disadvantage in the global context.

In the field of cryptoassets, the development of EU regulation (MiCA) in parallel to the work of global standard setters may consolidate the backwardness of the EU compared to the US. In contrast with previous examples, this may reflect a deliberate policy choice of regulation, given the mistrust of EU regulators towards cryptoassets.

To sum-up: although the lack of Bigtech champions in the EU cannot be attributed exclusively (not even mainly) to the impact of regulation, it may be a limiting factor. And in recent regulations concerning what is arguably the most important transformation in the world economy in recent years (AI), the combination of well-intended regulations with very strict privacy rules may leave Europe outside crucial forthcoming transformations.

---

[6] See Fernandez de Lis (2024): "European leadership in digital finance regulation: Pros and cons", in Duckbucks, Regulation in the age of digital finance, September 2024. www.duckbucks.com

5. COMPETITIVENESS, SIMPLIFICATION, DEREGULATION

The Draghi Report on European Competitiveness underscored the need for financial sector reforms, advocating for regulatory simplification and enabling mergers to foster dynamism. However, as I analyzed in a previous article[7], a stark contrast emerges between this vision and the stance of the ECB's Supervisory Board Chair, Claudia Buch, who, around the same time of the publication of the Draghi report, stated in the European Parliament that the SSM's mandate is strictly financial stability, not competitiveness. This divergence is further highlighted by Commission President Ursula von der Leyen's mission letter to the new Financial Services Commissioner, María Luisa Albuquerque, emphasizing competitiveness and sustainable finance as core priorities.

The UK's recent financial reforms, particularly the Financial Services and Markets Act 2023, explicitly integrates competitiveness into regulatory objectives. Section 3(2)(e) states that regulatory actions should "facilitate the international competitiveness of the UK economy and its medium- to long-term growth." Applying this new approach, Rachel Reeves, the Labor Chancellor of the Exchequer, noted in her first Mansion House speech that "these changes [the reform following the global financial crisis] have resulted in a system that sought to eliminate risk-taking. That has gone too far... the UK has been regulating for risk, but not for growth... We have sent letters on their growth-focused tasks to the Financial Conduct Authority (FCA), the Prudential Regulation Authority (PRA), the Monetary Policy Committee (MPC), the Financial Policy Committee (FPC), and the Payment Systems Regulator (PSR). These letters make clear that I expect them to fully support this government's ambitions for economic growth". Around the same time the Chancellor forced out the Chair of the competition authority (CMA) on the grounds that she wants pro-business decisions to drive prosperity and growth, and appointed a former BigTech executive as new Chair. And in another move to simplify the regulatory framework, the UK decided to include the Payments System Regulator under the FCA.

In the aftermath of the Draghi and Letta reports, the debate on whether and how to incorporate objectives in terms of competitiveness or growth in EU financial regulation has gained momentum, triggered also by the delay and watering down of the finalization of Basel III in the UK and the US. The Trump presidency also appointed Elon Musk for a special agency in charge of deregulation: the Department of Government Efficiency (DOGE). In the EU deregulation seems to be a bad word, but the EU Commission has put forward a Competitiveness Compass[8] and announced a simplification of regulation focusing initially on sustainability (where an Omnibus Directive has been presented), but that could (and should) also reach other files.

---

[7] Fernández de Lis, Santiago (2024): Competitiveness as an Objective of EU Financial Regulation, The International Banker, November 27, 2024.
https://internationalbanker.com/tag/santiago-fernandez-de-lis/

[8] EU Commission: A Competitiveness Compass for the EU, 29.1.2025
https://commission.europa.eu/document/download/10017eb1-4722-4333-add2-e0ed18105a34_en

The Competitiveness Compass elaborates on the three transformational imperatives to boost competitiveness identified in the Draghi report: (i) innovation, (ii) decarbonisation and (iii) strategic autonomy and security. In a characteristic European approach to deregulation and simplicity, instead of eliminating regulations currently in the pipeline whose need is not obvious (like FiDA en the Retail Investment Strategy, RIS), the Compass envisages 11 Acts and numerous strategies, initiatives, guidelines, plans, packages, frameworks… Among the potentially most powerful ideas is the 28th regime, a new streamlined EU-wide regime for innovative companies covering labor, bankruptcy and tax rules. It remains unclear whether Member States will support this proposal. A related proposal is the Competitiveness Lab, a procedure suggested by the Spanish government that allows a sub-group of EU countries to go ahead in terms of integration, to which other Member States may join in a future stage. However, some Member States, especially small ones, have criticized this two-speeds approach, and it is difficult to assess whether it may gather sufficient support. Another criticism is that the Compass focus on 'scaling up' start-ups risks worsening the threshold effects that keep European firms small.[9]

Shortly after the publication of the Compass the Commission made public the Omnibus initiative, focused on sustainability, with amendment proposals to several pieces of legislation. The Corporate Sustainability Due Diligence Directive (CSDDD) is postponed one year and the review clause for financial institutions is eliminated. The transition plans requirements are aligned with the Corporate Sustainability Reporting Directive (CSRD), which in its turn reduces by 80% the scope of companies covered, and a future revision to reduce data points is foreseen. A consultation was open regarding the taxonomy regulation, where the definition of Do Not Significant Harm (DNSH) and the reporting templates are simplified, but the Green Asset Ratio (GAR), which was the main concern of the financial industry, is not eliminated. These changes are not definitive and the process may be long, since the proposal will now enter a negotiation process.

Simplification is becoming a buzzword in EU regulatory debates. But complexity is to a certain extent embedded in EU Multi-Layered Governance System, which needs detailed and binding rules to prevent regulatory arbitrage inside the Single Market (see table 1 for a ChatGPT summary of the reasons why Europe regulates so much). The EU legislative process involves multiple layers of rule-making, interpretation, and enforcement (Level 1, Level 2 and Level 3 regulation, plus supervision) which implies that regulatory adaptation becomes a continuous process rather than a one-time compliance effort.

In the exercise of simplifying EU regulation there are a series of trade-offs that it would be better to avoid:

- Less European regulation should not be achieved in exchange for more national regulation. The simplification exercise should be done without creating addi-

[9] For a critical view of the Competitiveness Compass see Garicano and Garicano (2025): 20 thoughts on the Competitiveness Compass,
https://www.siliconcontinent.com/p/20-thoughts-on-the-competitiveness

tional fragmentation in the single market. Indeed, the simplification exercise perhaps requires reducing regulation mostly at the national level.

- Less Level 1 regulation should not lead to more Level 2 regulation. Broadening the scope of independent agencies without strengthening their accountability and clarifying the overlaps in their mandates risks increasing (instead of reducing) complexity (see section 6).
- For similar reasons, less regulation in exchange for more supervision does not look like the best approach. Supervision is probably the source of the most restrictive interpretations of the regulation. Extending their scope of action would reduce the predictability of the regulation and exacerbate the uncertainty under which EU banks operate.

Part of the problem of the simplification process in the EU is that the institution in charge of carrying it out (the European Commission) is a bureaucracy created to regulate and whose main purpose is to develop rules that ensure the level playing field in the single market. The Commission needs to run against its instincts in simplifying regulation.

Table 1. 10 reasons why Europe regulates so much.

1. Historical Experience with Crises
2. The European Model of Social Market Economy
3. Fragmented Political Landscape & the EU's Need for Harmonization
4. Precautionary Principle
5. Strong Public Support for Regulation
6. Influence of the European Parliament & Bureaucracy
7. Geopolitical and Economic Competitiveness Strategies
8. Legal Traditions Favoring Rules Over Market Solutions
9. Risk Aversion & Stability Prioritization
10. Digital & Financial Sector Oversight

Source: ChatGPT

6. THE OBJECTIVE(S) OF INDEPENDENT AGENCIES AND DEMOCRATIC ACCOUNTABILITY

The scope for simplification of regulation is closely related to the regulatory architecture, the role played by different stakeholders and the dividing line between regulation and supervision. The ideal scheme should be based on (i) high-level international standards, (ii) principles - based regulation (level 1) and (iii) more technical and detailed regulation and supervision in charge of independent agencies (level 2) with appropriate accountability.

Over recent years international standards have become increasingly detailed, but their enforcement is increasingly weaker, which suggests a certain inconsistency in the whole process. We should move towards less detailed standards and reinforce their application through peer reviews and similar exercises. To facilitate the operation of international banks, regulation should avoid extraterritoriality and rely more on equivalence and substituted compliance.[10]

Regarding the balance between level 1 and level 2 legislation, it is important to ensure that banking regulation is in accordance with legislators' objectives and at the same time based on sound technical analyses, which requires a clear mandate to the agencies and accountability on their part. This is more or less the UK model (reinforced after the 2023 reform) and was the US model before the Trump 2.0 Presidency, which has put into question the independence of the agencies.

Accountability is very limited in the EU, in particular in the supervisory field. The SSM has inherited the independence of the ECB, in what is probably an excessive interpretation of the Treaty. The rationale for the ECB independence is clear in the monetary policy domain, to avoid decisions based on short-term political objectives (for instance, a reduction in interest rates to stimulate growth and favor the reelection of an incumbent government) that may undermine the long-term objective of price stability (the so-called time inconsistency problem). But the rationale of extending this independence to the banking supervision field is not obvious.

This debate is related to the coexistence of multiple objectives in an independent institution. Accountability is easier with agencies that have a single objective. But over recent years the ECB has expanded its array of objectives to include, on top of price stability, banking supervision, payment systems efficiency or contributing to climate change objectives, to name a few. At the same time, other institutions have been created with narrow mandates (like the SRB in the area of resolution, AMLA in money laundering or the ESRB in macroprudential policies) that tend to overlap with that of the ECB.

To sum up, in Europe we have a weak government (as compared to Member States), a weak parliament (as compared to national parliaments), a strong bureaucracy tasked with developing regulation as its main purpose (the Commission), a very powerful in-

[10] See Fernández de Lis, S. (2017): Towards More Selective and Enforceable International Regulatory Standards, International Banker, December 11, 2017. https://internationalbanker.com/banking/towards-selective-enforceable-international-regulatory-standards/

dependent supervisor (the ECB/SSM) and a series of new regulatory agencies with narrow mandates and very limited accountability, focused on only partial objectives, without a broader picture. These new institutions tend to defend their territory by being more orthodox than the other agencies. It is not surprising that we overregulate, and it is certainly challenging to instill regulatory simplification in this architecture, a review of which should be a priority.

7. STRENGTHENING THE IMPACT ANALYSIS OF REGULATIONS

The EU carries out Impact Analysis (AI) of its regulation that scrutinizes legislative and non-legislative initiatives, delegated acts and implementing measures, with significant economic, environmental or social impacts. It was recently reviewed in the Better Regulation Communication of 2021. It comprises several steps: (i) problem definition and objective setting; (ii) identification of policy options; (iii) elaboration of an impact assessment report; and (iv) check by the Regulatory Scrutiny Board (RSB).

Impact Assessments must serve as honest evaluative mechanisms, identifying flaws and areas for improvement, to determine if a legislative proposal is the best policy option to achieve the intended objectives. The current process looks rather as a mechanism to confirm the appropriateness of the Commission's initiatives, as illustrated by the low and decreasing number of withdrawn or rejected Commission proposals. A negative IA should have the ability to halt proposals that have been deemed unnecessary.

The current static IA process, which focuses only on the pre-legislative stage, must be enhanced with dynamic IAs that incorporate systematic ex-post evaluations. This would ensure continuous monitoring and adjustment of policies based on real-world impacts and stakeholder feedback during the legislative process as well as after the legislation has been implemented. These should then lead to changes in the legislation themselves.

The IA process should prioritize competitiveness checks to ensure that new policies do not inadvertently harm economic growth or the competitiveness stance of EU companies. These checks must go beyond mere formalities and should be weighted significantly in the evaluation process and avoid "tick the box" exercises.

The current governance mechanisms, such as the Regulatory Scrutiny Board (RSB), need to be more effective. The absence of a significant number of final negative opinions from the RSB raises concerns about its ability to effectively evaluate the quality of IAs. Elevating the authority of the RSB by making its opinions binding would ensure higher quality and accountability in IAs before advancing the legislative proposals. Additionally, the composition of the RSB should include more external experts to objectively evaluate the IAs. Introducing stricter oversight measures and strengthening the RSB governance could improve the credibility and robustness of the IA process.

Other ideas that can be explored to improve the IA process are the following: broadening IA analyses to include factors like competitiveness, simplicity, cross-sectoral impacts, and broader economic implications, not just compliance costs; explaining more clearly IA methodologies, including assumptions, data used and calculations, to allow industry stakeholders to replicate and validate findings; include third-country impacts on the subsidiaries of EU companies, especially for industries like banking, where global competitiveness is critical; extend IAs to critical level 2 regulations and national transpositions, to ensure more clarity and predictability in implementation and less fragmentation; and improving industry data collection to ensure IAs are based on accurate, real-world inputs.

8. CONCLUSIONS AND SPECIFIC PROPOSALS

The European financial regulatory framework has grown increasingly complex, raising concerns about its impact on bank competitiveness. This note outlines a few proposals to streamline regulation, strengthen institutional accountability, and promote efficiency:

1. Clarify the scope of EU vs national competences.

- To avoid a rush to regulate when competences are unclear, it would be helpful to delineate more clearly ex ante the national vs EU competences, especially in the digital domain.

2. Embed Competitiveness into Regulatory Mandates.

- EBA and ESMA already include in their mandates the efficiency of the financial system, which is taken into account in their analyses of risks and vulnerabilities. There is no need to change these mandates, but perhaps reinforce the competitiveness/efficiency element in their impact analyses (see below)
- The SSM currently lacks a competitiveness goal and does not even consider it an implicit objective. A legislative "quick fix" could integrate efficiency/ competitiveness in the SSM mandate, mirroring the UK's 2023 reform.

3. Strengthen the SSM Accountability

The accountability of the SSM towards the European Parliament should be enhanced. The SSM should publish annual competitiveness or growth reports, detailing the impact of its policies on these objectives.

4. Create Better Avenues for Challenging SSM Decisions

- A senior-level dialogue between the industry and the SSM should help escalate technical issues that affect banks' competitiveness.
- The Administrative Board of Review (ABoR) should include independent experts, increase its transparency, and play a challenging role.

5. Reform the EBA Governance

- The EBA's board should include more independent members and less representation of national authorities. This would help making the consultation process of level 2 regulations more open.

- The European Commission should improve the oversight of EBA by assessing more systematically whether delegated acts stay within the legal mandates.

6. Enhance Impact Assessments

- Regulatory proposals should include evaluations focusing on economic and competitiveness impacts. Impact Assessments should be done also ex post (for instance 4-5 years after adoption), to ensure that the intended effects have been reached.
- The Regulatory Scrutiny Board of the Commission should include more independent experts.

7. Eliminate Redundant Authorities

- Every time an EU institution is created an analysis on whether the corresponding national authorities are still relevant should be carried out. The burden of proof should be on the need to maintain these national agencies.

8. Expand ESMA's Role

- In support of a deeper Savings and Investment Union (SIU), ESMA should supervise systemic market infrastructures and manage cross-border asset managers through harmonized oversight structures.

9. Simplify Capital Requirements

- Regulations like MREL should be simplified to reduce the compliance burden.
- The buffer structure of banks' capital requirements should be simplified, to avoid overlapping requirements decided by different authorities, with a special focus on the Systemic Risk Buffer, the Countercyclical Buffer and the Pillar 2 Buffers.
- EU banks should go further in the simplification of internal models, moving as a rule towards the standard model, as the US did a few years ago.