Why weakening prudential rules does not help the EU economy

Why aiming for EU competitiveness does not mean aiming for bank competitiveness?

It is essential to distinguish EU competitiveness from EU bank competitiveness. On one hand, EU competitiveness is defined by EU texts as an economy that sustains high productivity, supports innovation, and ensures robust public and private investment, all within the context of the single market, digital and green transitions, and strategic autonomy[1]. On the other, bank competitiveness is a relatively vague concept linked by the ECB to profit efficiency, i.e "a bank's ability to convert inputs (e.g., funding and staff costs) into output (income)"[2].

These definitions have the merit of showing there is no obvious connection between these two kinds of competitiveness, and that nothing guarantees that higher bank income would turn into higher financing for EU companies and to the mentioned EU priorities. As research commissioned by the EU Parliament underlines, "the collective market share of EU banks is not of straightforward public interest, it only matters to the extent it affects the sector's resilience and the availability of credit and financing to the EU economy"[3]. To say it differently, **policymakers can look at how the banking sector contributes to EU competitiveness but should not have the competitiveness and profitability of EU banks themselves for objective**.

In fact, aiming for bank competitiveness would mean policymakers deliberately favoring one economic sector over the others and could ultimately impair EU competitiveness. Indeed, **while Eurosystem central bankers repeatedly underline that "enhanced capital and liquidity requirements have allowed the European banking sector to weather successive stresses over the recent years"[4], the demands of the banking lobby to boost their competitiveness often aim at lowering these requirements**. This ignores the fact that "a resilient financial system is a prerequisite for a competitive European Union"[5].

Furthermore, **many of the most competitive economies (in the past and today) regulate their banks like public utilities**[6]**. These strong regulations keep long-term bank credit readily accessible at low-**

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[1] See: Eur-Lex glossary, "Competitiveness" / European Commission, "A Competitiveness Compass for the EU", January 2025

[2] See: ECB Working paper "Capital requirements: a pillar or a burden for bank competitiveness?" (2025).

[3] See Part 1.2.

[4] See the letter from the Bundesbank, Banque de France, Banco de Espana and Banca d'Italia to Commissioner Albuquerque.

[5] Ibid.

[6] See:

- Monnet, Eric. 2018. *Controlling Credit: Central Banking and the Planned Economy in Postwar France, 1948–1973*. Cambridge: Cambridge University Press.
- Mikheeva, Olga, and Josh Ryan-Collins. 2022. "Governing Finance to Support the Net-Zero Transition: Lessons from Successful Industrialisations."
- Bezemer, Dirk, Josh Ryan-Collins, Frank van Lerven, and Lu Zhang. 2023. "Credit Policy and the 'Debt Shift' in Advanced Economies." Socio-Economic Review.

cost for companies, households and governments and keep the banking sector simple and stable. If this also depresses banking profits, this means that the value is kept at the level of real economy actors. This points to the fact that **finance in itself is not productive, that financial services that generate profits without improving capital allocation or supporting real investment have developed (e.g high-frequency trading, speculative derivatives..), and that the growth of the financial sector can take up value from productive sectors**[7]. For example, a 2017 study estimated the financial system diverted $2.6-3.9 trillion from the US economy and generated $3.6-4.2 trillion in excess pay and profits from 1990 and 2005[8].

Why is the debate around the level of capital not the right one?

Lower capital requirements do not mean higher bank competitiveness. On the contrary, ECB analysis suggests that strengthening capital positions improves it for less capitalized banks, by reducing bank funding costs and the volatility of earnings[9]. Overall, evidence points to the fact that capital regulation supports both the stability and long-term competitiveness of the banking sector.

A literature review of existing studies shows the positive impact of capital regulation on financial stability and its large contribution to reducing potential losses[10]. If relaxing capital requirements can be expected to have a stimulative effect on lending in the short term, its medium and long-term impact is much more uncertain and carries considerable risks for banking supervision and financial stability. Furthermore, there is no evidence of credit scarcity in the EU and differences with the US are tied to more sustained credit demand[11]. As ECB Vice-President Luis de Guindos underlined, capital levels are not currently restricting lending[12].

In this context, **it is crucial that the EU separates the debate about complexity from that about levels of requirements, which some banking lobbyists tend to deliberately confuse**. **As research commissioned by the EU Parliament underlines, "now is not the time to water down capital and broader loss absorbency requirements – if anything, there would be a sound argument for ramping them up"**[13]. On the contrary: "any streamlining should aim at keeping the requirements at least at their current (fully loaded) level in aggregate, even though the impact of reform would inevitably be differentiated across individual banks"[14]. This view is largely echoed by Bundesbank head Joachim Nagel's perspective that clarifies that "simplification stands for a targeted reduction of unnecessary or perhaps even counterproductive complexity. In other words, we are striving to make regulation clearer, more understandable and more efficient – while continuing to safeguard the stability of the banking system"[15]. Similarly, ECB Vice-President Luis de Guindos underlines that simplification is possible without lowering capital levels and that indeed none of the measures envisioned by the ECB Taskforce on simplification implies this[16].

- Menand, Lev, and Morgan Ricks. "Rebuilding Banking Law: Banks as Public Utilities." Yale J. on Reg. 41 (2024): 591
- Duan, Kun, Plamen Ivanov, and Richard Werner. 2025. "Deciphering the Chinese Economic Miracle: The Resolution of an Age-Old Economists' Debate—and Its Central Role in Rapid Economic Development." Review of Political Economy 37 (1): 202–226.

[7] See: Christophers, Brett. "Making finance productive." Economy and Society 40, no. 1 (2011): 112-140
[8] See : Gerald Epstein, Juan Antonio MontecinoReport "Overcharged: The High Cost of High Finance" (2016)
[9] See: ECB Working paper "Capital requirements: a pillar or a burden for bank competitiveness?" (2025)
[10] See Part 1.4.
[11] See Part 3.3.2.
[12] Luis de Guindos, Interview with El Periódico, December 2025
[13] See Part 4.2.2.
[14] Ibid
[15] J. Nagel, "Banking regulation: as complex as necessary, as simple as possible", Bundesbank, 2025
[16] Luis de Guindos, Interview with El Periódico, December 2025

What does comparing EU and US banks really tell us?

Some advocate EU banks have low profitability – and thus a difficulty to compete – by comparing them to their US peers. However, **profitability is only one element of overall performance, which also involves other aspects such as risk taking, business model sustainability, and prudential regulation**. Furthermore, **they are major differences that make the EU-US comparison potentially misleading, leading ECB researchers to say that "US institutions are not necessarily a good benchmark for euro area banks" and that "the drivers of US banks' better financial performance [shouldn't] be taken as a "recipe for success" for euro area institutions"**[17]:

- The differing macroeconomic environments and financial systems in which banks.
- US banks operate in a more market-oriented financial system, in which non-bank financial intermediation and capital markets-based finance shape banking business strategies.
- Banking sector concentration is greater in the United States, which may allow the biggest banks to exert more pricing power.
- Larger US banks also seem to be more geographically diversified than the largest euro area banks.

Additionally, **a comparison of major US and EU banks (G-SIBs) conducted by the ECB shows differences in profitability are not related to banking regulation[18]. They rather originate from the characteristics of banks' activities themselves**, notably:

1. US banks benefit from much larger income from market activities (investment banking, trading...) that their EU counterparts[19].
2. US banks benefit from a higher rate environment, increased exposure to higher-yield loans, larger debt portfolios and a high reliance on deposits. Yet, larger loan portfolios from EU banks compensate for these advantages.
3. EU banks are still dealing with the burden of legacy nonperforming loans (NPLs) built up during the Great Financial Crisis (GFC) and the subsequent sovereign debt crisis, while the better quality of assets in US banks' portfolios resulted in structurally lower cost of risk.
4. Operating expenses have been significantly higher for US banks (higher staff remuneration and more sizeable IT investment), thus contributing to lower profitability than EU counterparts on paper but also allowing them to build up a competitive advantage.

Finally, it is worth noting that the global dominance of EU banks in terms of total assets ended due to the Great Finance Crisis (GFC). In fact, "EU banks' total assets, which had hovered around 40 percent of the global total pre-crisis, declined precipitously to about half that share after 2017, while the share of US banks remained about constant"[20]. This shows how weaker capital positions largely contributed to EU banks losing advantages compared to US peers.

Providing the above elements, pushing for more alignment with the US would ignore differing realities and would contribute to the accumulation of systemic risk, especially as the Trump administration choose to ignore essential work on financial risk[21].

[17] Luca Di Vito and al, "Understanding the profitability gap between euro area and US global systemically important banks", ECB (2025)
[18] Ibid
[19] The ECB notes that "non-interest income is the main driver of the excess profitability of US G-SIBs compared with EA G-SIBs". Major US banks dominate global investment banking activities, as they "seem to be able to leverage the expertise developed domestically" to outcompete European banks in global capital markets.
[20] See Part 2.2.
[21] See Part 4.1.2.

Why should simplification not extend to the limited measures adopted on climate-related risk?

As the ECB made abundantly clear in its last Supervisory priorities, **prudent management of climate and nature-related risks is essential to strenghten banks' resilience to geopolitical risk and macro-financial uncertainties**[22]. Beyond the EU, supervisors and central bankers have long insisted on the need to tackle climate-related risk[23] and stressed its potential systemic impact[24].

The relevance of these calls is becoming more and more evident as studies document the dire effects climate change is already having on our economies and societies[25], and the cost of climate-related events keeps rising[26]. Furthermore, each delay in climate action both increases the magnitude of physical impacts and the likelihood of a "last minute" transition, more brutal and where transition risk sharply materializes[27].

Worryingly, **supervisors are still underestimating the risk**. Their analysis cannot cope with the radical uncertainty that surrounds climate change and related risk[28]. On the contrary, they remain mostly based on past data that are inadequate to consider such risk, and they fail to account for tail risk – for example scenarios where climate tipping points are breached, and effects suddenly amplify[29]. At the same time, **supervisors are only starting to consider major potential risks[30] stemming from the depletion of nature and ecosystems** and have not imposed significant related requirements to banks. Both crises are likely to amplify each other[31], resulting in much higher losses than anticipated.

In fact, **banks have been implementing climate-related prudential obligations for the last five years, with their supervision proving to be a slow process with limited consequences for them.** Indeed, the ECB expected banks to apply its expectations published in 2020 by the end of 2024. From the 28 banks the ECB found to have made insufficient progress in March 2023[32], only one has been sanctioned by November 2025[33].

Banks have been complying with these requirements before the CSRD came into force, relying on preexisting disclosures from companies but also on data providers as well as their own internal analysis. Many of them went further than their regulatory obligations, by adopting climate strategies or "transition

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[22] See ECB Supervisory Priorities 2026-2028.
[23] Frank Elderson, "From charting the course to staying the course: the path ahead for climate and nature risk supervision", *ECB*, 2025
[24] Integrating climate-related risk is one of the main goal of the Network For Greening the Financial System (NGFS) created in 2017 to gather central bankers and supervisors. In 2020, the report *The green swan Central banking and financial stability in the age of climate change* published by the Bank of International Settlement (BIS) and Banque de France put the spothlight on the systemic dimension of climate risk.
[25] Richard S.J Tol, "A meta-analysis of the total economic impact of climate change", *Energy Policy*, 2024
[26] International Chamber of Commerce, *The economic cost of extreme weather events*, 2024 / Paige Benett, "Climate change is costing the world $16 million per hour: study", *World Economic Forum*, 2023
[27] Régis Gourdel and al, "The double materiality of climate physical and transition risks in the euro area", *Journal of Financial Stability*, 2024 / NGFS, Not to late – Confronting the growing odds of a late and disorderly transition, 2022
[28] Chenet and al, "Finance, climate-change and radical uncertainty: Towards a precautionary approach to financial policy", *Journal of Financial Stability*, 2021 / Thomas Laribe, *A prudent approach to climate risk*, Finance Watch, 2025
[29] Tom Strachan, "Climate Tipping Points Explained for Risk Professionals", *GARP*, 2025
[30] ECB, "Nature at risk: Implications for the euro area economy and financial stability", Occasional Paper, 2025
[31] OECD, *Environmental Outlook on the Triple Planetary Crisis*, 2025
[32] Frank Elderson, "Banks have made good progress in managing climate and nature risks – and must continue", *ECB*, 2025
[33] ECB, "ECB imposes periodic penalty payments on ABANCA for failing to sufficiently identify climate risks", 2025

plans" - albeit not credible in most cases[34] - laying out their commitments to climate mitigation and how they intend to meet them. Therefore, if the reduction of the weakening of CSRD will cancel most of the benefits the directive could have had for financial supervision[35], it is by no means an obstacle to fulfilling climate-related obligations.

In this context, any reduction in the level of ambition of climate provisions in CRR/CRD would jeopardize the slow progress achieved over the past years and impair the ability of EU supervisors to ensure financial stability in the era of climate change. Ultimately, **it could also harm banks' competitiveness**: higher resilience than counterparts – including from the US – are likely to make European banks more attractive to investors worried about the impact of climate change[36] and to enable them to capture climate opportunities[37].

What does reasonable prudential "simplification" look like?

First, as explained above, it is essential to note that simplification should not mean a reduction of capital levels or of recent prudential requirements aimed at tackling emerging risk, including those stemming from climate change.

As the ECB's proposal makes clear, simplification should strictly aim at clarifying prudential rules, without reducing the resilience of the system, and impairing its ability to face all sorts of financial risk[38]. For example, building on the ECB's proposal such a simplification could include:

- A reduction in the number of capital buffers and/or the integration of macro-prudential buffers at the level of the union;
- Ensuring that own funds requirements are satisfied solely through CET1, letting other forms of capital be used for additional fund requirements and avoiding overlaps;
- Propose limited adaptations for small banks, providing this does not reduce their ability to cope with risk, including climate-related risk;
- Increase the level of harmonization at several levels (supervisory practices, level 2 and 3..);
- Improve the data sharing infrastructure.

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[34] Reclaim Finance, *Bank transition plans: a roadmap to nowhere*, 2025
[35] ECB, *Opinion of the European Central Bank of 8 May 2025 on proposals for amendments to corporate sustainability reporting and due diligence requirements*, 2025
[36] Matt Mace, "Majority of asset owners view climate risk as a 'major concern'", *Edie*, 2025
[37] Frank Elderson, "From charting the course to staying the course: the path ahead for climate and nature risk supervision", *ECB*, 2025
[38] The ECB notably underlines that: "Resilience should be maintained – any proposal to change the EU prudential framework should sustain current levels of resilience" ; "Effectiveness in meeting prudential objectives needs to be maintained – microprudential, macroprudential and resolution authorities should be able to meet their respective objectives in an effective manner and capture all relevant dimensions of risk".