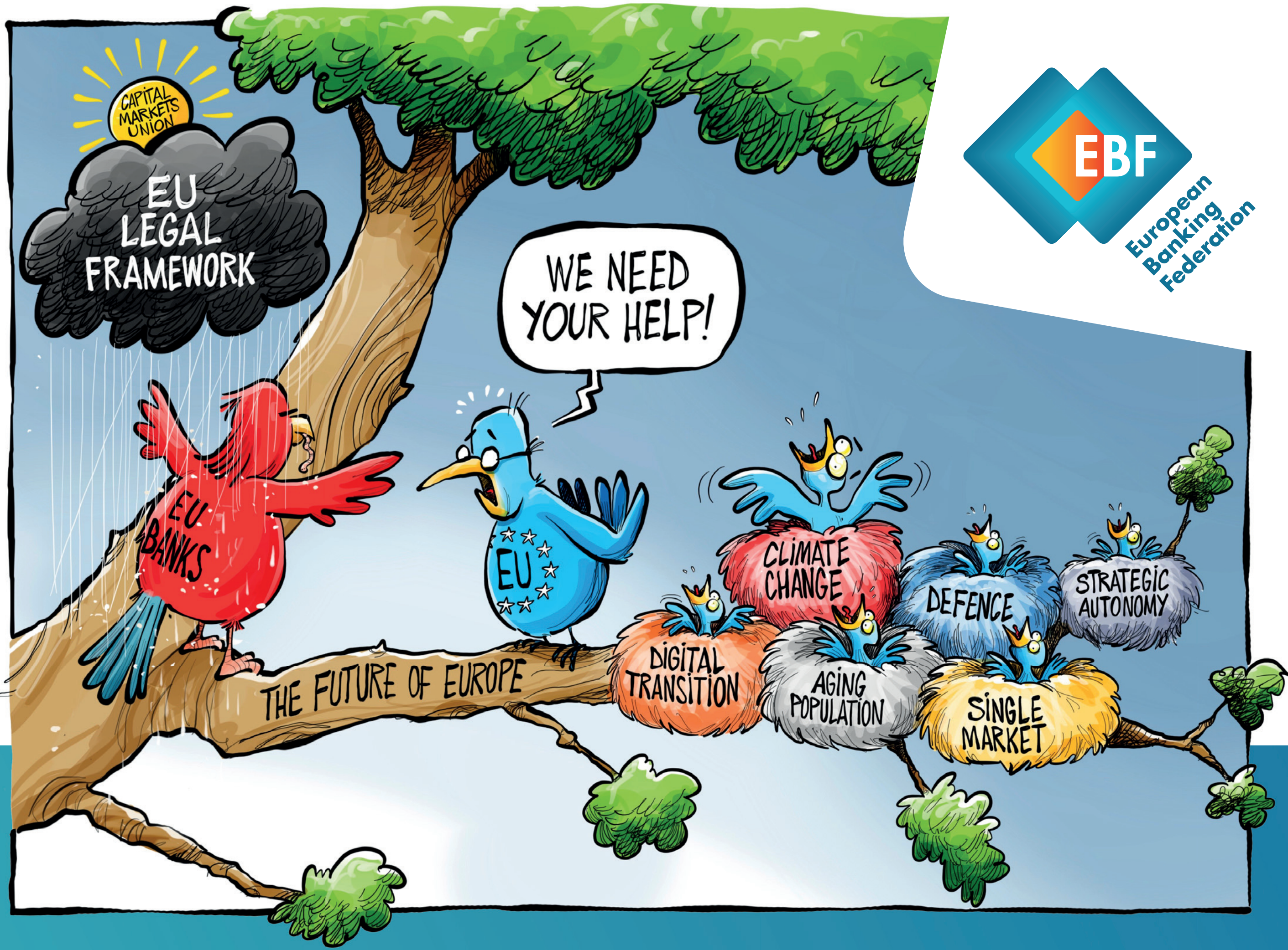


Financing the future: a strategic banking sector for a competitive Europe

Recommendations of the European Banking Federation
for the EU 2024-2029 term

Foreword

As we approach a pivotal moment in the European Union, marked by the upcoming EU elections in June 2024, it is essential to acknowledge the vital and strategic role of banks in Europe's transformation.

The European Banking Federation's recommendations for the forthcoming legislative period underscore the significant shifts we are witnessing: from the green transition and digital transformation to demographic challenges and the evolving global political landscape.

The banking sector has demonstrated remarkable resilience amidst crises such as the COVID-19 pandemic, the conflict in Ukraine, and recent financial turmoil in other parts of the world. At the same time, tectonic economic and geopolitical shifts have exposed the vulnerabilities of global value chains and further accelerated Europe's comparative loss of competitiveness. I am convinced that Europe has the human capital and economic potential to keep pace, but the continent must become more ambitious in shaping its own future.

At the forefront of these changes, Europe's banks emerge as essential catalysts for progress in enabling the transition to a more competitive, more resilient and more sustainable economy. To meet these unprecedented challenges, significant financing and investments are required, making the involvement of banks indispensable. In doing so, they will support the welfare of European citizens, boost sustainable growth and help restore Europe's global competitiveness, while building its strategic autonomy. In these efforts, the need for a resilient, profitable, and competitive banking sector in Europe is more evident than ever.

The EBF recommendations are a call to action for all European policymakers taking the helm this year. The banking sector is ready to assume its responsibilities in funding the substantial investments needed for Europe's future. However, this can only be achieved through a regulatory framework that fosters competitiveness and profitability in a rapidly evolving global market, ensuring fair competition among all financial entities in Europe and beyond. The EBF recommendations outline top priorities for the next five years, including bolstering the EU's economic competitiveness, promoting transition finance for the EU Green Deal, boosting a secure digital transformation, and completing the Single Market for financial services. In addition, they emphasize the urgent need for an integrated, open, and liquid capital market in Europe, capable of mobilising private capital at the scale required for Europe's economic transformation.

To conclude, I believe that the European banking sector does play a critical role in advancing Europe's new ambitions for the generations to come. To get there, the European Banking Federation is keen to continue engaging in dialogue with European policymakers, citizens and stakeholders at the European level.

CHRISTIAN SEWING
President, European Banking Federation

Introduction

The current European legislature is coming to an end, marked by profound upheavals and crises. In such tough times, the European banking sector has demonstrated its resilience. Moreover, the turmoil caused by the failure of US regional banks and the takeover of Credit Suisse in 2023 was yet another stress test successfully passed by our sector.

The upcoming European leadership will inherit challenging years going forward, in a rapidly and ever-changing world. The need for significant investments will be ever more important, particularly to finance the climate transition, digital transformation, and Europe's strategic needs, especially in terms of security and defence.
In this context, Europe needs its banks and the development of capital markets more than ever. It is crucial to support them in their financing capacity to fund the future of Europe, its businesses, and citizens.

The European Banking Federation therefore puts forward recommendations, categorised under 3 main priorities:

1 Finance Europe's future prosperity and strategic autonomy

- by acknowledging the banking sector as a strategic sector in the context of the EU's open strategic autonomy vision promoted by the European Union
- by ensuring that European banks can be more competitive, to the benefit of European households and businesses within an enabling regulatory and supervisory framework
- by completing the Single Market, considering the Banking Union as a single jurisdiction, and developing European Capital Markets

2 Maintain Europe's leading role & act together to achieve the transition towards a sustainable economy

3 Develop a strategic vision for Europe's digital financial services where banks can deploy meaningful innovation in a cyber resilient ecosystem

Financing Europe's future prosperity and strategic autonomy

Banks: A strategic sector essential for Europe's sustainable growth and strategic objectives

As mentioned, the recent period in Europe has been characterised by significant international and European crises and transformations. These crises have tested the resilience and importance of European banks, highlighting their role in maintaining stability and collaborating with policymakers to support citizens and businesses.

These challenges have also revealed vulnerabilities in the European value chain and reliance on global markets, **contributing to Europe's decline in global GDP share and competitiveness**, particularly against the US and Asia. However, sustainable growth is imperative for Europe: the ability to service debt, fund the green and digital transitions, finance increased defence efforts, and provide support for an ageing population, they all depend on growth. If these challenges are left unaddressed, they will only escalate and further negatively impact Europe's prosperity and future.

All these challenges have one thing in common: they require huge additional financing and investment - estimated at approximately **1 trillion euros per year** - to support sustained and sustainable growth. **Achieving the 2030 EU climate targets alone necessitates investments amounting to 700 billion euros annually. This formidable challenge necessitates a robust, efficient, competitive and profitable banking sector, coupled with deeper European capital markets.**

RECOMMENDATION

The EU should recognize the banking sector as a strategic sector, also in the context of its open strategic autonomy vision. A high-level dialogue is suggested to define a shared vision and actions for the global competitiveness of the European financial sector, benefiting businesses and citizens.

Making banks more competitive to the benefit of European households and businesses

Banks are fully prepared to assume their responsibilities and play their role in society. However, they need a regulatory and supervisory framework that enables them to stay competitive and profitable in the global market.

Since the 2008 financial crisis, significant reforms have bolstered the resilience of the financial sector, as highlighted by the stability of EU banks during the turbulence of March 2023. The European banking sector is now strong and resilient, with solid capital and liquidity positions that substantially exceed minimum requirements. The recent implementation of the Basel III banking package in Europe has culminated the regulatory reform. It is essential now to ensure an international level playing field notably dependent on the implementation of Basel III in the US.

However, the current framework is overly complex and lacks a holistic view of its overall impact. There is a need to alleviate the regulatory and supervisory costs to prevent the shift of financing activities to the less regulated and less transparent shadow banking sector.

The European banking sector has been constantly **losing competitiveness** for more than 15 years, notably when compared to US banks. Larger European banks are currently outnumbered in the top 10 global banks, with only 2 European banks remaining, and only eight in the top 30 banks worldwide. The profitability of European banks during the past decade is insufficient – to make them attractive enough to investors. Arguably, regulatory complexity is undermining EU banks' return on equity and therefore their market value:

In the euro area, the average price-to-book ratio of banks currently stands at around 0.7%, substantially lower than in the US (1.2%). The price-to-book ratio of European banks has been constantly below 1 since the Great Financial Crisis, which signals that investors are not interested in buying European bank stocks, despite the large price discount. The main reason is that European banks' dividends remain substantially below the compensation expected by investors for holding bank equity. Also, it compares negatively with those of other European companies in sectors like energy, technology or pharma which are therefore relatively more attractive sectors to invest in.

To achieve this, the sector must demonstrate competitiveness, innovation, and be profitable. It also **needs a regulatory and supervisory framework that enables European banks to remain competitive and profitable in a rapidly evolving global market.**

The European banking sector is also affected by the extraterritorial application of EU laws, which hinders the competitiveness of globally operating banks. **While banking regulation has focused on stability, there is now a growing need to prioritise competitiveness and growth.**

To address these issues, a series of recommendations is available on the following page.

RECOMMENDATIONS

- The European Commission needs to conduct a comprehensive assessment of the current regulatory framework, including Level 2 standards. This assessment should evaluate the impact and efficiency of regulations, considering stability, resilience, effectiveness, competitiveness, and support for sustainable growth. Adjustments should be made to recalibrate any counterproductive or inefficient requirements.
- Policymakers should evaluate the impact of any legislative proposal on Europe's competitiveness, ensuring that proposals are relevant and properly calibrated (Competitiveness Test).
- A complementary objective focusing on international competitiveness and growth should be added to the mandates of European supervisory authorities.
- The practice of stipulating fixed revision dates in legislative acts should be reconsidered. Reviews should be based on necessity rather than predetermined schedules.
- A thorough evaluation of the current multilevel decision-making system, particularly for Level 1 and Level 2 standards, is needed to determine its effectiveness and potential need for adaptation.
- Enhance the powers of European Supervisory Authorities (ESAs) to issue binding supervisory recommendations to national competent authorities for no-action letters.

Completing the Single Market, considering the Banking Union as a single jurisdiction, and developing European Capital Markets

Such a strategic vision for Europe can only be driven by **deeper cooperation within the EU**. It is urgent to harness the potential of a united Europe with greater strength and consistency than ever before. **The Single Market is a key EU endeavour valued by European companies, but even after 30 years it remains incomplete. In too many areas, including finance, the EU remains a patchwork of 27 national markets and economies**. A deeper and more dynamic internal market would empower Member States to efficiently pool resources and work towards shared goals.

The establishment of the Banking Union is a significant achievement for the EU. However, the Banking Union is incomplete, with ongoing political and regulatory challenges that impede the development of cross-border banking business models. A key unaddressed aspect is the third pillar of the Banking Union.

Simultaneously, resolving the home-host debate is crucial. Lack of progress in the third pillar of the Banking Union – as well as the limitations on capital and liquidity movement within the Banking Union – are a source of fragmentation and act as structural barriers to bank consolidation across the

Eurozone and the development of a single capital market. Banks, as key players in capital markets, face restrictions that prevent them from operating freely across the Euro area. The banking sector still faces significant barriers due to the absence of liquidity waivers and the higher risk-weighted assets for cross-border subsidiaries. Recognizing the Banking Union as a single jurisdiction is essential for reducing fragmentation and simplifying the existing overly complex framework. In a fully functional Banking Union, there should be no distinction between home and host supervisors, and "national bias" in regulation and supervision should be eliminated.

Europe needs to streamline its banking regulation and make it consistent across borders

A robust, proportionate, and predictable macroprudential framework is vital for the effective functioning of the European financial sector. The EU's macroprudential framework is overly complex, and the COVID-19 crisis highlighted deficiencies in buffer usability. There is a need for a clearer understanding regarding the risks covered by each buffer, ensuring there is no overlap with other macroprudential buffers, Pillar 2 Requirements (P2R), Pillar 2 Guidance (P2G), and Pillar 1 requirements.

RECOMMENDATION

The upcoming review of the macroprudential framework should enhance predictability and buffer usability, clarify covered risks to prevent overlaps and ensure harmonization in the use of tools to address similar risks, all without resulting in increased capital requirements for banks.

In the fight against organised crime, the banking sector fully supports efforts for a more harmonized European approach to **combating money laundering**. The banking sector, a key player in detecting money laundering, has supported revising the AML/CFT legal framework, including establishing the new European AML authority (AMLA). An effective combat against financial crime requires new tools and technologies, a data protection framework enabling public-private partnerships, and improved information sharing. The new AMLA represents a significant opportunity to enhance the effectiveness of the AML/CFT framework and supervision. It should ensure clear roles to prevent overlaps, coordinate Financial Intelligence Units (FIUs) at the EU level, and **facilitate information exchange between various stakeholders, including financial institutions**. The possibility of genuine cooperation between the public and private sectors, as well as the ability for real information sharing among them and between banks, is a key success factor. Without this, the fight against money laundering will never be truly effective.

Equally important are conditions that ensure fair competition for all entities providing financial services. The banking sector faces increasing competition from non-bank entities and big tech companies, which are subject to fewer regulatory burdens. While competition is beneficial for innovation, customer service, and progress, it needs to be fair. Shadow banking, or non-depository institutions outside traditional banking regulation, has grown significantly, potentially increasing systemic risks. Addressing these risks could involve more direct regulation, transparent financial reporting, and limitations on asset/liability mismatches.

Additionally, banks compete with non-European big tech companies, which have powerful networks, substantial investment capacities, and access to vast troves of user data. This competition will continue fundamentally altering the banking landscape even more, potentially to the detriment of consumers. Big tech companies' use of user data – sometimes without informed consent - and their digital infrastructures could lead to monopolistic «walled gardens», reducing real consumer choice and shifting financial services outside regulatory boundaries.

Ensuring a level playing field in digital finance, particularly for financial institutions, is vital. This requires preventing big tech companies from unfairly leveraging data and infrastructure access and guaranteeing consistent consumer protection across financial services. **Proposals like the Financial Data Access (FIDA), which mandates data sharing by banks, bring new challenges**, such as potentially strengthening the domination of big tech companies by sharing customer data. Obligations related to data sharing should not solely target financial institutions to avoid further competitive imbalances.

Regularly reassessing regulatory boundaries is crucial to ensure comprehensive coverage of non-banks providing financial services.

Urgent push ahead needed on European Capital Markets

Banks in Europe provide the bulk of investment funding. They alone, however, cannot help the EU win the global investment race, especially in comparison with the United States.[1]

The Capital Markets Union (CMU) initiative, launched in 2015, aims to integrate national capital markets into a single, efficient European market. However, progress has been slow. Financial integration in Europe remains low, with fragmented market structures across Member States deterring large, especially non-EU, investors. The EU's share of global capital markets activity has declined significantly, and Europe lags behind in areas like corporate bond and equity-based financing.

This limits the capacity to finance the EU economy. Funding crucial areas like green and digital transitions, diversifying supply chains, financing defence, and supporting an aging population require massive capital, which cannot be met by banks and governments alone. This is why private capital is essential. Alternatively, Europe will not be able to finance its sustainable transformation and keep up with technological advancements. **The development and integration of capital markets are therefore crucial. Future reforms in the EU legislative cycle need to be prioritised to integrate Europe's capital markets further**. This includes harmonizing withholding taxes, insolvency laws, streamlining regulations, and aligning securities and company laws.

[1] Paschal Donohoe, Werner Hoyer, Christine Lagarde, Charles Michel, and Ursula von der Leyen, "Channelling Europe's savings into growth," ECB Blog (Frankfurt, 2023)

European capital markets are still significantly fragmented, leading to complexities and potential inefficiencies. The EU has also a far more extensive market infrastructure. The disparity is clearly pictured when looking at a comparative analysis between Europe and the US: there are 3 times as many exchange groups, 18 central counterparties, and 22 central securities depositories in Europe, compared to just one of each in the US. Though the market itself primarily needs to adapt, it is also opportune to reflect on ways to encourage further consolidation of capital market infrastructures in the EU, which could lead to deeper liquidity pools, enhancing the attractiveness of the EU for investors.

The absence of a true European capital market has been a significant barrier to achieving a more integrated banking system. This is also one of the structural factors contributing to the lower profitability of European banks compared to their US counterparts. A developed European capital market, particularly through further securitisation of loans, would enable banks to manage their balance sheets more efficiently.

Securitisation is crucial. The European securitisation market is much smaller than the US and needs reform to unlock its potential. The difficulties in securitising loans and distributing them to market participants through liquid instruments force European banks to hold to maturity a larger proportion of the assets that they originate, which is highly inefficient. As a result, European banks' balance sheets are larger and less remunerative than those of their US counterparts. Regulatory treatment, supervisory processes, and disclosure requirements need urgent improvement, and the possibility of state guarantees for securitisation portfolios should be further explored.

Regarding retail investors, there is a disparity between the US and the EU in terms of households owning financial products. Encouraging retail participation in capital markets is key for private risk-sharing and sustainable economic growth. The Retail Investment Strategy (RIS) introduced by the EU aims to increase retail participation. However, the current proposal from the European Commission may lead to opposite results and will not enhance the customer experience. It is crucial to maintain consumer choice, streamline disclosure requirements, simplify the distribution process, conduct consumer testing for new regulations, and enhance transparency.

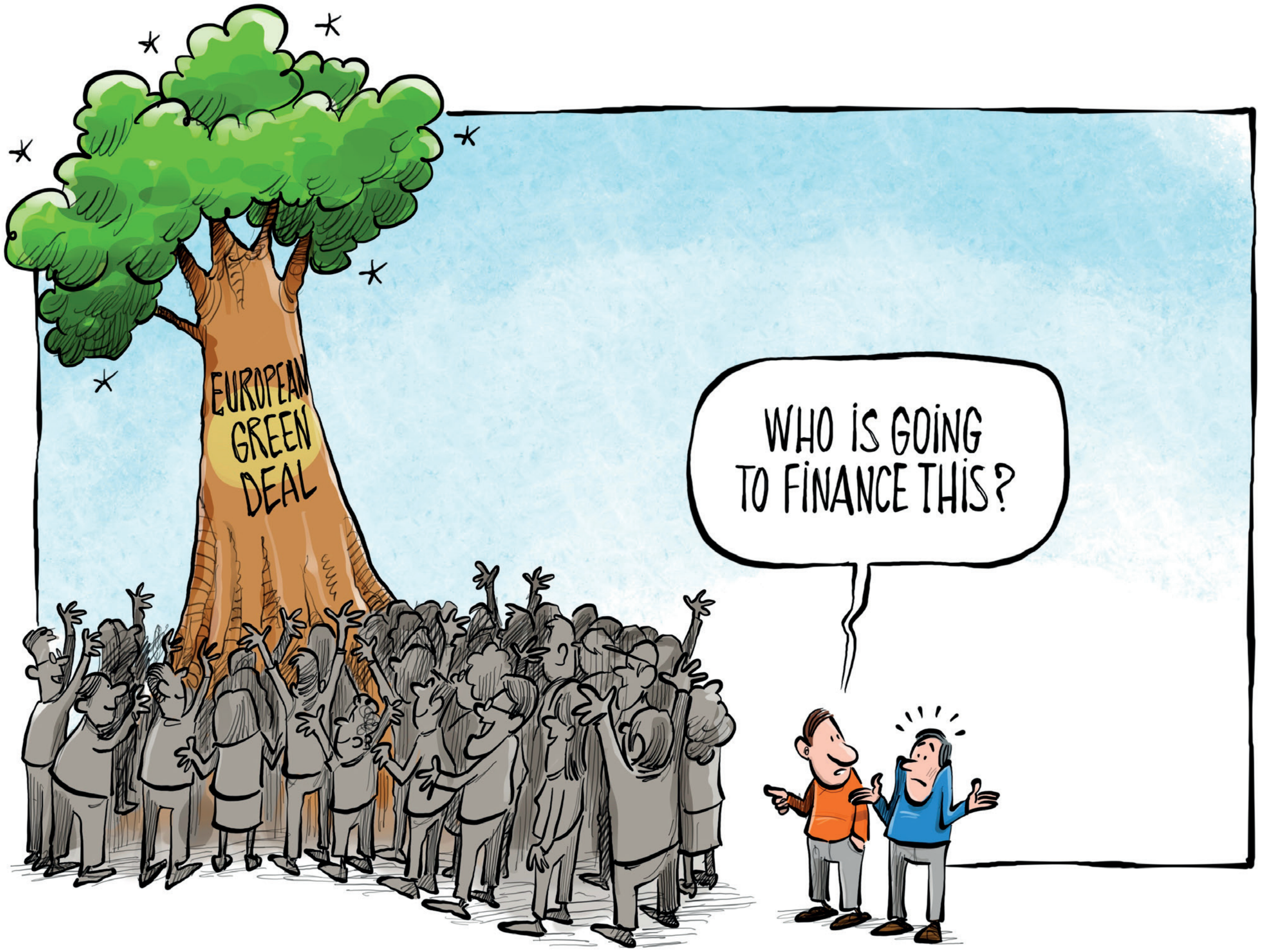
Financial education is also essential, as low levels of financial literacy in Europe affect financial well-being and resilience. National governments should support the development of deeper capital markets and foster a "capital markets mindset."

A complementary bottom-up approach to the CMU, focusing on individual Member States, would be necessary. This includes fostering national innovation, ensuring transparency and coordination, and monitoring progress with key performance indicators.

RECOMMENDATIONS

- Urgently reform the securitisation framework, removing unjustified regulatory and supervisory constraints.
- Prioritize and sequence next-generation reforms for deeper and more integrated capital markets.
- Foster a more attractive environment for retail investors by streamlining the distribution process and disclosure requirements.
- Develop and support financial education initiatives at the EU and national levels.
- Involve Member States in developing their national capital markets, promoting innovation, transparency, and coordination. Regular monitoring should assess CMU initiatives' effectiveness.

Maintain Europe's leading role & act together to achieve the transition towards a sustainable economy



The European Green Deal, aiming for climate neutrality by 2050, is a major legislative endeavour, requiring over 700 billion euros in yearly investments. It also takes a substantial rethink — not just within society and businesses, but also amongst policy makers and regulators.

For the banking sector, sustainable finance is a priority. Europe's banks are adapting their systems to align with EU sustainability goals. Banks are in a unique position and stand ready to assist their clients in their transition, helping them raise necessary financing and advising them at every stage of this complex sustainability transformation journey. **However, banks, as intermediaries, cannot drive alone the transition of the economy**. It is up to governments to define clear and consistent policies that incentivise all sectors and businesses to progress in this transition and increase the economic viability of sustainable investments.

Europe leads in this field, offering opportunities for banks and businesses. **To maintain this leadership, the EU legal framework should support, not burden, these entities**. More clarity, certainty, coherence, usability, and global alignment in sustainable financial regulations will further mobilize finance for the transition.

Consequently, we advocate for four overarching objectives:

1. **Avoiding regulatory fragmentation and aiming for a unified global regulatory approach, including consistent reporting standards, climate scenarios, and stress tests. Prudential frameworks should remain risk-based and internationally defined, ensuring a comprehensive and level playing field.**

2. **Urgently simplifying a regulatory framework that has become excessively complex, inconsistent, and indecipherable. The rules must also be proportionate and tailored to SMEs.**

3. **Focusing on transition finance, currently missing within the European sustainability framework.**

4. **Enhancing data accessibility and closing the data gap as access to data is crucial for financial institutions to fulfil their sustainability obligations.**

RECOMMENDATIONS

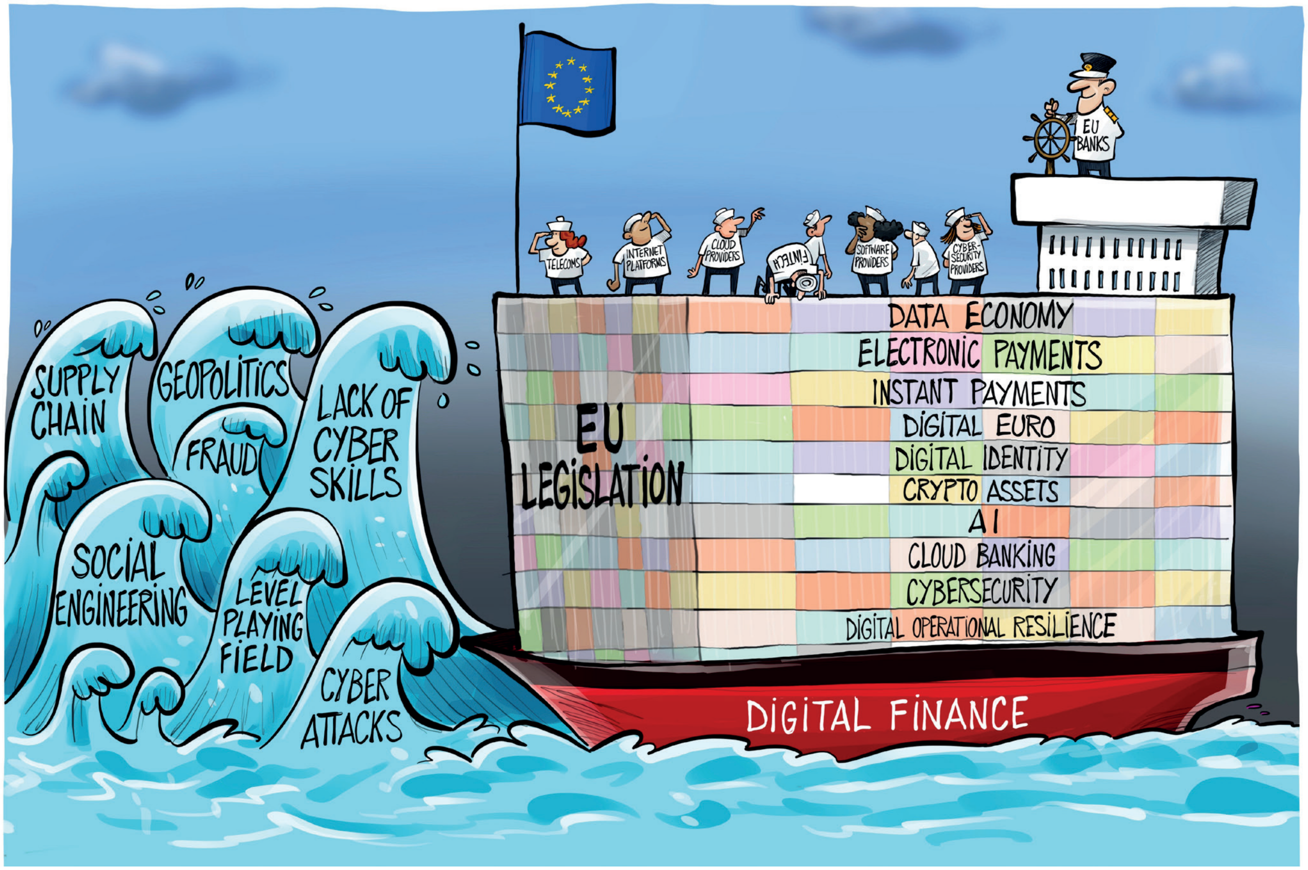
- EU institutions should establish a clear and orderly transition finance framework at the EU level, defining sectoral pathways and roadmaps for climate and biodiversity against which companies can benchmark their transition plans. Companies should be required to publish high-quality transition plans.

- Consider a ‘usability’ omnibus legislative proposal early in the next legislature to simplify and address existing misalignments and inconsistencies in the sustainability regulatory framework.

- Implement President von der Leyen’s initiative to simplify reporting requirements, reducing burdens for corporates and financial institutions. The reduction of reporting burdens for corporates should be accompanied by equivalent alleviations in disclosure obligations for the users of such data, such as financial institutions.

- Encourage public agencies to disclose relevant ESG data centrally and support the establishment of national databases for energy performance data.

Develop a strategic vision for Europe's digital financial services where banks can deploy meaningful innovation in a cyber resilient ecosystem



Over the past five years, there has been a significant increase in digital and cyber-related policymaking in Europe, leading to a proliferation of policies covering a wide range of areas, including the digital economy, payments, cyber resilience, the digital euro, crypto-assets, digital identity, and AI. While intended to manage the numerous opportunities and risks of digitalization, this surge has led to policy fragmentation, overlapping regulations, and sometimes vague policy scopes. Moreover, the complexities and costs of implementing these policies have often been underestimated compared to their expected benefits (e.g., in cases like FIDA and the digital euro). The resulting landscape following the coming into force of all these policies seems uncertain and not always clearly beneficial for European citizens.

To shape a strategic vision for Europe's digital financial services, it is crucial to engage actively with the banking sector. This means conducting **a comprehensive review of both existing and upcoming legislation to identify and resolve any inconsistencies or redundancies, and aim for a more balanced legislative framework**. Additionally, there is a need to **streamline and consolidate supervisory structures and processes to ensure more efficient and holistic implementation**.

Cybersecurity and digital operational resilience are the cornerstone and foundation of the sustainable digital transformation of banks and society as a whole. It has become increasingly important for banks' overall resilience, while cyber threats have been multiplying, no less due to the geopolitical developments affecting Europe. **Harmonizing and streamlining cybersecurity requirements and structures, fostering a culture of partnership between the private and public sectors, and adopting a holistic approach** are key to ensuring cyber resilience across the banking value and supply chains.

Finally, **cyber-risk awareness raising** for all segments of the population should be a continuous priority at both the European and national levels. Equally important are continuous actions to **nurture a wide pool of digital skills and talent** to tackle the rapidly increasing demand for professionals in all sectors of the economy.

Enable a sovereign, competitive, safe and resilient EU payments landscape

The EU boasts a secure and efficient electronic payments market with a Single Market for payments. European consumers and businesses have access to a wide range of payment methods, including credit transfers (instant too), direct debits, cards, and cash, along with diverse channels like mobile banking, wallets, and contactless payments. This dynamic market is characterized by active competition, evolving business models, and new entrants joining the ecosystem.

At the same time, the EU payments landscape is dominated by non-EU providers. To counter this dependency and foster a sovereign, competitive, and resilient EU payments system, **aligning various policy initiatives is key**. This is especially true for instant payments and the digital euro. As these projects have similar goals, identifying clear synergies and explicit added value is vital to prevent overlaps and redundant investments but also to boost innovation. A unified and effective approach is necessary to boost strategic autonomy in payments and avoid overburdening the industry with two major, competing mandatory projects.

Europe has the assets to further develop private European payment systems.

RECOMMENDATION

The EU institutions should support and capitalize on private initiatives, such as some currently being developed, and enable sustainable business models to meet the objectives of the sovereignty of the European payment system as desired.

To ensure safe and reliable payment systems, addressing digitally enabled fraud, especially social engineering, **is critical**. While banks invest heavily in fraud prevention, **all parties in the fraud chain, including telecom companies and internet platforms, should also be legally required to implement and collaborate on fraud prevention strategies and also participate in the reimbursement of victims of these frauds**. Furthermore, consumer awareness is key to prevent complacency and maintain vigilance against fraud, and this applies to all risks to users of all digital services, tools and platforms. Over-reliance on refunds will have the opposite effect in terms of consumer protection, including moral hazard.

RECOMMENDATIONS

- **All parties in the chain leading to fraud in authorised payments, especially telecom companies and internet platforms, should be legally required to implement fraud prevention measures and collaborate with others in the chain and take their share in reimbursing victims of fraud.**
- **The rules on fraud victim reimbursement need to be clearly framed to essentially protect consumers from giving up vigilance and the market from moral hazard.**

Digital euro

The creation of the digital euro is a complex undertaking with profound implications for society and economic actors, including the banking sector. If not properly framed, it could cause significant damage to the European financial system. It introduces a new concept that interacts with private electronic payment methods and necessitates an in-depth exercise to balance various impacts on the economy as a whole and on financial intermediation in particular.

As the digital euro project has entered the preparation phase, the EBF considers it vital **to pursue a constructive and comprehensive dialogue between the co-legislators, the ECB and the banks, to find together the balance that will ensure the success of the digital euro, along with the introduction of robust mitigating measures for all the above risks.**

There are three areas of possible impact that should be counterbalanced from the start:

1. The risk of displacement of bank deposits, with the potential consequences of a massive adoption of the digital euro: increase of funding costs, reduction of credit for the economy, especially long-term financing that is backed with stable deposits, potential inability to replace the lost deposits from the market especially in times of stress.

2. The investment and recurring costs of implementation of such a complex and large-scale project with a consequent reduction of innovation capacity and therefore of competitiveness for banks.

3. The overlap with existing payment means and the possibly fundamental alteration of the retail banking model, with a consequent erosion of related revenue streams that may affect the profitability of banks, which is vital for their resilience.

RECOMMENDATION

The decision to eventually issue the digital euro should be subject to scrutiny by the European Parliament, the Council and the Commission based on a report by the ECB that demonstrates that the issuance of the digital euro will create concrete benefits to end-users, intermediaries and the economy as a whole, while having mitigated ex ante any adverse effects on financial stability (especially in periods of stress) or on existing payment solutions.

A European data-driven economy

Data-driven innovation in the financial sector hinges on successful data sharing. After the mandatory payment data sharing introduced by PSD2, the European Commission is expanding open banking through the Review of PSD2 (PSD3/PSR) and moving towards Open Finance with the introduction of the Financial Data Access Framework (FIDA) proposal. **However, the true added value lies in cross-sectoral data sharing.** A voluntary approach to data sharing would allow for a true market-driven implementation, especially as mandatory requirements are still missing in other sectors.

RECOMMENDATIONS

→ The framework should strike a fair balance in value distribution and risk allocation, providing not only for financial compensation for data sharing but also for realistic timelines and a phased deployment.

→ The principle of compensation should also be applied to payment data.

→ Cross-sectoral data sharing initiatives need to be implemented in parallel as this is the true value of the data sharing economy.

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