EBF study

In January 2023, the **EBF published a comparative study on the EU and US banking sector**. A key issue is profitability on which the report argues that EU banks are lagging behind US banks, mainly attributing this to four factors:

- **The swift and proactive measures by the US government after the GFC vs. slower and more reactive responses in the EU in the context of both the GFC and the sovereign debt crisis, damaging confidence in the EU banking system.**

- **The low interest rate policy of the ECB being especially damaging considering EU banks’ strong reliance on Net Interest Income (NII) and on balance-sheet lending (reinforced by the absence of a securitisation market), whereas US banks tend to focus on capital markets and pass-through loans to government agencies (Fannie Mae, etc.).**

- **More competitive EU banking market with (national) fragmentation limiting economies of scale.**

- **Higher regulatory-induced costs for EU banks compared to the US for which they estimate the RoE impact at 0.8-1.0 percentage point (the total RoE gap between EU and US banks stands at 2.3 percentage point).**

- **The report attributes it to**
  - higher EU capital requirements,
  - SRF/DGS contributions (x2 in comparison to the US),
  - MREL requirements (approximately +3.9 percentage points compared to TLAC requirements).

Based on the above, the following main policy messages are conveyed:

- **Policymakers should finish the Banking Union and CMU. The development of the EU securitisation market should be encouraged.**

- **Supervisors should simplify their processes** to reduce strains on banks’ resources (targeting the Supervisory Review and Evaluation Process and the stress testing framework).

- **Single Resolution Fund and DGS contributions** as well as MREL requirements should be reduced.

- **Banks should continue to improve efficiency, consolidate** (also on a cross-border basis), and stop defending national privileges.

**Defensive**

*EBF study: A review of current capital requirements and supervisory processes could provide capacity for around EUR 4 trillion additional bank lending to finance the green and digital transitions and strengthen the competitiveness of the EU economy.*

- We have reviewed the EBF’s study and found it interesting and well-researched. But, overall, **now is not the time to ask for lower capital requirements, it seems a bit “tone deaf”**.
• Also, a lot of our choices in the EU, notably applying Basel III and MREL requirements to all banks (admittedly, very small banks have no MREL) have been vindicated by recent events. Generally, we expect the distance between EU and US banks to decrease given that the US is likely to increase requirements on smaller/medium-sized bank.

• When looking at capital requirements and lending volumes, the report mentions “4 trillion lending” that could be enabled by reducing capital requirements. Frankly, it is relatively easy to come up with large volumes of lending “freed up” by reducing capital requirements [with a 4% leverage ratio, there is a x25 multiplier]. Our view is different: Requiring banks to hold a bit more capital has only a marginal impact on the cost of capital for the EU economy but ensures financial stability (and avoids a credit crunch).

• Also, we do not see that the study makes a convincing argument to reduce supervisory scrutiny.

• On capital requirements: The Basel III reform agenda has already been implemented to a large extent in the EU. The current Banking Package does not have as its primary aim to further increase the overall level of capital requirements. The package is not leading to a significant increase in Tier 1 capital requirements on average (less than 10% in the medium term).

• However, the direct quantitative comparison of regulatory ratios between EU and US banks should be interpreted with caution, notably because of the inherent structural differences between the two banking sectors, including in terms of risk-weight densities and portfolio profiles.

• This being said, we share the views that the EU banking sector would benefit from a well-functioning securitisation market and of further cross-border integration. We deploy many efforts to make progress in these areas. We see the recent adoption of the CMDI package as a promising achievement in that context.

• But, to note that we also agree with the report’s views that banks need to improve efficiency and themselves work towards cross-border consolidation.
Commission legislative agenda and Basel III finalisation

Main messages

Need of further financial integration and an efficient regulatory framework that allows banks contribute to growth and the digital and green transitions

- As regards ongoing efforts for greening the economy, banks need to manage the risks stemming from climate change. Also, banks need to finance the transition: we estimate that over the next decade, we will need around EUR 390 billion to meet the 2030 emissions-reduction targets.

- The other element is the digital transformation, which as of today is having a profound impact on financial services. This will drive change to your own value chains, be it via customer experience, operational efficiencies, or your ability to use data to measure risks. But, it will also drive business volumes when it comes to financing investments in infrastructure and technology needed for our economy to transition.

- For both transitions, the role of banks is paramount. Either by deploying balance sheets, or by being intermediaries and facilitating investor access to future-proof industries.

Digitalisation of Finance

- Digitalisation leads to new products, new services and entry of new entities providing ICT services to financial firms. These technology firms may also over time start providing financial services themselves.

- These developments raise the question whether existing financial regulation and supervision is entirely fit for purpose. The Commission’s digital finance strategy, adopted in 2020, sets out the Commission’s ambition to review financial regulation to harness the potential of digital innovation while addressing risks.

Sustainable finance

- Progress is being made with the implementation of the foundations of the EU’s sustainable finance framework and that companies are starting to comply with new and often unfamiliar reporting obligations. Most of the regulations adopted in the context of the 2018 Action Plan on Financing Sustainable Growth (in particular the Sustainable Finance Disclosure Regulation (SFDR) and the Taxonomy Regulation) have started to apply.

- We know that the implementation of all these regulations by market participants and companies is a challenge, and the Commission is committed to ensure the coherence and a smooth implementation of the overall framework. With its new mandate, the Platform on Sustainable Finance will focus on usability to improve the implementation of our ambitious sustainable finance agenda.

Commission legislative agenda

- As we are entering the last year of the current Commission’s mandate, we are facing a very busy legislative agenda with a number of files edging towards conclusion, such as the EU’s implementation of Basel 3 or the reform of MiFID, while others have only recently been launched, such as the review of EMIR or the CMDI package.

- Overall, the impact of our policy work on banks’ competitiveness is something that we consider carefully, alongside with other considerations, notably financial stability, innovation and consumer protection.
Meeting with the Institute of International Banking of Santander
Brussels, 23 May 2023

Basel III

- As regards Basel III, we are committed to finalising the implementation of these international standards. We aim to reach a political agreement with co-legislators in June.

- Events in recent weeks have shown the importance of a solid framework applying to all banks across the EU as well as the importance of strong, demanding, and effective bank supervision, particularly at the current juncture.

- We have heard industry’s concerns about the increase in capital requirements and have addressed these by striking a delicate balance in our proposals. We need to be faithful to the Basel standards. At the same time, we need to mitigate the overall capital impact and maintain a level playing field.

- In this context, much has already been done to preserve the competitiveness of the EU banking sector and take account of its specificities. Some areas of the framework may be more impactful than others, but we think we need to consider the interaction of these areas holistically and look rather at the global effect on capital requirements.

- Overall, we believe that the average impact of the package would remain moderate (ca. +10%), even smaller when the new requirements will apply and can be managed by EU banks over the transitional period without impeding on their profitability or competitiveness.

- With respect to financing the transition, the Commission proposed a preferential treatment for high quality object financing [Basel deviation] – to see if it will be kept as the Council has not taken it on board (Parliament kept it). Also, the Parliament proposes to link the beneficial treatment of infrastructure financing to sustainability (i.e. “greening” the infrastructure supporting factor).

- In parallel, we are paying particular attention to the developments in other jurisdictions to ensure that the level playing field is maintained. Importantly, for market risk capital requirements, the delegated act for the FRTB implementation (Fundamental Review of the Trading Book), maintained by the co-legislators, will allow us to monitor the level playing field and adapt to the situation in other jurisdictions.

- Recent events likely go into the direction of a faithful implementation in the US, it seems they will come out over the summer. The UK will combine remaining close to the Basel standards with using the supervisory space and a more nimble framework to undercut the EU in a targeted way.

- Overall, we have the feeling that the banking package is well balanced and paid due attention to competitiveness issues, but we would be interested in your views.

Defensives

How likely is it that the Banking Package will stick to its timeline, i.e. agreement by June (next month) and starting date of application by 1 January 2025?

- We remain optimistic that Parliament and Council will be able to find an agreement soon.

- While co-legislators are not too far apart on most topics, it is difficult to give a definite answer.

At the outset, the Commission made clear its intention that the Banking Package should not lead to a significant increase in the overall capital requirements of EU banks. How will you ensure the capital increase remains moderate as the regulation goes through trilogues and as technical standards are drafted?

- The Banking Package aims to strike a delicate balance between
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- staying faithful to the Basel agreement,
- while using the flexibility within it and certain temporary adjustments to reflect the specific features of the EU financial system, and
- avoid a significant increase in capital requirements in the short term.

We deem that our proposal has achieved these objectives: **the package is not leading to a significant increase in Tier 1 capital requirements** on average (less than 10% in the medium term), and the most significant targeted amendments are only meant to be temporary, so they do not affect compliance with the Basel standards after the transition period. I would not expect the agreement reached during the trilogue discussions to lead to a material increase in the overall capital requirements, as co-legislators broadly share the objective to avoid significant capital increases.

As regards **technical standards**, these acts are aimed mainly at specifying and harmonising the rules included in the basic legislative act. Moreover, they undergo consultation with stakeholders and regulatory scrutiny to prevent unintended consequences (such as an undue increase in capital requirements).

**Open Finance:** Banks might soon be requested to open our data more widely, including to non-European players. How do you address these concerns and ensure a level playing field?

- On this issue, we are still carrying on our work, but the open finance proposal should be out by the summer.
- The open finance framework builds on open banking experiences and builds on PSD2 review, stakeholder consultations and input from our Expert Group on data [one expert is Ms Catalina Hernandez Serra, Banco Santander]
- The framework will be designed to address the key obstacles to data sharing we see:
  - consumers hesitate to share data, as they are not sure how e.g. their privacy will be addressed;
  - unclear legal rules about extent to which data can be shared;
  - a lack of standardisation and technical interfaces for sharing data; and
  - a lack of incentives to deliver standardisation and technical infrastructures.
- The key issues we are currently considering are:
  - What types of data would be most relevant and deliver most value to customers?
  - How do we best put customers in control of their data? How ensure that they know what data they are sharing, who it is being shared with and why?
  - We also believe that companies accessing data should be regulated and supervised, alongside the companies that hold onto the data. All companies should operate on a level playing field.
  - In terms of the modalities governing access to data, it is hard to see how Open Finance could work if we don't give access rights to new data, beyond payment accounts.
  - **Level playing field issue:** The Digital Markets Act enables financial firms to access customer data held by gatekeeper platforms. Data access will accordingly no longer be a one-way street.
  - A final issue concerns standardisation. To what extent should we standardise technical interfaces and how data is presented?
- Let me assure you that we will develop a balanced policy fostering the usability and the access to financial data, but clearly reflecting the considerations that I just mentioned.
Digital Euro: While many other jurisdictions are testing wholesale digital currency, Europe’s approach to a retail digital euro will have a huge impact on our funding capacity, as pointed out even by the ECB

- In the digital age we need to offer central bank money in digital form to meet the increased demand for digital payments.
- The digital euro could act as a monetary anchor, i.e. ensuring trust in commercial bank money in the digital age, just like cash is fulfilling this function today. It is important that people and businesses can convert their commercial bank money/deposits to a usable central bank money at any time.
- The digital euro can also foster the effectiveness and competitiveness of pan-European payment market by increasing the consumers’ choice and enabling PSPs access to a European cross country payment system.
- A digital euro can also support the EU’s open strategic autonomy vis-à-vis stablecoins or third country central-bank-digital currencies.
- When developing and running the digital euro, cooperation of private intermediaries and the euro system has clear benefits.
- In the distribution of digital euro, PSPs experience, available systems and processes for dealing with end-users need to be leveraged.
- The design of the digital euro also needs to ensure that banks are not disintermediated and the financial stability is protected. We have received a lot of input on the matter in response to our consultation before the summer, and are assessing the issue very carefully.