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Financial regulation and growth: what should be the European policy priorities?

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1. Introduction

It is now evident to all that the world economy has become increasingly complex due to technological disruption and significant changes in the geopolitical order, among other factors. Simultaneously, we are witnessing an important debate around some elements of an (arguably imperfect) policy consensus that has prevailed for decades.

This consensus rested on the assumption that there is no fundamental trade-off between financial stability and sustainable growth. In particular, this framework posits that economic prosperity cannot be achieved without safe and sound financial institutions.

The current policy debate, however, appears to challenge some elements of this prevailing consensus. In certain jurisdictions, we have already observed policy initiatives that, when combined, could lead to a relaxation of existing financial regulations. In other jurisdictions, including those in Europe, some stakeholders are also advocating – albeit to varying degrees of intensity – for a substantial realignment of policy priorities for financial regulation.

This revisionist view is explicitly predicated on supporting the competitiveness of the financial industry and enhancing financial firms' ability to foster economic growth. Given the potential social relevance of these arguments, they must be rigorously examined. Good financial regulation, like other policies, must consider all relevant trade-offs across different time horizons.

Given my current position at the international organisation with the mission to promote monetary and financial stability, it will probably not surprise this audience that I disagree with those that advocate for a fundamental overhaul of the current policy priorities for the financial industry.

However, this should not be misinterpreted as a desire to leave everything unchanged. On the contrary, I believe the current debate provides an opportunity to reflect on elements of the existing policy arrangements that could be improved – and, of course, this is by no means an empty set. Regulation is always an evolving journey.

In the case of Europe, that reflection is particularly opportune as regulatory policies, including those in the financial domain, have been put on the spot by the highly influential Letta and Draghi reports.[1] They both stress that European regulation should be revisited in order to foster the dynamism and competitiveness of the European economy.

In the rest of my intervention, I will address the possibility that the recent regulatory reform could have had unintended effects on growth and competitiveness and what improvements could be foreseen in that regard. I will conclude with a few remarks on what I believe should be the policy priorities for the financial sector in Europe.

2. The evidence

Let me first address the potential side effects of recent regulatory reforms on the banking industry and the broader economy.

There is general agreement that the post-crisis regulatory reforms have significantly contributed to fostering financial stability, particularly by enhancing banks' resilience. At the same time, some observers and even policymakers argue that the regulatory reforms may have gone too far and that a rethinking is necessary to preserve banks' ability to perform their intermediation function.

Specifically, it has been argued that current regulation significantly affects banks' performance and market valuations, their ability to compete with non-bank financial intermediaries and, ultimately, the amount of credit they can provide to the real economy.

As mentioned earlier, these concerns are, in principle, legitimate. It would be a mistake to assume that the objectives of prudential regulation justify any means to achieve them. Effective regulation should aim to minimise unintended effects on firms' operations, the competitive landscape and, ultimately, growth and welfare.

That said, I believe the claim that the post-crisis prudential framework is significantly undermining banks' businesses has yet to be convincingly substantiated.

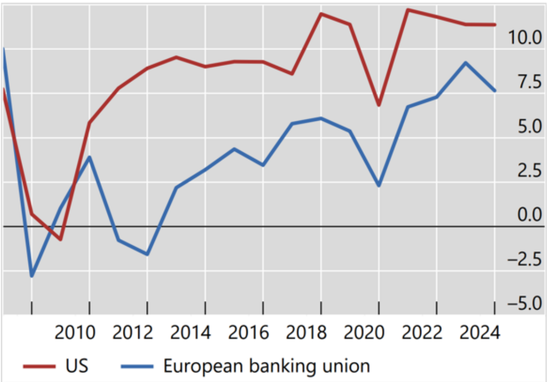
For instance, the profitability of the banking business (measured by standard return on equity or return on assets indicators) has increased markedly since the Great Financial Crisis (GFC). Additionally, banks' market valuations (measured as a percentage of book values) have risen significantly in some jurisdictions over the same period, almost reaching pre-GFC levels.

Arguably, the performance of European banks has been much less positive. Before the GFC, large US and European banking union banks showed broadly comparable profitability and market valuations (Graphs 1 and 2). After experimenting a significant drop at the beginning of the crisis, performance indicators recovered in both areas. Yet since then, and coinciding with the

[1] See Letta (2024) and Draghi (2024).

implementation of the global regulatory reforms, US banks have clearly and persistently outperformed their EU counterparts.

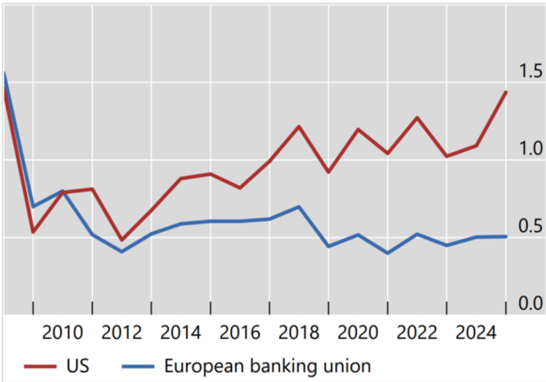
Banks profitability[1] Graph 1



[1] Sector-wide return on equity data from each region.

Sources: FDIC (2025); ECB (2025).

Bank market valuation[1] Graph 2

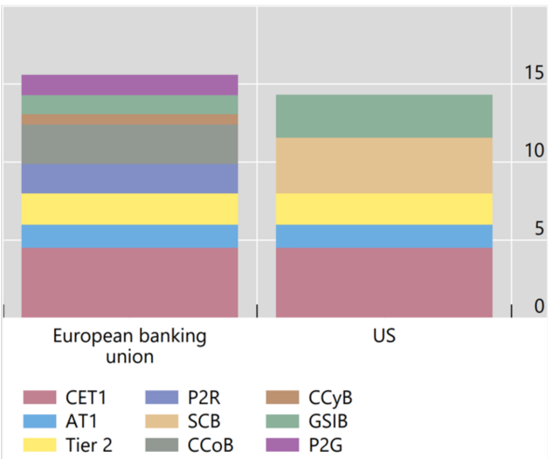


[1] Weighted average price-to-book ratio of six globally systemically important banks (G-SIBs) each from the US and the European banking union. Only four European G-SIBs for 2007 and 2008 due to lack of data.

Source: CompaniesMarketCap (2025).

It is important to note that there is no evidence that capital requirements for banks in the EU are significantly more stringent than those in the United States, at least for large internationally active banks (Graphs 3 and 4). More broadly, the argument that particularly demanding prudential policies in the European banking union place European banks at a disadvantage compared with their international competitors has not been effectively substantiated so far.

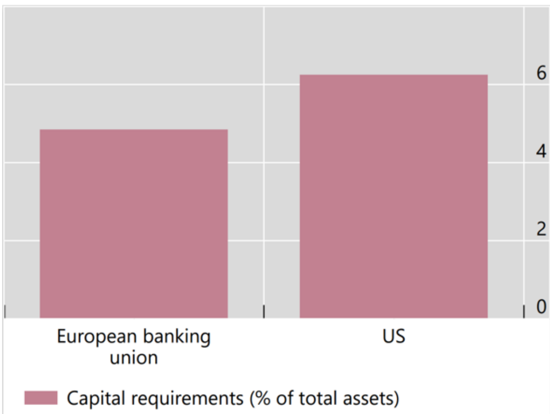
Capital requirements (% of RWA)[1] Graph 3



[1] Capital requirements and buffers for all GSIBs in the respective regions.

Sources: ECB (2025); Federal Reserve (2025); Bank of France (2023).

Capital requirements (% of total assets)[1] Graph 4



[1] Same figures as Graph 3, converted using average RWA density from the respective regions.

Sources: ECB (2025); Federal Reserve (2025); Bank of France (2023); BCBS (2025).

Therefore, since large banks have been subject to a comparable regulatory tightening across geographies, data suggest that differences in performance across jurisdictions are more likely driven by idiosyncratic or structural factors than global developments, such as post-crisis reforms.

Regarding the overall impact of the regulatory tightening on economic growth, the expected effect of effective regulation on financial and economic stability should not be forgotten. If something kills growth, this is certainly a financial crisis. In fact, the empirical evidence is relatively clear: without considering the ability of regulatory reforms to reduce the probability and severity of financial crises, tighter prudential standards would have a moderate to small negative impact on growth. However, when the medium-term benefits associated with financial stability are factored in, the evidence unambiguously points to a significant positive impact.[2]

Of course, the available evidence should be interpreted with caution. At most, it suggests that the overall stringency of Basel standards is not disproportionate and does not unduly constrain the banking industry's ability to provide credit to the real economy. However, it does not address the question of whether the same outcomes could be achieved with a more efficient regulatory framework that imposes fewer short-term costs on the industry.

3. What could be improved?

In this regard, recent stress episodes have highlighted areas where the current prudential framework could be improved. Those areas include regulators' ability to adjust regulatory requirements to the state of the economy in the business and financial cycles, the balance between qualitative and quantitative supervisory measures, and the regulation of some non-bank competitors in the market for financial services.

For example, the Covid-19 crisis illustrated that banks had generally achieved satisfactory resilience due to post-GFC regulatory tightening. However, this episode also revealed that the Basel Framework's capital stack was overly complex and not fully functional.

Total capital requirements are derived from the superposition of minimum requirements and various buffers designed to meet different objectives, whether macroprudential, microprudential or both. These buffers are sometimes fixed and, in other cases, releasable at the discretion of the authority. Within the fixed category, some are mandatory at all times, while others can be depleted during periods of stress.

Importantly, different buffers are often set by different authorities. In Europe, this is especially relevant as microprudential and macroprudential responsibilities are mainly in the hands of a European agency (the ECB / Single Supervisory Mechanism (SSM)) in the former case and on the national authorities in the latter.[3] Moreover, there are no official coordination mechanisms that would ensure that firms' overall required capital is adequate to meet both macroprudential and microprudential objectives.

[2] BCBS (2021).

[3] Coelho and Restoy (2024).

Therefore, there is clear scope to simplify the determination of capital requirements for banking institutions and to make them more effective in supporting both the resilience of individual institutions and the continuity of credit flows to the real economy throughout the business cycle.

Furthermore, the 2023 banking turmoil highlighted the limitations of excessively capital-centric regulatory and supervisory frameworks in many jurisdictions.[4] The failure of regional banks in the United States, in particular, demonstrated that no sensible amount of capital can compensate for unsustainable business models and poor governance. Adequate supervision – implying timely action to identify and address vulnerabilities in these areas through qualitative measures – emerged as the most effective policy response.[5]

Regarding the competitive position of banks relative to other intermediaries, I believe that regulatory distortions may indeed exist. Of course, as a matter of principle, it is not advisable to blindly apply banking regulations to non-banks, nor does it make sense to compromise on banks' safety and soundness to enhance their competitiveness with other entities. However, developments following the GFC highlight gaps in existing regulations for non-banks active in financial services. Closing these gaps would not only further enhance financial stability but also promote a level playing field between banks and other market participants.

For instance, in my view, there hasn't been sufficient policy action to introduce entity-based requirements addressing the specific risks posed by entities – such as big tech firms – that uniquely combine the provision of a wide array of financial and non-financial services using shared data and technological infrastructure.[6]

Moreover, the recent growth in the role of non-bank financial intermediaries – such as hedge funds, private equity firms and asset managers – in the global financial system can be seen as a logical consequence of tighter banking regulation. However, this increased role may heighten risks, as their leverage, market behaviour and strong interlinkages with commercial banks could affect financial stability. These factors argue for tighter oversight and, in some cases, additional regulation of these institutions.

4. What needs to be done in Europe?

As I have been arguing, while some aspects of the current global regulatory framework could eventually be revised, there is little available evidence at present that would convincingly support significantly reducing the current stringency of European prudential regulation. Similarly, I am not

[4] Dahlgren et al (2023).

[5] Balan et al (2025).

[6] Restoy (2021).

convinced that there is a case to further increase the direct intervention of governments and elected officials in the regulatory process.

Yet there could be scope to simplify rules and processes, although action in that domain should be carefully calibrated.

The EU framework comprises a complex overlay of various policy actions, including laws, regulations, standards, guidelines and supervisory expectations, implemented by different bodies (co-legislators, the Commission, European Supervisory Authorities). This complexity could inflate compliance and reporting costs for European banks relative to other jurisdictions. I believe a comprehensive analysis, including relevant cross-jurisdictional comparisons, as currently envisaged, can be helpful in this regard.

The correction of possible inefficiencies may, however, need to face complex trade-offs. In particular, the current proliferation of different types of technical standards is mostly attributable to the intention to avoid different interpretations of European legislation or varied supervisory practices that could damage the single market. Therefore, it is inaccurate to believe that, in order to strengthen the single market, authorities just need to simplify or eliminate rules and regulations.

Indeed, a move towards reducing and streamlining those European regulatory standards would imply more autonomy for national supervisory agencies and to the ECB/SSM when applying European rules. That would normally enhance regulatory efficiency, thereby supporting the external competitiveness of the European banking industry. At the same time, such a move would also entail accepting somewhat more policy heterogeneity that could eventually create some competitiveness distortions within the single market. Once more, there is no such a thing as a free lunch.

Yet, at least in terms of banking supervision, it might be worth exploring that route: a single agency, the ECB/SSM, now supervises approximately 90% of the EU banking sector, either directly or indirectly. Issues related to diverging supervisory practices or interpretations of EU rules by national authorities have therefore lost much of their relevance.

Another important area where a possible simplification of the existing regulation could be warranted is securitisation. That practice allows banks to free up resources for additional investment activities, thereby supporting profitability. Moreover, securitisation enables the diversification of credit risk among investors, thereby contributing to a more integrated financial system.

However, securitisation markets in the EU remain insufficiently active. Unlike the US market, securitisation activity in the EU has not regained the dynamism it exhibited before the GFC. This is somewhat paradoxical, as the clear deficiencies in the securitisation framework that the GFC highlighted were primarily associated with US asset-backed securities and related instruments rather than to securitisation practices in the EU.

Consequently, there appears to be scope to review current regulations to determine the extent to which they are dampening securitisation activity in the EU. So far, studies point to excessive reporting burdens for originators, securitisation vehicles and investors, as well as duplications in due diligence requirements across all entities that participate in the securitisation chain. Since this is a market where only institutional investors participate on the buy side, there may be opportunities to streamline procedures without compromising investor protection. The current review by the European Commission seems to me a welcome initiative.

Nevertheless, as highlighted in the recent Letta and Draghi reports, the main factor undermining the competitiveness of European banks – similar to other economic sectors – is their failure to fully capitalise on the opportunities presented by a single, integrated market.

The integration of the European banking industry remains very limited. Most European banks remain predominantly domestically focused. Importantly, since the creation of the banking union, the volume of cross-border mergers and cross-border lending and deposit-taking activities has not noticeably increased.

In an environment where technology amplifies economies of scale in the banking business, the insufficient consolidation of the sector hampers the industry's efficiency and profitability. More significantly, the lack of pan-European integration among European banks prevents the cross-border diversification of domestic financial risks, which is essential for a well functioning monetary union.

Cross-border mergers often encounter political obstacles. Yet the root causes of the lack of integration in the European market for banking services are deep and structural. For instance, overcapacity in the sector in several countries leaves little room for new foreign competitors. Additionally, the strong presence of savings and mutual banks – which are typically subject to limited market discipline – in some core European countries weakens market incentives for consolidation.

Existing regulations may also play a role. For example, local subsidiaries of the few pan-European groups must comply not only with obligations imposed on the entire group by home authorities but also with stringent requirements on loss-absorbing capacity and liquidity imposed by host authorities. This ring-fencing prevents these entities from realising efficiency gains through centralised resource management across the group.

Current ring-fencing practices are a direct consequence of the incomplete nature of the banking union. Despite the creation of the SSM and the Single Resolution Mechanism (SRM), there remains a significant risk that the failure of a subsidiary of a foreign bank in a particular jurisdiction would have to be borne by local banks – via, for example, their contributions to national deposit insurance schemes – and, ultimately, taxpayers in that jurisdiction. This justifies host authorities' efforts to mitigate this risk by imposing prudential requirements on local subsidiaries rather than simply relying on uncertain intragroup support.

Therefore, while not a panacea, completing the banking union appears to be a prerequisite for achieving a more integrated banking sector in Europe. Such a step would support both the stability of the euro area and the profitability of the industry. This requires creating a single deposit insurance scheme – the third pillar of the banking union – and a more effective single resolution mechanism capable of centrally addressing the failure of all significant banks, using mutualised external funds as needed to preserve financial stability.

6. Conclusions

To conclude, the financial industry is navigating a challenging period due to critical developments, including technological disruption, which is reshaping the competitive landscape, and tighter regulations aimed at safeguarding financial stability.

Policymakers certainly have a role to play in facilitating the industry's orderly adjustment to these new challenges. Regulation should aim to minimise unintended effects and, in particular, avoid creating unnecessary competitive distortions.

At present, there is no compelling evidence that tighter prudential regulations after the GFC have generated a disproportionate general impact on banks' lending capacity or the macroeconomy. However, there is scope to improve certain aspects of the current framework. In particular, simplifying some requirements and rebalancing the combination of across-the-board regulations and tailored supervisory actions in favour of the latter could be considered. Importantly, there is a clear public policy case to strengthen the regulation of non-bank providers of financial services by introducing entity-specific requirements aimed at addressing the concrete risk they pose for the financial system.

Finally, in Europe, it is worthwhile to explore the extent to which the complexity of the institutional framework for banking regulation could possibly impose excessive compliance costs on European banks. However, the main policy priority for fostering the efficiency and profitability of the industry remains promoting an integrated banking system – an objective that is far from being achieved. This requires – as a necessary, albeit not sufficient, condition – removing political obstacles to cross-border consolidation and taking more decisive steps to complete the banking union, which should become, in my view, a top concrete policy priority and not only a medium-term aspiration.

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