TASK FORCE REPORT

MORE FINANCE, LESS FRICTION

HOW TO SIMPLIFY THE EU'S FINANCIAL REGULATION AND STRENGTHEN SUPERVISORY STRUCTURES

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CEPS is an independent think tank based in Brussels. Its mission is to produce sound policy research leading to constructive solutions to the challenges facing Europe and the world. ECMI examines capital markets policy and ECRI credit markets and retail finance policies. They are both separate entities managed by CEPS.

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Foreword

Over the last 15 years, the European Union has worked consistently to build a strong regulatory and supervisory framework for our financial services industry. As a result, we have increased financial stability and improved investor and consumer protection. Our rulebook is much broader; supervision is much tighter.

But as the pendulum has swung, it has brought with it a new problem: European growth has slowed, while the stream of rules and guidance has kept on coming. So our biggest problem today is not a lack of rules. It is a lack of growth. Without that we can forget our aspirations for greater European sovereignty. Without growth we will not be able to stand on our own two feet. Nor will we have financial – or political – stability.

Over time, legislative measures, regulatory standards and supervisory guidance have piled up, step by step, stone on stone. The result? Not regulatory inadequacy. But regulatory density. We know that this is a burden that presses down on businesses right across the European economy. Yet for banks, it has a further systemic impact: it cuts the amount of money that can be invested in making the European economy stronger. And we cannot ignore the fact that other jurisdictions – jurisdictions with which we compete directly – are moving fast in a different direction on regulation and supervision.

It is against this background that this report advances a practical agenda for reform. While we argue that stability and market integrity should remain non-negotiable public goods, we make the case for regulation and supervision that is proportionate and coherent. At level 1, we call for clearly articulated policy objectives combined with more streamlined delegation. We believe that clear mandates with appropriately constrained discretion would strengthen accountability and give us faster and more predictable regulatory outcomes.

As for levels 2 and 3, we need a new discipline of 'replace rather than add'. We should aim for net simplification wherever possible, and any new initiatives should be considered alongside existing rules. Impact assessments must have real teeth, backed up by systematic ex-post evaluations. Where EU-level bodies intervene with guidance or the setting of expectations, these measures must also be traceable, reviewable and subject to appropriate accountability.

If we are serious about entering a new phase of economic transformation in Europe, we need to change our mindset. Stability alone is no longer a sufficient goal. That's why I believe that supervisory mandates need explicitly to recognise a secondary objective of competitiveness and growth, alongside financial stability. And regulators and supervisors need to be held properly to account for the progress they make against that objective. In other jurisdictions, regulators and supervisors seem to adopt a somewhat more balanced

approach to risk. This may invite reflection on whether there could be room for a similar calibration in the EU context. Likewise, accountability frameworks appear to be articulated more explicitly elsewhere. It would be worth considering how we might further strengthen these dimensions within our own system.

Meanwhile, completing the Banking Union remains a precondition for a genuine single market, one grounded in trust, resilience and seamless cross-border financial integration. The Savings and Investment Union, as proposed in the Letta report, seeks to better channel Europe's abundant savings into productive investments. But its effectiveness depends on a solid and complete Banking Union. Without it, deeper financial integration will remain aspirational.

We are at a decision point in Europe: either we can continue layering complexity onto the existing framework, or we can bring regulation and supervision into line with our long-term growth objectives.

This is the debate we must have in Europe in the months ahead. I would like to thank the CEPS, ECMI and ECRI Task Force for the valuable contributions it has made to that discussion, and for the rigorous analysis and practical recommendations it has brought to the table.

José Antonio Alvarez, Vice Chairman of Santander and Chair of the Task Force

EXECUTIVE SUMMARY

Context and diagnosis

The EU's framework for regulating and supervising financial services has delivered important gains in stability, resilience and investor and consumer protection gains. Over the past two decades, the EU has developed one of the world's most extensive financial rulebooks. But that framework is becoming harder to operate as a coherent system across the single market. Layered legislation, detailed technical standards and expanding guidance has increased complexity and reduced usability. Uneven national implementation has further weakened the practical force of mutual recognition, home-country control and single licencing.

The core competitiveness problem is not a lack of rules, but the friction created by how rules are designed, sequenced and applied across borders. As competition for capital, listings, intermediaries and financial innovation intensifies, the current EU framework too often turns intended harmonisation into duplication and fragmentation. In several sectors, firms face high fixed compliance costs and repeated 'rebuild cycles' in internal systems because level 2 and 3 measures arrive late, change over time or are introduced iteratively. Divergent supervisory expectations also discourage cross-border expansion, reduce predictability and weaken incentives to invest in EU-based market development.

A further weakness is a lack of agility. The global financial system is moving towards private asset markets and non-bank intermediation, data- and AI-enabled financial services, and new market structures such as tokenisation and crypto-asset markets. Yet the EU's regulatory and supervisory machinery still relies on slow recalibration, detailed *ex-ante* specification and extensive layering of level 2 and 3 measures. The result is a framework that is often too rigid for fast-moving innovation and too fragmented to supervise cross-border activity efficiently. This creates risks both for competitiveness and for consistent outcomes.

Regulatory and supervisory complexity now acts as a structural constraint on integration, investment and market depth. The costs are visible within firms, through legal interpretation, reporting systems and governance processes, and within authorities, through parallel oversight layers, coordination demands and limited capacity for forward-looking supervision. These frictions weight most heavily on smaller institutions, new entrants and cross-border business models. They also contribute to a broader EU challenge: the difficulty of mobilising savings into productive and strategic investment.

Regulation – simplifying the rulemaking pipeline

A central source of complexity is the EU's multi-tier rulemaking model, which has shifted from promoting flexibility to causing regulatory inflation. The Lamfalussy architecture was designed to separate high-level political choices from adaptable technical implementation. Over time, however, level 2 and 3 measures have grown in volume and operational reach. They now often prescribe detailed reporting templates, methodologies, disclosure formats and internal processes, while also embedding policy choices after level 1 legislation has already been adopted by the Council and the European Parliament. This weakens proportionality, compresses implementation timelines and creates repeated adjustment cycles as technical deliverables evolve. At the same time, the absence of a systematic mechanism to consolidate, sunset or assess the cumulative impact of successive level 2 and 3 outputs has led to layering, overlap and rising compliance costs without equivalent gains in consistency or risk reduction.

Level 1 legislation has also become more detailed, reducing agility and forcing the reopening of political negotiations for technical recalibration. In several files, detailed parameters and operational prescriptions have been written into primary law (often around firm entities rather than activities), even where markets evolve quickly and adjustment is unavoidable. The combined result is 'complexity without agility'. Firms and supervisors face constant implementation pressure from technical updates, yet the system remains slow to adapt where core features require change. This increases uncertainty and weakens competitiveness relative to jurisdictions where agencies can move faster under clearer statutory mandates.

A credible agenda for regulatory reform should therefore focus on process re-engineering rather than deregulation. The aim is to reinforce the EU's capacity to mobilise capital at scale while preserving financial stability and high standards of consumer and investor protection. This means redesigning how rules are produced, sequenced and maintained. Compliance efforts should move away from repeated rebuilds and towards predictable, automation-ready maintenance that also supports cross-border activity. That, in turn, requires a more disciplined allocation of functions across the Lamfalussy levels: level 1 texts focused on objectives, scope and bounded delegation; level 2 measures disciplined by sequencing and review; and level 3 instruments that are traceable, version-controlled and used sparingly rather than as a substitute for clearer law.

The EU needs a stronger 'replace rather than add' approach across levels 1 to 3. New initiatives should map existing obligations and demonstrate where legacy requirements will be consolidated or repealed, especially where multiple files interact. This would reduce accumulation, improve readability and limit the need for recurring legislative reopenings.

Better regulation tools need to function as binding restraints in financial services, especially when legislative negotiations materially expand the scope and compliance costs. Impact assessments frequently give insufficient weight to implementation and competitiveness and are rarely updated when co-legislator amendments alter regulatory obligations late in the process. There is a need for updated impact assessments when the substance changes materially during negotiations, while level 2 measures with significant operational effects should be subject to stronger scrutiny. *Ex-post* evaluation should become routine, treating regulation as a lifecycle to be designed, implemented, reviewed and adjusted, rather than as a one-off act.

Stability and competitiveness can be jointly strengthened by targeting the mechanisms that turn complexity into burden: late sequencing, duplicate reporting and inconsistent definitions across files. Stronger discipline in implementation sequencing, including 'readiness gates' for essential technical standards and guidance, would enable firms to build and test systems with fewer redesigns. Checks on definitions and reporting systems for cross-file interoperability would also help prevent siloed legislation from generating duplicative obligations and inconsistent implementation across sectors.

Supervision – making implementation consistent, proportionate and accountable

Supervision shapes markets and is thus a core competitiveness variable, not merely a compliance function. Timeliness, predictability and consistency in supervisory processes matter because they affect market entry, product roll-out, cross-border expansion and the viability of specific business models. In the EU's hybrid setup, with centralised banking supervision for significant institutions alongside coordination models in other sectors, divergent national practices can create uneven competitive conditions and hinder the development of scalable EU-wide business models.

A persistent weakness is the gap between formal harmonisation and practical convergence, owing to national discretion, disparities in capacity and varied operating practices. Even where legal texts are harmonised, differences in interpretation, supervisory intensity, authorisation timelines, data demands and approaches to enforcement create compliance uncertainty. They also encourage risk-averse or duplicated operating structures. Convergence tools such as guidelines, Q&As, peer reviews and thematic work remain useful, but they often stop at diagnosis without structured remediation and follow-up.

A shift from ad hoc convergence to an operational convergence model with follow-up and measurable outcomes would improve effectiveness. This could involve stronger convergence work led by the European Supervisory Authorities in areas that matter most

for cross-border integrity and systemic relevance. Peer and thematic reviews could then translate into remediation plans, timelines and public reporting on implementation. This would also require better alignment between accountability and impact, so that when EU-level bodies shape market outcomes through guidance or expectations, these instruments are traceable, reviewable and subject to appropriate transparency.

Cross-border approvals and group-level decisions should be organised for predictability by assigning clear decision ownership and reducing sequential veto points. For activities that are inherently cross-border – such as mergers within the Banking Union, organised group approvals or key waivers affecting capital and liquidity management – single-process decision-making with binding timelines and well-defined criteria would enhance predictability. This would not remove prudential safeguards, but it would reduce uncertainty and prevent process intensity from operating as a de facto barrier to integration.

Proportionality should be operationalised as a design constraint rather than a general principle, especially for smaller and more innovative firms. Proportionality could be embedded in supervisory methodologies and in reporting and engagement plans through risk-sensitive segmentation, rather than relying only on static size thresholds. The objective is to maintain the 'same risk, same rules' principle while ensuring that 'same rules' does not automatically imply identical processes, templates or supervisory burdens regardless of business model or risk profile.

Data infrastructure is the enabling condition for both better supervision and lower burden. Shifting from 'more data' to 'better, reusable data' would help align effectiveness with proportionality. Supervisory reporting should start from concrete, supervisory use cases, rationalise duplicative templates and accelerate machine-readable taxonomies that allow reuse and automation. Pilots for more granular, on-demand data access could also be useful where feasible, provided they are paired with strong security and governance safeguards. This would enable supervisors to obtain targeted information without continually expanding periodic reporting burdens.

A functional way forward – aligning oversight with market integration

Because EU financial markets differ in their degree of integration, a functional 'supervisory efficiency test' could help align supervisory responsibilities to market reality. The test would assess factors such as standardisation, passporting intensity, market concentration, investor base, the existing supervisory landscape and how easily enforcement works across borders. It would support function-by-function decisions rather than binary debates between national and EU-level supervision. In practice, this could help determine where supervision should remain primarily national, where

coordination through colleges or shared tools is sufficient and where targeted EU-level supervision is warranted for highly integrated activities.

The overall direction is one of strategic rebalancing: simpler, more principles-based regulation paired with greater convergence and accountability in supervision. The EU does not face a choice between safeguarding stability and improving competitiveness; it faces a design challenge in making the framework easier to implement and maintain, and more consistent across borders. The EU can restore coherence by treating the rulebook as a managed delivery chain, reducing the drivers of fragmentation and modernising supervisory data and operating models. That would relieve unnecessary burdens and strengthen the single market's capacity to mobilise savings for productive and strategic investment.

1. INTRODUCTION

Europe's financial regulatory and supervisory framework has delivered major stability and protection gains over the past two decades, but it has become increasingly difficult to operate as a coherent single-market system. The core challenge is not a lack of rules, but the frictions created by how rules are designed, sequenced and applied across borders. These frictions translate into higher fixed costs, slower time-to-market and weaker incentives to scale cross-border activity. In a context where the EU is seeking to mobilise savings more effectively, deepen capital markets and support strategic investment under its Savings and Investment Union agenda, regulatory and supervisory usability has become a first-order competitiveness issue.

Against this backdrop, the political and institutional momentum for simplification has intensified. In December 2025, the Council (ECOFIN) adopted Conclusions on simplifying the Union's financial services regulation, explicitly recognising that the EU regulatory framework has become more complex and extensive than necessary. They call for a coordinated effort to reduce unnecessary burdens while preserving financial stability. The Conclusions emphasise the need to address both the existing stock and the future flow of regulation, with improvements to impact assessments, reduced duplicative reporting and better sequenced timelines for implementation. They also advocate rebalancing the use of legislative acts, delegated measures and supervisory guidance.

In parallel, institutional reflections at the supervisory level have pointed in the same direction. The ECB's High-Level Task Force on Simplification has highlighted how cumulative prudential requirements and overlapping capital layers have increased complexity without necessarily improving the usability or transparency of bank capital – adding to the case for a more coherent, system-wide approach to regulation and supervision. Together, these developments provide a clear institutional framing for the analysis and recommendations developed in this report.

The EU's current framework is the result of an evolution in which global standards, largely non-binding and dependent on national implementation, have been progressively embedded in EU law and significantly expanded following the global financial crisis. Post-crisis reforms strengthened safeguards and established a new institutional architecture, including the European Supervisory Authorities (ESAs) (the European Banking Authority (EBA), European Securities and Markets Authority (ESMA) and European Insurance and Occupational Pensions Authority (EIOPA)). For banking, the Single Supervisory Mechanism (SSM) was set up. This marked a decisive shift towards supranational supervision in the euro area. A fuller account of this institutional and historical evolution is set out in Appendix C.

Data are a central enabling condition for both effective supervision and meaningful convergence. Only with the establishment of the SSM in 2014 did consistent and comparable data for euro area banks become publicly available. This was gradually extended to capital markets and insurance via ESMA and EIOPA. As a result, there is now roughly a decade of EU-wide financial market data. Yet the process remains incomplete. Gaps in granularity, coverage and standardisation continue to hamper supervisory convergence and effective risk assessment, particularly in fast-evolving domains. Additional background on the structural trends driving complexity – including regulatory expansion into adjacent domains such as digital and sustainability regimes, developments in financial intermediation and the resulting coordination challenge – is provided in Appendix D.

This report provides a comprehensive examination of how the EU's regulatory and supervisory framework affects the competitiveness of its financial system, and what can be done to improve it. Chapter 2 defines competitiveness in a financial context and assesses how regulatory and supervisory barriers hinder performance across sectors. Chapter 3 presents a concise diagnostic synthesis of why the EU framework has become harder to run and harder to converge, while the detailed analysis and supporting examples are provided in Appendices E and F. Chapters 4 and 5 set out the report's reform proposals to improve rulemaking and supervisory effectiveness in a proportionate and implementation-oriented way. Chapter 6 distils the analysis into targeted recommendations aimed at restoring coherence, reducing avoidable burden and keeping the EU framework fit for purpose in a changing global and technological landscape.

1.1. THE COSTS OF REGULATORY AND SUPERVISORY COMPLEXITY

Regulatory and supervisory complexity in EU financial services is often perceived as a matter of administrative burden. This understates the scale of the problem. Complexity has translated into a substantial reallocation of resources, both within supervisory authorities and across the financial industry, with direct implications for market integration, supervisory effectiveness and competitiveness.

The costs of the current framework are visible in several dimensions:

- *Rising supervisory resource intensity*. The EU's supervisory architecture has expanded significantly over time. Across the SSM, the ESAs and the Single Resolution Board, around 3 150 staff (as of 2024) are engaged in supervisory and regulatory tasks at the EU level, in addition to extensive resources deployed by national competent authorities (NCAs). Importantly, EU-level supervision has not replaced national supervision: evidence shows that the establishment of the SSM

has coincided with continued growth in the staffing and budgets of the NCAs, reflecting a layered rather than substitutive institutional model.

- *Institutional layering and duplication*. Supervisory responsibilities are often shared across the EU and national levels, generating parallel processes and coordination costs. In financial market infrastructure, for example, 13 national supervisory teams, in addition to ESMA, are involved in supervising just 14 EU-based central counterparties (CCPs), illustrating the resource intensity of multilayered oversight.

- *High and rising compliance costs for firms*. Compliance costs associated with EU financial legislation are estimated at 2-4% of total operating costs across banking, insurance and capital markets (ICF and CEPS, 2019). Compared with 2009, both one-off and ongoing compliance expenditures have increased five- to six-fold, driven by regulatory layering, fragmented implementation and expanding reporting requirements.

- *Resource diversion within financial institutions*. Financial institutions must allocate growing numbers of staff to compliance, legal interpretation, data production and supervisory interaction. These resources are largely absorbed by process-driven obligations, reducing capacity for innovation, cross-border expansion and market development.

- *Dual-burden dynamics*. The same complexity that increases supervisory staffing and coordination needs also raises the compliance burden for firms. As a result, resources are simultaneously absorbed on the public and private sides of the system, with limited evidence of proportional gains in supervisory effectiveness or market integration.

Taken together, these costs show that regulatory and supervisory complexity is not a marginal inconvenience. It constitutes a structural impediment to the objectives of a Capital Markets Union and financial competitiveness, and, if left unchecked, risks becoming increasingly self-perpetuating over time.

1.2. WHAT DRIVES COMPLEXITY AND FRAGMENTATION TODAY

The EU's complexity challenge is the result not only of the growing stock of rules, but also of the ongoing flow of operational requirements generated through delegated measures, technical standards and supervisory guidance, combined with uneven national implementation. While common rules are intended to promote convergence and legal certainty, in practice the system can produce recurring implementation cycles, duplicative reporting demands and differences in supervisory expectations across Member States – especially in cross-border settings.

These dynamics are compounded as regulation and supervision expand into cross-cutting domains (digital resilience, AI-enabled processes and sustainability-related obligations) that require tighter coordination across mandates, clearer allocation of responsibilities and interoperable data infrastructure. Without this, new layers of requirements risk amplifying uncertainty and burden through overlaps and inconsistent supervisory approaches. A fuller discussion of these structural trends, including non-bank intermediation and institutional coordination issues, is provided in Appendix D.

1.3. SUPERVISORY CAPACITY UNDER STRAIN

As the EU's framework for financial regulation has evolved in scale and ambition, so too have the difficulties of ensuring consistent implementation, effective supervision and practical enforceability. While the introduction of the single rulebook was intended to promote convergence and legal certainty, the reality on the ground often reflects fragmentation, duplication and wide disparities in supervisory outcomes across Member States[1].

Despite common rules, national authorities retain significant discretion, particularly in the remaining, albeit few, areas where directives leave room for interpretation or where local practices diverge from the intent of EU-level legislation. The result is that financial institutions operating cross-border often face conflicting compliance requirements, with varying timelines, enforcement approaches and supervisory expectations. This undermines the integrity of the single market and creates operational inefficiencies for both firms and regulators.

Moreover, the complexity and layering of EU legislation, especially in areas governed by level 1 texts supplemented by extensive level 2 and 3 measures, pose major challenges. Hundreds of delegated and implementing acts, technical standards, guidelines and Q&As are required to operationalise EU financial legislation. While this granularity is intended to reduce discretion for both supervised entities and authorities, thereby supporting legal certainty and a level playing field, its cumulative volume and pace of expansion can pose operational dilemmas for compliance systems and complicate the practical application of the framework. Financial institutions must dedicate vast resources to monitoring regulatory updates, interpreting supervisory expectations and adapting internal systems

[1] These problems are often most acute in smaller Member States, where bank-based financial structures, limited capital-market depth, and constrained supervisory resources interact to magnify the relative burden of uniform regulatory and reporting requirements. This can stretch supervisory capacity, increase reliance on national discretion in implementation, and – over time – reinforce divergence and structural asymmetries between larger financial centres and smaller markets, thereby impeding convergence and cross-border integration.

– resources that are disproportionately burdensome for smaller market participants and new entrants.

This complexity also affects supervisors. NCAs and EU-level bodies are expected to oversee institutions across a widening range of risks (e.g. prudential, conduct, digital, cyber and sustainability) while managing increasingly disparate data flows and reporting obligations. Yet supervisory capacity and enforcement quality may remain uneven at the national level and coordination issues persist in cross-border cases, especially for capital markets.

Furthermore, critical gaps remain in the availability and comparability of supervisory data. While the establishment of the SSM significantly improved data transparency and harmonisation for euro area banks, similar progress has not been achieved in capital markets or insurance. ESMA and EIOPA have made advances, but systemic gaps in data granularity, timeliness and consistency continue to hamper supervisory effectiveness.

These challenges highlight the limits of a regulatory model that relies heavily on rule proliferation without corresponding improvements in supervisory capacity, data infrastructure and institutional clarity. Addressing these gaps requires more than technical refinements; it calls for a broader rethinking of how EU regulatory and supervisory systems are designed, resourced and coordinated in practice. This report's detailed diagnostic analysis of rulemaking and supervision is presented in Appendices E and F, underpinning the reform proposals developed in the main chapters.

2. The framing of competitiveness in the financial sector

Key findings

- **Competitiveness in financial services is at the system level.** It is about the financial system's capacity to allocate capital efficiently, support innovation and resilience, and enable transformation of the real economy, not just individual firm performance.
- **Regulation is a primary lever of competitiveness.** Rule design shapes market structure, compliance costs, entry conditions and incentives for innovation, as well as consolidation and risk-taking.
- **Competitiveness does not equate to deregulation.** The objective is a clear, proportionate and coherent framework that remains anchored on stability and consumer protection while reducing avoidable frictions.
- **Supervision is market-shaping.** Timeliness, predictability and consistency in supervisory processes are important. They influence approvals, business model viability, cross-border scaling and the uptake of innovations. These factors can have disproportionate effects on smaller and newer entrants.
- **The EU's hybrid supervisory setup sustains uneven conditions.** The combination of centralisation in banking and coordination elsewhere, alongside divergent national practices and capacity gaps, limits convergence and undermines scalability in the single market.
- **Structural bottlenecks persist across sectors and infrastructure.** Diverse retail/consumer regimes, varied Solvency II implementation, distribution-driven segmentation in asset management and siloed market infrastructure constrain scale and raise operating costs.
- **The competitiveness gap is ultimately an investment-and-scaling problem.** Fragmentation and regulatory/supervisory frictions, together with subscale and differentiated capital markets, impede the mobilisation of savings into productive and strategic investment and reduce the EU's global standing.

As the EU enters a new phase of economic transformation – driven by digitalisation, sustainability goals and shifting geopolitical dynamics – the performance of its financial system is under renewed scrutiny. The financial sector is not only a key industry in its own

right but also a strategic enabler of investment, innovation and resilience across the entire economy. Ensuring that the EU's financial system remains competitive, both internally and globally, is now central to the broader debate on Europe's long-term growth model.

Yet competitiveness in financial services is not a single metric. It reflects how effectively the EU's financial ecosystem converts savings into productive investment, how readily firms can expand across borders and how quickly market structures adapt to new technologies and risks. These outcomes depend heavily on the design and interaction of regulation and supervision. Rules and oversight can either reduce frictions and support innovation or entrench fragmentation and raise fixed compliance costs. In this sense, competitiveness is not a call for weaker safeguards, but for a framework that achieves stability and protection with fewer avoidable inefficiencies and clearer incentives. Ultimately, the end-beneficiaries are savers and investors. An effective Savings and Investment Union should translate into better-value products and services, wider choice, lower frictions and stronger long-term outcomes for end-investors across the single market.

This chapter unpacks the concept of competitiveness as it applies to EU financial services. It begins by clarifying the different dimensions of competitiveness in financial regulation and why they matter for the EU's economic agenda (Section 2.1). It then turns to financial supervision, examining how supervisory practices affect innovation, entry conditions and the ability of firms to scale across borders (Section 2.2). The final section (2.3) offers a detailed sector-by-sector assessment of structural constraints across banking, insurance, asset management, financial infrastructure and capital markets – highlighting where misalignment, regulatory barriers or institutional frictions continue to limit performance.

2.1. WHY COMPETITIVENESS MATTERS IN FINANCIAL REGULATION

Competitiveness in the financial sector can be assessed along three interrelated dimensions that capture both the performance of the sector and its contribution to the wider economy:

- *Competitiveness of the financial sector*. This refers to the global standing of EU-based financial institutions in comparison with peers in other jurisdictions, particularly the US and Asia. It reflects their ability to attract capital, innovate, expand internationally and operate at scale (see Box 1).

- *Competitiveness within the financial sector*. This relates to the internal dynamics of the market. More specifically, it concerns the extent of competition among financial service providers, the presence of market concentration or fragmentation and the ease with which new entrants can challenge incumbents.

- *Contribution of the financial sector to the EU's broader competitiveness*. This is perhaps the most important dimension. A financial system that efficiently allocates capital to productive investment, supports innovation and facilitates economic transformation is a cornerstone of long-term competitiveness across the real economy.

Box 1. What the EU can learn from the US, UK and Asia on financial competitiveness

While the EU's financial architecture faces unique institutional and market integration challenges, other jurisdictions have pursued distinct strategies to enhance competitiveness, often with greater agility and scale.

United States

The US benefits from a deep, unified capital market underpinned by a single currency, centralised supervision and extensive use of market-based finance. The Securities and Exchange Commission plays a central rulemaking role with comparatively simpler, scalable disclosure regimes, especially for initial public offerings. Wide coverage of equity research, active secondary markets and broad retail participation further boost liquidity and innovation financing.

United Kingdom

Post-Brexit, the UK has sought to reposition itself through regulatory flexibility. The Future Regulatory Framework aims to restore more domestic control over financial rulemaking, with a focus on competitiveness and growth. Initiatives include the Edinburgh Reforms, which revisit rules in the style of the Markets in Financial Instruments Directive, streamline listing requirements, and foster scale in capital markets. The UK's approach allows for quicker adaptation of technical rules via the Financial Conduct Authority and Prudential Regulation Authority.

Singapore and Hong Kong

Asia's financial hubs blend prudential oversight with targeted innovation support. Singapore, in particular, runs dedicated regulatory sandboxes, tax incentives and fintech innovation testbeds under the Monetary Authority of Singapore. Singapore's policies are closely integrated across government, central bank and innovation agencies, helping startups to scale within a secure regulatory environment. Hong Kong likewise combines liberal capital access with robust investor protections and active promotion of capital markets.

Financial regulation plays a decisive role across all three dimensions. Rules influence the structure of markets, the cost and complexity of doing business, and the incentives for innovation or consolidation. A regulatory environment that is overly rigid, differentiated

or slow to adapt can create high compliance burdens, reinforce incumbency and limit the financial sector's contribution to broader EU goals.

Competitiveness, in this context, does not mean deregulation. It means ensuring that rules are clear, proportionate, coherent and future-proof. It means aligning the regulatory framework with strategic economic objectives, while preserving stability and consumer protection. A competitive financial system is one that allows fort both prudence and dynamism, enabling firms to innovate and grow while safeguarding public trust.

These issues are increasingly recognised in high-level EU discussions. The Draghi (2024) and Letta (2024) reports, as well as the European Court of Auditors, have identified regulatory complexity, market subscale and supervisory differences as key barriers to EU financial development. If the EU is to close its investment gap (estimated at EUR 800 billion annually) and position its financial sector as a global leader, competitiveness must become a central design principle of financial services policy.

2.2 WHY COMPETITIVENESS MATTERS FOR FINANCIAL SUPERVISION

While regulation sets out the rules of the game, supervision determines how those rules are applied in practice. It is not a neutral or purely technical process; it is a critical mechanism through which the financial system operates, evolves and adapts. The quality, consistency and responsiveness of supervision directly influence how firms allocate capital, manage risks and bring innovation to market. In this sense, supervision is a core determinant of competitiveness.

Several aspects link supervision to market outcomes. First is certainty and timeliness: when supervisory processes are slow, opaque or inconsistent, they delay approvals, raise costs and discourage cross-border or innovative activity. Second is consistency across jurisdictions: divergent supervisory practices – whether in interpreting rules, approving models or applying stress tests – undermine the single market and create barriers to scale. Third is proportionality: when supervisory expectations are not calibrated to a firm's size, complexity, risk or business model, smaller and more agile players bear disproportionate burdens, distorting competition and perpetuating incumbency[2].

The institutional landscape of EU supervision reflects a hybrid model: centralisation in banking (via the SSM), coordination in capital markets and insurance (via the ESAs) and continued reliance on NCAs. This structure creates both opportunities and obstacles for convergence. Supervisory innovation (e.g. sandboxes, digital tools and AI-based

[2] Proportionality should be understood as outcome-based tailoring. Supervisory intensity and process requirements should be scaled to the risks generated by the firm's activities and business model (including interconnectedness, substitutability and operational complexity), and designed to achieve the supervisory objective without imposing unnecessary procedural or data burdens.

monitoring) has emerged in some Member States but remains unevenly distributed and insufficiently coordinated at the EU level.

Ultimately, a competitive supervisory system is one that is predictable, efficient, proportionate and forward-looking. It enables firms to scale across borders, supports responsible innovation and ensures a level playing field for both incumbents and new entrants. If the EU is to close its investment gap, deepen the single market and position its financial sector as globally competitive, supervision must evolve accordingly – not only to safeguard stability, but also to actively enable progress.

2.3. An assessment of competitiveness by sector

While the overall competitiveness of the EU financial system is shaped by macro-level regulatory and supervisory frameworks, many of the structural bottlenecks are sector-specific. Different financial services face distinct problems in terms of market integration, economies of scale, innovation capacity and regulatory coherence. Table 1 summarises the core constraints that cut across five key segments. Understanding these differences is essential for designing targeted reforms that can enhance the performance and contribution of each sector.

Table 1. Structural barriers to competitiveness across EU financial services

Sector	Key fragmentation issues	Regulatory constraints	Innovation/scale barriers
Banking	Market segmentation, retail isolation	Supervisory inconsistency, overlapping reporting	Low profitability, legacy IT, underinvestment in tech
Insurance	Limited cross-border penetration, focus on domestic products	National discretion in Solvency II implementation	Product heterogeneity, legal uncertainty, limited scale
Asset management	Distribution networks, wrapper bias	PRIIPs-MiFID-SFDR misalignment	High compliance costs, barriers to cross-border scaling
Financial infrastructure	CCP/CSD silos, different trading venues	EMIR, CSDR rigidity, uneven enforcement of open access	High transaction costs, low interoperability

Capital markets	Shallow equity and bond markets, separate listings	Complex prospectus regimes, diverse national rules	Weak IPO pipeline, low research coverage, limited liquidity
Market making	Varying liquidity pools and venue landscape, limited EU-wide growth potential	Supervisory inconsistency, artificial constraints on liquidity provision	Underinvestment in EU markets, less ability to support liquidity in markets/new products

Notes: CCP = central counterparty; CSD = central securities depositories; CSDR = Central Securities Depositories Regulation; EMIR = European Market Infrastructure Regulation; IPO = initial public offering; MiFID = Markets in Financial Instruments Directive; PRIIPs = Packaged Retail and Insurance-based Investment Products (Regulation); SFDR = Sustainable Finance Disclosure Regulation.
Source: Authors' compilation.

2.3.1. Banking

Since the financial crisis, a competitive banking sector has been viewed as a well-capitalised one, with low levels of non-performing loans. European banks have healthy levels of capital, Common Equity Tier 1 (CET1), which has enabled them to be resilient through a series of shocks in recent years, such as Covid-19 or the March 2023 international banking turmoil. Banks with lower levels of capital will restrain lending in downturns, which would directly affect the real economy (for well-capitalised banks, supervisors can use other tools to maintain lending). CET1 capital (risk-weighted) stood at 17% at the end of 2024, compared with 8% in 2007, while the leverage ratio (not risk-weighted core equity) increased to 5.9% (Buch, 2025).

Yet the big problem for EU financial markets is competition. According to many indicators, financial markets are fragmented, for a variety of reasons. An IMF (2024) paper estimates that the remaining intra-EU trade barriers are equivalent to up to 110% for the services sector, well above levels in US states. However, the ECB's financial market integration indicator (mostly based on banking and capital markets) has recently increased significantly, above all the price-based index (showing price competition is improving) but also the quantity-based indicator (more products are sold across borders) – both higher than the average (ECB, 2025b). This is possibly co-related to M&A activity, which grew markedly in banking after more than a decade at a very low level.

Limited competition means that banks can charge higher interest rates, or that they have limited incentives to provide loans. The recent ECB lending survey showed that, in markets where banks are more concentrated, as is the case in the majority of EU Member States, lending standards are slightly stricter, and firms effectively report more difficulty accessing loans (ECB, 2026). The more banks can scale up and operate in a larger market, the more

they can contribute to reducing concentration, reap economies of scale, and scope and foster growth.

Despite improved capitalisation, European banks remain less profitable than their global peers. Return on equity is consistently lower than that of US banks, partly due to structural inefficiencies and cost pressures. Differences in regulation and supervisory expectations and overlapping reporting requirements across Member States lead to higher compliance costs and operational duplication. These factors not only affect profitability but also reduce the resources available for strategic investment, particularly in digital transformation.

The lack of scale also stifles innovation. Many EU banks, especially smaller ones, struggle to justify large investments in modern IT systems, cybersecurity and fintech integration. This places them at a disadvantage compared with larger global competitors that benefit from a single regulatory environment and deeper capital markets. Digital transformation is essential for operational efficiency as well as for offering competitive products, improving customer experience and strengthening risk management.

Retail banking illustrates the consequences of fragmentation most clearly. Despite progress on open banking and digital ID initiatives, there are still no truly pan-European retail banking offers. Consumers in one Member State often cannot open a bank account or access credit products in another Member State without undergoing complex procedures, if at all. Differences in consumer protection laws, payment systems, taxation, anti-money laundering practices and credit scoring methodologies hinder market entry and restrict consumer choice. As a result, competition in retail banking remains largely national and cross-border innovation is limited.

Improving the competitiveness of the EU banking sector will require not just deepening market integration but also aligning supervisory practices, simplifying compliance processes and enabling more effective use of technology and data. Without these changes, European banks risk being locked into a low-profit, high-cost equilibrium that limits their capacity to support the real economy and compete globally.

2.3.2. Insurance

The insurance sector, in contrast to banking, is already moderately concentrated, with the top 5 groups controlling more than half the market. Life insurance is noticeably more concentrated than non-life. The 20 largest groups account for approximately 59% of insurance premia underwritten in the EEA, while firms using internal models represent around 53% of total premia, reflecting their size and sophistication. Profitability and

solvency remain solid across the sector, with a slight improvement in capital positions and strong levels of high-quality own funds, according to EIOPA (2025b).

At the same time, cross-border integration in insurance remains limited. Only around 11% of insurance premia in the EEA stem from cross-border activity, a figure that has remained largely flat over the past decade. Structural barriers such as inconsistent tax treatment, differing conduct and consumer protection regimes, and persistent legal uncertainty around liability and contract law continue to inhibit the emergence of pan-European insurance products. Life insurance, in particular, remains highly domestically oriented due to national frameworks for long-term savings and retirement products.

The patchy implementation of Solvency II has also contributed to segmentation. While the framework provides a common prudential baseline, national discretion in key areas (e.g. the application of the matching adjustment, volatility adjustment and internal model approval) creates uneven capital requirements and supervisory expectations. This reduces comparability, complicates cross-border group supervision and raises compliance costs for pan-European insurers. As EIOPA has noted, progress on supervisory convergence remains too slow to unlock the full benefits of the single market (EIOPA, 2025a).

2.3.3. Asset management

In asset management, competition from large global firms is intense, but EU institutions remain resilient, largely due to their control over domestic distribution channels. This results in a highly disjointed market, with considerable variation in the role of banks, insurers and independent managers across Member States. Only four asset managers are seen to operate independently of bank or insurance parent groups, and even these players face hindrances in expanding across borders (Morningstar, 2025).

Despite the industry's global nature, EU asset management remains divided by national regulatory regimes, fund legal structures and labels (e.g. Undertakings for Collective Investment in Transferable Securities (UCITS) and Alternative Investment Funds (AIFs)), as well as distribution networks. Regulatory complexity further exacerbates the fragmentation. The interaction between the Packaged Retail and Insurance-based Investment Products Regulation, the product governance rules for the Markets in Financial Instruments Directive II (MiFID II), sustainability disclosures of the Sustainable Finance Disclosure Regulation (SFDR) and diverging national interpretation generate uncertainty. Combined, they also disincentivise cross-border product development and

distribution[3]. Small and mid-sized asset managers in particular face high fixed costs in navigating these overlapping obligations, limiting their ability to compete at scale.

These divergences have implications for capital markets development. Without efficient pooling of retail and institutional capital across borders, investment in long-term assets such as infrastructure, private equity and sustainable finance remains suboptimal. A more competitive and integrated asset management industry could better support the Capital Markets Union by deepening market liquidity, reducing costs for investors and improving the allocation of savings across the EU economy.

2.3.4. Financial infrastructure

The backbone of financial markets is formed by their infrastructure – trading platforms, CCPs, settlement systems and payment networks. Yet this infrastructure often remains a critical impediment to market integration in the EU. The lack of interoperability across systems continues to curtail cross-border activity, limit scale and increase transaction costs. These issues have been identified repeatedly since the early 2000s but remain only partially addressed.

Some market consolidation has occurred, but the overall structure remains piecemeal, with uneven application of open access principles and non-discriminatory membership criteria. Smaller market participants often access core infrastructure indirectly (e.g. via client clearing), reflecting high fixed participation costs and scale-dependent pricing[4]. The consequence is a structurally higher cost base, which undermines efficiency and acts as a barrier to entry and innovation.

These disparities have concrete implications for competitiveness. Post-trade processes are more expensive and slower than in integrated jurisdictions like the US and clearing and settlement arrangements often remain siloed by asset class and geography. TARGET2-Securities, launched by the ECB to harmonise securities settlement across the euro area, has reduced some costs but has not fully solved inconsistencies at the level of central securities depositories. Despite years of policy effort, the objectives of the 2014 Central Securities Depositories Regulation, such as improving settlement discipline and cross-border access, are only partially met. Similarly, the European Market Infrastructure

[3] This is compounded by operational frictions in passporting (notification procedures), fund authorisation processes and heterogeneous national requirements for marketing materials.

[4] Smaller firms often choose client clearing rather than CCP membership because direct access involves high fixed operational and legal costs, as well as scale-dependent default-resource and operational requirements. While client clearing is rational, it can embed intermediation and concentration effects (fees, balance-sheet constraints and limited choice of clearing members), raising the all-in cost of access and potentially constraining entry and innovation.

Regulation (EMIR) has improved transparency and risk mitigation in derivatives markets but has not fully resolved structural issues around CCP access and supervisory differences.

The cumulative effect of these limitations is a financial system that lacks the scale benefits and liquidity depth of more integrated jurisdictions. On the public markets side, the EU remains a patchwork of regulated markets and alternative trading facilities. Such a trading landscape tightens liquidity, increases costs and reduces the attractiveness of EU capital markets for both issuers and investors. Wider bid-ask spreads, higher market impact costs and the prevalence of dark trading all stem from this structural dispersion. Dark trading is not inherently problematic; it is often used – particularly by institutional investors – to execute large orders while limiting information leakage and market impact. The issue arises when its prevalence, combined with scattered venues, drains liquidity from lit markets and impairs price discovery[5].

Despite several harmonisation rounds, the absence of a truly single prospectus regime continues to dampen cross-border initial public offering (IPO) activity. This puts EU equity markets at a disadvantage compared with jurisdictions where streamlined issuance and deep secondary markets enable firms to raise capital faster and cheaper. Even in bond markets, where a wholesale issuance regime does exist, liquidity remains tight, with most trades occurring over-the-counter and with limited post-trade transparency.

On the secondary market side, the EU equity turnover ratio stands at 1.7 times (trading volume relative to market capitalisation), compared with 3.2 times in the US and 4.3 in China (AFME, 2026). Bond market turnover is lower than in US markets by a factor of 3-4. These figures point to a shallower market depth, higher trading costs and weaker cross-border capital flows. The result is that even institutional investors face challenges in efficiently reallocating capital across the EU.

Private markets are equally affected. Venture capital and private equity are underdeveloped relative to the US, despite higher historical returns in the EU. Private capital – especially in early-stage innovation, the energy transition and digital infrastructure – is critical to closing the competitiveness and investment gap. Private capital funds have returned about 1.2 times the value of their public market equivalents in the EU during the past 20 years, compared with around 1.1 times in the US (McKinsey, 2025b). But fragmentation, regulatory hurdles and inconsistent treatment of alternative investment vehicles limit the ability of funds to scale across borders.

[5] In market microstructure terms, dark execution can reduce information leakage and adverse selection for large orders, lowering market impact costs. However, if a significant share of volume shifts away from displayed order books, especially in an environment of different venues, displayed liquidity and price discovery can decrease, potentially widening spreads and increasing the cost of capital.

Private credit, while growing, also faces structural constraints. Although institutional non-bank lending is catching up to US levels (with market size estimated at EUR 1.5-2 trillion in the EU vs USD 2.3-2.5 trillion in the US), EU insurance companies are still limited by prudential rules and eligibility criteria that restrict their capacity to participate fully (McKinsey, 2025a). Private placements, a key component of this market, are often hampered by legal uncertainty and documentation standards that vary by jurisdiction.

Looking ahead, greater investment in shared digital infrastructure is needed to reduce friction and expand access. A harmonised credit data infrastructure, interoperable information on environmental, social and governance (ESG) aspects and scalable post-trade solutions would all lower entry barriers and reduce costs.

Technology, innovation and digitalisation are already proving essential in improving operational efficiency and responding to market complexity. A Financial Economic Complexity Framework, inspired by Hidalgo and Hausmann (2009), could be developed at the EU level to benchmark the breadth, sophistication and resilience of financial services. Such metrics, updated regularly, would support more evidence-based policy and highlight areas where infrastructure gaps weaken competitiveness. This would also operationalise the Council's recent 'stock-and-flow' agenda, aiming to simplify the existing stock of rules while strengthening *ex-ante* impact assessment and the monitoring of cumulative costs and benefits from the flow of new legislation.

2.3.5. Capital markets

Capital markets are essential to a competitive financial ecosystem, enabling firms to raise capital, investors to diversify risk and economies to channel savings into productive investment. Even so, the EU's capital markets remain subscale, split and insufficiently attractive compared with global benchmarks.

Despite a common regulatory base and years of political momentum behind the Capital Markets Union (CMU), EU capital markets continue to underperform. EU equity markets are notably shallower, with turnover ratios less than half those in the US. The EU bond market, while large in nominal terms, is divided across national lines, dominated by over-the-counter trading and lacking in the transparency and liquidity of more integrated systems. For institutional investors and large corporates alike, this limits the efficient pricing of risk and the ability to execute large transactions without significant market impact.

A core symptom of this underdevelopment is the thin IPO pipeline. Europe consistently lags behind the US and Asia in both the number and size of new public offerings. For growth companies and startups, limited access to public markets translates into fewer exit

options, lower valuations and heavier reliance on bank lending or private equity. This, in turn, weakens the venture capital ecosystem and narrows the funding pathways available to high-potential firms – notably in strategic sectors like deep tech, defence and green innovation.

A key factor behind these shortcomings is the diversity of listing and disclosure regimes. Despite the existence of the EU Prospectus Regulation, national practices diverge in terms of documentation standards, tax treatment and post-listing obligations. Exchanges remain nationally oriented. The absence of a unified framework for equity trading reduces liquidity and cross-border engagement of investors. Issuers face duplicative or inconsistent requirements when attempting to access multiple markets, increasing the cost and complexity of raising capital.

Beyond listing, the supporting ecosystem for capital markets lacks scale and cohesion. Europe has seen a decline in independent equity research coverage, particularly for small and mid-cap firms, due to market pressures. This impairs price discovery and limits investor visibility, especially outside national investor bases. Market-making and liquidity provision also suffer from varying approaches, reducing trading depth and widening bid-ask spreads.

Retail investor participation is another limiting factor. While retail savings in the EU remain high, household allocation to capital markets is low by international standards[6]. Pensions and long-term investment products remain dominated by national schemes, and differences in taxation, financial literacy and product availability further discourage retail market access. Without sufficient retail demand, equity markets struggle to scale and the breadth of the investor base remains constrained.

These structural weaknesses directly affect the competitiveness of European firms. Companies that cannot efficiently access scale-up capital domestically are more likely to turn to foreign markets or exit via non-European buyers. This undermines strategic autonomy and the EU's ability to anchor the next generation of global champions in critical industries.

[6] However, several Member States provide credible EU success stories that demonstrate what works when long-term savings vehicles and distribution channels are well engineered. Sweden shows consistently high household participation in capital markets, supported by a funded pension architecture (Thomadakis, 2025). The Netherlands and Denmark illustrate the scale effects of large funded occupational pension systems. France's Plan d'Épargne en Actions offers a widely used tax-advantaged wrapper for equity investment.

2.3.6. Market-making

Market-making is a cross-cutting market function rather than a sector in the narrow sense, but it is central to competitiveness because it underpins liquidity, price discovery and reliable execution for issuers and investors. In the EU, the economic case for market-making is weakened by the same structural fragmentation that affects trading and post-trade. Liquidity remains dispersed across venues and jurisdictions, with limited scope to internalise scale benefits in a genuinely EU-wide operating model. As a result, market-making capacity is often lower, more procyclical and less resilient than in more integrated markets.

Market-making is also highly mobile internationally. The largest liquidity providers deploy balance sheet and technology dynamically across markets and can reallocate activity quickly when relative regulatory and supervisory costs change. This makes non-EU regimes for non-bank liquidity providers directly relevant for EU market quality and for the ability of EU-based firms to remain competitive in global trading and market-making.

Regulatory and supervisory conditions also matter disproportionately for liquidity providers. One illustration is the prudential regime for investment firms (the Investment Firms Regulation and Directive): stakeholders have argued that aspects of calibration for large market-making firms can squeeze liquidity provision and may increase incentives to relocate activity or scale growth outside the EU, to the detriment of the strength and attractiveness of European capital markets (EBA-ESMA, 2024; FIA, 2024). Where prudential, market structure and operational requirements interact without a clear and consistent supervisory operating model, the cumulative effect can be to raise the cost of providing liquidity and restrain balance-sheet deployment. This can reduce the willingness to make continuous two-way prices, especially in less liquid instruments and during stressed conditions. Even when the legal framework is harmonised, supervisory inconsistency in implementation, interpretation and intensity can translate into uneven competitive conditions for firms operating across multiple Member States.

A related competitiveness issue is the regulatory perimeter and calibration. Compared with other major jurisdictions, the EU has often applied bank-style prudential concepts to parts of non-bank market-making, rather than developing a more activity-calibrated framework for specialist liquidity providers. This can increase the relative cost of deploying balance sheets for market-making in the EU and weaken incentives to scale liquidity provision locally, especially where competing jurisdictions rely on regimes that are more tailored to the risk profile and business model of non-bank dealers and trading firms.

From a competitiveness perspective, the consequence is an underinvestment problem. A fragmented and compliance-intensive environment reduces incentives to commit capital, technology and risk appetite to EU market-making. It can also limit the ability of liquidity providers to scale support for new instruments and market segments. Strengthening market-making does not require weaker safeguards, but it does require a more coherent end-to-end market design: less differentiation in trading and post-trade, more predictable supervisory expectations and a clearer assessment of how cumulative requirements affect liquidity provision at the system level.

3. DIAGNOSTIC SYNTHESIS – A FRAMEWORK THAT IS HARD TO RUN AND CONVERGE

Key findings

- **The EU rulebook is robust, but it is becoming increasingly hard to run.** The cumulative obligations across sectors have created a framework that is difficult to navigate, maintain and stabilise over time.
- **The Lamfalussy pipeline has become a source of regulatory inflation.** Expanding level 2 and 3 outputs multiply technical requirements and guidance, while level 1 increasingly hard-codes operational detail into legislation.
- **The system risks 'complexity without agility'.** The combination of frequent marginal updates and slow core recalibration generates recurring implementation cycles, uncertainty and uneven cross-border application.
- **Supervision is market-shaping, not merely administrative.** How supervisors interpret and apply rules influences incentives, business models, market structure and trust.
- **Supervisory fragmentation remains a material barrier to integration.** Divergent national approaches to authorisations, data demands and enforcement create legal uncertainty and competitive asymmetries.
- **Convergence tools and capacity are not yet commensurate with market integration.** Follow-through is often weak and gaps in capacity – especially in fast-evolving domains – lead to inconsistent supervisory outcomes and delay innovation.
- **The forward agenda involves process re-engineering and data-enabled supervision**. Improving outcomes while reducing avoidable frictions calls for stable definitions, sequenced implementation, consolidation of levels 2 and 3, shared data foundations and proportionality by design.

The EU's regulatory and supervisory framework has delivered substantial stability and protection gains, but it has also become even more difficult to operate as a coherent single-market system. The central challenge is no longer whether the EU has enough rules, but whether the way rules are designed, delivered and supervised reduces avoidable friction while preserving robust safeguards. This diagnosis is particularly relevant as the agenda on a Savings and Investments Union raises the bar for cross-border scale, innovation and supervisory consistency.

This chapter summarises the report's core diagnosis of why the EU framework has grown progressively harder to operate. It distils the main findings on rulemaking and supervision that underpin the reform proposals in the subsequent chapters, while the full analysis and supporting examples are provided in Appendices E and F. The focus here is on the mechanisms that generate complexity and fragmentation, and on why they matter for competitiveness, integration and resilience.

3.1. A SMARTER RULEBOOK: FROM ACCUMULATION TO PROCESS RE-ENGINEERING

Over the past two decades – and especially after the global financial crisis – the EU has built one of the world's most extensive frameworks for financial stability, market integrity and investor protection. The framework has strengthened safeguards, but it has also produced a dense accumulation of obligations across sectors, increasingly driven by expanding level 2 and 3 outputs (technical standards, guidance and Q&As). At the same time, level 1 texts have drifted towards over-specification, embedding technical parameters and operational detail in primary law. The combined effect is a system that changes often at the margins but adjusts slowly at the core.

This matters because complexity in finance is not only a question of how many rules exist, but also how rules are designed and put into effect. When requirements arrive late in the implementation sequence, evolve through interpretation and are difficult to automate, firms face repeated 'rebuild cycles' in systems, controls and reporting. These cycles raise fixed compliance costs, absorb senior management attention, and disproportionately affect smaller and specialised firms that cannot spread compliance investment across scale. They also make supervisory expectations harder to align across Member States, weakening the practical force of the single rulebook.

A forward-looking approach is therefore less about deregulation and more about process re-engineering: stable definitions, sequenced implementation, consolidation and pruning routines for outputs at levels 2 and 3. It involves automation-ready reporting so that compliance shifts from continual change management to predictable, risk-based maintenance. A fuller account of the rulemaking diagnosis with illustrative examples is provided in Appendix E.

3.2. Smarter supervision: from fragmented to convergent with accountability

Regulation sets the formal rules, while supervision determines how they are interpreted, applied and enforced. In practice, supervision is market-shaping. It affects authorisation speed, model approvals, data demands and enforcement intensity. Ultimately these factors shape firms' incentives to enter, scale, innovate or retreat. In the EU single market, divergence in national supervisory approaches remains a material integration barrier, creating legal uncertainty and competitive asymmetries – particularly for cross-border groups and innovative business models.

The EU has developed supervisory convergence tools (guidelines, Q&As, peer reviews, handbooks and mediation procedures), and the SSM has improved convergence for significant banks. Yet the overall picture remains uneven. Convergence tools often stop at benchmarking without structured remediation and consequences. In banking, convergence gains at the top end can be offset by the operational costs of layered EU and national processes, while less significant institutions remain subject to varied national approaches. Across sectors, unstructured discretion and reliance on informal instruments can reduce predictability when documentation, escalation pathways and reviewability are weak.

Gaps in capacity increasingly drive divergence. Differences in expertise, data infrastructure and supervisory technology are most visible in fast-evolving domains (cyber resilience, AI, digital assets and ESG). Strengthening EU supervision therefore requires a pragmatic move towards data-enabled, risk-focused supervision with clearer accountability. This means shared data foundations, common standards and methodologies, proportionality by design, and convergence tools with stronger follow-through. The full supervisory diagnosis, including discussion of centralisation versus coordination and international examples, is set out in Appendix F.

3.3. Why this diagnosis matters for competitiveness and integration

The interaction of a 'hard-to-run' rulebook and 'hard-to-converge' supervision produces three recurring frictions with direct implications for competitiveness. First, it raises fixed costs and slows time-to-market, especially for cross-border and innovative firms. Second, it reduces legal certainty and reinforces national segmentation, limiting scale and entrenching the EU's structural reliance on domestic financial models. Third, it constrains the EU's ability to adapt to market and technological change, as technical requirements evolve rapidly while core legislative calibration remains slow.

This diagnostic synthesis underlies the reforms subsequently proposed. The objective is not to weaken safeguards. Instead, it is to make the system more usable, predictable and capable of supporting integration and innovation, while continuing to deliver stability and investor protection.

4. Reforms to rulemaking – simpler, proportionate and strategic

Key findings

- **Treat rulemaking as a managed 'delivery chain'**. Introduce end-to-end governance that links level 1 design, production at levels 2 and 3, implementation readiness and ex-post maintenance, so complexity does not reappear as an operational burden.
- **Hard-wire sequencing discipline**. Align application dates with 'readiness gates' for regulatory/implementing technical standards and essential guidance, ensuring that technical deliverables are finalised early enough to support build-and-test cycles and avoid rebuilds.
- **Establish a process for rulebook stock management**. Create an EU-wide inventory across levels 1–3 and adopt a 'replace rather than add' approach, with consolidation packages, sunset/retirement routines and default repeal or streamlining decisions where value is low.
- **Make impact analysis resilient to changes in negotiation**. Require updated impact assessments when substance changes materially during the legislative process, so decision-makers assess the final package, not the initial draft.
- **Clarify the status and lifecycle of level 3 instruments**. Introduce a taxonomy and version control as well as review triggers for guidance and Q&As, so they remain traceable, contestable where necessary, and do not become moving compliance targets.
- **Build interoperability into the design rather than retrofitting it**. Apply cross-file coherence checks (on definitions, reporting systems and sequencing) to prevent sectoral silos from generating duplicative obligations and inconsistent implementation.
- **Anchor simplification in enforceable convergence**. Pair a simpler, more principles-based rulebook with stronger convergence tools, remediation follow-up and outcome transparency, so that consistent application replaces compensatory granularity.
- **Embed competitiveness as a regular test**. Operationalise it through measurable indicators and feedback loops, using evidence to recalibrate or retire requirements that create friction without commensurate supervisory or consumer value.

This chapter assesses how EU financial regulation can be made more coherent, proportionate and responsive by fixing the regulatory 'delivery chain' rather than adding new layers. It sets out a practical simplification programme (for inventory, consolidation, proportionality and cross-file interoperability), and proposes design rules to rebalance multi-level rulemaking through smarter delegation and systematic review. It also addresses how to operationalise competitiveness as an ongoing consideration in rulemaking, improve impact assessments and *ex-post* evaluation, and ensure enforcement and governance can sustain simpler, more principles-based rules over time.

4.1. A STRATEGIC APPROACH TO SIMPLIFICATION AND BURDEN REDUCTION

A credible simplification agenda in EU financial services is less about isolated technical edits and more about establishing a disciplined programme. This means a clear scope, an inventory of obligations across the legislative hierarchy, prioritisation criteria and governance to ensure that simplification is durable rather than offset by new layers. The objective is to improve clarity, coherence and usability of the rulebook while preserving core prudential and conduct outcomes.

The scale of the challenge is visible in the accumulated stock of EU financial regulation. The EU rulebook now spans some 15 000 pages, with 13 000 new legal acts adopted over the last five years on top of extensive national requirements. By comparison, the US has adopted less than half this volume. This growth is not only quantitative; it also reflects the increasing density of operational requirements that firms must translate into systems, reporting and internal controls.

Financial services are particularly exposed to this dynamic. As of mid-2024, around 26% of the 1 634 delegated acts across EU policy areas relate to financial services (over 400 individual measures). From 2021 to 2023, an average of 83 new acts were adopted annually. At the same time, RTS have grown markedly: EBA mandates more than doubled in five years, from 62 in 2019 to 139 in 2024.

International comparisons underline the extent of granular codification. The EU banking rulebook alone consists of around 193 texts totalling nearly 9 000 pages, compared with roughly 2 500 pages across the US and Canada, and fewer than 900 for the Basel global standards. The issue is not only volume, but also the operational consequences of maintaining and updating dense requirements across the full regulatory stack.

To be effective, simplification needs an explicit strategy that targets the mechanisms through which complexity persists and reproduces. Four principles are central:

- *Streamline secondary and tertiary legislation*. Build and maintain an EU-wide inventory of RTS, ITS, guidelines and Q&As; classify them by purpose, legal effect

and operational burden; and prioritise those that are outdated, duplicative or no longer linked to a clear supervisory or market function. Rationalisation should proceed in packages, with consolidation where feasible and repeal where measures no longer add value.

- *Take a lifecycle approach to regulation*. Treat regulation as a managed cycle rather than a one-off legislative act. This implies stricter *ex-ante* discipline, systematic post-trilogue updates when legislative changes materially alter scope or cost and regularised *ex-post* evaluation with clear review clauses, metrics and follow-up obligations. Without this lifecycle structure, simplification will remain episodic and quickly be overtaken by new amendments and guidance.

- *Consolidate and replace rather than add*. Require new initiatives to map existing obligations in the same policy space and demonstrate how the proposal consolidates, repeals or explicitly supersedes legacy provisions. This is particularly relevant where multiple acts coexist with overlapping scopes and parallel implementation timelines (for example in ESG disclosure, investor protection and digital finance).

- *Build proportionality and user-operability*. Embed proportionality in obligations (thresholds, phased requirements and differentiated reporting) and institutionalise 'user testing' through structured feedback loops with smaller firms, new entrants and cross-border providers. The goal is to ensure that rules can be implemented with predictable sequencing, reasonable transition periods and realistic automation potential.

Horizontal coherence is also essential. Vertical silos in EU financial regulation leave firms operating across multiple regulatory regimes without consistent definitions, risk concepts or compliance and reporting systems. Asset management is a recurrent example, sitting across banking, insurance and securities rules without a fully coherent cross-sector framework, while payments and market infrastructure face overlapping regimes and fragmented implementation[7]. A simplification programme should therefore include an explicit 'interoperability check' across files – focused on definitional alignment, reporting compatibility and implementation sequencing – so that consolidation is not offset by cross-regime inconsistencies.

Simplification will only translate into lower burden if it is operationally absorbed. Large, complex institutions often run duplicated control functions, segregated data lineages and

[7] Likewise, commercial banking and investment services remain regulated under largely unified capital requirements, despite different risk profiles and market roles, which may limit the development of specialised capital market players.

parallel compliance processes that amplify the costs of regulatory change and increase supervisory interaction (ECB, 2025a). A programme that rationalises EU-level obligations should be paired with stronger incentives and clearer supervisory expectations for internal simplification (e.g. shared data standards, reuse of reporting and consolidated control testing), so that firms can actually realise the gains from clearer, more standardised rules[8].

Box 2 illustrates how this could work in practice. Targeted burden reduction, anchored in proportionality and risk-based differentiation, can be delivered without weakening prudential safeguards. The broader lesson is that simplification needs an enabling governance channel: clear political sponsorship, discipline against gold-plating during negotiations and a structured approach to revisiting legacy requirements. If not, it risks being diluted in the legislative process or offset by new layers introduced elsewhere.

Box 2. EIOPA's simplification effort under Solvency II

As part of the broader review of Solvency II, the European Insurance and Occupational Pensions Authority launched a targeted simplification initiative at the end of 2023, aimed at reducing the regulatory and reporting burden, particularly for small and non-complex undertakings (SNCUs)[9]. While there is no formal, quantified target for burden reduction (e.g. 20%), the initiative reflects a growing recognition that proportionality and streamlining are critical to ensuring a workable supervisory framework.

Key elements of the simplification effort include:

- reducing the volume and granularity of reporting requirements for SNCUs, including proposals to limit the frequency or scope of certain templates;
- revising guidelines and supervisory expectations to make them more accessible and less burdensome for smaller insurers;
- encouraging NCAs to apply proportionality more consistently in areas such as governance, internal controls, and documentation standards;
- introducing risk-based thresholds to differentiate reporting and compliance obligations by firm size and complexity.

[8] This dynamic has been evident in the evolution of internal risk-based models and resolution planning. The push for advanced modelling frameworks since the 1990s has increased supervisory reliance on complex methodologies, culminating in post-crisis capital debates such as the output floor in Capital Requirements Directive VI. Likewise, the work of the Single Resolution Board on resolvability has responded to the structural complexity of financial conglomerates.

[9] ESMA has similarly set out a simplification and burden-reduction approach across its remit, including discontinuing duplicative transparency/volume-cap reporting flows in the Markets in Financial Instruments Regulation (MiFIR) by reusing transaction data already reported under MiFIR Article 26. It also seeks to streamline transaction reporting through reference-data alignment (including with EMIR) and phase digitalisation requirements for sustainability and financial disclosures under the European Single Electronic Format.

EIOPA also signalled the need for early involvement of supervisory authorities during the legislative drafting phase, to ensure that technical complexity and downstream compliance costs are considered from the outset.

While focused on the insurance sector, this initiative provides a valuable template for burden reduction efforts across the EU financial regulatory framework. It illustrates how simplification can be achieved without compromising prudential standards, particularly when rooted in proportionality, stakeholder input and supervisory convergence.

4.2. A rebalanced regulatory architecture

The EU's financial rulemaking framework is based on a multi-level structure. The issue is no longer its existence, but its operating logic. Too much technical granularity is fixed in level 1, while outputs at levels 2 and 3 arrive late in the sequence, accumulate without systematic retirement and are not consistently designed for implementability or review. Table 2 summarises how the roles of each level could be recalibrated. The priority is to make delegation predictable, sequenced and accountable, so that technical rulemaking becomes easier to implement and easier to amend as markets evolve.

Table 2. Current vs proposed practice at EU regulatory levels

Regulatory level	Current practice	Proposed reform
Level 1	Lays down highly detailed rules, including technical specifications and exemptions; attempts to pre-empt divergence by encoding precision in primary law	Focus on core objectives, principles, and delegation criteria; remove technical granularity to improve readability and flexibility
Level 2	Accumulates detailed rules, is often reactive and duplicative; subject to long delays and insufficient review	Rationalise existing RTS/ITS through systematic ex-post evaluation; prioritise durable, proportionate standards with built-in review clauses
Level 3	Expands volume and has a de facto binding effect; generates legal ambiguity and uneven uptake across NCAs	Clarify scope and legal status; strengthen peer reviews and convergence mechanisms; develop criteria for enforceable guidance
ESAs	Given limited ability to adapt technical rules dynamically;	Grant Meroni-compatible empowerment: allow ESAs to adjust

	constrained by the Meroni doctrine	parameters within clear mandates, subject to transparency and oversight

Notes: ESAs = European Supervisory Authorities; NCAs = national competent authorities; RTS/ITS = Regulatory/Implementing Technical Standards.
Source: Authors' compilation.

In practice, 'smart delegation' requires design rules that discipline what is put in level 1, how level 2 mandates are drafted and sequenced, and how level 3 instruments are issued, escalated and reviewed. This implies: i) clearer delegation criteria and established parameter ranges for level 2 mandates; ii) implementation sequencing and 'RTS readiness' gates so firms are not forced into late-stage rebuild cycles; iii) systematic review clauses and sunset/retirement routines for level 2 and 3 outputs; and iv) a clearer taxonomy for the status of level 3 instruments, including publication, traceability and escalation pathways.

A related structural issue concerns the choice between regulations and directives. Regulations have increasingly been in EU financial rulemaking since the financial crisis, but their potential to reduce fragmentation has not always been realised. In several instances, regulations have functioned as de facto directives, containing extensive options, discretion or implementation flexibilities that invite divergent national practices. This undermines the core purpose of the instrument – ensuring uniform application across the single market. A more restrained and legally consistent use of regulations, with fewer national options and clearer drafting, would support simplification, enhance legal certainty and reduce the need for compensatory detail at levels 2 and 3.

4.2.1. Fixing level 1: from overreach to principles

Level 1 should set objectives, scope, core obligations and delegation criteria, which are principle-based but operationally precise[10]. It should not include technical calibrations that require frequent adjustment. In practice, level 1 drafting should:

- *express* the intended outcome and risk logic (what is being prevented or achieved);
- *specify* what must be harmonised versus where proportionality or national discretion is justified;

[10] The Financial Data Access Regulation illustrates the importance of process engineering. As drafted, it creates extensive data-sharing and governance obligations across multiple actors, while leaving key operational parameters, standards and interfaces to be specified later. This increases the risk of late clarification, compressed implementation windows and divergent interpretation. A narrower initial scope focused on essential datasets and mass-retail use cases, combined with phased implementation and early standard setting, would better align the instrument's delivery design with proportionality and feasibility, while preserving its policy intent.

- *establish* delegation triggers (when level 2 is needed), the permissible parameter ranges and the evidence requirements for calibration; and
- *embed* review points for key calibrations that are likely to change with market structure or technology.

This approach would improve readability and reduce the need to reopen level 1 texts when technical parameters become outdated.

4.2.2. Fixing level 2: rationalising technical rulemaking

Level 2 measures are essential for comparability and operational standardisation, but they are often produced under tight timelines and without a systematic retirement cycle. The Commission's 2025 decision to de-prioritise 115 RTS/ITS measures by 2027 is a useful pause, but postponement is not simplification.

A systematic ex-post review of level 2 measures is needed to identify where technical rules can be consolidated, repealed or adapted. This requires: i) mandate hygiene, so level 1 mandates do not hard-code specifications that force repeated revisions; ii) better sequencing, so key RTS/ITS are finalised early enough for build-and-test cycles; and iii) built-in review clauses with an *ex-post* performance test (for usage, clarity, duplication and automation potential). Simplification should aim not only at quantity reduction, but also at functional clarity.

4.2.3. Fixing level 3: making soft law more effective

Level 3 instruments are valuable where they clarify supervisory expectations quickly, but their effectiveness depends on the legal setup (i.e. clarity of status, traceability and escalation pathways). They should also be used sparingly: clearer drafting at levels 1 and 2 should reduce reliance on level 3 and limit its overall volume. Three reforms would improve predictability without turning guidance into shadow rulemaking:

- *Status taxonomy and labelling*. Each level 3 instrument should clearly state its legal nature, addressee, intended use (with interpretation vs operational examples) and whether it is expected to be applied consistently by NCAs.
- *Publication and traceability standards*. Guidance should be version-controlled, consolidated (to avoid scattered Q&As) and accompanied by an implementation note that maps it onto the underlying provisions at levels 1 and 2.
- *Escalation and review*. Where level 3 materially changes expectations, there should be a specified pathway (consultation threshold, adoption governance and

review date) so guidance does not accumulate indefinitely and firms can plan compliance systems with confidence.

4.2.4. Empowering the ESAs within the limits of the Meroni doctrine

Meroni-compatible empowerment is most credible when framed as bounded parameter-setting rather than open-ended discretion[11]. In practice, this means legislative bodies set the objective, the risk metric and the permissible calibration range, while ESAs adjust parameters within that range based on evidence and transparent methodology.

A workable model would include:

- *Parameter ranges*. Level 1 would set the policy objective and a bounded range (or rule) for technical parameters (thresholds, templates and frequencies), including the criteria that justify movement within the range.
- *Methodology and evidence*. ESAs would publish the calibration methodology, data sources and an implementation impact note (including automation feasibility and reporting reuse).
- *Oversight and accountability*. The model would specify reporting to the European Parliament/Council, public consultation for material recalibrations and ex-post review of outcomes against the stated objective.
- *Reviewability and legal certainty*. Clear documentation, version control and predictable entry-into-force and transition arrangements would prevent technical updates from creating continual 'moving target' compliance.

This approach would improve responsiveness while preserving democratic control through clear mandates, transparency and ex-post accountability.

4.3. COMPETITIVENESS EMBEDDED AS A SECONDARY OBJECTIVE

As the EU reconsiders how to make its financial regulation more agile and growth-oriented, one of the more prominent proposals is to formally embed competitiveness as a secondary objective of financial regulation (Arnal *et al.*, 2025). This idea has gained

[11] The Meroni doctrine comes from the Court of Justice's *Meroni* case judgments (*Case 9/56 Meroni v High Authority (Meroni I) ECLI:EU:C:1958:7*; *Case 10/56 Meroni v High Authority (Meroni II) ECLI:EU:C:1958:8*), an early foundational line of case law that has had a long-lasting influence on the EU's institutional architecture. It sets limits on the delegation of powers to EU agencies or other bodies. The core idea is that EU co-legislators and institutions cannot delegate broad discretionary power that would effectively allow an agency to make major policy choices. Delegated powers must be clearly defined, rule-bound and constrained by objective criteria, so that the agency applies a mandate rather than redefining it. In practical terms, the Meroni doctrine is often read as favouring 'bounded calibration' models. Co-legislators set objectives, key concepts and permissible ranges, while agencies adjust technical parameters within those limits under transparent methods and accountability.

traction in recent years, partly inspired by reforms in the UK (see Box 3) and other jurisdictions (see Table 3), as well as the broader strategic need to mobilise private investment to close Europe's financing gaps.

Box 3. The UK's secondary mandate on competitiveness

The UK offers a prominent example of how a secondary mandate on competitiveness can be embedded in financial supervision. Under the Financial Services and Markets Act 2023, both the Prudential Regulatory Authority and the Financial Conduct Authority were given an explicit secondary objective to support the international competitiveness and long-term growth of the UK economy.

This mandate does not override the primary objectives (i.e. financial stability, consumer protection and market integrity) but must be actively considered when regulators make policy, supervisory or rulemaking decisions. To operationalise the mandate, UK regulators have introduced:

- dedicated key performance indicators to measure impacts on competitiveness and growth;
- periodic reporting to Parliament, with scrutiny by the Treasury Select Committee;
- public consultations where proposals must explicitly explain how the competitiveness objective is considered;
- internal organisational changes, including new competitiveness units and guidance for staff.

While broadly welcomed by industry, the UK model has also raised questions about mission creep, regulatory arbitrage and the risk of subordinating prudential concerns to short-term growth pressures. Ongoing evaluations will test whether the new structure leads to substantively different outcomes or decision-making cultures.

For the EU, the main question is not whether competitiveness matters, but how such an objective could be devised, safeguarded and measured so that it improves regulatory discipline (*ex ante* and *ex post*) without diluting primary mandates. In practice, this implies a system-level focus: the contribution of regulation and supervision to scalable market structures, efficient capital allocation and innovation financing, rather than support for individual firms[12].

[12] A practical illustration is securitisation, where national prudential overlays can materially weaken the economic case for cross-border risk transfer even when EU rules allow significant risk transfer (SRT). For example, some Member States have applied a Pillar 2 approach to 'flowback risk' associated with securitisation, which can constrain the extent to which banks can rely on securitisation for capital relief and, in turn, reduce incentives to execute SRT transactions. More generally, because capital-relief securitisation can free up regulatory capital for new lending and risk-taking capacity, national measures that systematically neutralise capital relief may create competitive distortions within the single market and should be treated as potential friction points when operationalising a competitiveness objective.

Table 3. Competitiveness mandates in financial regulation

Jurisdiction	Primary regulatory objectives	Competitiveness mandate	Key implementation features
EU	Financial stability, consumer/investor protection, market integrity	Not formally adopted (debated as a secondary objective)	Impact assessments now include a 'competitiveness check' (via the better regulation toolbox); no ESA-level mandate
UK	Financial stability (PRA), consumer protection and market integrity (FCA)	Secondary mandate under the Financial Services and Markets Act 2023	Key performance indicators, mandatory reporting, consultation obligations, internal units focused on competitiveness
US	Safety and soundness, market efficiency, fair treatment, capital formation (SEC)	No formal competitiveness mandate	Indirect consideration via cost-benefit analysis, Office of Financial Research, and innovation initiatives (e.g. Office of the Controller of Currency's Project REACh)
Australia	Financial stability, efficiency, fairness, competition	Not a formal objective, but implicit in the mandates of ASIC and APRA	ASIC promotes efficient and competitive markets; APRA prioritises stability but makes an effort to maintain proportionality
Singapore	Financial stability, development of the financial sector	Dual mandate (prudential + growth) for MAS	MAS uses SupTech and regulatory sandboxes to balance innovation with supervision; guided by long-term strategic plans

Notes: ARPA = Australian Prudential Regulation Authority; ASIC = Australian Securities and Investments Commission; ESA = European Supervisory Authority; FCA = Financial Conduct Authority; MAS = Monetary Authority of Singapore; PRA = Prudential Regulatory Authority; SEC = Securities and Exchange Commission; SupTech = supervisory technology.
Source: Authors' compilation.

However, there are legitimate concerns about introducing competitiveness as a regulatory objective. Chief among them is the risk of mission creep – that is, encouraging rule makers to balance incompatible goals, or creating confusion over priorities during

crisis situations. Clear legal drafting and a strictly subordinate hierarchy of objectives would therefore be essential.

There is also a reputational and governance risk if competitiveness is interpreted narrowly, for example as support for individual firms, national champions or deregulation. This would undermine public trust and could repeat pre-crisis mistakes where regulatory competition contributed to systemic vulnerabilities. For this reason, any competitiveness objective should be set and constrained. It should apply at the macro/systemic level, not the micro/firm-specific level, and remain strictly subordinate to primary mandates on prudential soundness, conduct and market integrity.

Operationalisation would also require making the objective measurable and contestable. This would entail developing macro-focused key performance indicators such as the EU financial system's contribution to productive investment, innovation financing or capital allocation efficiency[13]. It may also be useful to complement these with sector-specific indicators to monitor friction points and to use a dashboard approach (e.g. traffic-light scoring) that draws on metrics already embedded in impact assessments and supervisory reviews[14].

Importantly, any such objective should be applied only when primary objectives are already met. A conditional approach would preserve prudential discipline while encouraging regulators and supervisors to anticipate unintended consequences, prioritise reforms with high economic payoffs and support the EU's long-term competitiveness agenda. More broadly, it would strengthen incentives to treat simplification and proportionality as tools to improve both compliance and resilience.

4.4. Improved impact assessments, transparency and *ex-post* evaluation

A high-quality regulatory framework does not begin or end with the adoption of legislation. It requires a full lifecycle approach to policy: starting from robust *ex-ante* impact assessments, followed by transparent rulemaking and culminating in rigorous *ex-post* evaluation. Yet in EU financial regulation, several weaknesses persist throughout this cycle, limiting the system's capacity to assess trade-offs, anticipate unintended consequences or adjust rules to changing realities.

Despite the central role of impact assessments, major gaps persist in how they are used throughout the legislative process. While the Commission routinely prepares impact

[13] While useful for transparency, such key performance indicators may have limited influence without a corresponding shift in political and supervisory priorities.

[14] For example, IPO pipeline strength, fund passporting costs, time-to-market for financial products, capital allocation efficiency, market contestability, innovation support, systemic resilience and profitability.

assessments for its proposals, amendments introduced by the European Parliament and the Council during trilogues can materially alter the scope, costs and even the objectives of legislation, without any systematic reassessment. As a result, the original impact assessment often becomes outdated by the time final texts emerge, weakening transparency, accountability and the evidence base for proportionality. A credible simplification agenda requires closing this gap. Substantive changes by the European Parliament or Council should trigger mandatory updated assessments, so that political compromises are transparent and late-stage regulatory inflation is avoided.

In recent years, the better regulation toolbox has introduced new tools, including a competitiveness check, to support more balanced policymaking. But, these instruments are underused or applied inconsistently, especially for files with systemic market implications (e.g. the Omnibus I package on sustainability, see Marcus and Thomadakis, 2025). Applying them more rigorously would strengthen discipline in legislative design and help ensure that costs and benefits are assessed on a comparable basis across proposals.

Similarly, the Regulatory Scrutiny Board (RSB) plays a vital quality-control role[15], but its effectiveness depends on the transparency and consistency of inputs[16]. It should be empowered to issue more specific guidance on assessing competitiveness, proportionality and innovation effects in financial services files, and to require follow-up where material post-trilogue changes have occurred.

Stakeholder input remains an essential but often under-leveraged part of the process. Public consultations can be valuable, but too often the feedback loops are weak, with limited clarity on how responses are used. Enhancing transparency in how consultation results inform regulatory decisions (e.g. through 'consultation impact statements') would build trust and improve policy design. More specifically, financial regulation should better incorporate input from underrepresented actors, such as smaller firms, innovative entrants or cross-border service providers, which often face the most regulatory friction but have the least lobbying power.

Finally, *ex-post* evaluations remain sporadic and disconnected from new legislative cycles. Regular reviews of regulatory effectiveness, proportionality and coherence should be standardised across financial legislation, with clear review clauses, performance

[15] Over the 2019-24 legislative period, the RSB issued negative opinions in 39% of all draft impact assessments, with significant year-to-year variation. The highest share of negative opinions was recorded in 2020, at 46% (RSB, 2023; Pircher, 2023).

[16] While the RSB provides an important quality filter, the Commission's better regulation toolbox allows an initiative to proceed even after an unfavourable RSB assessment under certain conditions (including, where relevant, after a second negative opinion, subject to a College-level decision). This has fuelled debate about whether the RSB's leverage is sufficiently strong and whether additional safeguards are needed to ensure substantive follow-up on negative opinions.

indicators and follow-up obligations. As in other jurisdictions, such as the UK and Australia, this can help foster a more dynamic regulatory environment, where rules evolve based on evidence, not inertia.

4.5. Enforcement and governance

The credibility of simplification depends on enforcement. As the EU streamlines its rulebook and shifts towards more principles-based drafting, outcomes can only be preserved if enforcement is predictable, transparent and capable of escalation across borders. Without that backstop, simplification risks producing uneven outcomes and renewed pressure to re-introduce prescriptive detail.

Enforcement in the EU is necessarily multi-actor, but simplification increases the premium on role clarity: who detects non-compliance, who escalates, who coordinates cross-border cases and who is accountable for follow-up. A streamlined rulebook should be matched with clearer allocation of responsibilities and more consistent use of EU-level coordination tools, combined with a visible record of remediation and outcomes. The SSM provides a useful benchmark: where escalation pathways and supervisory methodologies are standardised, enforcement tends to be more predictable and less dependent on local capacity constraints[17]. Against this backdrop, Table 4 summarises the current allocation of enforcement responsibilities across sectors and illustrates where EU-level coordination is structurally stronger or weaker.

Table 4. Enforcement responsibilities across financial sectors in the EU

Sector	Primary enforcement level	EU-level body involved	Tools and mechanisms	Degree of centralisation
Banking	ECB (SSM) for significant institutions; NCAs for less significant ones	ECB, EBA	On-site inspections, stress testing, SRB coordination	High (post-SSM)
Insurance	NCAs	EIOPA	Supervisory convergence tools, peer reviews, opinions	Low to moderate

[17] Since its creation in 2014, the SSM has helped improve the capital strength of European banks, with CET1 ratios of significant institutions rising from 12.7% (Q2 2015) to 16.1% (Q3 2025), and non-performing loan ratios declining from 7.5% to 1.9% over the same period (Buch, 2025).

Securities	NCAs	ESMA	Q&As, opinions, peer reviews, Union-wide Strategic Supervisory Priorities	Moderate
Asset management	NCAs	ESMA	AIFMD/UCITS supervision, cooperation platforms	Low
Payments & fintech	NCAs	EBA (for AML/CFT), ECB (TIPS)	Guidelines, opinions, technical standards	Low
Consumer protection	NCAs	ESAs (joint committee role)	Guidelines, warnings, product intervention powers	Low to moderate

Notes: The degree of centralisation reflects relative authority and operational responsibility at the EU vs national level. 'Tools and mechanisms' include both binding and soft law instruments. AIFMD = Alternative Investment Fund Managers Directive; AML/CFT = anti-money laundering/countering the financing of terrorism; EBA = European Banking Authority; EIOPA = European Insurance and Occupational Pensions Authority; ESAs = European Supervisory Authorities; ESMA = European Securities and Markets Authority; NCAs = national competent authorities; SRB = Single Resolution Board; SSM = Single Supervisory Mechanism; TIPS = TARGET Instant Payment Settlement; UCITS = Undertakings for Collective Investment in Transferable Securities.
Source: Authors' compilation.

To make simplification durable, the system for enforcement needs a minimum set of features:

- *Strong ESA convergence tools* (e.g. peer reviews and thematic reviews). Ensure they do not stop at diagnosis, but include structured remediation plans, timelines and transparent reporting on whether corrective actions have been implemented (including clear escalation where persistent non-compliance remains).
- *Predictable 'soft enforcement' with traceability*. Q&As and supervisory statements can be useful, but they should be version-controlled, consolidated and clearly linked to the underlying level 1 and 2 provisions, so firms can treat them as reliable compliance inputs rather than informal signals.
- *Clear escalation triggers and role clarity for ESAs*. Where ESAs have coordination, dispute-settlement or crisis powers, there should be greater clarity on the trigger

conditions and procedures, as well as expected outputs. This would reduce reliance on ad hoc mobilisation and to make cross-border escalation credible.

- *Outcome transparency and enforcement accountability*. More systematic publication of aggregate findings, follow-up actions and supervisory priorities would improve comparability and deter under-enforcement, while supporting a level playing field for firms operating cross-border.

- *Institutional options for the visibility of single market enforcement*. Proposals such as an 'enforcement commissioner' (as floated in the Letta report) merit consideration insofar as they strengthen the visibility, coordination and accountability of enforcement across the single market[18].

In the short term, the priority is to strengthen monitoring, escalation and transparency within the existing institutional setup so that streamlined rules translate into consistent outcomes. Over the longer term, moving further towards principles-based lawmaking will require a governance model that can credibly enforce outcomes with less prescriptive detail, including clearer delegation, stronger EU-level coordination and a more systematic approach to measuring enforcement effectiveness.

4.6. Long-term reform

Improving the EU's framework for financial regulation cannot rely solely on incremental fixes or short-term streamlining. Over time, deeper governance reform is needed to support more adaptive, coherent rulemaking in a rapidly changing financial environment.

This implies a rebalancing of responsibilities across the EU regulatory chain. Primary legislation should focus on objectives, scope and core obligations, while technical calibration and updating should be organised through clearer mandates, stronger accountability and more systematic review at subordinate levels. In parallel, convergence and enforcement capacity must be sufficient to make a less prescriptive rulebook workable in practice; otherwise simplification risks becoming merely a shift in where complexity reappears.

Within this rebalancing, the ESAs' role needs to evolve from primarily coordinating practices towards being able to maintain the technical coherence of the framework over time. Without changing the hierarchy of objectives or undermining political

[18] This proposal, originally put forward in the Letta report, aimed to consolidate fragmented enforcement responsibilities under a dedicated enforcement commissioner within the European Commission. While politically ambitious, it has not been pursued during the current legislative cycle. The role was envisaged as a cross-sectoral watchdog with a mandate to improve visibility, monitor implementation and coordinate enforcement efforts across regulatory domains, including financial services, competition policy and digital markets.

accountability, this calls for more structured delegation of technical maintenance tasks – such as updating reporting templates, supervisory methodologies and disclosure requirements – within clearly defined mandates and institutional checks.

Long-term reform also depends on improving the system's capacity to detect, prevent and remove unnecessary accumulation. This requires a more systematic approach to monitoring the coherence of the single rulebook over time (i.e. identifying overlaps, outdated requirements and conflicts across files) and triggering consolidation or repeal where provisions no longer serve a clear regulatory purpose.

Finally, targeted optional EU-wide frameworks ('28th regimes') can support long-term coherence in areas where fragmentation persists[19]. Optional regimes are not new to the EU, and several sector-specific EU frameworks have enabled cross-border business models and reduced legal fragmentation. In fields where harmonisation remains partial, particularly in parts of non-bank finance, optional EU-wide regimes could offer a controlled route to greater legal certainty and scalability without displacing national prerogatives, while also creating practical pressure for convergence through voluntary uptake[20].

Above all, a governance reset means shifting from a reactive to a strategic model of rulemaking. It should be one that builds institutional capacity to maintain coherence over time, without sacrificing the integrity, safety or fairness of the financial system.

[19] To succeed, such optional frameworks must be built on strong political commitment, clear supervisory responsibilities and minimum standards that ensure investor and consumer confidence (Thomadakis *et al.*, 2025). They should also complement, not replace, efforts to enforce existing single licences and remove unjustified barriers to cross-border activity.

[20] For example, a candidate area for such an optional EU regime is the circulation of native digital financial instruments and tokenised securities, where divergent national rules on civil-law transfer and holder-rights rules risk hard-wiring fragmentation and slowing interoperability.

5. Reforms to the supervisory framework – more coherent and efficient

Key findings

- **Move from a patchwork to a clearer operating model**. Define who does what across EU and national supervisors, reduce overlaps and make escalation paths explicit to prevent new bodies from creating parallel processes and extra data demands.
- **Fix reporting by starting from supervisory needs**. Streamline templates and requests, apply proportionality in practice and ensure that data collection is tied to concrete supervisory decisions.
- **Aim for better data, not more data**. Use common, machine-readable standards and test on-demand data access so supervisors can get what they need without continual new reporting.
- **Treat national options and discretion as design flaws to be reduced**. Run a structured programme to remove the most distortive carve-outs, especially those that block group-wide capital and liquidity management.
- **Make cross-border approvals faster and more predictable**. Use single decision ownership for genuinely cross-border cases, with clear timelines and transparent criteria, so prudential checks do not become procedural blockages.
- **Strengthen the ESAs by focusing their capacity on convergence that delivers**. Prioritise cross-border and systemic issues, require follow-up when problems are found, and strengthen governance and accountability in parallel.
- **Use a 'supervisory efficiency test' to match supervision to market reality**. Conduct a structured check of how integrated and enforceable a market is and adjust supervisory tasks accordingly (coordination where it works, targeted EU-level supervision where needed).
- **Stop complexity from rebuilding**. Learn from the experience of the supervisory review and evaluation process (SREP). Without stronger accountability and independent evaluation, attempts to streamline the process will keep recurring rather than delivering a lasting reset.

Targeted adjustments to the EU's supervisory framework could improve coherence, proportionality and operational efficiency without requiring a wholesale redesign. In this chapter, the focus is on practical levers that could reduce duplication and uncertainty while strengthening risk-based oversight:

- streamlining supervisory reporting so that data collection serves supervisory use cases;
- narrowing the most distortionary national options and discretion and making cross-border approvals more predictable;
- strengthening the ESAs' capacity, governance and follow-up discipline as the anchor of convergence outside banking;
- applying a functional supervisory efficiency test to align supervisory tasks with the degree of market integration and the enforceability of outcomes.

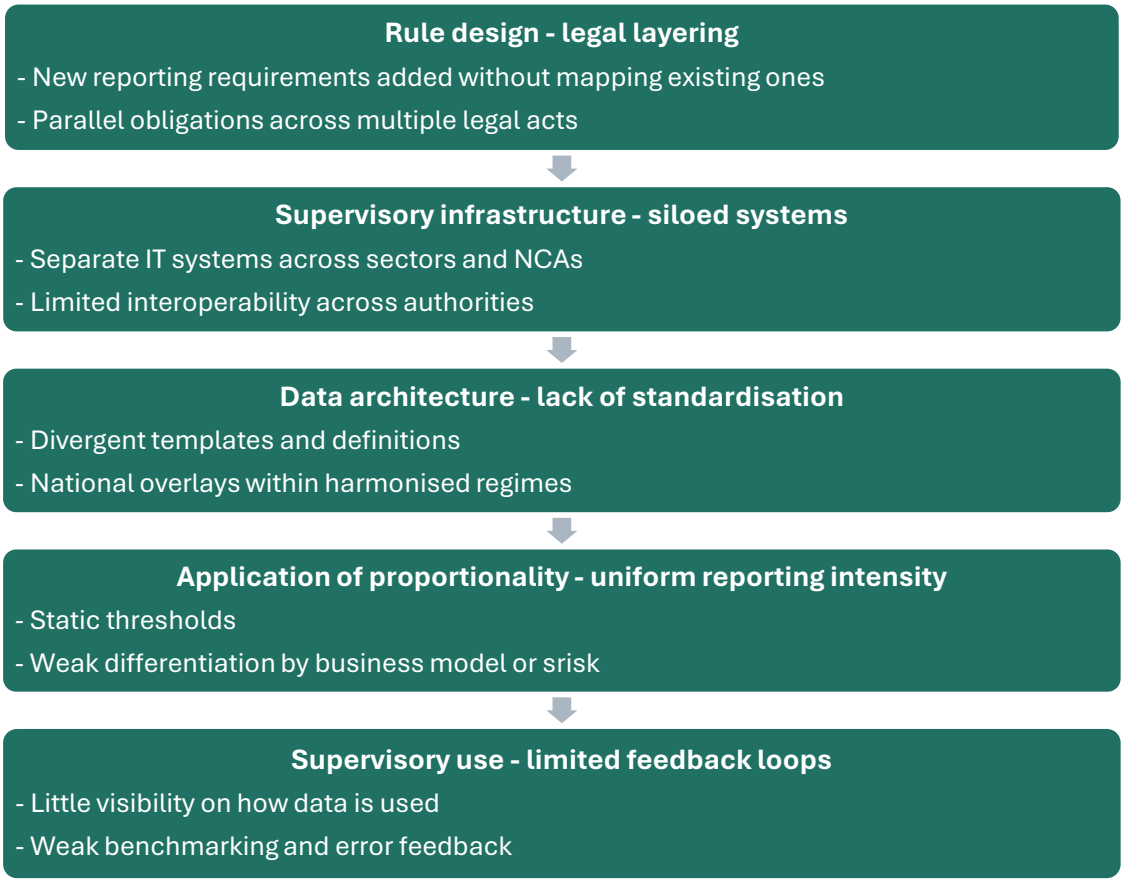
5.1. STREAMLINED SUPERVISORY REPORTING

Supervisory reporting is not just paperwork. It is the operational backbone of supervision – when reporting is coherent, timely and usable, supervisors can detect emerging risks early and intervene proportionately. Yet in the EU, reporting obligations remain fragmented and duplicative, and too often misaligned with actual supervisory use cases and firms' implementation capacity (see Figure 1).

The challenge is therefore twofold: reducing avoidable burden (especially for smaller and cross-border firms) while improving the quality, consistency and usability of supervisory data. Achieving this balance is central to a more risk-based and forward-looking supervisory model.

The banking sector illustrates both the potential and the remaining frictions. Under the SSM, euro area banks report through harmonised templates and shared definitions, supporting more consistent oversight and better risk visibility. However, parallel national requests and additional interpretative demands persist in practice, and Joint Supervisory Teams still need to reconcile domestic conventions with ECB-level expectations. In other sectors (e.g. insurance, securities markets, asset management and payments) reporting remains more siloed, inconsistent and costly.

Figure 1. Structural limitations of the EU's framework for supervisory reporting



Source: Authors' elaboration.

5.1.1. Towards integrated, risk-sensitive reporting

To overcome these barriers, the EU should aim to create a cohesive supervisory reporting ecosystem built on the following pillars:

- *Consolidation and rationalisation of reporting requirements*. The starting point should be a cross-sectoral fitness check of supervisory reporting obligations to identify requirements that do not provide real added value for supervision, with a mandate to delete or streamline them. This should be paired with eliminating duplicative templates and harmonising definitions across relevant legislation (e.g. the SFDR, MiFID and Insurance Distribution Directive (IDD)). At the same time, new proposals should include explicit reporting and impact assessments, and new obligations should replace or streamline existing ones rather than add to the overall burden.

- *Standardised, machine-readable taxonomies*. The development of common, machine-readable, EU-wide taxonomies should be accelerated – building on initiatives such as the European Financial Data Space and the European Single

Access Point – so data are structured, interoperable and reusable[21]. Making new supervisory reporting templates machine-readable by default should become standard, reducing compliance costs while improving data quality and accessibility.

- *Granular, on-demand access models for supervisors*. Instead of relying exclusively on periodic template-based submissions, supervisors should move towards more dynamic access models that allow retrieval of subsets of granular firm-level data on demand, subject to privacy and security safeguards. The ECB and ESAs should initiate pilot projects in selected domains (e.g. liquidity monitoring, CCP stress testing and AI-driven conduct supervision) to test operational feasibility, using sandboxes where needed.

- *Dynamic risk segmentation and proportionality tools*. Proportionality should evolve beyond static thresholds. Reporting frequency, scope and granularity should be calibrated through dynamic risk-based segmentation reflecting size, business model, risk profile and systemic relevance. Supervisory handbooks and IT systems at ESAs and NCAs should embed this form of risk-based tailoring.

- *Greater transparency and feedback for reporting entities*. Better reporting also requires better feedback loops. Institutions should receive regular summaries or dashboards showing how data are used (e.g. error rates, benchmarking insights and supervisory findings). In parallel, ESAs should publish annual 'reporting burden statements' as part of their work programmes to track cumulative reporting impacts and identify areas for streamlining.

5.2. REDUCED FRAGMENTATION FROM WAIVERS, OPTIONS AND NATIONAL DISCRETION

A central barrier to more integrated supervision space is not the absence of EU rules, but the persistence of national options and discretion embedded in those rules. These flexibilities were often introduced to accommodate national specificities and ease political agreement. In practice, they operate as a design flaw: they reproduce divergence within a formally harmonised rulebook, create persistent supervisory variability, and complicate cross-border group management and oversight.

In banking, the effect is visible in the continued segmentation of capital and liquidity within cross-border groups. Under the framework of the Capital Requirements Directive

[21] This could be complemented by more centralised EU-level 'calculation centres' for data collection, processing and analytics (e.g. shared supervisory data platforms operated at the EU level). The objective would be to improve data quality, reduce duplication across authorities and enable more holistic, cross-sector risk analysis – without changing the allocation of supervisory decisions.

(CRD) and Regulation (CRR), the limited availability of waivers for intra-group exposures has been associated with an estimated EUR 225 billion in trapped capital and EUR 250 billion in liquidity (AFME, 2025). These prudential resources cannot be mobilised efficiently within the group when needed, weakening group-wide risk management and reducing the practical benefits of cross-border structures from both a firm and supervisory perspective.

Divergence driven by national options and discretion is also evident in the calibration and application of key buffers and supervisory tools. Under CRD VI, the systemic risk buffer remains subject to heterogeneous methodologies and practices across Member States[22]. Differences in the use and calibration of the countercyclical buffer, as well as supervisory approaches to Pillar 2 guidance, can likewise generate uneven outcomes for comparable institutions. Similar patterns can be observed in other sectors where national implementation choices remain wide (e.g. distribution and conduct frameworks under the IDD and supervisory practices under the Alternative Investment Fund Managers Directive (AIFMD). They limit the effectiveness of convergence tools and increase cross-border compliance friction.

Fragmentation is particularly acute in cross-border mergers and acquisitions, where supervisory approvals remain sequential, process-heavy and insufficiently predictable (Lamandini and Thomadakis, 2025). Despite mutual recognition principles, transactions typically require multiple assessments across authorities and layers, with limited transparency over timelines and decision criteria. The proposed UniCredit-Commerzbank transaction reportedly required nine months for ECB clearance. AFME (2025) estimates that average authorisation timelines have increased by more than 100 days since the launch of the Banking Union. In practice, national authorities can still delay or discourage cross-border acquisitions, including through procedural intensity and uncertainty, even where prudential concerns could be addressed through standardised safeguards.

Addressing these issues does not require a wholesale institutional redesign. It requires a targeted clean-up of the most distortionary flexibilities and a more disciplined operating model for cross-border approvals.

[22] A natural implication is tighter EU-level constraint on both calibration methodology and stacking logic. On methodology, greater harmonisation would mean a common EU framework for identifying the systemic risk addressed (risk indicators, scope/exposure subsets and transparent calibration rationale), reducing scope for divergent national approaches. On stacking, an additional source of divergence is the extent to which the systemic risk buffer can be applied cumulatively on top of the buffers for globally systemically important institutions (G-SII) and other systemically important institutions (O-SII); this 'additivity' has increased complexity and widened national variation in effective buffer stacks. A more integration-friendly approach would be to limit cumulative application where buffers address overlapping systemic concerns. This may require reintroducing, where appropriate, a 'higher of the two' logic unless the authority can demonstrate that the systemic risk buffer targets distinct risks not already covered by the G-SII/O-SII buffer.

- *Start with the root problem: reduce national options and discretion*. A structured reduction programme for national options and discretion should identify the most integration-relevant carve-outs and prioritise those with the largest cross-border impact (including waivers and intra-group constraints). It should set clear timelines for their removal, harmonisation or conversion into EU-level parameters with strict bounds. This should extend beyond banking to areas where national discretion systematically recreates divergence (e.g. parts of the IDD, AIFMD and the forthcoming Solvency II review agenda).

- *Clean up the approval maze for mergers*. Cross-border M&A approvals should be harmonised through established procedural steps, binding timelines and transparent assessment criteria. Prudential safeguards should remain central, but the process should not function as a de facto phase for political veto. Within the euro area, a strengthened ECB role – such as clearer decision ownership, binding mediation in home-host disputes or sole responsibility for specific approval stages – would reduce uncertainty and improve consistency.

- *Rethink ring-fencing through EU-level safeguards*. Host concerns about local resilience are legitimate, but ring-fencing should not be the default solution. The EU should explore alternatives that protect local stakeholders while enabling internal capital mobility, such as group-level guarantees administered by the ECB, collateralised support arrangements or predefined triggers for temporary restrictions under stress. Properly designed, these mechanisms can preserve financial stability while reducing structural incentives to keep capital and liquidity trapped.

The objective is not to dilute prudential protections, but to remove avoidable design features that perpetuate fragmentation. A more coherent approach to national options and discretion and to cross-border approvals would strengthen group-wide supervision, improve predictability and support integration without requiring a binary choice between full centralisation and the status quo.

5.3. STRONGER ESAS THROUGH CONVERGENCE, COORDINATION AND ACCOUNTABILITY

The ESAs sit at the centre of the EU's coordination model for supervision outside banking. Over time, their remit has broadened well beyond supervisory convergence to include an expanding portfolio of technical standard setting, guidance, data work and crisis-related tasks. This creates a structural tension. The more the ESAs are used as a delivery vehicle for additional tasks, the less bandwidth they retain for the sustained operational work needed to narrow day-to-day supervisory divergence.

This constraint is visible in resourcing and prioritisation. ESMA, for instance, is able to conduct only around 2.5 peer reviews of NCAs per year, an insufficient number given the breadth of sectors and the dispersion of supervisory practices across 27 Member States. Similar trade-offs affect the EBA and EIOPA. The implication is practical: without a sharper allocation of responsibilities and greater operational capacity, convergence activity risks remaining selective and episodic rather than systematic.

At the same time, the ESAs' experience in specific domains shows where EU-level involvement can be operationally meaningful. ESMA's enhanced role in Tier 2 CCP oversight under EMIR 2.2 and EMIR 3.0 is a useful precedent. ESMA now validates key risk models, coordinates supervisory colleges and conducts EU-wide stress tests for CCPs, including non-EU CCPs. Yet the supervisory setup remains multilayered: 13 national supervisory teams, in addition to ESMA, are involved in supervising 14 EU-based CCPs. This demonstrates both the value of EU-level technical leadership and the coordination costs that persist when responsibilities remain split across multiple authorities.

Reform should therefore focus on three priorities.

- *Refocus and support the convergence mandate*. The ESAs should have a clearer, more operational remit to identify where supervisory practices diverge materially and to drive convergence through thematic work and targeted reviews, prioritised by cross-border relevance and systemic importance. Where inconsistencies threaten the integrity of the single market, the ESAs should be able to deploy stronger coordination and mediation tools, backed by transparent evidence[23].

- *Strengthen follow-up discipline*. Where weaknesses are identified, convergence tools should be paired with structured remediation: clear expectations, timelines and reporting on implementation. This would shift ESA work from diagnosis to measurable correction and reduce the scope for persistent divergence to remain unresolved. Where persistent non-compliance remains, the EU should consider streamlining and widening the practical usability of the breach-of-Union law mechanism (e.g. under Article 17 of the ESMA Regulation), including by reducing procedural dependencies that can delay enforceability.

- *Upgrade accountability and governance in line with a stronger role*. Any reinforcement of ESA powers should be matched with clearer performance scrutiny and institutional checks. This includes more systematic reporting on convergence outcomes, regular parliamentary engagement on results (not only

[23] An example is amending Article 21 of the ESMA Regulation to introduce a harmonised framework for supervisory colleges, with ESMA as chair to coordinate discussions and, where needed, act as an escalation point to resolve conflicting views or persistent divergence among participating authorities.

on activity) and governance arrangements that support independence and technical credibility[24].

The objective is to make the ESA layer more effective as a convergence and coordination anchor, while reducing the risk that expanding task portfolios continue to dilute the ESAs' capacity to deliver consistent supervisory outcomes across the single market.

5.4. A SUPERVISORY EFFICIENCY TEST FOR CAPITAL MARKETS

Despite sustained efforts to deepen financial integration, supervisory arrangements in EU capital markets remain misaligned with the cross-border reality of many activities. Oversight is still predominantly national even where firms, infrastructure and investor flows operate at EU scale. To address this mismatch, a more functional approach is needed: a supervisory efficiency test that evaluates, for any given activity, whether the allocation of supervisory tasks matches the degree of market integration, complexity and risk (Demarigny and Thomadakis, 2025).

At its core, the test would rest on a simple proposition: the more integrated and cross-border a financial activity becomes, the stronger the case for supervisory coordination or centralisation. Conversely, for activities that remain domestic in scope or subject to national legal frameworks, national supervision may remain the most efficient and proportionate model.

Rather than imposing a rigid one-size-fits-all solution, the supervisory efficiency test would provide a flexible framework that could be embedded in the EU's regulatory lifecycle. It could be applied during legislative reviews, after significant market developments, or when new supervisory responsibilities are being assigned. In this way, it would act as a kind of regulatory subsidiarity mechanism – helping to determine the right level of oversight based on how markets actually function rather than on politics.

The test would rely on six key questions. Is the market standardised? Is passporting common? Who holds market power? Are investors local or cross-border? Who supervises, and how well? And finally, can rules actually be enforced across borders? It would cover the following indicators:

- *standardisation* – the extent to which rules are harmonised across Member States, particularly whether the activity is governed by a regulation or a directive, and how much interpretive discretion is left to national authorities;

[24] An option would be to establish an executive board (replacing the Management Board), composed of a small number of independent members, to take key supervisory decisions and reduce conflicts of interest in ESA governance.

- *passporting intensity* – the volume and pattern of cross-border activity, based on the actual use of passports and the presence of dominant 'exporter' or 'importer' jurisdictions;
- *market concentration* – whether activity is spread across many domestic players or concentrated among a few large, cross-border groups;
- *investor base* – whether the market is primarily retail or institutional, local or pan-European, with implications for protection needs and supervisory capacity;
- *supervisory landscape* – how many authorities are involved in oversight, and whether there is already a lead supervisor or scattered allocation of tasks;
- *enforcement fluidity* – the extent to which enforcement can be effectively carried out across jurisdictions, including access to data and consistency in sanctions.

Using these indicators, the test would generate an integration profile for a given market segment or activity. This profile would then be compared against a menu of possible supervisory arrangements ranging from purely national supervision to mutual recognition models, coordinated supervision through colleges, and, at the most integrated end, direct supervision by ESMA.

Importantly, the test would not be designed to produce a binary outcome (centralised vs decentralised), but rather to assess each supervisory function (e.g. licencing, reporting, enforcement and product approval) individually. This function-by-function diagnosis would allow for task-specific oversight models, recognising that not all responsibilities require the same institutional setup. For example, licencing may remain national where legally feasible while ongoing supervision could be centralised for large cross-border players, and enforcement responsibilities could be coordinated[25].

Applied consistently, the test could inform a new supervisory strategy for the EU that reflects both the diversity of financial markets and the need for coherent, efficient and proportionate oversight. It would also help overcome the current impasse over ESA

[25] Legal and constitutional constraints matter here. Authorisation and ongoing supervision are typically designed to travel together, since licencing fixes the regulatory perimeter and conditions. Any functional unbundling (e.g. national authorisation with EU-level ongoing supervision for a subset of cross-border/systemic entities) would therefore require a clear EU legal basis, a precisely defined allocation of tasks and decision rights, and unambiguous accountability. The same applies to shared enforcement: cooperation and joint investigations can be shared, but enforceable decisions normally require a single legally responsible authority to ensure due process and legal certainty, including a workable appeal route. In practice, this points either to EU-level direct powers for a defined population (with NCAs supporting operationally) or to national enforcement under strengthened EU coordination/mediation tools. Any hybrid model must specify *ex ante* which body adopts the enforceable act and which review forum applies (an EU-level review for ESA acts; national courts for NCA acts).

reform by providing a structured way to justify new powers or the reallocation of tasks, grounded in technical criteria rather than political compromise.

Over time, the test could serve multiple purposes: as an input into legislative design, as part of impact assessments, as a benchmark for regulatory reviews or even as a tool for budget and resource allocation across supervisory authorities. It would also align with the broader better regulation agenda, offering a way to ensure that supervisory governance evolves alongside financial innovation and integration.

5.5. A REAPPRAISAL OF THE SUPERVISORY ARCHITECTURE: THE SREP AS A CASE STUDY

The evolution of the supervisory review and evaluation process is a useful illustration of how EU supervisory practice can end up absorbing complexity generated elsewhere in the prudential framework. What began as a risk-based tool has progressively expanded as new requirements, horizontal priorities and cross-cutting expectations have been layered into a single recurring cycle.

These shortcomings were first formally identified in the independent expert review of ECB Banking Supervision published in 2023. The review concluded that the SREP had become increasingly mechanical, resource-intensive and insufficiently differentiated by risk. It pointed in particular to comprehensive annual assessments across all risk categories, extensive and repetitive data requests, and limited proportionality as factors that diminish supervisory focus on what is material.

Building on this assessment, ECB Banking Supervision conducted an internal review, culminating in its report, Streamlining supervision, safeguarding resilience (December 2025). The ECB explicitly acknowledged that the SREP had evolved into an all-encompassing annual exercise, increasingly acting as a point of aggregation for multiple prudential, macroprudential and resolution-related demands. The requirements and guidance under Pillar 2 are thus calibrated in an environment already shaped by Pillar 1 constraints, macroprudential buffers and the minimum requirements for own funds and eligible liabilities (MREL), without a consistently transparent articulation of how overlapping risks and constraints are treated across layers.

The ECB's response has focused on process adjustments rather than changes to the underlying regulatory architecture. Reforms introduced since 2023 and further developed in 2025-26 aim to make supervision more risk-based and proportionate through multi-year planning, differentiated supervisory intensity, streamlined data collection and improved coordination across supervisory activities. These measures are intended to reduce administrative burden and improve clarity while operating within existing legislation.

The SREP reform nevertheless highlights a structural limitation. If the underlying framework continues to generate overlapping requirements and dense interaction effects, process simplification can reduce friction at the margin but cannot eliminate cumulative burden at source. Over time, a 'streamlined' SREP risks becoming a recurring optimisation exercise rather than a durable reset.

This has direct implications for supervisory architecture and accountability. Key drivers of supervisory outcomes are often embedded in operational supervisory practice and iterative supervisory expectations, while external scrutiny tends to concentrate on procedural transparency rather than on proportionality, cumulative impact and outcomes. The experience of the SREP reform suggests that, without stronger accountability channels and systematic independent evaluation of the supervisory burden versus the risk-reduction benefits, simplification efforts risk remaining episodic and ultimately ineffective if they do not change the underlying incentives and practices that generate burden.

6. RECOMMENDATIONS

Europe's financial system has benefited from two decades of ambitious regulatory and supervisory development. These efforts have delivered stability, investor protection and alignment with global standards. However, the cumulative result is a framework that has become dense, rigid and often misaligned, with unintended consequences for legal clarity, operational efficiency and cross-border integration. This complexity has weakened the functioning of the single financial market, eroding the effectiveness of mutual recognition, the single licence model and home-country control.

At the same time, the EU faces growing regulatory competition – both internally, from divergent national approaches, and externally, as other jurisdictions streamline their frameworks to attract global capital. While EU rules aim to provide a level playing field through mutual recognition and one-stop supervision, in practice the architecture remains skewed towards a universal banking model, with limited adaptation for brokers, large investment firms or fintechs. This imbalance risks stifling innovation and reducing competitiveness.

The recommendations below are designed to address the root causes of this complexity. They focus on two areas: improving the way financial rules are designed and adopted (regulation) and enhancing the way those rules are implemented and enforced (supervision). All proposals are targeted, actionable and intended to improve coherence without compromising the EU's commitment to financial soundness and market integrity.

6.1. REGULATION – SIMPLER, MORE PREDICTABLE AND BALANCED

- Avoid over-specification in primary legislation. The EU should reserve technical formulas, reporting templates and operational thresholds for levels 2 and 3, not level 1. When detailed parameters are fixed at the legislative level, even small adjustments (e.g. to reflect market or technological developments) require reopening complex political negotiations. This limits responsiveness and makes the system inflexible. Lawmakers should focus primary texts on policy goals and principles, complemented by clearly bounded delegation of technical design to better adapted instruments.

- Introduce a check for regulatory coherence and necessity before adopting new rules. All major initiatives should undergo a formal test for internal consistency, necessity, duplication and interaction with existing frameworks. This check should substantiate the need for new measures and flag overlaps, inconsistent definitions or conflicting obligations (notably in ESG, digital and prudential policy). Preventing fragmentation at the drafting stage will reduce costs and improve legal clarity for firms and supervisors.

- Develop tailor-made regulatory regimes only where existing categories do not fit market diversity or innovation. The objective is not more regulation, but an activity-based and proportionate framework where today's categories are ill suited. Targeted regimes such as those for market in crypto-assets, AIFMD and the Payment Services Directive show how a calibrated set of rules can support innovation and competition while preserving safeguards. Where gaps persist (e.g. for large investment firms, brokers and AI-enabled financial services), targeted modules may be justified, provided they avoid regime proliferation and new fault lines in the single market, and meet clear eligibility, interoperability and net-value tests.

- Embed targeted *ex-post* review and continual adjustment in the regulatory process. Technical rules, delegated acts and supervisory guidance should sit under a disciplined, structured review framework, with cycles that are risk-based rather than uniform. Stable regimes can be reviewed less frequently to preserve legal certainty, while fast-evolving areas should trigger earlier and more regular checks. Reviews should be prioritised according to clear criteria (materiality, cross-border impact, duplication and low supervisory value) and operate with a presumption of repeal/streamlining where provisions are outdated, redundant or disproportionate. The Commission and ESAs should also sequence reviews to avoid overload for supervisors and market participants, aligning timetables with implementation capacity and allowing time to operationalise reforms.

- Improve impact assessments and make compliance costs a non-optional input into decision-making. Every financial services proposal should include a quantified estimate of compliance costs, distinguishing one-off implementation from recurring obligations (e.g. reporting, staffing and IT) and broken down by firm type and activity. The Regulatory Scrutiny Board's conclusions should carry greater practical weight: proposals receiving negative opinions should not proceed without a documented response and revised analysis. Assessments should also be updated when the substance changes materially during negotiations, so legislative bodies assess the final package rather than the initial draft. Impact assessments should be produced by independent, technical panels in line with international practice.

- Prohibit national gold-plating, including through interpretation, in fully harmonised areas. Where EU rules are intended to be fully harmonised, Member States should not add requirements through national legislation or supervisory interpretation (e.g. local guidance, expectations, templates and process add-ons) unless the EU act explicitly allows discretion. Gold-plating entrenches

fragmentation, raises compliance costs and hinders cross-border scalability. Enforcement should combine transparent implementation mapping (what was added, by whom and on what legal basis) with structured escalation that allows the Commission and ESAs to challenge interpretive add-ons alongside infringement action where persistent deviations erode the single rulebook.

- Coordinate legislative timelines across related policy areas. Regulatory coherence also depends on sequencing. Laws that apply to the same institutions or activities (e.g. ESG disclosures, anti-money laundering or digital resilience) should be developed and implemented with aligned timelines and core definitions. Better synchronisation would reduce operational strain on firms and supervisors and prevent overlapping data requests, IT upgrades or reporting obligations from being imposed simultaneously.

- Consolidate a results-oriented regulatory culture, anchored in measurable outcomes. The EU should move beyond a compliance-only logic towards an outcomes-based approach, where efficiency, innovation, integration and resilience are treated as testable objectives throughout the policy cycle. This requires embedding a limited set of standard outcome indicators in impact assessments and ex-post evaluations (e.g. approval timelines, reporting costs, cross-border activity, market entry/exit and supervisory divergence), with clear data ownership and publication. Where indicators reveal unintended burden, divergence or limited effectiveness, rules and guidance should be adjusted or repealed. This discipline would curb over-specification and support more adaptive, principle-based frameworks.

- Clarify the use of capital instruments across objectives. Regulatory simplification should address the multiple uses of capital and loss-absorbing resources across requirements for Pillars 1 and 2, buffers and resolution. The EU should sharpen the distinction between going-concern and gone-concern resources and reduce cases where institutions are effectively required to demonstrate loss-absorption capacity multiple times against the same risk drivers through overlapping layers.

- Decide and deliver on the Additional Tier 1 (AT1) endgame. The ECB's High-Level Task Force has identified two credible options: either bolster AT1 as a genuine going-concern and loss-absorbing instrument or remove AT1 from going-concern prudential requirements and rely solely on Common Equity Tier 1. Keeping both options open prolongs uncertainty for banks, supervisors and investors, and undermines predictability and simplification. A clear policy choice is required, implemented consistently across prudential and resolution frameworks and calibrated to avoid inadvertent net tightening for cumulative interactions.

- **Align MREL recapitalisation capacity with instrument purpose**. For institutions with reliable market access, the recapitalisation component of MREL should be met primarily through senior non-preferred debt rather than regulatory own funds. This would reduce redundancy between prudential and resolution stacks and improve transparency in capital planning. For smaller institutions without market access, MREL calibration should be tied explicitly to the preferred resolution strategy (transfer or liquidation), avoiding disproportionate subordinated-debt requirements that would not be credible or usable in resolution.

6.2. Supervision – more effective, consistent and accountable

- **Create a single decision owner for cross-border approvals and waivers for financial groups**. For inherently cross-border decisions (e.g. acquisitions and mergers within the banking union, intra-group capital and liquidity waivers and organised group approvals), the EU should move from sequential national sign-offs to a single process with clear decision ownership, binding timelines and transparent criteria. Where the supervisory efficiency test indicates high integration and spillovers, decision-making should sit at the EU level (or be overseen by an EU supervisor), with NCAs contributing via established input channels rather than parallel veto stages. This would reduce uncertainty, limit home-host frictions and make group-wide risk management and supervision more effective.

- **Hard-wire proportionality into supervisory standards and guidance**. Proportionality should be a non-optional design constraint in level 2 and 3 outputs and supervisory methodologies. Every guideline, supervisory standard or handbook update should include a short proportionality statement that specifies i) which obligations vary by size, complexity and risk; ii) what the simplified path is for low-risk firms; iii) and how supervisors will apply this in practice. ESAs should test proportionality *ex post* through peer reviews and publish findings, so that the 'same rulebook' does not translate into the 'same process' regardless of risk.

- **Strengthen and standardise the scope of supervisory accountability, including for informal instruments with material effect**. At present, established review and appeal mechanisms attach most clearly to acts classified as formal decisions. In practice, however, supervisors also steer outcomes through informal instruments (e.g. expectations, letters, horizontal communications, Joint Supervisory Team communications, on-site inspection findings and interpretative guidance). These can have de facto binding effects but are not always documented or channelled in a consistent, reviewable way. Accountability should be applied more uniformly by specifying when such instruments are permissible. It should require traceability

and attribution, and provide clear escalation and review pathways where effects are significant, including *ex-post* challenge where appropriate.

- Consolidate and harmonise reporting on supervisory transparency. Building on existing reporting and accountability practices, supervisors should publish a combined transparency dashboard that brings together periodic 'supervisory burden statements' and a limited set of supervisory performance indicators, in a format that is comparable across Member States and sectors. Burden reporting should cover the operational load from reporting templates, ad hoc data requests, guidance and expectations. Performance indicators should track timeliness and consistency (e.g. authorisation timelines, divergence metrics, data-submission bottlenecks and implementation delays). This would support planning by firms, improve comparability and help target convergence efforts where frictions are most material.

- Strengthen ESA-led convergence in guidance and Q&As, with structured NCA support where ESAs are lead supervisors. The issuance of supervisory guidance, Q&As and interpretive statements should be coordinated with clearer steering by ESAs (including the SSM and NCAs) to avoid conflicting instructions, duplicative expectations and de facto gold-plating through divergent interpretations. Where guidance touches multiple mandates (e.g. ESG disclosures, digital finance and outsourcing), ESAs should operate a joint clearing process (or single access point) to align definitions, templates and supervisory expectations before publication. In areas where an ESA acts as a lead or direct supervisor, NCAs should be required to support delivery through standardised information-sharing, consistent application of the common interpretation and coordinated follow-up.

- Introduce a supervisory efficiency test for cross-border markets. The EU should adopt a formal test to assess whether supervisory responsibilities in each market segment match the degree of integration, complexity and cross-border activity involved. This would provide an evidence base for choosing between national supervision, strengthened EU-level coordination, or targeted centralisation, and for aligning resources accordingly. The test should be applied alongside full use of existing convergence and coordination tools. Centralisation should be considered where evidence shows that coordinated models cannot deliver consistent outcomes in materially integrated markets. Independent evaluation of the test's application and of resulting efficiency gains could be supported by audit work at the EU level (e.g. by the European Court of Auditors).

- Support credible private enforcement and structured self-regulation as complements to supervision. Public supervision cannot carry the full enforcement

load, particularly in fast-evolving areas. The EU should encourage well-governed complementary mechanisms such as recognised industry codes with minimum governance standards and conflict-of-interest safeguards, as well as accredited alternative dispute resolution/ombuds and dispute-resolution platforms. These mechanisms should be supported by sector-led implementation guidance that is transparent and subject to supervisory challenge. These tools should not substitute for public enforcement but instead reduce friction, accelerate consistent practice and improve access to redress – especially where rules are new or operationally complex (e.g. sustainable finance and AI-enabled services). EU and national authorities can foster this by clarifying legal status, promoting coordination platforms, and enhancing consumer and investor redress channels.

- Build implementation capacity around shared infrastructure for EU supervisory data, with clear task ownership, access gateways and sustainable funding. Simplification and convergence will not deliver results if authorities lack the people, data infrastructure and technical tools to implement and enforce rules consistently. The EU should establish an interoperable system for supervisory data (with common identifiers, machine-readable taxonomies, application programming interfaces and secure access controls) so that data can be reused across authorities rather than repeatedly collected. Task ownership should be explicit: ESAs and the SSM should provide shared methodologies, taxonomies and reusable data/IT components; NCAs should remain primary data holders and focus on execution and local risk intelligence; and EU bodies should have legal gateways to access and aggregate data for convergence and cross-border risk monitoring, with confidentiality safeguards. Governance should specify maintenance and cost-sharing. Funding should match this division of labour via a dedicated EU capacity envelope, risk-based fees where appropriate and reallocation from the low-value reporting/administrative activities freed up by simplification.

- Strengthen holistic governance of capital demand. Coordination bodies (e.g. the Macroprudential Forum) should operate under clearer procedural discipline, including shared methodologies, transparent criteria to identify overlaps across buffers and requirements, and a comply-or-explain mechanism when cumulative demands exceed agreed benchmarks. Without this, coordination could remain consultative rather than constraining. Over time, the approach should be extendable beyond the Banking Union to avoid widening divergence between SSM and non-SSM Member States.

- Institutionalise independent evaluation and bolster parliamentary scrutiny of banking supervision. The 2023 independent review of ECB Banking Supervision

demonstrated the value of external assessment in triggering operational reform, but its one-off nature limits durability. The EU should establish a standing, independent evaluation mechanism to assess proportionality, consistency and cumulative supervisory burden at regular intervals, with published findings and follow-up expectations. Parliamentary oversight should then be anchored in these evaluations, moving beyond procedural transparency towards structured scrutiny of supervisory outcomes and trade-offs. This implies more specialised, continual oversight capacity to interrogate results, monitor remediation and ensure accountability for material supervisory choices.

These recommendations are not intended as a wholesale redesign of the EU financial framework. Rather, they offer practical ways to restore clarity, reduce duplication and improve both the quality of rulemaking and the consistency of supervision. If implemented, they would help ensure that the EU's regulatory architecture remains resilient and credible, while also becoming more agile, innovation-friendly and fit to support long-term competitiveness in a changing global environment.

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APPENDIX A. MEMBERS OF THE TASK FORCE[26]

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[26] This report was drafted by the rapporteurs of the Task Force. Its recommendations do not necessarily reflect a common position reached or endorsed by all members, nor by the institutions to which they belong.

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APPENDIX B. TASK FORCE MEETINGS AND SPEAKERS

1. First meeting – EU financial regulation and simplification: what can be achieved (14.05.2025)

   Petra Hielkema, Chairperson, EIOPA

2. Second meeting – Revisiting the Lamfalussy procedures and structuring the different levels (02.07.2025)

   John Berrigan, Deputy Director-General for Financial Stability, Financial Services and Capital Markets Union, DG FISMA

3. Third meeting – Adjusting supervisory structures (16.09.2025)

   Klaus Löber, Chair of the CCP Supervisory Committee, ESMA

   Fernando Restoy, Chair of the Financial Stability Institute, Bank for International Settlements

   Jonathan Hill, Former EU Commissioner for financial services

4. Fourth meeting – Feedback on the first draft of the final report (10.12.2025)

Appendix C. From global standards to EU financial supervision and data

European financial market policy is a relatively recent development. Even at the global level, cooperation on the financial market is new compared with the long-standing presence of international banking. The main international supervisory bodies – the Basel Committee on Banking Supervision (1975), the International Organization of Securities Commissions (1983) and the International Association of Insurance Supervisors (1994) – have been around for half a century at most. While these bodies have advanced global cooperation and standard setting, their agreements remain non-binding. Moreover, the nature of these standards and their reliance on national implementation means that the effectiveness of global rules has always depended on political commitment and domestic institutional capacity.

The Basel Committee was a pioneer. Following the Herstatt collapse in 1974, it was formed by central banks of the G10 countries (mostly European, plus the US and Japan). Its 1975 Concordat laid down principles for home-host supervision of international banks, later enshrined in the EU's first Banking Directive. The 1988 Basel I Capital Accord (also known as the Cooke ratio) introduced minimum capital requirements based on risk-weighted assets and became the basis for the EU's second Banking Directive. These early steps provided the first building blocks for EU financial integration, establishing the principle that common prudential rules were a prerequisite for a functioning single market.

Basel's influence has grown. The Committee now includes 45 institutions across 28 jurisdictions and has over 140 countries endorsing its principles. Basel II, proposed in 1999, built on this with new provisions on credit risk, trading books and the use of internal models[27]. The EU followed closely, adopting Basel-inspired rules through the Capital Requirements Directives and expanding its single market through key milestones such as the 1992 single banking licence and the Financial Services Action Plan in 1999. However, these frameworks also introduced complexity and discretion, which became evident in the varied interpretation and application of rules across Member States.

The global financial crisis marked a turning point. It exposed major weaknesses in supervisory coordination, data reliability and availability, and the enforcement of prudential standards. In response, the EU undertook a deep re-regulation of financial markets to reduce risks to financial stability and conduct, closely aligned with international standards. A new institutional architecture emerged from the de Larosière

[27] Directive 2006/48/EC transposed into EU law the Basel II rules on measuring own funds and capital requirements, enabling credit institutions to choose amongst three approaches (of varying complexity) for the calculation of minimum capital requirements (recital 42).

report of 2009. It led to the creation of the European Supervisory Authorities (ESAs) (the European Banking Authority, European Securities and Markets Authority (ESMA) and European Insurance and Occupational Pensions Authority (EIOPA)). In 2014, the launch of the Single Supervisory Mechanism (SSM) marked a decisive shift towards supranational banking supervision. While banking oversight was centralised in the euro area, supervision of securities and insurance markets remained largely in national hands.

Parallel to these post-crisis reforms, broader EU policy agendas were launched to deepen integration and reduce structural imbalances. The Capital Markets Union (CMU), unveiled during the Juncker Commission, sought to diversify sources of financing, while the concept of a Savings and Investment Union, introduced in the Letta report, aimed to complement the Banking Union and fill institutional gaps.

Institutionally, many of the foundations for EU-level cooperation had already been laid out earlier. The first Banking Directive created the Banking Advisory Committee (BAC), composed of national competent authorities, to coordinate regulatory matters. A separate forum, the 'Groupe de Contact', was created for supervisory cooperation. Similar bodies were later established for securities and insurance. These committees were formalised under the Lamfalussy report of 2001 and later evolved into the ESAs after the crisis.

Despite these institutional advances, a major structural weakness persisted: the lack of reliable and comparable supervisory data. Until the crisis, there was little public information on the condition of EU-based financial institutions. Under the first Capital Requirements Directive (CRD I), which implemented Basel II, national discretion led to divergent implementation and made key metrics such as own funds difficult to compare. This hindered early risk detection and highlighted the need for ensuring comparable outcomes across Member States. More centralised supervision was one of the solutions.

Only with the establishment of the SSM in 2014 did consistent and comparable data for euro area banks become publicly available. This was gradually extended to capital markets and insurance via ESMA and EIOPA. As a result, there is now roughly a decade of EU-wide financial market data, but the process remains incomplete. Gaps in granularity, coverage and standardisation continue to hamper supervisory convergence and effective risk assessment. Another key challenge is the limited capacity of supervisory bodies to develop and maintain comprehensive data systems for analysis and risk monitoring. A major step forward is expected with ESMA's upcoming consolidated equity and bond market data feeds, which will provide essential tools for both market integration and regulatory oversight.

Appendix D. Regulatory expansion, adjacent policy domains and the coordination challenge

The EU's regulatory framework for financial services has expanded dramatically in size and complexity. In 1992, the entire corpus of banking, securities and insurance rules could fit in three volumes totalling about 500 pages. Today, financial regulation includes hundreds of legal texts, delegated acts and technical standards – making it virtually impossible to be an expert across the whole field. Expertise is now limited to specific domains and subsectors. Even within single files, the number of cross-references, delegated responsibilities and technical clarifications has reached a scale that impedes effective navigation, interpretation and implementation.

This expansion in rulemaking reflects deeper trends. The size of financial assets relative to GDP has more than doubled, signalling the financialisation of the economy and the central role of finance in household and firm wealth. Rapid innovation – from derivatives to algorithmic trading, structured products and ETFs, robo-advice, blockchain, crypto and tokenisation – has further complicated the regulatory landscape. The rise of new asset classes, the proliferation of cross-border activities and the increasing speed of market transactions have required regulators to address risks that did not exist (or were not systemically relevant) only a decade ago.

In response, regulation has had to evolve. The global financial crisis exposed major gaps, inconsistent implementation and regulatory arbitrage. The G20 and the Financial Stability Board took the lead internationally, with the EU following and adapting global recommendations. Implementation of the Basel III package is still ongoing – with the final elements, including output floors on internal models, only adopted in Capital Requirements Directive VI and Capital Requirements Regulation III, and to be fully applied by 2032. While Basel III aims to reduce systemic risk and enhance bank resilience, its implementation across a highly diverse EU banking landscape has itself generated regulatory fragmentation and supervisory divergence.

Beyond traditional financial services, regulation is expanding into adjacent domains – particularly digital and sustainability – with direct implications for financial institutions. Rulemaking in these areas has accelerated rapidly in response to European objectives. No major trading partner (except perhaps the UK) has produced a comparable volume of legislation. In the digital sphere, for example, the US has only a handful of sector-specific acts – such as the Communications Decency Act of 1995, which governs internet content liability, and the GENIUS Act, which targets payment stablecoins. Meanwhile, most other areas (like competition, privacy and consumer protection) are regulated through generic federal or state-level provisions.

The EU's ambition to become a global regulatory setter has led to the adoption of highly prescriptive frameworks such as the Digital Services Act, Digital Markets Act and the Artificial Intelligence Act (AI Act). These regimes, while groundbreaking, overlap with existing financial legislation in ways that introduce compliance uncertainty. For example, financial firms deploying AI in credit scoring or algorithmic trading may fall simultaneously under financial regulation, AI rules and data protection obligations – without a clear hierarchy or allocation of responsibilities among supervisory bodies.

Yet, this regulatory leadership no longer automatically translates into global standard setting. The 'Brussels effect' – most clearly associated with the General Data Protection Regulation (GDPR)[28] – has not been replicated by newer regimes such as the AI Act or the Markets in Crypto-Assets Regulation, which have yet to become clear international benchmarks (Crum, 2025). When EU frameworks become overly complex, burdensome or poorly coordinated, the first-mover advantage can quickly turn into a competitive handicap, particularly for financial institutions caught between multiple, overlapping regimes. This is especially true for small and mid-sized institutions, which may lack the compliance infrastructure to navigate parallel requirements, and for cross-border institutions, which must reconcile EU-specific obligations with non-EU frameworks. As a result, regulatory risk becomes a key strategic consideration for market participation and product innovation.

In the sustainability domain, rules are now widespread across advanced economies and increasingly in major emerging markets, but they remain uneven and only partially coordinated. The EU has taken a leading role with the taxonomy and disclosure framework, and a growing number of jurisdictions have developed parallel regimes, often borrowing elements of EU design while adapting scope and materiality concepts to domestic market structures.

At the global level, the International Sustainability Standards Board (ISSB) is emerging as the most important baseline-setter for convergence. A number of Asian jurisdictions, in particular, are leveraging ISSB standards as a reference point for domestic requirements and implementation roadmaps, and in some cases are positioning themselves as early movers in operationalising ISSB-aligned reporting. That said, the ISSB's role is not frictionless. Key jurisdictions differ on core design choices, notably the boundary between financial materiality and broader impact reporting, and the degree of prescriptiveness and assurance expected. The US debate is one visible expression of this tension, including

[28] The GDPR (and data protection) is often cited as a benchmark case of EU rule diffusion (Bradford, 2019; Johnson, 2022): many global firms operationalised GDPR-style privacy controls across markets (*de facto* diffusion), while multiple non-EU jurisdictions adopted GDPR-inspired reforms (*de jure* diffusion). Convergence has nonetheless been uneven and adapted locally, so the effect is better understood as a shift in international compliance baselines than as full global harmonisation (Renda, 2022; Birnhack and Mundlak, 2025).

concerns that an overly expansive ISSB remit could complicate interoperability with US requirements and recognition arrangements (Atkins, 2025).

Within the EU, there are also signs of regulatory tension, particularly around proportionality, interoperability and the capacity of SMEs to meet increasingly complex disclosure requirements for environmental, social and governance aspects. The role of financial institutions as intermediaries in sustainability reporting (e.g. under the Sustainable Finance Disclosure Regulation (SFDR) or the Green Taxonomy) raises operational and liability risks that are not yet fully addressed by existing supervisory or legal mechanisms.

At the same time, political pressure to roll back rules is growing. Revisions to the Corporate Sustainability Reporting Directive, the Corporate Sustainability Due Diligence Directive (CSDDD), and soon the SFDR point to a broader retrenchment. The digital sector is also pushing back. These trends raise important questions about whether and how to adjust the regulatory framework for financial services. They also raise the question of how much regulatory layering the system can bear without undermining its objectives. The EU's credibility as a standard-setter may depend not only on the ambition and coherence of its rules but also on their durability and enforceability in a changing political and economic landscape.

At the same time, the post-crisis regulatory framework has coincided with a profound transformation in the structure of the financial system. A growing share of financial intermediation has migrated outside the traditional banking sector towards non-bank financial institutions (NBFIs). Recent analysis shows that, in the euro area, the NBFI sector now exceeds the size of the banking system and is larger than in the US, marking a significant shift in the locus of financial risk (Pelizzon *et al.*, 2025).

This development complicates the assessment of post-crisis stability. While banks are undeniably better capitalised and more resilient, the expansion of NBFIs prompts the question of whether risk has been reduced or merely displaced. Part of this shift appears consistent with regulatory arbitrage dynamics, whereby tighter prudential requirements on banks have incentivised the relocation of activities towards less regulated or differently regulated segments of the financial system, as highlighted in recent BIS analysis.

Importantly, much of the NBFI sector has yet to be tested in a full cyclical downturn. Its growing systemic relevance therefore challenges the assumption that the post-crisis regulatory framework has delivered a durable increase in financial stability at the system-wide level. Instead, it suggests that regulatory design and supervisory focus may not yet be fully aligned with the evolving structure of financial intermediation and risk. This raises a broader concern that regulatory complexity and institutional inertia may have

contributed to a framework that is increasingly backward-looking, highly detailed and demanding in areas where risks have already been addressed, while slower to adapt to emerging vulnerabilities and shifts in market structure.

Finally, the institutional landscape itself has grown more complex. In many areas (e.g. digital finance, cybersecurity and sustainability) multiple authorities share overlapping or adjacent responsibilities, including for example DG FISMA, DG COMP, DG CONNECT, the European Supervisory Authorities, the ECB, ENISA and national regulators[29]. Coordination mechanisms are often informal or ad hoc, and there is no clear 'single point of accountability' for cross-cutting risks. This institutional diffusion may lead to delayed responses, fragmented supervision and reduced ability to anticipate or manage emerging threats.

Overall, these dynamics illustrate why the EU faces not only a growing stock of regulation, but also an increasingly complex coordination problem across mandates, sectors and institutional layers.

[29] A prominent illustration is market-abuse enforcement involving energy derivatives, where responsibilities can be split across securities-market supervision under the Market Abuse Regulation and energy-market monitoring under the Regulation on Wholesale Energy Market Integrity and Transparency, reflecting imperfect cross-framework coordination.

Appendix E. Regulating risk in finance – an ever-expanding rulebook

The EU financial sector operates under one of the most extensive and complex regulatory frameworks in the world. Over the past two decades, the need to ensure systemic stability, market integrity and consumer protection has driven an ambitious and expansive approach to rulemaking. The 2008 financial crisis further spotlighted the importance of statutory oversight, prompting a wave of reforms to strengthen prudential supervision, align with global standards and close gaps in investor and depositor safeguards.

However, the post-crisis regulatory response has also revealed significant structural tensions: a dense layering of legislative acts, growing reliance on technical standards and supervisory guidance, and an accumulation of obligations across sectors. These dynamics have raised concerns about whether the EU's approach remains fit for purpose – particularly in light of the bloc's broader competitiveness agenda and the financial sector's evolving role in digitalisation, sustainability and innovation.

This appendix first reviews how the EU's rulemaking architecture has evolved and why it now struggles to reconcile risk control with adaptability. It then explains how the Lamfalussy model has shifted from a mechanism for technical flexibility into a driver of regulatory inflation through expanding level 2 and 3 outputs, while level 1 texts have simultaneously become more operationally prescriptive and harder to recalibrate. The analysis highlights the resulting 'complexity without agility' problem and shows how these design choices translate into recurring compliance and supervisory costs, uneven cross-border implementation and weaker capacity to respond to fast-moving market and technological change.

Why regulate financial risk? The foundations of statutory oversight

At its core, financial regulation exists to manage and contain risk (e.g. systemic, institutional and individual) within a sector that is inherently exposed to volatility, interconnection and public trust. The financial system performs critical functions: intermediating savings and investment, enabling payments, allocating capital, and absorbing and redistributing risk. When these functions fail or are distorted, the repercussions for the broader economy can be severe.

The 2008 global financial crisis was a stark reminder of how rapidly risks in the financial system can propagate and how deeply they can affect the real economy. The collapse of systemically important institutions, the freezing of credit markets and the erosion of public confidence triggered a prolonged recession. Significant job losses ensured, along with a massive transfer of private liabilities to public balance sheets. These events

reaffirmed a fundamental premise: left entirely to market forces, the financial sector can become a source of systemic fragility rather than a channel of stability.

The rationale for financial regulation, therefore, rests on three pillars:

- *Systemic stability*. Reduce the likelihood and severity of financial crises by curbing excessive risk-taking, ensuring sufficient capital and liquidity buffers, and fostering resilience to shocks.
- *Market integrity*. Protect against market abuse, insider trading, conflicts of interest and fraud – ensuring that financial markets are fair, orderly and transparent.
- *Consumer and investor protection*. Safeguard users of financial services, especially retail customers, from mis-selling, hidden risks and discriminatory practices, while promoting access and confidence in the system.

These objectives are not new, but their implementation has evolved significantly over time. In an era of global financial interdependence, the coordination of regulatory responses across jurisdictions has become increasingly important. As financial institutions and capital markets operate across borders, the effectiveness of national regulation depends on the consistency and compatibility of rules internationally.

Over the past four decades, a network of global standard-setters has emerged to address this challenge. The Basel Committee on Banking Supervision has provided the global reference point for capital, liquidity and supervisory standards in banking. The International Organization of Securities Commissions has promoted cross-border consistency in securities regulation and market conduct. The International Association of Insurance Supervisors has developed frameworks for prudential and conduct supervision in the insurance sector.

While these bodies do not issue binding laws, their frameworks have become the de facto baseline for national and regional rulemaking. Their standards are embedded in EU legislation (e.g. the Capital Requirements Directive (CRD) and Regulation (CRR), Solvency II and Markets in Financial Instruments Directive (MiFID) and adjusted for the specific features of the European financial system and the single market.

Yet, the process of transposing global standards into EU law introduces an important tension: how to maintain alignment with international norms while tailoring rules to the EU's unique institutional structure and diversity of national markets. This is not a simple technical exercise. It requires difficult policy trade-offs between flexibility and harmonisation, simplicity and precision, national discretion and EU centralisation.

Moreover, regulation is not only about controlling downside risks. It also shapes incentives for financial innovation, market entry and the efficient allocation of capital. Poorly designed rules can suppress competition, entrench incumbents and stifle new business models. Overly complex or fragmented regulation can increase compliance costs, reduce supervisory clarity and ultimately harm users of financial services.

Effective regulation must therefore strike a careful balance. It should contain systemic risk but not create unnecessary barriers to market development. It should foster resilience, without undermining dynamism or diversity. It should promote trust, while supporting innovation and inclusion.

This balance becomes even more important in times of structural transformation, such as the twin digital and green transitions currently underway in the EU. A rigid or excessively reactive regulatory approach may inhibit the ability of the financial sector to support long-term investment, channel private capital to strategic priorities and scale innovative solutions.

The EU's better regulation agenda – intentions vs reality

The EU has long recognised the importance of improving how it designs, adopts and evaluates legislation. Under the better regulation agenda – formalised in successive Commission communications and the 2016 Interinstitutional Agreement on Better Law-Making – the stated objective is to ensure that EU rules deliver policy objectives in the most effective, efficient and proportionate way possible.

The core principles of better regulation are well established:

- *Evidence-based policy*. Ground legislative proposals in sound data, risk assessments and stakeholder input.
- *Simplification and burden reduction*. Reduce unnecessary complexity and cumulative costs, particularly for SMEs.
- *Proportionality and subsidiarity*. Ensure that legislation is neither too intrusive nor applied at the wrong level of governance.
- *Transparency and stakeholder consultation*. Engage a wide range of actors at all stages of the legislative process.
- *Continuous evaluation and revision*. Evaluate through *ex-post* review, the REFIT programme (on regulatory fitness and performance programme), and take a 'one in, one out' (OIOO) approach to administrative burdens.

- The architecture supporting these principles is elaborate. The Regulatory Scrutiny Board (RSB) independently reviews Commission impact assessments and major evaluations. The Standard Cost Model provides a tool to estimate compliance burdens and the cumulative cost assessment aims to quantify the full impact of regulation on particular sectors (see Box 4).

Box 4. EU burden reduction through the years – a moving target

The European Commission has pursued multiple waves of simplification over the past decades, each with new targets and tools. Key milestones include:

- 1985-92 Single Market Programme – simplification formed part of Jacques Delors's drive to eliminate internal trade barriers;
- 1992 Edinburgh European Council – the first formal call for subsidiarity and proportionality checks on EU legislation;
- 1996 SLIM (simpler legislation for the internal market) initiative – followed by a Council resolution supporting simplification;
- 2005-09 – the Commission claimed a 10% reduction in the size of the EU rulebook;
- 2007 – introduction of a target to reduce administrative burdens on businesses by 25% by 2012, setup of the Stoiber High-Level Group;
- 2012 – launch of REFIT (regulatory fitness and performance programme);
- 2015 better regulation package – establishment of the Regulatory Scrutiny Board and the REFIT platform;
- 2021 – adoption of the 'one in, one out' principle in the better regulation communication;
- 2021-2024 – creation of the Fit for Future Platform, replacing REFIT as a new simplification initiative;
- 2025 (December) – ECOFIN Council Conclusions on simplifying financial services regulation.

In theory, these mechanisms should ensure that regulation is both effective and economically sensible. And in some respects, the agenda has delivered. Process transparency has improved, with more visibility on consultations, roadmaps and RSB opinions. Stakeholder engagement is now more structured, with input from affected sectors increasingly built into the legislative cycle. Review cycles are more regular, with REFIT providing a formal structure for simplification.

Yet in practice, the results fall short. The gap between ambition and execution remains wide, especially in financial regulation. Several key weaknesses stand out.

Excessive volume, complexity and instability of rules

Despite better regulation principles, the quantity and complexity of EU financial legislation have continued to grow. Legislative acts are often sprawling and are followed by extensive delegated and implementing measures, technical standards and guidelines – producing regulatory inflation rather than simplification. In some policy areas, legislative interventions have also become increasingly frequent, leaving limited time for rules to stabilise before the next revision or layer of guidance. The result is a dense, multilayered framework that is hard to navigate and even harder to apply consistently across 27 Member States, with adverse implications for legal certainty and supervisory convergence.

Weak economic and proportionality analysis in impact assessments

Impact assessments too often focus on legal and administrative aspects rather than on broader economic outcomes. Effects on credit supply, innovation, market structure, competition or investment tend to receive insufficient attention. Even when costs are assessed, they are not always benchmarked against alternative policy designs or international comparators. Macroeconomic consequences, such as potential drag on financial intermediation, are frequently underestimated or omitted altogether.

Limited ex-post review and cumulative cost tracking

While REFIT and cumulative cost assessments exist in theory, their application in financial services remains partial and infrequent. Reviews are often triggered only by legislative review clauses, rather than as part of a proactive, systematic evaluation of whether rules remain fit for purpose. Even basic cost assessments (e.g. under the Standard Cost Model) have rarely been updated[30]. A handful of studies, such as the 2020 assessment of compliance costs across EU financial services, offer insight, but these remain the exception.

One in, one out policy is inconsistently applied

The Commission's commitment to offsetting new administrative burdens with equivalent reductions (i.e. OIOO) lacks clear accountability. New regulatory initiatives often bypass the principle, especially when politically urgent. OIOO also applies narrowly to administrative burdens, not to overall compliance costs or supervisory intensity, limiting its impact on real-world competitiveness.

[30] Where exercises have been attempted, they have often struggled in practice because supervisors and firms do not always use comparable baselines, definitions and metrics. This makes results hard to aggregate, validate and operationalise.

Lack of political accountability

One of the structural flaws in the better regulation toolbox is that most accountability mechanisms apply only to the European Commission. The European Parliament and Council, co-legislators with equal weight, are not bound by the same transparency and assessment requirements. Impact assessments are almost never conducted for European Parliament amendments, while there is no obligation for the Council to conduct impact assessments on its positions, despite its critical role in shaping final legislation. Moreover, trilogue negotiations, where the final compromise is brokered, remain largely opaque.

As a result, significant changes to legal texts can be introduced late in the process – often after the Commission's initial impact assessment – without any structured economic evaluation of the final compromise. The democratic legitimacy of EU law is not in question, but the quality and coherence of rulemaking suffer.

Delegated acts and guidelines often lack impact assessments

Despite being increasingly central to how EU rules are applied, delegated and implementing acts rarely undergo impact assessments. In the year ending May 2023, only 3 out of nearly 600 delegated acts and implementing measures were accompanied by a formal impact assessment (European Council, 2023). Similarly, level 3 measures, such as guidelines and Q&As issued by the European Supervisory Authorities (ESAs), lack consistent scrutiny or cost analysis, even though they often impose significant compliance obligations.

Evidence-based assessment and independent scrutiny are also needed for level 2 measures. Too often, the economic rationale for proposed prudential or conduct standards is asserted rather than demonstrated, and quantification remains the exception rather than the rule – even where measures clearly have significant operational and compliance implications.

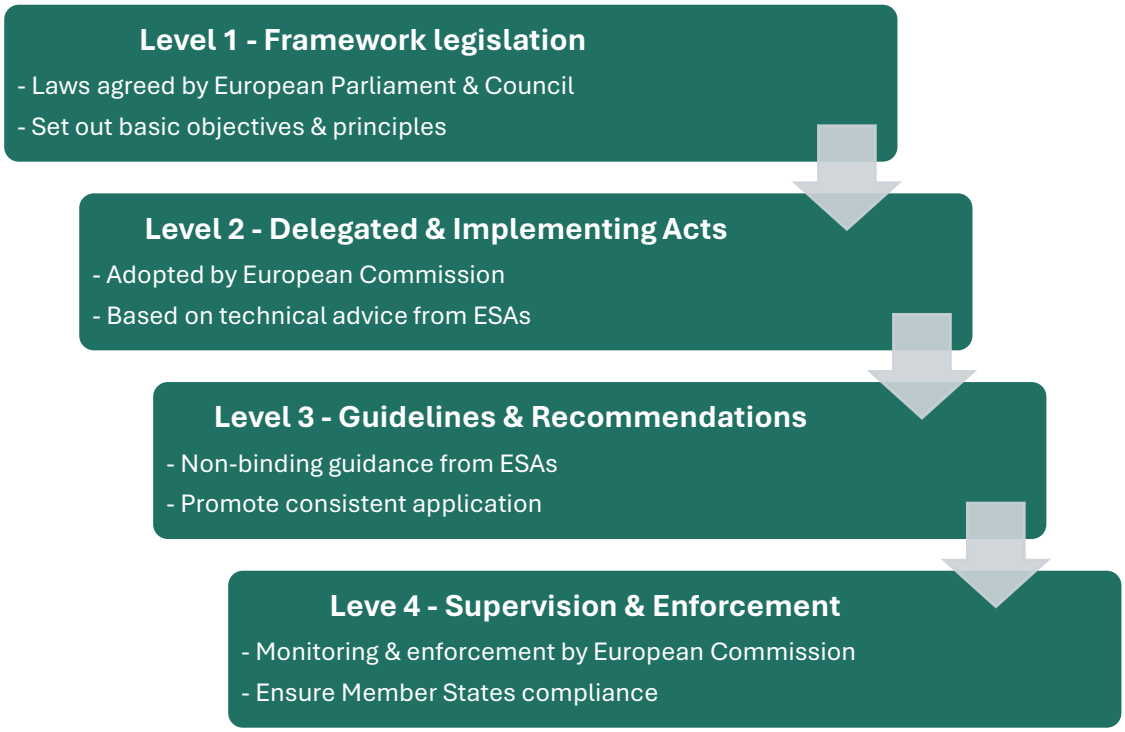
Separately, better regulation also implies stronger enforcement and proper implementation of existing law. While the latest Single Market Scoreboard shows some improvement in compliance indicators, it remains unclear whether the recent decline in infringement cases reflects genuine improvement or simply more bilateral settlements between the Commission and Member States. The growing number of single market cases reaching the Court of Justice of the European Union (CJEU) may indicate that enforcement is shifting to the judicial level, but it does not fully explain the previous surge in infringement proceedings[31].

[31] The number of cases before the CJEU may provide some evidence that more cases were settled on that level in 2024, but not necessarily for the big increase in infringement cases in single market law (CJEU Annual Report, 2024).

The EU's multi-tier rulemaking model – from flexibility to inflation

The EU's financial rulebook is structured according to a multi-tier model, originally developed in the early 2000s through the Lamfalussy process. This approach was designed to balance democratic legitimacy with technical flexibility by dividing rulemaking into four levels (see Figure 2)[32].

Figure 2. The EU's financial rulebook: the Lamfalussy process



Source: Authors' elaboration.

Originally hailed as a smart legislative architecture, this layered model was meant to ensure that high-level political decisions could be swiftly translated into detailed technical rules, while remaining adaptable to market developments and supervisory experience. However, over time, this flexibility has morphed into a source of regulatory inflation. This dynamic is now explicitly recognised in the Commission's simplification agenda, including a recent initiative to de-prioritise non-essential level 2 mandates[33].

[32] The current layered rulemaking system was introduced by the 2001 Lamfalussy report as part of the Financial Services Action Plan. It aimed to improve flexibility and technical precision through four levels of legislation and implementation. But adherence to the structure has weakened over time, leading to regulatory sprawl. That said, notable simplification efforts, such as FINREP (financial reporting) and COREP (common reporting) for banking supervision, have improved data consistency and reduced reporting burdens, particularly for smaller institutions.

[33] In the 2019–2024 legislature, Level 1 acts empowered the Commission to adopt around 430 Level 2 measures. In consultation with co-legislators, the Commission indicated it would not adopt 115 non-essential Level 2 acts before 1 October 2027, and would propose amendments or repeal of empowerments with legal deadlines in upcoming Level 1 revisions.

The delegation of tasks to the Commission and the ESAs has become increasingly extensive, leading to a proliferation of secondary legislation and soft law instruments. The Capital Requirements Directive (CRD) and Regulation (CRR) are illustrative: while level 1 texts establish the prudential framework for banks, they are accompanied by an extraordinary number of regulatory/implementing technical standards (RTS/ITS) under the mandate of the European Banking Authority (EBA). These standards cover areas such as credit risk modelling, liquidity ratios, reporting templates (e.g. COREP and FINREP), large exposure limits, own funds and internal governance (see Table 5).

Table 5. Key EU legislative acts in financial services

Sector	Core measures	Scope
Banking	1st and 2nd Banking Directives, CRD I to CRD VI and CRR I to CRR III	Prudential regulation, capital adequacy, single banking market
Insurance	Solvency I and II, IORP I and II	Risk-based capital requirements, cross-border pension supervision
Capital markets	Investment Services Directive (1993), MiFID I (2004), MiFID II (2014)	Market transparency, investor protection, trading venue rules
Market making	MiFID II/MiFIR, IFD/IFR	Conduct rules and prudential regulation (including capital adequacy)
Asset management	UCITS I to IV, AIFMD, ELTIF, IFR/IFD	Fund regulation, retail investor protection, long-term investment
Financial infrastructure	CSDR, EMIR I to III	Clearing, settlement, derivatives oversight, systemic risk
Payment systems	E-money, PSD I and II, draft PSD III, MiCA	Retail payments, open banking, crypto-assets regulation

Notes: AIFMD = Alternative Investment Fund Managers Directive; CRD (CRR) = Capital Requirements Directive (Regulation); CSDR = Central Securities Depositories Regulation; ELTIF = European Long-Term Investment Fund; EMIR = European Market Infrastructure Regulation; IFD (IFR) = Investment Firms Directive (Regulation); IORP = Institutions for Occupational Retirement Provision; MiCA = markets in crypto-assets; MiFID (MiFIR) = Markets in Financial Instruments Directive (Regulation); PSD = Payment Services Directive; UCITS = Undertakings for Collective Investment in Transferable Securities.
Source: Authors' compilation.

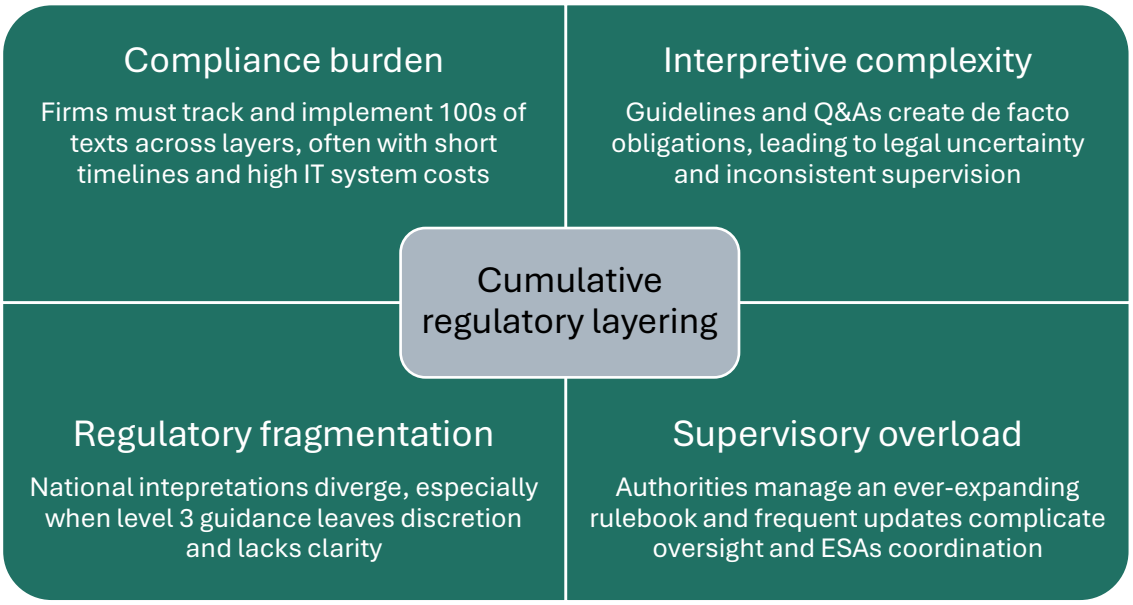
With CRD VI and CRR III, the situation has intensified. These revisions contain roughly 140 new mandates for the EBA to develop additional RTS, ITS and guidelines – adding yet another layer to an already dense framework.

A similar 'template transfer' dynamic can be observed in the prudential framework for investment firms. Here, the EU has sought to extend bank-style prudential logic to a sector that is far more heterogeneous in business models and risk profiles. While the objective of consistency is understandable, in some areas calibration has not always been sufficiently activity-sensitive – particularly for market-making and other functions of capital markets intermediation that are critical for liquidity provision, including under stress. The resulting competitiveness concern is that requirements designed around banking balance sheets may be ill-suited for parts of the investment firm sector, potentially incentivising restructuring or relocation of certain activities to jurisdictions perceived as more proportionate.

In Solvency II, the prudential regime for insurers, a comparable dynamic is evident. While the directive sets overarching capital requirements, the granular calibration of risk modules, asset classes, and stress factors is delegated to the European Insurance and Occupational Pensions Authority, supported by dozens of implementing and delegated acts. The result is a highly technical and evolving regime that requires continual updates, recalculations and re-interpretation by firms.

Even retail (product) regulation, such as the Packaged Retail and Insurance-based Investment Products Regulation, illustrates the same trajectory. The core rules are embedded in level 1, but performance scenarios, cost metrics and disclosure formats are dictated by level 2 RTS, which have been revised multiple times. This forces financial firms to reprogram systems, update templates and re-educate distributors with each amendment. The main consequences of this regulatory layering are summarised in Figure 3.

Figure 3. Consequences of regulatory layering



Source: Authors' elaboration.

These issues are particularly acute for cross-border firms. Institutions operating in multiple Member States must reconcile differing national practices, fulfil duplicative reporting obligations and interpret evolving guidance streams. The intended benefits of the single rulebook – legal certainty and cross-border consistency – are undermined by the sheer volume and granularity of regulation.

Meanwhile, supervisors themselves face institutional challenges. Fragmented obligations and frequent updates require expanded resources, specialised staff and more sophisticated IT systems. As supervision expands into areas like environmental, social and governance (ESG) aspects, digital operational resilience and AI, the cumulative load increases, especially in jurisdictions where rulebooks are most dense.

Regulatory rigidity: an over-concentration of technical detail in primary law

While the EU's financial regulatory system has suffered from excessive delegation to secondary and tertiary legislation, the opposite problem has also emerged: an over-concentration of technical detail in level 1 legislation (i.e. in the primary law adopted by the European Parliament and Council). This over-specification often stems from a political desire for certainty, control or balance among national interests. However, the unintended consequence is a system that lacks flexibility and adaptability.

Rather than entrusting supervisory authorities with implementation through principles and adaptive tools, level 1 texts in the EU frequently codify highly specific parameters, formulas and disclosure obligations. This rigid approach contrasts sharply with jurisdictions like the UK and US, where regulators operate with greater latitude under

broad statutory mandates and can update technical requirements through agency rulebooks or handbooks.

Illustrative cases of inflexibility

MiFID II and MiFIR: The revised Markets in Financial Instruments Directive and Regulation are prime examples of excessive legislative granularity. Provisions on trading transparency, tick sizes, dark pool thresholds, systematic internalisers and data reporting are embedded directly in level 1, despite the fact that these parameters need frequent updating in response to market structure and technology. As a result, recalibrations require a full legislative amendment process – a long and politically complex route.

CSDR and T+1 settlement: The Central Securities Depositories Regulation similarly embeds operational details, including settlement discipline regimes and procedures for shortening settlement cycles. When the US Securities and Exchange Commission adopted rule changes to move to T+1 settlement in 2023 via a delegated rule, the EU faced significant hurdles: even minor technical adjustments like this require reopening the level 1 regulation, delaying implementation and creating uncertainty.

PSD2 and strong customer authentication: The Payment Services Directive 2 includes detailed authentication requirements, such as the list of exemptions to strong customer authentication (SCA). These technical criteria are set in law, thus making any adjustment – such as raising transaction thresholds or adapting to new fraud patterns – subject to legislative revision rather than regulatory discretion. By contrast, the UK's Financial Conduct Authority can adjust SCA criteria through its handbook, ensuring both flexibility and responsiveness.

CSRD and sustainability disclosure: The Corporate Sustainability Reporting Directive illustrates how quickly sustainability reporting can become 'locked in' at level 1. The CSRD hard-codes extensive scope and disclosure architecture in primary law, limiting flexibility when data quality, methodologies, or international baselines evolve. This rigidity has already triggered a corrective political response through the Omnibus package on sustainability. In 2025, the EU adopted a 'stop-the-clock' mechanism delaying application for some cohorts. It agreed to simplify the CSRD and the Corporate Sustainability Due Diligence Directive, and set higher thresholds and targeted exemptions aimed at reducing burden and spillovers to smaller firms. The broader lesson for regulatory design remains: when a highly operational reporting system is embedded in level 1, adjustment tends to require politically heavy reopening or ad hoc repair packages, rather than routine technical recalibration through delegated instruments.

CRR III and the FRTB: The handling by the Capital Requirements Regulation III of the Fundamental Review of the Trading Book shows how level 1 rigidity limits the EU's ability to respond to uneven global implementation. Article 461(a) allows the Commission to postpone or adjust the FRTB through delegated acts where other jurisdictions delay or deviate. In practice, the EU has already postponed implementation and proposed time-limited amendments to offset capital impacts, reflecting continued uncertainty around US implementation and the UK's postponement. However, delegated acts can only deliver temporary relief. Persistent calibration and design issues in the FRTB framework cannot be resolved without reopening level 1, making the EU reliant on recurring postponements and patching rather than durable adjustment.

CRD VI and prudential transition plans: The revised Capital Requirements Directive VI introduces mandatory transition plans in banks' prudential risk management, accompanied by EBA guidelines (Article 76(2)). While the prudential objective is clear, the level 1 obligation was introduced amid still-evolving data quality, methodologies and international standards for transition risk assessment. By hard-wiring the requirement into primary law, the EU has limited its ability to recalibrate scope and granularity as practices mature. This raises the risk of heavy operational build-outs before the underlying inputs are stable, reducing proportionality and potentially generating compliance costs that are not matched by supervisory value.

Comparative perspective – the UK and US models

In both the UK and the US, regulatory systems typically adopt a principle-based approach at the legislative level. Legislative bodies provide high-level goals and powers (e.g. consumer protection, market integrity and financial stability), while agencies such as the Financial Conduct Authority, Prudential Regulatory Authority, Securities and Exchange Commission, or Federal Reserve are empowered to design and adjust technical rules.

This framework allows for i) faster policy response to market failures or innovations (e.g. sandbox tools and digital payments); ii) iterative calibration of parameters like capital ratios, thresholds or reporting formats; iii) coherent rulebooks maintained by regulators and updated without legislative delay; and iv) clearer accountability, as regulators are directly responsible for their rules within a statutory mandate.

By contrast, the EU model often relies on political consensus to settle technical detail, rather than delegating it to regulators. This in effect freezes detailed parameters in law and requires trilogue negotiation even for technical adjustments.

Consequences for market dynamism

The result is a rigid, slow-moving regulatory framework at odds with the speed of financial innovation. Financial markets evolve rapidly – whether through algorithmic trading, tokenised assets, climate risk metrics or AI-driven credit models. The EU's system lacks the agility to adapt in real-time, creating lag, legal uncertainty and potential competitive disadvantages vis-à-vis more responsive jurisdictions.

Moreover, the combination of over-delegation (inflation) and over-legislation (rigidity) compounds difficulties in implementation. Even where regulators want to simplify, they are constrained by statute. This paradox is central to the EU's regulatory dilemma – an abundance of rules with limited adaptability.

Dual imbalance: complexity without agility

When binding requirements proliferate through technical standards and quasi-binding guidance, while primary law remains rigid, supervisory expectations can diverge across Member States. Accountability thus grows blurred between rulemaking and supervision (see Box 5 for an illustration in banking).

This tension is most visible in fast-moving areas such as digital finance, ESG reporting and payments, where rapid technical updates coexist with slow legislative recalibration – creating uncertainty for firms and supervisors alike. In these sectors, innovation and regulatory clarity are both essential. But when regulation moves too fast at the technical margins and too slowly at its core, the system becomes misaligned with market needs. Firms may hesitate to invest in new products or processes, while supervisors struggle to keep expectations aligned with evolving risks and operational realities.

This structural imbalance, between excess and inertia, reduces regulatory competitiveness. While the EU has prioritised harmonisation and democratic accountability, it has done so at the cost of adaptability. By contrast, jurisdictions such as the UK and US typically equip regulators with clearer mandates and more flexible tools, allowing parameters and technical requirements to be recalibrated more quickly through supervisory handbooks or agency rulemaking.

Box 5. The EU banking capital stack – an example of regulatory layering

The EU banking framework exemplifies how regulatory layers can accumulate over time, creating complexity and reducing coherence. At the core lies the Pillar 1 minimum requirement, complemented by institution-specific Pillar 2 requirements, supervisory expectations under Pillar 2 guidance and macroprudential buffers. In parallel, the

resolution framework imposes the minimum requirement for own funds and eligible liabilities (MREL) to ensure loss-absorbing capacity in a gone-concern scenario.

Crucially, many of these layers rely on the same instrument, namely Common Equity Tier 1 capital. As a result, such capital is subject to multiple, overlapping regulatory claims, as it is required to underpin several distinct prudential, supervisory and resolution objectives. The result is a capital stack in which capital usability becomes less transparent and more constrained, particularly under stress.

Institutional fragmentation compounds this problem. Co-legislators set the rules, the Single Supervisory Mechanism calibrates Pillar 2 requirements and guidance, national authorities set systemic buffers, and the Single Resolution Board determines MREL. Each authority operates within its mandate, but there is no binding framework to assess the cumulative effect of these decisions on banks' usable capital or on the overall level of constraint imposed on the system. This siloed approach reduces transparency and complicates supervisory coordination.

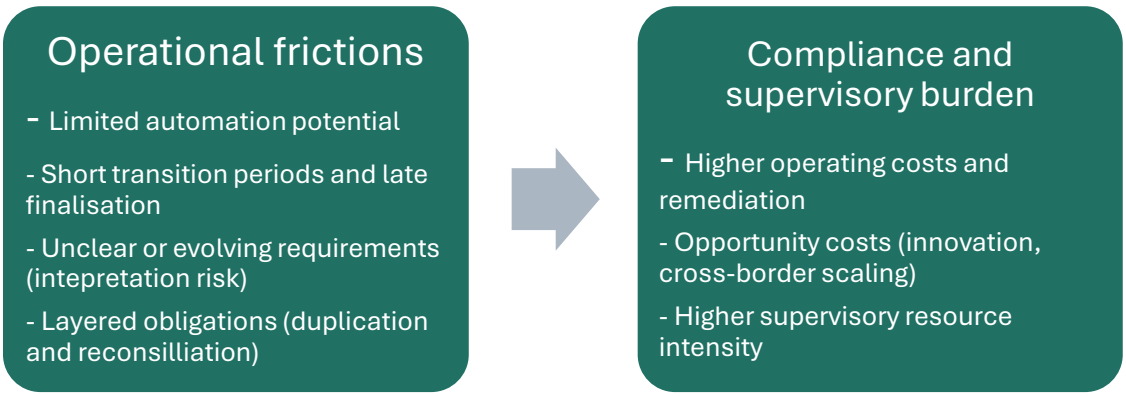
These structural weaknesses have been explicitly recognised by the ECB in the work of its High-Level Task Force on Simplification. It provides a structured diagnosis of the EU capital framework, identifying three interrelated sources of complexity: the accumulation of multiple capital buffers, the ambiguous role of hybrid instruments for going concerns, and the interaction between prudential and resolution requirements calibrated by different authorities.

The mechanisms behind compliance and supervisory costs

Regulatory complexity translates into burden not only through the volume of obligations, but also through the operational frictions it creates in implementation, interpretation and control. The key issue is that compliance becomes a continual change-management process: institutions must repeatedly translate evolving requirements into processes, data infrastructure, governance steps and system changes, often under tight sequencing constraints and with limited scope for automation.

Figure 4 summarises the main mechanisms through which these frictions generate costs. In essence, complexity becomes costly when requirements are difficult to automate, arrive late in the implementation sequence, evolve through interpretation and require reconciliation across overlapping layers. The result is both recurring operational workload and periodic 'rebuild' cycles in systems and controls.

Figure 4. Operational mechanisms driving compliance and supervisory costs



Source: Authors' elaboration.

These mechanisms also generate a strategic opportunity cost. Compliance competes for senior attention, project capacity and technology budgets, diverting resources from innovation, client service and cross-border expansion. For smaller institutions and specialised firms, the effect is typically regressive, as fixed compliance investment cannot be spread over a large activity base, thus affecting business-model viability and incentives to innovate.

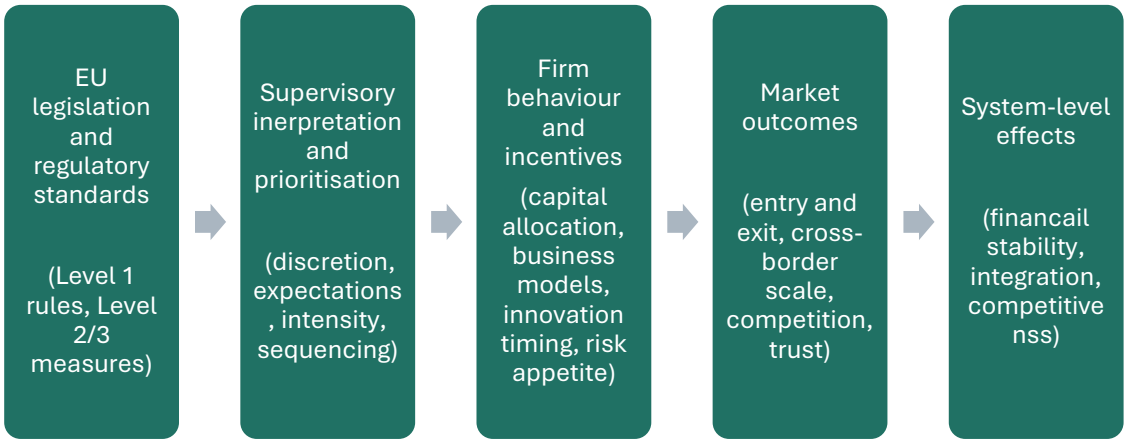
On the public side, similar frictions shape supervisory resource needs. As supervision expands into cross-cutting domains (e.g. cyber resilience, operational digitalisation and climate-related risk), authorities must invest in specialist expertise, data infrastructure and horizontal coordination. Where supervised entities operate under evolving interpretations and layered reporting demands, supervisory teams also spend more time on validation, dialogue and remediation follow-up, increasing the resource intensity of oversight.

The policy implication is that cost control is not achieved solely by reducing the number of rules. It also depends on how requirements are devised and delivered. Automation-friendly design, stable implementation sequencing, clarity of interpretation and reporting rationalisation can lower both private compliance costs and public supervisory costs without diminishing prudential objectives.

APPENDIX F. RISK SUPERVISION – WHERE THE SYSTEM FALLS SHORT

While regulation lays down the formal rules of the game, supervision determines how those rules are interpreted, applied and enforced in practice. In the EU's complex and multilayered financial architecture, the effectiveness of supervision is just as critical as the quality of regulation in shaping market outcomes, managing risks and fostering a competitive financial sector (see Figure 5). Yet supervision has often been treated as a second-order issue – primarily technical, reactive and operational.

Figure 5. Supervision as a market-shaping transmission mechanism



Source: Authors' elaboration.

A shift in perspective is therefore needed. Supervision should be understood not merely as a compliance function, but as a market-shaping force. How supervisory discretion is exercised, how capacities are distributed and how coordination is managed across Member States all have far-reaching implications for integration, innovation and the EU's global financial standing.

Fragmentation, inconsistency and institutional asymmetries within the supervisory system risk undermining both the single market and the EU's strategic priorities. These asymmetries can be exacerbated where supervisors rely heavily on informal instruments (e.g. supervisory expectations, follow-up letters or horizontal communications) to steer firm behaviour. Such tools can be useful as a proportionate, intermediate step, but when they become a primary channel for setting expectations without clear documentation, escalation pathways or reviewability, they may reduce transparency and make supervisory discretion harder to contest.

Building on this diagnosis, this appendix develops the case for a supervisory model that is more convergent, capacity-aware and outcome-focused. It shows how supervisory discretion, resourcing gaps and national operating practices translate into uneven market access, inconsistent risk treatment and avoidable compliance frictions, especially for

cross-border and innovative business models. From there, it shifts to what 'smarter supervision' means in practice, with a focus on stronger use of data and SupTech, proportionality by design and the strategic trade-off between deeper centralisation and more effective coordination within today's decentralised architecture. The overall objective is to improve supervisory outcomes and consistency while reducing avoidable frictions that undermine integration and the level playing field across Member States.

Beyond enforcement: how supervision shapes markets

Supervision is often seen as a back-office function: reactive, technical and rule-bound. In reality, it plays a much more consequential role. Supervision does not merely enforce regulatory requirements – it also interprets them, prioritises them and applies them in specific market contexts. In doing so, it shapes the incentives, behaviours and expectations of financial firms, and ultimately the structure and evolution of the financial system itself.

Supervisory decisions influence which business models thrive, how quickly innovation can be brought to market and how risks are priced and monitored. The tone, intensity and predictability of supervisory engagement affect everything from capital allocation to product design and customer interaction. It can encourage firms to expand, invest and compete or (conversely) to consolidate, delay or retreat. In fragmented markets such as the EU, these effects are magnified by the diversity of supervisory cultures and practices across Member States.

Supervision serves the public interest by ensuring the safety and soundness of financial institutions, protecting consumers and safeguarding financial stability – in accordance with the mandate provided by the law. But the way supervision is exercised also carries implicit trade-offs, between risk sensitivity and simplicity, between standardisation and flexibility, and between prudential caution and market dynamism. These trade-offs are rarely neutral in competitive terms. A supervisory approach that is overly rigid, slow or inconsistent can de facto contribute to limiting entry or cross-border expansion, especially for smaller or innovative firms.

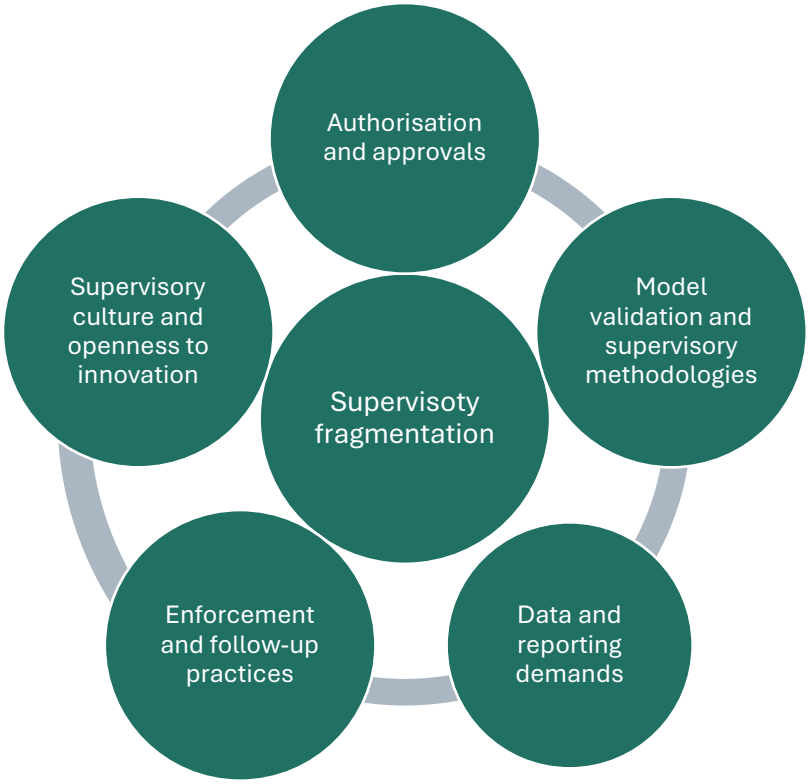
The EU has made substantial progress in developing common supervisory frameworks, most notably through the Single Supervisory Mechanism (SSM) for banking and the coordination role of European Supervisory Authorities (ESAs) in insurance, securities and pensions. Yet the practice of supervision remains far from uniform. National competent authorities (NCAs) differ widely in their interpretation of guidelines, their resource capacity and their openness to innovation. This creates not only legal uncertainty but also competitive asymmetries within the single market.

In this sense, supervision is also a lever of both integration and competitiveness. If the EU's financial system is to support strategic goals such as capital markets development, technological sovereignty and the green transition, supervision should deliver its primary objectives (i.e. financial stability, market integrity and investor/consumer protection) in a way that is consistent, proportionate and forward-looking. This does not imply expanding supervisory mandates into industrial policy. It means recognising that the quality of supervision (e.g. risk-based, predictable and responsive) shapes market trust and affects whether firms can adapt, scale and innovate within the guardrails of a robust supervisory framework.

Fragmentation in supervisory approaches

Despite more than a decade of institutional progress, supervisory fragmentation remains a persistent and material challenge across the EU. While common frameworks and regulatory standards exist on paper, their interpretation, implementation and enforcement continue to diverge widely at the national level (see Figure 6). This inconsistency undermines legal certainty, creates competitive distortions and hampers the development of a truly integrated financial market.

Figure 6. Sources of supervisory fragmentation in the EU single market



Source: Authors' elaboration.

The problem is not just structural, it is operational. NCAs differ significantly in how they approach core supervisory functions: from the speed and predictability of authorisation processes to the requirements for internal model approvals, the granularity of data submissions, and the use of stress testing or scenario analysis. Even within banking, where the SSM has centralised supervision of significant institutions, less significant ones remain under national oversight, leading to varying supervisory expectations across otherwise comparable entities[34]. In insurance and capital markets, where the European Insurance and Occupational Pensions Authority and European Securities and Markets Authority rely primarily on non-binding instruments, differentiation is even more pronounced.

This heterogeneity affects both large cross-border groups and smaller firms seeking to scale or innovate. A firm operating across multiple Member States may face different interpretations of the same level 1 regulation, inconsistent disclosure templates, or conflicting guidance on outsourcing, governance or sustainability-related risks. This increases compliance costs, delays time-to-market and deters investment. In some cases, firms may choose to operate through parallel national structures rather than integrate operations, leading to inefficiencies and reduced economies of scale.

Fragmentation also undermines trust in the level playing field. Firms perceive, sometimes rightly, that supervisory intensity is not uniform, and that regulatory arbitrage (i.e. choosing jurisdictions based on perceived leniency or procedural ease) remains possible. This distorts competition and weakens the credibility of the EU's single rulebook. The case of internal model approvals in banking is illustrative: some NCAs are seen as more permissive or faster in granting approval, while others apply more conservative or resource-intensive methodologies. These discrepancies have direct implications for capital requirements, pricing and risk-taking behaviour.

Beyond technical implementation, supervisory culture also varies. Some NCAs take a more cooperative, open-door approach, while others are perceived as formalistic or risk-averse. This variation affects firms' willingness to engage early with supervisors on new products or technologies. This is particularly consequential in fast-evolving areas where early supervisory engagement and consistent expectations are critical for innovation.

Supervisory convergence is therefore not just a matter of harmonising rules but of aligning practices, processes and mindsets. Without greater coordination and

[34] Indeed, the dual structure of ECB–NCA supervision requires extensive coordination across Joint Supervisory Teams. This system often results in parallel documentation, multiple supervisory interfaces for cross-border banks and increased frequency of supervisory engagement, all of which reflect structural layering rather than streamlined oversight.

comparability in supervisory approaches, many of the benefits of regulatory integration (e.g. cross-border scale, innovation and competitive neutrality) will remain out of reach.

Challenges in supervisory convergence

In response to persistent divergence in supervisory practices across Member States, the EU has developed a set of supervisory convergence tools at the European level. But their impact has remained patchy in practice, reflecting limits in legal force, procedural complexity and continued reliance on national implementation.

The ESAs promote convergence through a mix of guidance and coordination tools, ranging from non-binding instruments (e.g. guidelines, Q&As, opinions, supervisory handbooks and peer reviews) to more intrusive mechanisms in specific cases (e.g. recommendations, warnings, mediation and breach-of-Union-law procedures). In practice, however, convergence still depends heavily on national implementation and on complex procedural and governance steps at the EU level. Guidelines can be applied through national interpretive lenses; peer reviews often diagnose divergence without ensuring timely remediation; and Q&As, while valuable for legal clarity, are inherently reactive and cannot substitute for shared supervisory judgement in fast-moving market situations. This helps explain both the heavy reliance on guidance in areas such as consumer protection, sustainable finance and digital innovation, and the persistence of differences where national discretion remains wide.

The SSM represents a more advanced model, where supervisory convergence is not just encouraged but institutionalised. The ECB directly supervises significant institutions, applies common methodologies and leads Joint Supervisory Teams that include staff from NCAs. This has significantly narrowed divergence in banking supervision at the top end of the system. Yet, even within the SSM, challenges remain – ranging from varied supervisory intensity to differences in national legal frameworks that still shape how supervisory decisions are executed.

For less significant institutions, which remain under NCA responsibility, convergence tools are even weaker. Available assessments suggest that the establishment of the SSM has not translated into a commensurate consolidation of national supervisory resources: NCAs continue to carry substantial day-to-day responsibilities (notably for less significant institutions) and contribute extensively to SSM work on significant institutions, while also retaining substantial non-SSM responsibilities under national law[35].

[35] The SSM is designed as an integrated mechanism in which the ECB performs direct supervision of significant institutions but relies structurally on NCAs for large parts of supervisory execution and for the direct supervision of less significant institutions. Joint Supervisory Teams and on-site work are staffed with both ECB and NCA supervisors, and NCAs typically retain additional responsibilities outside the SSM perimeter under national law. As a result, the SSM adds an EU-level supervisory layer without automatically replacing national supervisory capacity, which helps explain why

This dual structure thus generates cumulative rather than substitutive resource demands, contributing to supervisory divergence and raising questions about the long-term efficiency of a model that layers national and supranational competences without fully integrating them.

The question, then, is whether existing tools are sufficient to close the gap between formal harmonisation and practical convergence. Some recent peer review exercises show both the value and limitations of these tools in practice (see Box 6). Evidence increasingly suggests they are not. Inconsistencies persist in internal model approvals, fit-and-proper assessments, outsourcing policies and the supervision of risks related to environmental, social or governance (ESG) concerns, among other areas. Market participants continue to report different supervisory burdens and expectations across jurisdictions, which affects investment decisions, business models, and pricing strategies.

This raises a broader institutional question: can supervisory convergence be meaningfully deepened without full centralisation? While political appetite for transferring more powers to the European level remains limited, the costs of maintaining fragmented supervision are becoming more visible. This is evident not just in terms of compliance and legal uncertainty, but also in lost competitiveness and underdeveloped capital markets. A more strategic approach may be required – one that enhances the ESAs' ability to coordinate, steer and benchmark national supervision, while gradually building capacity for targeted direct oversight in high-impact areas (e.g. cross-border fintechs, ESG disclosures and large non-EU service providers).

Ultimately, convergence is not only a technical process; it is also political. It requires trust among national authorities, commitment to a level playing field and a shared understanding of supervisory objectives. In the absence of stronger mandates or enforcement mechanisms, the effectiveness of convergence tools will depend on the willingness of Member States to align practices and limit national deviations.

Box 6. Peer reviews in practice – a mixed record on convergence

Recent peer reviews illustrate both the diagnostic value and the limited remedial traction of this tool.

- *EIOPA's 2024 peer review on the prudent person principle*. The review by the European Insurance and Occupational Pensions Authority evaluated how national competent authorities supervise insurers' investment practices under Solvency II.

national resourcing has not necessarily contracted in parallel with the ECB's expanded supervisory role (European Court of Auditors, 2016; Huertas, 2025).

It revealed substantial divergence in supervisory expectations, especially regarding complex or illiquid assets such as infrastructure, private equity or sustainable finance. While EIOPA issued 7 recommended actions and 10 best practices, implementation remains voluntary, and legal constraints limit the enforceability of changes across jurisdictions.

- *ESMA's 2020 review of the Market Abuse Regulation (MAR)*. The European Securities and Markets Authority identified inconsistencies in how national competent authorities monitor and enforce MAR obligations, including insider lists and suspicious transaction reporting. It noted that some NCAs lacked specialised IT tools or dedicated resources, leading to weaker surveillance. While ESMA issued guidelines and recommendations, the absence of binding follow-up action limited their immediate impact.
- *EBA's 2020 report on the convergence of supervisory practices*. The European Banking Authority evaluated how NCAs approve and monitor internal models for credit risk. It found diverging practices in documentation requirements, timelines and supervisory intensity – differences that directly affect banks' capital requirements. The EBA proposed convergence in validation methodologies, but national discretion and legal frameworks continue to limit full alignment.

These examples illustrate both the strengths and constraints of peer review as a convergence mechanism. While valuable for transparency and benchmarking, its influence depends on political will, supervisory capacity and the perceived legitimacy of coordination led by the European Supervisory Authorities.

The supervisory operating model – discretion, capacity and accountability

The effectiveness of supervision in the EU depends not only on rules or institutions, but also on the underlying operating model – how discretion is exercised, how resources are allocated and how accountability is maintained. The diversity of NCAs in terms of size, mandate, capabilities and independence creates wide disparities in supervisory outcomes, with direct implications for market fairness, integration and competitiveness.

The structural complexity of supervision is further amplified by the expansion of its supervisory agenda into areas such as cybersecurity, digital resilience, climate and nature-related risks and, increasingly, geopolitical stress testing. Each new thematic priority adds pressure to an already dense supervisory structure, accentuating the resource intensity of the model.

Discretion and its consequences

Supervisory discretion is a necessary feature of modern financial oversight. It allows authorities to adapt to context-specific risks, interpret principles-based regulation and

respond to innovation. However, excessive or unstructured discretion can lead to fragmentation, legal uncertainty and competitive distortions. Firms operating in multiple jurisdictions often face different expectations for the same regulatory requirement (e.g. internal model approval, licencing or cross-border group supervision). While flexibility can be valuable, its application must be predictable and anchored in consistent supervisory outcomes.

Capacity gaps and resource asymmetries

Differences in NCA resources and capability translate into variable supervisory depth and speed across the EU. In some Member States, authorities are well resourced and can deploy specialist expertise and digital tools; in others, budget and staffing constraints, combined with legacy systems, limit the intensity and sophistication of supervision, particularly in complex areas such as cyber risk, AI or digital assets. Smaller or more specialised NCAs may also have less capacity to engage in international standard setting, peer learning or cross-border coordination, creating gaps in collective oversight. The ESAs can help mitigate some of these disparities, but their powers and resources remain limited relative to the challenge.

Accountability and independence

Effective supervision also depends on credible independence[36]. NCAs must be insulated from short-term political pressure while remaining accountable for their performance and use of discretion. In practice, the balance between independence and oversight varies widely across the EU. In some jurisdictions, supervisory mandates are tightly embedded in ministries or face political influence over appointments and strategic priorities. Elsewhere, accountability mechanisms may be limited to annual reports or general budget scrutiny, without meaningful performance review. This uneven institutional design raises questions about legitimacy, consistency and trust.

A needed shift in supervision

The future of financial supervision in the EU will depend not only on convergence and coordination, but also on technological modernisation. In a system as complex and decentralised as the EU's, traditional supervisory methods based on static reporting cycles, backward-looking reviews and case-by-case inspections are increasingly strained

[36] Supervisory independence is explicitly recognised in the ESAs' framework. Article 8(1)(b) of the ESA Regulation tasks the ESAs with fostering and monitoring supervisory independence as part of developing a common supervisory culture, while Article 30(3) provides that peer reviews may be used to assess the degree of independence and governance arrangements of competent authorities. In October 2023, the Joint Committee of the ESAs also published common criteria on supervisory independence, structured around operational, personal and financial independence, as well as accountability and transparency.

when risks evolve quickly or business models diverge. Smarter supervision requires a shift towards data-enabled and risk-focused approaches that improve early detection and prioritisation, while remaining proportionate for smaller or innovative firms[37].

From reports to real-time oversight

New technologies are reshaping supervisory models worldwide. Supervisory technology is increasingly used to improve both efficiency and effectiveness, including machine learning to detect anomalies in data submissions, natural language processing to screen disclosures and filings, and visual analytics to map interconnected risks across markets and firms.

More granular and more frequent data access can help supervisors shift from reactive processes to earlier, more targeted risk identification, particularly in areas such as algorithmic trading, cryptoassets, cyber risk and ESG disclosures. A more data-driven approach can also support better prioritisation: by focusing supervisory effort on risks evidenced in the data, supervisors can reduce the incentive to 'overregulate out of precaution' when uncertainty is high. At the same time, near real-time monitoring is not a free efficiency gain. It requires robust data infrastructure, specialised skills and operational capacity to interpret signals, distinguish noise from material issues and translate analytics into proportionate supervisory action. Human judgement remains central.

The EU has begun exploring SupTech pilots, but uptake varies widely across Member States. Some NCAs continue to rely on manual processes or fragmented systems, while others are already deploying data-driven supervisory tools. The lack of shared standards or pooled infrastructure risks widening these gaps. Box 7 presents international examples from the UK and Singapore, illustrating how other advanced jurisdictions are embedding smart supervision in their regulatory architecture.

[37] This shift is not purely technological. Effective judgement in complex institutions depends on accumulated supervisory experience, sectoral expertise and continuity of engagement. Rotational practices and frequent changes in supervisory teams can dilute firm-specific understanding of strategy, governance and business model, and can encourage 'outlier hunting' without sufficient context. Transparency also matters: where benchmarking and peer comparisons are opaque, firms may struggle to interpret supervisory signals and to explain differences that are driven by legitimate model features rather than weaknesses. Improving the 'quality of supervision' therefore requires investment in skills and continuity as well as better tools.

Box 7. International examples of smart supervision

The UK's Financial Conduct Authority (FCA) has been a front-runner in supervisory innovation. It launched its Regulatory Sandbox in 2016, allowing firms to test new products and services with real customers in a controlled environment. This sandbox has since become an 'always-open' service and has served as a model for regulators globally. Building on this, the FCA piloted a Digital Sandbox in 2020 and, in August 2023, made it a permanent online platform. The Digital Sandbox provides firms with access to synthetic datasets, application programming interfaces and expert guidance to experiment with data-intensive tools such as AI and distributed ledger technology in a supervised setting.

The FCA also oversees a Regulatory Initiatives Grid, first launched in 2020 by the cross-agency Financial Services Regulatory Initiatives Forum. This includes the FCA, Bank of England/Prudential Regulatory Authority, Payment Systems Regulator, Competition and Markets Authority and other bodies. The Grid offers a forward-looking schedule of regulatory initiatives over a one-to-three-year horizon, helping firms anticipate regulatory changes while enabling authorities to better coordinate and sequence their interventions in a proportionate and agile manner.

In Asia, Singapore's Monetary Authority (MAS) has also taken major steps towards technology-enabled supervision. Since the late 2010s, MAS has deployed AI-enabled dashboards to monitor payments fraud, market volatility and insurance product risks. It has progressively modernised its reporting framework by adopting API- and cloud-based architectures, reducing firms' manual reporting burdens while improving the granularity and timeliness of supervisory data. MAS has also developed a governance framework for the responsible use of AI and data analytics, promoting transparency and accountability in both the supervisory process and in firms' compliance practices.

Smarter supervision needs proportionality by design

A persistent problem is the tendency to apply identical processes to fundamentally different entities, creating unnecessary friction for fintechs, scale-ups and specialised non-bank providers, while not necessarily improving outcomes. Proportionality should therefore be built into supervisory design, not treated as a general principle. This means tailoring reporting, authorisation, model validation and engagement intensity not only to size and systemic footprint, but also to business model, complexity, interconnectedness and risk profile. It further implies a more dynamic approach. Proportionality should be calibrated using risk indicators and supervisory experience, rather than relying mainly on fixed thresholds or rigid classifications.

Smarter supervision should also remain explicitly forward-looking. Supervisors need the tools and capacity to anticipate emerging risks and to adapt focus as market practices

evolve. This is only feasible with interoperable data foundations, modern analytical capabilities and sustained investment in supervisory expertise. Finally, proportionality must not dilute the level playing field: 'same risk, same rules' should remain the anchor, while 'same risk' is assessed with greater granularity and with closer attention to business model differences.

Centralisation vs coordination – finding the right supervisory structure

A key strategic question for the future of EU financial supervision is whether the system should evolve towards deeper centralisation of supervisory powers, or instead double down on more effective coordination mechanisms within the current decentralised framework. Both paths offer potential benefits and significant hurdles.

The case for centralisation

Proponents of greater centralisation argue that the current decentralised model continues to generate significant supervisory divergence, with knock-on effects for market integration and systemic resilience. For pan-European financial institutions, the current framework often means managing multiple supervisory dialogues, adapting to varied expectations and absorbing higher compliance costs.

Centralisation could address many of these issues. A single supervisory authority, or a more empowered central body, would bring greater consistency, reduce regulatory arbitrage and facilitate the supervision of emerging systemic risks that transcend borders (e.g. cyber threats and ESG-linked exposures). It could also accelerate innovation-friendly supervision by streamlining approval processes, authorisations and model validations across the single market.

However, the political and institutional obstacles to centralisation remain substantial. National authorities continue to guard supervisory sovereignty and the diversity of financial systems across the EU makes a one-size-fits-all approach difficult. Moreover, the case for centralisation is not uniformly applicable. Where markets are primarily domestic, or where national supervisory models demonstrably support effective and well-functioning market structures, shifting responsibilities to the EU level could create unnecessary disruption. Centralisation also raises accountability concerns. Empowering EU-level bodies without robust checks and stakeholder engagement risks weakening democratic oversight and diminishing local responsiveness to risk, affecting the principle of proximity to local markets and supervised entities.

Furthermore, a comprehensive reform of the ESA's governance, funding model and workforce seems to be a necessary step before additional, direct, supervisory responsibilities could be evaluated for potential centralisation. Also, any action of this kind

should follow a thorough cost-benefit analysis, avoiding the creation of a burdensome double-layered system without real added value (in application of the subsidiarity principle).

The case for smarter coordination

Given these trade-offs, a more pragmatic and scalable approach may lie in enhanced coordination, rather than full institutional consolidation. This would mean building stronger supervisory alignment through common tools, standards and infrastructure, without removing primary responsibilities from national authorities.

Several instruments already exist but could be scaled or reformed. Joint Supervisory Teams, shared data platforms, or cross-border colleges could help build trust and mutual understanding. Common risk indicators, harmonised methodologies and binding technical standards could reduce discrepancies in supervision, while preserving local implementation capacity. The ESAs and ECB could play a stronger role within these coordination structures – for example, by convening and, where relevant, chairing colleges, embedding staff in joint teams, issuing common methodologies, and operating clearer escalation and mediation pathways when national practices diverge materially from EU benchmarks.

Such a model would still allow for flexibility and subsidiarity, while addressing the most harmful effects of fragmentation. Importantly, it could improve convergence across both prudential and conduct supervision – areas where national divergence remains wide.

Governance and legitimacy

Regardless of whether the EU moves towards centralisation or coordination, reforms must be accompanied by improvements in supervisory governance. As EU-level bodies gain more operational influence, their accountability and transparency must keep pace. This includes clearer performance benchmarks, independent evaluation of supervisory outcomes, stakeholder consultation mechanisms and regular scrutiny by the European Parliament and Council. Without such measures, even well-intentioned reforms may face resistance due to perceived shortfalls in legitimacy.

At the same time, better internal governance within the supervisory system – including streamlined decision-making, reduced duplication and more agile responses to risk – could enhance trust and credibility, both with firms and the public.

PRINCIPLE S AND GUIDELINES FOR THE TASK FORCE

The Task Force process is a structured dialogue among experts, (former) politicians, diplomats, policymakers, NGOs, academia and think tanks who are brought together for several meetings. The Task Force report is the final output of the research carried out independently by CEPS and its partners, and in the context of the Task Force.

Participants in a Task Force

- The Chair is an expert who steers the dialogue during the meetings and advises CEPS as to the general conduct of the activities of the Task Force.
- Members provide input as independent experts.
- Rapporteurs are CEPS researchers who organise the Task Force, conduct the research independently and draft the final report.

Objectives of a Task Force report

- Task Force reports are meant to contribute to policy debates by presenting a balanced set of arguments, based on available data, literature, and views.
- Reports seek to provide readers with a constructive basis for discussion. They do not seek to advance a single position or misrepresent the complexity of any subject matter.
- Task Force reports also fulfil an educational purpose and are drafted in a manner that is easy to understand, without jargon, and with any technical terminology fully defined.

Drafting of the report

- Task Force reports reflect members' views.
- However, there does not need to be consensus or broad agreement among Task Force members for every recommendation that features in the report. Recommendations which triggered significant dissent are marked accordingly.
- Task Force reports feature data that are considered both relevant and accurate by the rapporteurs. After consultation with other Task Force members, the rapporteurs may decide either to exclude data or to mention these concerns in the main body of the text.

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