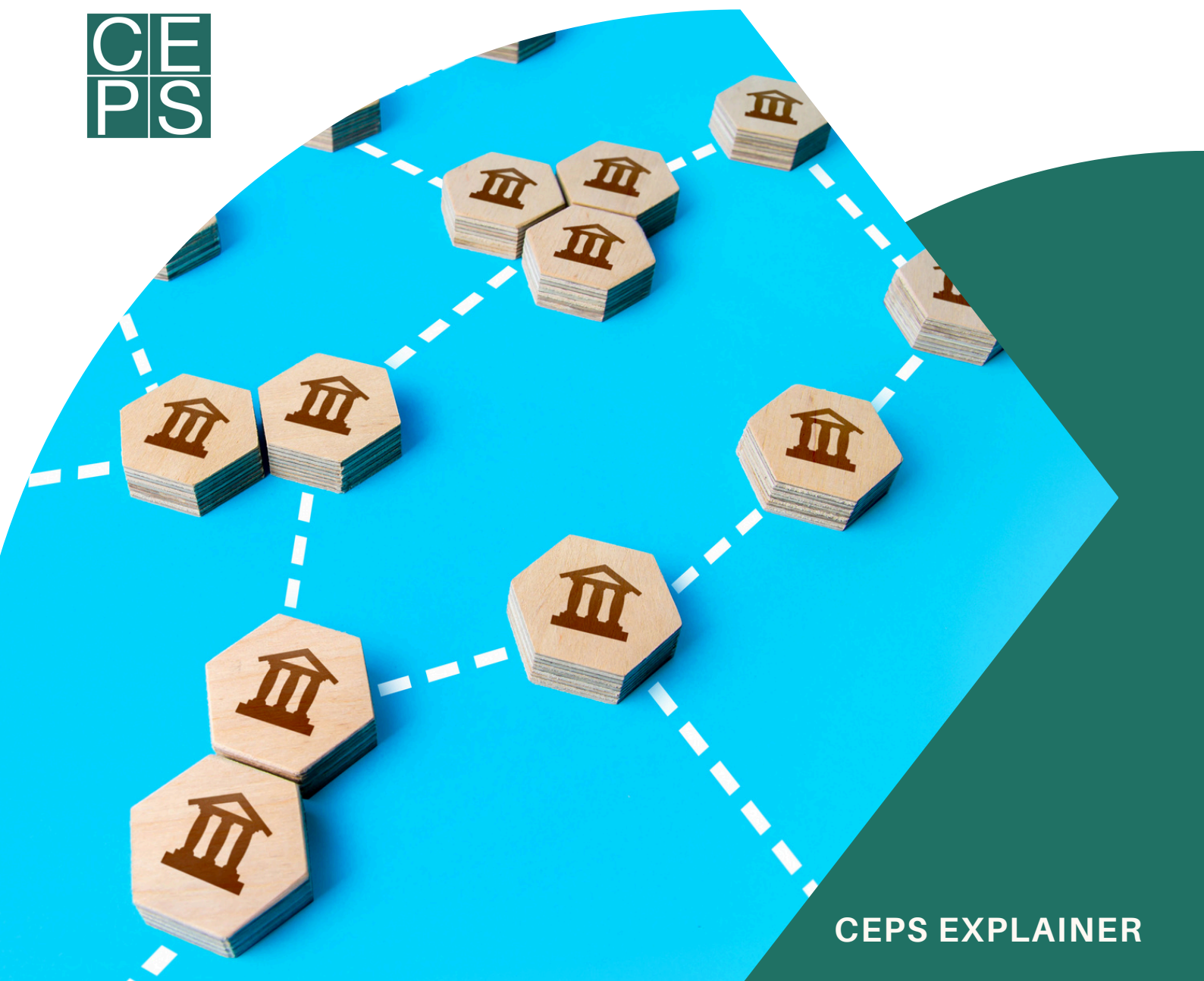




CEPS EXPLAINER

BANK COMPETITIVENESS IN EUROPE: INTEGRATION, CAPITAL AND THE UNFINISHED SINGLE MARKET



SUMMARY

Europe's debate on bank competitiveness is often framed in terms of high capital requirements. But a more fundamental challenge is the persistent fragmentation of the European banking market. Even as Europe has made progress in building resilience, Europeanising supervision and developing a common rulebook, key constraints remain national, limiting the ability to deploy capital and liquidity efficiently across borders and ensuring banks can scale up their operations.

The explainer argues that concluding Banking Union, notably by resolving the outstanding home-host issue, is thus key to competitiveness. Enhanced flexibility of capital and liquidity use requires appropriate safeguards to protect the host authorities, including through effective deposit protection and group-level supervision. Meanwhile, international comparisons of capital ratios of banks need to go beyond headline numbers. Differences in risk-weighted assets, internal models, business models and regulatory architectures complicate direct EU-US comparisons of capital ratios. The output floor is indicative of this: while it provides an important prudential backstop, reliance on a less risk-sensitive standardised benchmark may have material capital implications for certain exposures and should be assessed in the context of the entire capital stack.

Meaningful simplification should thus focus on ensuring coherence, proportionality and cumulative implications, not just deregulation. The forthcoming reform should tackle prudential calibration, supervisory convergence and market integration simultaneously. In the end, Europe's task is to mutate its common regulatory architecture into a genuine common banking market.



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INTRODUCTION

Bank competitiveness has become an increasingly prominent issue on Europe's policy agenda. Immediate questions surround familiar topics: capital requirements, regulatory complexity, proportionality, supervisory practices and implementation of international standards. But behind them lies a more fundamental issue that has been under discussion for decades and for which Europe still does not have an answer: **the absence of a genuinely integrated banking market.**

The European Commission's July 2026 [Communication](#) on the competitiveness of the banking sector and the single market in banking has re-opened this debate at an important moment. Europe's banks are considerably [more resilient](#) than they were before the global financial crisis, supervision has been substantially Europeanised and the regulatory framework is much more developed. Yet many of the structural barriers that prevent banks from operating efficiently across borders remain in place. Fragmentation, regulatory complexity, national safeguards and differences in implementation continue to constrain the ability of European banks to achieve scale and deploy resources efficiently across the single market. The debate is now moving towards a broader reform agenda covering simplification, prudential calibration and the remaining barriers to banking integration. How these elements are combined and sequenced will be as important as the substance of the individual reforms.

This does not mean that every element of the prudential framework should be relaxed, nor that Europe's banks are simply 'overcapitalised'. The more relevant question is whether the regulatory, supervisory and institutional architecture operates as a coherent whole and whether it supports both resilience and an integrated banking market.

European banks operate under an increasingly European system of rules and supervision, especially within Banking Union, but many of the constraints on how they function are still national. Capital and liquidity cannot necessarily be deployed freely across a group. Deposit guarantee systems remain predominantly national. Home and host authorities continue to have different interests and responsibilities. Cross border expansion continues to be more complicated than domestic consolidation. Regulation and supervision have accumulated several layers that do not always interact coherently.

From this perspective, bank competitiveness is not so much about choosing between regulation and deregulation. It is about whether Europe can make its regulatory and institutional architecture work as a coherent system.

Against this backdrop, six issues stand out. Together, they concern the structural barriers to integration, the calibration and interaction of prudential requirements, and how the forthcoming reforms should be designed and sequenced.

FRAGMENTATION, RATHER THAN THE LEVEL OF CAPITAL ALONE, IS THE CENTRAL COMPETITIVENESS PROBLEM

Europe has spent more than three decades building a single market in financial services and over ten years constructing Banking Union. Yet important segments of European banking remain predominantly national. The consequences of fragmentation are more than just the administrative inconvenience of having to comply with different national arrangements. Fragmentation has implications for the economics of banking.

For a banking group active across several Member States, it may be necessary to hold capital and liquidity within individual subsidiaries rather than being able to manage these efficiently at group level. National supervisory expectations and legal requirements may affect the organisation of the group. Deposit insurance is national. Consumer, insolvency and other areas of law remain divergent. The consequence is that there can be higher institutional and financial costs when expanding across borders than when doing so within one national market.

This makes the distinction between domestic consolidation and European integration critical. Europe has witnessed considerable consolidation within national banking systems. What it has witnessed far less is consolidation across national borders. Crucially, **domestic consolidation alone does not create a European banking market**. Indeed, further concentration within national markets can diminish competition without delivering the economies of scale that come with a truly integrated European market.

This also means that the international competitiveness dimension is important. Large international banks operating in Europe can internalise some of the costs of fragmentation because they already have considerable size, technology and organisational know-how. European fragmentation can thus be a competitive disadvantage for European institutions themselves. It is not just about whether a European bank faces a capital ratio that is one or two percentage points higher than a US competitor. It is also about whether the European institution can operate across its home market with comparable scale and flexibility.

That implies that we need a more extended definition of competitiveness, where regulatory costs and capital requirements are not the only influencing factors, but also market structures. The presence of a large integrated market enables firms to spread their fixed costs over a larger customer base, to allocate resources more efficiently and to scale

their investments in technology. A fragmented market does the exact opposite. Thus, regulatory simplification measures which do not regard these structural barriers are not capable of overcoming the inherent scale problem.

The distinction is an important one because a lot of the policy debate risks confusing two issues: whether individual prudential requirements are well-designed, and whether the European banking market itself permits banks to use their resources efficiently. Both are worthy of consideration, but they are not the same thing.

THE UNRESOLVED HOME-HOST PROBLEM SITS AT THE CENTRE OF BANKING UNION

If fragmentation is the diagnosis, the home-host problem is one of its main institutional manifestations.

Banking Union [radically changed European supervision](#). Significant banks in the participating Member States are supervised in the Single Supervisory Mechanism and resolution has also been substantially Europeanised. Banks themselves are considerably better capitalised, and more resilient, than before the global financial crisis.

But national interests have not disappeared as supervision moved to the European level.

The fundamental concern is that a banking group might be supervised at European level, but when problems arise at the subsidiary level, this can have important implications for the host Member State. Deposit guarantee arrangements remain national or, in some cases, sectoral. National authorities, therefore, remain concerned about the availability of resources at the local level should a subsidiary face difficulties.

This explains why the [free movement](#) of capital and liquidity within cross-border banking groups continues to pose a political challenge. It is a challenge for the banking group because of the constraints on deployment of resources that [restrictions](#) might entail. But it is also a challenge for the host authority, which may fear a depletion of resources available at the local level in the event of crisis.

This lack of trust between home and host jurisdictions continues to be one of the main obstacles to further integration. And after a decade of Banking Union, the institutional architecture has failed to fully overcome the challenge. The policy implication is not merely that national safeguards should be dismantled. It is that safeguards should be redesigned to enable integration.

Three elements in particular are important: [deposit protection](#), [credible group-level supervision](#) and arrangements concerning how banking groups can [support their](#)

subsidiaries in times of stress. These mechanisms can give host authorities reassurance while still giving banking groups flexibility in normal operations.

Importantly, this should not necessarily be seen as a choice between total national ring-fencing or an unconditional waiver of capital and liquidity requirements. Banking groups are very different in their structures and business models. Some are highly integrated, others have significant autonomy within the group structure. The appropriate supervisory safeguards may therefore also have to differ. It is probably better to have a more flexible tool-kit rather than assuming that a single instrument can cover all the different types of banking groups.

This also explains why the completion of Banking Union cannot be entirely separated from the competitiveness agenda. More flexibility on capital and liquidity is much easier to contemplate if authorities continue to trust the arrangements that apply when a bank comes under pressure. The link between the institutional architecture and the prudential framework therefore has to be understood: **risk-sharing and market integration have to move together**.

INTERNATIONAL COMPARISONS OF BANK CAPITAL ARE MUCH LESS STRAIGHTFORWARD THAN THEY APPEAR

Capital inevitably features centrally in the competitiveness debate.

European banks and policymakers routinely compare the regulatory burden that banks face in the EU with that which they face in the US, UK and other jurisdictions. But such comparisons are not always as revealing as they seem. A focus on headline capital requirements may lead to a conclusion that the EU approach is relatively conservative. Different jurisdictions apply different combinations of minimum requirements, buffers and supervisory add-ons. Basel standards themselves set international minimums; they do not require all jurisdictions to mirror the same framework. Countries can impose additional requirements and have also implemented the final elements of Basel III at different speeds.

But this is only part of the story. The bank's actual capital position will depend not only on the percentage requirement that is imposed, but also on the denominator against which it is measured. Risk-weighted assets play a critical role. And risk-weighted asset densities themselves reflect a mixture of portfolio composition, regulatory rules, supervisory preferences and the extent to which banks are permitted to use internal models rather than standardised approaches.

By incorporating those factors, the differences between jurisdictions can become substantially compressed compared to a comparison of headline capital stacks. Jurisdictions with seemingly lower percentage requirements can have [significantly higher risk-weight densities](#), and jurisdictions with higher capital stacks can have [lower densities](#).

The comparison with the US is particularly challenging given the structural difference in the two frameworks. Under the [March 2026 US proposal](#), most advanced approaches for credit and operational risk would be eliminated and the revised framework would apply mainly to the largest banks. The EU, by contrast, continues to permit the use of internal models for credit risk, subject to the output floor, across a broader banking sector. The absence of the Basel-style output floor in the US thus does not imply that banks in that country are allowed to operate under the same internal-model framework without the European constraint. The US proposal would remove most advanced approaches for credit and operational risk while the EU continues to permit internal models subject to an output floor that is being [phased in](#) towards the Basel calibration of 72.5 % in 2030 (currently 55 %).

This has implications for the European debate in at least three respects.

First, it highlights the limitations of using a single international comparator to inform policy. The observation that a European bank faces a higher headline requirement than a US bank is not in itself sufficient to understand the magnitude of the competitive disadvantage that may exist. A useful comparison requires an understanding of the capital requirements and risk-weighted assets, leverage constraints, business models and balance sheet composition.

Second, it provides an illustration of the importance of data and transparency. Even sophisticated international comparisons are challenging, since regulatory reporting is not entirely comparable. More and better data are essential if policymakers want to understand whether European regulation creates a systematic competitive disadvantage.

Finally, it transforms the nature of the policy question. The question is not merely, 'is the European capital stack too high?' but whether **the total prudential framework** generates requirements that are coherent, proportionate and commensurate with risk, also relative to other major jurisdictions.

This is a much more challenging exercise than comparing ratios. But it is also the only way to avoid taking policy decisions on the basis of incomplete comparisons.

THE OUTPUT FLOOR POSES A DEEPER QUESTION OF RISK SENSITIVITY

The Basel III output floor raises the question of risk sensitivity in a particularly acute way.

The problem cannot be framed as a trade-off between the resilience of banks and their lending. The output floor [limits](#) the degree that capital requirements derived from banks' internal models may fall below a minimum calculated upon the standardised approach. Its aim is to restrict excessive variability in risk weights and serves to provide a backstop against risks being systematically under-estimated.

That function is important. Internal models can result in lower risk weights and if model-based requirements fall significantly below those based on the standardised approach, legitimate grounds for concern may exist. The output floor is also [not a substitute for the leverage ratio](#): they deal with different issues and there may be situations where the elimination of the output floor would not leave any backstop against model based requirements that are too low.

At the same time, the standardised approach itself may create problems. Internal models used for regulatory purposes are subject to [supervisory approval, investigation and ongoing monitoring](#), and over the past decade have also been subject to a dedicated EU [model-repair programme](#) and extensive efforts to [harmonise supervisory practices](#). The standardised approach, by contrast, can be [insufficiently risk-sensitive for particular European exposures](#).

The problem arises when the standardised risk weight is materially higher than the risk implied by a bank's validated internal model. Since the output floor requires model-based risk-weighted assets to always exceed a fixed percentage of those derived from the standardised approach, a relatively coarse standardised risk weight can prove to be binding, even if the internal model suggests significantly less risk. In such cases, the floor has the effect not only of limiting excessive model variability, but also of transferring limitations in the standardised benchmark to the capital requirement as well. Using it as the reference point for the output floor can thus have [material capital implications](#) for some banks and exposures.

This issue is particularly relevant for business models and classes of assets that are structurally different across jurisdictions. Lending to unrated corporates is one such example. European companies, in particular those which rely predominantly on bank finance rather than capital markets, may not have external credit ratings. Mortgages can also be subject to significantly different treatment in different national banking systems.

The policy question is therefore not only whether there should be an output floor. It is also whether the standardised benchmark on which it is based is sufficiently risk-sensitive

for the exposures concerned, and whether its interaction with the rest of the capital stack produces the intended overall capital outcome.

The case of unrated corporates also exposes an interesting tension between banking policy and the wider objective of developing European capital markets. One argument is that firms have had time to obtain ratings and that encouraging a broader ratings infrastructure could support capital-market development. Where the standardised treatment depends on external ratings, however, an unrated company can attract a higher standardised risk weight even where a bank's internal assessment indicates relatively low credit risk. But there is also a practical constraint: if firms do not find it economically worthwhile to obtain a rating and alternative sources of finance are available, higher regulatory costs on bank lending may reduce the supply of bank credit or make it more expensive, while alternative sources of finance may become relatively more attractive.

That possibility deserves attention. A prudential measure can change not only the amount of risk in the financial system but also where that risk is intermediated. If regulation makes particular types of bank lending significantly more expensive, financing may move towards private credit, non-European banks or other non-bank channels. Whether this improves the resilience or competitiveness of the European financial system cannot be answered simply by looking at bank capital ratios.

There is yet another dimension to the output-floor question which is arguably even more important: how it interacts with the rest of the capital framework. The European prudential regime includes more than Basel Pillar 1 requirements. Banks face Pillar 2 requirements, macroprudential buffers, leverage requirements, MREL (Minimum Requirement for Own Funds and Eligible Liabilities) and other constraints. So it matters if the addition of further requirements through the output floor is accompanied by other adjustments. If enhanced Pillar 1 requirements do not lower the need for other supervisory or macroprudential overlays, the framework as a whole may prove more onerous without a specific decision that the overall level of desired resilience should be higher.

This suggests a useful principle for the forthcoming review: **assess the capital stack as a system rather than instrument by instrument**. A requirement may be perfectly defensible when viewed in isolation, but when combined with other requirements addressing similar risks it may create an inefficient or redundant overall framework.

SIMPLIFICATION SHOULD MEAN COHERENCE AND PROPORTIONALITY, NOT MECHANICAL DEREGULATION

The same considerations apply to regulatory simplification.

The EU banking framework has grown complex. This is partly unavoidable given the diversity of business models and risk profiles of banks and the need for financial regulation to address a variety of prudential concerns. However, complexity can also stem from an [accumulation of successive regulatory layers](#) without adequate reassessment of their interplay. Thus, the term 'simplification' can cover very different approaches.

In its narrowest sense, simplification may be a euphemism for reducing regulatory requirements. But this would miss many of the issues. A more useful exercise is to determine whether there are overlaps in requirements, whether reporting or supervisory expectations are being unnecessarily duplicated, whether the same or similar risks are covered by several different instruments, or whether the regulatory framework is still broadly proportionate to the institutions and activities to which it applies.

The capital stack is one obvious example. Pillar 1, Pillar 2 requirements, Pillar 2 guidance and macroprudential instruments have different objectives but their cumulative impact needs to be understood. The addition of any new constraint without reconsideration of the others can lead to unforeseen overlaps.

Proportionality is another issue that requires similar considerations. The current approach to the definition of small and non-complex institutions can in itself reflect a predominantly national view of banking markets. But a proportionate European regime should ideally [differentiate](#) between institutions on the basis of the risks and complexity of their business models rather than reflect national boundaries. That is especially important if compliance costs include a significant element of fixed costs, and hence tend to [weigh more heavily on smaller institutions](#).

The impact of supervisory practice is also relevant. Formal EU harmonisation does not necessarily lead to [harmonised outcomes](#) if regulatory provisions are interpreted and applied in divergent ways. The culture of supervision, national preferences and the interaction between European and national authorities can all affect the actual burden on banks.

This is why the question of competitiveness cannot be addressed solely by amendments to the Capital Requirements Regulation (CRR) or Directive (CRD). While some aspects may require changes in legislation, others may be better addressed by supervisory convergence, changes in implementation practices or more consistent use of existing tools.

A broader review should therefore ask three questions.

- 1) Are individual requirements still justified by the risks they were designed to address?
- 2) Do the different parts of the framework work coherently together?
- 3) Are equivalent institutions and activities treated sufficiently consistently across the single market?

Those questions are harder than simply identifying provisions that can be deleted. But they come closer to what meaningful simplification should involve.

EUROPE SHOULD AVOID SEPARATING THE EASY REFORMS FROM THE DIFFICULT ONES

A final question concerns how these reforms should be structured and sequenced.

The temptation to split the exercise is obvious. One package could deal relatively quickly with simplification, regulatory adjustments and perhaps elements of the capital framework, thereby enabling European banks to provide parts of the necessary investments as highlighted by the Draghi report. A second could address the politically more difficult questions of Banking Union, home-host relations and market integration.

In procedural terms, this may appear pragmatic. In [political terms](#), however, it could reproduce precisely the pattern that has characterised European banking integration for much of the past decade. The easier reforms would move ahead. The difficult institutional questions would remain for later. And ‘later’ could mean many years.

Home-host issues are not a discrete technical question that can be separated from the rest of the competitiveness agenda. They have an impact on capital and liquidity waivers, group structures, supervisory practices and the economics of cross-border banking. Separating integration and simplification could therefore have a detrimental impact on the internal consistency of the reforms themselves.

More fundamentally, the sequencing would send a signal. If Europe can easily agree measures that reduce regulatory burdens but requires another decade to get somewhere on the single market, investors and banks may plausibly conclude that the fundamental structural bottlenecks will not disappear. Regulatory relief may make profitability slightly more attractive but would have little impact on the fundamental prospects for European scale and cross-border expansion.

A comprehensive package in which [simplification, prudential calibration and market integration](#) all form part of the same political bargain would therefore be a much better route forward. This is also important from a political-economy perspective as [prudential requirements and risk-sharing arrangements are interdependent](#). The difficult parts of the package may thus help to justify the easier ones. Host countries may be more amenable to greater flexibility on capital and liquidity if the [credibility of safeguards is enhanced](#). Banks may get more operational freedom in exchange for measures providing greater comfort in cross-border groups. Adjustments to elements of the capital framework can be considered alongside the evolution of integration rather than as standalone concessions. Splitting the package apart would eliminate those opportunities for trade-offs.

A FINAL POINT: THE BANKING SECTOR ALSO HAS A ROLE TO PLAY

Competitiveness cannot be delivered by policymakers alone.

Banks themselves need to demonstrate that they will make full use of the opportunities offered by a more integrated market. Industry arguments understandably concentrate heavily on the capital side of the equation: existing capital levels are high, further increases should be avoided and requirements should be recalibrated where they create distortions.

These arguments deserve to be considered on their merits, but they do not represent a strategy for European financial integration. In order to convince policymakers to remove barriers to cross-border activity, banks must show how they will exploit the opportunities for developing truly European products and services, leveraging cross-border scale and investing in the infrastructure needed for an integrated market.

Payments, for example, highlight the challenges of creating truly pan-European private payment solutions in Europe despite years of integration efforts. The obstacles are not only public regulation, but also commercial coordination and overcoming legacy national infrastructures.

The broader lesson is that integration requires changes in both public policy and private-sector behaviour. This is particularly important because the ultimate purpose of greater banking competitiveness is not to increase bank profitability as an objective in itself. Greater scale, efficiency and profitability matter insofar as they strengthen the capacity of the financial system to serve the wider European economy: financing firms, households, innovation and investment. The case for reform becomes considerably stronger when this link is explicit.

CONCLUSION: FROM RESILIENCE TO INTEGRATION

The EU banking framework in 2026 is very different from the one that existed on the eve of the financial crisis. Capital has increased, resolution frameworks have been created, supervision Europeanised for the majority of the banking system, and common rules have expanded considerably. These achievements should not be regarded as impediments to competitiveness; rather they should provide part of the institutional foundation for the next stage of integration.

This has important implications for how the policy debate should be framed. The choice is not between returning to the pre-crisis regulatory model and preserving every element of the post-crisis framework unchanged. Nor is it simply between financial stability and competitiveness. The more relevant question is whether a framework built over many years primarily to strengthen resilience can now be made more coherent, proportionate and conducive to integration without sacrificing that resilience.

This requires looking beyond comparisons of headline capital ratios with the US or identifying individual rules for deletion. It requires looking at the capital stack and the interactions between its components; the identification of genuine international competitive disadvantages versus those that disappear when risk-weighted assets and business models are considered; reconsidering the interaction of international standards with specifically European market structures; and enhancing supervisory convergence. Above all, it requires addressing the home-host problem that continues to inhibit the operation of Banking Union.

The forthcoming reform package therefore offers an opportunity beyond regulatory streamlining. Europe has created much of the institutional machinery for Banking Union. What it has yet to do is allow that machinery to deliver the extent of market integration promised by its inception.

If the competitiveness debate focuses on reducing specific capital requirements, that chance may be lost. But if instead it takes the stronger resilience of European banks as a foundation for moving on fragmentation, increasing the coherence of the prudential framework and progressing towards cross-border banking, it could shift the debate to much more important grounds.

The problem is not how much capital European banks should maintain, but rather if Europe is finally ready to **turn a common regulatory regime into a common banking market.**

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