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Banking Regulation: Reforming Without Retreating

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Abstract

Across all political areas, there is ongoing discussion about streamlining processes and reducing bureaucracy in order to enhance the competitiveness of European industry. This also applies to banking regulation. This paper highlights the outstanding reform steps that still need to be implemented, reflecting the lessons of the 2028 financial crisis as well as the disruptions of 2023. Competitiveness requires financial stability. At the same time, there are significant opportunities to simplify rules or to harmonize and reduce reporting requirements—especially given the overlap of national and European regulations and supervisory bodies. With a view toward the desired transfer of risks to the capital market, the regulations for securitizations should also be simplified. The path forward lies not in wholesale deregulation but in thoughtful reform that preserves the essential protections while eliminating unnecessary complexity.

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Financial regulation – indispensable safeguard for financial stability

Banking regulation – what a difference a year can make! In 2024, much of the discussion about banking regulation focused on understanding and addressing the banking failures in the US and Switzerland in March 2023[1]. Just one year later, public and political attention has shifted towards deregulation - or at least the simplification - of financial regulation[2].

The debate on re-visiting regulation and seeking simplification is not limited to banking regulation; it is a discussion worth having. The key question is just whether we are taking the questions „in the right order".

Banking regulation, or more broadly financial market regulation, is a cornerstone in ensuring the overall resilience of the financial system in case of shocks, thereby reducing the likelihood of systemic crisis. At the same time, financial regulation is meant to build public confidence in the system and its institutions, just to mention its most important objectives. In recent months, and in light of the financing needs to transform our economies and strengthen our (military) defense, the goal of "ensuring competitiveness" has been repeatedly added to the regulatory agenda. A word of caution is warranted: a safe and sound financial system is best serving competitiveness. De-regulation might result in weak standards and a system that cannot withstand shocks, while over-regulation will indeed hinder competitiveness. Effective and efficient regulation, therefore, must be our aim.

Since the Great Financial Crisis of 2007-2008 (GFC) banking regulators, mandated by the G20, have been overhauling banking regulation. This has led to stronger capital and liquidity requirements, particularly for the largest banks. More than 15 years after the GFC, a core piece of this regulation, Basel III, remains only partially implemented in major financial markets and is currently, once again, heavily debated. In the US, the Federal Reserve and the FDIC continue to assess the implementation of Basel III. In the UK and in the European Union this is carefully watched. In any case, the implementation will be further postponed.

At the same time, the discussion about whether and how to regulate the fast-growing market of Non-Bank Financial Intermediation (NBFI) is ongoing. Here the concern is that certain risks in this field might remain unaddressed, and that the different treatment of similar risks between banks and NBFIs leads to bank disintermediation by creating an uneven playing field.

Furthermore, regulations aimed at consumer protection as well as those addressing money laundering and terrorism financing add further requirements. Overall, these factors have led to an increasingly complex regulatory landscape. It is therefore essential to periodically reassess the efficiency of legislation and seek, at least, opportunities for simplification. This is a task for both legislators as well as regulators that implement the legal requirements.

Financial regulation – a need for internationally agreed standards

The starting point of this debate should be the political question of risk appetite. After the GFC there was general consensus that banks' capital and liquidity requirements should be strengthened so that they could better withstand shocks. In the event of a bank's failure, the institution should be resolved without recourse to tax payer funds and without triggering a widespread systemic crisis. To be clear: The intent has never been - and should never be - that no bank will ever fail. Rather, it is about ensuring that any failure, as in other industries, can be managed without causing broader instability while aligning risks and rewards.

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[1] See Martin J. Gruenberg, Lessons learned from the U.S. regional Bank Failures of 2023, Institute for Law and Finance Series, Vol. 28, 2024 and other articles in this booklet; Bericht des (schweizerischen) Bundesrats zur Bankenstabilität einschließlich Evaluation gemäß Art. 52 des Bankengesetzes vom 10. April 2024, BBl 2024, 1053; Financial Stability Board (FSB), Peer Review of Switzerland, 29 February 2024.

[2] See FDIC, Statement from Acting Chairman Travis Hill, January 21, 2025; https://www.fdic.gov/system/files/2024-07/fr-npr-on-brokered-deposit-restrictions_1.pdf.

What could this lead to?

First, we need to complete the implementation of the essential regulatory framework, particularly in areas crucial for financial stability.

The **Basel III implementation**, for instance, should be finalized faithfully by all relevant jurisdictions - but without unnecessary 'gold plating' that could create competitive disadvantages or undue operational burden. The focus should be on achieving the core objectives of financial stability while avoiding excessive complexity. Since the GFC banks have significantly strengthened their capital and proven in general resilient to stress. Thus, the focus of implementing Basel III should be on the quality of capital rather than on simply increasing the overall capital requirements. A focus on quality of capital is a lesson of the bank failures in March 2023.

The picture might look different when it comes to liquidity requirements. While the faithful implementation of the Basel III capital requirements remains crucial for establishing a global level playing field, recent bank failures have exposed gaps in the regulatory framework, particularly regarding liquidity management and deposit flight risk. The unprecedented speed of deposit withdrawals in 2023 demonstrates that traditional liquidity requirements need rethinking, possibly including incorporating circuit breakers and developing more sophisticated deposit insurance frameworks[3] that reflect banks' specific liability structures. In any case, a bank's ability to generate (market based) liquidity in case of a crisis, as well as its untainted ability to access central bank liquidity, must be monitored and tested frequently.

In March 2023, following some targeted de-regulation by the US authorities, the failure of a few large regional banks in the US risked causing wide-spread financial instability. In response, it is necessary to reconsider the scope of application of the most stringent regulatory requirements. Proportionality is needed. At the same time, limiting the most stringent requirements solely to globally systemic institutions (G-SIBs), does not adequately address the risks - as demonstrated in 2023. Consequently, resolution planning should be extended to domestically systemic banks where this is not yet the case, and a long-term debt requirement should be introduced for these banks[4].

Moreover, the growing significance of **Non-Bank Financial Intermediation (NBFI)** presents its own regulatory challenges. Although NBFIs generally operate with less leverage than banks, their "funding short, investing long" model carries inherent risks – especially without access to additional liquidity sources or a lender of last resort. This shift from traditional banking to various forms of market-based financing, requires careful consideration of how to maintain financial stability while enabling innovation. The Financial Stability Board (FSB) has been monitoring the “NBFI-space” since its inception; however, the liquidity risk and the spillover risk to banks still need to be properly addressed[5].

These are most likely the most relevant areas where pending regulation must be finalized for both banks and non-banks. This will be evolution, not revolution.

So, where to simplify?

When banks call for regulatory simplification, it is crucial to distinguish between their requests for easing substantive requirements and the genuine and warranted need for procedural simplification. Often, industry demands for “simplification” are effectively calls for lower capital requirements, reduced liquidity buffers, or fewer restrictions on certain business activities. However, the events of 2023 have once again demonstrated that strong substantive requirements remain essential for financial stability.

[3] See FDIC, Options for Deposit Insurance Reform, 01 May 2023; SAFE, European lessons from Silicon Valley Bank resolution: A plea for a comprehensive demand deposit protection scheme (CDDPS), policy letter no. 98, March 2023.
[4] See FDIC Notice of Proposed Rulemaking to Impose a Long-Term Debt Requirement for Certain Insured Depository Institutions, 29 August 2024.
[5] FSB, Global Monitoring Report on Non-Bank Financial Intermediation 2024, 16 December 2024 and FSB, Consultation Report “Leverage in Non-bank Financial Intermediation, 18 December 2024.

Financial regulation – need for clarification, streamlining, addressing overlap

True simplification should focus on making rules clearer and more straightforward to implement without compromising their protective effect. For instance, the current European regulatory framework - with its complex interplay between directly applicable regulations (such as the CRR), national implementations of EU directives, and various layers of regulatory technical standards - creates a challenging maze of requirements, not to mention the still numerous national options and discretions. This complexity itself can become a source of risk when institutions struggle to ensure complete compliance across all applicable requirements. It might also lead to "unintended gold-plating" by financial institutions that want to avoid any non-compliance and thus over-comply. A more streamlined regulatory architecture with clearer hierarchies and fewer cross-references could enhance both compliance and supervision while maintaining the same level of protection. A **principles-based, less descriptive legislation** should allow regulators and the industry to address the challenges of evolving products and emerging risks.

The existing inefficiencies in the current regulatory framework must be addressed by both regulators and legislators. Technological development, including the use of artificial intelligence to streamline regulatory approval processes, should be embraced. One clear example is the redundant data collection across different regulatory requirements and authorities. Banks often need to report similar data points in slightly different formats or at different intervals to various supervisory bodies. This creates unnecessary operational overhead without providing proportional regulatory or supervisory benefit. A **systematic review of regulatory reporting requirements** – across regulators - could identify overlaps and streamline these processes while maintaining the quality of supervisory oversight. This will require data sharing by regulators or ideally a joint database without undue burden of business confidentiality and a clear framework exempting authorities from liability when sharing data with each other.

Certain disclosure requirements, particularly in areas like MiFID, warrant careful review. While investor protection remains crucial, we should evaluate whether the current volume and frequency of disclosures actually serve their intended purpose of enabling better-informed investment decisions. In some cases, the sheer amount of information might actually impede, rather than enhance, consumer understanding and thus consumer protection.

The European approach to **proportionality** offers another example where simplification could enhance effectiveness without weakening standards. Currently, smaller institutions must navigate complex regulations to determine which simplified approaches they may apply. A more structured "small banking box" with clear, simple rules for smaller institutions could reduce operational burden while maintaining appropriate risk sensitivity. Similarly, the multiple overlapping reporting requirements under different European frameworks (COREP, FINREP, resolution reporting, statistical reporting) could be consolidated into a more coherent system. The key is to focus on eliminating procedural complexity while preserving – or even strengthening – the substantive protections that ensure financial stability.

Also, the current approach to **bi-annual stress testing of banks**, in Europe conducted by European Banking Authority and European Central Bank, could benefit from more focused assessments that better utilize both banks' and regulators' resources. The stress tests were originally designed to restore public confidence in the banking system, but it is doubtful that this remains a valid or necessary aim. Therefore, more focused regulatory assessments – with or without publication of the results – might better serve supervisory needs and reduce the burden for regulators and banks.

In addition, a fresh look at the **regulatory approval process for securitizations** is warranted. Securitizations were at the center of the GFC and thus regulation was tightened considerably in the aftermath. At the same time, securitization remains a valid and efficient tool to transfer risk from banks into the capital market and thus core for an efficient capital markets union[6]. In recent years, there has been consensus on the need to develop a framework for simple, transparent and standardized securitizations (STS). However, the supervisory pre-approval process is still by

[6] FSB, Evaluation of the G20 Financial Regulatory Reforms on Securitization, 22 January 2025; European Commission, Targeted Consultation on the Functioning of the Securitization Framework 2024 and the Factual Summary Report; ECB Banking Supervision, Supervision Newsletter, Securitizations: a push for safety and simplicity, February 19, 2025.

individual transaction; it is lengthy and burdensome. The ECB is working on streamlining the approval process, but more might be needed. Artificial intelligence could be used to - at least - semi-automate the pre-approval of STS securitizations and perhaps even take over some of the analytical tasks of the supervisory and resolution authorities. In a next step and part of the reform package to implement a European Savings and Investment Union (SIU), it might be considered to truly standardize the features of these STS securitizations in the interest of issuers and investors.

Meanwhile, emerging challenges – such as crypto-assets and evolving money laundering risks - demand clear frameworks that assign responsibility and ensure adequate customer protection. Beyond traditional financial risks, there must be a clear focus on preventing interference in critical infrastructure, such as communication networks, to ensure that banks' systems stay resilient.

Conclusion

The way forward should focus on "smart regulation" rather than wholesale deregulation. This means:

- Maintaining robust standards in areas essential for financial stability,
- Focus on principles-based regulation and avoid being overly descriptive,
- Eliminating redundancies and operational inefficiencies, and promoting data sharing between regulatory authorities,
- Ensuring proportionality in regulatory requirements,
- Leveraging technological solutions to reduce compliance burden while improving supervisory effectiveness.

The path forward lies not in wholesale deregulation but in thoughtful reform that preserves the essential protections while eliminating unnecessary complexity. This requires balancing multiple objectives:

- maintaining financial stability,
- ensuring operational efficiency,
- enabling innovation, and
- protecting consumers.

Success will depend on international coordination and a commitment to evidence-based policymaking that learns from past crises while preparing for future challenges. The goal is not to retreat from the progress made since the GFC, but to reform our regulatory framework to be more effective, efficient, and resilient in an evolving financial landscape. The European Commission's fresh look at regulation as well as the work to create an "Investment and Savings Union" offer a chance to achieve this.

About the author

Elke Koenig was the first Chair of the Single Resolution Board (SRB), Brussels, from March 2015 until January 2023. Prior to this, and after a long career in accounting and as CFO of an international reinsurance group, she was President of the German Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht, BaFin, Bonn) from 2012 until 2015. She was also a representative of the Supervisory Board of the Single Supervisory Mechanism. Since the beginning of 2023 she is a Senior Policy Fellow of the Leibniz Institute for Financial Research SAFE in Frankfurt a.M. She is also a member of the CFA Institute's Systemic Risk Council.

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