Financing Europe's Future: A Social and Sustainable Banking Framework

July 2026

The **FEBEA Advocacy Lab** is a joint initiative by the **European Federation of Ethical and Alternative Banks and Financiers** and the **Sustainable Banking Coalition**. The Advocacy Lab is a powerful platform uniting Europe's ethical and sustainable finance sector, bringing together **40+ financial institutions** across **15+ countries** - managing **€75+ billion in assets**. Its aim is to shape an EU financial system that **serves the real economy**, **finances the just and green transition**, and **strengthens social, environmental** and **financial resilience**.

The European Commission's work on the competitiveness of the EU banking sector[1] comes at a pivotal moment. Europe needs a financial system that can both support the green transition, finance social investments, and remain resilient to financial, geopolitical, energy price, as well as climate and nature-related shocks. In a predominantly bank-based economy, where households and businesses rely heavily on bank lending, the calibration of the regulatory framework is essential[2].

Any review of EU banking legislation must therefore start from a clear premise: **The main objective cannot be to maximise bank profitability, but to ensure that banks effectively finance the real economy and the green, just transition while maintaining stability.** Simplification and stronger market integration can help if carefully designed. The Commission should strengthen the financial system's role in serving the real economy - not treat competitiveness as an end in itself. A competitive banking sector is one that is resilient, well-capitalised and capable of scaling up financing for Europe's green and social investment needs.

Europe Already Has a Strong and Resilient Banking System

Since the global financial crisis, European banks have significantly strengthened their resilience. Driven by the implementation of the Basel Framework[3], they have improved capital positions, enhanced asset quality and improved risk management The current prudential framework has restored trust in the banking sector and reduced the likelihood that future shocks are borne by taxpayers or the wider economy[4].

[1] European Commission, Communication on the Savings and Investments Union, 2025
[2] Finance Watch, Position paper 'Resilient banks, resilient economy', 2026
[3] Basel Committee on Banking Supervision, The Basel Framework
[4] Finance Watch, Position paper 'Resilient banks, resilient economy', 2026

This resilience is itself a key competitive advantage[5]. A banking system that can sustain lending through economic downturns is more valuable than one that maximises short-term returns but amplifies instability. For this reason, prudential regulation should not be framed as a constraint on competitiveness. On the contrary, strong prudential standards are a precondition for a stable, credible and attractive financial system. In addition, a climate-sensitive prudential framework could use banking supervision and risk-based capital rules to mobilise private finance for Europe's industrial transition[6].

This is supported by analysis from the European Central Bank[7], which shows that EU banks are not structurally disadvantaged by stricter capital rules[8]. In some cases, capital requirements are comparable to or even higher in other jurisdictions, like the United States. At the same time, the existence of a resilient framework does not mean that improvements could not be beneficial. A targeted review - using data sharing, "report once" procedures and more proportionate liquidity requirements - can refine the framework where needed, provided it strengthens the system rather than weakens it. Any recalibration must be designed to support real-economy financing, not simply boost bank profitability. As recent developments in the United States show, looser requirements can lead to excess capital being channelled into shareholder returns, rather than additional lending. European banks have already significantly increased dividends in the last years. This underscores the need to ensure that changes remain tightly targeted[9].

Avoiding a Deregulatory Reopening

A broad reopening of the prudential and supervisory framework, particularly the Capital Requirements Regulation III (CRR3) and the Capital Requirements Directive VI (CRD6), risks creating pressure to dilute core safeguards, including prudential and climate-related requirements. Such an approach would undermine the credibility of the EU regulatory framework at a time when stability is challenged by geopolitical shifts.

The ongoing process[10] risks creating pressure for visible, short-term "wins" that do not address the real drivers of EU banking competitiveness. This pressure should not translate into cutting requirements that are not constraining competitiveness. The Commission should therefore clearly define what a targeted review can deliver, and prioritise measures that address genuine competitiveness bottlenecks over weakening essential safeguards. A targeted reform is both possible and desirable, but it must remain focused. Simplification should not become a proxy for deregulation. Instead, it should aim to improve clarity, reduce unnecessary duplication and ensure that

[5] European Central Bank, Occasional Papers Series 'Capital requirements: a pillar or a burden for bank competitiveness?', 2025
[6] European Commission, Report on the monitoring of climate-related risk to financial stability, 2024
[7] European Central Bank, Occasional Paper Series 'Understanding the banking sector capital framework in the European Union', 2026
[8] European Central Bank, Occasional Paper Series 'Understanding the profitability gap between euro area and US global systemically important banks', 2023
[9] Finance Watch, Position paper 'Resilient banks, resilient economy', 2026
[10] European Commission, Targeted consultation on the competitiveness of the EU banking sector, 2026

requirements are proportionate to the risks and business models they are meant to address. Any changes should be closely tied to clear public interest outcomes, including financial stability, effective lending to the real economy, the preservation of banking diversity and the management of climate and sustainability risks[11]. Importantly, proportionality must not lead to the weakening of climate considerations.

Defining Competitiveness: Stability, Sustainability and Real Economy Support

The debate on banking competitiveness must be grounded in a clear and appropriate definition. Competitiveness should not be equated with profitability. Rather, it should be understood as the capacity of the banking sector to support the real economy, allocate capital efficiently, remain resilient during periods of stress and contribute to Europe's long-term economic, environmental and social objectives.

Over the past decade, European banks have improved their efficiency significantly. Analysis by the European Parliament's Economic Governance and EMU Scrutiny Unit[12] shows that cost-to-income ratios have steadily declined and are broadly comparable to those of international peers. This suggests that EU banks are competitive in operational terms[13]. A Bundesbank's analysis suggests that claims of broad-based competition between EU and US banks are overstated[14]. Direct EU-US competition is largely confined to investment banking, trading, and a limited number of specialised activities carried out by internationally active large banks. In this context, banking competitiveness means the sector's ability to finance Europe's strategic priorities, strengthen economic resilience, and support the just and green transition.

Ethical and Sustainable Banks as Pillars of the EU Financial System

The strength of the European banking sector lies in the diversity of its institutional landscape, as highlighted in the reports by Mario Draghi[15] and Enrico Letta[16]. Smaller and regionally embedded institutions complement larger banking groups by serving different segments of the economy, particularly households, small and medium-sized enterprises (SMEs) and local communities[17].

Within this ecosystem, ethical and sustainable banks represent a distinct and valuable segment. Managing €79 billion in assets across Europe, this banking segment channels 68% of those assets into loans to the real economy and more than 70% directed towards positive impact initiatives.

[11] European Central Bank, Supervisory priorities 2026-28
[12] European Parliament, ECON Committee, In-depth analysis 'How have European banks developed along different dimensions of international competitiveness?', 2025
[13] Deutsche Bundesbank, 'Do capital requirements and their international differences affect banks' profitability?', 2025
[14] Deutsche Bundesbank, Wettbewerbsfähigkeit des deutschen Bankensektors: Vom Zusammenspiel von Regulierung und Wettbewerbsbedingungen, 2026
[15] European Commission, The Draghi report on EU competitiveness, 2024
[16] European Commission, The Letta report on the EU Single Market, 2024
[17] City St George's, University of London, 'The origin of financial instability and systemic risk: Do bank business models matter?', 2025

In some cases, up to 93% of their lending goes to micro-enterprises typically excluded from the traditional banking system[18]. Their funding relies primarily on stable retail deposits and apply environmental and social criteria as part of their credit allocation. This model gives them a competitive advantage in segments of the banking sector where resilience, trust, local relationship banking and long-term real-economy financing matter more than complex financial-market activity. In practice, it mobilises household savings into productive lending while limiting exposure to speculative activities.

Empirical evidence confirms the soundness of this model. Ethical and sustainable banks maintain a non-performing loan ratio of 1.61%, below the 1.89% recorded by comparable significant banks, while their return on assets (0.75%) has outperformed significant banks (0.64%) in eight of the last ten years, with notably stable performance across the economic cycle[19]. These institutions tend to contribute less to systemic risk during periods of financial instability[20]. At the same time, they play a critical role in financing the just and green transition, supporting sustainable and social infrastructure, enabling innovation in clean technologies and financing entrepreneurs. Their contribution strengthens both the resilience and the long-term competitiveness of the European economy.

A robust regulatory framework must therefore preserve and support this diversity. This requires maintaining strong prudential standards, ensuring the effective integration of climate-related risks into supervision and recognising different banking models through proportionate regulation. The objective of any review should be to improve the clarity, coherence and effectiveness of the framework without undermining its resilience.

Strengthening What Works

The EU banking framework does not require a fundamental overhaul, but it does benefit from targeted improvements that enhance its effectiveness while preserving its strengths. The framework should better reflect the diversity of the sector by applying more effective proportionality, reducing disproportionate compliance requirements on smaller, non-complex and real-economy-focused institutions and aligning requirements with actual risk[21,22]. At the same time, climate and sustainability considerations need to be more firmly embedded in the prudential framework, recognising their systemic impact on financial stability and ensuring banks actively manage transition risks and support their clients. Reforms should enhance banks' capacity to finance the real economy by improving the allocation of capital towards productive activities such as households, SMEs, sustainable infrastructure and clean technologies - and not just deliver symbolic simplification.

[18] FEBEA, 8th Report on Ethical Finance in Europe, 2025
[19] FEBEA, 8th Report on Ethical Finance in Europe, 2025
[20] ECGI, Finance Working Paper 'Banking stability: the impact of financial sector heterogeneity on systemic risk in financial. crises and economic recessions', 2023
[21] European Central Bank, Simplification of the European prudential regulatory, supervisory and reporting framework, 2025
[22] Deutsche Bundesbank, 'Europe's small banks need simplified rules', 2025

Five Key Recommendations

All recommendations are firmly grounded in existing regulatory thinking at both European and national level, notably the work of the European Central Bank's High-Level Task Force on Simplification[23], as well as the small-banking regime proposed by Bundesanstalt für Finanzdienstleistungsaufsicht and the Deutsche Bundesbank[24]. Together, these frameworks provide a credible and well-established foundation for advancing a more proportionate, effective and efficient supervisory approach.

[1] Establish an EU-Wide Simplified Regime for Small and Non-Complex Banks

Recommendation: Create a coherent, EU-wide, opt-in simplified regime for small and non-complex banks, based on business model and risk profile rather than size alone. Potential eligibility criteria include:

- GDP-linked size threshold (0.10–0.15% of GDP)
- ≥75% real-economy lending
- No speculative activities (banking book only)
- Use of the standardised approach only
- Simple corporate structure (maximum 20 legal entities, maximum two layers of subconsolidation)
- Operations in ≤5 countries
- Stable retail deposit funding (loan-to-deposit ratio within 80–90%)

Rationale: Existing proportionality measures rely too heavily on size and do not adequately capture key risk drivers such as complexity, funding structure and interconnectedness[25]. The current SNCI category, with its €5 billion threshold, captures scale but leaves complexity, risk profile, and business model largely unaddressed, with the consequence that many functionally non-complex institutions bear the full compliance burden of significant banks. A more targeted regime, anchored in the ECB High-Level Task Force on Simplification recommendations and informed by the Brazilian proportionality model, which has applied a comparable architecture for over a decade and confirmed its operational viability at scale, would align requirements with actual risk, reduce unnecessary compliance costs, and preserve a diverse banking ecosystem that supports SMEs, households, and local investment. For this regime to deliver meaningful proportionality, it must be applied coherently across the three pillars of the framework. A simplified Pillar 1 package should be accompanied by proportionality across the wider prudential and resolution framework, while fully preserving the role of capital buffers in safeguarding financial stability. The objective is not to weaken systemic or macroprudential protections, but to avoid applying requirements designed for large, complex or systemically important institutions to eligible small and non-complex banks.

[23] European Central Bank, Simplification of the European prudential regulatory, supervisory and reporting framework, 2025
[24] Deutsche Bundesbank, 'Europe's small banks need simplified rules', 2025
[25] Basel Committee on Banking Supervision, Global systemically important banks: revised assessment methodology and the higher loss absorbency requirement, 2018

The benefits of simplification would be undermined if these institutions continued to face full Pillar 2 Supervisory Review and Evaluation Process requirements calibrated around complex banks, institution-specific systemic buffers where they are not systemically relevant, broader macroprudential tools such as the countercyclical capital buffer or systemic risk buffer where their application is insufficiently tailored, and minimum requirement for own funds and eligible liabilities expectations that are disproportionate to their likely resolution strategy.

Proportionality must not, however, become a mechanism for exempting smaller institutions from climate and ESG risk management obligations. Community-oriented banks face climate risk through their lending portfolios to households, SMEs, and social economy organisations operating in territories directly exposed to physical and transition risks; the obligation to identify, manage, and monitor those risks applies to them as to any institution. What proportionality permits is that the methods and reporting formats used to fulfil that obligation reflect the institution's actual capacity and exposure.

[2] Implement a "Report Once" Principle

Recommendation: Operationalise the 'report once' approach already foreseen in CRR3 Article 430 by deriving Pillar 3 disclosures from supervisory reporting, eliminating duplicative data requests across authorities, introducing materiality thresholds to exempt immaterial errors from mandatory resubmissions, and completing the transition to data-element-based reporting.

Rationale: There is an opportunity to make the reporting framework more coherent, efficient and proportionate, particularly for smaller institutions. Better alignment between reporting streams, fewer immaterial resubmissions, and a stronger "report once" approach would reduce unnecessary costs while improving the quality and usefulness of supervisory data. Survey data from FEBEA members indicates that resubmission processes for corrections with no supervisory significance can consume more than four person-days per occurrence. CRR3 Article 430(7) delegates to the European Banking Authority the implementing technical standards on uniform reporting formats, frequency, and IT solutions - the natural vehicle for deriving Pillar 3 disclosures directly from supervisory reporting, in conjunction with Articles 434, 434a and 434c on the Pillar 3 framework. Article 430(11) of the same Regulation already empowers competent authorities to waive duplicative data requests and requires them, together with resolution and designated authorities, to use data-exchange mechanisms wherever possible. What is missing is their operationalisation through binding technical standards and inter-authority data governance agreements.

As a medium-term evolution, the Commission should explore replacing backward-looking periodic Pillar 3 reporting with confidential real-time data-sharing with the competent authority, using payment-system data, credit-risk data, and liquidity.

positions that supervisors already hold, shifting supervision from periodic compliance verification toward genuine forward-looking risk monitoring. Implementation would require adequate data infrastructure at both bank and supervisory level, and appropriate confidentiality safeguards.

[3] Simplify Liquidity Requirements for Deposit-Funded Banks

Recommendation: Introduce a simplified liquidity framework for eligible, deposit-funded banks, replacing the Net Stable Funding Ratio (NSFR) with a more proportionate toolkit. Within this framework, liquidity requirements could be calibrated to the proven risk profile of the institution and the underlying lending activity, including through a variable liquidity ratio for verified social and environmental lending.

Rationale: The current liquidity framework was designed to address risks exposed during the financial crisis, particularly banks' overreliance on short-term wholesale funding. While appropriate for complex, market-funded institutions, it can create unnecessary complexity for smaller, deposit-funded ethical and sustainable banks whose liquidity risk profile is materially different[26]. Evidence from FEBEA's 8th Report on Ethical Finance in Europe shows that ethical and sustainable banks maintained an average loan-to-deposit ratio of 82.4% over 2014–2023, consistently within a prudentially sound range and without reliance on wholesale markets. By contrast, significant banks averaged 112.6%, reflecting a structurally different and more wholesale-dependent funding model.

A simplified liquidity framework could therefore preserve prudential discipline while reducing operational burden. Rather than applying the full NSFR framework designed for more complex institutions, eligible banks could be subject to a simpler toolkit combining, for example, a loan-to-deposit cap, a minimum liquid-assets floor, and supervisory monitoring of deposit stability. Within that toolkit, a variable liquidity ratio could provide further risk sensitivity. Where banks finance projects with verified social or environmental integrity, stable repayment profiles and robust safeguards, liquidity requirements could be calibrated more proportionately. This would free up lending capacity for households, SMEs and transition-related investments without weakening financial stability. Where the funding profile, asset quality and repayment characteristics justify it, liquidity treatment should reflect the actual risk.

[4] Introduce an Opt-In Leverage Ratio Regime for Eligible Banks

Recommendation: Establish a clearly defined, opt-in Pillar 1 regime based on the leverage ratio for strictly eligible small and non-complex banks with a predominantly real-economy-focused business model - see recommendation 3 for more details.

[26] European Banking Authority, Enhancing proportionality in liquidity reporting, n.d.

Rationale: The low risk profile of ethical and sustainable banks is evidenced not by their risk-weighted asset (RWA) calculations, but by the stability of their long-run performance: specifically, low non-performing loan ratios, conservative funding structures, and minimal volatility across economic cycles. The apparent paradox of high RWA density coexisting with low actual credit deterioration stems from regulatory constraints. These institutions typically cannot access Internal Ratings-Based (IRB) models, as the authorisation requirements under CRR3 Article 143 presuppose the scale and resources of significant institutions. Consequently, their risk weights are mechanically inflated relative to their true risk profile[27,28]. This creates a structural disadvantage for smaller, mission-driven institutions without strengthening financial stability[29].

An opt-in leverage-based regime would better reflect actual risk, restore proportionality, and remove disincentives to finance the real economy. In practice, this would support the flow of capital to long-term activities, including sustainable and social investments, while maintaining robust capital safeguards.

[5] Preserve and Strengthen Forward-Looking Supervision

Recommendation: Maintain and further develop the existing framework for risks on which historical data is unavailable and/or not reflective of the future ahead - focusing on climate and environmental risks., This includes transition planning and forward-looking supervision, ensuring that simplification efforts do not weaken its scope or ambition - no matter the size/complexity of the financial institution.

Rationale: Climate and environmental risks are financial risks with direct implications for asset quality, collateral values and financial stability[30]. The current framework is crucial for prudential supervision by linking strategy, risk management and portfolio alignment. Any dilution would create material blind spots in risk assessment and undermine the resilience of the financial system. At the same time, the framework would benefit from further strengthening, including more consistent approaches on transition planning and clearer integration of ESG into risk management processes. The CRD6 transition-plan requirement should be strengthened from a procedural obligation into a credible prudential risk-management tool. Banks should be required to assess portfolio and counterparty-level deviation from credible transition pathways and apply clear escalation measures where counterparties fail to transition. Supervisors should be empowered to challenge weak plans through Supervisory Review and Evaluation Process (SREP) and require corrective measures where transition risks are material and unmanaged. Strengthening these elements would improve risk sensitivity, support financial stability, and ensure that institutions are adequately prepared for the transition. Over time, this forward-looking approach could also be extended to other systemic risks, including nature-related risks.

27 Basel Committee on Banking Supervision, Analysis of risk-weighted assets for credit risk in the banking book, 2013
28 Banque de France, 'Lower bank capital requirements as a policy tool to support credit to SMEs: evidence from a policy experiment', 2019
29 European Banking Authority, Discussion paper on proportionality assessment methodology, 2021
30 European Central Bank, Guide on climate-related and environmental risks: Supervisory expectations relating to risk management and disclosure, 2020

Funded by the European Union. Views and opinions expressed are however those of the author(s) only and do not necessarily reflect those of the European Union or the European Commission. Neither the European Union nor the granting authority can be held responsible for them

Rue des Alexiens 16/B - 1000 – Bruxelles, Beligum

www.febea.org

Co-funded by the European Union