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One Market, One Vision: How Interstate Consolidation Can Transform Europe's Banking Landscape

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ABSTRACT

As the European Union advances financial integration, eliminating regulatory and institutional barriers to interstate banking consolidation must become a priority. This is particularly relevant for large, systemically important financial institutions within the euro area, whose performance has ripple effects worldwide. Interstate consolidation offers numerous advantages: greater financial stability through diversification, improved market efficiency, and enhanced global competitiveness of European financial markets. It also supports internal EU goals, such as completing the Banking Union and advancing the Capital Markets Union, as emphasized by reports by Mario Draghi and Enrico Letta.

However, regulatory fragmentation, political resistance, and prudential barriers remain significant obstacles. Achieving greater interstate consolidation requires a multi-faceted legislative strategy. Key actions include facilitating the formation and growth of cross-border financial groups by simplifying transaction mechanisms, ensuring an unfettered market for corporate control, and addressing prudential barriers; enhancing group-wide capital and liquidity management through revisions to the Capital Requirements Regulation to allow capital and liquidity waivers for EU subsidiaries; and establishing legal certainty in resolution frameworks by specifying enforceable conditions for intra-group asset transfers and loss-sharing arrangements during resolution.

Without these reforms, EU financial fragmentation will persist, weakening Europe's international competitiveness and leaving its markets vulnerable in an increasingly competitive global environment.

KEYWORDS: interstate consolidation, cross-border banking, financial integration, prudential regulation, banking resolution

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I. THE CASE FOR INTERSTATE CONSOLIDATION

The European Union faces a pivotal moment, marked by several converging challenges and opportunities that underscore the need for decisive action. Externally, the EU is experiencing increasing competition from global financial powerhouses like the US and China, which have achieved higher levels of integration and scale in their financial markets. Internally, the bloc must contend with the dual pressures of the need to ensure financial stability while driving the green and digital transitions. Simultaneously, unresolved structural issues, such as regulatory fragmentation and delays in completing the Banking Union,[1] hinder progress. Together, these factors place the EU at a critical juncture where advancing financial integration is not only an economic necessity but also a strategic imperative for global competitiveness.

Interstate consolidation—the process of merging financial institutions across national borders to form larger, more integrated cross-border banking groups—offers significant advantages for both financial stability and economic resilience. This process operates through several causal mechanisms, primarily by promoting geographical and business model diversification. Diversification reduces risk concentration and facilitates the spreading of financial shocks across regions and industries, rather than confining them to a single jurisdiction. In turn, this dispersion enhances the resilience of financial institutions to asymmetric shocks and weakens the harmful sovereign-bank nexus.[2] This diversification ensures that banks are less exposed to local economic fluctuations, making them more stable and reliable contributors to financial stability.[3]

From a market standpoint, a more consolidated banking system delivers benefits that extend well beyond regional boundaries, including greater resilience to financial crises, which often have global spillovers. Consolidation fosters healthy competition, improves service quality, and breaks down segmentation along national borders. Larger banking groups achieve economies of scale, enabling more efficient cost structures and lower barriers to innovation. This supports investment in cutting-edge digital infrastructure and advanced analytics, which are crucial for staying competitive in the digital age. For international investors and institutions, a robust and unified banking market translates into a more attractive, reliable, and predictable partner in global finance.

Furthermore, consolidation's benefits extend beyond traditional banking into adjacent sectors, such as asset management, insurance, and private equity. These sectors remain fragmented and lack the scale to compete effectively on a global stage. Unified cross-border banking groups can act as a catalyst for these industries, driving a ripple effect that strengthens broader financial markets. By building interconnected financial ecosystems, regions can offer more competitive options to global investors, providing diversification opportunities alongside strong regulatory frameworks.

However, these potential benefits come with tradeoffs that warrant careful consideration. The concentration of financial power in a smaller number of large institutions could introduce systemic risks, as the failure of a major cross-border bank would have widespread repercussions. Additionally, cross-border consolidation may reduce local market competition in certain regions, potentially disadvantaging smaller firms or consumers who rely on localized financial

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1 Karel Lannoo, Apostolos Thomadakis and Judith Arnal, *Staying ahead of the curve: Shaping EU financial sector policy under von der Leyen II* (September 2024) Task Force Report, Centre for European Policy Studies, European Capital Markets Institute and European Credit Research Institute, Brussels <https://www.ceps.eu/ceps-publications/staying-ahead-of-the-curve/> accessed 17 January 2025.

2 European Central Bank, 'Financial integration in Europe' (May 2017) <https://www.ecb.europa.eu/pub/pdf/fie/ecb.financialintegrationineurope201705.en.pdf> accessed 6 January 2025.

3 Bank for International Settlements, 'Structural change in banking after the crisis' (January 2018) <https://www.bis.org/publ/cgfs60.pdf> accessed 6 January 2025.

services. The process of consolidation must also navigate differing national regulatory frameworks and cultural attitudes toward banking, which could pose challenges to seamless integration. Balancing these tradeoffs requires a robust regulatory framework that ensures financial stability without stifling innovation or market competition.

II. ADDRESSING REGULATORY BARRIERS

Despite its advantages, interstate consolidation in Europe faces significant challenges stemming from outdated regulatory frameworks and nationalistic resistance. For years, political reluctance and fears of financial contagion have stalled progress. However, many of the associated risks have been substantially mitigated through advancements in resolution preparedness. Notably, the achievement of fully loaded Minimum Requirement for own funds and Eligible Liabilities (MREL) and Total Loss-Absorbing Capacity (TLAC) targets by 2024 Q1 marks a critical step toward ensuring that financial institutions are better equipped to handle crises without resorting to taxpayer bailouts.[4]

The European Central Bank (ECB) and the European Banking Authority (EBA) have played key roles in laying the groundwork for overcoming these regulatory and political barriers. For example, the ECB's 2021 guide on consolidation clarified supervisory expectations, underscoring the economic and prudential benefits of cross-border mergers.[5] Similarly, the European Commission's 2023 report on the Single Supervisory Mechanism (SSM)[6] highlighted persistent market segmentation and limited cross-border activity as ongoing challenges that demand urgent attention to achieve a truly integrated financial market.[7]

Interstate consolidation is also a pivotal element in advancing the Capital Markets Union (CMU). As noted by the 2020 High Level Forum report,[8] a fundamental weakness of European financial markets lies in the structural obstacles that discourage financial operators from scaling up their activities, particularly across borders. Enrico Letta, in his report,[9] calls for a new wave of regulatory reform to simplify cross-border transactions and streamline prudential requirements, while Mario Draghi, in his report on a competitiveness strategy for Europe,[10] warns that inaction risks deepening Europe's financial inefficiencies.

These long-standing barriers have undermined the competitiveness of EU markets on a global scale, deterred foreign investment, and prevented European financial firms from competing on

4 Single Resolution Board, 'SRB MREL Dashboard—Q1.2024' (July 2024) <https://www.srb.europa.eu/system/files/media/document/2024-07-30_MREL-Dashboard-Q1-2024_0.pdf> accessed 7 January 2025.

5 European Central Bank, 'Guide on the supervisory approach to consolidation in the banking sector' (January 2021) <https://www.bankingsupervision.europa.eu/ecb/pub/pdf/ssm.guideconsolidation2101~fb6f871dc2.en.pdf> accessed 6 January 2025.

6 European Commission, 'Report on the Single Supervisory Mechanism established pursuant to Regulation (EU) No 1024/2013' (April 2023) <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52023DC0212> accessed 6 January 2025.

7 Although the SSM marked a major advance in the EU integration process, shifting from a highly fragmented system of national banking supervision to a unified European approach and developing more harmonized, transparent, and comparable supervisory practices, it faces legal, supervisory, judicial, and political dilemmas that need to be addressed. See Marco Lamandini and Apostolos Thomadakis, 'A decade of the Single Supervisory Mechanism—Lessons learned and future direction' (2024) 39 Journal of International Banking Law and Regulation 341. <https://drive.google.com/file/d/12u5-dRlF7DtUoOyFNvPX8seyMerZ6cWG/view>

8 European Commission, 'A new Vision for Europe's capital markets—Final Report of the High Level Forum on the Capital Markets Union' (June 2020) <https://finance.ec.europa.eu/document/download/e3689370-b1ba-49fd-8829-646592d9464f_en?filename=200610-cmu-high-level-forum-final-report_en.pdf> accessed 6 January 2025.

9 Enrico Letta, 'Much more than a market—Speed, Security, Solidarity: Empowering the Single Market to deliver a sustainable future and prosperity for all EU Citizens' (April 2024) <https://www.consilium.europa.eu/media/ny3j24sm/much-more-than-a-market-report-by-enrico-letta.pdf> accessed 6 January 2025.

10 Mario Draghi, 'The future of European competitiveness—A competitiveness strategy for Europe' (September 2024) <https://commission.europa.eu/document/download/97e481fd-2dc3-412d-be4c-f152a8232961_en?filename=The%20future%20of%20European%20competitiveness%20_%20A%20competitiveness%20strategy%20for%20Europe.pdf> accessed 6 January 2025.

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equal terms with their international peers. Addressing these challenges is essential not only for fostering consolidation but also for enhancing the attractiveness and efficiency of EU financial markets. Both the Letta and Draghi reports make a compelling case for prioritizing interstate consolidation to ensure a level playing field and drive Europe's financial competitiveness.

However, political disputes continue to impede progress. The prolonged debates surrounding the third pillar of the Banking Union—a European Deposit Insurance Scheme (EDIS)—exemplify this gridlock. Concerns over debt mutualization, the establishment of a European Stability Mechanism (ESM) credit line, and persistent ring-fencing practices remain sticking points. While EDIS is undoubtedly a cornerstone of the Banking Union, its delays should not become a pretext for stalling other critical reforms. Facilitating interstate consolidation is one such reform that can proceed independently and yield immediate benefits for the resilience and integration of the EU financial system.

III. LESSONS FROM THE US

Europe's cautious stance on interstate banking bears striking similarities to the historical resistance to interstate bank branching in the US. In the US, it took transformative legislation to overcome these barriers.[11] This shift allowed for greater geographic diversification, strengthened the financial system, and ultimately reshaped the US financial landscape. Europe, however, risks remaining trapped in a regulatory and political inertia akin to the mid-20th century American experience.

The hesitation in Europe mirrors the US's earlier fears of interstate banking. Much like American concerns that branching across state lines would enable large banks from major states to dominate smaller regional banks and concentrate excessive financial power, European policymakers fear that interstate consolidation could disproportionately benefit large institutions in major Member States. These anxieties have perpetuated a fragmented financial system where national borders continue to limit the scale, efficiency, and competitiveness of financial services.

To move forward, European policymakers must confront these outdated apprehensions, particularly the fear of cross-border contagion and unequal risk-sharing. Lessons from past crises, such as the 2010 Greek sovereign debt crisis, highlight the necessity of coordinated risk management and strong resolution frameworks. Advances in these areas, including the establishment of robust mechanisms for loss absorption like MREL and TLAC, should inspire greater confidence in pursuing integration.

Beyond mitigating risks, policymakers must also acknowledge the costs of inaction. The current patchwork of national regulatory frameworks creates inefficiencies, hampers cross-border activity and prevents the emergence of globally competitive financial institutions. Without significant reform, Europe risks falling even further behind global competitors, particularly the US and China, in terms of financial innovation, resilience, and scale.

The US example underscores that embracing interstate banking is not just about fostering integration—it is about building a stronger, more unified financial system capable of driving growth and weathering economic shocks. For Europe, the path forward requires bold political will, a departure from entrenched nationalistic concerns, and a recognition that a truly integrated financial market is key to unlocking the EU's economic potential on the global stage.

IV. A PRAGMATIC LEGISLATIVE PATH FORWARD

To enable interstate consolidation, the EU must adopt a pragmatic, bespoke legislative framework tailored to the needs of cross-border banking groups and financial conglomerates.

[11] Starting with the Bank Holding Company Act of 1956 and culminating in the Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994.

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Amendments to the Capital Requirements Regulation (CRR)[12] and the Single Resolution Mechanism Regulation (SRMR)[13] could establish a comprehensive approach addressing the entire lifecycle of financial groups: birth and growth, adult life, and resolution. This framework must strike a balance between simplicity and precision by leveraging existing legal structures while introducing selective improvements.

1. Birth and growth: facilitating cross-border financial groups

a. Simplified transaction mechanisms

Current company law provisions, particularly those governing mergers and takeovers, are often excessively complex and costly. To address this, European policymakers could consider implementing a mechanism similar to the share exchange models commonly used in the US. This approach would provide a fast-track option for cross-border financial consolidation. Unlike traditional mergers, share exchanges preserve the legal identity of the entities involved, thus simplifying compliance and prudential supervision—especially regarding the continued use of internal rating models post-consolidation.

This concept was explored during the drafting of the 2019 Cross-Border Mergers Directive[14] but was excluded to avoid political contention. Reviving this mechanism specifically for financial institutions could offer a pragmatic solution while respecting national sensitivities, such as employee participation rights, which are central to governance frameworks in Member States like Germany (eg Mitbestimmung).

b. A functional market for corporate control

Cross-border integration also requires a fully functional market for corporate control. Making the breakthrough rule under article 11 of the 2004 Takeover Directive[15] mandatory for financial institutions could prevent entrenched minority protections from obstructing mergers. A review of this directive is long overdue and could address these barriers. Similar rules in other advanced economies, such as the US and Japan, have facilitated smoother corporate consolidation in financial markets.

Additionally, dual-share structures,[16] while valuable in other sectors, may impede cross-border consolidation in finance by enabling minority coalitions to block hostile takeovers. Public law restrictions on cross-border consolidation must also be addressed. Granting the European Commission exclusive oversight of such transactions (ie foreign direct investments into the EU) by inserting a provision in Regulation (EU) 2019/452,[17] akin to its role under article 21 of the EC Merger Regulation,[18] could harmonize regulatory powers, reduce fragmentation, and ensure a consistent EU-wide approach.

12 Council Regulation (EU) 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012 [2013] OJ L176/1.

13 Council Regulation (EU) 806/2014 of 15 July 2014 on establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 [2014] OJ L225/1.

14 Council Directive (EU) 2019/2121 of 27 November 2019 amending Directive (EU) 2017/1132 as regards cross-border conversions, mergers and divisions [2019] OJ L321/1.

15 The rule states that when a bidder acquires 75 per cent or more of a company's voting shares, any restrictions on transferring shares or voting rights, as well as special shareholder rights related to appointing or removing board members, no longer apply. Council Directive 2004/25/EC of 21 April 2004 on takeover bids [2004] OJ L142/12.

16 As those currently envisaged by the directive proposal on multiple vote-share structure for the growth market. European Commission, 'Proposal for a Directive on multiple-vote share structures in companies that seek the admission to trading of their shares on an SME growth market' (December 2022) <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52022PC0761> accessed 7 January 2025.

17 Council Regulation (EU) 2019/452 of 19 March 2019 establishing a framework for the screening of foreign direct investments into the Union [2019] OJ L79/1.

18 Under article 21 the Commission shall have sole jurisdiction to examine concentrations with a Union dimension and Member States shall not apply their national competition laws to such concentrations. Council Regulation (EC) 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation) [2004] OJ L24/1.

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c. Streamlining prudential barriers

Although the ECB's 2020 Guide clarified that interstate consolidation does not inherently necessitate capital add-ons, prudential barriers persist. For instance, fragmented exemptions for intra-group exposures under articles 36 and 49 of the CRR impose inconsistent large exposures limits across Member States.[19] Establishing a uniform EU-wide regime would ensure streamlined capital deployment within cross-border banking groups.

2. Adult life: enhancing group-wide capital and liquidity management

Cross-border banking groups face persistent challenges in managing capital and liquidity efficiently across Member States. Revisiting the European Commission's 2016 proposals to revise Articles 7 and 8 of CRR to introduce capital and liquidity waivers for EU subsidiaries could provide a solution. A modernized framework, free from burdensome conditions such as collateralized guarantees, would better reflect current market realities and alleviate supervisory concerns.

a. Legal certainty for intra-group transfers

Legal uncertainties surrounding intra-group capital and liquidity transfers hinder effective group-wide management. Directors often hesitate to approve such transfers due to liability risks under entity-centric national laws, while supervisory authorities face challenges enforcing parent guarantees or intra-group support mechanisms.

To resolve this, the EU could expand the scope of existing provisions under articles 19–26 of the Bank Recovery and Resolution Directive (BRRD).[20] These provisions, which currently govern intra-group support agreements during early intervention, could be broadened to cover normal operations. Doing so would clarify procedural and substantive aspects, including safeguards for minority interests and creditors. Simplifying and increasing the flexibility of these mechanisms is essential, as their current complexity has deterred usage by banking groups.[21]

Incorporating these provisions directly into the CRR and SRMR would enhance legal certainty and foster trust between home and host authorities. This approach aligns with the Court of Justice of the European Union's recognition of the value-enhancing potential of cross-border structures[22] and international standards, such as Principle 5 on the governance of group structures of the Basel Committee's Corporate Governance Principles for banks.[23]

3. Death: establishing legal certainty in resolution

Resolution is the most critical stage in a financial group's lifecycle. Effective frameworks must ensure the seamless upstreaming of losses and downstreaming of funds within cross-border groups. However, significant legal ambiguities persist, exacerbating tensions between Member

[19] While some Member States grant a fully fledged exemption for intra-group exposures for banking groups and conglomerates subject to supplementary supervision, other do not exempt intra-group exposures within conglomerates. There are also some that do not even address the issue.

[20] Council Directive (EU) 2014/59 of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms [2014] OJ L173/190.

[21] European Banking Authority, 'Report on interlinkages between recovery and resolution planning' (May 2020) <https://www.eba.europa.eu/sites/default/files/document_library/Publications/Reports/2020/883941/Report%20on%20Interlinkages%20between%20rec%20and%20res%20planning.pdf> accessed 6 January 2025.

[22] Case C-528/12 *Mömax* EU:C:2014:51; Case C-292/16 *A Oy* EU:C:2017:888; Case C-386/14 *Groupe Steria* EU:C:2015:524; Case C-524/04 *Test Claimants in the Thin Cap Group Litigation* EU:C:2007:161; Case C-311/08 *Société de Gestion Industrielle* EU:C:2010:26; Case C-382/16 *Hornbach Baumarkt* EU:C:2018:366. For an insightful discussion, see Schön, 'Organisationsfreiheit und Gruppeninteresse in Europäischen Konzernrecht' (2019) 48 Zeitschrift für Unternehmens- und Gesellschaftrecht 343.

[23] Bank for International Settlements, 'Guidelines—Corporate governance principles for banks' (July 2015) <https://www.bis.org/bcbs/publ/d328.pdf> accessed 6 January 2025.

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States and undermining trust in the resolution process.[24] Directly applicable EU provisions could resolve these uncertainties by specifying the conditions under which intra-group asset transfers and loss-sharing arrangements occur during resolution.[25]

V. CONCLUSION

Interstate financial consolidation is more than a technical adjustment—it is a cornerstone of financial stability and economic resilience. By removing barriers to consolidation, policymakers can strengthen the competitiveness of financial institutions, deepen capital markets, and enhance the EU's standing in a competitive global financial landscape.

Concerns over national sovereignty and systemic risks must be addressed through smart regulation, supervisory cooperation and a clear political commitment. Delays risk undermining the Banking Union, the CMU, and Europe's economic sovereignty. Fragmentation weakens financial institutions, limits access to financing and reduces the EU's ability to respond effectively to economic shocks.

Ultimately, consolidation is not an end in itself but a critical tool for fostering resilience, competitiveness and sustainable growth. Policymakers must act decisively to solidify Europe's leadership in global finance or risk ceding ground to more dynamic and integrated markets elsewhere.

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[24] In fact, capital and liquidity waivers granted by supervisors are sometimes not mirrored by internal MREL waivers granted by resolution authorities.

[25] For example, the framework could build on the safeguards embedded in article 45(f)(3) of the BRRD and articles 12g and 12h of the SRMR, which lay down the conditions under which the transfer of own funds or repayments of liabilities within a group can take place.

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