Current Trends in Prudential Banking Regulation

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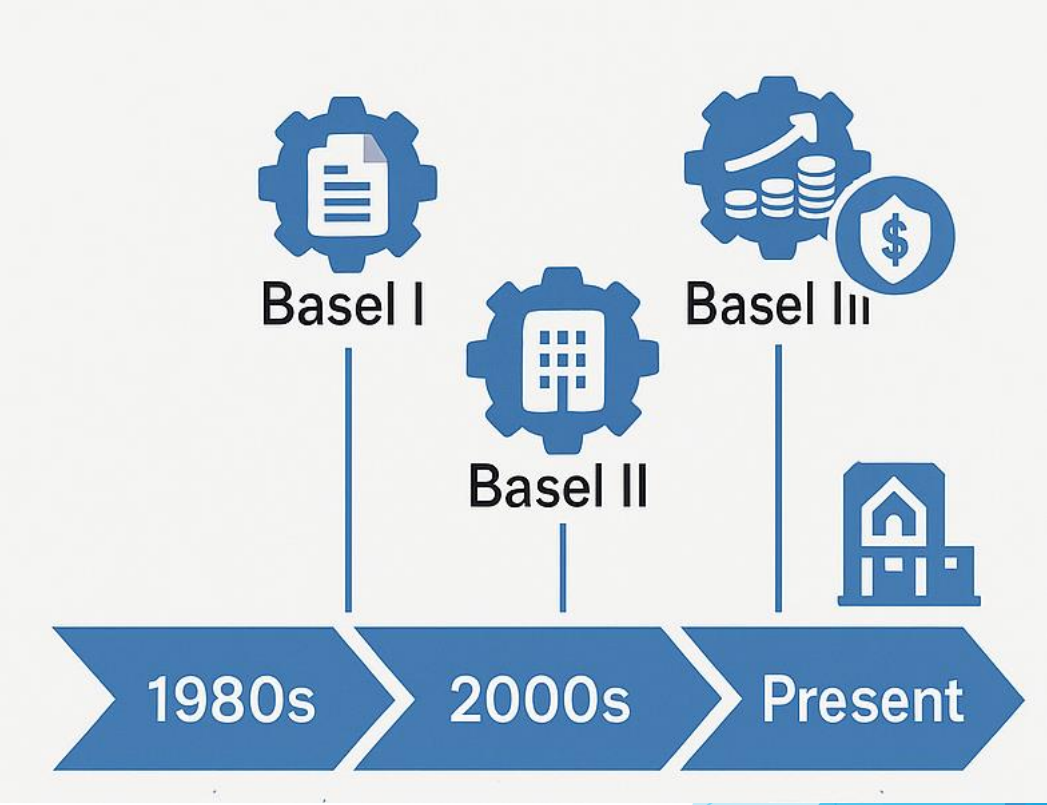
Introduction

- Motivation: concerns about overregulation and complexity among regulators and regulated entities
- Focus on prudential regulation, excluding conduct rules and consumer protection
- The current prudential banking regulation has largely evolved since the 1980s
- Possible future directions
- Purpose: take stock and stimulate discussion on future development

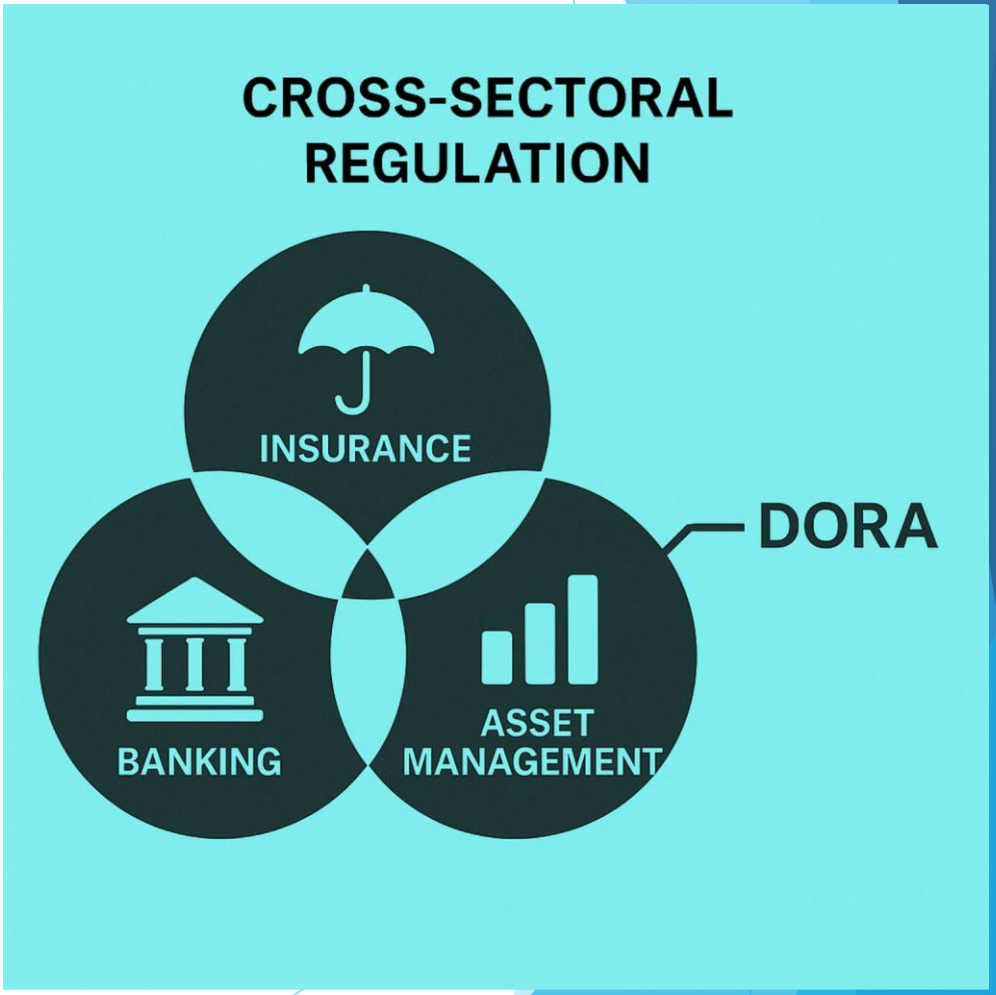


Trend 1: Increasing Scope and Complexity of Regulation

- The Basel Committee on Banking Supervision is the so-called standard setter
- Basel concept became a global standard since 80s/90s
- Basel III – new wave after GFC
- In the EU transposed into several levels of EU regulation
- Continuous growth in volume and depth, frequent changes
- Higher compliance costs and reduced flexibility for banks
- Impact on market competition and systemic risk – regulation itself may be a source of risk

Trend 2: Expansion of Horizontal Cross-Sectoral Regulation

- Shift from sector-specific to cross-sectoral rules
- Financial conglomerates operating in multiple sectors
- Example: Digital Operational Resilience Act (DORA)
- Benefits: better systemic risk management,
- Challenges in coordination, increased compliance burden, lack the sector-specific granularity needed to address unique risks



Trend 3: Harmonization of Regulation

- Move towards EU-wide binding regulations replacing directives
- Reduced regulatory fragmentation promotes stability and integration
- Advantage for large cross-border groups
- Potential downside: less tailoring to local/domestic contexts

Trend 4: Emphasis on the Proportionality Principle

- Regulation adapted to size, complexity, and systemic importance
- Helps reduce burden on smaller institutions
- Partial remedy/counterbalance of the consequences of the harmonisation trend
- Practical challenges in clear classification and avoiding disputes
- More complexity

Trend 5: Simplification Efforts

- Recent (2025) EU moves to cut red tape and simplify compliance
- taking into account global tendencies and the necessity to boost EU competitiveness
- Omnibus packages addressing sustainability reporting
- Concerns about partial and cautious approaches limiting effectiveness

Trend 6: Inclusion of Non-Prudential Elements

- Introduction of factors supporting policy goals (e.g. SME Supporting Factor)
- Mixing prudential with economic or social objectives which should be better treated by other instruments
- Risks of overloading prudential regulation and complexity

Trend 7 & 8: Regulatory Documents and Stakeholders

- Proliferation of detailed regulatory technical standards and guidelines
- Growing number and diversity of stakeholders (banks, regulators, consultants, lobbyists)
- Conflicting interests contributing to regulatory complexity

Future Directions: Key Priorities

- Clarify core objectives of prudential regulation from political level
- Avoid regulatory overload with non-prudential goals
- In-depth review
- Simplify and streamline regulatory texts and frameworks –e.g. find and remove overlaps or near overlaps
- Improve legal clarity and certainty
- Consider two-tier regulation based on size and complexity of regulated entities
- Use technology (SupTech, AI) for better supervision

Conclusion

- Future regulation should focus on quality, coherence, and proportionality, not just quantity and new layers of regulation.
- Regulatory direction depends on banking models evolution: more risk-taking demands stronger systemic focus; traditional banking allows simpler rules.
- Clear political support, expert supervision, and dialogue are key for effective regulation.
- Root causes of market failures—like misaligned incentives and short-termism and social position investing —need addressing beyond just adding rules.
- Overcomplex rules may reduce clarity and create even more risks and opportunities for social position investing.