

RIGA

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The European Commission
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The Finance Latvia Association (hereinafter – the Association) is an organisation representing the Latvian financial sector at both national and international level, bringing together not only credit institutions registered in Latvia and branches of foreign credit institutions, but also financial technology start-ups.

The Association has contributed to the targeted consultation on the competitiveness of the EU banking sector. This consultation will feed into the European Commission's 2026 report on the competitiveness of the EU banking sector, which forms part of the Savings and Investment Union (SIU) strategy. The opinions and arguments below were submitted to the Commission in accordance with the consultation questionnaire.

Respectfully

Uldis Cērps
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**Response in accordance with the consultation document: TARGETED
CONSULTATION ON THE COMPETITIVENESS OF THE EU BANKING SECTOR**

Question 2.1.: Is current credit demand adequately met by banks and how is the demand and the capacity to meet it likely to evolve in the medium and long-term?

Answer: Yes

Question 2.2.: Are you observing barriers affecting bank financing in support of the economy, including in areas identified as political priorities by the EU or Member States?

Answer: Yes

Please elaborate by providing evidence and identifying economic sectors where access to credit could be improved.

Answer: The competitiveness and resilience of the financial system depend not only on the banking sector as a source of financing, but also on well-functioning capital markets, including the role of pension funds as long-term institutional investors. Pension systems play a critical role in supporting domestic capital-market depth, providing stable long-term funding and facilitating diversification of financing sources beyond bank credit.

At the same time, policy decisions taken at national level do not always support these objectives. In two of the three Baltic states, measures allowing the broad dismantling of second pillar pension schemes have weakened long-term savings and reduced the availability of domestic long-term capital. In Latvia, growing political uncertainty surrounding the future of the second pension pillar raises similar concerns. Such developments risk undermining capital market development, increasing overreliance on bank financing and weakening the overall competitiveness and resilience of the financial system.

In the defence sector, an additional structural constraint is the limited availability of long-term contracts on the borrower side. Where producers and suppliers do not have predictable, multi-year procurement commitments or firm offtake agreements, lenders face heightened uncertainty about future cash flows and order pipelines.

In addition, banks' lending capacity is further constrained by a relatively inflexible approach to credit risk modelling. Crisis periods embedded in long historical time series - often spanning up to 15 years - continue to drive higher risk weights for the banks that are permitted to use internal models. At the same time, the framework provides limited scope to reflect that certain shocks were exceptional in nature and that banks' risk profiles, governance and control environments have materially improved since 2008, alongside significant structural changes such as the euro adoption and the establishment

of credit registers. As a result, risk sensitivity may be reduced and lending capacity constrained, despite strong capital positions and effective risk mitigation measures.

Supervisory practice should therefore allow well-justified, case-by-case flexibility where robust data and prudent risk management support such adjustments. A more enabling supervisory approach would support innovation and product development, while preserving sound risk-management standards.

Question 7: To what extent would the EU economy benefit from the following changes in the banking landscape?

Answer:

	To a very large extent	To a large extent	Neutral	To a small extent	Not at all	Don't know - No opinion - Not applicable
Cross-border bank consolidation	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Domestic bank consolidation	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>
Banking services offered across the single market	<input type="radio"/>	<input type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Digitalised banking services	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Other	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

Please explain.

Answer: The EU banking and capital markets landscape remains highly fragmented compared with global peers. Keeping pace with accelerating technology cycles requires scale, sustained investment and cross-border integration. Purely domestic consolidation is unlikely to deliver meaningful competitiveness gains and may, in some cases, be outweighed by integration costs.

Competitive pressure increasingly comes from non-bank financial intermediaries operating across borders and, in some cases, under different regulatory constraints. In digitally advanced regions, including the Nordic and Baltic markets, digitalisation is already a baseline expectation rather than a differentiating factor. Competitiveness therefore depends on enabling scale, innovation and cross-border market integration, supported by a consistent and proportionate regulatory and supervisory framework.

Question 8: What are in your view the main risks faced by EU banks today?

Answer: EU banks face a growing risk of erosion of competitiveness vis-à-vis both global peers and other financial-service providers. A disproportionate accumulation of regulatory, supervisory and compliance obligations divert management attention and resources away from strategy, innovation and growth, at a time when banks must invest heavily in digital transformation, operational resilience and fraud prevention.

In several areas, regulatory requirements are not applied in a sufficiently proportionate or technology-neutral manner. GDPR-related compliance obligations and liability considerations can materially slow down product development and extend time-to-market, particularly where supervisory expectations go beyond what is necessary to achieve data protection objectives.

Banks are also increasingly relied upon as implementers of public-policy initiatives, with additional social or quasi-public responsibilities being assigned without adequate consideration of proportionality, cost and operational impact. In some Member States, including Latvia, this includes legal requirements to maintain and expand physical branch presence, despite clear evidence that demand remains predominantly digital. In Latvia, banks were mandated by the Bank of Latvia to open 21 new branches during 2025. Such measures may weaken business model sustainability and reduce the capacity to invest in innovation.

Question 15: How would you assess the competition between banks and other entities performing financial services (such as financial conglomerates, investment firms,

FinTechs, etc.) from the perspective of the overall functioning of capital markets (provision of liquidity, transparent market information and pricing, scaling up of trading venues etc.)?

Answer: FinTech firms compete with banks by offering fast, user-centric and digitally native services, notably in payments and other consumer-facing solutions. This increases competitive pressure and accelerates innovation, while also fostering partnerships in which banks contribute balance sheet capacity, resilience and scale, and FinTechs contribute speed and specialised technology. At the same time, competitive dynamics may be less favourable for banks in certain activities where non-bank firms can operate with lower cost bases and under different, often less rigorous, regulatory constraints. For example, in Latvia, consumer lending is not subject to prudential requirements if offered to consumers by non-banks.

Overall, competition is beneficial; however, regulatory arbitrage persists in certain areas and does not always serve consumers' best interests. PSD2 increased competition by enabling licensed third parties to initiate payments. In the Baltic region, these services were rapidly adopted in e-commerce and contributed to intense price competition among service providers serving merchants. In some cases, this pushed fees below sustainable levels, with certain regulated service providers relying on opportunistic funding models and consequently going bankrupt. The replacement of card payments with API-based account-to-account initiation has, in practice, weakened certain consumer protections, including dispute-resolution mechanisms and the clear allocation of liability, while merchant failure cases may leave consumers as unsecured creditors. Future market-wide standards should therefore be developed for all retail payment products involving the relevant stakeholders, envisage transparent compensation mechanisms, and embed clear responsibilities and accountability for fraud and merchant conduct across the payments ecosystem.

In Latvia, additional level-playing-field concerns arise from the competitive position of non-bank lenders, which are not subject to prudential capital requirements and therefore can compete with banks on preferential terms. This regulatory asymmetry allows certain non-bank credit providers to offer financing without internalising comparable risk and resilience costs, potentially distorting competition and undermining sustainable, risk-based lending models.

In parallel, the growing role of national development finance institutions raises similar level-playing-field concerns. Where development finance institutions on occasions compete directly with private-sector banks and other market-based providers, differentiated regulatory treatment may distort competition. In particular, development finance institutions are typically not subject to the same prudential capital requirements as commercial banks, allowing them to offer financing on terms that may not fully reflect underlying risks. While public development finance can play an important counter-cyclical

and policy-supporting role, its use should be carefully calibrated to avoid crowding out private capital or undermining sustainable market-based financing models. A clear delineation between complementary public support and direct market competition, combined with greater transparency and proportionality in the application of regulatory requirements, is essential to preserve fair competition and efficient capital allocation.

Question 18: What factors prevent EU banks from engaging in more cross-border activity within the EU or make cross-border activity more costly?

Answer:

	Fully agree	Somewhat agree	Neutral	Somewhat disagree	Fully disagree	Don't know - No opinion - Not applicable
Divergent implementation of EU banking rules across Member States	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Supervisory divergence/gold-plating by Member States/national supervisors	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Requirements for allocation of capital and liquidity at local level	<input type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Non-harmonised macroprudential buffers	<input type="radio"/>	<input type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
National discretion in intragroup large exposure limits	<input type="radio"/>	<input type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Incomplete banking union (lack of a European deposit insurance scheme, liquidity in resolution, etc.)	<input type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Non-prudential barriers (insolvency, investor protection, company law, taxation)	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Political barriers (government direct or indirect interference)	<input type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Complexity and length of mergers and acquisition supervisory authorisation procedures	<input type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Costs/risks of mergers and acquisitions	<input type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Absence of economies of scale from engaging in cross-border activities	<input type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Other	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

Please explain.

Answer: Cross-border expansion by EU banks remains constrained by supervisory ring-fencing and an incomplete Banking Union. Divergent insolvency and company-law

regimes, uneven national implementation, and an uneven supervisory landscape create incentives for regulatory arbitrage, raising the cost and complexity of integrated cross-border banking models. National gold-plating therefore remains a material barrier to competitiveness and undermines progress towards an integrated EU banking market.

In Latvia, several measures go beyond EU minimum requirements and disproportionately affect banks' operating models. These include a bank solidarity levy (8% of earned net interest income in 2025), a broad ban on advertising most retail consumer credit products, requirements to maintain and expand physical branch presence, and elements of price regulation (e.g., caps on certain bank fees). Planned caps on early repayment fees for loans to legal entities are under public debate and mirror the mechanism already introduced for refinancing residential mortgage loans for private individuals.

The current design of the bank solidarity levy raises concerns regarding both its structure and its potential economic impact. The levy resulted in extra taxation on the banking sector amounting to 73 million euros in 2025. Although the measure is presented as means to support public finances without harming growth, its design may discourage new lending. The model defines a fixed reference period from 2018 to 2022, characterized by a negative interest rate environment. It allows banks' annual net interest income to increase by only 50% above the five-year average of the reference period, with any further increase taxed at a 60% rate. Consequently, the model does not sufficiently reflect economic cycles or structural changes in the banking sector. As a result, banks that have actively expanded lending in 2023 and 2024 may be placed in a less favourable position than those that have not, which could weaken incentives to expand credit. This effect is reinforced by treating net interest income as a proxy for profit and by applying a 60% tax rate once the 50% growth threshold is exceeded, which may significantly weaken incentives to provide new, particularly long-term, loans. Moreover, the impact of the contribution is not proportionate across the sector, as smaller banks require less effort in meeting the relief criteria. The absence of a robust assessment of tax design options further increases regulatory uncertainty. In the view of the Finance Latvia Association, the current model does not achieve its stated objectives and should be revised to ensure proportionality, neutrality and genuine support for economic growth, and it should be abolished before its planned expiration date in Q1 2028.

Central banks and policymakers are increasingly introducing measures that effectively require the re-establishment of physical infrastructure, despite observed customer behaviour that clearly shows a preference for digital financial services. Mandating an extensive branch network is unlikely to be efficient and may be associated with weaker, less sustainable business models, even if politically appealing. Latvia's branch-presence requirements are not business-model neutral: they apply only to banks licensed in Latvia or operating through a Latvian branch and only above certain thresholds, concentrating operational burdens on a subset of large players. Meanwhile, neobanks operating cross-

border under freedom of services can reach comparable scale and relevance without equivalent obligations. This distorts competition, favours specific business models, and risks discouraging investment and innovation in highly digitalised markets.

Consideration should be given to reassessing the Consumer Rights Protection Law requirement for credit institutions to offer loans where borrower liability is limited to the value of the real estate collateral (a US-style “hand over the keys” approach). This is national gold-plating that goes beyond EU law and adds complexity to otherwise harmonised lending frameworks. By requiring parallel offers regardless of customer interest, it imposes a disproportionate burden and fragments standardised lending processes, without clear evidence of better consumer outcomes.

Taken together, these tax and market-conduct measures raise operating costs, constrain pricing and product design, and reduce banks’ ability to adapt to digital preferences. Importantly, national gold-plating is not applied in a technology- or business-model-neutral manner, amplifying its impact in smaller, highly digitalised markets. This further fragments the Single Market and weakens incentives for cross-border activity and investment.

Question 26: What factors are constraining the ability of EU banks to finance large-scale projects, including in the areas of digitalisation, climate transition and defence, compared to their international peers?

In particular, to what extent do differences in profitability, cost structures, balance-sheet capacity, risk-appetite, scale, or regulatory and market conditions explain any observed gaps?

Answer: EU banks are, in aggregate, well capitalised, and capital adequacy as such is not the primary constraint on financing large-scale investments. The more relevant constraints relate to how risk capacity can be deployed in practice, particularly in smaller markets. In such markets, large projects are often highly concentrated by sector, geography or counterparty, which increases exposure concentrations and interacts with regulatory requirements in a way that limits effective risk-taking, even where capital ratios are strong. This effect is reinforced by conservative, regulation-driven credit-risk modelling assumptions, limited diversification opportunities and supervisory practices that place greater weight on downside scenarios than on improved governance, collateral structures or risk-mitigation mechanisms.

In addition, extensive regulatory, supervisory and reporting obligations absorb managerial and operational resources, reducing banks’ ability to structure, monitor and actively manage complex long-term exposures. While banks are required to support the EU’s strategic priorities such as digitalisation, the climate transition and defence, the current

framework does not always sufficiently distinguish between balance sheet capacity and deployable risk capacity, with banks' actual risk-taking capacity being significantly smaller than what the difference between regulatory capital requirements and available capital may suggest.

Finally, fragmented capital markets and limited availability of long-term institutional capital - including domestic pension funds - increase reliance on bank financing for large projects, further concentrating risks on bank balance sheets. Addressing these constraints therefore requires more proportionate supervisory approaches, better risk sharing mechanisms and deeper capital markets to complement bank lending.

Question 28: In the context of the increasing digitalisation of financial services, what do you consider could enhance confidence of clients in digitally provided investment products and services, thereby influencing the dynamic of new business models?

Answer: Digitalisation supports efficiency, customer experience and competitiveness, and increasingly underpins risk management and regulatory compliance. However, digital transformation is progressing at different speeds across the EU, and national market practices and technical standards remain uneven.

Client confidence in digital channels depends on clear consumer protection and predictable liability rules, supported by interoperable and secure infrastructures that assign responsibilities and ensure an appropriate allocation of liability - including for losses arising from telecom-related failures - to actors best placed to manage and mitigate the underlying risks.

In the case of digitally provided investment products, confidence can be further enhanced through clear and comparable disclosures (including on costs, risks and conflicts of interest), robust suitability and appropriateness assessment processes, and effective complaint handling and redress mechanisms that function seamlessly in digital channels. Wider uptake of trusted digital identity and secure authentication solutions would also support safer onboarding and reduce the scope for mis-selling and impersonation risks.

Question 30: Do you expect in the near future the emergence of significant new players in the provision of financial services within the EU, such as non-financial conglomerates, FinTechs, or BigTech companies?

Answer: Yes

If yes, what would this mean for traditional banks? If yes, what would be the impact on households and businesses?

Answer: With more harmonised regulation across Member States and financial sub-sectors, structural incentives for large non-financial groups to enter fully regulated core banking services at scale would increase. Significant new players are likely to continue expanding in such segments as customer interfaces, distribution, payments-related services and embedded finance, where data and scale advantages are the strongest.

For traditional banks, this implies potential disintermediation and margin pressure, with banks increasingly providing regulated infrastructure while customer relationships shift towards platforms.

If yes, what would be the impact on households and businesses?

Answer: For households and businesses, this may improve convenience but can also increase concentration and switching costs. Competitive distortions may re-emerge where comparable services are subject to materially different obligations (e.g. on customer due diligence, operational resilience and conduct), enabling regulatory arbitrage and weakening the level playing field and consumer protection.

Question 31: How should the bank regulatory framework and supervisory practice adapt to the changes in the banking sector triggered by digitalisation?

Answer: Supervisory practice should evolve toward a more integrated view of digital transformation, reflecting the cumulative impact of GDPR, PSD2, DORA, the AI Act and MiCAR, as well as planned initiatives such as FIDA and the digital euro, on banks' operating models. As digitalisation becomes a core supervisory priority, supervisors should provide clearer and more consistent expectations to support responsible innovation, while avoiding duplicative or misaligned requirements across frameworks. Such a review may lead to the conclusion that certain new regulatory initiatives deliver comparatively limited added value and should therefore be either reconsidered or implemented in a minimalist fashion (e.g. FIDA).

A level playing field requires eliminating regulatory arbitrage and strengthening EU-wide standardisation. To remain internationally competitive, the cumulative pace and volume of new regulatory requirements should be calibrated so that they do not materially exceed those in peer jurisdictions, while preserving internationally agreed standards of financial stability and consumer protection.

A similar consideration arises in the context of the digital euro. From the perspective of the banking sector, the design of IT architecture will be the key determinant of operational impact, including implementation costs, integration with existing payment infrastructures and long-term sustainability. By contrast, risks related to deposit outflows and associated liquidity effects appear manageable, provided that the ECB maintains its current position

of not remunerating digital euro holdings held by end-users and sets a reasonably low holding limit; under these conditions, the digital euro is unlikely to function as a store of value competing with bank deposits.

Taken together, these developments underline the importance of assessing the cumulative impact of regulatory measures and ensuring that responsibilities, risks and costs are allocated in a proportionate manner across all relevant actors. A clear, coherent, technology-neutral and business-model-neutral supervisory approach is essential to support innovation and competition without undermining sustainable banking business models.

Question 34: What regulatory measures could facilitate or improve efficiency for cross-border EU banking groups?

What safeguards would be necessary to preserve resilience and resolvability, and provide reassurance to all relevant Member States in case of distress/failure?

Answer: To address headwinds from regulatory fragmentation across EU markets, banking groups should be able to increase efficiency through centralised group services and competence sharing. In practice, however, current requirements for intra-group (internal) outsourcing are often overly complex and documentation-heavy, and they replicate controls that already exist at group level (e.g., group governance, transfer pricing arrangements, business-continuity set-ups and resolvability frameworks). This can discourage sensible centralisation and impose disproportionate compliance costs without commensurate resilience benefits. Supervisory authorities should therefore simplify expectations for intra-group outsourcing, rely more on group-wide controls where risks are demonstrably managed, and avoid conflicting or duplicative requirements for cross-border groups operating through subsidiary structures.

Question 37: What are the main non-prudential barriers that impede cross-border activities?

Answer:

	Fully agree	Somewhat agree	Neutral	Somewhat disagree	Fully disagree	Don't know - No opinion - Not applicable
Divergent national tax treatment attached to certain banking products (mortgages, savings accounts, deposits) or banking operations (Value Added Tax, corporate and personal income taxation)	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
More generally, lack of unified banking product offering across EU or sub-regions, forcing product adaptation to each national market	<input type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Labour laws and contract laws hindering the servicing of EU bank clients in a Member State by a branch/entity located in another Member State.	<input type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Preference by local customers of local bank brands	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Divergent insolvency laws and collateral foreclosure rules	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Consumer protection laws and client specific documentation	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Divergent (non-prudential) reporting requirements	<input type="radio"/>	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Language barriers	<input checked="" type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

Please explain which actions should be taken to overcome these non-prudential barriers and improve the integration of banking markets in the EU.

Answer: Policymakers should pursue deeper harmonisation of key non-prudential national regimes that materially affect cross-border banking activities, including insolvency, company and consumer law, labour law and taxation. This should be complemented by structural reforms and sustained political commitments to reduce domestic protectionism and to streamline market entry and operating conditions across Member States.

Question 54: How would you assess the level of enforcement of EU banking rules?

How can this be improved?

Answer: Supervisory effectiveness is increasingly challenged by the multi-layered nature of regulation and supervision, combining EU regulations, technical standards and guidelines issued by the European Supervisory Authorities (EBA, ESMA, EIOPA and AMLA), the supervisory and regulatory practices of the ECB, and national legislators and local supervisory practices. In practice, the cumulative impact of these layers is not always assessed holistically, resulting in overlapping requirements, inconsistent supervisory expectations and a growing administrative burden for banks.

While the EU has made significant progress in harmonising and enforcing prudential banking rules - most notably through the Banking Union and the transfer of supervision of significant institutions to the ECB – supervision and enforcement remain fragmented. Differences in national implementation, legal frameworks and supervisory practices continue to produce inconsistent outcomes across Member States. Strengthening supervisory convergence in the interpretation and day-to-day application of EU rules would materially improve enforcement consistency.

A broader challenge for cross-border groups is the uneven pace and depth of supervisory and regulatory requirements applied to different entities of the same banking group. In practice, the ECB may introduce faster and more prescriptive expectations for systemic subsidiaries, while parent institutions remain subject to EBA-driven timelines and a different level of detail and scope. This can result in banks having to implement essentially the same requirements twice, increasing costs and operational complexity without improving outcomes.

One practical example of this broader duplication is resolution planning for cross-border groups, which is particularly relevant for Swedish banking groups' subsidiaries. Under an SPE strategy, multiple authorities, timelines and procedural expectations apply across parent and subsidiary levels. In such a set-up, loss absorption is upstreamed to the parent, while capital and resources are expected to be made available to support a distressed subsidiary; accordingly, more intensive resolution expectations would typically sit at parent level (under the SNDO and the EU resolution college), with more proportionate requirements at subsidiary level (addressed by the SRB). In practice, however, expectations can at times appear to be applied in the opposite direction, creating overlapping processes with limited operational relevance and making consistent implementation of the SPE strategy more challenging.

At the same time, the centralisation of prudential supervision at ECB level has not led to a proportionate reduction in the overall supervisory costs. Systemic banks cover the cost of supervision of both the ECB and the Bank of Latvia. In smaller markets, banks continue

to face high direct and indirect supervisory costs that are not commensurate with their systemic relevance or the scale of their activities, raising concerns about cost efficiency and proportionality of the current supervisory set-up.

More broadly, the principle of proportionality is not consistently applied in supervisory practice. This is evident across several areas, including corporate governance requirements and investment services supervision, reducing supervisory effectiveness and placing a disproportionate burden on certain segments of the banking sector.

These challenges are further illustrated in the area of sustainability (ESG), where supervisory expectations increasingly extend beyond the intended scope of the legislator's mandate and risk becoming detached from practical data availability. In particular, banks are expected to continue collecting, processing and reporting ESG-related data that are not required from, or available at, the level of the underlying data sources (i.e. their borrowers). This creates a structural disconnect between supervisory expectations and the legal obligations to provide data applicable to the borrowers. As a result, compliance with such requirements becomes increasingly difficult and, in some cases, practically unworkable, despite banks' best efforts. This undermines the effectiveness and credibility of the supervisory framework and diverts resources toward compliance exercises that deliver limited incremental risk management value.

Taken together, these issues underline the need for a more risk-based, proportionate and context-sensitive supervisory approach. Greater alignment between supervisory expectations, legislative requirements and data availability, combined with deeper harmonisation, would strengthen supervisory effectiveness while supporting sustainable banking business models and competitiveness, particularly in smaller EU markets.

Question 60: Does the prudential framework balance sufficiently risk sensitivity and complexity?

Answer: No

If not, how should this disequilibrium be addressed?

Answer: The practical application of Internal Ratings-Based (IRB) models remains particularly challenging in smaller markets due to structural data limitations. Limited historical data, smaller and less diversified portfolios, and lower default frequencies reduce the statistical robustness of model calibration and validation. As a result, banks operating in small and highly concentrated markets are often required to apply conservative assumptions or supervisory add-ons that may not accurately reflect underlying risk. In practice, this can lead to higher capital requirements than warranted by the actual risk, constraining lending capacity and reducing the effectiveness of risk-based regulation.

A more proportionate supervisory approach is therefore needed, allowing greater flexibility in model validation and calibration where data constraints are structural rather than risk-driven, while maintaining sound risk management standards. In this context, consideration could be given to enabling targeted pilot portfolios (for example for SMEs and innovative sectors) to allow testing of capital impact of proportionately calibrated covenant structures and other risk factors while preserving the integrity of data inputs and performance metrics used for conventional IRB model calibration and validation.

In addition, the current Definition of Default and the treatment of forbearance measures are, in practice, overly restrictive. This can limit banks' ability to apply proportionate solutions that balance customer-specific circumstances with broader economic needs, even where a client's risk and profitability profile would justify such measures, due to the potential for triggering broad forbearance classification and associated supervisory consequences.

Beyond capital modelling, complexity is also evident in corporate governance requirements. The requirement to annually re-assess the individual and collective suitability of the management bodies appears disproportionate, particularly given that re-assessments are already required upon the occurrence of triggering events.