

THE REGULATORY SQUEEZE

How EU Regulation Has Undermined European Banks

A Report on the Unintended Consequences of European Financial Regulation

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CONFIDENTIAL

Executive Summary

Over the past decade, the European Union has introduced a sweeping programme of financial regulation aimed at increasing competition, enhancing consumer protection, and fortifying financial stability. While these objectives are laudable, the cumulative impact of these regulations has produced a troubling pattern of unintended consequences that have materially weakened European banks relative to their American counterparts and, paradoxically, strengthened the very non-European players the regulations were meant to discipline.

This report examines how the Interchange Fee Regulation (IFR), the Payment Services Directives (PSD2/PSD3), Basel III implementation, GDPR, and other regulatory initiatives have collectively eroded the revenue base, competitive positioning, and innovation capacity of EU banks. The principal beneficiaries of this regulatory framework have been US-headquartered card networks (Visa and Mastercard), Big Tech companies (notably Apple), and non-bank fintech challengers.

Key findings include the fact that the average Merchant Service Charge (MSC) in the EU almost doubled between 2018 and 2022, yet the additional revenue flowed not to European banks but to international card schemes. EU banks face higher capital requirements and nearly double the contributions to deposit and resolution funds compared to their US peers. PSD2 forced banks to open their data to third-party competitors at their own expense. And a proliferation of overlapping EU regulatory bodies has created a compliance burden that stifles innovation and consolidation.

1. The Interchange Fee Regulation: A Revenue Transfer to Card Schemes

1.1 Background and Intent

The Interchange Fee Regulation (EU) 2015/751 came into force on 8 June 2015, introducing caps on interchange fees for consumer card transactions: 0.2% of the transaction value for debit cards and 0.3% for credit cards. The regulation was designed to lower costs for merchants, stimulate competition, and ultimately deliver savings to consumers. Prior to the IFR, interchange fees varied significantly across EU Member States, and the European Commission estimated that these fees cost the European economy up to €9 billion annually.

1.2 The Revenue Shift: From Banks to Card Schemes

The IFR achieved its immediate objective: interchange fees fell by approximately €2.7 billion between 2015 and 2017, directly reducing the revenue that issuing banks could earn from card transactions. However, the regulation contained a critical blind spot: it capped interchange fees (which flow to banks) but left scheme fees (which flow to Visa and Mastercard) entirely unregulated.

The consequences have been stark. A study commissioned by the European Commission itself found that the average net MSC applied by card schemes in the EU almost doubled between 2018 and 2022, rising from 0.27% to 0.44%. The Copenhagen Economics study for the Commission estimated that card schemes gained revenue of approximately €550 million per year from higher issuer and acquirer scheme fees, predominantly from international schemes. Ten years after the IFR's implementation, the average cost of card payments in the EU has exceeded the levels observed at the time of the regulation's introduction in 2015, entirely neutralising its intended benefits.

Ecommerce Europe, the trade body representing online merchants, concluded bluntly in June 2025 that the IFR "has not delivered on its core promise." The rise of scheme fees does not reflect any specific cost drivers or additional risks and is uncorrelated with the volume or value of transactions. It represents a straightforward transfer of value from European banks and merchants to US-headquartered card networks.

Fee Evolution Summary

Component	Pre-IFR (2015)	Post-IFR (2022)
Interchange Fee (to banks)	Varied (up to 1.5%+)	Capped at 0.2%/0.3%
Scheme Fees (to Visa/MC)	Low (unregulated)	Risen sharply (unregulated)
Average Net MSC	~0.27%	~0.44%
Net Beneficiary	EU issuing banks	Visa & Mastercard

1.3 Additional Fee Categories Exploiting Gaps

International card schemes have also introduced a range of new charges that were not contemplated by the original regulation. These include: SCA-related fees imposed on merchants for every Strong Customer Authentication option chosen; charge retry and charge decline fees; fees related to non-tokenisation or non-use of new scheme solutions; mandatory chargeback process changes imposed unilaterally by Visa from April 2024; and elevated interchange fees on cross-border UK–EU transactions post-Brexit, rising from 0.2%/0.3% to 1.15%/1.5%. Commercial cards, which are exempt from the IFR, have also seen increased issuance as banks and schemes shift cardholders from consumer to commercial cards to avoid the caps. This regulatory arbitrage further undermines the regulation’s effectiveness.

2. PSD2 and Open Banking: Forcing Banks to Fund Their Competitors

2.1 The Open Banking Mandate

The Payment Services Directive 2 (PSD2), adopted in 2015 and fully implemented in 2018, required banks to open their payments infrastructure and customer data to authorised Third-Party Providers (TPPs) via secure APIs. The directive was designed to break what was described as banks’ “monopoly on user data” and to stimulate competition from fintech entrants.

While PSD2 has delivered benefits in terms of innovation and fraud reduction through Strong Customer Authentication, it has imposed significant asymmetric costs on incumbent banks. Banks were required to build and maintain API infrastructure, implement complex SCA requirements, and effectively provide free data access to competitors. Compliance was neither cheap nor straightforward: industry surveys indicated that only around 60% of banks were fully compliant even by 2019, and ongoing maintenance costs remain substantial.

2.2 Big Tech as the Primary Beneficiary

The PSD2 review study itself identified a critical concern: the functioning of competition could be distorted due to the strong market position of Big Tech companies. Platforms such as Amazon and Apple gained access to banking infrastructure and customer data without bearing the cost of building or maintaining it. The study specifically called for closer cooperation between national supervisory authorities to address the divergent application of PSD2 requirements to these platforms.

The lack of standardisation among PSD2 APIs hindered interoperability, and some banks met only the minimum requirements, further fragmenting the landscape. The result has been that well-resourced Big Tech firms, with their established user bases and superior digital infrastructure, have been the primary beneficiaries of open banking, while smaller EU banks have struggled with the compliance burden.

3. Apple Pay and the NFC Monopoly

3.1 The Fee Squeeze on European Banks

Apple Pay exemplifies the compounding effect of EU regulation on European banks. Every time a consumer makes an in-store purchase via Apple Pay, the participating bank pays Apple a transaction-based fee. In the US, Apple reportedly charges credit card issuers 0.15% and debit card issuers 0.5%. In Europe, where the IFR caps interchange fees at 0.2% for debit and 0.3% for credit, Apple’s fee consumes a substantial proportion of the already-capped interchange revenue that banks receive. This creates a situation where EU banks are effectively subsidising Apple’s payment business from their constrained revenue pool.

Until January 2024, Apple Pay was the only mobile wallet permitted to access the NFC hardware on iOS devices for in-store contactless payments. The European Commission found in 2022 that Apple had abused its dominant position by refusing to make its NFC technology available to third-party mobile wallet developers. This exclusivity forced banks into a binary choice: either pay Apple’s fees to participate in Apple Pay, or simply be unable to offer mobile payments to the significant portion of their customer base using iPhones.

3.2 The Regulatory Resolution

In July 2024, the European Commission accepted legally binding commitments from Apple to open NFC access to third-party wallet developers for ten years. Apple committed to allowing access free of charge using Host Card Emulation (HCE) mode, enabling rival wallets to function without relying on Apple’s secure element. However, given Apple Pay’s entrenched position and consumer habits, the practical impact on shifting market share back to bank-owned wallets remains uncertain. Some analysts have noted that “convincing customers to change behaviour will be very difficult” given that the vast majority of issuers have already enabled Apple Pay and consumers are habituated to using it.

4. Capital Requirements and Prudential Regulation: An Uneven Playing Field

4.1 Basel III and the EU’s Gold-Plating Problem

EU banks operate under a demonstrably heavier regulatory burden than their US competitors. An Oliver Wyman study commissioned by the European Banking Federation found that EU banks face higher average Common Equity Tier 1 capital requirements (10.6%) compared to US peers (9.9%). EU banks also face nearly double the contributions to deposit and resolution funds at EU and Member State level compared to US counterparts, while requirements on bail-in capacity (MREL/TLAC) are 3.9 percentage points higher than in the US.

The EU has also been a more aggressive early implementer of Basel III. The EU began applying the standards from 1 January 2025, while other major jurisdictions—including the United States—have delayed or are reconsidering implementation. The European Commission itself acknowledged in April 2025 that this situation is “leading to distortions in the international level playing field and competitive disadvantages to EU banks in their trading activities.” The US Federal Reserve withdrew draft rules to implement the Basel III Fundamental Review of the Trading Book (FRTB) in September 2024, further widening the gap.

EU vs US: Regulatory Burden Comparison

Metric	EU Banks	US Banks
CET1 Capital Requirement	10.6%	9.9%
Deposit & Resolution Fund Contributions	~2x higher	Baseline
Bail-in Capacity (MREL/TLAC)	+3.9pp higher	Baseline
Basel III FRTB Status	Implementing (delayed to Jan 2026)	Withdrawn / under review
Return on Equity (trend)	Below cost of capital	At/above pre-crisis levels

4.2 The Profitability Gap

These regulatory asymmetries have contributed to a persistent profitability gap. US banks have returned to pre-crisis profitability levels, while the EU banking sector has, until very recently, consistently failed to earn its cost of capital. Before the Global Financial Crisis, large US and European banks showed broadly comparable profitability and market valuations. That parity has since disappeared, with US banks now dramatically outperforming their European counterparts. This divergence cannot be attributed solely to regulation—structural fragmentation across 27 national markets, late policy responses to the Eurozone debt crisis, and a prolonged period of negative interest rates all played roles—but regulation is a significant contributing factor.

5. The Proliferation of Regulatory Bodies and Rules

Since the financial crisis, the EU has created an extensive web of new regulatory and supervisory bodies: the European Banking Authority (EBA), the Single Supervisory Mechanism (SSM), the Single Resolution Board (SRB), the European Systemic Risk Board (ESRB), and most recently the Anti-Money Laundering Authority (AMLA). Between 2019 and 2024, the EU issued approximately 13,000 new regulations, and the EU’s financial rulebook now exceeds 15,000 pages of directives and standards.

The cumulative regulatory burden includes not just banking-specific regulations but also horizontal legislation with significant compliance implications: GDPR (with cumulative fines reaching approximately €5.88 billion by January 2025), the Digital Operational Resilience Act (DORA), the Markets in Crypto-Assets Regulation (MiCA), and the EU AI Act. Each layer imposes additional compliance costs, and the overlapping jurisdictions of multiple national, Eurozone, and EU-level authorities create what one analyst described as authorities that “compete with each other in terms of orthodoxy.”

The Mario Draghi report on EU competitiveness (September 2024) and the Enrico Letta report on deepening the EU single market (April 2024) both highlighted the urgent need to reduce regulatory burdens. The finance ministries of France, Germany, and Italy have jointly written to the European Commission calling for a “stronger emphasis on the competitiveness of the financial sector” and a “level playing field vis-à-vis other major jurisdictions.”

6. Structural Consequences for the European Banking Sector

6.1 Barriers to Consolidation

The regulatory framework has actively inhibited cross-border consolidation within the EU. Requirements that banks meet all prudential requirements at both parent and subsidiary level, combined with restrictions on liquidity transfers within the Banking Union, prevent the emergence of pan-European universal banks that could compete at scale with US institutions. The Banking Union remains incomplete, with political and regulatory restrictions blocking the cross-border mergers that are essential for achieving efficiency and scale.

6.2 Domestic Scheme Erosion

Before the IFR, a number of domestic card schemes exited the market as banks were attracted by higher interchange fees offered by Mastercard and Visa. While no further exits have occurred since the IFR’s entry into force, only nine domestic schemes remain in the EEA. Visa and Mastercard retain very high market shares, with widespread co-badging meaning they are present on almost every card. The European Payments Initiative (EPI), which launched the Wero wallet as an attempt to build a European alternative, faces an uphill battle against entrenched US-owned infrastructure.

6.3 Innovation Drag

Strict data-consent requirements under GDPR complicate the use of AI and data analytics, prompting global technology

players to delay or exclude EU launches of new functionalities. While regulation is not the primary explanation for the absence of European Big Tech champions—market fragmentation plays a larger role—it contributes to an environment where European financial institutions are slower to innovate and adopt new technologies than their US or Asian counterparts.

7. Conclusions and Outlook

The EU's regulatory framework for banking and payments was designed with sound objectives: protecting consumers, enhancing competition, and safeguarding financial stability. Many of these objectives have been at least partially achieved—SCA has reduced online payment fraud, and the IFR did initially lower interchange fees. However, the cumulative and compounding effects of these regulations have produced a set of deeply problematic outcomes:

1. **Revenue transfer to non-EU entities.** The IFR capped bank interchange fees while leaving scheme fees unregulated, creating a direct revenue transfer from EU banks to Visa and Mastercard. Apple Pay extracts a significant portion of banks' already-capped interchange revenue.
2. **Asymmetric data sharing.** PSD2 forced banks to open their infrastructure to competitors at their own expense, disproportionately benefiting Big Tech platforms with existing user bases and resources.
3. **Competitive disadvantage vs US banks.** Higher capital requirements, earlier Basel III implementation, and heavier fund contributions put EU banks at a structural disadvantage in global markets.
4. **Compliance overload.** The proliferation of overlapping regulations and regulatory bodies imposes costs that drain resources from innovation and growth.
5. **Consolidation barriers.** The incomplete Banking Union and prudential requirements at every level prevent the cross-border scaling that European banks need to compete globally.

Looking ahead, the European Commission has signalled awareness of these issues. The proposed PSD3 directive and the new Payment Services Regulation (PSR) aim to address some of the IFR's shortcomings, including the question of scheme fees. The Commission's Competitiveness Compass, the Omnibus simplification proposals, and the Savings and Investments Union initiative all point toward a desire to rebalance regulation with competitiveness. The critical question is whether these reforms will arrive in time, and with sufficient ambition, to reverse a decade of regulatory-driven competitive erosion before the gap with US banking becomes irreversible.

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