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Simplifying the EU Capital Stack

March 2026

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Foreword

Adam Farkas
Chief Executive
Association for Financial Markets in Europe (AFME)

Over the past decade, Europe has built one of the most robust banking regulatory frameworks in the world. The reforms introduced following the global financial crisis have significantly strengthened the resilience of the banking system, ensuring that banks are better capitalised and able to withstand economic shocks. This resilience has been demonstrated in practice: European banks continued to support households and businesses through the pandemic and have remained stable during recent episodes of global financial stress.

Preserving this resilience must remain a central objective of the European regulatory framework. At the same time, it is increasingly clear that Europe must also ensure that its rules remain efficient, coherent and fit for purpose in a rapidly evolving economic environment.

Today, Europe faces significant investment needs. Financing the green transition, supporting digital transformation and maintaining global competitiveness will require large volumes of capital to flow efficiently through the financial system. Banks will play a central role in mobilising this investment and supporting economic growth across the European Union.

Against this backdrop, policy makers across Europe are increasingly examining how the regulatory framework can support these objectives while maintaining the high standards that underpin financial stability. In particular, attention is turning to the growing complexity of the EU prudential framework.

Over time, layers of capital buffers, supervisory requirements and resolution rules have accumulated. While each component may serve a legitimate policy objective, the overall system has become increasingly complex. This complexity can create inefficiencies, raise funding costs and ultimately reduce the capacity of banks to support lending to the real economy.

This report seeks to contribute constructively to this discussion. It presents analysis and proposals for simplifying key elements of the EU bank capital framework while preserving the resilience that has been achieved since the financial crisis. By reducing overlapping requirements and improving the coherence of the capital stack, the EU can maintain strong prudential safeguards while ensuring that banks are able to effectively support the financing needs of Europe's economy.

AFME looks forward to engaging with policy makers, supervisors and stakeholders across Europe as this important debate continues. A clear, efficient and internationally competitive regulatory framework will be essential in ensuring that Europe's banking sector can continue to play its full role in supporting investment, growth and economic resilience.

"Over time, layers of capital buffers, supervisory requirements and resolution rules have accumulated. While each component may serve a legitimate policy objective, the overall system has become increasingly complex."

1. Executive Summary

Streamlining the EU Bank Capital Stack

AFME proposes a decisive simplification of the EU bank capital stack to eliminate overlap, reduce unnecessary complexity, and strengthen risk alignment.

The current going concern framework layers on top of Pillar 1 seven partially duplicative buffers addressing macro-procyclicality, systemic risk, stress, and idiosyncratic risks. This fragmented structure adds opacity and constraint without proportionate prudential benefit. AFME's proposal consolidates these requirements into three clearly defined components. In addition to Pillar 1, systemic risks would continue to be covered by the G-SII/O-SII buffer, where G-SII would only be subject to the G-SII buffer and not both. Pillar 2R and Pillar 2G would remain in place for idiosyncratic risks. The CCyB would be retained but set to zero, also avoiding positive-neutral CCyB, reflecting supervisory experience that Pillar 2 has so far operated as the effective countercyclical buffer in practice. The SyRB would be phased out due to substantial overlap with existing buffers and its status as non-Basel "gold-plating".

For loss-absorbing ("gone-concern") requirements, AFME proposes replacing MREL with a framework combining TLAC and a TLOF subordination requirement for all resolution entities linked to access to the Single Resolution Fund, improving consistency with international standards.

CET1, AT1, and Tier 2 would retain their current roles, reflecting the demonstrated effectiveness and continued viability of these instruments.

In terms of governance, we propose establishing a central EU banking forum between the relevant authorities to help considering the operational impact and capital demand of their decisions on firms.

Overall, this proposal delivers a simpler, more coherent, and more credible capital framework that preserves resilience while materially improving usability and supervisory clarity.

The AFME proposal would generate approximately EUR 2.8tn in additional lending to the real economy and lower EU banks' cost of capital by 62bps. For G-SIIs, the changes amount to 28bps reduction in cost of capital, for O-SIIs to 51bps and to 132bps decline in their cost of capital for LSIs.

"The AFME proposal delivers a simpler, more coherent, and more credible capital framework that preserves resilience while materially improving usability and supervisory clarity"

2. The EU Capital Stack: Costly inefficiencies

The regulatory reforms in response to the Global Financial Crisis (GFC) were a necessary step to stabilise the global financial system. Together with re-defining the quality of own funds (CET1 and AT1) and improving how risks are measured, global, regional and domestic authorities also recognised that the crisis revealed vulnerabilities that ordinary microprudential regulation could not address. The systemic interconnectedness of banks created contagion way beyond the financial system, while some large banks under stress lacked sufficient capacity to address viability concerns, which ultimately amplified the financial downturn.

At the same time regulators lacked the experience, procedures, and tools needed to resolve failing large banks in an orderly way. As a result, governments resorted to extensive public support for banks. The details of the crisis are, of course, more complex, but this overview is meant to set the context for understanding why today's regulatory framework looks the way it does.

A cumbersome post-GFC legacy framework

Driven by fears politicians and policy makers had experienced in Europe during the GFC and the subsequent sovereign crisis in the EU, new institutions were founded – for supervision the Single Supervisory Mechanism (SSM) was set up giving the ECB supervisory powers for the EU's most significant institutions. For bank recovery and resolution the Single Resolution Board (SRB) was set up to facilitate orderly bank resolution. In parallel, national authorities have still retained responsibilities on some parts of the framework, especially the macroprudential aspects as well as the direct supervision and resolution of less significant institutions. Alongside this, rulebooks such as the Bank Recovery and Resolution Directive and CRR3 came into force in the EU, reflecting the EU's adoption of international frameworks established at a global level via the FSB and the Basel Committee.

Multiple players were activated, each of them trying to fulfil their brief with their specific technical expertise. However, in the process of implementing these changes, holistic, cross-framework stock-takes were not carried out consistently, and inconsistencies arose at regional level to reflect the nature of domestic practices and markets. This has resulted in a complex capital framework spanning across multiple layers of risk weighted and non-risk weighted requirements, assets and liabilities, measurable and non-measurable risk, financial and non-financial risks, integral dependencies, institutional power struggles and governance issues... the list could go on.

The resulting post-crisis EU capital stack is extremely complex

As the ECB, Bundesbank, Banque de France, and Bank of Spain have noted, the EU capital stack framework is overly complex. According to the Bundesbank, the complexity lies in the number of capital stacks that exist in parallel (horizontal complexity) but also in the layering of buffers in each stack (vertical complexity)[1]. Vertically, as illustrated in Figure 1, EU banks face a stack of seven capital buffer layers, three of which (CCyB, SyRB, and the O-SII buffers) are set at national discretion. As a result, a cross-border banking group operating across all EU Member States may be subject to as many as 86 distinct buffer layer requirements[2] (including 27 national CCyB, SyRB, and O-SII calibrations). This stands in contrast to the United States, where the going-concern capital framework comprises only three uniform, nationwide buffer layers.

"EU banks face a stack of seven capital buffer layers, three of which (CCyB, SyRB, and the O-SII buffers) are set at national discretion. As a result, a cross-border banking group operating across all EU Member States may be subject to as many as 86 distinct buffer layer requirements."

1 *Non-paper "Reducing regulatory complexity" (2025)*
2 *P1, CCoB, P2R, P2G, 27 CcyB, 27 SyRB, 27 OSII, and GSIB*

Figure 1: EU and US vertical complexity of going concern capital stack

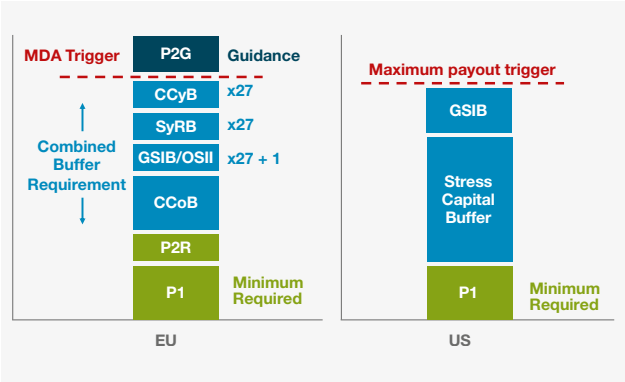


Figure 2: Horizontal complexity of EU and US capital stack. Number of capital requirements[3]

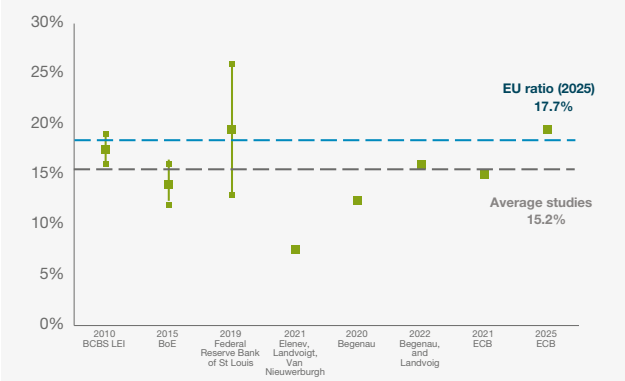
Horizontally, complexity can be well illustrated by the overlapping nature of the gone concern requirements. The EU operates two parallel gone concern frameworks (TLAC and, MREL) which result in six different requirements as shown on chart 2. The MREL requirement is set by the Single Resolution Board (SRB), introducing an additional institutional actor which comes with complexity in coordination, implementation, and supervisory alignment. By contrast, the US gone-concern capital structure relies on a far more streamlined hierarchy, centred on TLAC and Long-Term Debt (LTD) requirements within a single, federal framework.

EU banks also operate at capital levels above optimal levels and above those of other jurisdictions

The EU banking sector operates under a capital regime shaped by Basel III, CRR/CRD, and the TLAC/MREL frameworks. Over the past decade, these measures have strengthened the banking sector's resilience. However, the layered nature of the capital stack has also introduced complexity, redundancy, and inefficiencies which make banks operate above optimal capital levels.

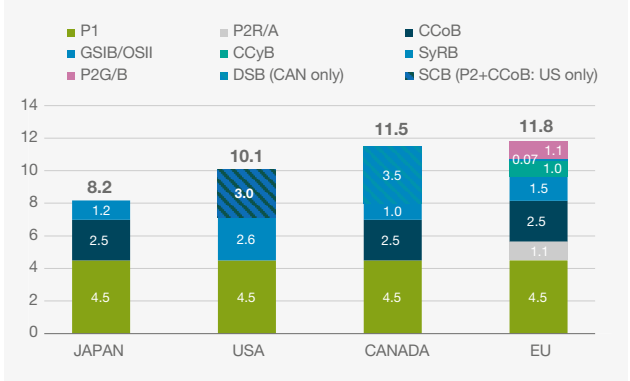
Chart 3 compares various ranges of estimated optimal Tier 1 capital ratios from multiple studies against observed EU ratios. EBA data indicates that EU banks now hold Tier 1 capital ratios at 17.7%[4], above estimated "optimal" levels found in multiple studies (15.2%), above official benchmark estimated in other jurisdictions like the UK[5] (13%), and significantly above those required in other major banking jurisdictions like the US, Japan and Canada (see chart 4).

Figure 3: Optimal T1 Capital estimates across select studies



Source: PwC, ECB, BoE. ECB (2021) study refers to optimal capital ratio implying that it refers to total capital (which includes T1 capital). The LEI study reported optimum T1 ratios ranging from 13.5-17.5% expressed in Basel II terms. The numbers represent the range converted to a Basel III equivalent, as reported in the Bank of England (2015) paper. ECB (2025) and Elenev et al (2021) estimate CET1 levels at 18% and 6% respectively; for purposes of this chart, a 1.5% buffer associated with the AT1 Basel III requirement has been added for comparability.

Figure 4: CET 1 ratio requirement and guidance for GSIBs across jurisdictions (%RWAs)



Source: US FED, ESRB, ECB, and Pillar 3 reports of GSIBs. CCyB in Canada refers to the Domestic Stability buffer. In the US, Stress test amount included is floored at 2.5%. US GSIB buffer based on maximum of method 1 and method 2, which typically results in method 2.

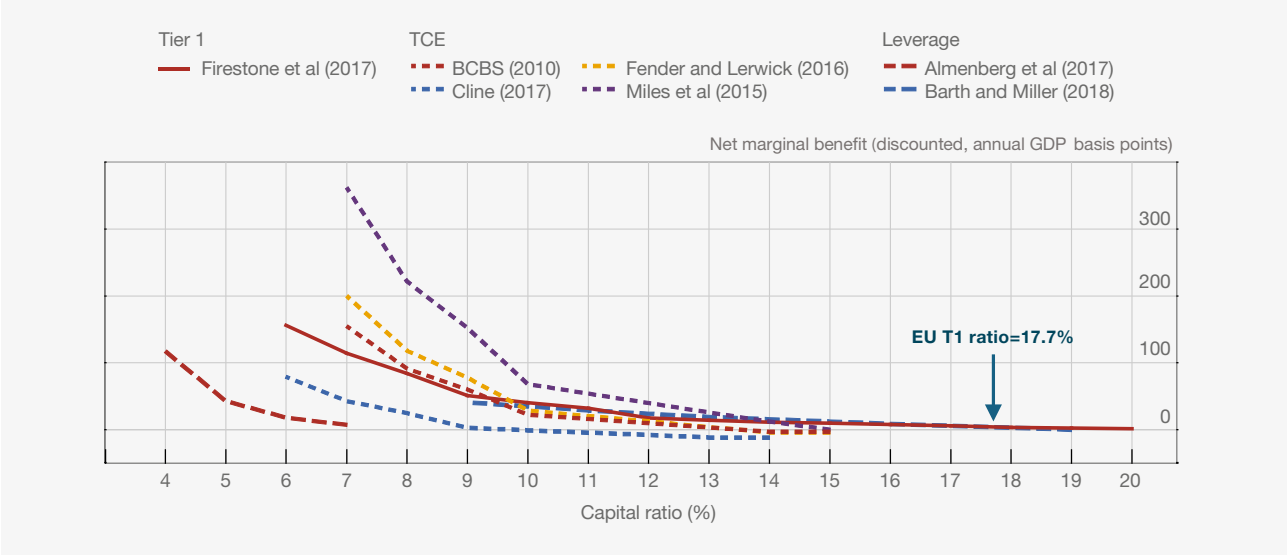
3 *Subordination calibrated on total liabilities and own funds (TLOF) but requirement set on RWAs and EM. Also comprises a senior non-preferred debt component*

4 *https://www.sifma.org/resources/news/blog/identifying-an-optimal-level-of-capital-and-evaluating-the-impact-of-higher-bank-capital-requirements-on-us-capital-markets/*

5 *For the Bank of England FPC, the appropriate level of capital in the banking system is lies at 12-16% of RWAs, with a midpoint at 14% which was recently reduced to 13% in late 2025. Macroeconomic costs could rise when capital requirements fall outside the estimated optimal range.*

This brings into question whether capital accumulation is already generating diminishing returns to the overall economy, the additional cost borne to enhance the protection against major banking crisis being no longer justified versus the sacrifice in terms of economic growth. A BIS[6] report shows that across various academic studies, the net marginal benefit of higher bank capital declines as capital ratios increase. Beyond an optimal range of 10–15%, extra capital provides little or no net economic benefit. See figure 5.

Figure 5: Net marginal benefit of higher bank capital



Source: BCBS Working Paper No. 37, 2019. EU T1 ratio added for illustration

An ECB study[7] published recently cites "rising bank funding costs and tighter prudential requirements have further restrained lending" and thus have contributed to the persistent negative credit gap observed in the Euro area.

"Is capital accumulation already generating diminishing returns to the overall economy and the additional cost borne to enhance the protection against a major banking crisis no longer justified?"

6 *The costs and benefits of bank capital – a review of the literature. BCBS Working paper No 37*
7 *Mind the gap: credit dynamics in the euro area (THE ECB BLOG, 26 January 2026)*

3. Reforming the EU capital requirements

a. Goals for refining the capital framework

As the Industry has been considering refinements to the capital frameworks and stress testing, the need to simplify these frameworks to make them easier to apply and understand, without compromising resilience of the banking system has been at the forefront of our thinking.

One of the great challenges of a regulator is to write rules that are comprehensive and detailed enough to be well understood while also being consistent and simple enough to be effective. There is a well-documented tendency for regulation to grow by accretion. In Europe this is compounded by a multiplicity of policy-making parties involved. And with that, there is always a risk that regulatory regimes will become less effective as they grow, developing redundancies and inconsistencies that can obscure initial intentions and impair well-functioning. This is not a desirable outcome for financial regulation, and indeed, it is the responsibility of any regulator to ensure that the rule frameworks remain well integrated and fit for purpose. This includes respecting the concept of minimum requirements and the intended purpose of capital buffers.

The second goal, in considering these adjustments, is to maintain the high level of loss-absorbing capacity in the EU banking system without structurally increasing CET1 requirements deployed across “going concern” and “gone concern” requirements at bank level. Our financial system today is far more resilient than it was before the crisis and we as an industry want to maintain that resilience. EU banks have been able to withstand the Covid crisis and have remained unaffected by the 2023 banking turmoil (Credit Suisse and Californian banks failures), continuing to serve their clients and to lend credit to the economy throughout these shocks. Adjusting regulation in measured ways, such as those we will describe, is an appropriate and, in fact, necessary way to preserve the success achieved in strengthening the EU financial system post GFC.

Other key jurisdictions (e.g., the US and the UK) are also reassessing the calibration of capital requirements, and a synchronisation of proposals and timelines would be very welcome by internationally active banks.

b. Proposal for going concern capital requirements

Simplification of parallel stacks: AT1 should remain an integral part of the structure

Different analyses suggest the need to reduce the number of parallel stacks of capital. In particular, some policy makers discuss the need to increase loss-absorbency of additional tier 1 capital (AT1) as an eligible going-concern capital instruments or even replacing AT1 and / or Tier 2 capital altogether. We believe AT1 should remain an integral part of the going concern capital structure. On the contrary, any changes to the AT1 framework would undermine the simplification initiative and competitiveness of banks in the EU: AT1 plays an important role in the capital mix for banks by a) substantially increasing and diversifying the investor base in bank capital, b) creating a means to manage the FX mix in the capital stack to reduce ratio volatility, c) for banks which require AGM approval for share issuances, AT1 provide for a flexible and quick means to increase capital, and d) increase a bank‘s pool of recovery options.

AT1 fulfils an essential role as loss absorbing instrument

The combination of suspending call decisions and cancellation of coupon payments makes the AT1 instruments akin to equity and ensures that it remains available for absorbing losses within the designed hierarchy.

AT1 is a cost-effective instrument

AT1 and T2 are forms of debt capital that are comparatively more cost-efficient for banks than CET1. According to the EBA[8], European banks had as of end 2025 an outstanding amount of EUR 151bn in AT1 debt and EUR 263bn in T2, representing 1.5% and 2.6% of RWAs respectively. According to the ECB[9], the cost of equity (cost of CET1) for European banks has fluctuated over the last decade at around 8-12%. AFME estimates[10] indicate a cost of equity of 9.2% as of 2025, which is significantly higher than AT1 costs of c6.2% pre-tax (4.5% after tax[11] , considering the tax deductibility of coupon payments) and T2 of 4% pre-tax (2.9% after-tax).

8 *EBA 2025 risk assessment report*

9 *See ECB 254 Occasional paper https://www.ecb.europa.eu/pub/pdf/scpops/ecb.op254~664ed99e11.en.pdf*

10 *Estimated as CAPM based on: i) risk-free rate of 3.3% based on 30Y nominal AAA euro area yield according to the ECB; ii) equity beta for EU GSIBs sourced from Eikon LSEG with a median GSIB value of 1.17; iii) equity risk premia based on country of location of each GSIB sourced from data of NYU Professor Damodaran which for 2025 stood on average at 5%.*

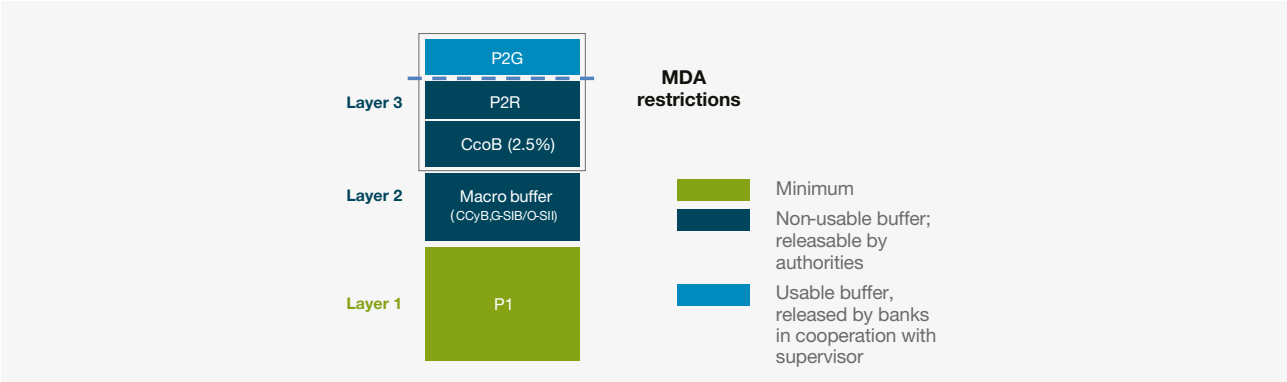
11 *Based on iBoxx indices. After-tax assumes a 27% marginal tax rate. The rate and tax deductibility of AT1s varies by country. In the Netherlands, AT1s are treated as equity and therefore not tax deductible, while in other European countries AT1 are treated as debt instruments and therefore subject to tax deductibility.*

As stated in the report by the ECB High Level Task Force on Simplification (HLTF), discarding AT1 or T2 from the going-concern capital framework without lowering capital requirement levels would "[raise] questions of capital neutrality" and, on the contrary, would signify a costly increase in CET1 capital for banks should CET1 replace in full or even in part AT1 or T2 instruments. This would result in banks having to increase CET1 equity by EUR 414bn (the equivalent of the current AT1 and T2 amount) with banks having to bear EUR23.6bn per year in extra funding costs by replacing AT1 and T2 with CET1. These costs would be likely passed through to the real economy resulting in higher permanent loan interest rates and an aggregate reduction in lending for households and corporates that we estimate at cEUR 75bn[12].

Simplification of capital layers: Three layers for stability and usability

The AFME proposal for the simplification of the capital layers under "going concern" suggests three layers: 1) the regulatory minimum, 2) a macro-prudential component and 3) a micro-prudential component. The proposed capital stack is displayed in Figure 6. The proposal maintains regulatory flexibility and reflects regulatory developments like pillar 1 backstops and stress testing results and enables more effective response to economic cycles, policy goals and competitive dynamics. The proposal increases the responsibility of European supervisors to take into account prevailing requirements when evaluating banks' risk-to-capital status.

Figure 6: AFME proposed going concern capital requirements



Source: AFME

In this proposal the **regulatory minimum requirements,** the first layer**,** reflecting pillar 1 capital remain in place unchanged.

The **macro-prudential component,** the second layer**,** is streamlined by removing the systemic risk buffer. The CCyB and the G-SIB/O-SII buffer would remain. The proposal abolishes the (SyRB) as an example of unnecessary layering, unwarranted national discretions, complex reciprocation mechanisms and unpredictability. The SyRB is a unique feature of the EU capital framework and has no equivalent either in the BCBS standards or in other major jurisdictions. The SyRB was meant to address systemic risks not already covered by macroprudential requirements in the CRR, other macro-buffers (CCoB, CCyB) and the G-SII/O-SII buffers. In practice such systemic risks have not been identified on a consistent, economically sound basis. It is a complex and non-transparent tool both in scope and level of application and suffers from a lack of usability.

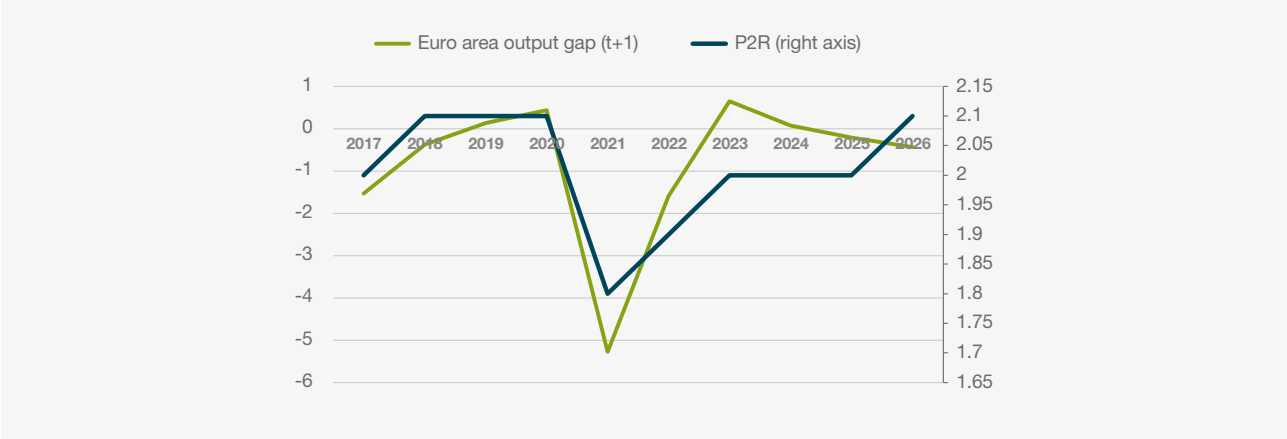
The CCyB, which was part of the original Basel III accord, is a macroprudential tool that allows authorities to dynamically adjust capital levels of banking firms when the risks to financial stability are growing in relation to the credit cycle. In practice, national authorities take a wider range of financial-system vulnerabilities and other factors into account as they evaluate settings for the buffer. When authorities determine that vulnerabilities have risen to be meaningfully above normal, the purpose of the CCyB is to increase capital to a level that compensates for those other rising vulnerabilities and thus reduces risks back to a normal level. Some of those vulnerabilities have indeed been rising in recent years, and some national authorities have decided on using the CCyB. However, and in contradiction to the concept of countercyclical buffers, some member states have set standing, so called positive neutral CCyB rates without a macro-economic justification.

12 *An ECB study estimates the elasticity of total credit demand to interest rates at an average of 2.1 (with loan measured as stock). We have used four different methods to estimate the size of the expected increase in loan rates, which we later apply to the 2.1 elasticity of demand and a euro area loan book of EUR 12.6tn. Method 1: extra funding costs of EUR 23bn relative to the size of the euro area loan book (EUR 12.6tn) is equivalent to 0.19%, which can be assumed would be fully pass-through to the economy in the long run (as shown by this Bank of England study). Method 2: estimate of changes to banks' weighted average cost of capital considering CET1, AT1, T2, and other bank liabilities like SNP (2.2% after-tax), SP (2.1% after tax), secured debt (1.8% after tax), and deposits (1.5% after tax). Weights of each from of liability are based on ECB SSM data for euro area banks. Replacement of AT1 and T2 results in a weighted average increase of 8bps in funding costs. Method 3: A BIS study finds that a 1pp increase in capital requirements is associated with a 15bps increase in loan rates, which we have extrapolated to the 4.4pp increase in CET1 capital from replacing AT1 and T2. Note, however, that a US FED study estimates that a 1pp increase in capital requirements is associated with a 8.8bps increase in loan rates. For Method 2, we have assumed a negligible Modigliani-Miller compensation of lower borrowing costs as T1 stays unchanged.*

The effect is a structural increase in the level of capital requirements through the cycle, as no compensation on other capital components is done in exchange. The argument of enhanced releasability as put forward by the proponents of the positive neutral CCyB is questionable given the general reluctance of policy makers to release capital once it is in the system. We would encourage policy makers to abandon the concept of “positive neutral” CCyB rates.

In the EU as a whole, because of the strength of the EU’s capital requirements, the assessment of overall vulnerabilities remained moderate. This raises the question of whether the through-the-cycle capital levels in the EU have been set so high, that a form of countercyclical buffer is effectively already "on": we already have capital at a level that compensates for these increases in vulnerability, but we did not reach that capital level through activation of the CCyB. In **Figure 7** we show the output gap of the Euro area (left axis) and the aggregated P2R (right axis) over time. The analysis indicates that the P2 requirements are set with a countercyclical effect, if not a countercyclical purpose, i.e., P2R is on average lower in periods of contraction and higher in periods of expansion. On P2G we also recommend countercyclical macroeconomic stress test scenarios as the basis to calibrate P2G levels. This follows the idea of a proactively steering supervisor that takes the state of the economy into account. This means, when the economy is in expansion as measured by a positive GDP output gap[13], the adverse macroeconomic scenario should be designed to be more severe reflected in larger cumulative loss of GDP which can ultimately lead to more stringent P2G levels. Conversely, when the economy is contracting, the severity of the ESRB scenarios should be relatively mild. The COVID period illustrates this idea well. The stress tests’ scenarios were originally designed in 2019 for application in 2020 (i.e. before the pandemic). As the economy contracted sharply in 2020, the stress tests were postponed to 2021 and the ESRB revised the scenarios to a less stringent severity. Unfortunately, though, this is the only example where an active steering of banks’ capital in relation to the state of the economic environment can be observed in the EU-wide stress test since its inception.

Figure 7: Average euro area P2R (%RWAs) and euro area output gap (%)



Source: ECB and IMF. Output gap shown with a 1-year lead as the P2R level is set on the previous year for application on the following year

Against the aforementioned shortcomings, we propose to calibrate the remaining macro component based on the countercyclical buffer (CCyB) and G-SII/O-SII requirements. We suggest resetting the CCyB to 0% across the EU at this point in time based on the through-the-cycle capital requirements that do have countercyclical characteristics and buffer economic cycles (see Figure 7) and euro area output gap (%). One could argue that with a buffer rate of 0% there is no way of acting countercyclically in a future downturn, however we think that the P2 elements can account for that with help of countercyclically calibrated stress test scenarios and appropriate calibration of P2R. If there was the desire to have a positive CCyB rate, this would in effect act as a static capital component not dissimilar to the CCoB. Therefore, a positive CCyB should be reflected in lower through-the-cycle requirements where the supervisor is given the option to offset a nationally activated CCyB through the P2. The UK's approach to bank capitalisation serves as a strong precedent for this proposal. As outlined in the PRA PS 15/20, the PRA may adjust firm-specific Pillar 2A (P2R equivalent) capital requirements to offset increases in the CCyB. This approach ensures that the overall level of loss-absorbing capacity in the banking system remains broadly constant, while preventing a "double counting" of risks. The core reasoning is to shift the balance of capital requirements from fixed minimums towards buffers that can be drawn down, thereby enabling banks to absorb losses while continuing to support the real economy through lending during a downturn.

13 *Output gap is a measure that indicates the state of the cycle of the economy. It’s calculated as the difference between an economy's observed GDP and its potential output (i.e. what it could produce at full capacity). A positive value indicates that the economy is under expansion (overheated), while a negative value indicates the economy is under recession or operating below its full capacity.*

We acknowledge that the governance of macro-prudential buffers and micro-prudential requirements and guidance lie in principle with different authorities in the EU. This makes a coordinated approach challenging. However, as part of the simplification agenda, this governance should be reviewed. At the minimum we propose a forum that coordinates capital requirements of all kinds at EU level.

Further, we propose abolishing O-SII requirements for all entities under a G-SII group as unnecessary layering. For G-SIIs under the Banking Union, calibrating a separate O-SII buffer is duplicative of the G-SII buffer determined by the Financial Stability Board (FSB) standard. To an extent, it challenges the calibration determined by the FSB and can result in a buffer inconsistent with and higher than that prescribed by the FSB. We also suggest setting the O-SII buffer in reference to the EU Banking Union and not on the national economy. However, in order to acknowledge the fact that the systemic impact of the failure of an O-SII which is not identified as a G-SII is by construction lower than the systemic impact of the failure of a bank that has been identified as G-SII, the O-SII buffer rate should be capped at 0.75%, i.e. below lowest level of the G-SII buffer as per FSB rules to ensure effective discrimination between G-SII and O-SII buffers. This would also be a way to address the issue of the vast and undue heterogeneity[14] of the O-SII bucketing methodology across Member States.

The **third layer** of the proposal is the **supervisory component** consisting of a firm-specific usable guidance, and a non-usable requirement.

The supervisory component includes, as it does today, the supervisory review and evaluation outcome (P2R) and supervisory guidance based on stress test (P2G). However, for illustrative purposes we do group the Basel requirement of capital conservation with the current P2 elements. We do this, similar to the US stack, to highlight the CCoB's function of ensuring capital availability during downturns. While this "grouping" does not affect the Total SREP Capital Requirements and current MDA thresholds, we do think it illustrates a way to to effectively address the overlap in particular with P2G as the countercyclical stress test outcomes amplify the capital amount held for adverse conditions unnecessarily[15].

It is noted that our proposal preserves a "non-simple" status quo of a split P2 where a single supervisory buffer might be preferable in **avoiding the cumulative "tightening"** that occurs when multiple independent buffers are applied simultaneously. A single buffer could still be calibrated to reflect both point-in-time and through-the-cycle (stressed) risks. This in turn would aid addressing methodological issues with the P2G determination, namely that the buffer is set on absolute depletion regardless of the starting CET1 level and also that the EU-wide stress test methodology, in contrast to CCAR and UK Pilar 2B, does not allow for any stress recovery. However, we don't regard a single supervisory buffer feasible in the EU at this point as it requires supervisors to be mandated with the holistic responsibility of a bank's total capital requirement, and act accordingly when setting P2 capital. Whilst keeping the split P2, we believe that further transparency in their calibration is warranted, including any qualitative discretion applied by the competent authority in its calibration.

In any case, we believe that buffer usability could be further strengthened by increased regulatory transparency to support draw down. Whether banks have a legal ability to draw down becomes moot if there is no clear market signal that doing so does not imply weakness. Supervisors should implement clear communication plans that set out expectations that banks' draw downs, subject to oversight, are desirable in stress conditions. Usability could further be improved by providing ex-ante expectations for re-instating the drawn down buffer, e.g. a suitable timeline for the build-up.

We also wish to mention that increased flexibility, predictability and simplification in the capital framework would be further brought by the removal of the compounding MDA triggers across the prudential framework, namely from the Leverage stack and from the TLAC / MREL stack (see below our recommendations in sections c and d). Indeed, the multiplication of these unwarranted backstops in the various stacks hinder the ability of banks to make the most efficient use of their capital in going-concern and leads to the constitution of oversized management buffers on top of regulatory ones.[16]

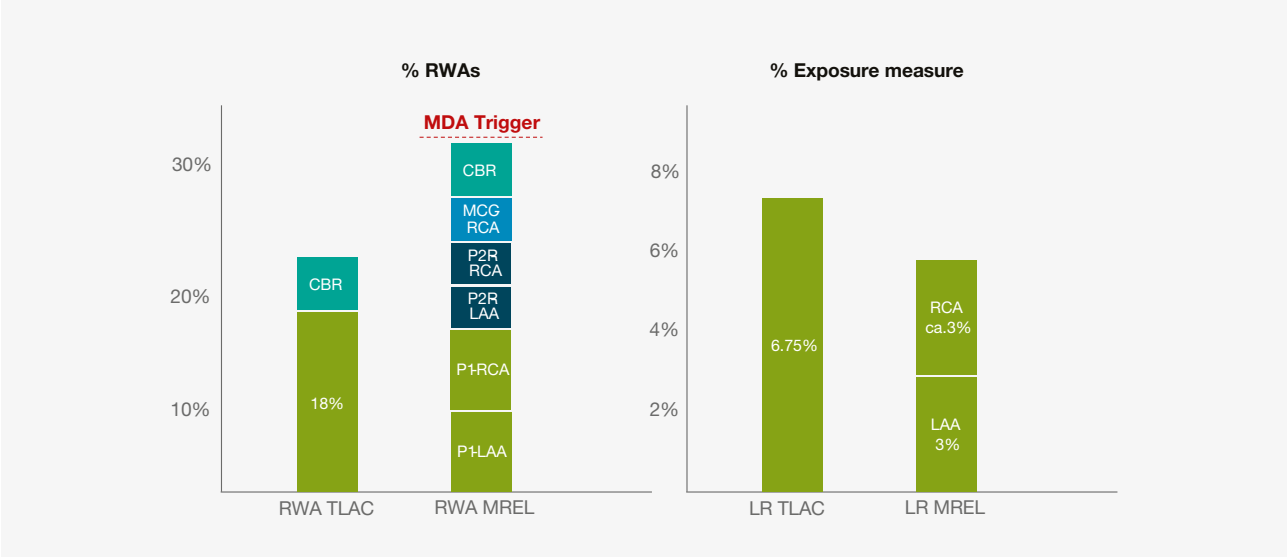
Lastly, we recommend that any desired change in the capital stack framework should be thoroughly reviewed and tested prior to release to avoid unintended consequences and de-linking a firms capital position from the actual risks they are exposed to.

14 *See also "Banking Union: measuring progress and identifying implementation gaps", AFME (2025)*
15 *While assessment of overlaps is prescribed in the EBA SREP guidelines, we do think that embedded consideration in the capital stack would be preferable.*
16 *Also see "Stacking orders and capital buffers", EBA (2024), p. 6f.*

c. *Proposal for loss-absorbing capital requirements*

Gone concern capital aims to ensure banks have sufficient loss-absorbing and recapitalisation capacity to implement an orderly resolution. Requirements are set out under the EU's regulatory framework for resolution. As with going concern capital, gone concern is made up of multiple layers.

Figure 8: "Gone concern" capital requirement in the EU



Source: AFME

CBR: Combined Buffer Requirement (CCyB, CCoB, GSII, O-SII, and SyRB); LAA: Loss Absorption Amount (equal to going-concern capital requirements excluding buffer, i.e., P1+P2R); RCA: Recapitalisation Amount; MCC: Market Confidence Charge (generally equal to CBR subject to possible limited adjustments

Proposal for simplification of gone concern capital stacks: TLAC and TLOF without MDA triggers

The AFME proposal suggests using **TLAC for the risk-based perspective and TLOF for the assets-based** perspective (replacing the leverage-based one) **as the only resolution stacks** applicable to all non-liquidation banks operating in the EU subject to possible flexibility regarding the subordination requirements.

For risk-based requirements, the proposal to only use TLAC and to extend its use to all EU resolution entities would mean one simpler, internationally agreed concept rather than two partially very complex ones. Focus on TLAC[17] would heal the current calibration mechanic whereby any increase in the going-concern stack automatically ends up almost doubled in the gone-concern one via the automatic calibration of Recapitalisation Amount (RCA): as it stands, post-resolution considerations are not reflected automatically in RCA calibration leading to banks holding significantly higher contingent capital than actually required in practice. Lastly, the proposal removes conceptual misalignment in MREL, i.e. the market confidence charge: market confidence cannot be rebuilt via a buffer. We note that, if the proposal was to be adopted, more work is required for instance on topics like eligible instruments to cover TLAC (i.e. determination of Senior debt allowance) and multiple / single point of entry resolution models (e.g. deductions).

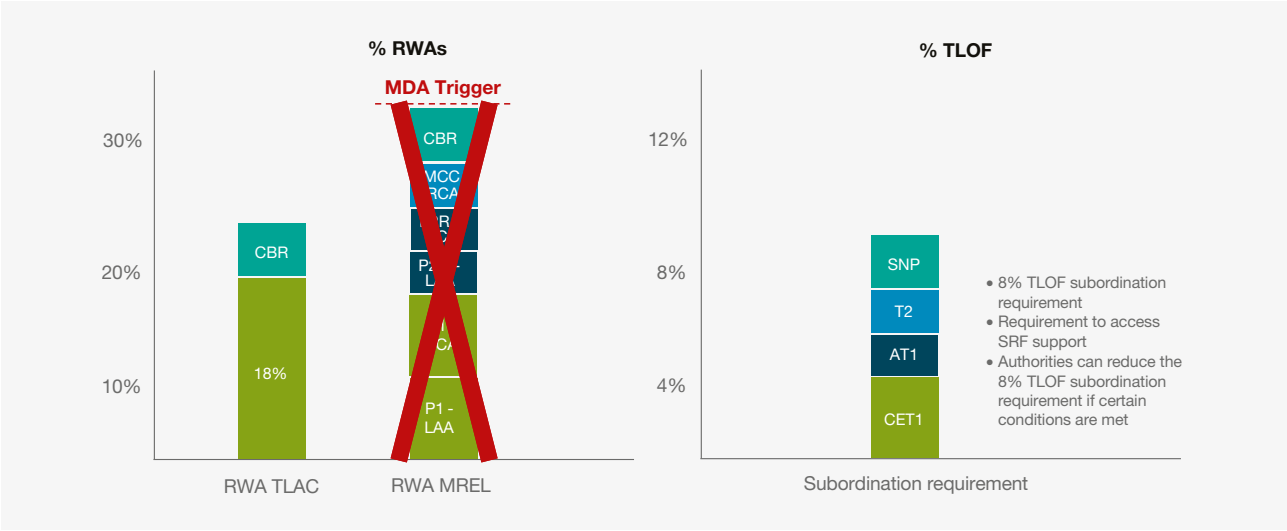
From a non-risk based (asset-based) perspective, TLOF would remain a mainly subordinated (subject to allowance foreseen in Art. 72b (3) CRR) requirement for all firms currently under MREL requirements. This proposal would significantly increase transparency and predictability for firms and all their stakeholders.

Similar to recent CMDI reforms[18] we suggest a floor for banks with sale of business and market exit as preferred resolution strategy (linked to the use of DGS funds to access the SRF).

Finally, MDA triggers currently embedded in the gone concern capital stack would be removed. Not having MDA triggers in the gone concern view is conceptually desirable because it avoids perceptions of stress and hence instability without actual cause for concern and would make the concept simpler, more transparent and easier to understand for investors. Indeed, cases where a bank would not breach its going-concern capital requirements, CBR included, but would breach its loss-absorbing ones, CBR included, are much more likely to occur due to financial market disruptions than to bank-specific issues. In case of bank-specific issues, the going-concern MDA would likely be triggered too, making the loss-absorbing one largely redundant.

17 *Regarding non-resolution entities, we urge the EU/SRB to align more closely with the FSB's standard regarding the 75%-90% scaling range for internal loss-absorbing capacity.*
18 *Art. 45c/12d BRRD/SRMR.*

Figure 9: AFME proposal for simplifying the EU gone concern capital layers



***CBR**: Combined Buffer Requirement (CCyB, GSII / O-SII, CCoB); **LAA**: Loss Absorption Amount; **RCA**: Recapitalisation Amount; **MCC**: Market Confidence Charge. **SNP**: Senior non-preferred debt*

d. Leverage ratios

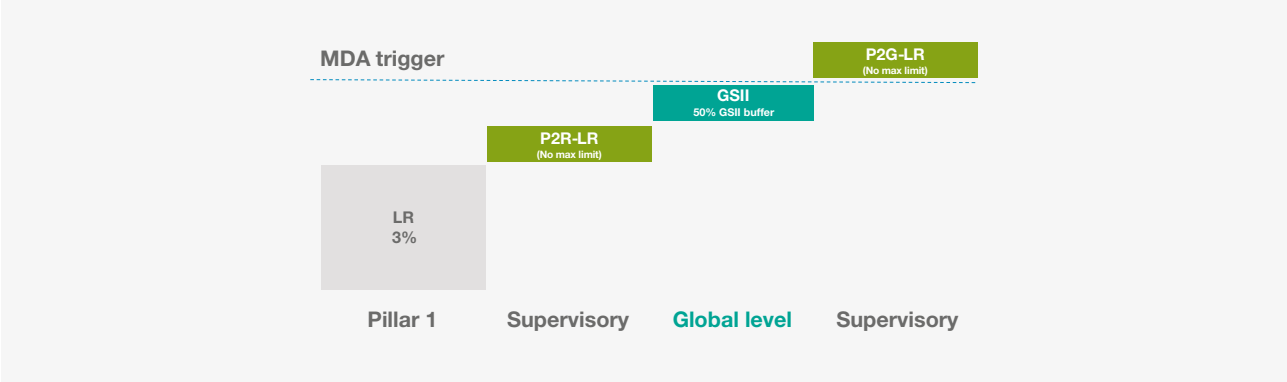
The Basel standards require banks to maintain a Tier 1 Leverage Ratio of at least 3%. The purpose of the Leverage Ratio is to reduce the risk of periods of deleveraging and to act as a non-risk based 'backstop' to complement banks' risk-based capital requirements. In the EU, the requirement is implemented through the Capital Requirements Regulation.

There are several other layers in the Leverage Ratio stack in addition to the 3% leverage ratio minimum. The additional layers are:

- Pillar 2 Requirement Leverage Ratio: this captures the risks of excessive leverage that remain or are insufficiently captured by the 3% minimum requirement.
- Leverage Ratio G-SII buffer: this additional layer applies to G-SIIs, calibrated to 50% of the G-SII buffer requirement in the solvency framework
- Pillar 2 Guidance Leverage Ratio: this buffer on top of the G-SII buffer to reflect supervisory expectations. It is non-binding and indicates the level of capital that a bank should maintain to be able to withstand periods of financial stress from a leverage perspective.

Each component of the leverage ratio stack must be met with T1 capital.

Figure 10: Current EU leverage ratio framework



Proposal for Simplification: A single leverage ratio without MDA triggers

The AFME proposal would put the **internationally agreed leverage ratio at its center**. Hereby, in particular add-ons that were imposed in relation to supervision would be removed. In effect, this is simplification at its best because the convoluted European leverage framework serve the intended backstop function where non-compliance is met with supervisory and market discipline.

In the interest of consistency and simplification, **no MDA trigger would apply to the leverage ratio**. In this way, the leverage ratio can serve as a true backstop, where non-compliance with the leverage ratio will always meet the appropriate and disciplinary response from markets and investors.

In the view of international alignment and well-functioning monetary policy transmission, it is recommended to review scope and **exclude central bank deposits from the exposure measure**. In jurisdictions like the UK, central bank deposits are exempted from the leverage ratio primarily to prevent regulatory requirements from impeding the transmission of monetary policy, particularly during periods of high liquidity or central bank asset purchases. Because these deposits are considered risk-free, including them in the leverage ratio (which acts as a constraint on total assets) could restrict banks' capacity to lend, hold client deposits, or utilise central bank liquidity facilities, thus hindering financial stability.

e. Governance

Proposal for Simplification: An EU banking forum

To support engagement between competent (micro and macro) and resolution authorities, limit overlaps across various requirements and streamline initiatives, we propose **establishing a central EU banking forum** between the relevant authorities, including national ones, to help authorities to consider the operational impact and capital demand of their decisions on firms. While similar on substance and motivation, in terms of regional scope our proposal targets the EU as a whole as opposed to the Banking Union. This is an important extension of the scope as banks' challenges with overlapping requirements goes beyond the Banking Union's boundaries.

Our proposal is agnostic of where such a central forum should be established or how it should be governed, as long as an EU-wide holistic assessment of micro- and macroprudential as well as resolution requirements is ensured and cross-country overlaps are addressed effectively. We also support the Task Force's recommendation to foster common methodologies and guidelines across the EU, including stress testing. This is an important step towards reducing the level of heterogeneity in capital decisions and to facilitate greater coordination and consistency in setting micro- and macroprudential instruments across jurisdictions.

f. Capital impact

The AFME proposal is expected to generate approximately EUR 2.8tn in additional lending to the real economy and lower EU banks' cost of capital by 62bps.

To produce these estimates, we analysed the balance-sheet structure of EU G-SIBs, non-GSIB O-SIIs (also deemed SIs), and LSIs, focusing on the consumption of each capital buffer and requirement and the extent to which the proposed changes would release CET1 capital.

We also evaluated the transmission of these changes to banks' weighted average cost of capital (WACC), taking into account the funding mix and capital requirement constraints of banks.

Finally, we estimated the impact on credit supply by modelling how the resulting capital relief would expand banks' capacity to support lending to households and firms.

The results by size of credit institution and for the EU as a whole by source of capital relief are shown in Figure 11 below. The estimates have been produced individually by size of institution, while the EU aggregate is a weighted average estimate by the individual impact by type of institution.

Figure 11: Impact of AFME proposal
Impact of buffer streamlining and MREL Removal on CET1 Capital Requirements (% of RWAs)

	GSIBs	OSIIs (non-GSIB SIs)	Small banks (LSIs)	EU banks
SyRB phase-out	0.07%	0.32%	0.30%	0.25%
OSII removal for GSIBs	0.32%	0%	0%	0.09%
OSII cap at 0.75%	0.00%	0.48%	0%	0.25%
CCyB = 0	0.71%	0.74%	0.74%	0.74%
MREL phase-out	0%	1.20%	1.50%	0.94%
Total	1.10%	2.74%	2.54%	2.26%
Impact on cost of capital (bps)				-62
Lending to the economy				**EUR 2.8tn**

Source: AFME estimates. GSIB balance sheet data and requirements from P3 disclosures and EBA risk dashboard. LSI balance sheet data from SSM, SRB, and model assumptions, requirements based on EBA and ESRB. O-SII balance sheet data sourced from EBA 2025 Transparency exercise data templates (Capital, Leverage, P&L, RWAs and Financial Assets). See sources on next tables for further detail.

Phase-out of the Systemic Risk Buffer (SyRB)

The impact of the SyRB phase-out represents on aggregate 0.25% on CET1 (%RWAs), but this varies significantly by bank size, reflecting differences in the degree of exposure to countries that have a SyRB in place and to product lines subject to the SyRB.

The SyRB phase-out is generally more impactful for domestically focused banks and with exposures to mortgages, than for internationally diversified GSIBs. This is because the SyRB is more frequently applied to mortgage exposures, where, according to the ESRB[19] as of early 2026, 9 of the 10 sectoral SyRB buffers in the EU are applied on real estate exposures. Currently 16 of the 27 EU MS make use of a sectoral or general SyRB.

GSIBs see only a marginal effect (0.07% of RWAs), as SyRB consumes a small share of their total capital according to Pillar 3 disclosure releases[20]. The lower proportion is due to their international diversified business model with exposures to countries that don't apply a SyRB framework.

LSIs benefit more substantially, with a 0.30% reduction in CET1, as LSIs typically have more domestic exposures and mortgage portfolios, which account for a disproportionately large share of LSIs' balance sheets[21].

O-SIIs experience a 0.32% CET1 relief, considering ESRB data SyRB consumes a similar share of capital for this group[22].

Removal of the O-SII Buffer for GSIB holding companies

This measure applies narrowly to GSIBs that currently face domestic O-SII buffers set above the global GSIB FSB buffer. For GSIBs, the removal of the O-SII buffer delivers an aggregate 0.30% CET1 free-up (as % of RWAs), by affecting 3 of the 7 EU GSIBs currently subject to higher domestic O-SII buffers that the FSB level[23].

LSIs do not benefit from this measure, as they are not subject to O-SII buffers.

Cap of the O-SII Buffer at 0.75% and removing O-SII buffer for GSIB subsidiaries

This measure affects 60 of the 164 O-SII banks, dropping the average O-SII buffer from a current 1.06% of RWAs (according to ESRB data[24]) to 0.58%, corresponding to an aggregate 0.48% CET1 reduction for this group of banks.

LSIs are not impacted, as they are not subject to O-SII requirements.

19 *See https://www.esrb.europa.eu/national_policy/systemic/html/index.en.html*
20 *Current capital consumption from SyRB sourced from Pillar 3 disclosures for BNPP (0.14%), CA (0.11%), SocGen (0.04%), ING (0%), DB (0.14%), BPCE (0%), and Santander (0.06%)*
21 *See 2025 EBA Risk Assessment report https://www.eba.europa.eu/publications-and-media/publications/capital-and-risk-weighted-assets-1*
22 *See 2025 EBA risk assessment report*
23 *According to ESRB Combined Buffer Requirements as of 31 December 2025 report. ING (2%), DB (2%), and Santander (1.25%) have a higher OSII buffer than their Basel GSIB buffer (all at 1%).*
24 *According to ESRB Combined Buffer Requirements as of 31 December 2025.*

Recalibration of the CCyB to zero

The recalibration of the CCyB is a material and broadly distributed source of CET1 relief across all bank categories.

According to Pillar 3 public disclosures, the CCyB consumes 0.71% of GSIB CET1 (as % of RWAs). LSIs and O-SIIs experience a similar effect, with a 0.74% reduction, based on the current capital consumption as measured by the EBA[25].

Phase-out of MREL, introducing TLAC for O-SII and LSIs, and TLOF maintained

The phase-out of MREL, while implementing a TLAC for non-GSIBs and preserving an 8% TLOF subordination requirement, is the most structurally significant reform. Its quantitative impact, however, significantly varies across bank types.

For GSIBs, the removal of MREL delivers significant simplification benefits but very limited capital relief. This is because GSIBs subordination requirement, measured by total loss-absorbing funds (i.e. TLOF) is currently[26] binding at 8.1% of total assets[27]. As this constraint remains unchanged under the proposal, even if MREL is phased-out, GSIBs would continue limited by the TLOF requirement leaving little scope for any CET1 capital relief. Other balance-sheet adjustments for GSIBs are expected to occur mainly through the repurposing of senior preferred (SP) liabilities, which are no longer required once MREL is phased out and can be replaced by more cost-efficient funding.

For LSIs, the impact is substantial, delivering around 1.50% CET1 relief (as % of RWAs). Currently, MREL for small non-Pillar 1 institutions on an RWA basis is binding at approximately 26% of RWAs[28], while LSIs hold a large gap relative to the 8% TLOF requirement (c.13.7%). This creates significant headroom to reduce subordinated liabilities toward the 8% level and comply with a recalibrated TLAC requirement of 20.5% of RWAs composed of 18% plus a recalibrated Combined Buffer Requirement of 2.5% (2.5% CCoB + 0% O-SII + 0% CCyB + 0% SyRB).

O-SIIs benefit from a 1.20% CET1 reduction through the recalibration of resolution requirements from MREL to TLAC. Under the new framework, the TLAC requirement for O-SIIs would stand at 21.1% of RWAs, composed of 18% minimum TLAC, plus a 3.1% Combined Buffer Requirement (2.5% CCoB + 0.58% recalibrated O-SII buffer + 0% CCyB + 0% SyRB). CET1 reductions are modelled by maintaining a 1% management buffer above the new TLAC requirement.

Aggregate Effects on Cost of Capital

The AFME proposal translates into a 62-basis-point reduction in EU bank cost of capital, with differences in the distribution size by type of bank. The differences stem from the size of the CET1 free up and the distribution of liabilities, as banks with higher CET1 intensity experience larger cost-of-capital reductions as this is typically the most expensive form of liability for banks.

For the cost of each form of liabilities, we have estimated the cost of CET1 capital using a CAPM approach. The cost of debt is based on coupon rates of constituent instruments of iBoxx EUR bank indices. See Figure 12 below.

Figure 12: Cost of each form of liability for GSIB banks, Nominal terms. 2025

	pre-tax	after-tax
Senior secured	2.5%	1.8%
SP	2.9%	2.1%
SNP	3.0%	2.2%
T2	4.0%	2.9%
AT1	6.2%	4.5%
CoE (CET1)	9.2%	9.2%

Source: AFME with LSEG, EBA, ECB, EBA, NYU (Damodaran), Datastream and S&P. Indices: Markit iBoxx EUR Contingent Convertible Liquid Developed Market AT1, iBoxx EUR Banks Tier 2, Markit iBoxx EUR Banks Senior Preferred, Markit iBoxx EUR Banks Senior Bail-in

25 *See 2025 EBA risk assessment report*
26 *CET1, AT1, T2, RWAs, Total assets, and SNP debt sourced from GSIB P3 disclosures and earnings reports.*
27 *Used total assets as approximation due to the lack of disclosure of TLOF amounts for banks.*
28 *See SRB MREL Dashboard https://www.srb.europa.eu/system/files/media/document/2025-11-07_MREL-dashboard_H1-2025.pdf*

GSIBs see an overall 1.1% reduction in CET1 requirements, translating into a 28-basis-point decline in cost of capital. LSIs experience a 2.54% reduction in capital requirements, resulting in a 132-basis-point decline in cost of capital, far larger than for GSIBs. O-SIIs benefit from a reduction in cost of capital of 51 bps.

The impact considers Modigliani–Miller compensation effects from reduced buffers. Details are on Annex 2.

Impact on lending: extra EUR 2.8tn in lending for the real economy

When translated into lending terms, the AFME proposal could support an estimated EUR 2.8 trillion of additional lending to the economy.

This has been estimated considering that, as shown on Figure 11, the proposals would deliver an aggregate relief of 2.26% CET1 (%RWAs), which represents EUR 281bn in CET1 capital, based on EUR 12.4 trillion in EU banking sector RWAs[29].

The EUR 281bn of freed up CET1 capital is assumed to be repurposed by applying a 15% CET1 required ratio and a 65% risk weight results in EUR 2.8tn in freed up capacity for lending[30]. This compares with a current outstanding amount of EUR 33tn euro area banking assets (GSIBs, O-SII, and LSIs). More specifically:

$$CET1\ ratio\ requirement = \left(\frac{\text{CET1}}{RWAs}\right) = \left(\frac{\text{CET1}}{Risk\ weight\ x\ Assets}\right)$$

Rearranging:

$$Assets = \left(\frac{\text{CET1}}{Risk\ weight\ x\ CET1\ ratio\ requirement}\right) = \left(\frac{€\,281\text{bn}}{65\%\ x\ 15\%}\right) = €\,2.8tn\ (approx.\ 10x\ multiplier)$$

29 *EUR 3.3tn in GSIBs according to P3 reports, 6.5tn in OSIIs according to the EBA EU-wide Transparency register, and 2.6tn in LSIs according to the ECB (SUP.Q.B01.W0._Z.LE999._T.LSI._Z.ALL.LE.E.C)*

30 *Assuming banks would need to comply with a CET1 15% ratio and a 65% risk weight which is equivalent to lending to investment grade corporates.*

Annex 1: Capital impact

We have estimated the capital impact by size of institution (G-SIBs, non-GSIB O-SIIs, and LSIs), based on the balance-sheet structure of these banks in the EU. We have focused the analysis on the relative contribution of each capital buffer and requirement relative to RWAs and the extent to which the proposed changes would release CET1 capital.

In this annex, we seek to provide further detail on the data and the impact by type of institution in addition to what was presented on Figure 11 in section f.

Impact on GSIBS

Table A1 below shows a simplified version of the balance sheet structure of GSIBs with the amount of capital, eligible liabilities, and other forms of debt. The right panel shows the impact on the balance sheet structure of the AFME proposal, which includes phase-out of SyRB, O-SII removal for GSIBs, recalibration of O-SIIs, and phase-out of MREL while retaining the TLOF subordination requirement.

In the footnotes, we note the various sources used for the amount of liabilities for GSIBs. The CET1 impact noted in the right panel are based on Pillar 3 disclosures as discussed in section f, which includes[31] a 0.07% on RWAs from phasing-out SyRB, 0.32% from the O-SII removal for GSIBs, and a recalibration of the CCyB to 0.

Table A1: EU GSIBs balance sheet evaluated under AFME proposal

	Current	AFME proposal	
Senior secured debt	178	323	↑
SP	146	-	↓
SNP	299	336	↑
T2	91	91	
AT1	61	61	
CET1	513	476	↓
Liabilities	1,287	1,287	
Assets	11,909	11,909	
RWAs	3,361	3,361	
WACC (after-tax, %)	**5.09**	**4.81**	↓
CET1 ratio	15.3%	14.2%	↓
T1 ratio (CET1, AT1, %RWAs)	17.1%	16.0%	↓
Total capital ratio (CET1, AT1, T2, %RWAs)	19.8%	18.7%	↓
MREL ratio (CET1, AT1, T2, SNP, SP, %RWAs)	33.0%	28.7%	↓
TLAC ratio (%RWAs) (CET1, AT1,T2 and SNP, %RWAs)	32.2%	28.7%	↓
TLOF (CET1,AT1,T2,SNP, % Assets)	8.1%	8.1%	

1. Lower CET1 from SyRB phase-out (0.07% of RWAs), OSII removal for GSIBs (0.32%), recalibration of CCyB (0.71%)
2. Changes in CET1 would be absorbed by higher SNP debt to continue compliance with TLOF (8% assets)
3. No capital relief from MREL phase -out, as banks are limited by TLOF 8% requirement .
4. Banks can repurpose the stock of SP debt as MREL is phased-out. Replaced SP by more cost-efficient debt.

Source: CET1, T1, T2, RWAs, Total assets and SNP sourced from GSIB P3 disclosures. Senior secured debt amount sourced from EBA risk monitoring: BNPP (here), CA (here), DB (here), ING (here), BPCE (here), SocGen (here). Senior preferred (SP) amount estimated extrapolating the total EU-wide senior unsecured amount according to the EBA risk assessment report (Fig 29 here) adjusted to GSIBs market contribution. Ratios and other figures are AFME estimates.

For purposes of estimating the cost of capital under the AFME going concern proposal, we have assumed that all these changes in CET1 would be absorbed by higher SNP debt to continue compliance with the TLOF 8% subordination requirement which is currently a binding requirement according to AFME estimates. The increase in SNP would allow banks to redeploy CET1 into new lending while adjusting their liability structure toward SNP to meet TLOF.

Regarding changes to the MREL framework, considering the continuation of the 8% TLOF requirement as discussed in the report, our modelling indicates that the main balance-sheet adjustments would arise from the repurposing of senior preferred (SP) liabilities as these instruments would no longer be required following the phase-out of the MREL framework and can be replaced with more cost-efficient funding sources.

31 *SyRB and CCyB estimate based on Pillar 3 disclosures. OSII impact based on reduction in surcharge for 3 banks (DB, SAN, ING) currently penalised with a higher OSII than GSIB buffer.*

Impact on LSIs

Table A2 below shows a simplified version of LSIs balance sheet. The right panel shows how the impact affects the balance sheet structure.

In the footnotes, we note the various sources used to estimate the amount of liabilities for LSIs. The CET1 impact on the right panel are based on AFME estimates from the balance sheet structure of LSIs and the EBA risk assessment report which indicates the consumption of SyRB and CCyB for banks in the EU, which has been assumed to impact at the same proportion to LSIs.

Table A2: EU LSIs balance sheet evaluated under AFME proposal

	Current	AFME proposal	
Other	91	156	↑
Sub	159	159	
T2	28	28	
AT1	4	4	
CET1	474	408	↓
Liabilities	755	755	
Assets	4,848	4,848	
RWAs	2,572	2,572	
WACC (after-tax, %)	**6.53**	**5.20**	↓
CET1 ratio	18.4%	15.9%	↓
T1 ratio (CET1, AT1, %RWAs)	18.6%	16.0%	↓
Total capital ratio (CET1, AT1, T2, %RWAs)	19.6%	17.1%	↓
TLAC ratio (%RWAs) (CET1, AT1,T2 and Sub, %RWAs)	25.8%	23.3%	↓
TLOF (CET1,AT1,T2,Sub, % Assets)	13.7%	12.4%	↓

1. Lower CET1 from SyRB phase-out (0.3% of RWAs) and recalibration of CCyB (0.74%)
2. CET1 relief from MREL phase -out of c1.5% of RWAs as MREL is a binding constraint for LSIs. Lower CET1 until banks reach a binding capital constraint.
3. CET1 reduction offset by increase of other cost - efficient liabilities to maintain balance sheet size.

Source: LSI balance sheet data from SSM Supervisory Banking Statistics. CET1: SUP.Q.B01.W0._Z.O1100._T.LSI._Z.ALL.LE.E.C ; T1: SUP.Q.B01.W0._Z.NSV12._T.LSI._Z.ALL.LE.E.C; Total capital: SUP.Q.B01.W0._Z.O0000._T.LSI._Z.ALL.LE.E.C. RWAs: SUP.Q.B01.W0._Z.E0000._T.LSI._Z.ALL.LE.E.C; Total assets: SUP.Q.B01.W0._Z.LE999._T.LSI._Z.ALL.LE.E.C Subordinated liabilities estimated assuming a 26% ratio based on Small SI institutions from SSM supervisory Statistics which is equivalent to a 26% SRB requirement for small non-Pillar 1 banks as per SRB H1 2025 MREL Dashboard, considering observed total capital numbers from SSM data as noted above. Other non-eligible liabilities are estimated by using the stock of outstanding debt securities for small SI institutions as per SSM Supervisory statistics (T.02.04.3), readjusted for LSI balance sheet size.

As it was the case for GSIBs, we have assumed the reduction would come predominantly from lower CET1 which is the most expensive form of capital until banks reach a binding capital constraint.

O-SII impact supported by recalibration of O-SII buffer

Table A3 below shows a simplified version of O-SIIs balance sheet structure with the amount of relevant liabilities for this analysis. The right panel shows how the impact affects the balance sheet structure. In the footnotes, we note the various sources used to estimate the amount of liabilities for O-SIIs.

Table A3: EU O-SII balance sheet evaluated under AFME proposal

	Current	AFME proposal	
Other	3,475	3,623	↑
Sub	228	228	
T2	173	173	
AT1	85	85	
CET1	1,134	987	↓
Assets	17,068	17,068	
RWAs	6,507	6,507	
Subordinated Liabilities	1,620	1,473	↓
CET1 ratio	17.4%	15.2%	↓
T1 ratio (CET1, AT1, %RWAs)	18.7%	16.5%	↓
Total capital ratio (CET1, AT1, T2, %RWAs)	21.4%	19.1%	↓
TLAC ratio (%RWAs) (CET1, AT1,T2 and Sub, %RWAs)	24.9%	22.6%	↓
TLOF (CET1,AT1,T2,Sub, % Assets)	9.5%	8.6%	↓

1. Lower CET1 from SyRB phase-out (0.32% of RWAs), OSII cap at 0.75% (0.48%) and recalibration of CCyB (0.74%)
2. CET1 relief from MREL phase -out of c1.2% of RWAs. OSIIs would be subject to a recalibrated TLAC requirement of 21.1% of RWAs.
3. CET1 reduction offset by increase of other cost - efficient liabilities to maintain balance sheet size.

Source: EBA 2025 EU wide transparencyy excercise data for O-SII banks

Annex 2: Cost of capital impact

We seek to evaluate how AFME's proposed recalibration of the EU capital stack could affect banks' cost of capital. We do so by modelling potential impacts on banks' weighted average cost of capital (WACC) under two alternative capital stack scenarios: (1) current capital stack, and (2) AFME proposed recalibration of the capital stack.

As the AFME capital stack proposal seeks to evaluate various forms of debt and equity, we propose to breakdown the two traditional components of the cost of capital measure as follows:

$$\text{WACC} = \left(\frac{\text{CET1}}{\text{A}}\right)\text{R}CET1 + \left(\frac{\text{AT1}}{\text{A}}\right)\text{R}AT1(1-T) + \left(\frac{\text{T2}}{\text{A}}\right)\text{R}T2(1-T) + \left(\frac{\text{SNP}}{\text{A}}\right)\text{RSNP}\ (1-T) +$$

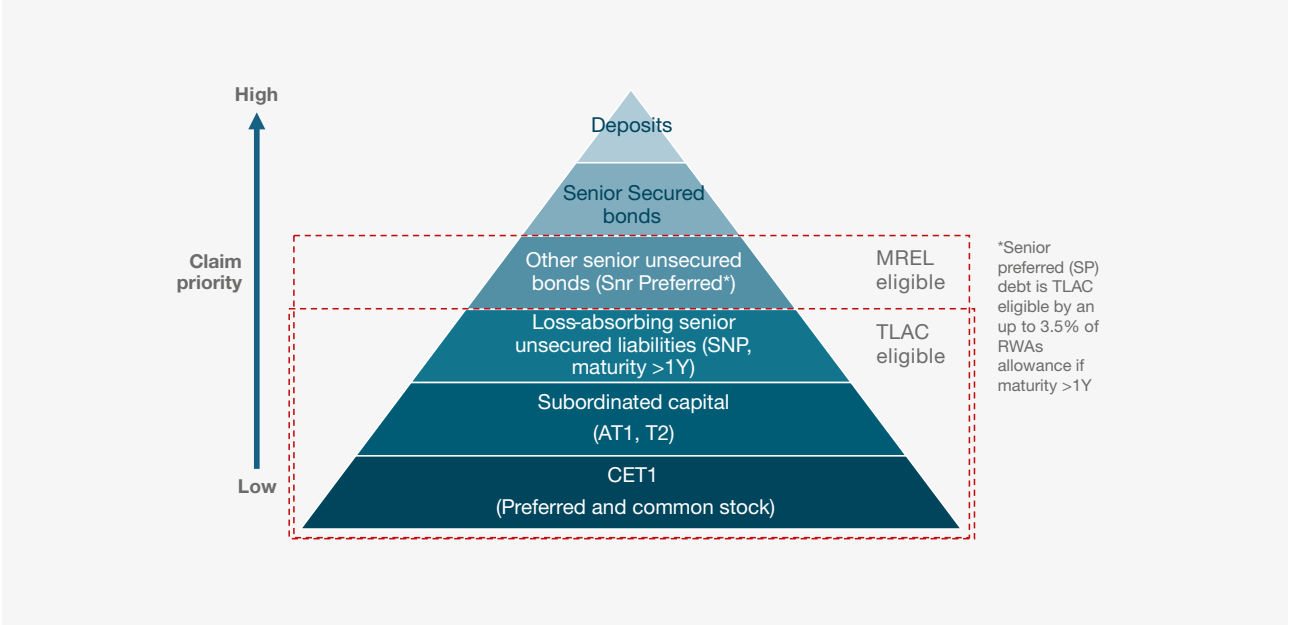
$$\left(\frac{\text{SP}}{\text{A}}\right)\text{R}SP(1-T) + \left(\frac{\text{Senior}_{\text{secured}}}{\text{A}}\right)\text{R}Snr\ Secured(1-\text{T})$$

Where:

- CET1, AT1, T2, SNP, SP, and Snr Secured instruments are total amount of each layer of liabilities. TLAC represents the TLAC eligible liabilities such as senior non-preferred bonds.
- RCET1, RAT1, RT2, RSNP, RSP, and RSnr Secured are the cost associated with each layer (cost of equity and of the various forms of debt)
- A is total assets (sum of all layers)
- T: corporate tax rate, to consider tax deductibility of coupon and interest payments

This formulation directly mirrors the capital hierarchy as illustrated in the chart below, placing CET1 at the base of loss absorption (and thus the most expensive component), and progressively incorporating cheaper, more senior instruments up the structure.

Figure A4: Capital hierarchy



**SNP stands for senior non preferred*

The most challenging aspect of the exercise is estimating the cost associated with each layer of capital.

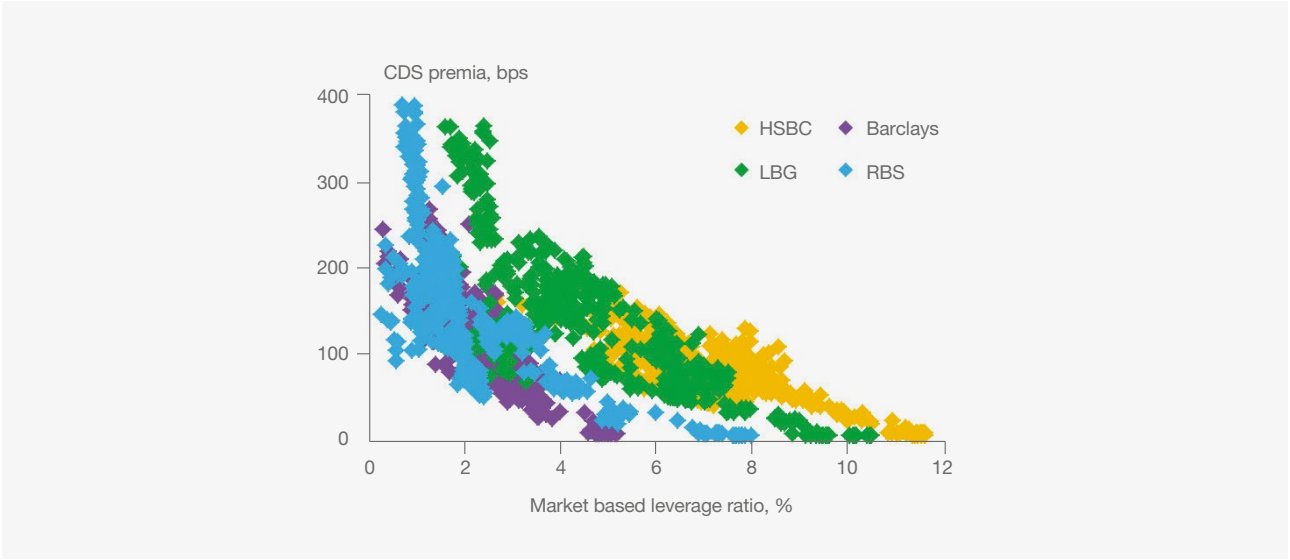
Cost of capital layers and non-linearities

An important observation relating to the cost of capital layers is that higher capital ratios can enhance creditworthiness and resilience, lowering borrowing costs, but only up to a point. Extra capital brings minimal market benefit, creating a "flat spot" in the cost of capital curve

Analysis undertaken by the Bank of England and by the ECB suggests that higher capital ratios correspond with lower CDS spreads and lower borrowing costs.

Bank of England analysis32 shows how CDS spreads decline as market-based leverage ratios (T1/exposure measure) increase, based on data for major UK banks. This indicates that higher leverage (or lower capital) is associated with higher perceived credit risk and therefore higher CDS premia and higher borrowing costs.

Figure A5: Weekly CDS spreads (vertical axis) and Market-Based Leverage Ratio (horizontal axis) for four UK banks between 2007 and 2016



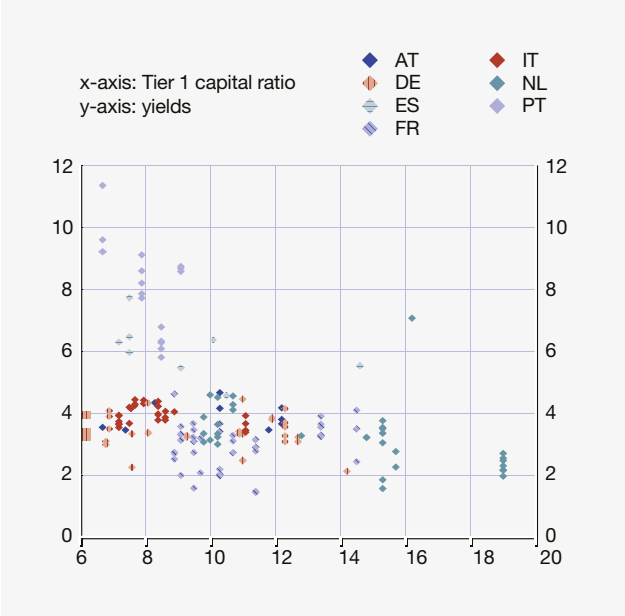
Source: Bank Underground

However, the relationship is notably non-linear, which is typical of credit quality dynamics in fixed income instruments (see e.g. AFME insolvency report). For example, reducing the capital amount by 2% (measured by leverage ratio) from 12% to 10% barely affects CDS spreads, while the same 2% reduction from 3% to 1% can significantly widen spreads by several hundred basis points as shown on the chart above.

The ECB[33] also produced a similar analysis correlating bond yields against Tier 1 capital ratios for European banks, showing that banks with higher Tier 1 ratios tend to have lower funding costs on senior unsecured and covered bonds. The correlation is also visibly not linear, further supporting the observation that when banks operate with high capital ratios (or at record levels, as they currently do), additional increases in capital have only a marginal and negligible benefit on improving market-implied creditworthiness.

32 *https://bankunderground.co.uk/2021/02/18/what-is-the-relationship-between-a-markets-based-measure-of-leverage-and-banks-funding-costs/*
33 *https://www.ecb.europa.eu/press/financial-stability-publications/fsr/focus/2011/pdf/ecb~1dd912ac7f.fsrbox201106_09.pdf*

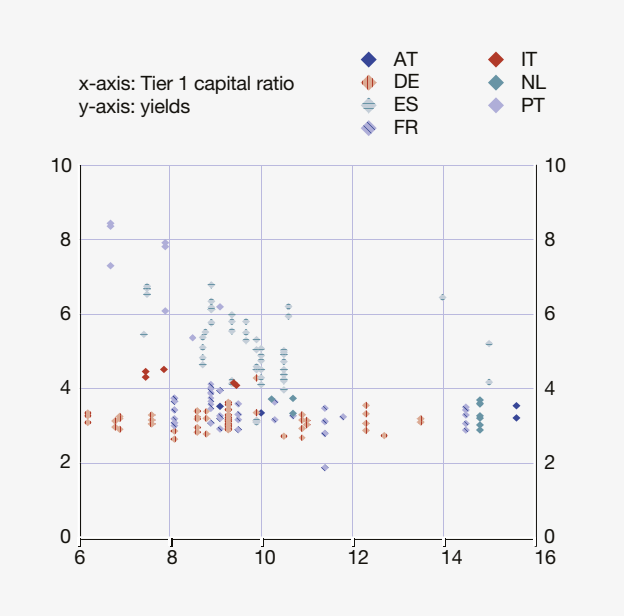
Figure A6: Yields on senior unsecured debt and the Tier I capital ratio of the issuer bank (March 2011; three-to-fi ve-year maturities; percentages)



Source: ECB, Bloomberg and individual institutions' financial reports

Notes: Yields refer to fi xed rate, euro-denominated instruments. If more than one instrument of the given maturity is available for one institution, the largest issues and the instruments of maturity closest to the middle of the bucket are displayed.

Figure A7: Covered bond yields and the Tier I capital ratio of the issuer bank (March 2011; three-to-seven-year maturities; percentages)



Source: ECB, Bloomberg and individual institutions' financial reports

Notes: Yields refer to fixed rate, euro-denominated instruments. If more than one instrument of the given maturity is available for one institution, the largest issues and the instruments of maturity closest to the middle of the bucket are displayed.

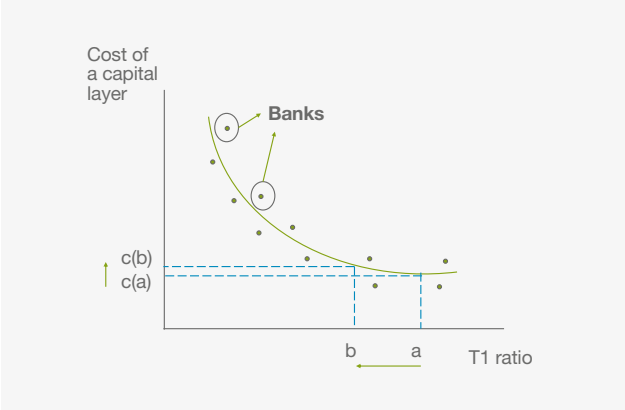
Excess capital therefore may not yield incremental market benefits beyond a threshold (c.15% Tier 1 ratio as estimated in the optimal capital studies), suggesting a potential "flat spot" in the cost of capital curve.

As a result, under this approach, total WACC varies not only through changes in weights (i.e. "volume effect" by replacing expensive equity with lower-cost senior debt) but also by a "price effect" where changes in capital have an indirect effect on its own cost via changes in perception of creditworthiness.

The literature also defines this as a Modigliani-Miller compensation (see Modigliani and Miller, 1958 and BIS, 2014) where higher equity reduces financial leverage and solvency risk, which lowers the required return on equity (cost of equity). Investors perceive highly-capitalised banks as safer, so they demand a lower risk premium. However, we argue that this cost effect diminishes as capital levels increase where the marginal benefit becomes smaller at higher capital ratios. For example, reducing capital from 30% to 25% has a relatively minor impact on creditworthiness and solvency when compared to a reduction from 10% to 5%.

We therefore expect to observe that changes in the cost of a capital layer may be minimal when banks already hold substantial buffers, as illustrated in the chart below.

Figure A8: Changes in the cost of a capital layer



Cost of capital components

We have estimated the cost of the key forms of liabilities, including the cost of equity, Additional Tier 1 (AT1), Tier 2 (T2), SNP, SP, and senior secured debt. Our findings are consistent with the priority claim hierarchy: instruments with higher priority in the capital structure exhibit lower funding costs. Specifically, the cost of equity stands at 9.2%, representing the lowest-priority claim, while senior secured debt stands at 2.5%.

Figure A9: Cost of each form of liability for GSIB banks (Nominal terms. 2025)

	pre-tax	after-tax
Senior secured	2.5%	1.8%
SP	2.9%	2.1%
SNP	3.0%	2.2%
T2	4.0%	2.9%
AT1	6.2%	4.5%
CoE (CET1)	9.2%	9.2%

Source: AFME with LSEG, EBA, ECB, EBA, NYU (Damodaran), Datastream and S&P. Indices: Markit iBoxx EUR Contingent Convertible Liquid Developed Market AT1, iBoxx EUR Banks Tier 2, Markit iBoxx EUR Banks Senior Preferred, Markit iBoxx EUR Banks Senior Bail-in

The Cost of Equity (CET1) is based on the Capital asset pricing model (CAPM) for GSIBs based on banks' and market 2025 data as: $RCET1 = Rf + \beta(Rm - Rf)$

Where Rf: Risk-free rate (30Y AAA sovereign bond); β: Sensitivity of the bank's equity returns to market movements (systematic risk), Rm – Rf : Equity market risk premium

The of debt liabilities is based on coupon rates of constituent instruments of iBoxx EUR bank indices.

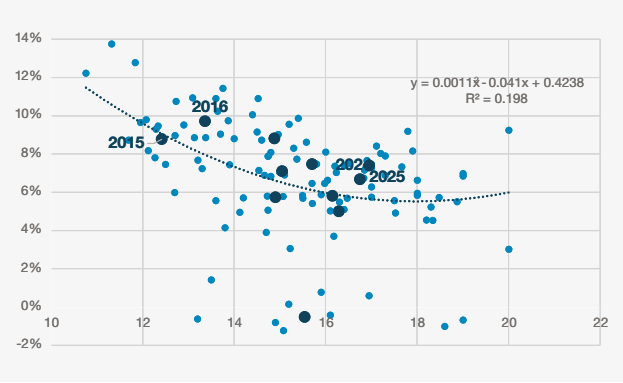
Capital structure and funding cost sensitivities

Our initial findings also confirm the expected negative correlation between banks' cost of equity (CoE) and their capital ratios. Similarly, the borrowing costs of Additional Tier 1 (AT1) instruments also exhibit a negative correlation with Tier 1 (T1) ratios. However, in the upper layers of the liability's priority (i.e. senior and secured liabilities) the cost of debt seems less sensitive to changes on T1 ratios.

Our estimates also show a non-linear relationship between the cost of equity and cost of AT1, T2 components and the T1 ratio. This means that at higher levels of capitalisation, markets become largely insensitive to further increases in capital, implying diminishing marginal benefits from increasing capital ratios. In other words, the price effect (or Modigliani–Miller compensation effect), whereby higher capital enhances creditworthiness and reduces funding costs, effectively disappears at elevated capital ratios.

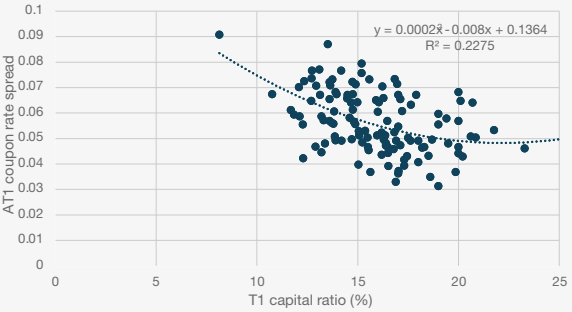
To consider how changes in balance sheet can have impact on banks' overall funding costs, we have estimated the non-linearities associated with the relationship between the cost of each capital layer and the T1 ratio resulting from the AFME proposal. The relationship of each capital layer is modelled as shown in the below panel of charts.

Figure A10: T1 ratio and Cost of equity: European GSIBs only. In real terms (adjusted for inflation). 2015-25



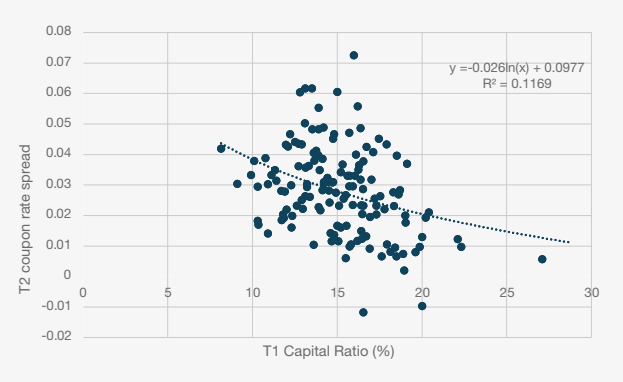
Source: AFME with LSEG, NYU (Damodaran), EBA, ECB, and banks' pillar 3 reports. Each dot represents a bank and its CoE in a respective year. Dark dot is the GSIB average for a given year.

Figure A11: Cost of AT1 and T1 ratio. Spread against EU risk free rate (10Y AAA European bond). European GSIBs and other large banks. 2015-2025



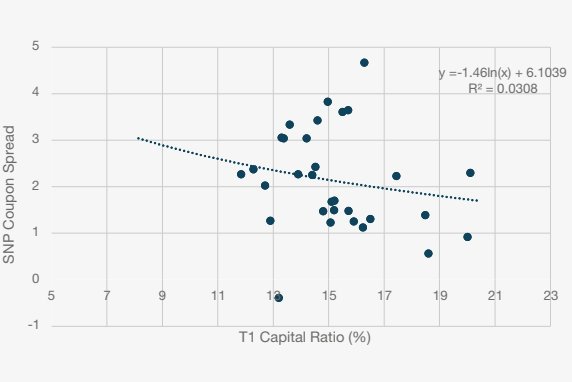
Source: AFME with Dealogic, EBA, ECB, and banks' pillar 3 reports. Each dot represents the average AT1 coupon spread for each bank in a respective year

Figure A12: Cost of 10Y T2 and T1 ratio. Spread against EU risk free rate (10Y AAA European bond). European GSIBs and other large banks. 2015-2025



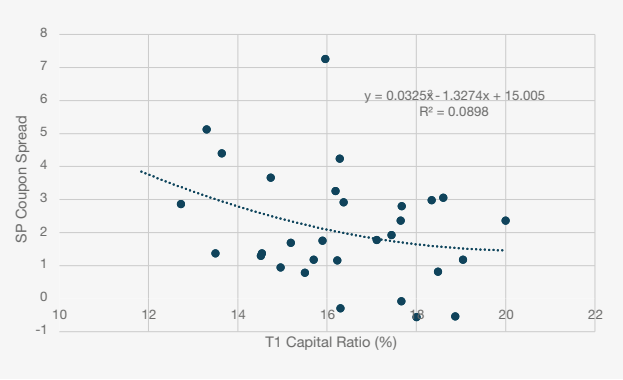
Source: AFME with Dealogic, EBA, ECB, and banks' pillar 3 reports. Each dot represents a the average T2 coupon spread in a respective year

Figure A13: Cost of Senior Non-Preferred debt and T1 ratio. Spread against EU risk free rate (10Y AAA European bond). European GSIBs. 2015-2025



Source: Dealogic

Figure A14: Cost of Senior Preferred debt and T1 ratio. Spread against EU risk free rate (10Y AAA European bond). European GSIBs and large banks. 2015-2025



Source: Dealogic

Contacts

Caroline Liesegang
Head of Prudential Regulation, Sustainable Finance, and Research
Caroline.Liesegang@afme.eu
+44 (0)20 3828 2676

Julio Suarez
Managing Director, Research
Julio.Suarez@afme.eu
+32 2 788 3970

Amy Hogan
Graduate, Research
Amy.Hogan@afme.eu
+32 2 883 55 42

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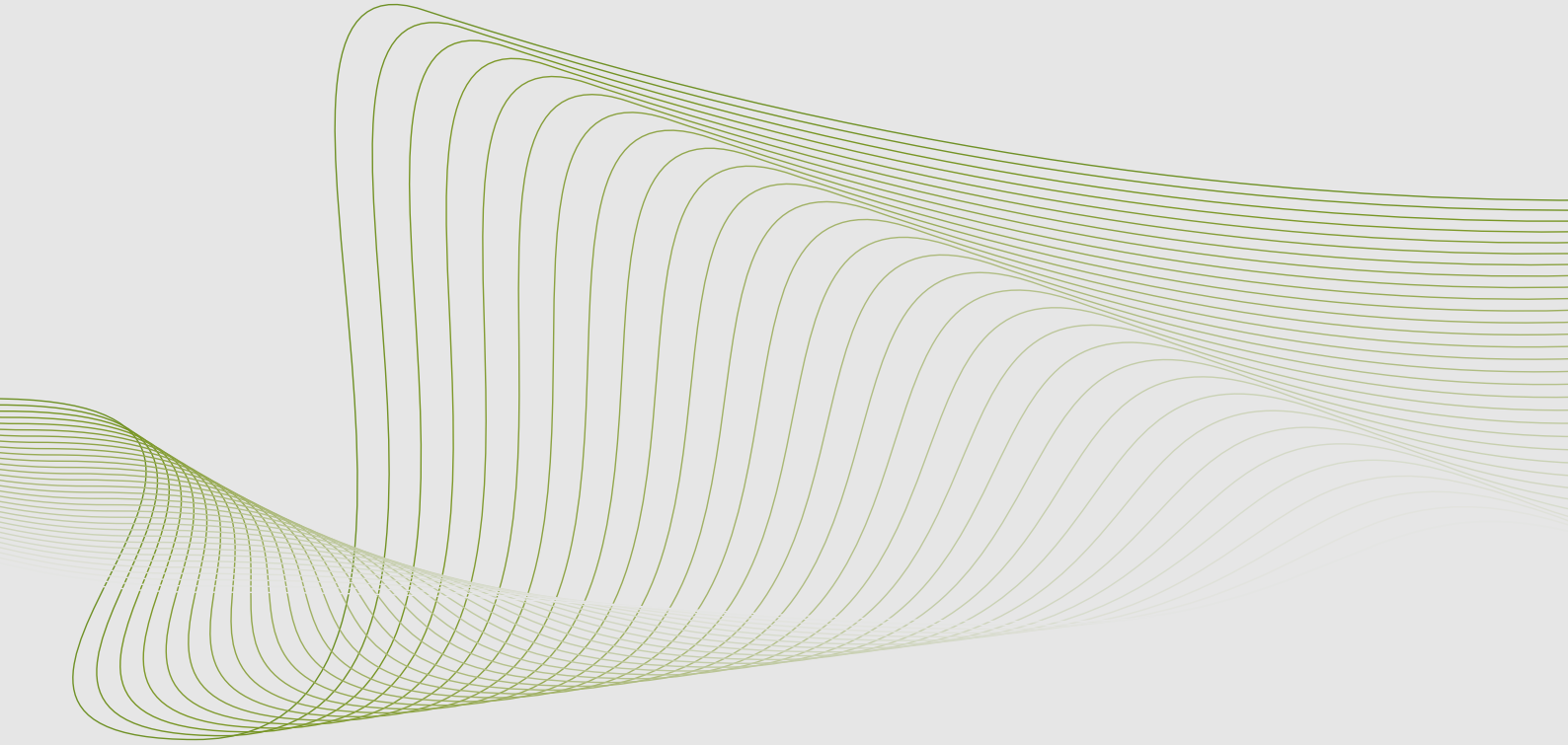

London Office
Level 10
20 Churchill Place
London E14 5HJ
United Kingdom
+44 (0)20 3828 2700

Press enquiries
Rebecca Hansford
Head of Communications
and Marketing
rebecca.hansford@afme.eu
+44 (0)20 3828 2693

Brussels Office
Rue de la Loi, 82
1040 Brussels
Belgium
+32 (0)2 883 5540

Membership
Elena Travaglini
Head of Membership
elena.travaglini@afme.eu
+44 (0)20 3828 2733

Frankfurt Office
Große Gallusstraße 16-18
60312 Frankfurt am Main
Germany
+49 (0)69 710 456 660

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