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How Banks Use Capital: Financing Growth and Supporting Competitiveness

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Executive Summary

Europe does not face a choice between resilient banks and competitive banks.The post-financial-crisis reforms have materially strengthened the banking sector: between 2013 and 2019, Tier 1 capital among EU G-SIBs increased by 47%, while RWAs grew by around 4.5%. Today, these banks maintain approximately €96 billion of capital above regulatory requirements and supervisory guidance. The policy priority should therefore be to build on this resilience by making the framework simpler, more coherent and proportionate, while addressing requirements that are duplicative, insufficiently risk-sensitive or place EU banks at an unjustified competitive disadvantage.

This requires assessing the cumulative impact of regulation and supervision, including overlapping macro and micro prudential rules, the market risk framework, the leverage ratio, the output floor, reporting requirements, trade finance and specialised lending rules and the treatment of software assets, to name a few. The appropriate test going forward should be whether incremental requirements deliver financial-stability benefits proportionate to their economic cost.

Greater capital capacity would not automatically translate into shareholder distributions. Evidence shows that capital allocation responds to economic opportunity: in 2021, amid stronger growth and credit demand, EU G-SIBs retained and redeployed €28 billion, equivalent to 64% of earnings. Capacity can also support investment in technology, digitalisation and cyber resilience, while sustainable investor returns also help banks attract equity and lower their cost of capital.

However, shareholder returns are also an important component of bank competitiveness. European G-SIBs distributed an average 36.2% of net earnings between 2013 and 2025, compared with 75.4% for US banks and 50-60% for other European listed companies. Maintaining competitive returns supports banks' ability to attract equity and contain their cost of capital, with ECB evidence from the COVID-era dividend restrictions illustrating how constraints on distributions can negatively affect bank valuations and funding.

Capital requirements reform should consequently go hand-in-hand with measures creating opportunities to deploy that capacity. Removing Banking Union barriers and national ring-fencing, with credible safeguards in place, would enable capital and liquidity to move more efficiently while preserving critical functions (at national level) and financial stability.

Enabling the efficient movement of capital and liquidity across the Banking Union is essential if European banks are to achieve the scale and capacity needed to support European companies and fund Europe's strategic priorities. .

Banks will play essential part in delivering on the major future financing needs of Europe which span digital, energy, defence, infrastructure and industrial transformations. A coherent competitiveness agenda should therefore combine genuine prudential reforms, proportionate supervision and greater Banking Union integration, enabling resilient European banks to deploy capital efficiently, attract investment and support long-term European growth.

"Enabling the efficient movement of capital and liquidity across the Banking Union is essential"

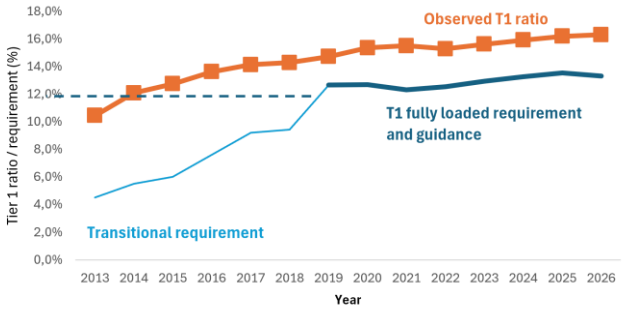
Assessing the marginal cost of increased requirements

Europe needs a banking sector that is both resilient and internationally competitive. The reforms introduced since the global financial crisis have materially strengthened banks' resilience, and this is visible in their capital positions. That resilience is an essential foundation for financial stability, and it should also enable banks to perform their core economic function: channeling savings towards productive investment and ensuring that capital can be deployed where it generates the greatest benefit for European growth.

Between 2013 and 2019, aggregate Tier 1 capital among EU G-SIBs increased by 47%, from €325 billion to €478 billion, in comparison to RWA growth of around 4.5%. Banks have subsequently continued to maintain substantial capital above regulatory minima: EU G-SIBs currently hold capital headroom of around 2.7% of RWAs above regulatory requirements and supervisory guidance, representing approximately €96 billion in additional capital.

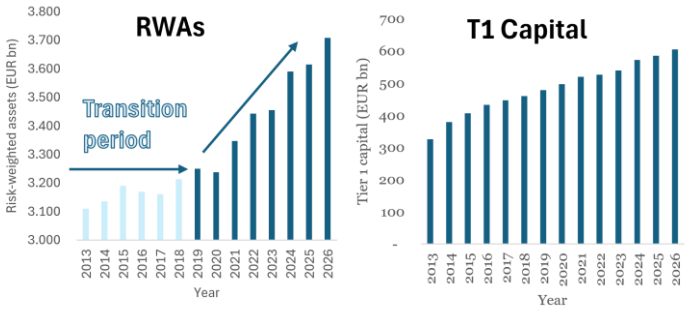
This provides an important starting point for the competitiveness debate: the backdrop is a banking system that has already accumulated significant capital buffers and is operating beyond minimum requirements.

1. Tier 1 ratios and requirements for EU GSIBs (%RWAs)



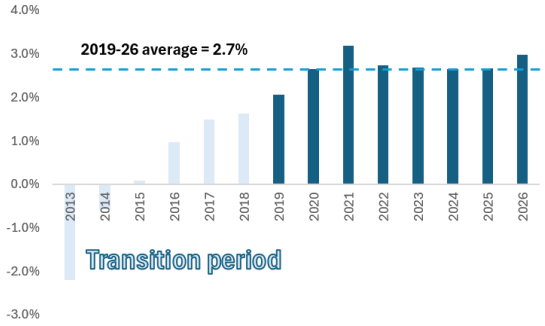
Source: AFME and Pillar 3 reports. All ratios are expressed as a percentage of RWAs.

1.2 EU GSIBs' RWAs and Tier 1 capital (EURbn)



Source: AFME and Pillar 3 reports. The transition period (2013-2018) refers to the initial phase-in of Basel III, during which capital requirements and buffers were progressively introduced. The main capital buffers become fully effective on 1 January 2019.

1.3 T1 headroom against fully loaded requirement and guidance (%RWAs)



Source: AFME and Pillar 3 reports. Transition period refers to the 2013-2019 Basel implementation (CRR) transition period. Headroom during transition period estimated as difference between observed fully loaded T1 ratio and 2019 fully loaded requirement and guidance which is assumed as the expected target for banks once the transition period concluded.

1.4 EU GSIBs average buffers (%RWAs)

	2019	2025	2027
Systemic risk buffers (CET1)	1.4%	1.4%	1.5%
CCyB (CET1)	0.3%	0.7%	0.8%
P2R (CET1+AT1+T2)	1.9%	2.1%	2.0%
P2G (CET1)	1.0%	1.2%	1.0%
Total	**4.60%**	**5.40%**	**5.30%**

Source: ECB SREP exercise aggregated G-SIB results for 2019, 2025, and 2027

AFME is recommending[1] changes which are firmly rooted in the robust prudential framework established in the EU since the global financial crisis and does not seek a return to pre-crisis standards. The objective now should be to build on that framework by making it simpler, more coherent and more proportionate, addressing requirements that are duplicative, insufficiently risk-sensitive or unnecessarily complex, as well as areas where the EU framework places its banks at an unjustified competitive disadvantage[2].

[1] See AFME response to the European Commission banking competitiveness consultation https://www.afme.eu/media/lwlkacr2/cu-paper-competitiveness-report.pdf

[2] We would also note that the Commission, in its July 2026 Communication (see page 3), acknowledges that changes to the frameworks too remove overlaps and the simplify the framework should be expected to have an impact on capital levels

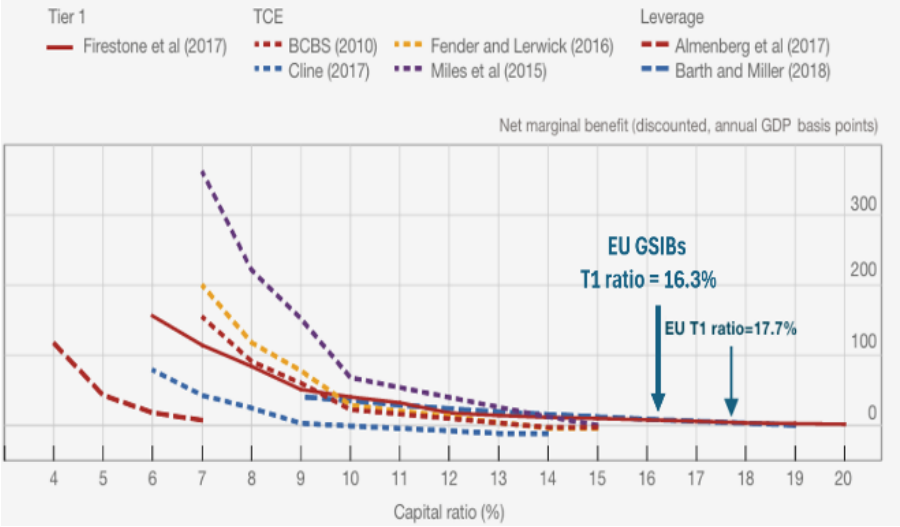
This includes for instance examining the interaction between overlapping buffers and requirements in the EU, the complexity of the EU capital stacks, the calibration of the leverage ratio, the prudential treatment of software assets, and the impact of implementing the Basel Output Floor in an EU context and the international market-risk framework.

The objective of the upcoming banking package should not be to reduce certain requirements in isolation, but to assess whether the EU prudential framework is coherent, proportionate and capable of delivering the right balance between prudential requirements and banks' ability to finance the economy.

When examining upcoming choices, we think it is important that policymakers assess capital requirements on a marginal basis rather than on the assumption that more capital always produces proportionately greater resilience. BIS research[3] shows that the net marginal macroeconomic benefit of additional bank capital declines as capital ratios increase, with the studies covered in this literature review indicating that these benefits may become limited at capital levels of approximately 10-15%, depending on the assumption used. This is important in the European context: EU G-SIBs currently maintain Tier 1 ratios above that range and substantial headroom above their regulatory requirements as shown above.

The question is therefore not whether capital provides resilience, but whether each incremental requirement continues to deliver financial stability benefits sufficient to justify its economic cost. Capital requirements can also affect the economics of lending at the margin: where more equity is required to support an exposure, the return that must be generated for that lending to be economically viable may also increase.

1.5 Net marginal macroeconomic benefit of higher bank capital



Source: BIS, EBA, EUGSIBs pillar 3 reports

Crucially, formal minimum requirements tell only part of the story. The amount of capital that banks can deploy is also shaped by supervisory expectations, Pillar 2 measures, management buffers and other constraints that influence how much headroom banks consider necessary to maintain. These requirements may be assessed separately, but their economic effects are cumulative. Any credible competitiveness agenda must therefore examine how the regulatory and supervisory framework operates as a whole, and how it affects banks' capacity and willingness to deploy capital in support of lending, investment and growth.

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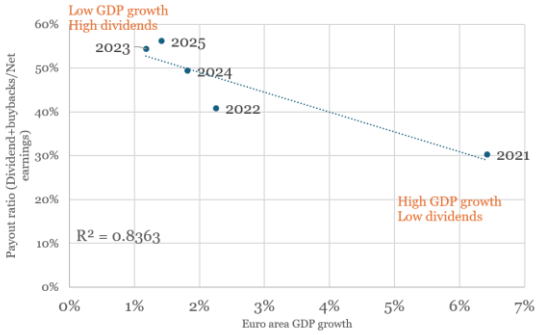
[3] See BCBS(2019), The Costs and Benefits of Bank Capital: A review of the Literature: here.

How banks use capital surplus: a nuanced equation

It is sometimes argued that a reduction in capital below current levels would simply result in higher shareholder distributions rather than additional lending. However, banks do not allocate surplus capital according to a fixed formula between lending and shareholder distributions. Instead, this varies with economic conditions, expected credit demand and the availability of viable[4] investment opportunities. When such opportunities are stronger, banks have historically retained a greater proportion of their earnings to support balance-sheet growth; where opportunities are more limited, a greater proportion of surplus capital has been returned to shareholders[5].

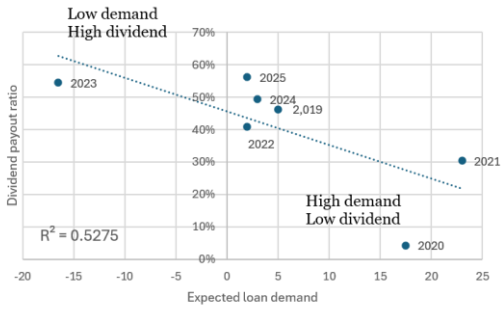
The post-pandemic recovery provides a useful illustration. In 2021, following the release[6] of capital buffers and against expectations of stronger economic growth and credit demand, EU G-SIBs retained and redeployed €28 billion through their balance sheets, equivalent to 64% of earnings. Shareholder distributions accounted for only around 30% of earnings. It would therefore be misleading to assume that additional capital capacity would necessarily flow predominantly to distributions: where demand and economically viable investment opportunities exist, banks have strong incentives to retain capital and deploy it in support of balance-sheet growth.

2.1 EU GSIBs payout ratio (buybacks+dividends) and GDP growth



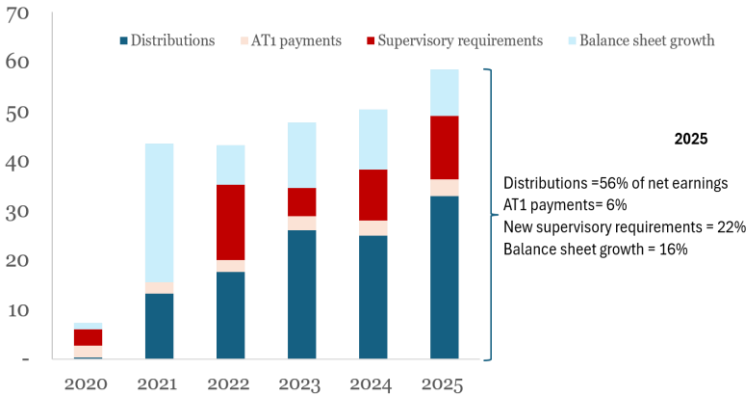
Source: Pillar 3 reports, LSEG, IMF. Excludes 2013-2019 Basel implementation (CRR) transition period and 2020 pandemic related distribution and buyback restrictions

2.2 EU GSIBs payout ratio and euro area expected loan demand



Source: ECB lending survey, Pillar 3 reports, LSEG

2.3 Net earnings use by component (EURbn)



Source: AFME with Pillar 3 reports and ECB data

Another example is also instructive. In 2025, amid more subdued growth opportunities, around 56% of EU G-SIB earnings were returned to shareholders through dividends and buybacks. Yet, in the same year, around 22% of earnings were retained to accommodate increases in Tier 1 capital requirements[7] and a further 16% supported

[4] Lending-related growth should not come at the expense of sustained asset quality.
[5] Based on capital consumption from annual changes in T1 supervisory requirements and guidance.
[6] Note that outright dividend and buyback ban had been lifted at the end of 2020, but the ECB still advised extreme caution until Sept 2021. Nevertheless, banks still saw the need to support the additional demand coming from their clients during this period.
[7] Source: AFME calculations based on banks' Pillar 3 reports and AFME data. The estimated increase in Tier 1 capital requirements and supervisory guidance between 2024 and 2025 amounts to approximately €12.9bn, equivalent to 22% of aggregate 2025 earnings.

organic growth and investment. The contrast with 2021 reinforces the central point that the use of capital capacity depends importantly on the opportunities available to banks to deploy it productively.

This also underlines the need for policymakers to complement reforms to the banking framework with broader supply-side measures that improve the EU's investability, strengthen the pipeline of viable financing opportunities and, ultimately, enable banks to put more of their capital to work in support of European growth.

Additional capacity can also support banks' own investment in technology, digitalisation, cyber resilience and operational transformation. These are increasingly material calls on bank resources. Technology already absorbs more than 10% of bank revenues according to research carried out by BCG (for the 25 largest banks globally in 2023), while global bank IT expenditure is expected to grow by around 9% annually[8]. Other sources point to European corporate and investment banks increasing technology spending by around 30% between 2019 and 2025, compared with 48% among US peers[9]. Having sufficient capacity to invest is therefore of itself a competitiveness issue, particularly as banks need to modernise legacy infrastructure and invest in cloud, AI, automation, cyber resilience and digital services. Revising the EU's prudential treatment of software to ensure these assets are treated in a globally consistent manner is therefore essential.

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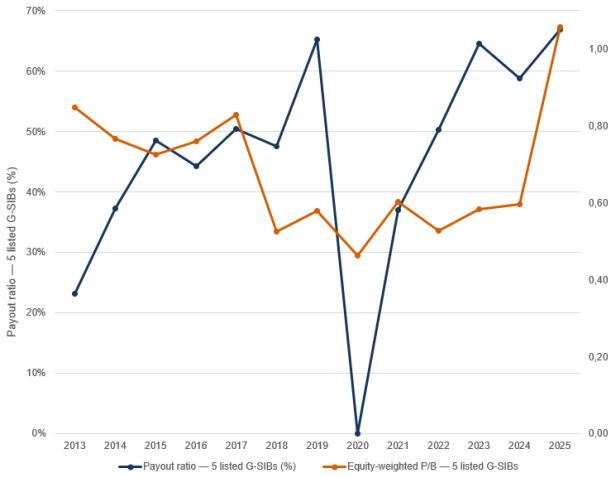
Finally, banks compete for capital with companies across sectors and jurisdictions, and investors require competitive returns. In this respect, distributions should not be seen, per se, as a negative decision. European listed companies have traditionally distributed around 50–60% of earnings, while EU G-SIB dividend payout ratios have generally been around 30–40%. Maintaining the capacity to offer competitive returns therefore matters to banks' investibility and ability to attract equity capital. ECB's own evaluation of the impact of its dividend restrictions during the COVID crisis shows a significant impact on bank valuations (around 7%), leading to higher long-term cost of equity. This is not separate from financing the economy: a lower cost of equity reduces the return that banks need to earn from lending and other client activities and can therefore improve the economics of providing those services.

2.4 Dividend Payout Ratios: EU GSIBs and STOXX Europe 50 constituent companies



Source: EU G-SIB payout is calculated as aggregate common cash dividends divided by aggregate net income for BNP, DB, Crédit Agricole, ING, BPCE, Santander and Société Générale; buybacks and AT1 payments are excluded. The STOXX Europe 50 and EURO STOXX Banks series are dividend-only implied payout proxies calculated daily as dividend yield × P/E / 100 and summarised using annual medians.

2.5 Listed EU GSIBs Payout ratios and Price to Book ratios

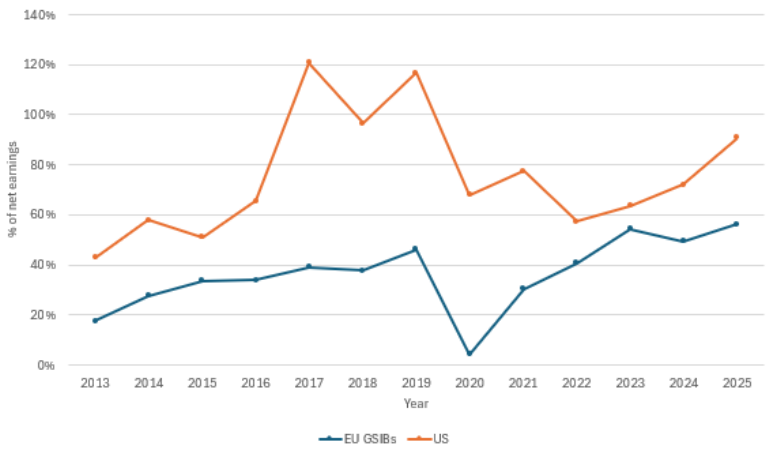


Source: AFME and LSEG – Refinitiv Eikon, monthly data; Y-right axis is Equity weighted P/B – 5 listed G-SIBs. Excludes BPCE as an unlisted entity and Crédit Agricole Group, as only Crédit Agricole S.A., which represents part of the Group's GSIB perimeter, is publicly listed.

[8] See BCG Tech in Banking 2025 report here
[9] See Coalition study.

It is important to also note that higher distributions should be considered in an international context. Between 2013 and 2025, European G-SIBs distributed an average of 36.2% of net earnings, compared with 75.4% for US banks. European G-SIBs have therefore historically returned a substantially smaller share of earnings to shareholders than their US peers, reinforcing the importance of considering sustainable distributions as part of banks' ability to compete for equity capital internationally.

2.6 Distributions as a share of net earnings: EU and US GSIBs



Source: LSEG.

This also illustrates why banking competitiveness should not be considered in isolation from the EU's wider competitiveness and Single Market agenda. Removing unnecessary capital constraints increases banks' capacity to finance growth; removing barriers within the Banking Union increases the opportunities to deploy that capacity.

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From national ring-fencing to credible safeguards

Fragmentation prevents capital and liquidity from being deployed where they can best support European firms and households. At the same time, concerns that cross-border waivers could weaken local financing or leave host member states authorities without adequate resources during periods of stress must be addressed. However, greater flexibility in the allocation of capital and liquidity within a banking group should not be equated with a reduced commitment to the markets in which that group operates.

Banks establish and maintain a presence in individual Member States because there is a commercial rationale for doing so: they have customers to serve, relationships to maintain and viable business opportunities in those markets. This economic rationale does not disappear simply because capital and liquidity can be managed more efficiently across the group. Banks operating cross-border have a strong interest in maintaining durable local franchises and supporting the households, corporates and institutions that underpin those franchises. Prudential waivers would therefore not remove the underlying commercial incentives for banks to remain present and active in local economies. Rather, they would allow banking groups to use resources more efficiently while maintaining their customer-facing activities and local market presence.

European cross-border banking integration has frequently taken place through the acquisition of existing national banks, which naturally resulted in groups operating networks of separately incorporated subsidiaries. This model has subsequently been reinforced by national regulatory frameworks, supervisory practices and the incomplete development of the Banking Union. The continued prevalence of subsidiaries among EU-headquartered groups should therefore not necessarily be interpreted as evidence that subsidiarisation is inherently required to preserve local lending, local presence or financial stability.

The appropriate safeguard for host Member States should instead focus on outcomes: banks should be able to demonstrate that resolution at parent-entity level would not disrupt the ability of entities in host Member States from continuing performing critical functions or to access the services and operational capabilities necessary for their continuity. Existing resolution-planning and operational-continuity requirements (e.g. under SRB Operational Continuity in Resolution requirements) provide an important framework through which these safeguards are established.

Europe can improve banking competitiveness while preserving national critical functions. The objective should be to establish credible safeguards that facilitate the movement of capital and liquidity across the Banking Union, while protecting depositors, maintaining financial stability and ensuring continuity of local financing. Further progress on deposit insurance, including a suitably designed Single Deposit Insurance Mechanism, together with credible arrangements for liquidity in resolution, should also be central to this approach. These measures would strengthen mutual confidence among Member States, reduce financial fragmentation and support a more resilient and competitive Banking Union.

Lack of competitiveness is reducing EU banks market share

EU banks have lost market share across various activities in Europe over the past two decades. For instance, EU banks share of European M&A has fallen from 45% to 36%, while their share of ECM has declined more sharply, from 58% to 36%. In global equity markets, EU banks' market share has also fallen from 35% to 20% over the past decade.

The erosion of EU banks' global market share is not a reflection of weaker expertise or business models, but of a structural inability to achieve sufficient scale. As noted in the November 2026 ECB Financial Stability Report, scale is fundamental for bank competitiveness[10]. Addressing the barriers that fragment capital and liquidity is essential if EU banks are to build scale, strengthen competitiveness and reverse the loss of market share.

"The erosion of EU banks' global market share is not a reflection of weaker expertise or business models, but of a structural inability to achieve sufficient scale"

[10] The ECB concludes that "Euro area banks could become more competitive if progress is made on completing the savings and investments union or through further consolidation".

Capital to meet future lending demand

The ECB Bank Lending Survey is routinely used to show that current loan demand in the euro area is broadly being met. On the basis of current financing conditions, the ECB in its November 2026 Financial Stability Report[11] stresssed that "there seems to be no evidence to date that reducing capital requirements in normal times would foster competitiveness by increasing lending".

It should be stressed however that this is a snapshot of current demand, but in no way a measure or predictor of Europe's future financing needs. A recent economic analysis by Oliver Wyman[12] estimated that Europe will need to mobilise €1.2 trillion annually to meet its strategic needs (a 50% increase on the Draghi report figure of €800 Billion).

According to ECB and IMF estimates, reducing cross-border banking barriers could generate substantial economic gains[13] of between 1.6% to 4% on long-run euro area GDP, with the largest impact on periphery countries and therefore improving convergence and financial integration. Applying the historical relationship between economic growth and banks' capital allocation, AFME estimates that growth of the magnitude identified in ECB[14] and IMF[15] research could be associated with bank payout ratios around 7–18.1 percentage points below historical levels[16], with a correspondingly greater share of earnings retained to support balance-sheet expansion.

The implication is important, as policymakers striving for competitiveness and economic growth should not only consider banks' capital capacity in the context of today's fragmented internal market. Another relevant question is how that capacity would be deployed in a more integrated European economy with stronger investment, deeper cross-border activity and greater credit demand.

Europe must finance digital, energy, defence, infrastructure and industrial transformation over many years. Banks will remain essential enablers of these efforts as direct lenders as well as arrangers, underwriters, market-makers and distributors of market-based finance. Consequently, ensuring that banks can deploy capital efficiently needs across the economy remains an important component of Europe's competitiveness agenda. Regulatory measures that risk inhibiting financing capacity because of a lack of risk sensitivity – such as the impact of the output floor on financing unrated corporates – may have wider economic consequences in Europe than in other jurisdictions where market-based finance is more developed.

"Europe must finance digital, energy, defence, infrastructure and industrial transformation over many years"

[11] See https://www.ecb.europa.eu/press/financial-stability-publications/fsr/html/ecb.fsr202611~e03b919d36.en.html
[12] See https://www.oliverwyman.com/our-expertise/insights/2026/feb/europe-remaining-competitive-investment-challenge.html
[13] IMF Working Paper WP/26/123, "Barriers to a European Banking Union" (2026)
[14] See Barriers to a European Banking Union and Arce and Montes-Galdón (2026). Two Pillars, One Goal. The Macroeconomics of Deeper Financial and Real Integration in Europe. 2026. Mimeo. Presentation at the House of Europe, October 2026.
[15] See Lifting Binding Constraints on Growth in Europe: Actionable Priorities to Deepen the Single Market, WP/25/113, June 2025 and https://www.imf.org/-/media/files/publications/wp/2025/english/wpiea2025040-print-pdf.pdf
[16] To Illustrate the potential implications for banks' capital allocation, assuming that the long-term GDP gains from reducing intra EU financial barriers of between 1.6-3% as estimated by ECB and IMF research. Applying the historical relationship observed in chart 2.1, this would be associated with a reduction in banks' payout ratios of approximately 7-13.5 percentage points, implying a corresponding increase in the share of earnings retained that could provide additional capital to support balance sheet expansion. Using the relationship between payout ratios and expected loan demand shown in chart 2.2, these changes would be consistent with an illustrative increase of around 7-13 percentage points increase in expected loan demand.

Conclusion

Europe therefore does not face a binary choice between safe banks and competitive banks, nor between capital resilience and financing growth.

European banks have built substantial capital buffers since the financial crisis and historical experience demonstrates that capital allocation responds to economic opportunities and financing demand. The objective of upcoming reform should be to preserve sufficient resilience while removing requirements and market barriers that unnecessarily raise the cost of intermediation or prevent capital from being deployed efficiently.

That requires the different strands of the competitiveness agenda to reinforce one another: targeted capital recalibration can create capacity; Banking Union and Single Market reform can create opportunities to deploy it; proportionate supervision can reduce unnecessary constraints on its use; and greater profitability and investability can allow banks to replenish capital organically and continue investing through the cycle.

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London Office
Level 10,
20 Churchill Place
London E14 5HJ
United Kingdom

Switchboard:
+44 (0)20 3828 2700

Brussels Office
Rue de la Loi, 82
1040 Brussels
Belgium

Switchboard:
+32 (0)2 883 5540

Frankfurt Office Neue
c/o SPACES – Regus,
First Floor Reception,
Große Gallusstraße 16-18, 60312,
Frankfurt am Main
Germany

Switchboard:
+ 49 (0)69 710 456 660

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