
Consultation Response – PRA CP 12/25

Pillar 2A Review – Phase 1

30 September 2025

Introduction and General Comments:

The Association for Financial Markets in Europe (AFME) welcomes this opportunity to comment on the PRA's consultation on its review of P2A – Phase 1 (CP 12/25) and we would also like to take the opportunity to reflect on PS 7/25.

Regarding implementation of 12/25, we welcome the clarification from the PRA during the consultation period on inclusion of Pension risk, Market and Counterparty risk updates from the CP in ICAAPs submitted after 1 July 2026, which was helpful. Regarding “Basel 3.1 go live and Pillar 2A changes for credit risk and operational risk” – we understand but would still welcome clarification on in the PS on whether these should be incorporated for the ICAAPs submitted in Q1 2027 with a balance sheet date of 31st December 2026 on a Basel 3.1 basis. We would also request the PRA take account of firms where the ICAAP reference date is not 31st December and where a C-SREP is not conducted automatically every year (for example, for a firm where the reference date for ICAAP is 31 March 2026, submitted in August 2026, will that be used to determine the P2A used in 2027?). **We therefore suggest that the PRA uses a reference date for all changes to go-live, especially given that firms ICAAP submissions are variable e.g. for credit and operational risk the changes should be applicable for ICAAPs with a reference date of 31.12.26 onwards.**

More generally we are concerned that the PRA does not reference that Pillar 2A capital requirements should reduce for certain risks following Basel 3.1 implementation, which it has previously committed to in its publication of the near final rules on 12 September 2024. For instance, FRTB will better capture illiquid risks in Pillar 1 Market RWA, and the standardised approach to operational risk is an improvement compared to the current framework, which will typically lead to higher RWAs. Therefore, we believe the PRA should explicitly clarify in the final PS its intention to reduce Pillar 2A capital requirements for these risks. We also recommend the PRA should consider reviewing the level of the FPC's CET1 14% target once the B3.1 is fully implemented.

Regarding the credit risk proposals, we are concerned these are unique to the UK and reduce international competitiveness and transparency of capital positions. We also have significant concerns with the proposed credit scenario analysis and view this as disproportionate and duplicative with the Pillar 2B stress test framework. The double stack credit risk approach further complicates the capital framework and does not provide sufficient scope for firms to select their own approaches in Pillar 2A.

We also note the case presented for non-zero risk weights for domestic currency Central Government/ Central Bank ('CG/CB') and Regional Government/ Local Authority ('RG/LA') exposures, however, we do not share the PRA's view of the S&P data¹ which was drawn on to justify this policy approach and have set out detailed alternative proposals. Alternatively, given zero risk weights occur under standardised for these exposures in a country deemed equivalent, in local currency and where given a domestic zero risk weight by the local regulator, the issue could be addressed for consistency purposes via a review of the equivalence process. We

¹ [fitchratings.com/research/sovereigns/sovereigns-2024-transition-default-study-27-03-2025](https://www.fitchratings.com/research/sovereigns/sovereigns-2024-transition-default-study-27-03-2025)

understand falls within the remit of the UK treasury and is currently being reviewed under the overseas recognition regime. Moreover, similar views were laid out by the BCBS in a discussion paper of 2017, but without the BCBS choosing to amend the framework – the PRA is therefore choosing to apply a unique approach to UK firms.

We are further concerned by the add-ons proposed for UCC and general lack of portfolio offset of credit risk add-ons with exposures where the P1 charge is higher than justified by the risk, which run counter to the PRA's initially stated intent to reduce P2A given the B3 increases to P1.

Overall, systematic credit risk methodologies undermine the principle of self-assessment that underpins Pillar 2A and undermine the flexibility afforded to firms and the PRA through Pillar 2 adjustments. We believe that the output floor creates a general 'Pillar 1 provision' for IRB firms with low-risk densities and so should be considered holistically with other mechanisms to address under-capitalisation. The introduction of systematic approaches to Pillar 2A will also have consequential effects on Pillar 2B (i.e. PRA/ Management buffers should be reduced accordingly).

Finally, it is difficult to fully assess the balance of changes introduced in Phase 1 of P2A without knowing what will come in Phase 2 and early clarity on what this will entail would be appreciated. Indeed, we believe the PRA should take the opportunity in Phase 2 to be bolder in its review of Pillar 2A methodologies. A number of methodologies were first disclosed to the industry in 2015 ("SoP5/15 – The PRA's methodologies for setting Pillar 2 capital). Since this time, as far as the industry is aware, the PRA has not reviewed these approaches and has not consulted on any material changes despite advances in associated risk management. This consultation process provides the PRA with an opportunity to assess and consult on whether more fundamental changes in methodologies or calibration are required. One area that we would support being in scope of such a review is credit concentration risk (including HHI), where the PRA disclosed a simplistic and risk insensitive approach in 2015, which can drive material capital requirements for firms. Likewise, we support a review of the IRRBB. Reviewing such methodologies would be in line with the PRA's secondary competitiveness and growth objective, and the need to ensure Pillar 2 continues to be refined and enhanced and does not remain static based on old, simplistic approaches that contribute to over calibration of capital requirements in the UK and can hinder economic growth. Moreover, it is unclear how the current timeline will accommodate these changes in time for Basel 3.1 implementation and avoid the overlaps between Pillar 1 and Pillar 2 which the PRA has committed to. Depending on magnitude of changes (particularly since we don't know what will be in the second phase of this consultation process), and that not all changes will come through in the 2027 submission, firms would want time to include any revisions in their 2028 ICAAP submission and at a minimum 12 months to incorporate.

We outline below detailed considerations relevant to each of the proposals.

Implementation timeline

1. **Paragraph 1.40:** Regarding implementation, we welcome the clarification from the PRA during the consultation period on inclusion of Pension risk, Market and Counterparty risk updates from the CP in ICAAPs submitted after 1 July 2026. We support the shorter implementation period for pension risk; however, more time may be needed for Market and Counterparty Credit Risk given the incremental changes being introduced e.g. for syndicated loans, so the extension from 2 March is welcome.

Nonetheless, given firms differ in their ICAAP submission timing, we recommend using a reference date as a simpler approach e.g. 30 April 2026.

2. **Paragraph 1.41:** Can the PRA confirm in its final policy statement that the “Basel 3.1 go live and Pillar 2A changes for credit risk and operational risk” - should be incorporated for the ICAAPs submitted in 2027 with a balance sheet date of 31st December 2026. As per our prior comments, **we propose that this is changed to a reference date of 31 December 2026 rather than a submission date.**
3. Can the PRA give clear forward indication of whether ICAAP for the other risk types (e.g. Market risk) is to be done assuming Pillar 1 requirements calculated using Basel 3.1 requirements (which will not be in force until the next working day) or Pillar 1 requirements calculated using Basel 2/2.5?
4. Can the PRA confirm if Phase 2 will be published before Basel 3.1 go-live on 1 Jan 2027? For any subsequent changes introduced in Phase 2 the PRA should consider using a 2028 reference date and at a minimum allow firms 12 months to incorporate.

Credit risk

5. From a high-level perspective, we are concerned on the key proposals put forward by the PRA in relation to sovereigns, UCCs, and credit scenarios, which will have a significant impact on firms and their international competitiveness as well as undermining the principle of self-assessment. Given the time limitations of the CP process, AFME has encouraged firms to submit their data individually to the PRA to support this view.

Minimum RWs for exposures to central governments and central banks (CG/CB), regional governments and local authorities (RG/LA)

6. AFME members have a number of concerns regarding the proposed minimum RWs for exposures to central governments and central banks (CG/CB), regional governments and local authorities (RG/LA). First and foremost we are concerned with the PRA's use of the data derived from the Standard & Poor's (S&P) report “Sovereigns 2024 Transition and Default Study”, upon which the PRA has in part based its policy approach (specifically the proposal for a 5% minimum risk weight on non-UK central government/central bank (CG/CB) exposures rated CQS2–3, replacing the current effective 0% weight that highly rated sovereigns get under CRR Article 114(7)). The justification given is that S&P historical default data show non-zero cumulative default rates for these rating categories over multi-year horizons (2-3years). We would challenge the following:
 - i. The methodology used by S&P and relied upon by the PRA is fundamentally misaligned between multi-year default metrics and the one-year PD framework of Basel;
 - ii. The methodological limitations of S&P's data in terms of its use as proxy by the PRA for its proposals; and
 - iii. The repetitive default instances potentially skewing the default stats used by the PRA to inform the CQS2 and 3 RW.

Multi-Year Default Rates vs. One-Year PD Framework

Basel requirements are most often built on a one-year probability-of-default horizon, we note the PRA on this instance is relying on a multi-year cumulative default rates. In CP12/25, the PRA notes that S&P data show zero sovereign defaults for CQS2 and CQS3 within a 1-year outcome window, but a positive default rate emerges over 3-year and 2-year windows respectively.

In other words, historically no country rated in these upper-medium grades defaulted within a year of being rated, but a handful did default after 2–3 years. By design Pillar 1 capital requirements already presume a one-year risk horizon, a risk weight of 0% for a highly rated sovereign implies that short-term default risk is negligible.

The PRA's proposal introduces additional capital for risk that materializes beyond the one-year horizon, this could lead to double-counting of risk: banks would hold Pillar 2A capital for multi-year default risk that is already meant to be captured by stress tests/Pillar 2B for severe scenarios.

S&P's own data demonstrate that for an investment-grade entity (e.g. S&P 'BBB' = CQS3), the 3-year cumulative default rate is less than 1%. Imposing a 5% risk weight in the CP – as if the 2–3 year risk should be capitalized immediately – misconstrues the timing of losses. We urge the PRA to recognize this horizon mismatch: Pillar 2A should address risks insufficiently captured in the one-year Pillar 1 framework, not introduce a new multi-year risk capital charge on assets that are by one-year measures relatively safe.

In summary, a one-year PD of zero should not justify a non-zero Pillar 2A charge, even if cumulative multi-year PDs are non-zero. If the PRA is concerned about what might happen over 2–3 years (e.g. rating downgrades and defaults in a stressed scenario), we consider the appropriate solution would be for the add-ons to only start applying when sovereign exposure moves to CQS4.

It is also noted the incremental risk is narrow considering the acknowledgement of the PRA that recognises the vast majority of UK firms' sovereign exposures are rated CQS1 and would remain unaffected, which suggests that the real risk to be addressed is small.

Methodological Limitations of S&P Default Data

The PRA has cited S&P's historical default data as a key reference point in CP 12/25, so it is important to also understand the data's own limitations for the purpose of the PRA's policy approach, which could affect the risk view of the exposures. It is worth noting our understanding of the nature of the S&P report as a public, transparent review by their analysts on default risk of how their ratings have performed over time and observed frequencies of default– the assessment of this does not constitute a PD given ratings are valid in the longer term. While our review has focused on the S&P dataset cited in the consultation, we note that similar cohort-based methodologies and default definitions are generally used by other ECAs. We have not assessed those datasets in detail for the purpose of this response.

- i. S&Ps non-zero 2–3 year default rates for CQ2-3 are misleading for the PRA policy approach, as most sovereigns had already migrated to speculative grade before default. Their cohort methodology freezes ratings at inception, so defaults are still attributed back to A/BBB even after multiple downgrades, inflating Investment Grade default statistics. In practice, 97.7% of defaulters were speculative grade at least one year prior to default, with only a handful of true investment grade defaults in recent decades². This means a 5% RW floor on CQS2-3 is overly conservative as one-year defaults only emerge at CQS4.
- ii. We understand the PRA is also borrowing from IRB low-default portfolio calibration logic. Such techniques were designed for more opaque portfolios where defaults are rare, and risks are unobservable; sovereigns on the other hand are transparent with credit deterioration evident through frequent rating migrations and market signals. Importing multi-year low-default logic into the standardised sovereign approach creates a misalignment with capital calibration (one-year PDs) and overstates the impact of a handful of idiosyncratic cases.
- iii. Limited number of defaulters; repetition drives non-zero rates: According to publicly available information from S&P, over the last 14 years there has been only one higher-rating sovereign default event, yet the cohort tables show non-zero 2–3 year rates. This is because the same sovereigns (e.g. Greece, Cyprus, Argentina, Uruguay, Indonesia) appear across multiple cohorts and, in some cases, multiple defaults are counted. This inflates and skews the statistics of default in investment-grade data, since it is very likely that emerging markets sovereigns contribute disproportionately to the “non-zero” 2–3 year rates. We therefore caution against drawing capital calibration conclusions from aggregate figures that embed multiple defaults by the same issuers, as this risks overstating the default probability for the advanced-economy sovereign exposures actually held by UK banks. The result is a statistical skew from a handful of episodes rather than a broad base of Investment Grade sovereigns.
- iv. Inclusion of Distressed Exchanges as “Defaults” – we urge the PRA to review the data so that distressed exchanges are excluded from the definition of default. We note for S&P purposes, distressed exchanges (e.g. Uruguay 2003, Greece 2012) are classified as defaults. While valid under their criteria, for capital calibration these events differ materially from outright payment failures and inflate the frequency of Investment Grade defaults.

Proposal:

These limitations for the purpose of the PRA’s exercise (unacknowledged in the CP) reinforce that the PRA’s proposed 5% RW floor at CQS2–3 is not aligned with Basel’s one-year PD framework and is being justified on the basis of multi-year cumulative data skewed by rating migration, distressed exchanges, and repeat defaulters. The net result is the basis of the methodology upon which the policy is framed is flawed and warrants a detailed reassessment of the data. A more proportionate calibration would be to recognise zero one-year defaults at CQS2–3 and, if a floor is deemed necessary, apply it only from CQS4 upward, where one-year default risk is empirically non-zero.

In detail:

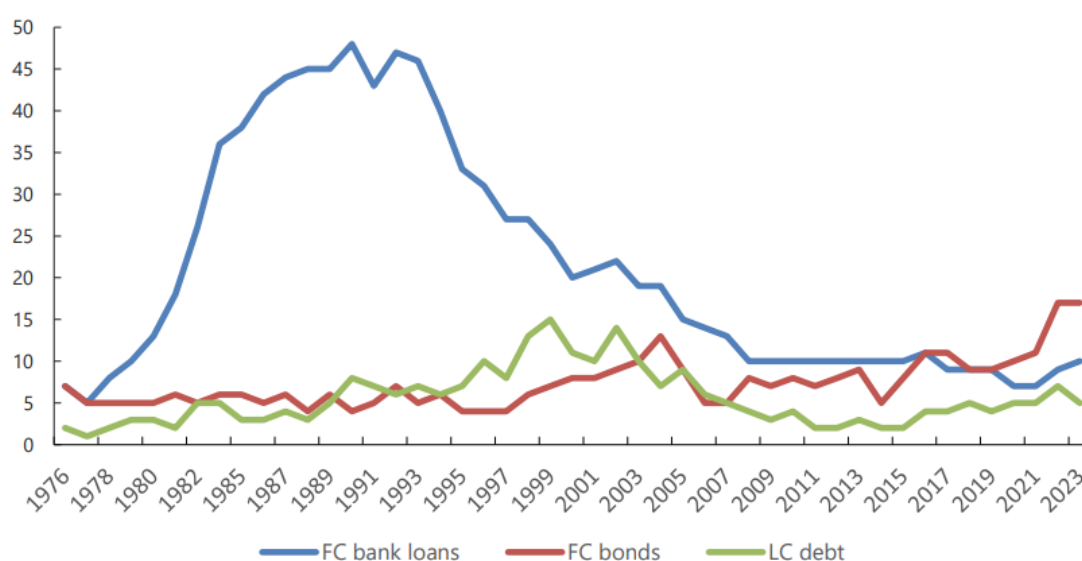
² S&P Global Ratings, Default, Transition and Recovery: 2024 Annual Global Corporate Default and Rating Transition Study, March 2025 p.36 table 13

- A one-year PD of zero cannot justify a non-zero Pillar 2A charge, even if cumulative multi-year PDs are non-zero. The appropriate solution would be for the add-ons to only start applying when sovereign exposure moves to CQS4.
 - Recalibrate the relevant data: We urge the PRA to reconsider the 5% Pillar 2A floor and seek more granular data where possible. As suggested, there are several shortcomings (e.g. Time to default, distressed exchanges, repeated defaults distortion) which are worth addressing in more detail.
 - Use Pillar 2B or targeted capital add-ons for idiosyncratic sovereign risk: Another approach is to address the perceived gap via Pillar 2B (capital for stress scenarios) or via firm-specific add-ons, rather than a fixed Pillar 2A charge. Pillar 2B is designed to ensure banks hold capital against forward-looking adverse scenarios, including sovereign stress. If the PRA's concern is that certain non-zero-risk sovereign exposures could default in a severe scenario (however remote in year 1, perhaps possible by year 3), that is exactly the kind of stress test scenario that Pillar 2B can capture (e.g. an emerging markets crisis leading to sovereign defaults). In practice, UK banks in their ICAAP often already assess concentration risk to sovereigns and consider stress losses on those positions. The PRA could rely on those processes or explicitly incorporate a severe sovereign downgrade/default scenario into the stress testing regime, rather than hardcoding a 5% RW. This would have the benefit of applying capital only where it's truly needed (e.g. if a bank has a large exposure to a particular CQS3 sovereign that could be at risk) and in proportion to that exposure's size and loss given default. It avoids penalising all banks equally for small, well-managed positions.
 - Consider a lower de minimis risk weight floor (e.g. 0%–2.5%) if a uniform floor is deemed necessary: If the PRA remains convinced that a non-zero floor must be applied uniformly to CQS2–3 sovereign exposures for prudence, we suggest exploring a more modest calibration. If the PRA's own analysis found that an 11-year window was needed to see any default for CQS1 and a 2–3 year window for CQS2/3, then a 5% RW (which equates to roughly a 0.25% one-year PD assumption at 45% LGD) is likely too high. A 5% risk weight, while low, is not immaterial [order of magnitude of benefit if halved]. Given the historical default likelihood of well-rated sovereigns is well under 1% over multi-year periods, a 5% risk weight could be seen as somewhat arbitrary and conservative. On the other hand, a 2.5% floor could be a compromise.
 - Alternatively, the PRA could consider addressing via the equivalence process.
7. Aside from the data concerns and proposals made above, we would highlight the following impacts and observations on the introduction of minimum risk weights for sovereigns:
- a. An uplift in non-UK exposures mainly in the Liquidity Buffer with further downstream impacts on concentration risk despite relatively low PDs.
 - b. Preferential treatment of UK exposures could result in increased exposure resulting in risk concentration and remove diversification benefits.
 - c. UK firms being at a competitive disadvantage vis-à-vis non-UK firms when trading with non-UK sovereigns.
 - d. Under the Insurance Stress Test and other Stress Test exercises, concentration of exposure in UK could increase sensitivity to macro-economic adversity impacting Pillar 2B with constrained diversification ability.
 - e. We note that in emerging markets in particular, banks are required to hold local government debt and/or reserves with the local central bank in order to operate in those jurisdictions. In certain cases, banks are required to hold sovereign debt to align with the local deposit base. Furthermore, due to capital controls and local regulatory restrictions/requirements, UK banks

operating in emerging markets are often constrained from moving surplus funding into other currencies which means it can be difficult to redeploy these surpluses. These proposals therefore reduce UK firms international competitiveness in those jurisdictions due to the increased costs of capital associated with non-discretionary sovereign exposures that firms are required to hold.

- f. Currently, preferential risk weights are applied where exposures are funded and denominated in local currency. This is reflective of the lower incidence of local currency (LC) sovereign default vs foreign currency (FC) default. Most recent data from the Bank of England and Bank of Canada's sovereign default database ([BoC-BoE Sovereign Default Database: What's new in 2024? - Bank of Canada](#)) underscores the lower incidence of LC sovereign defaults relative to FC defaults. This is shown in the chart below:

Chart 8: Number of sovereign defaults, 1976–2023



Note: FC is foreign currency and LC is local currency.
Source: BoC-BoE Sovereign Default Database 2024

Last observation: 2023

- g. Furthermore, there is more favourable treatment of LC than FC debt in event of a default. Even where there are incidences of concurrent LC and FC sovereign defaults, there is often significant divergence in treatment between FC and LC debt. For example, Sri Lanka defaulted on both LC and FC sovereign debt during its recent debt crisis. However, S&P and Fitch retained the sovereign's FC rating on default for a period of more than two years, whereas the LC rating was in default for a period of less than one month. This reflects more favourable treatment of LC debt via the government's Domestic Debt Optimisation Programme (DDO). Ghana, the other country to have recently experienced a concurrent LC and FC sovereign default, also experienced more limited period of LC than FC default.
- h. Finally, locally funded exposure does not have transfer & convertibility risk. According to Fitch, capital controls and other transfer and convertibility issues are the main channels "by which government action can impede payments in a manner relevant for our ratings".

8. **Table 4: Data underpinnings** – While we note the reference points for CG/CB exposures in Table 4 are set below the reference points suggested by Table 6, we note this table combines CG/CB and RG/LA exposures, increasing the figures. Additionally, this data set will be affected by the mandated minimum LGDs and CCFs for IRB in the existing CRR. These factors reduce the relevance of this data as a source for risk weights representing the actual risk of CG/CB exposures, accepting it remains relevant for comparison of the overall impact of the CG/CB RG/LA systematic methodologies on banks that have previously used the IRB approach for these exposures.
9. **Paragraph 2.28: CRM FCSM** – The approach regarding unfunded CRM is clear. However, there is also mention of the Financial Collateral Simple Method in the CP, which applies to funded CRM. Under this method, a flat 20% reduction in market value is applied to debt securities issued by CG/CBs eligible for a 0% risk weight (Near Final Art. 222 6 b)). It is not clear why additional capital is required in Pillar 2A given the existing conservative haircut on these securities.

Unconditionally Cancellable Commitments (UCC)

10. We would note the following concerns with the proposed treatment of Unconditionally Cancellable Commitments (UCC):
 - i. We understand the PRA has compared SA CCFs to IRB CCFs in isolation. We believe this is inappropriate. While it is true that some IRB firms may use higher modelled CCFs than those mandated under SA even after the uplift to an effective 20% CCF, it is very likely IRB firms will have lower risk weights for equivalent exposures overall where appropriate for customers with stronger credit. Effectively increasing the SA CCF via this P2A add-on will exacerbate the competitive advantage of IRB for customers with stronger credit, impeding the ability of SA businesses to compete for these customers.
 - ii. While under Basel 3.1 a 10% conversion factor (CF) is required under the SA in Pillar 1, an incremental 10% CF has been introduced in P2A unless a lower CF can be substantiated based on historic rates while maintaining a 10% minimum.
 - iii. We acknowledge that a P2A add-on for retail UCCs is not a new requirement per se; however, we would highlight that the retention of this P2A add-on compounds to the new Pillar 1 requirement for retail UCCs introduced under Basel 3.1 standards. This will increase the overall capital requirement for retail UCCs across Pillar 1 and P2A.
 - iv. This cumulative 20% CF across Pillar 1 and P2A raises competitiveness concerns with international banks (especially for US Cards) regarding the 20% which is super equivalent to Basel 3.1 and is a significant departure from the UK's growth and competitiveness mandate. The original US Basel 3 Endgame proposal included a 10% CF for UCCs under Pillar 1 and does consider a Pillar 2 approach. The PRA's proposed 20% CF would result in at least a 10% incremental increase compared to US banks under forthcoming Basel 3 Endgame, with risk for a larger divergence depending on where the US re-proposal lands.
 - v. Lending to the real economy can be curtailed by this requirement which can worsen availability of credit particularly under stress.
 - vi. For retail UCCs the conversion factor add-on is too high based on the PRA's 30% transactor assumption which is higher than banks' observations, but even the lower limit of 14% is not broad enough to take account of banks' experiences. The effect of a high transactor assumption leads to a 'false positive' that retail UCCs are undercapitalised under Pillar 1 requirements. An

assumed higher transactor population results in a lower Pillar 1 capital requirement under SA, thereby creating a higher perceived delta between SA and IRB capital requirements. This inflated delta is the foundation for the PRA's proposed Pillar 2A add-on for retail UCCs, as per para 2.43 of CP12/25. We believe the 20% CF uplift is mis-calibrated and should be removed entirely as it is super equivalent to Basel standards, will reduce the availability of credit to UK consumers, and will create an unlevel playing field from other major jurisdictions.

Credit Scenario expectations

11. **Paragraph 2.49-2.59** – Credit scenario expectations: we note the PRA expects firms to develop credit scenarios across all exposure classes in the SA (para 2.51), this will require substantial resources to set up which would be a strong concern and is excessively prescriptive for Pillar 2A. It is also unclear what risk the PRA are looking to capture through the credit scenarios that they are looking to adopt. We note in the PRA's Basel 3.1 proposals a change was included whereby firms will now be required to carry out additional due diligence under the standardised approach to ensure the external credit assessment (which drives the risk weight) is appropriate and prudentially reflects the risk (applicable to corporates, institutions, covered bonds). Consequently the 3.1 proposal should capture the risk appropriately and only risks not captured in the revision to due diligence should be addressed through Pillar 2A.

We would also welcome confirmation that there will be no overlap between the proposed Pillar 2A credit scenario testing with the existing Pillar 2 buffer stress testing. Indeed, it will be helpful if Phase 2 of the consultation alleviates any aspects of potential double counting in the two stress tests in Pillar 2A and 2B – in particular it will be important to avoid double counting with P2B. Ideally, the PRA should be looking at ways to simplify the capital stack, given counterparty risk is also included in the scenarios used to determine the overall stress buffer, the introduction of additional scenario under Pillar 2A would be a double count especially if the P2A scenario captures the tail risks that would be covered under the stress scenario.

As a minimum, the PRA should remove the proposed restrictions on using 'proxy IRB model's instead of credit scenario modelling so that these models can be used for all portfolios if firms justify their use in the ICAAP. Many firms have approved A-IRB models for portfolios which will move on to standardised with Basel 3.1 (e.g. sovereigns). These A-IRB models should be eligible to be used in Pillar 2A instead of credit scenario modelling. The PRA should also clarify that firms could continue to use economic capital models instead of credit scenarios.

Finally, we recommend the PRA undertake a cost benefit analysis to assess the benefit of the scenario analysis proposals, given there are already multiple overlapping stress testing requirements.

12. **Paragraph 2.55:** Alternative credit modelling for Pillar 2A – further guidance is needed for consistency purposes on specifications of these models, e.g. downturn assumptions, probability of default definitions and whether there needs to be alignment to IRB based definitions.

13. We would like to clarify if the expectations for firms to use credit scenarios in Chapter 2 is limited to traditional credit products, or an extension of the scenario is expected for counterparty credit exposures. Since in many cases banks have common counterparties with direct credit lending exposures and counterparty credit exposures, we expect the scenarios may require consideration of both. The same argument is applicable to other aspects of Chapter 2, in particular, with the application of Minimum Effective Risk Weights.
14. We expect further insights will be provided in the Phase 2 on the design and application of credit scenarios. We think general information on MEVs and severity levels will be useful to set some parameters on the expectations for Pillar 2A scenarios.
15. Further guidance on the governance expectations on IRB equivalent models for Pillar 2A assessment will be useful for planning and resourcing impact assessments.

Market Risk

16. In the 'near final B3.1 policy statement' the PRA updated that Pillar 1 refinements in Market Risk and CVA will result in reduction in Pillar 2As. Any potential double counting in Pillar 2A will be removed in subsequent publications. Examples of Illiquid risk and concentration risk were provided. Since CP 12/25 hasn't provided further clarifications on this aspect, we would welcome confirmation from the PRA confirm that it will be updated in phase 2.
17. The syndicated loan guidance is new, and we would welcome an appropriate timeframe to implement (we support the delay announced during the consultation period but would also a reference data approach rather than a submission date).
18. We understand the section on Market Risk involves a range of disclosures of the PRA's SREP approach to review firms' market risk capital rather than setting out expectations for firms to integrate with the disclosures provided in the CP 12/25. It will be useful if PRA provides feedback on our understanding (disclosures rather than setting expectations) of the overarching objective of this publication on market risk. As an example, we interpret that there is no risk exposure capitalisation requirement of intraday risk (market risk capitalization is based on end of day exposure) outside of the CP, not even in FRTB (which sets monitoring requirement only for such risk), and as such we read this as good practice in our toolbox in terms of identifying and monitoring pockets of intraday risks, not an expectation to capitalise on intraday exposure.
19. We would also welcome clarification from the PRA on the definition of Gap risk referred in the CP and whether that needs to be interpreted in conjunction with FRTB.

Operational Risk

20. **Paragraph 3.6-3.8:** We have no objection to adapting ICAAP to cover the additional points raised or the standards for scenario analysis. However, we would value more feedback from the PRA on factors that were considered when setting Pillar 2A requirements, where the assessment differs substantially from the banks internal assessment:

- a. It is currently difficult for firms to understand why the PRAs assessment differs (e.g. due to perceived weaknesses in calculation methodology, scenarios analysis, information presented in the ICAAP or different perceptions of the risk exposures)
 - b. This will help firms to take necessary action to improve the assessments or provide better information to the PRA if more feedback was provided.
21. We remain concerned that operational risk will remain a 'black box' with capital requirements that can't be reconciled, explained or justified.
22. The PRA should also explicitly clarify that Pillar 2A capital for operational risk will reduce with the introduction of the new standardised approach for operational risk introduced in Basel 3.1

Pension Risk

23. **Paragraphs 4.10-4.15:** We broadly welcome reduction in reporting requirements for well-funded schemes, but we note that forms FSA081 and ICAAP returns may now diverge. In terms of the pension obligation risk, we support proposal 2, which exempts well-funded plans with a funding ratio greater than 130%, under the condition that firms meeting the >130% funding ratio criteria should automatically qualify for the exemption without needing additional narrative or assessment.
24. **Pension Buy-in schemes (paragraph 4.11):** we note that pension schemes subject to a full buy-in are unlikely to present a material risk, and a full FSA081 submission is not required. Nonetheless the PRA "would continue to expect an assessment of the residual risks remaining following a buy-in, such as credit risk relating to the insurer counterparty," to be documented in ICAAP. Can the PRA provide guidance on:
- i. Where should this assessment be reflected in the ICAAP? The current interpretation leans toward including it in the Pensions Risk section of the ICAAP rather than, say, in the counterparty credit risk section.
 - ii. What does the PRA's expectation of "assessment of residual risks" mean in practice? The current interpretation leans toward a qualitative assessment taking into account the strength of the insurer or insurance regime, contractual protections and FSCS protection. If a quantitative assessment is expected instead, is there any guidance on a proposed approach or key principles to assess? The FSCS protection implies there is very limited residual risk for the bank. Specifically, the current position is that the FSCS covers 100% of the pension liabilities if the insurer defaults. Therefore, risk could only arise from the timing of payments to pensioners that may require the bank to step in and provide a short-term loan to the fund to cover the required payment until such time as the FSCS is able to make the payment to the UKRF.

Additional comments on PS7/25

- We take note of the PRA's intention to hold a roundtable on the implementation of this PS later in 2025, in the meantime we have some high-level concerns to share with the PRA on the process.

- While not part of the scope of CP12/25, this policy statement was released concurrently and has similar effect in altering a firm's Pillar 2A capital. The same conceptual objection regarding undermining the principle of self-assessment therefore applies.
- We note the PRA's intention stated in 2.20 to include PRA buffer deductions in the CAF formula and look forward to further detail on how this will work in practice to ensure overall capital requirements do not increase for these types of lending per the PRA's policy intention.
- The potential increases in capital requirements for SME and Infrastructure lending contradict the PRA's prior statements that:
 - *"[the PRA would] apply a firm-specific structural adjustment under Pillar 2A (the 'SME lending adjustment') to ensure that the removal of the support factor does not result in an increase in overall capital requirements for SME exposures" (PS 9/24 2.162)*
 - *"The infrastructure lending adjustment will minimise any disruption to infrastructure lending from the removal of the infrastructure support factor" (PS 9/24 2.142).*
 - *" [the PRA would] apply a firm-specific structural adjustment to reduce Pillar 2A capital requirements (the 'infrastructure lending adjustment') to ensure that the removal of the support factor does not result in an increase in overall capital requirements for infrastructure exposures." (PS 9/24 2.124).*

Contacts

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About AFME

AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.³

³ AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia. AFME is registered on the EU Transparency Register, registration number 65110063986-76.