

Engagement Paper Response

AFME response to FCA Engagement Paper on market risk capital requirements for FCA investment firms

09 February 2026

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to comment on the Financial Conduct Authority's (FCA) Engagement Paper on market risk capital requirements for FCA investment firms. AFME is the voice of the leading banks in Europe's financial markets, providing expertise across a broad range of regulatory and capital markets issues. We represent over 150 leading global and European banks and other significant market players. Our members play a vital role in Europe's financial ecosystem, underwriting around 90% of European corporate and sovereign debt, and 85% of European listed equity capital issuances. Importantly, AFME members are market makers, providing liquidity, which is essential for ensuring financial markets can function efficiently. We also represent law firms and other associate members which advise market participants and support AFME's legal and regulatory initiatives.

The views set out in this response have been developed by working with our members, many of whom have FCA investment firm businesses, making us well placed to provide a nuanced and comprehensive view.

Executive Summary

AFME and our members welcome the application of proportionate requirements for specialist investment firms. However, it is crucial that increased proportionality does not heighten the likelihood and impact of systemic risks crystallising. We have significant concerns that the current approach will lead to this unintended consequence as the Engagement Paper appears to downplay the risks associated with the largest investment firms, namely systemic non-bank liquidity providers, leading to insufficient targeting of the proposals under consideration.

Given the risks posed by systemic non-bank liquidity providers, including risks to retail investors, markets and financial stability, and the breadth of firms who currently appear to be in scope of the review, we emphasise that a one-size-fits-all approach is not appropriate. Market risk standards should be calibrated to the activities and systemic footprint of a firm, rather than the legal form or the presence of retail deposits.

We recommend that the FCA incorporates this key principle into its review and propose that the FCA develops a new categorisation for investment firms to ensure risk-based differentiation and support appropriate calibration. Under our proposal, the vast majority of specialised investment firms would still benefit from being able to use less complex approaches (with the lower risk-sensitivity reflected in capital requirements accordingly), while sophisticated, risk-sensitive approaches would be relevant only for the larger investment firms.

We consider that systemic non-bank liquidity providers should be subject to requirements aligned with those banks already comply with (where they conduct activities generating similar risks).

Furthermore, we recommend that non-systemic firms with insubstantial market risk be permitted, if they choose to do so, to continue to calculate their capital requirements for market risk under a simpler methodology similar to or simpler than the current methodology. This should be optional, i.e. non-systemic firms should be permitted to continue using the current approach. This will avoid

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increasing costs and complexity for those firms, which could outweigh the benefits, and undermine the objectives of, the review.

Design considerations for the review

We acknowledge and welcome the consideration the FCA is giving to the design of the review of market risk capital requirements for specialist investment firms. We support application of proportionate requirements to FCA supervised firms. However, we have grave concerns that important factors and principles do not appear to be factored into the review based on the cross-cutting issues raised in the Engagement Paper.

We are particularly concerned that the considerations outlined in the Engagement Paper do not take account of the disparate nature of the FCA investment firm population.

We recognise the complexity posed by the current approach to market risk capital requirements and support a simplified approach for non-systemic firms, as set out later in this paper (for example to address the treatment of non-linear risk, or the additional option to use the margin-based approach (K-CMG)). To avoid inadvertently increasing costs and barriers to entry, thereby undermining the objectives of the FCA's review, changes should be optional for non-systemic firms with insubstantial market risk relative to their balance sheet. These firms should be left the flexibility to continue calculating their capital requirements for market risk under the current methodology as the costs of assessing and implementing regulatory changes may outweigh any possible benefits. The current methodology for calculating the K-factor for market risk, as highlighted in the Engagement Paper (K-NPR), is relatively straightforward. Potentially complicating these calculations by asking firms with very limited trading books to assess hedged, diversified or netted exposures may therefore increase compliance costs.

However, the Engagement Paper does not reflect the systemic risks posed by large investment firms. Given these risks, which we set out below, and the diversity of investment firms, we emphasise that a one-size-fits-all approach is not appropriate. Market risk standards should be calibrated to the activities and systemic footprint of a firm, rather than the legal form or the presence of retail deposits.

We recommend that the FCA incorporates this key principle into its review. FCA investment firms conducting activities resulting in equivalent levels of risk as banks should be subject to equivalent regulation. For systemic firms, we recommend that the FCA require a more sophisticated approach to better capture the risks generated (a more sophisticated approach could also be permitted as an option, but not required, for non-systemic firms who wish to use it). This would avoid the need for over-conservatism in setting capital requirements.

We also note the inherent benefit of consistency between the approach for larger FCA-regulated firms and PRA-designated (CRR) firms, particularly for groups containing both types of entity. The ability to implement consistent requirements across these firms may provide an operational benefit.

A final design principle should be that less sophisticated approaches to capital should normally be more conservative than those which reflect risk more accurately, to allow for the potential that they underestimate the potential for loss.

We have set out below the risks that do not appear to be sufficiently factored into the design considerations of the review, in particular the risks posed by systemic non-bank liquidity providers.

Systemic risks from non-bank liquidity providers

Retail harm

Paragraph 2.6 in the Engagement Paper suggests that investment firms could be subject to less stringent prudential requirements than banks as they do not accept deposits, do not necessarily have external customers, and therefore pose less risk to financial stability. However, deposit taking and whether a firm has retail customers are insufficient proxies for determining risk to market integrity and retail harm where markets are concentrated, non-bank liquidity provision is systemically relied upon, and stress behaviour is procyclical. A small number of systemic non-bank liquidity providers are central to price formation and liquidity provision in several asset classes in UK markets (e.g. UK ETFs).

No investment firm holds retail deposits, even those currently deemed to be systemic by the Bank of England and subject to supervision by the Prudential Regulation Authority (PRA). This is because the Bank of England acknowledges that even where a firm has no retail clients or does not hold deposits, stress or failure of a dominant liquidity provider can cause systemic harm and undermine market integrity.

This is particularly relevant in the current context as UK authorities seek to encourage and increase retail participation in markets. Several exchanges have launched initiatives matching retail flow with that of non-bank liquidity providers. As the PRA has acknowledged, systemic non-bank liquidity providers have “largely displaced banks as the core market makers on organised venues,” particularly for agency business, such as cash equities and equity ETFs.¹ Furthermore, although investment firms do not hold retail deposits, in many cases they do offer services to retail investors.

As a result, ‘harm-based’ calibration should explicitly include retail investor harm via a loss in market integrity. It is critical that an assessment of retail harm includes evaluating impacts to retail investors in the event of a failure, stress, or perceived stress of a systemic non-bank liquidity provider.

Harm to markets

Paragraph 2.6 also suggests that the exit of investment firms from the market should generally affect other stakeholders less. However, this is not the case for systemic non-bank liquidity providers, where the failure, stress or perceived stress of one of these firms would be expected to harm market integrity.

This may be transmitted through:

- liquidity withdrawal and impaired price discovery leading to widened spreads, shallow depth, and increased volatility;
- fire sales through forced de-risking, potentially triggering margin and risk limits breaches;
- infrastructure propagation via margining, CCP exposures, and prime brokerages;
- cross-asset contagion with correlated moves and basis dislocations in related instruments.

The PRA has recognised the sheer volume and velocity of trades linked to these firms’ intraday liquidity provision and market making activities. This increases the counterparty risks associated with these firms, and at the same time, the speed of their trade executions has increased.²

The PRA has also said that the amount of information made available publicly by these firms is scant and that while these firms may have regulated broker dealers in their groups, they may use unregulated group companies to hold risk positions. The PRA has noted that the risks associated with these firms are not solely about their financial health and trading profile, but also about their trading systems controls, and whether their relevant technology change management processes are operationally sound and robust.³

The speed, interconnections to infrastructure and channels of risk transmission set out are highly likely to heighten a system-wide disruption, undermining the integrity of UK markets in stress or failure of these firms.

Operational resilience and capital adequacy under stress

In addition to market and funding risks, systemic non-bank liquidity providers are exposed to material operational risk under extreme market conditions.

Paragraph 2.6 emphasises the ability of investment firms to exit markets quickly with limited wider impact. However, recent experience demonstrates that operational constraints and capital strain can coincide with market stress, producing immediate disruption to market functioning and retail execution.

¹ ‘Frenemies at the gates – speech by Rebecca Jackson’ (February 2026).

<https://www.bankofengland.co.uk/speech/2026/february/rebecca-jackson-speech-on-intraday-risk-management-and-principal-trading>

² Ibid

³ Ibid

During the 2021 GameStop episode, a large proportion of market makers executing orders on behalf of retail brokerages materially constrained or ceased execution activity. This was largely due to their inability to absorb elevated order flow, margin requirements, and operational load within their existing capital and infrastructure limits. This episode illustrates that, for firms at the centre of retail order execution and market making, operational resilience and capital adequacy are inseparable, and failure in either one can impair market integrity and investor confidence even absent depositor exposure.

Operational risk resilience

Systemic non-bank liquidity providers rely heavily on algorithmic and highly automated trading systems that operate on ultra-low latencies. While these systems enhance market efficiency under normal conditions, they may give rise to risks of system outages, model errors, throttling mechanisms, or pre-programmed risk controls that can lead to sudden and simultaneous withdrawal of liquidity across venues and asset classes. Such events can materially impair price discovery and amplify volatility, even where firms remain solvent on a balance sheet basis.

Given the speed at which algorithmic strategies can scale positions and withdraw liquidity intraday, effective supervision of systemic non-bank liquidity providers requires more than end-of-day capital adequacy assessments. Without consolidated, intraday supervisory visibility into algorithmic exposure, concentration, margin utilisation, and liquidity buffers, supervisors may not be able to assess whether these firms have the operational and financial capacity to remain active during fast-moving stress events.

For example, when Knight Capital, an electronic market maker in the US, released new code within its trading systems into production in 2012, it triggered a continuous stream of erroneous orders onto the New York Stock Exchange, reportedly leading to losses of almost \$500mn and major disruption to the market. As the PRA has said, this illustrates that the risks of a runaway or rogue algorithm are not purely theoretical.⁴

Furthermore, the increasing market share and systemic importance of non-bank liquidity providers imply that the operational risks emanating from these firms are likely to grow in magnitude and potential impact. This situation is compounded by a regulatory disparity: while PRA-supervised investment firms are subject to stringent operational resilience requirements, systemic non-bank liquidity providers often operate under comparatively less transparent and onerous frameworks. This regulatory arbitrage can disincentivise PRA-supervised firms from undertaking certain market activities, creating an environment where entities with lower *ex-ante* resilience standards step in, thereby transferring and concentrating operational risks within a less supervised segment of the market.

Un-tested expansion into fixed income markets

The Engagement Paper notes the need to balance financial stability with proportionality and competitiveness when considering minimum capital levels for investment firms. In this context, we think it is important to highlight that systemic non-bank liquidity providers have expanded significantly into fixed income (including gilts) and related derivatives markets in recent years, yet none have been tested through a genuinely market-wide fixed income stress event or impact tolerance testing. This significant change in the structure and nature of intermediation in government bond markets has been highlighted by Andrew Bailey who recently noted that non-bank institutions dominate these markets.⁵

Unlike banks, which are subject to supervisory stress tests across multiple cycles, and resolution planning, the resilience of systemic non-bank liquidity providers has neither been subject to a supervisory stress test, nor have these firms undergone correlated fixed income market stress.

At present, regulators and supervisors do not have full transparency, on a consolidated basis and across the multiple jurisdictions in which these firms operate, to assess whether they possess the operational resilience, liquidity resources, and loss-absorbing capacity required to remain active liquidity providers for clients and the broader market in stress scenarios.

As a result, the regulatory framework should be designed to withstand severe but plausible stress events, rather than relying on assumptions of orderly exit or an ex-post assessment following a disruption.

⁴ Ibid

⁵ <https://committees.parliament.uk/oralevidence/17041/pdf/>

Disorderly liquidation

As referenced above, we disagree that liquidation of a systemic non-bank liquidity provider could be benign in a stress scenario. Rapid de-risking in stressed conditions is a principal mechanism for fire sales, price gaps, and margin amplification. For large investment firms, even the perception of stress can impose immediate economic and financial loss on retail investors, amongst other material externalities.

Substitutability in the failure of a systemic non-bank liquidity provider cannot be assumed, particularly where that firm has a commanding market share in a discreet asset class (e.g. UK ETFs). There are several reasons for this, including balance sheet constraints, risk limits, correlated strategy de-risking, and margin/funding conditions that could reduce the willingness and ability of competitors to intermediate.

Appropriate calibration of standards to the activities and systemic footprint of a firm

As mentioned previously, we support application of proportionate requirements to FCA-supervised investment firms. However, a one-size-fits-all approach is not appropriate for a disparate group of firms.

The stated intention of the investment firm prudential regime was to streamline and simplify prudential requirements for solo-regulated UK firms, to provide for simpler and more bespoke capital requirements for investment firms and to reflect better the nature, size, and complexity of investment firms' activities. It is clear that these objectives were set out with smaller, non-systemic investment firms in mind.

To support appropriate calibration, we recommend reviewing the categorisation of firms and have developed a proposal as set out below.

Proposal on firm categorisation

We acknowledge that the designation methodology currently uses balance sheet size (i.e. total consolidated asset size) as an objective reference point to indicate which firms are likely to be systemically relevant. However, we believe that equal weight should be given to other factors, including a firms' substitutability, interconnectedness and complexity to ensure standards are appropriately calibrated. This could be done by using a quantitative and qualitative assessment, such as that used as part of the O-SII buffer framework to determine a score representing a firm's systemic riskiness and hence appropriate supervision.

On this basis, we propose that investment firms be categorised into 2 groups:

- **“systemic non-bank liquidity providers”**, which could be subject to rules for category 1 firms, similar to the rules banks are already subject to; and
- **“other investment firms”**, which should continue to be subject to a more proportionate and simpler set of rules as set out later in this paper.

In terms of a definition for category 1 systemic non-bank liquidity providers, we recommend the following:

“FCA-supervised investment firms whose market making or liquidity provision is material to price formation in one or more asset classes.”

Under this proposal, an investment firm would be treated as a Category 1 firm if it meets at least one metric listed below on a per asset class basis:

- **Market share:** sustained top-tier share of traded volume and/or quoted depth in a well-established asset class, including on-exchange and bilateral trading mechanisms
- **Liquidity provision:** elevated contribution to order book liquidity and/or participation in venue market making schemes
- **Asset price impact:** demonstrable influence on price levels, spreads, depth, and volatility in well-established assets

- **Inter-connectedness:** material CCP clearing activity, margin flows, prime brokerage usage, and repo reliance
- **Speed / sophistication:** capacity to scale exposures intra-day via automated strategies and complex models

The liquidity of assets should be considered as part of the assessment against the above metrics to avoid disincentivising smaller providers from operating in niche markets or specialised products.

In addition, we recommend that the assessment is designed to avoid a cliff-edge i.e. the risk that a firm previously categorised as 'other investment firm' is suddenly re-categorised as a systemic non-bank liquidity provider, resulting in a sudden uplift in capital or more complex approach without sufficient time to prepare. This could be achieved in a number of ways, such as basing certain metrics on moving averages. This would be similar to the approach taken to mitigate cliff-edges in the PRA's Small Domestic Deposit Takers regime.

We also note that consideration should be given to bank holding companies, with UK FCA-regulated entities within them, that are headquartered and supervised outside the UK, to ensure such UK entities are not appropriately included in scope.

Where an investment firm is defined as a systemic non-bank liquidity provider, we consider that it should be subject to prudential and supervisory requirements similar to those for banks and PRA-designated investment firms, reflecting their levels of risk and where they carry out similar activities. We have set out below the rules which we consider relevant in this context:

- **Capital calibration:** capital should be sufficient to avoid forced deleveraging that would propagate dislocation.

The inherent level of price risk in holding a trading position should be the same, irrespective of the type of firm that holds it, therefore all firms should be subject to the same requirement (i.e. FRTB) to avoid opportunities for regulatory arbitrage. Banks calculate market risk capital requirements under FRTB (IMA or SA), which provides a more granular and comprehensive capture of market risk for firms with complex and active trading activities and ensures that capital held is more closely aligned with the actual risks undertaken, which is crucial for firms that derive a significant portion of their revenue from market-making or proprietary trading.

- **Consolidated supervision:** supervision at group-level, capturing risks to the UK regulated entities/group from unregulated or lightly regulated affiliates, intra-group guarantees, cross-entity booking, shared funding lines, and risk transfers. We propose that this be achieved within the existing framework for supervision, without changes to the population of firms that are supervised by the FCA or the PRA.

Most systemic non-bank liquidity providers are privately held and there is not a great deal of transparency into their activities, entities, or regulatory status globally. In the UK, their supervision is limited to the registered investment firm, and does not extend to its activities beyond that entity. As a result, no single supervisor has full insight into the totality of their activities, risk management, or governance across legal entities and jurisdictions. Consolidated supervision would ensure that the group maintains sufficient capital to cover risks throughout the group and that capital is effectively distributed and available where needed. This includes assessing capital adequacy on a group basis, taking into account unregulated entities and the risks they pose, including the interdependence of entities within a group. Without consolidated supervision, investment firms face severe unmitigated group risks that solo supervision cannot adequately address. Financial and reputational contagion as well as concentration risks create systemic vulnerabilities where parent company distress can rapidly spread to UK firms through intra-group exposures, shared funding sources, and operational dependencies, yet solo supervisors have no visibility into parent financial health and cannot monitor group-wide capital adequacy. In the absence of a consolidated supervisory approach, it is essential that capital requirements sufficiently capture this additional layer of group risk. One approach could be through the use of a capital multiplier to ensure that UK entities and therefore UK markets are sufficiently protected in times of stress. As we do not propose changing the population of firms subject to FCA or PRA supervision, consideration could also be given to enhanced data sharing between the FCA and PRA to support adequate oversight and risk monitoring.

- **Intraday monitoring & supervisory visibility** over gross/net exposures by major risk factors; concentration metric and limit utilisation; margin calls, collateral composition, and liquidity buffers; funding haircuts; intraday stress loss estimates and correlation/basis risk indicators.
- **Liquidity & resolution analysis:** firms should be required to undertake a liquidity and resolution analysis.

We would welcome further engagement with the FCA to discuss this proposal, with the objective of ensuring a categorisation of firms that enables suitable targeting and calibration of requirements.

Industry views on the possible approaches outlined in the Engagement Paper

We urge the FCA to reconsider the approach of its review as outlined above (i.e. to ensure risk-based differentiation), and to permit optionality for firms with insubstantial market risk relative to their balance sheet. We have sought to assess the different options set out in the Engagement Paper and identify those which would be suitable for an approach that calibrates standards to the activities and systemic footprint of a firm. This analysis reflects our members' views on the appropriateness of the options, both for the financial system as a whole, and for our members' entities that would have to implement the chosen approach(es).

Category 1: systemic non-bank liquidity providers

Reflecting the risks posed by systemic non-bank liquidity providers, we consider that these firms should be required to comply with a sophisticated approach based on the FRTB Standardised Approach (FRTB-SA) to sufficiently capture the risks their activities generate. This would also benefit these firms in avoiding the need for over-conservatism in setting capital requirements.

Category 2: other investment firms

Of the options set out, our members are most supportive of amendments to the standardised approach (Option 1) in combination with the "sensitivity-based approach" (Option 5), which could be based on FRTB-SA.

We consider that the optimal (and most consistent) approach would be to apply the simplified standardised approach (or an even more simplified version of it). Possible simplifications may include taking a simpler approach to non-linear risk⁶ or reducing the granularity of the calculations. In making such changes, references to the rest of the CRR (such as the credit risk framework) should also be removed. At the same time, the calibration of this simpler framework should be higher, to reflect its lack of risk sensitivity. This is the case for the simplified standardised approach in FRTB (FRTB-SSA).

These smaller firms could be given the option to apply FRTB-SA instead. This would be a step-up in sophistication and would recognise the variety of firms that would still remain in the 'other investment firms' category. The choice to move to an approach which better captures market risk should be incentivised with lower average capital requirements, as is the case with FRTB-SA vs FRTB-SSA.

This approach, under which it would be possible for FCA-regulated investment firms to take a consistent approach to PRA-regulated ones, would also have the benefit that in 'mixed' groups of firms, a single market risk calculation approach could be adopted. This would avoid, for example, consolidating entities in such groups having to restate their smaller investment firms' market risk requirements under FRTB-SA when including them in consolidated numbers.

Other options outlined in the Engagement Paper

We believe that the other options set out in the paper all have flaws and do not work as proxies for market risk.

Members have also raised concerns with certain options due to the increased compliance costs they would generate.

⁶ Where, in the current framework, requirements for options such as calculation of non-delta risk capital and approval to use own delta may be overly complex and burdensome for low-risk firms.

The proposal for a “weighted liquid exposure method” (Option 7) could result in double-counting, or overlaps, given that FCA-regulated investment firms are already subject to separate liquidity rules.

The proposal for an expanded “margin-based approach” (Option 2) would be complicated in cases where a financial instrument is not centrally cleared and potentially lead to double-counting in cases where instruments are centrally cleared. A bigger conceptual issue with the approach is that margin is not a good proxy for market risk. If anything, margin requirements may be seen as a measure of counterparty credit risk, which is already captured under K-TCD in the MIFIDPRU framework, and would thus be duplicative. For the same reason, we would suggest that FCA consider removing the current K-CMG approach, which would further simplify the framework.

Finally, the proposal for internal models (Option 3) would be difficult to implement. Where investment firms already do undertake internal models, for example in relation to credit risk, firms often face challenges in finding the right data and are left with unclear expectations from the regulator on how the results of internally modelled approaches should translate to capital planning. Scenarios applied to investment firms on the basis of internal models can also be inappropriate for the breadth of business models present in the investment firm community. In addition, we note that this approach would require significant resources from the FCA to review model applications and carry out subsequent monitoring. This may be disproportionate as we consider that only a very small number of investment firms may wish to make use of this approach.

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