Response document

AFME submission to the Financial Policy Committee's review of UK bank capital requirements

2 April 2026

The Association for Financial Markets in Europe (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.

Executive Summary

AFME and its members strongly support the Financial Policy Committee's (FPC) review of the UK's bank capital framework. The lowering of the FPC's benchmark for Tier 1 capital requirements rightly reflects the effectiveness of post-crisis reforms and improvements in risk measurement.

AFME members operate across global wholesale markets and see first-hand how regulatory design influences the depth of market liquidity and the efficiency of capital raising. Recent trends underline the need for action to ensure a more proportionate and better-calibrated capital regime. Productivity in the UK financial services sector, which represents approximately 9% of GDP, fell by around one percentage point between 2019 and 2024.[1]

A framework with lower structural conservatism, where capital is more commensurate with actual risk, would enable banks to intermediate more efficiently across wholesale and capital markets. For internationally active firms, a regime more aligned with international practice reduces costs and supports a wider range of financing, underwriting and market-making activities. These effects matter for the real economy: deeper, more liquid markets lower the cost of raising equity and debt for UK companies, improve price discovery, and strengthen the UK's position as a conduit for global investment flows. Adjustments to the capital stack can support real-economy lending alongside enhanced wholesale capacity. Where capital is freed up and the cost of equity falls, banks can price more competitively, widen the set of bankable projects and allocate their balance sheet to productive investment, such as infrastructure financing or corporate lending.

A well-calibrated reform package would therefore reinforce the UK's attractiveness for international business while improving the transmission of finance into households and firms, in line with the government's objectives for economic growth.

The FPC's suggestion that the move from a 14% to a 13% Tier 1 benchmark will be achieved automatically through Basel 3.1-related Pillar 2A adjustments or reductions in systemic importance does not align with members' analysis. While Basel 3.1 may lower headline Pillar 2A requirements by around 0.5 percentage points, this merely offsets the increase in capital that Basel 3.1 introduces and therefore does not represent a genuine easing of requirements. In addition, if decreases in systemic

[1] The Productivity Frontier: UK Leaders, Laggards and the Growing Gap | BCG

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importance were reflected in capital levels, these should already be demonstrated in lower average requirements of approximately 13.5%, yet this has not happened. The argument is, in any case, a statement of counterfactual compared to the FPC's 2015 expectations, rather than a reduction from current levels.

The FPC's reference to £60bn lower nominal capital requirements arising from declines in average risk weights similarly overstates real reductions in requirements since 2015. Members' analysis indicates that this largely reflects changes in balance-sheet composition over time, rather than reductions in risk-weight density for the same assets. On a like-for-like basis, risk-weights for asset classes that remain on banks' balance sheets have tended to increase, meaning there has been no substantive fall in capital requirements through this channel. Finally, although enhanced buffer usability is directionally helpful, members consider it unlikely on its own to reduce management buffers sufficiently to allow banks to operate at or near the FPC benchmark in normal conditions.

These factors suggest that structural changes to the framework are required if the benchmark is to be achievable in practice. For some firms, minimum and regulatory buffer requirements alone exceed the FPC benchmark; for others, binding constraints across capital stacks, alongside internal and external drivers of management buffers, leave limited scope to reduce Tier 1 ratios towards the benchmark without more substantive reform.

The FPC's review is an important opportunity to reduce bank capital requirements in a way that is sufficiently meaningful to have a significant firm-level impact across business models. A range of options are available. It is crucial that these are assessed holistically to take account of the interactions between requirements and to avoid competitive distortions.

We support international engagement to review international standards. However, international comparisons demonstrate that the FPC and Prudential Regulation Authority (PRA) have significant flexibility to consider reforms while continuing to align with existing international standards. Therefore, we encourage the FPC and PRA not to delay immediate action and to progress reforms in parallel, rather than sequentially.

Our recommended options are set out in the table below and ordered thematically. It is important to address the issues identified across each theme. For example, reductions in requirements in both the risk-weighted and leverage ratio frameworks are needed, as well as consideration of other factors such as MREL, given differences in binding constraints between firms.

AFME members stress that a reduction in UK bank capital requirements is needed to support sustainable growth, improve the overall alignment of capital with risk and enhance the UK's international competitiveness across business models. It is important that action is taken across the prudential framework to deliver comparable effects for all business models. This matters because G-SIBs, domestically focused firms (D-SIBs and others), and international banks are active in UK markets. All play significant and often overlapping roles in supporting the UK economy, and changes that impact unevenly could create competitive distortions that are unrelated to underlying risk. A narrow reform, underestimating areas of over capitalisation for some business models, could introduce competitive distortions between firms undertaking similar economic activities.

AFME and its members look forward to supporting the PRA and FPC in continuing to progress the review. AFME remains available to facilitate further engagement with the banking sector.

Theme	No.	Recommendation
Level of capital requirements	1	Reduce bank capital requirements in a way that is sufficiently meaningful to have a significant firm-level impact across business models. This should include setting regulatory minima below the FPC benchmark.
Approach to international comparisons	2	Review analysis to take account of US proposals for changes to the US capital framework, more precisely differentiate between firm cohorts, and compare requirements with large financial centres other than the EU and US, such as Japan and Canada.
Functioning of the leverage ratio framework – *address over-calibration and restore the leverage ratio's role of being a backstop measure*	3	Remove the Countercyclical Leverage Ratio Buffer for all firms. Alternatively, reduce the leverage buffer scalars to 25% or introduce an offset to the leverage framework.
	4	Remove the Additional Leverage Ratio Buffer for domestically significant banks.
	5	Reduce the requirement for at least 75% of the leverage ratio minimum requirement to be met with CET 1.
	6	Maintain exclusion of central bank deposits from leverage exposure measure but address impact of 25bps uplift for banks that do not benefit from the exclusions and for whom this acts as a structural additional requirement, such as through an opt-out mechanism or reviewing the scope of the exemption.
	7	Review supervisory expectations for firms below the threshold for application of the leverage ratio.
	8	Have regard to options that may be taken forward by updating international standards and engage internationally on these options.
Interactions of capital requirements that apply to domestic exposures – *address multiple counting of risks*	9	Review the calibration of Pillar 2 holistically to allow diversification.
	10	Refine the scope and purpose of Pillar 2A capital add-ons for geographic concentration risk, such as through guidance that Pillar 2A add-ons should primarily address residual geographic concentration risks not captured by the CCyB or O-SII buffer.
	11	Further reduce Pillar 2A to fully offset the impact of the CCyB positive neutral rate if it is retained at 2%.
	12	Review the O-SII buffer comprehensively with a view to removing it (or, if there are residual risks to be covered in light of other requirements, adjusting it downward).
Capital buffers – *simplify the capital stack and enhance buffer useability*	13	Progress proposals, including for international engagement, for a single releasable buffer.
	14	Amend or remove the MDA.
	15	Publish clear guidance on the consequences of drawing down capital buffers and to establish a sufficient timeline for rebuilding those buffers.
	16	Increase the buffers that are useable.
	17	Review interaction between the CCoB and Pillar 2B and other components of the capital stack to ensure the capital stack reflects firms' risk profiles and avoid unnecessary layering.

1. Introduction

AFME welcomes this opportunity to comment on the FPC's assessment of bank capital requirements and to submit evidence and analysis to inform the ongoing review. We support the FPC's consultative approach and the structured engagement organised by the Bank of England and PRA.

Objectives of the review

The review is an important opportunity to improve the capital framework and enable the banking sector to further support the UK economy by removing excessive conservatism, while maintaining resilience. This objective is particularly relevant in the context of the UK government's ambitions for growth, and to address continued challenges impacting productivity. The second National Infrastructure Assessment estimated that around £40 to £50 billion per annum of private investment alone would be required to meet priorities in economically regulated sectors during the 2030s. However, as the government recognised in its 10 year strategy for UK infrastructure, this likely now underestimates the amount of investment required.[2]

To achieve this objective, and as an over-arching point, AFME members encourage the FPC to take an ambitious, forward-looking approach. This is crucial to ensure that banks continue to have the capacity to meet demand for lending in future, and so that distributions to shareholders can be used to support growth. These are the principal mechanisms through which lower requirements will support growth:

- **Demand for lending:** at times when the economy is credit-constrained, additional capital can be deployed to alleviate any lack of supply to finance the UK's stated future investment needs. More fundamentally, lower capital requirements reduce the cost of lending, benefitting borrowers demanding loans, and potentially increasing demand from prospective borrowers who may be otherwise priced out of the market.

- **Increasing bank participation choices:** at times where there are no credit-constraints, capital could be distributed to shareholders. When this occurs, the equity part of the return on equity calculation reduces. Any reduction results in a one-for-one reduction in the risk-adjusted return required to meet a given return on equity. For example, a 10% reduction in capital for a hypothetical bank with a 15% return on tangible equity (ROTE) target would reduce the required returns to 13.5% to achieve the same ROTE. The impact of this will manifest through both an ability for business lines to price lower (as shown in the Bank of England's analysis, a 100bps reduction in capital leads to a 10bps reduction in pricing), and an ability for banks to take on more risk. As a direct result, more projects and clients will become bankable.

- **Distributions to shareholders:** by increasing demand and increasing the number of clients and projects that can be profitably financed, removing excess capital requirements benefits growth regardless of banks' distribution decisions. However, consistent and competitive shareholder distributions themselves increase banks' investibility. In doing so, distributions lower the cost of equity, reinforcing the two channels set out above. There should be no stigma attached to shareholder distributions as these are a central plank of a vibrant market economy, attract capital into the UK, and in many cases also directly benefit UK retail investors.

Members particularly encourage changes to reduce bank capital requirements that are sufficiently meaningful to have a significant firm-level impact across business models. Such measures are justified not only to support growth, but also as a result of the ring-fencing regime and the UK's comprehensive resolution regime. Banks' high MREL levels provide confidence for material reductions in CET1.

Under the existing framework, banks have limited scope to reduce their Tier 1 capital closer to the FPC's benchmark without breaching other binding constraints. Taken alongside the numerous internal

[2] CP 1344 – UK Infrastructure: A 10 Year Strategy

and external drivers for holding a management buffer, lowering the FPC's benchmark and enhancing buffer useability alone would not fundamentally alter bank behaviour in normal conditions, nor support banks to reduce the amount of capital that they hold. A lower FPC benchmark and improving buffer useability in a stress would need to be accompanied by measures to reduce the size of regulatory capital add-ons and measures to shift market and credit rating expectations on capital headroom.

Banks' minimum capital requirements

The Bank of England has said that banks currently maintain higher levels of capital than the FPC's benchmark for Tier 1 capital in part because they appear to be reluctant to use some regulatory buffers which are intended to be useable in stress.[3] However, for all banks, binding constraints, supervisory expectations, and market expectations limit their ability to do so, or to hold less of a management buffer in normal times.

Furthermore, analysis of Pillar 3 disclosures shows that minimum requirements require some banks, notably the major UK banks, to hold capital in excess of the FPC's benchmark. Analysis shows that the minimum requirements of all UK ring-fenced banks surpass the FPC's CET1 benchmark by between 0.7% and 1.6%, and the Tier 1 benchmark by between 0.7% and 2%, when assessed on a RWA basis and at ring-fenced level. That is without accounting for the confidential PRA buffer or required management buffers i.e. in practice, the difference would be expected to be even larger. Structural constraints are also clear when minimum requirements are considered at Group level. Reviewing minimum requirements on a leverage basis also shows that some banks (albeit a smaller number) would not be able to reduce their capital levels to the FPC benchmark. The analysis is set out in Annex 1.

AFME members consider that additional requirements, i.e. the confidential PRA buffer and management buffers, should be accounted for within the framework, and regulatory minima should be set below the benchmark to permit banks to deploy capital.

Approach of the review

A range of measures are available to reduce capital requirements. As these measures will impact banks in different ways (for example, benefitting some banks while not leading to changes for others), it will be crucial to avoid competitive distortions. Consideration of the level at which capital requirements are binding (at consolidated level, ring-fenced bank level or other entity level) should form part of this consideration, including to identify the cumulative impact of requirements and identify where and how reductions can be introduced most materially. This will ensure that both domestically focused and internationally active banks can continue to support the UK economy.

In addition, any measures taken will only be fully effective if the FPC and PRA take a holistic view, not least given the complex interactions between the different parts of the framework (and the multiple binding constraints within it).

While recognising the complexity of the questions posed by the review and the need for careful analysis of the costs and benefits, AFME members urge the FPC and PRA to progress the review and any subsequent changes to the framework as quickly as possible. Such prioritisation would reflect the benefits that the review could generate for the UK economy and to meet UK growth objectives. It would also leverage the considerable flexibility already available to the FPC and PRA to introduce reforms while adhering to international standards. Members therefore support progressing each of the different parts of the review in parallel, rather than sequentially. As a result, AFME members call on the PRA to bring forward its review of the application of the output floor to ring-fenced sub-groups (with a view to removing it).

[3] https://committees.parliament.uk/publications/51166/documents/283965/default/#:~:text=SW1A%200AA-,Dave%20Ramsden,in%20stress.

Members support international engagement to review international standards and for the PRA to encourage changes in other jurisdictions which have worked well in the UK, but this should not prevent more urgent progress.

2. Approach to comparing capital requirements across jurisdictions

AFME members welcome the FPC's analysis comparing UK capital requirements to those in the EU and US. Members emphasise that this is an important aspect for the FPC to continue to consider to ensure the competitiveness of the UK banking sector, especially in light of possible changes to the banking regulatory and capital framework in other jurisdictions.[4] In light of recent proposals from the US federal banking agencies to change capital requirements in the US, the Bank of England's analysis included in the December 2025 Financial Stability in Focus[5] should be updated.

Comments on Bank of England analysis and impact of US proposals

In addition to updating the analysis published in December, members encourage the FPC to take account of other considerations. First, as the FPC recognises, there are limitations to the adjustments that can be made to account for differences in approach between jurisdictions and it is important to also compare requirements on a non-adjusted basis. We note that the Bank of England reduced Pillar 2R requirements for EU banks to 0% for the adjusted comparison. This incorrectly implies that all Pillar 2R risks are captured under Pillar 1. These points are acknowledged in the Bank of England analysis, but do not appear to be sufficiently reflected in the conclusions.

When comparing risk-based requirements and guidance for G-SIBs on an unadjusted basis, as shown in Figure 1, AFME analysis indicates that requirements are higher in the UK compared to the US (based on current requirements and in line with the Bank of England analysis) and potentially the EU, depending on levels of P2B. Comparisons with the EU are impacted by the fact that Pillar 2B levels are not disclosed in the UK, nor are bank specific levels disclosed in the Euro area. AFME has therefore made assumptions on P2B levels, shown in Figure 1, where we assume Pillar 2B to be between 0-2%.

Differences between UK requirements and the new proposals that US federal banking agencies are consulting on are still being assessed. However, the US agencies estimate that the new proposals, when combined with the impact of proposed changes to stress tests, are estimated to reduce aggregate CET1 capital requirements for the largest banks by 4.8%.[6] This is equivalent to a reduction of approximately 0.6% of RWAs for G-SIBs which means that the bar representing US requirements in Figure 1 would reduce to 9.5%, although it is important to note that Figure 1 provides a comparison unadjusted for differences in the US approach to calculating RWAs. Combined with recent changes to the enhanced Supplementary Leverage Ratio (eSLR), the estimated impact for G-SIBs would be even larger: an estimated 6% reduction in aggregate Tier 1 capital requirements.

AFME members also urge the FPC to compare requirements by more comparable firm cohorts for non-G-SIBs. A comparison of requirements for UK ringfenced banks compared to US Category 3 firms (on an unadjusted basis) demonstrates differences in capital requirements for retail focused banks. We note estimates from the US banking agencies that their recent proposals would reduce CET1 capital requirements for Category 3 and 4 firms by 5.2% when combined with the effects of the stress test changes.[7]

Comparisons with other major banking jurisdictions

[4] For example, the European Commission is currently consulting on the competitiveness of the EU banking sector and a number of EU authorities have shared proposals for changes to EU bank capital requirements. In the US, the Federal Reserve is currently consulting on a re-proposal for implementation of the Basel 3 standards.

[5] https://www.bankofengland.co.uk/financial-stability-in-focus/2025/fsif-the-fpcs-assessment-of-bank-capital-requirements

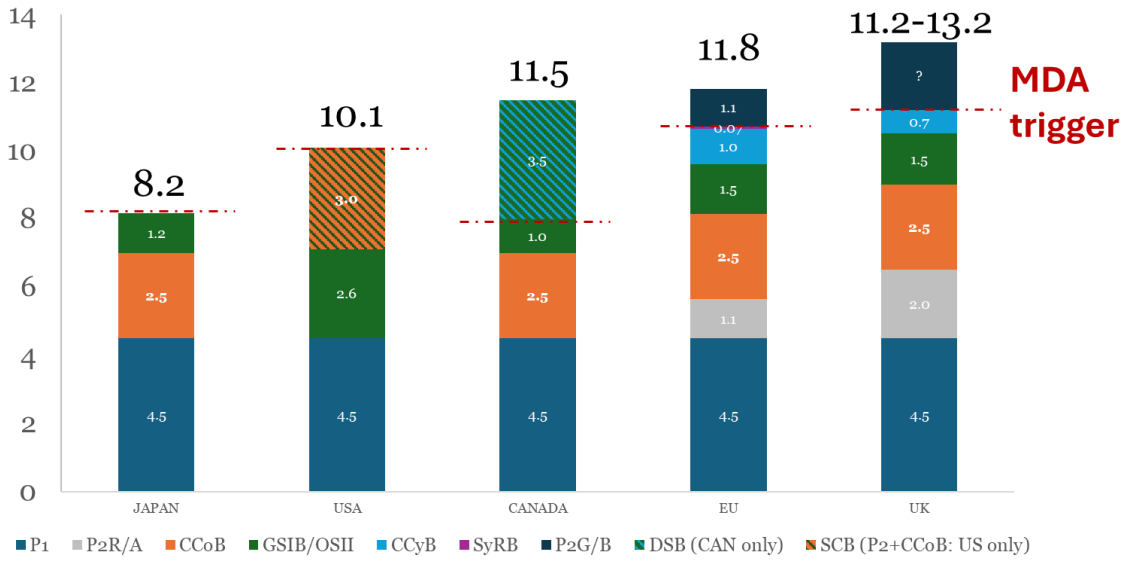
[6] https://www.federalreserve.gov/aboutthefed/boardmeetings/files/npr-expanded-risk-based-proposal-20260319.pdf

[7] Ibid

We encourage the FPC to consider comparisons with major banking jurisdictions other than the EU and the US. Based on AFME analysis, requirements in Japan are notably lower than in the UK. Requirements in Canada may be considered lower too, although we re-iterate the above constraints regarding P2B levels and note that the Domestic Stability Buffer (DSB) in Canada considers a wider range of risks than individual requirements in the UK. These impact a more detailed comparison.

It is worth highlighting the DSB as a unique feature of the Canadian regime. A breach of the DSB does not lead to automatic constraints on capital distributions, unlike buffers in other jurisdictions (such as the CCyB in the UK or the SCB in the US). The Canadian regime therefore enables smaller operating buffers above supervisory expectations.[8] Both Japan and Canada (in addition to the US and EU) have been assessed as compliant with Basel III standards for capital and leverage requirements by the Basel Committee on Banking Supervision.[9] This demonstrates that the FPC and PRA have significant scope to introduce measures to improve the UK capital framework while continuing to comply with international standards.

Figure 1: CET 1 ratio requirement and guidance for G-SIBs across jurisdictions (%RWAs) – based on current requirements

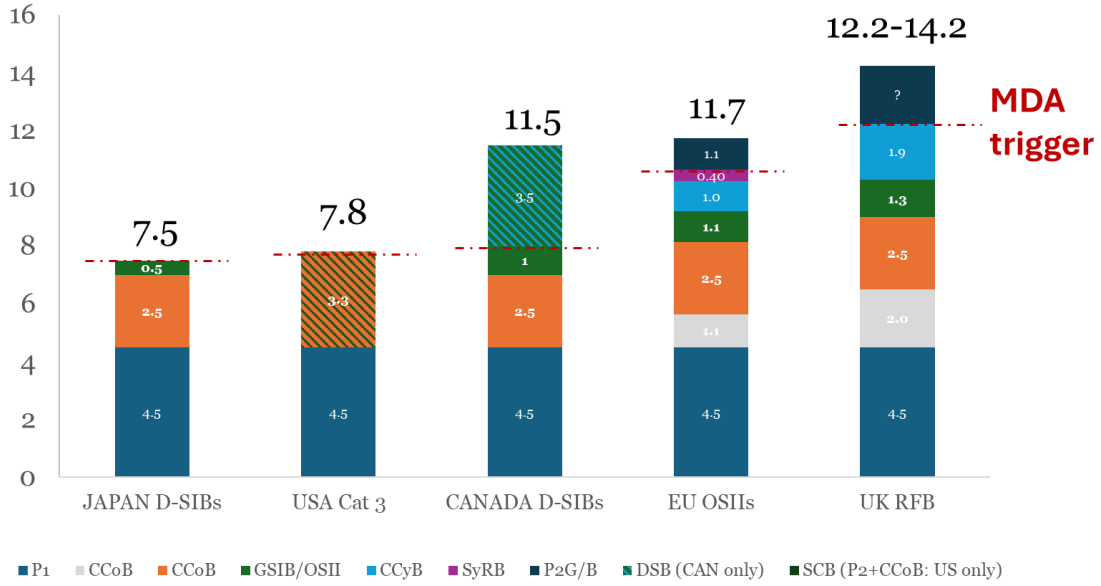


Source: US FED, ESRB, ECB and Pillar 3 disclosures of G-SIBs.

*Note: **For Canada,** the Domestic Stability Buffer (DSB) considers a wide range of risks including cyclical (household debt levels, global debt levels, housing prices, sovereign debt, among others), systemic (as it is applied only to 6 domestically-systemic institutions), and other firm specific risk metrics such capital adequacy and profitability of covered banks, among others. Breaches of the DSB will not result in banks being subject to automatic constraints on capital distributions (see paragraph 1.9.72 here), although there may be supervisory consequences. **In the US,** the stress test amount included is floored at 2.5% which is equivalent to the CCoB. The US GSIB buffer is based on the maximum of method 1 and method 2, which typically results in method 2. US requirements are expected to decrease as a result of proposals which are currently under consultation. The US approach to calculating RWAs is fundamentally different and this comparison has not made adjustments to account for that. **In the UK,** P2B is not publicly disclosed. Other institutions such as the Canadian Office of the Superintendent of Financial Institutions (OSFI) have estimated the UK P2B at 0.4% of RWAs as of early 2026 (see here).*

[8] https://www.osfi-bsif.gc.ca/en/about-osfi/reports-publications/benchmarking-canadian-bank-capital-ratios-international-peers-technical-note-february-2026
[9] https://www.bis.org/bcbs/implementation/rcap_reports.htm

Figure 2: CET 1 ratio requirement and guidance for Cat 3 US banks, Japanese and Canadian DSIBs, EU OSIIs and UK OSII RFBs – based on current requirements



Source: US FED, ESRB, ECB and Pillar 3 disclosures.

Note: Japanese and Canadian DSIBs, and EU OSIIs, exclude G-SIBs.

International standards

As a general point, AFME and its members support international engagement from the PRA on updates to international standards to complement a holistic domestic review and to encourage international alignment. However, AFME members consider that this should not delay measures that can already be taken forward by the FPC.

3. Functioning of the leverage ratio framework

AFME welcomes the FPC's acknowledgement of the differences in the UK's implementation of the leverage ratio framework compared to other jurisdictions and international standards. The UK framework incorporates significant gold-plating across quality of capital requirements and leverage ratio buffers. These are additional requirements which are unique to the UK. The US was the only other jurisdiction to exceed Basel requirements to this extent, but, as noted earlier in this paper, US authorities have now reduced the eSLR.

As recognised by the FPC, the conservative calibration of the UK leverage ratio has contributed to it becoming a binding constraint for many UK banks, and more generally moving away from acting as a backstop in the UK framework, as was the original policy intent. This is concerning given that the leverage ratio is a simple measure, designed to be risk-insensitive, and therefore a less appropriate measure for determining capital requirements than the risk-weighted framework. For example, whereas the risk-weighted framework attaches a 0% risk weight to items which are inherently low risk, the leverage framework applies gross exposures. Similarly, the leverage framework does not recognise that economic risks of certain activities are mitigated, such as ordinary course client facilitation of market making and hedging activity involving use of outright securities and derivatives. The leverage ratio penalises good risk management and creates incentives to invest in higher risk assets, reducing the supply of lending in certain lower risk asset classes.

The increasingly binding nature of the leverage ratio is compounded by a range of other factors, which impact banks in different ways. Factors include:

- ring-fencing requirements: as split balance sheets reduce ring-fenced banks' ability to diversify and the non-ring-fenced bank attracts both leverage and funding constraints;
- reductions in quantitative tightening leading to changes in central bank reserves; and
- flaws in the approach to internal MREL: the requirement to hold internal MREL, which is not required in the US for US subsidiaries of a US headquartered bank, forces subsidiaries in the UK to hold more expensive funding than they would otherwise choose to hold. This leaves banks with a challenging choice: hold that funding in cash (no return or leverage impact), deposit it at the Central Bank (generating a return, albeit less than the MREL cost, and no leverage impact) or deploy it into an asset (generating a return, but less than that from other funding sources, and impacting leverage). As such, the leverage exposure measure is likely to increase with a higher cost to traditional funding routes.

Members encourage the FPC to consider in its review not only recent developments in the market that have contributed to the leverage ratio becoming more binding, but also to take a forward-looking view that aims to future-proof. For example, the conditions that have led to the leverage ratio becoming an increasingly binding constraint could become more acute if deposit growth outpaces loan demand in future, particularly considering the run-off from quantitative tightening.

Furthermore, for some banks, leverage has been binding for as long as it has been applied to their entities. This indicates that issues with the calibration itself are leading to the leverage ratio being binding, rather than this being a result of market developments alone.

Banks and broker dealers becoming leverage constrained can have significant implications for their ability to support the UK economy. Banks and broker dealers in some instances may shrink their balance sheets in response, or decrease their activity in certain areas. This can have negative implications for the supply of lending in certain lower-risk asset classes, such as low LTV mortgages. It can also reduce banks' capacity for market-making activities related to fixed income, derivatives clearing or repo markets, which in turn has negative implications for market liquidity and can lead to higher transaction costs for clients. Moreover, leverage constraint reduces banks and broker dealers' capacity to market-make in the UK gilt and Treasury bill markets, as noted by respondents to the HMT/DMO consultation on deepening the UK Treasury bill market. This is especially important when taking into account the reduced structural demand for UK gilts from defined benefit pension schemes (who have traditionally been important investors in UK gilts), combined with likely large levels of issuance as debt levels start to decrease.

The FPC has set out its intention to prioritise reviewing the application of regulatory buffers in the leverage ratio framework (i.e. the application of the Additional Leverage Ratio Buffer (ALRB) and the Countercyclical Leverage Ratio Buffer (CCLB)). There is broad support for this review, and members note the CCLB, which is not present in other jurisdictions, increases capital requirements and creates additional operational complexity for international banks. We would note that at present, the CCLB and the CCyB in the RWA framework do not operate in a comparable way, with the lack of Pillar 2 offset under the CCLB driving up leverage requirements relative to RWA requirements.

In light of these issues, members consider that addressing super-equivalence in the UK leverage framework requires more than incremental adjustment. We therefore encourage the FPC to take a more holistic approach to the review and to prioritise reforms that deliver meaningful simplification and closer alignment with international standards, while avoiding competitive distortions. We have set out our specific recommendations below.

<u>Removal of the CCLB and ALRB</u>

Members support the removal of the CCLB for all firms, given its lack of international precedent, its misalignment with the operation of the CCyB, and its role in reinforcing the leverage ratio as a binding constraint rather than a backstop.

The leverage exposure measure does not suffer from the same procyclical issues that RWAs do and stress testing shows it does not increase in adverse conditions (unlike risk-weights). As the leverage ratio is more likely to be a binding constraint under normal conditions due to risk-weights being

lower, there is no justification for the CCLB. It would not be released under those conditions as its only purpose is to absorb losses and support continued lending under a stress scenario.

Other proposals to return the leverage ratio to its intended objective, i.e. to operate as a backstop, would be to reduce the leverage buffer scalars to 25% or, if removal of the CCLB is not considered feasible, to introduce an offset akin to that in place via Pillar 2 under the risk-weight framework, particularly as the CCLB is performing less of a role under the leverage framework than its RWA equivalent. An offset in the leverage framework should be greater than in the RWA framework to reflect that the leverage exposure measure does not suffer from the same procyclical issues that RWAs do. This lack of cyclicality in leverage means there should be a greater offset in the leverage framework than in the RWA framework, as it is solely accounting for the problem of a lack of releasable capital, and not the problem of procyclicality in the capital framework.

In addition, members encourage the FPC to remove the ALRB for domestically significant banks, where its interaction with ring-fencing, domestically focused business models and other UK-specific buffers results in a disproportionate and structural increase in leverage requirements that is not clearly justified by incremental systemic risk.

These changes would represent a targeted and proportionate step towards restoring the leverage ratio to its intended role within the capital framework, while preserving overall system resilience.

However, we note that removing these buffers would not allow firms subject to the Bank Capital Stress Test to lower their leverage ratio below 3.85% due to the Bank Capital Stress Test drawdown averaging 0.6%. This demonstrates the need for wider reform.

Review of quality of capital required to meet minimum leverage ratio requirements

Members encourage the FPC and PRA to broaden the review to include the quality of capital required to meet minimum leverage ratio requirements, in particular, the requirement for at least 75% of the leverage ratio minimum requirement to be met with CET1, in effect limiting the share of AT1 instruments eligible to meet the minimum requirement to 25%. This is a clear instance of gold-plating in the UK regime, given that international standards do not impose any restriction on the share of AT1 instruments eligible to meet the minimum requirement. We are not aware of any other jurisdiction with this requirement.

Previous FPC communications on the leverage ratio indicate that a key objective of the framework was to address risks arising from low-risk weighted portfolios, such as mortgages with capital requirements determined by the internal ratings-based approach, which the FPC considered risked leading to extremely high leverage levels[10]. However, this concern will be addressed through the output floor as part of the application of the Basel 3.1 standards.

While we recognise the interaction between the requirement on the quality of capital and ensuring that some CET1 is held against gilts/sovereign debt more broadly, 75% is significantly higher than required to adequately capitalise this asset class. The PRA will be finalising shortly its Pillar 2 risk-weights for sovereigns. A more proportionate requirement would align with the risk-weights under Pillar 2 for credit quality step (CQS) 2-3 sovereign debt. As set out in AFME's response to the PRA's CP 12/25[11], we consider that the PRA's proposed 5% risk-weight for CQS 2-3 is too high and should be lowered to 0-2.5%. This would correspond to a 7.5% CET1 leverage ratio requirement, or a 15% CET1 requirement if the 5% is retained. Either way, this represents a significant reduction in the amount of CET1 required to meet the leverage requirement, while still incorporating an adequate margin of conservatism, as the recommendation is based on A/BBB sovereign debt Pillar 2 requirements. This ensures that sufficient CET1 would continue to be held.

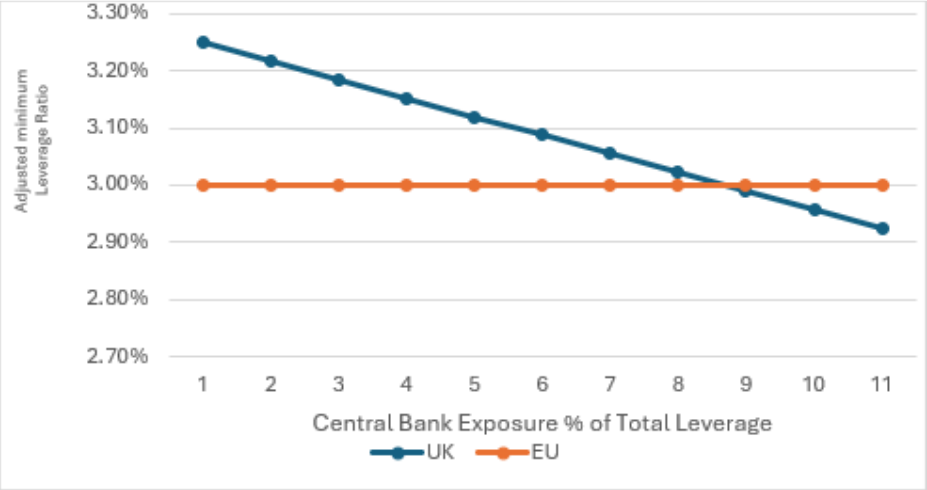
[10] https://www.bankofengland.co.uk/-/media/boe/files/paper/2014/the-fpc-review-of-the-leverage-ratio-consultation-july-2014.pdf
[11] https://www.afme.eu/media/runaekaf/250930-afme-response-to-pra-cp-1225-p2a-review-phase-1-final.pdf

The FPC has previously commented on the suitability of AT1 instruments for meeting the leverage ratio. However, we urge the FPC to review the requirement on the quality of capital in light of the gold-plating, implementation of the output floor, and continued sufficient CET1 levels. AFME members also note that concerns regarding AT1 instruments' loss absorbency are misplaced. While there are simplifications that could be made that could benefit the market (such as removing trigger levels, as these are not relevant and the point of non-viability is more likely to be key) and improvements that may be welcomed by investors (such as allowing coupons to be cumulative and introducing dividend stoppers), fundamentally, AT1 instruments do perform their primary loss absorbency role.
Furthermore, we disagree with previous conclusions from the FPC that, the 25% AT1 eligibility limit does not lead to significant costs for firms[12]. AFME analysis suggests that the 25% limit, when compared to a higher limit of 50%, adds an extra £81.25bn in CET1 and additional annual funding costs of £3.7bn.[13]

Mitigating impact of 25bps uplift to the minimum requirement for banks not benefitting from central bank deposit exclusion

Members propose that the scope of the review should include consideration of the 3.25% minimum requirement. There is strong support for continuing to exclude central bank deposits from the leverage exposure measure[14], and we hope to see other jurisdictions align with the FPC on this issue given deposit growth globally. However, we note that the resulting 25bps uplift in minimum requirements has a disproportionate impact on firms that hold a low portion of their LEM (approximately less than 8%) in Bank of England deposits, as shown in Figure 3. Moreover, for firms that are not permitted to exclude BoE deposits from their group consolidated LEM, or that structurally hold fewer Bank of England deposits (such as broker dealers), the additional 25bps acts as a permanent, structural capital requirement without the corresponding benefit. For these firms, the 3.25% minimum makes the UK minimum requirement structurally higher than international standards in practice and contributes to the leverage ratio acting as a binding constraint, rather than a backstop, for those firms.

Figure 3: Difference between the overall UK and EU minimum ratio requirements



We encourage the FPC to consider options for mitigating the impact on affected banks, such as an 'opt-out' mechanism, allowing firms to apply the lower of a 3.25% ratio (with the exemption applied) or a 3% ratio (with no exemption applied). Under this option, the PRA could explicitly note that maintaining capital resilience should be addressed through the UK's specific contingent leverage framework via the Internal Capital Adequacy Assessment Process (ICAAP). Firms could then assess Bank of England deposits as a form of 'capital efficient transaction' under these contingent leverage requirements, acknowledging that access to such deposits can be lost with significant changes in

[12] https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2021/october/ps2121.pdf
[13] AFME analysis is set out in Annex 2.
[14] As per BCBS LEV30.7.

monetary policy. This would allow for a more nuanced, firm-specific assessment of the risks associated with central bank holdings.

Alternatively, we encourage the FPC to review the scope of the exemption with a view to carving out broker-dealers. Consistent with the intention of the Basel standards[15], the exemption should apply only to banks whose balance sheets may be constrained by their central bank reserve holdings and that play a direct role in monetary policy transmission. This is not the case for broker-dealers with more than £10 billion in non-UK assets, which were brought into scope of the binding leverage requirement as part of the 2021 framework revisions. Revisiting the scope of the exemption would help ensure that firms not envisaged in the original policy design do not face a disproportionate and structural capital burden.

A further option could be to exempt HQLA Level 1 assets in currencies where the firm does not have a central bank account.

While members note that the FPC has previously considered feedback on mitigating the impact of the 25bps uplift, in particular in PS21/21, members are of the view that the question merits revisiting in the current context. In addition, we acknowledge the FPC's comments that the cost of the distributional impact in retaining the 3.25% minimum without central bank claims for all firms in scope is marginal.[16] However, it is important to assess costs for individual firms in respect of profitability and to avoid creating an unlevel playing field for banks who are structurally unable to benefit from the 'contingent benefit' outlined in PS21/21.

Supervisory expectations for firms under the thresholds for leverage ratio application

The PRA sets thresholds for leverage ratio application at £75 billion in retail deposits or £10 billion in non-UK assets. However, firms that sit under these thresholds still face supervisory expectations and reviews that mean they actively manage their balance sheet as if the leverage ratio were still a binding constraint. AFME members encourage the FPC to take forward an ambitious review that prioritises the proposals and factors identified above, but members that sit under the threshold also recommend that the PRA consider how meaningful the threshold is in practice. In particular, these members recommend that the PRA assess whether supervisory expectations can be relaxed in order to achieve their stated intentions of greater proportionality, competition and growth.

Longer term proposals and international engagement on the leverage ratio framework

Longer term, we encourage the FPC and PRA to share feedback from the review of the leverage ratio framework to inform and encourage updates to international standards. These should include international agreement on an exclusion of central bank deposits from the leverage exposure measure and (if scalars are not reviewed by the FPC as part of our recommendations regarding the CCLB and ALRB) use of a 35% scalar instead of the 50% suggested in Basel standards, as well as amending application to Holding Company level.

AFME members also recommend addressing MREL leverage, which has fallen out-of-step with risk-weights, resulting in MREL leverage being some banks' most binding constraint across UK entities. This has a highly significant impact on the efficacy of any going concern capital reforms. The benefits of reducing capital accrue through having to pay less for said capital. This is maximised when no capital needs to be replaced. If MREL leverage is a bank's binding constraint, any CET1 reduction, for example from leverage reform, is partially offset by having to issue more MREL to "fill the gap". This constraint is driven by the Financial Stability Board's (FSB) TLAC position, which includes an MREL leverage ratio requirement of 6.75%. This was designed to be equivalent to the risk-weight MREL minima, and a 40% average risk weight was used to justify this level. However, UK risk-weights are materially lower than this, averaging approximately 32%. Adjusting the 6.75% for this

[15] LEV 30.7: At national discretion**, and to facilitate the implementation of monetary policies**, a jurisdiction may temporarily exempt central bank reserves from the leverage ratio exposure measure in exceptional macroeconomic circumstances.

[16] https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2021/october/ps2121.pdf

lower risk-weight average would result in a ratio of approximately 5.8%. In practice, the ratio would not drop this far, as the "back-up" is twice the main leverage ratio (i.e. 6.5% minus central bank reserves). This "back-up" appears more appropriate and prevents variance in RWA assumptions and changes over time resulting in a more binding leverage framework. Members encourage engagement with the FSB on this calibration.

We acknowledge communications from the PRA regarding proposals to remove unencumbered gilts and Treasury bills (held outright or sourced via securities financing transactions) from the leverage exposure measure[17]. However, members encourage the FPC and the PRA to continue to have regard to this option which would serve to support the monetary policy objectives of the Bank of England and banks' ability to facilitate orderly gilt issuance, market liquidity and Treasury investment with limited incremental risk taking. In relation to the concerns raised regarding incentivising prudent risk management, we note that, in members' view the leverage ratio is not intended to be a measure for capitalising interest rate risk. Members believe that market risk RWA and IRRBB frameworks capture and capitalise these risks. International engagement on this issue would mitigate risks of competitive distortions.

Finally, to support international engagement, we draw the FPC and PRA's attention to proposals that AFME has developed to improve the EU leverage ratio framework. In addition to the recommendations included in AFME's report on simplifying the EU capital stack[18] (in particular regarding the central bank deposits exemption), AFME recommends that the European Commission:

- excludes certain sovereign bonds held within regulatory liquidity buffers from the leverage exposure measure to eliminate the counterintuitive interaction between the leverage ratio and the liquidity ratio;
- amends Article 429a of the CRR to permit exclusion of 0% risk weighted items such as default fund contributions, IA posted in a bankruptcy remote manner, and align systemic risk reduction frameworks (i.e. central clearing and initial margin) with the leverage ratio;
- refines SA-CCR to permit variation margin in the form of HQLA L1A securities to be treated equivalent to cash variation margin, aligning to NSFR, and reduce the Alpha factor to 1 across all types of counterparties, not restricted to non-financial corporates and pension schemes; and
- apply the leverage ratio at the consolidated level, instead of standalone legal entity level.

We recommend that the FPC and PRA consider these additional measures too to support international alignment.

4. Interactions of capital requirements that apply to domestic exposures

We welcome the FPC's support for further work considering overlaps in the treatment of domestic exposures within the capital framework. As noted by the FPC, while serving distinct policy objectives, the UK CCyB, the O-SII buffer and Pillar 2A requirements for geographic concentration risk are all calibrated based on measures of domestic lending. While the UK CCyB and Pillar 2A concentration risk charges are more explicitly calibrated in relation to banks' UK exposures, the domestic focus of the O-SII buffer is a deliberate feature, created by the Government through the ring-fencing regime and the application of the O-SII buffer to ring-fenced banks and large building societies. This leads to overlap and multiple counting of capitalisation of domestic exposures, which in turn increases the 'hurdle rate' for domestic lending within banks.

In addition, AFME members note that domestic exposures are captured through several mechanisms, such as G-SIB indicators, stress-test calibration and leverage ratio requirements. Depending on the bank, capital requirements may bind at different legal entities or levels of consolidation. Therefore, as

[17] https://www.bankofengland.co.uk/speech/2025/october/sam-woods-speech-at-annual-city-banquet-at-mansion-house?utm_source=Bank+of+England+updates&utm_campaign=b034802cf3-EMAIL_CAMPAIGN_2025_10_22_02_22&utm_medium=email&utm_term=0_-b034802cf3-468446722

[18] https://www.afme.eu/publications/reports/simplifying-the-eu-capital-stack/

mentioned earlier, any assessment of the multiple counting of domestic risk should consider the full consolidated capital stack to avoid creating competitive distortions between domestically focused banks and internationally active G-SIBs.

As noted, by design, the ring-fence limits the amount of business that in-scope firms can do outside the UK. For ring-fenced banks, this naturally results in a higher degree of domestic concentration, which in turn results in a higher Herfindahl-Hirschman indicator (HHI) factor, and a larger Pillar 2 credit geographic concentration risk capital add-on. Where firms are required to have a stronger domestic focus, as a result of regulation, than they would have done otherwise, they should not be penalised via Pillar 2 as a result.

Moreover, the FPC's decision to retain a positive neutral CCyB of 2% (which is higher than many other jurisdictions with a positive neutral CCyB rate, and indeed other major jurisdictions such as the US, Japan, India, China and Brazil that have set the CCyB at 0%) means that banks increasing the proportion of their lending to UK counterparties (vs other jurisdictions) will often face a higher CCyB rate as a result.

Figure 4: Countries with a Positive Neutral Countercyclical Capital Buffer

Armenia	1.5%	Latvia	1%
Australia	1%	Lithuania	1%
Cyprus	0.5%	New Zealand	1.5%
Czech Republic	1%	The Netherlands	2%
Chile	1%	Poland	2%
Estonia	1%	Portugal	0.75%
Greece	0.5%	Slovenia	1%
Hong Kong SAR	1%	South Africa	1%
Hungary	1%	Spain	1%
Iceland	2-2.5%	Sweden	2%
Ireland	1.5%	United Arab Emirates	0.5%
Georgia	1%	**United Kingdom**	**2%**

Source: IMF, Department Paper on Rethinking Macroprudential Capital Buffers, 2025

AFME analysis has found a further overlap between Pillar 2 requirements and the CCyB due to the strong relationship between the severity of supervisory stress scenarios and the economy's position in the business cycle, as measured by the output gap.[19] When the economy is operating above potential and experiencing strong expansion, stress test scenarios tend to be calibrated more severely. Conversely, during periods of economic contraction, stress scenarios are typically less severe. In this sense, stress test severity is highly cyclical and contingent on macroeconomic conditions. This cyclicality implies a potential overlap between Pillar 2 and CCyB, as both instruments respond (explicitly or implicitly) to the same underlying phase of the economic cycle.

Recommendations to address the double or triple counting of risks

Recommendations on Pillar 2

Further review of the Pillar 2 framework, both in relation to the treatment of geographic concentration risk and more broadly, is a high priority for AFME members. AFME members see scope for the PRA to take a bolder approach in phase 2 of the Pillar 2 review. In the same way that UK concentration is double counted through the different components of the capital stack, AFME members believe the PRA's 'layering' approach to Pillar 2 components is flawed in that it creates overlaps and ignores potential diversification benefits between risks and components of the capital stack. We would strongly encourage the PRA to review the calibration of Pillar 2 holistically to allow diversification.

Without pre-empting the outcome of that review, within the current framework there is room for the PRA to refine the scope and purpose of Pillar 2A capital add-ons for geographic concentration risk. For example, the PRA could provide explicit guidance that Pillar 2A add-ons should primarily address

[19] Please refer to Annex 2 for relevant charts.

residual geographic concentration risks not captured by the CCyB or O-SII buffer. Pillar 2A add-ons could instead be limited to addressing more idiosyncratic geographic concentration risks – for example, at a more granular, regional level.

More generally, in the context of the P2A review, members support a more holistic review of Pillar 2A methodologies including IRRBB, CSRBB, and concentration risk (including HHI) and ensuring sufficient time for implementation (e.g. 12 months). The split nature of the Pillar 2A review is challenging as the overall impact of the measures proposed in phase 1 of the Pillar 2A review is difficult for firms to assess without the full picture of the reforms.

Furthermore, to address the constraint created by the UK's 2% positive-neutral CCyB, should it remain at that level, we encourage the PRA to consider further reducing Pillar 2A to fully offset its impact. This alternative approach would preserve the PRA's intended level of releasable capital while easing the disproportionate burden placed on UK firms relative to other jurisdictions.

Recommendations on the O-SII buffer

Other options to address the multiple counting of risks include removing (or, if this is not possible, adjusting) the O-SII buffer. AFME members encourage the FPC to review the O-SII buffer comprehensively, with a view to removing it (or, if there are residual risks to be covered in light of other requirements, adjusting it downward). Where domestic systemic risk is already addressed through ring-fencing and robust MREL requirements, the layering an additional O-SII buffer is duplicative and a residual overlay rather than a risk based requirement.

A review of the O-SII buffer should include an assessment of the entity level at which meaningful relief is more likely to arise and account for differences between banks in this regard.

We note that the UK Finance submission to the FPC provides further detail on this proposal.

Other considerations

Members note that overcapitalisation is compounded by excessive conservatism in the RWA framework. This includes, for example, the hybrid approach for mortgage modelling. This AFME response focuses on issues that are mostly relevant to wholesale markets. However, we note that issues such as mortgage modelling are important to some of our more domestically focused members to enhance their ability to lend to the real economy. We agree with the analysis included in the UK Finance submission to the FPC in this respect.

5. Capital buffers

<u>Enhancing buffer useability</u>

AFME members welcome the FPC inviting discussion on buffer usability. We do not consider that enhanced buffer useability alone would be sufficient to enable all banks to reduce their capital requirements to the FPC's benchmark. However, as acknowledged by the FPC, there is significant scope for improvement in the effectiveness, efficiency and proportionality of the capital buffer framework, while maintaining resilience.

The FPC suggests in its report that it will give further consideration to the ideas introduced in Sam Woods' 2019 "Bufferati" speech, including moving to a single releasable buffer, and re-placing automatic distribution restrictions with a ladder of intervention tools operated with supervisory judgment. AFME members regret the lack of progress since 2019, both at international level and in the UK, with no concrete policy proposals published to improve the framework.

AFME members consider that the following options would enhance buffer useability:

- Removing or amending the MDA, and ensuring that dividend restrictions are one of the last tools to be deployed (and limited to where the PRA has material concerns about a firm

potentially entering resolution) could help to change market and credit rating agencies expectations on capital headroom. That said, some of our members are of the view that amendments to the MDA in isolation would have a limited effect, given that investors' expectations are a function of regulatory requirements.

- Members would support regulators publishing clearer guidance on the consequences of drawing down capital buffers. This should include clarifying that banks would not be penalised for minor breaches in a non-stress scenario (for example, due to a forecasting error which can be quickly reversed), nor would banks be penalised for using buffers in mild stress scenarios. For example, the guidance could set out how much of any combined buffer may be used depending on the stress taking place. Guidance should also set out more explicitly a sufficient timeline for rebuilding those buffers.
- Increasing the buffers that are useable. In the short term, this could focus on Pillar 2A. Longer term, the objective should be for all buffers above the effective floor of minimum CET1 requirements and the capital conservation buffer to be releasable.

For the benefits of enhanced buffer useability to materialise, it will be important that other parts of the capital framework do not introduce additional requirements for banks (for example, in relation to AT1 instruments, Tier 2, or MREL). Furthermore, we note that if a greater proportion of capital is releasable, the CCyB positive neutral rate should be reviewed.

Management buffers

The FPC rightly acknowledges in its report that there are various reasons why banks must hold capital in excess of the benchmark set by the FPC. The FPC's reduction of its Tier 1 benchmark does not change individual firms' capital requirements, nor does it necessarily diminish the internal and external drivers listed below. This is why, even if the proposals outlined above to enhance buffer useability are taken forward, banks will not be able to reduce their capital levels to the FPC benchmark.

External drivers:

- **Supervisory expectations:** The FPC notes that the PRA does not *oblige* banks to hold a management buffer, although in practice setting Pillar 2B in excess of required buffers does have a similar effect and the degree of supervisory oversight during the ICAAP process can influence the setting of the management buffers. However, some banks operating in the UK are subject to explicit supervisory expectations from over-seas authorities, such as the ECB and Federal Reserve, to define management buffers above regulatory and supervisory minima. Moreover, guidance by the Bank of England that banks can or should use their buffers to support the real economy will not always be mirrored elsewhere. No matter the jurisdiction, an important factor in banks willingness to use their capital buffers is the speed at which supervisors will expect those buffers to be replenished.

- **Market perception:** Breaching, or coming close to breaching, regulatory capital requirements is perceived by market participants as a sign of financial weakness or dis-tress, and can trigger adverse reactions from investors, counterparties, and customers. Research by the BCBS, for example, found that market indicators such as cost of equity, 1-year expected default frequency, 5-year CDS spreads and price-to-book ratio are all related to distance to minimum capital requirements (and the MDA triggers). Even with the FPC having communicated a lower benchmark for system-wide capital requirements, AFME members are of the view that investors will continue to expect that banks maintain a buffer above regulatory buffers.

- **Ratings implications:** Credit ratings agencies typically incorporate headroom over regulatory minimum requirements into their credit rating methodologies for banks. Indeed, statements published by major ratings agencies in response to the FPC paper suggested that any material reduction in banks' headroom above regulatory requirements could have an impact on banks' ratings, with a consequent impact on banks' funding costs and market access.

Internal drivers:

- **Risk appetite:** As noted in recent research published by the BIS, banks' management buffers are to some extent a reflection of management's tolerance to the risk of breaching regulatory requirements. Certain business models (such as custody banking) require banks to maintain a significantly more conservative risk appetite, holding capital far in excess of minimum requirements. This is also partially externally driven, given supervisory expectations for banks to establish a risk appetite, and to avoid set-ting risk indicators and triggers too close to regulatory minima.

- **Strategic objectives:** Management buffers provide flexibility for banks to execute their strategic objectives under both normal and stressed conditions, and banks may deploy the capital in the event of M&A activity, investment in technology, or new product launches. As a result, we would emphasise that capital held in excess of regulatory requirements is not necessarily 'unproductive' as has been suggested in some commentary on capital headroom.

- **Cost of replacing buffers:** A constraint on banks depleting their capital buffers is concern that external stakeholders (either regulators or the market) might apply pressure on the bank to replenish used buffers at a time when it is expensive to do so, or market access is unfavourable. Any decision to voluntarily deplete a bank's capital buffers will be contingent on the value creation associated with the deployment of the capital offsetting both the additional risks incurred and the cost of addressing the resulting capital shortfall.

While it is true that concerns about buffer usability in stress are a contributing factor to the size of management buffers, and efforts to improve the usability of buffers in stress would be welcome, the factors above would remain prevalent even in the event that regulators took action to improve the usability of capital buffers. Our members take the view that investors will always demand headroom above regulatory requirements. For this reason, adjusting regulatory benchmarks or messaging around buffer usability would not, on their own, fundamentally alter bank behaviour in normal conditions. Alignment with the FPC's benchmark would require additional measures to reduce the size of regulatory capital add-ons, and/or measures to shift market and credit rating expectations on capital headroom.

Capital Buffer Stack (CCoB)

More generally, AFME members encourage the FPC and PRA to consider simplifications to the capital buffer stack. Since the introduction of the Capital Conservation Buffer (CCoB) under Basel III in 2016, supervisory stress-testing frameworks have become substantially more sophisticated, providing a more granular and credible assessment of a firm's resilience, with extensive PRA review. Despite this, the fixed 2.5% CCoB continues to bind (in addition to other components) for firms whose stress-test outcomes have demonstrated that a materially lower Pillar 2B requirement (including negative PRA buffers) is both prudent and appropriate. This results in an overall capital stack that does not reflect the risk profile evidenced through these stress-testing regimes.

We encourage the PRA to review the interaction between the CCoB and Pillar 2B and other components of the capital stack to avoid this effect, and unnecessary layering of capital requirements more generally.

6. International developments

Simplifying the framework for capital requirements is an issue attracting significant interest and commentary in other important financial centres. For example, the ECB recent published recommendations to the European Commission for a simplified buffer framework, comprising a releasable and a non-releasable component. A benefit of a materially simplified framework is that it would facilitate more meaningful discussion around setting capital at a level that strikes an optimal balance between financial stability and economic growth: rather than debating the level at which each individual buffer is set, the debate could focus on simply calibrating capital requirements at the appropriate confidence interval over and above Pillar 1, with institution-specific add-ons (e.g. for G-SIBs) where appropriate.

AFME is actively contributing to discussions on capital requirements in an EU context and has published proposals to simplify the EU capital stack[20]. While proposals that have been raised by authorities such as the ECB are not in scope of the FPC's review, we would like to make the FPC aware of industry's position on some the ECB's proposals. In particular, AFME notes that the ECB recommended adjusting the role or design of Additional Tier 1 (AT1) and Tier 2 instruments in the capital stack, either by enhancing the features of AT1 instruments, or completely removing non-CET1 (AT1 and Tier 2) instruments from the going-concern capital stack. AFME members would strongly oppose the Bank of England considering similar measures without strong commitments from policy makers not to replace discontinued instruments with CET1. Replacing AT1 and Tier 2 with CET1 would increase the cost of capital for UK banks. AFME research found that cost of equity (CET1) for UK banks is 10.4%[21]; whereas the cost of AT1 was 7.9% in 2025 (5.9% after tax, with a corporate tax rate of 25%) and the cost of T2 was 4.8% (3.6% after tax).

Overall, AFME members consider that AT1 instruments should remain an integral part of the going concern capital structure. AT1 instruments substantially increase and diversify the investor base in bank capital and help to manage the FX mix in the capital stack to reduce ratio volatility. For banks which require AGM approval for share issuances, AT1 instruments provide a flexible and quick means to increase capital. They also increase a bank's pool of recovery options.

We support international engagement from the FPC on possible simplifications, not least to support international alignment. However, this should not prevent the FPC from progressing reforms domestically.

7. Conclusion

The FPC's review is taking place at a key time. We recognise the complexity and challenge of the work ahead. This is why we urge the FPC to adopt a holistic approach and to assess the options set out in this paper collectively, but urgently.

We look forward to continuing to inform the work of the FPC and the PRA.

[20] https://www.afme.eu/publications/reports/simplifying-the-eu-capital-stack/

[21] The 10.4% cost for CET1 is a cost of equity estimate based on a CAPM model for five UK banks: HSBC, Barclays, Lloyd's, Natwest, and Standard Chartered. It does not include other non-UK headquartered banks, some of which may fund CET1 with debt liabilities issued by their parent company. Measured in this way, however, we are able to consider the opportunity costs of CET1 as a core equity capital component.
RCET1 = Rf + β(Rm – Rf). Rf: 30Y UK GILT = 5%; β: Beta for the 5 individual banks = 1.19 median [HSBC=1.15; SC= 1.19; BARC=1.49; LLOY=1.12; NW=1.22]; Rm – Rf: Equity risk premia. Estimated at 4.6 according to NYU Damodaran for the UK.

Annex 1: Analysis of minimum capital requirements

AFME analysis of Q4 2025 Pillar 3 disclosures shows that minimum capital requirements for UK ring-fenced banks surpass the FPC benchmark. Minimum requirements also exceed the FPC benchmark when considered at Group level. The breakdown below does not include the confidential PRA buffer or required management buffers.

CET 1 (ring-fenced bank level and consolidated level)

	P1	P2A	CCyB	CCoB	GSIB/OSII	Regulatory min.	Overshoot
HSBC UK plc (RFB)	4.5	2.1	1.9	2.5	1	12.00	1
HSBC Holdings plc	4.5	1.4	0.7	2.5	2	11.1	0.1
Barclays Bank UK plc (RFB)	4.5	2.6	2	2.5	1	12.60	1.6
Barclays plc	4.5	2.7	1	2.5	1.5	12.2	1.2
Lloyds Bank plc (RFB)	4.5	1.6	1.9	2.5	2	12.50	1.5
Lloyds Banking Group plc	4.5	1.4	1.8	2.5	1.6*	11.8	0.8*
NatWest Holdings plc (RFB)	4.5	1.3	1.9	2.5	1.5	11.70	0.7
NatWest Group plc	4.5	1.6	1.7	2.5	1.25**	11.55	0.55**
Santander UK Group Holdings plc (RFB)	4.5	2.4	1.98	2.5	1	12.38	1.4

* Although Lloyds Banking Group plc does not have an O-SII buffer, it is required to hold additional CET1 capital to meet its RFB's O-SII buffer of 2.0%, which equates to 1.6% of the Group's total REA.
** Although NatWest Group plc does not have an O-SII buffer, it is required to hold additional CET1 capital to meet its RFB's O-SII buffer of 1.5%, which equates to 1.25% of the Group's total REA.

Tier 1 (ring-fenced bank and consolidated level)

	P1	P2A	CCyB	CCoB	GSIB/OSII	Regulatory min.	Overshoot
HSBC UK plc (RFB)	6	2.8	1.9	2.5	1	14.20	1.20
HSBC Holdings plc	6	1.9	0.7	2.5	2	13.1	0.1
Barclays Bank UK plc (RFB)	6	3.5	2	2.5	1	15.00	2.00
Barclays plc	6	3.6	1	2.5	1.5	14.6	1.6
Lloyds Bank plc (RFB)	6	2.2	1.9	2.5	2	14.60	1.60
Lloyds Banking Group plc	6	1.9	1.8	2.5	1.6	13.8	0.8*
NatWest Holdings plc (RFB)	6	1.8	1.9	2.5	1.5	13.70	0.70
NatWest Group plc	6	2.2	1.7	2.5	1.25	13.65	0.65**
Santander UK Group Holdings plc (RFB)	6	3.2	1.98	2.5	1	14.68	1.68

* Although Lloyds Banking Group plc does not have an O-SII buffer, it is required to hold additional CET1 capital to meet its RFB's O-SII buffer of 2.0%, which equates to 1.6% of the Group's total REA.
** Although NatWest Group plc does not have an O-SII buffer, it is required to hold additional CET1 capital to meet its RFB's O-SII buffer of 1.5%, which equates to 1.25% of the Group's total REA.

Comparison of minimum requirements at ring-fenced bank and Group level on a leverage basis

	(a)	(b)	(c)=(a/b)	(d)	(e)=(d/c)	(f)	(g)=(a)x(f)	(h)=(d)x(b)
	RWA (£bn)	EM (£bn)	Density	Leverage ratio req. (incl. ALRB, CCLB)	Levex inferred RWA T1 req. (% RWAs)	T1 regulatory min.	Nominal T1 capital req. (RWA, £bn)	Nominal T1 capital req. (Leverage, £bn)
HSBC (cons.)	661	2,139	31%	4.15	**13.4**	**13.1**	86.54	88.77
HSBC (RFB)	117	326	36%	4.35	**12.1**	**14.2**	16.68	14.18
Barclays (cons.)	357	1,247	29%	4.05	**14.2**	**14.6**	52.09	50.52
Barclays (RFB)	85	278	31%	4.35	**14.2**	**15.0**	12.76	12.10
Lloyds (cons.)	236	708	33%	4.45	**13.4**	**13.8**	32.50	31.52
Lloyds (RFB)	194	613	32%	4.65	**14.7**	**14.6**	28.37	28.49
NatWest (cons.)	193	655	30%	3.85	**13.0**	**13.65**	23.97	25.22

NatWest (RFB)	161	498	32%	4.38	**13.5**	**13.7**	22.04	21.80
Santander (RFB)	68	252	27%	4.35	**16.0**	**14.7**	10.04	10.96

Sources:

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Annex 2: Analysis of cost of 25% AT1 limit for meeting minimum leverage ratio requirements

AFME analysis estimates that the 25% limit, when compared to a higher limit of 50%, adds an extra £81.25bn in CET1 and additional annual funding costs of £3.7bn.

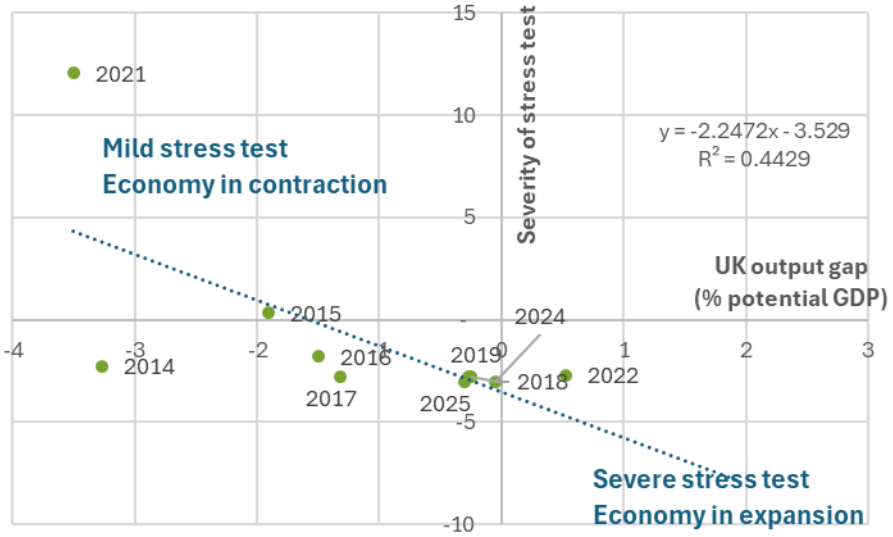
This estimate is based on the following:

- Average Cost of equity (CET1) for large UK banks is 10.4%. This compares to 5.9% after-tax cost of AT1s (or a 4.5% gap).
- Requiring 75% of LR met with CET1 as opposed to 50% means an extra **GBP 81.25bn** in CET1 and additional annual funding costs of **GBP 3.7bn**.
- Details are: T1 req = LR x EM = 3.25% x 10tn (approx UK banking assets)
- CET1 required to comply w/ LR = 75% of T1 req = 75% x 3.25% x 10tn = 243.75bn
- CET1 required to comply LR if 50% (instead of 75%) = 50% x 3.25% x 10tn = 162.5bn
- Extra CET1 = 243.75 - 162.5 = **81.25bn**
- That extra CET1 pays an extra 4.5% in funding costs, which in GBP is equal to = 81.25 x 4.5% = **3.7bn**

This is based on the minimum requirements.

Annex 3: Correlation of economic cycle and severity of stress test scenarios

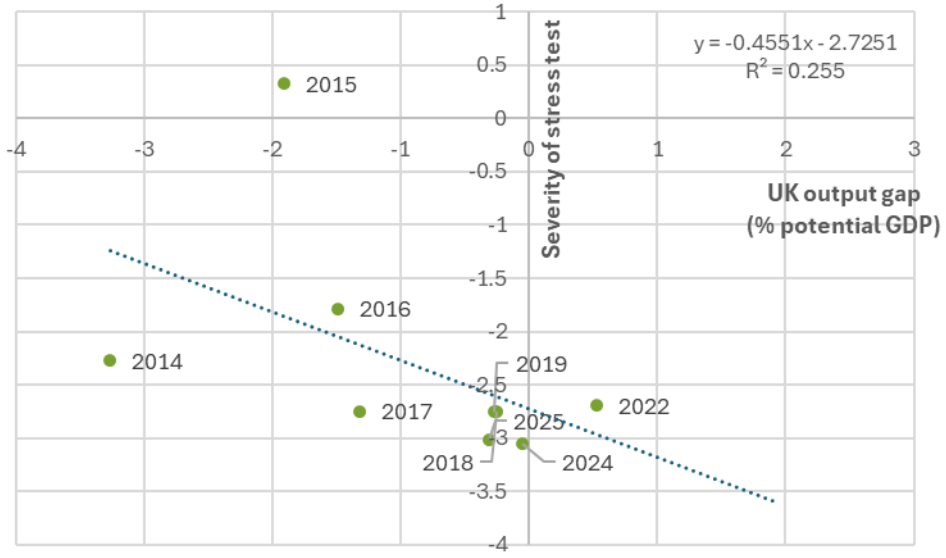
Correlation of economic cycle and severity of stress test scenarios (year of stress test in label)



Source: IMF and Bank of England

Note: Severity of stress tests has been measured as the difference between the latest observable real UK GDP amount and the real GDP amount 3Y after under the stress scenario. Output gap is sourced from the IMF measured as the difference in observed GDP vs potential GDP. Output gap is lagged 1 period as the stress test is constructed in year t but the output gap in year t is not known (only t-1).

Correlation of economic cycle and severity of stress test scenarios (year of stress test in label. Excludes COVID year)



Source: IMF and Bank of England

Note: Severity of stress tests has been measured as the difference between the latest observable real UK GDP amount and the real GDP amount 3Y after under the stress scenario. Output gap is sourced from the IMF measured as the difference in observed GDP vs potential GDP. Output gap is lagged 1 period as the stress test is constructed in year t but the output gap in year t is not known (only t-1).