

Lowering the Bar: The Global Impact of Eased U.S. Bank Capital Requirements

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Executive Summary

- U.S. SLR Reform: Trump's SLR reduction from 5% to 3% frees \$70B in capital, enabling \$500B in Treasury purchases, supporting fiscal dominance and domestic debt holdings. The changes may lower Treasury yields and offer support to bank stocks.
- European vs U.S. Bank Debt Structures: European banks rely on various hybrid bonds, sophisticated instruments, constrained by fragmented regulations; U.S. banks instead favor securitization and simpler subordinated debt, reflecting a more homogeneous market.
- With greater homogeneity, the new reform could further strengthen the advantage of American banks and improve the federal government's financing conditions, since it does not face the kind of fragmentation seen in Europe.

The Achilles heel of the Trump administration seems to be the amount of public debt and the resulting pressure on interest rates. During April, we witnessed a significant turnaround on tariffs, after the initial aggressive announcements of "Liberation Day". In our view, this occurred when Treasuries suddenly lost their safe haven status and yields, especially on long maturities began to rise amid a general sell-off of risky assets, led by equities.

Bessent's economic policy began with the "3-3-3" targets (3% budget deficit, 3% real GDP growth, 3 million additional oil barrels extraction), which were welcomed by investors. However, the resounding failure of the DOGE programme has eliminated any possibility of seeing a reduction in the deficit in the coming years. On the contrary, the approval of the "One Big Beautiful Bill" goes in the opposite direction, and the Congressional Budget Office estimates that the impact on debt will be over 3 trillion over the next 10 years.

Although there are no explicit statements, it seems that Trump's economic policy has in fact changed, and we feel we can define it as opportunistic "fiscal dominance". On the one hand, we are seeing continued pressure on Powell and the near certainty that his successor will be more aligned with the White House. This should ensure a structurally lower Fed Funds rate, allowing the Treasury to finance itself better on the short end of the curve. On the other hand, fiscal policies will be continuously expansionary and procyclical, supporting nominal growth. Through high nominal growth, in the order of 5%-6%, the debt burden on GDP could even decrease over the years, if there are no

recessions. This is certainly a risky policy, but one that could work and continue to favour the stock market over the bond market in the coming years.

To promote debt sustainability, the administration is approving two regulatory changes that conceptually represent a soft form of financial repression. The aim is to encourage the purchase of treasury bonds, shifting the composition of debt holders from foreign to domestic in the long term. So, on the one hand, they are reforming the SLR (Supplementary Leverage Ratio) requirements for banks; on the other, the GENIUS Act regulates and promotes stablecoins. We will write another in-depth article on this topic, but the macro implication is clear and consistent with the SLR reform: stablecoins deposit assets in treasury bills and have now become an important holder of Treasuries.

Summary of Changes to the Supplementary Leverage Ratio (SLR) and Its Market Impact

The Supplementary Leverage Ratio (SLR) is a key regulatory requirement introduced under Basel III in 2018 to ensure large banks hold sufficient capital against their total leverage exposure, including low-risk assets like U.S. Treasury securities. Unlike risk-based capital requirements, which assign zero risk weights to government bonds, the SLR imposes a uniform capital charge (5% for large U.S. banks, 3% for smaller ones), impacting banks' ability to hold Treasuries and provide market liquidity.

Proposed Changes to the SLR

The Federal Reserve and the FDIC proposed modifying the enhanced Supplementary Leverage Ratio (eSLR) standards for US Global Systemically Important Banks (GSIBs) and their depository institution subsidiaries. These changes aim to reduce disincentives for GSIBs to engage in low-risk activities, such as US Treasury market intermediation, which has been constrained by the SLR's capital charges on risk-free assets.

Market Consequences

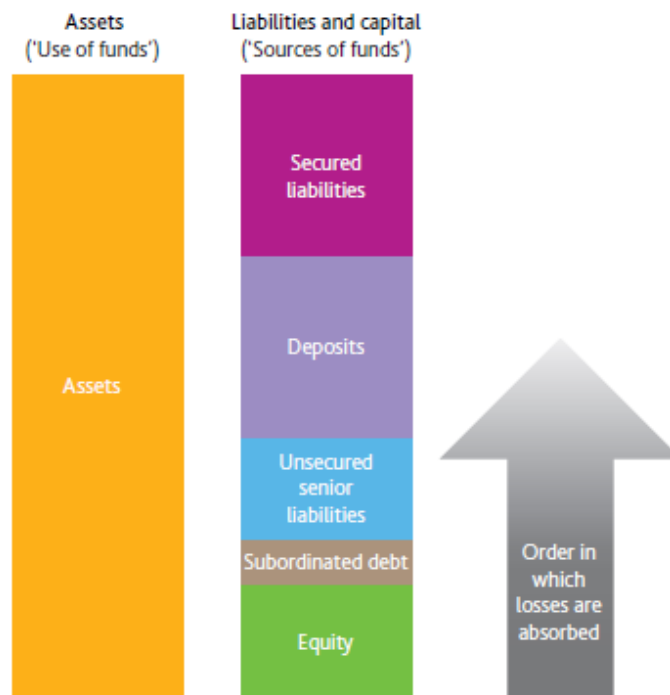
The proposed SLR relaxation is expected to have several market effects:

- **Increased Treasury Demand and Lower Yields:** By reducing the SLR from 5% to 3% for large banks, approximately \$70 billion in capital could be freed, potentially enabling \$500 billion in additional Treasury purchases.
- **Positive for Bank Stocks:** Relaxed capital requirements would allow banks to allocate capital more flexibly, supporting activities like broker-dealing and boosting earnings.

Conclusion
It is interesting to note that this change in regulation comes at a time when debt tensions have shifted from Europe to America. The days of European spreads seem long gone. After all, as we see in the second section of this paper, the capital structure of European banks is different from that of American banks. In a sense, it can be said that European regulation is already equipped to support the debt burden of governments, and the United States is aligning itself with this approach.


Debt Structure of European and American Banks

Figure 1 Simplified bank balance sheet



The debt structure of European and American banks is significantly different. There are several reasons for this: differences in regulation, important cultural differences, and the fact that the banking market is relatively homogeneous in the United States, whereas it remains rather national among European banks. Moreover, there continues to be a large number of players in Europe, with banks generally having a primarily national scope. The lack of European harmonization does not allow for economies of scale; generally, when a European bank absorbs one of its peers, it is above all to diversify its revenues, because there are few synergies: different information systems, different legislation.

First, we propose to study the debt structure of European banks by analysing their financing instruments, from the most defensive for investors to the riskiest.

Decreasing quality of capital 					
	Equity	AT1	Tier 2	Bail-In Senior	Senior Pref
Seniority	Junior Subordinated	Deeply Subordinated	Subordinated	Senior Subordinated	Senior
Maturity	Perpetual	Perpetual, Typically NC5	Typically 10NC5	Usually >5y	Usually 3-5y
Payments	Discretionary	Discretionary Non-cumulative	Must Pay	Must Pay	Must Pay
Loss absorption	Going concern	Contractual Trigger PoNV (Statutory)	PoNV (Statutory)	In resolution upon use of Bail-In tool	N/A*

Covered Bonds:

Covered bonds have experienced strong growth in recent years among European banks, mainly due to their very low financing costs. These issuances are generally rated AAA, with a very low spread compared to senior debt. For investors, this type of issuance offers high credit quality: the issuance is of course guaranteed by the bank, but in case of the bank's default, the investor is secured by the bank's assets (customer loans) with significant over-collateralization. However, there is still a lack of harmonization and standardization between different national legislations. To properly select an investment in covered bonds, one must first conduct a classic credit analysis of the issuing bank, then correctly analyse the collateral provided as a guarantee (the risk is not the same between a residential mortgage and a commercial real estate loan), assess the level of over-collateralization provided, and finally analyse the level of security linked to the national legislation.

Senior Preferred and Senior Non preferred (SNP):

The differentiation between these two types of issuances is recent, mainly explained by the implementation of complementary regulation (TLAC, MREL) to secure customer deposits and avoid injecting public money to rescue banks. In case of a bail-in, the bank's customer deposits have seniority over SNP issuances, which ultimately act as an intermediate financing tool between SP and subordinated debt. Moreover, they share some features with Tier 2 debt, such as call dates before the final maturity.


Tier 2 Debt (T2):

This type of debt strengthens the bank's extended capital calculation. As the name suggests, the repayment of these securities is subordinated to the repayment capacity of debts with higher seniority. Generally, these issuances include a possible early call date. Tier 2 debt can be converted into equity to save a bank.

AT1/CoCo:

This is the riskiest category of bank issuances. For the bank, the purpose is clear: to strengthen its capital. This perpetual debt carries several risks: firstly, the risk of non-repayment in case of bankruptcy, then its conversion into shares if the bank's capital is too low, as well as the non-payment of coupons if capital ratios are too weak. These bonds generally have a first call date, then regular call opportunities at set intervals. If the call is not exercised, the coupon usually becomes floating with a high spread (also known as a step-up); the higher the step-up, the stronger the incentive for the issuer to repay the debt. Generally, for an investor, a short first call date and a strong step-up encouraging the issuer to repay are preferred.

We propose the same study this time for American banks, with significant differences compared to their European peers.

Decreasing Quality of Capital 					
	Equity	Preferred Shares	Tier 2	Holding Company Sr	Senior Bank
Seniority	Junior Subordinated	Deeply Subordinated	Subordinated	Senior Subordinated	Senior
Maturity	Perpetual	Perpetual, Typically, NC5/NC10	Typically, 10yr to 15NC10	Usually >3- 30yr	Usually 3-5y
Payments	Discretionary	Discretionary Non-cumulative	Must Pay	Must Pay	Must Pay
Loss absorption	Going concern	OLA	OLA	OLA	Title I/OLA

There are no covered bonds in the US; banks generally prefer to securitize their loans rather than hold them on their balance sheet and use them as collateral, which makes them more asset-light. In Europe, securitization is gradually gaining ground: initially, European banks carried out self-retained securitizations to obtain collateral to finance themselves with the ECB. To validate the liquidity of these securitizations, some were placed on the market, and gradually European banks also seek to lighten their balance sheets through this channel and diversify their sources of liquidity.

Similar to SP and SNP, there are in the US senior unsecured and senior subordinated debts. As their names suggest, there is a subordination link, and within the framework of TLAC, subordinated debts are included.

Tier 2 debts are subordinated to the aforementioned debts and, just as in Europe, these debts strengthen the bank's Tier 2 capital.

Finally, so-called deeply subordinated (or junior subordinated) debts are in fact preferred shares, sharing some characteristics with European CoCos — callable, with a step-up — but the rules around conversion to shares or write-downs are much less automatic than in the case of European AT1s. Overall, the AT1 market is smaller in the US than in Europe.

Aspect	European Banks	U.S. Banks
Covered Bonds	Highly developed, rated AAA, strong regulatory support, used as low-cost funding with significant over-collateralization	Absent; U.S. banks do not use covered bonds
Securitization	Initially limited, now growing to lighten balance sheets and diversify liquidity	Highly developed, preferred over covered bonds, banks more "asset-light"
Senior Preferred / SNP	Present, recently differentiated to meet TLAC/MREL requirements	Present as senior unsecured and senior subordinated, with similar subordination logic
Tier 2 (T2)	Used to strengthen extended capital, frequent early call dates, convertible into equity if needed	Same role to reinforce Tier 2 capital, subordinated to senior debt
AT1 / CoCo	Well developed, perpetual high-risk instruments, automatic conversion or write-down in crisis	Less developed, mostly in the form of preferred shares (deeply subordinated), conversion less automatic
Market	More fragmented (national markets), less homogeneous, strong diversity in regulatory frameworks	More homogeneous on a federal scale, benefits from larger critical mass
Regulation	Harmonization in progress, but persistent national disparities	More centralized and unified regulation
Business model	More balance-sheet-based funding (covered bonds, ECB collateral)	More oriented toward off-balance-sheet securitization, asset-light culture

In summary, to meet their regulators' constraints, American and European banks have developed different financing strategies, which is also linked to their rather different business models.

The U.S. SLR reduction from 5% to 3% frees \$70 billion in capital, enabling \$500 billion in Treasury purchases, supporting fiscal dominance and potentially lowering yields. U.S. banks, leveraging securitization and simpler debt structures, gain flexibility over European peers, who face fragmented regulations and rely on covered bonds, SP/SNP, Tier 2, and AT1 instruments.

This reform strengthens U.S. banks' role in domestic debt markets, while Europe's complex framework ensures sovereign debt support but limits scalability. Sustained growth is critical to manage rising U.S. debt.