The Tower of Basel III: fragmented implementation of the revised capital framework across the EU, UK and US

This document provides a detailed examination of the Basel III finalisation package as set out by the Basel Committee on Banking Supervision (BCBS) and evaluates how its key components have been implemented across the EU, UK, and US.

In particular, we benchmark each jurisdiction's rules against the BCBS requirements across eight critical areas of the revised capital framework:

1 Credit risk standardised approach;

2 Credit risk Internal Ratings–Based (IRB) approach;

3 Operational risk;

4 Market risk standardised approach under the Fundamental Review of the Trading Book (FRTB);

5 Market risk internal model approach;

6 CVA risk;

7 Output floor;

8 Pillar 3 disclosures.

Through comparison of both the technical design and supervisory calibration of these elements, the analysis highlights where jurisdictions remain aligned with the global standard and where national adaptations have resulted in material divergence, creating a complex landscape for internationally active banks that must comply with multiple versions of Basel III.

Standardised approach for credit risk

- **BCBS Guidelines**

  The Basel III final reforms significantly revise the Standardised Approach for Credit Risk (SA-CR) with the dual objectives of increasing risk sensitivity and reducing undue reliance on external credit ratings. A core element of these reforms is the introduction of due diligence requirements, obliging banks to assess (at origination and on an ongoing basis) the risk profile and key characteristics of their counterparties. This due diligence ensures that any external ratings used for regulatory purposes are consistent with the bank's own assessment of counterparty creditworthiness.

  Basel III also removes the longstanding option to link a bank's exposure risk weights to that of the sovereign in which they are incorporated, further reducing mechanistic reliance on external references.

  While the revised SA-CR continues to permit the use of external ratings through the External Credit Risk Assessment (ECRA) approach, it introduces an alternative: the Standardised Credit Risk Assessment (SCRA). SCRA provides a methodology for jurisdictions that do not permit the use of external ratings. Together, ECRA and SCRA broaden the framework's applicability while ensuring more risk-sensitive outcomes across rating-permissible and rating-restricted environments.

Real estate exposures undergo some of the most substantial reforms under the revised SA-CR. Basel III introduces a more risk-sensitive, loan-to-value (LTV)–based framework and classifies real estate exposures into three categories: (1) Regulatory Real Estate, (2) Other Real Estate and (3) Land Acquisition, Development and Construction (ADC).

Regulatory real estate is further divided into residential and commercial exposures and distinguishes between properties materially dependent on the cash flows generated by the property and those that are not. For regulatory real estate exposures not materially cash-flow dependent, banks may apply either a whole-loan approach or a loan-splitting approach to determine risk weights—introducing greater granularity and alignment to underlying credit risk.

Risk weights for corporate exposures have been recalibrated and may be determined using either ECRA or SCRA. Basel III also enhances the treatment of specialised lending, explicitly addressing object finance, commodities finance and project finance. For project finance, additional differentiation is introduced between pre-operational and operational phases, recognising the materially different risk characteristics at each stage.

Retail exposures are also made more granular by making a distinction between (1) regulatory retail exposures that do not arise from exposures to "transactors", (2) regulatory retail exposures to "transactors" and (3) other retail exposures. A more favourable risk weight is given to retail exposures to transactors, reflecting their lower risk profile. In addition, a 1.5× risk multiplier for retail and residential retail exposures will be applied where the lending currency differs from the borrower's source of income.

Where Basel II applied a relatively flat 100% risk weight to equity and subordinated instruments, Basel III introduces greater differentiation for speculative unlisted exposures for short-term resale, equity exposures to national legislated programmes and subordinated debt or capital other than equities, which attract a risk weight of 400%, 100% and 150%, respectively.

Credit conversion factors (CCF) of off-balance sheet items have been recalibrated, introducing a CCF of 10% for unconditionally cancellable commitments and a CCF of 40% for other commitments regardless of maturity.

In addition, direct credit substitutes, note issuance facilities and transaction-related contingent items have a CCF of 100%, 50% and 50%, respectively. This was an uplift from Basel II, which only required a 20% CCF for less than one year and 50% CCF for those that are longer than one year.

Lastly, the definition of default is aligned with the Internal Ratings-Based (IRB) framework, expanding beyond the traditional 90-day-past-due criterion to incorporate additional default indicators. These include the placement of a material credit obligation on non-accrual status, as well as instances of write-offs or the recognition of account-specific provisions due to credit deterioration.

The capital treatment of defaulted exposures is also refined: risk weights are now directly linked to the level of specific provisions recorded. Exposures with less than 20% specific provision attract a 100% risk weight, while those with 20% or more are subject to a 150% risk weight. This alignment strengthens the consistency between accounting-driven indicators of credit deterioration and regulatory capital requirements.

- **EU CRRIII/CRDVI**

  The EU's CRR III framework adopts the Basel III revised SA-CR principles. However, the EU introduces several material deviations from the BCBS baseline that generally result in lower capital requirements. Most notably, the EU retains the SME Supporting Factor (and related infrastructure supporting factors), which reduces risk weights for SME and qualifying infrastructure exposures beyond what Basel allows. This is a long-standing EU policy choice and represents one of the clearest departures from the Basel framework.

  For real estate exposures (i.e. immovable properties), CRR III introduces several important deviations that make the EU regime more prescriptive and, in many cases, more conservative.

  While Basel relies on a full LTV-based risk weight curve for regulatory residential and commercial real estate, CRR III replaces this with a tranche-based structure in which only the first 55% of the property's value receives the preferential risk weights of 20% and 60% for qualifying residential and qualifying commercial properties, respectively, while the remainder is treated as unsecured. It incorporates more legal detail around eligibility conditions to apply a preferential risk weight, while delegating definitional precision to EBA guidelines.

  Finally, the EU adds an expansive macroprudential overlay, enabling authorities to tighten risk weights or eligibility conditions and requiring coordination across Member States.

- **UK Basel 3.1**

  The UK version largely follows the Basel risk-weighting structure (e.g. LTV-based real estate, revised corporates, due diligence rules) but does not have the EU-style support factors. Overall, the differences are conservative refinements rather than structural departures.

- **US Basel III Endgame**
  The US replaces the SA/IRB Approach split with an "Expanded Risk Based Approach" that is structurally different and tailored to US law (i.e. no external ratings, different segmentation, higher risk weights for several retail/mortgage buckets, no Basel STC securitisation framework).

  A key divergence is higher and more restrictive calibrations for real estate and retail credit. The Notice of Proposed Rulemaking (NPR) applies Basel-style LTV grids, but industry analyses highlight that US residential mortgage risk weights are set materially above Basel levels (about 20 percentage points in each key band), with tighter conditions around cash-flow dependence for commercial real estate and acquisition/development/construction (ADC) lending. This makes the US approach distinctly more punitive for mortgage-heavy and credit-heavy balance sheets than a BCBS-pure SA-CR.

For wholesale corporates, the NPR partially mirrors Basel's ratings-permitted structure but adds US-specific constraints. It introduces a 65% risk weight for "investment-grade" corporates only if they have publicly traded securities or meet other US-defined marketability tests, while other corporates fall into higher buckets (including 100% and a more punitive unrated/non-IG treatment than Basel's default 100% non-IG band). The proposal also expands granularity for retail, subordinated debt, specialised lending, and equity exposures in ways that generally raise Risk-Weighted Assets (RWA s) relative to BCBS, contributing to the agencies' own estimate of a large aggregate RWA uplift.

Table 1: Proposed risk weights for regulatory residential real estate exposures that are not dependent on the cash flows of the property.

Risk weights	LTV <= 50%	50% < LTV <= 60%	60% < LTV <= 80%	80% < LTV <= 90%	90% < LTV <= 100%	LTV > 100%
BCBS	20%	25%	30%	40%	50%	70%
US	40%	45%	50%	60%	70%	90%

Table 2: Proposed risk weights for regulatory residential real estate exposures that are dependent on the cash flows of the property.

Risk weights	LTV < 50%	50% < LTV <= 60%	60% < LTV <= 80%	80% < LTV <= 90%	90% < LTV <= 100%	LTV > 100%
BCBS	30%	35%	45%	60%	75%	105%
US	50%	55%	65%	80%	95%	125%

Internal ratings-based approach to credit risk

- **BCBS Guidelines**

  Basel III retained the IRB framework but introduced substantial restrictions to address excessive RWA variability and the lack of comparability observed under Basel II. The most important structural change is the removal of Advanced IRB (A-IRB) for portfolios where internal modelling was judged unreliable or too discretionary.

  Banks are no longer permitted to use A-IRB for large corporates, banks, and financial institutions, and must instead use the Foundation IRB (F-IRB) or, in the case of equity exposures, the SA-CR. This eliminates internal estimates for Loss Given Default (LGD) and Exposure at Default (EAD) in these asset classes and directly reduces model-driven differences across banks.

For portfolios where A-IRB remains permitted (such as retail exposures and certain specialised lending), Basel III introduces a series of input floors on the key model parameters:

For EAD under the advanced approach, institutions are allowed to use their own internal estimates of EAD for undrawn revolving commitments, provided the exposure is not subject to a credit conversion factorof 100% in the F-IRB. The EAD of each exposure (except for the sovereign asset class) shall be subject to a floor that is the sum of: (1) the on-balance sheet amount and (ii) 50% of the off-balance sheet exposure using the applicable CCF in the standardised approach.

Meanwhile, Basel imposes a minimum effective maturity floor of 1 year and a cap of 5 years.

Table 3: Probability of Default (PD) floors

Collateral type	Floor (Minimum LGD)
Retail exposures	
• QRRE (Transactors and Revolvers)	0.1%
• All other exposures	0.05%
Corporate, Bank and Sovereign Exposures	
• Sovereign	No Floor
• All other exposures	0.05%

The reforms also overhaul the treatment of specialised lending, introducing a hybrid structure: certain specialised lending categories (object finance, project finance in the pre-operational phase) must use supervisory slotting, while other categories may remain under IRB with parameter floors.

The BCBS removed the legacy 1.06 IRB scaling factor, judging it unnecessary given the tighter IRB perimeter and input floors.

The reforms strengthen expectations for data representativeness, margin of conservatism, downturn LGD estimation, validation, and model governance, with supervisors empowered to require fallback to SA where models are not robust. Taken together, the Basel III IRB reforms preserve model-based risk sensitivity, but within a much more tightly bounded and comparable Pillar 1 framework.

Table 4: LGD floors

Collateral type	Floor (Minimum LGD)
Retail Exposures	
• Unsecured	
1 Mortgages	Not Applicable
2 QRRE (Transactors and Revolvers)	50%
3 Other retail	30%
• Secured	
1 Mortgages	5%
2 Collateral type: Financial	0%
3 Collateral type: Receivables	10%
4 Collateral type: Commercial or Residential Real Estate	10%
5 Collateral type: Other physical	15%
6 Other retail	
Corporate Exposures	
• Unsecured	25%
• Secured	
1 Collateral type: Financial	0%
2 Collateral type: Receivables	10%
3 Collateral type: Commercial or Residential Real Estate	10%
4 Collateral type: Other physical	15%

- **EU CRRIII/CRDVI**
  The EU implements the core Basel III IRB reforms, including the removal of A-IRB for large corporates (>€500m revenue), banks and financial institutions, and the elimination of IRB for equity exposures — but introduces several EU-specific calibrations and discretions that soften Basel's constraints. CRR III applies the new Basel PD and LGD input floors but with EU-specific calibration choices, such as PD floors of 0.05% for corporates and retail exposures, and 0.1% for qualifying revolving retail exposures (QRRE), and LGD floors of 25% for senior unsecured corporates and 30% for retail exposures. Importantly, guaranteed sovereign exposures are exempt from these PD/LGD floors, a significant deviation from BCBS intent and a major capital-reducing feature unique to the EU.

  Additional EU divergences include lower LGD floors for certain non-financial senior unsecured corporates (40%), compared with the BCBS-recommended minima, as well as EU-specific rules for default definition, downturn LGD estimation, and credit risk mitigation eligibility.

  CRR III also keeps long-standing EU policy choices such as the SME Supporting Factor and Infrastructure Supporting Factor, which reduce capital requirements even for IRB portfolios — something not permitted under Basel.

- **UK Basel 3.1**
  The PRA's Basel 3.1 IRB package tracks the BCBS final reforms very closely in structure: it removes A-IRB for large corporates, banks and other financial institutions, eliminates IRB for equity exposures, and implements the Basel PD/LGD/EAD input-floor architecture.

  Where the UK does diverge is mainly through UK-specific conservatism and tighter modelling standards. The PRA introduces stronger anti-cherry-picking / partial-use controls than the Basel text, reflecting supervisory concern that some firms might selectively migrate exposures to SA where SA is lighter (notably QRRE and specialised lending). The PRA also gives itself more explicit latitude to require SA use inside IRB roll-out classes if model outputs appear inappropriately low.

  In addition, the PRA applies a more conservative supervisory stance on where IRB can be used reliably, including restrictions or higher hurdles for certain low-default / data-scarce portfolios (with sovereigns a key example in PRA discussions) – areas where BCBS left more room to national discretion because global consensus on modelling reliability was weaker. Industry summaries of the final rules describe this as a "super-equivalent" tightening in parts of the IRB perimeter compared to a textbook Basel implementation.

  The PRA also tightens IRB modelling practice by, for example, prohibiting continuous rating-scale PD models and withdrawing legacy wholesale LGD/EAD frameworks, forcing firms onto Basel-consistent discrete-grade structures and updated downturn estimation expectations.

  For UK residential retail mortgages, banks have to apply a PD floor of 0.10% (instead of 0.05%) as a safeguard against structurally low RWAs on UK IRB mortgage portfolios and the scarcity of default data at very low PD levels. For qualifying SME and infrastructure lending, the PRA intends to make a structural adjustment to the bank-specific Pillar 2A requirements that corresponds to the supporting factors in the EU legislation.

- **US Basel III Endgame**
  While the BCBS merely constrains IRB usage, the US proposes to eliminate the IRB approach, pushing banks to apply the expanded standardised approach.

Operational risk

- **BCBS Guidelines**
  The BCBS replaced the previous suite of operational risk approaches – the Basic Indicator Approach (BIA), the Standardised Approach (TSA), the Alternative Standardised Approach (ASA) and the Advanced Measurement Approaches (AMA) – with a single, standardised, non-modelled approach called the Standardised Measurement Approach (SMA).

  The BCBS abolished the AMA after identifying excessive RWA variability, weak comparability across banks, and frequent supervisory concerns regarding internal model integrity, data availability, and loss capture practices. The new SMA was designed to be simpler, more consistent, and more comparable, while still remaining sufficiently risk-sensitive.

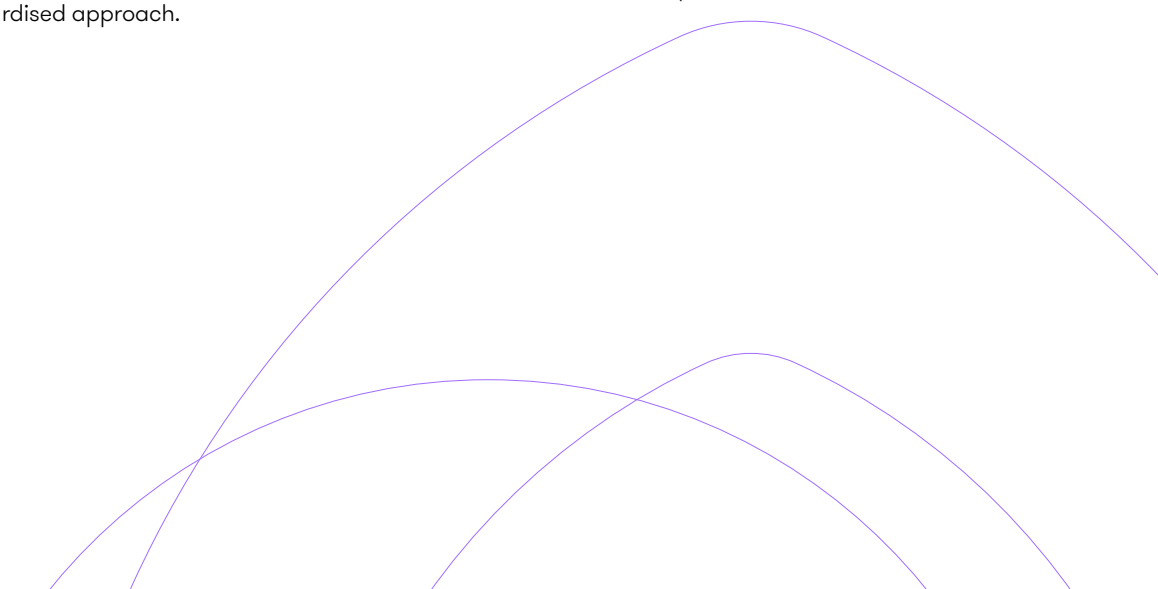
  The SMA is structured around two components: (i) the Business Indicator (BI) and (ii) the Internal Loss Multiplier (ILM).

  1 The Business Indicator is a measure of bank size and activity derived from income statement components across three business lines:

    - interest, leases and dividend-related activity,
    - services component (fees and commissions), and
    - financial component (trading and fair-value activities).

    Banks are assigned to BI "buckets," each with a corresponding progressive marginal coefficient, making the SMA charge increase more-than-proportionally with size.

  2 The Internal Loss Multiplier (ILM) introduces risk-sensitivity by scaling capital requirements based on a bank's historical operational losses. It is calculated using 10 years of internal loss data, entered through a loss component formula that compares a bank's actual loss experience to a reference loss level. A bank with lower-than-expected losses receives an ILM below 1, reducing its SMA capital requirement, while a bank with higher-than-expected losses receives an ILM above 1, increasing its capital. The ILM is required only for banks with BI above €1 billion; smaller banks use a simplified formula without loss data.



The SMA therefore produces capital that is size-sensitive, loss-sensitive, and highly comparable across institutions because all banks must use the same standardised formula. There is no modelling, no scenario analysis, and no supervisory approval of internal models, addressing long-standing weaknesses in the AMA regime.

In addition, the SMA output automatically feeds into the Basel III output floor baseline, because Basel requires that standardised operational risk RWAs be included fully in the SA-RWA denominator of the floor.

- **EU CRRIII/CRDVI**
  Under CRR III, the EU formally adopts the Basel III Standardised Measurement Approach (SMA) for operational risk, using the same Business Indicator (BI) structure, progressive BI buckets and coefficients as in the BCBS standard.

  However, the EU exercises a major jurisdictional discretion: the Internal Loss Multiplier (ILM) is fixed at 1 for all banks, regardless of their actual 10-year loss experience. This removes the risk-sensitivity of the ILM and effectively neutralises the historical loss component of the SMA while still requiring institutions to collect and report loss data. This is a significant departure from the BCBS framework, in which the ILM is the key mechanism for scaling capital upward or downward based on internal loss history.

  In addition to eliminating the ILM's variability, the EU also modifies certain BI components, making them more conservative (i.e. capital-intensive) but tailored to EU regulatory preferences. Notably, it introduces a cap on net interest margin to limit volatility and prevent disproportionately low capital requirements for high-margin banking models. It also applies a more conservative treatment of fee-related components by requiring banks to take the higher of fee income or fee expenses, thereby inflating the BI relative to Basel's earlier approaches and supporting a more robust measure of operational risk exposure.

  CRR III also mandates loss data collection for all institutions with a BI above €750 million, even though those data no longer feed into the ILM-based scaling of capital. This maintains supervisory insight into operational risk events but continues the EU's policy choice to avoid the procyclicality and volatility of the ILM. Overall, while CRR III preserves the SMA's structural design, its fixed ILM and BI adjustments create one of the most pronounced divergences from the BCBS Basel III operational risk framework globally.

- **UK Basel 3.1**
  As in the EU, the UK has exercised its national discretion to fix the Internal Loss Multiplier (ILM) at 1 for all banks. Importantly, the PRA has made clear that any material decline in operational risk RWA arising from these reforms is expected to be offset through Pillar 2A add-ons, ensuring that overall capital requirements remain broadly stable at the firm level.

- **US Basel III Endgame**
  The US implementation is "very much aligned" with the BCBS framework. Under the NPR, the ILM would be floored at 1, as in the BCBS framework, and allowed to rise above 1 for firms with higher operational losses. As a result, the US remains the only jurisdiction among the EU, UK, and US trio to preserve full Pillar 1 loss sensitivity, maintaining the Basel Committee's original intent that operational risk capital should scale with a bank's internal loss experience.

  Although the US approach follows the BCBS methodology in structure and philosophy, it introduces granular data, reporting, and modelling specifications, which reflect US supervisory practice rather than conceptual departures from Basel. These refinements tighten requirements on loss data collection, BI segmentation, and treatment of loss outliers.

Market risk: FRTB standardised approach

- **BCBS Guidelines**
  The Basel III Fundamental Review of the Trading Book (FRTB) introduces a completely redesigned Standardised Approach (FRTB-SA) for market risk to replace the earlier Basel 2.5 standardised charges. The new SA is far more risk-sensitive, closely mirroring the structure of the Internal Models Approach (IMA) while using prescribed supervisory sensitivities, risk weights, and correlations. In addition, the SA is anchored to the new trading book vs banking book boundary rules, which reduce arbitrage opportunities through clear classification criteria and restrictions on switching.

  At the centre of the FRTB-SA is a sensitivities-based method, which captures three dimensions of market risk: delta (price sensitivity), vega (volatility sensitivity), and curvature (non-linear responses to large shocks).

  These sensitivities are calculated across five supervisory risk classes: interest rate, credit spread, equity, foreign exchange and commodities. Each is subdivided into buckets with prescribed risk weights, correlations and aggregation rules. This structure ensures that capital requirements reflect the risk profile of positions while preserving consistency across banks and jurisdictions.

In addition to the sensitivities-based charge, the FRTB-SA includes a Default Risk Charge (DRC) to capture jump-to-default risk of trading book positions, and a Residual Risk Add-On (RRAO) for instruments with exotic or hard-to-model features. These components ensure that the SA covers both spread-driven valuation movements and extreme credit events, even in the absence of internal modelling. Liquidity horizons are also embedded in the approach, scaling capital for different instruments to reflect the time required to exit or hedge positions under stressed conditions.

Overall, the BCBS FRTB-SA represents a major enhancement in the risk sensitivity and robustness of the standardised market risk framework. By prescribing risk weights, correlations and modellability rules, the Basel standard reduces RWA variability, strengthens comparability across banks and provides a more stable benchmark for the output floor.

- **EU CRRIII/CRDVI**

  The EU adopts the core structure of the Basel III FRTB-SA, but its implementation trajectory includes several transitional and technical deviations from the BCBS baseline. Under CRR II, FRTB-SA initially applied for reporting only, not capital purposes, and CRR III makes FRTB-SA a binding Pillar 1 charge only from January 2027, after multiple postponements in order to align with the expected timelines of the US and UK. However, this is expected to be the final postponement that can be made through a delegated act under the existing CRR. Any further delay would require a full legislative amendment, i.e. a new co-legislator process involving the European Parliament and the Council, which significantly raises the bar for any future changes to the FRTB go-live date.

  From a calibration perspective, the EU generally follows BCBS parameters, but the regulatory framework introduces more prescriptive and granular Regulatory Technical Standards (RTS) developed by the EBA. These RTS specify detailed operational requirements—such as bucketing, data input standards, treatment of sensitivities, and application of liquidity horizons—that go beyond the Basel text. While the RTS do not materially alter the core formulae, they create less modelling flexibility and a more uniform application across EU banks, which can lead in practice to higher or more rigid capital outcomes relative to the BCBS framework.

  EU smaller institutions may also rely more heavily on simplified SA calculations or be exempted from certain granular sensitivities templates, creating a tiered application that does not exist in the Basel standard. These features dampen the initial capital impact and delay full alignment with FRTB-SA.

- **UK Basel 3.1**

  The PRA aims to implement the Basel SA "as designed," with minimal deviation to ensure consistency and comparability for internationally active UK firms. Unlike the EU, the UK is implementing FRTB as a binding capital requirement from January 2027, with no extended multi-year deferral or "reporting-only" phase.

  Where the UK diverges from the BCBS standard is primarily through supervisory conservatism and clarifications, rather than mathematical recalibration. A notable UK deviation relates to the treatment of Collective Investment Undertakings (CIUs). The PRA has confirmed that certain exchange-traded, closed-ended CIUs may be treated as listed equities under the FRTB-SA, rather than applying the more complex CIU look-through or fallback methodologies. This results in lower capital charges for eligible CIUs compared with the Basel baseline and improves alignment with the economic characteristics of exchange-traded funds and investment trusts.

  The UK also widens operability under the FRTB-SA by expanding the scope of eligible third parties whose data and analytics may be used for CIU capital calculations. Whereas the BCBS text provides a narrow definition, the PRA permits additional third-party providers—subject to external audit validation—allowing banks practical flexibility without weakening data quality requirements.

  Further UK specificity appears in the PRA's clarifications to the RRAO. The PRA gives more detailed guidance on which instruments fall into RRAO, particularly for exotic derivatives and structures with material non-linear or path-dependent risks. It explicitly identifies circumstances where perfectly matched back-to-back structures may fall outside RRAO if they do not introduce residual risk. This level of operational detail goes beyond the Basel text, which leaves the definition less prescriptive.

- **US Basel III Endgame**

  The US Basel III Endgame proposal adopts the core structure of the Basel FRTB-SA within an updated Market Risk Capital Rule but introduces several parameter and scope adjustments that make the US FRTB-SA capital requirements more conservative than the Basel baseline.

  The most significant deviations arise from US-specific calibrations of shocks, correlations, and bucket parameters. A noted difference is that in the US NPR, the Russian rouble is excluded from the list of currencies that can apply a preferential risk weight of 15% divided by $\sqrt{2}$ in calculating the sensitivity of foreign exchange risk. For commodities, electricity is given a preferential risk weight of 45% compared to the BCBS version of 60%. The US also maintains a broad and relatively punitive RRAO, with a wider set of complex or path-dependent instruments falling into the add-on than under typical Basel or EU interpretations. These features disproportionately increase capital for structured and exotic products.

  A further US divergence is the restrictive treatment of hedging recognition under the SA. While the Basel framework permits certain offsetting relationships between buckets and risk classes, the US version narrows the scope of allowable hedges and prescribes tighter constraints on cross-bucket diversification. This reflects US supervisory caution around basis and correlation risks and generally increases the SA charge for portfolios that rely heavily on relative-value trading or index-to-single-name hedging.

  Finally, the supervisory posture embedded in the NPR is intentionally conservative. US regulators expect FRTB-SA to be binding for a substantial portion of trading desks, even at banks that may qualify for some IMA use. Combined with higher shocks, stricter diversification parameters and a broad RRAO, the US FRTB-SA is structurally similar but parametrically far more conservative than the BCBS standard. It is widely expected to result in materially higher market-risk RWAs for US banks compared with international peers.

Market risk – FRTB internal model approach

- **BCBS Guidelines**

  Basel III introduces a completely redesigned Internal Models Approach (IMA) for market risk under the FRTB. The long-standing Value-at-Risk (VaR) metric is replaced with an Expected Shortfall (ES) framework that better captures tail risk and periods of market stress. Model approval is now granted at the trading desk level rather than firm-wide, to enhance risk-sensitivity, reduce unwarranted variability in RWA and strengthen supervisory control over where internal models may be deployed.

  Under FRTB, a desk is eligible for IMA only if it passes two key tests: Risk Factor Eligibility Test (RFET) and Profit and Loss Attribution Test (PLAT).

  1 RFET (modellability test) assesses whether each risk factor used in a model is "modellable" based on sufficient, representative real price observations. Risk factors that satisfy the test may be incorporated into the trading desk's ES model. Those that do not qualify are designated as non-modellable risk factors (NMRFs) and are capitalised separately through a dedicated stress scenario add-on, reflecting the heightened uncertainty associated with sparse or illiquid market data.

  2 PLAT assesses whether the desk's front-office pricing P&L aligns with the model's risk-theoretical P&L through prescribed statistical correlation and unexplained-component tests. Desks failing PLAT lose eligibility to use IMA for that trading desk and must fall back to the FRTB-SA.

  These tests must be passed on an ongoing basis. Persistent failures or deterioration in the modellability of risk factors can result in higher capital multipliers, supervisory restrictions, or withdrawal of IMA approval at the trading desk level.

  Once a trading desk is approved, the IMA capital requirement is driven primarily by the ES measure, computed separately across five supervisory risk classes and calibrated to a period of significant market stress. ES results are then aggregated using prescribed supervisory correlations that intentionally restrict diversification benefits.

  Beyond the core ES charge, the IMA also includes (1) a DRC to capture jump-to-default and default migration risk of trading book positions and (2) a capital charge for NMRFs calculated through a constrained scenario-based stress methodology that is independent of the trading desk's ES model.

- **EU CRRIII/CRDVI**

  At its core, the EU adopts the same modelling architecture as Basel: desk-level model approval, the ES framework, modellability assessments via the RFET, and the NMRF charge. However, the EU overlays this with extensive EBA-developed RTS that introduce highly detailed, binding definitions and methodologies. Key RTS components include precise modellability criteria under the RFET and prescriptive PLAT thresholds, calculation details and fallback treatments. These RTS are significantly more granular than the BCBS text, providing a harmonised rulebook for banks and supervisors across the EU but reducing the flexibility that Basel intentionally leaves to local implementation.

One specific difference noted is that, for the purpose of the PLAT, desks shall be classified into one of the four categories (green, orange, yellow and red), instead of the original three categories in Basel (red, amber and green).

EU supervisors have also signalled that model approvals will be granted conservatively and subject to ongoing performance monitoring—broadly similar to the UK's approach, though generally less restrictive in day-to-day supervisory interpretation.

- **UK Basel 3.1**

  The UK follows the BCBS framework on FRTB-IMA very closely, retaining the same core structure. Methodologically, the UK rules use the same modellability criteria, liquidity horizons, ES scaling, and DRC modelling requirements (99.9% one-year VaR, PD floor, correlation calibration, weekly calculation). The result is a framework that is substantively Basel-aligned in how capital is measured and how trading desks qualify for IMA.

  Where the UK diverges is mainly in implementation details rather than methodology. Similar to the EU's CRR, the PRA introduces a four-zone PLAT framework (green, yellow, orange, red) instead of the Basel three-zone structure, splitting the Basel amber zone into yellow (IMA-permitted with surcharge) and orange (treated as ineligible/ standardised), adding clearer supervisory consequences. The UK also embeds Basel requirements into a detailed CRR-style permission regime, including specific rules for gaining, losing, and regaining IMA approval at the trading desk level. In addition, the UK fixes certain national discretions—such as definitions of liquid currencies or equity size thresholds—in areas where Basel allows more flexibility. Overall, the UK IMA is a faithful Basel implementation with minor supervisory refinements, unlike the US approach, which materially departs from Basel.

- **US Basel III Endgame**

  The US version of the FRTB-IMA largely mirrors the BCBS Basel III text, but it departs in several targeted, operational ways. Most notably, it does not adopt Basel's requirement that at least 10% of a bank's market risk capital come from IMA desks, instead only requiring that a bank maintain at least one model-eligible desk.

  The NPR also embeds more prescriptive desk-level mechanics, including explicit exception thresholds for backtesting (both 97.5% and 99% VaR-based comparisons), hard rules for desk ineligibility and a codified PLA add-on formula where Basel leaves such supervisory responses more principles-based. Additionally, the US text gives agencies authority to require standardised-approach calculations per desk to support Profit Loss Attribution (PLA) add-ons, something not spelt out in Basel.

On risk factor modellability, the NPR follows Basel's RFET framework but adds more explicit accommodation for reference rate reform, allowing discontinued legacy rate observations to support modellability of new risk-free rates. It also requires minimum weekly data updates for model calibration versus Basel's monthly minimum (with preference for daily). Treatment of securitisation and correlation trading positions is aligned in outcome (i.e. no IMA capital benefit), but the US rule operationalises this through model-eligible desk prohibitions and add-ons rather than Basel's simpler exclusion.

An important departure is that the US NPR eliminates the Basel internal default risk charge model entirely. While Basel permits banks to internally model default risk under strict conditions, the NPR restricts internal modelling to non-default market risk only, requiring all default risk capital to be calculated using the standardised default risk charge. Overall, the NPR preserves Basel's structure while introducing more granular, enforceable operational requirements tailored to the US supervisory environment.

CVA risk

- **BCBS Guidelines**

  Under the Basel III reforms, the BCBS overhauled the Credit Valuation Adjustment (CVA) risk framework to better capture the market risk associated with the deterioration in the creditworthiness of derivative counterparties. The earlier Basel versions relied heavily on the Internal Model Method (IMM) and a simplified standardised approach that was loosely risk-sensitive, resulting in inconsistent capital outcomes and inadequate recognition of market-driven CVA volatility.

  The revised Basel CVA framework eliminates the IMM and introduces two standardised methodologies: the default Basic Approach (BA-CVA) and the more risk-sensitive Standardised Approach (SA-CVA).

  The BA-CVA is designed for banks with limited derivatives activity and uses supervisory risk weights applied to aggregated exposure measures across counterparty classes, hedging sets and maturities. The BA-CVA is available in two variants: (1) a full version, which recognises a limited set of hedges and (2) a reduced version, which does not recognise hedging instruments and is therefore more conservative.

The SA-CVA is designed for banks with material and sophisticated derivatives activity and incorporates delta and vega-style components consistent with the FRTB-SA market risk methodology, while also capturing basis and cross-currency effects in counterparty valuation. To be eligible to use the SA-CVA by its relevant supervisor, the bank must (1) be able to model the exposure and calculate, on at least a monthly basis, the CVA and CVA sensitivities to the market risk factors and (2) have a CVA desk which is responsible for risk management and hedging of CVA risk.

- **EU CRRIII/CRDVI**

  While the CRRIII adopts most of the key principles of CVA in Basel III, the EU exempts CVA capital requirements for counterparty exposures to sovereigns, pension funds, and non-financial counterparties (NFCs), as well as certain intragroup trades and a wide set of transactions qualifying for the "hedging exemption".

  These exemptions represent a long-standing and explicitly identified divergence highlighted by the BCBS in multiple Regulatory Consistency Assessment Programme (RCAP) assessments and reduce CVA RWAs compared with a pure Basel implementation, weakening comparability between EU and non-EU banks. These exemptions also interact with the output floor, as exempted portfolios do not contribute to the standardised CVA RWA baseline, reducing the binding effect of the floor for EU institutions.

- **UK Basel 3.1**

  The PRA's Basel 3.1 rules on CVA risk broadly align with the BCBS standard. As the PRA does not maintain the broad sovereign, pension fund or NFC CVA exemptions present in the EU's CRR III, UK banks apply CVA capital to a significantly wider set of exposures than EU peers and remain materially closer to the Basel standard.

  The PRA introduces a small number of targeted calibrations and clarifications. These include applying a reduced SA-CCR α-factor of 1.0 (instead of the standard 1.4) for derivative exposures to pension funds and NFCs, and assigning lower SA-CVA risk weights of 3.5% for investment-grade pension funds and 8.5% for non-investment-grade pension funds. These adjustments provide limited proportionality and reflect the PRA's assessment of the typically lower credit spread volatility of pension fund counterparties, while avoiding the broad exemptions that create substantial divergence in the EU regime.

- **US Basel III Endgame**

  The US NPR rules on CVA risk broadly align with the BCBS standard but introduce US-specific calibrations. The US framework applies CVA capital to a very broad perimeter of counterparties, with no exemptions for sovereigns, pension funds or non-financial corporates, making the scope of application materially stricter than both the EU and, in some respects, even the pure Basel standard.

  The NPR also introduces targeted recalibrations within the Basic Approach to CVA (BA-CVA). In particular, the US proposal assigns supervisory risk weights of 3% and 7% for speculative-grade and sub-speculative-grade sovereign and MDB exposures, respectively, values that differ from the uniform sovereign/MDB risk weights in the Basel BA-CVA tables.

  These adjustments reflect US supervisors' view that credit-spread volatility for lower-rated public-sector entities warrants more risk-sensitive differentiation, even within the simplified BA-CVA framework.

Output floor

- **BCBS Guidelines**

  The output floor was introduced as a Pillar 1 backstop to limit how much banks can reduce their RWAs through the use of internal models. Under this framework, a bank's total model-derived RWAs must not fall below a fixed percentage of its total RWAs calculated using the Basel standardised approaches. The floor applies at the level of total consolidated RWAs across all risk types (credit risk, market risk, operational risk, CVA risk and counterparty credit risk).

  To apply the output floor, banks must compute two figures: (i) total RWAs using internal models, supplemented by standardised charges where no model exists and (ii) total RWAs under the standardised approaches. The bank's final RWA cannot be lower than the total RWAs under the standardised approach multiplied by a corresponding percentage, starting at 50% in 2023 and rising to 72.5% in 2028.

  This framework also includes safeguards to prevent partial use or selective switching between approaches, ensuring that the standardised baseline is calculated consistently across the full risk profile of the bank.

- **EU CRRIII/CRDVI**
  CRR III follows the same principles as the Basel approach. However, the output floor will gradually increase from 50% in 2025 to 72.5% in 2030, with additional transitional measures until 2032 for exposures to real estate and unrated corporates. In addition, while the output floor applies on a solo level by default, it provides national authorities with an option to apply the output floor at the highest domesticated level.

- **UK Basel 3.1**
  The near-final rules in the UK follow the same principles as the Basel approach. However, the output floor will increase from 55% in 2027 to 72.5% in 2030. It applies the floored RWAs as the basis for buffers.

  The UK applies the output floor only to UK-headquartered groups (and ring-fenced bodies), whereas the EU's proposals apply more broadly and include foreign groups within EU entities.

- **US Basel III Endgame**
  The NPR introduces a "standardised output floor" at 72.5% of RWA under the expanded risk-based approach (which includes credit RWA, equity RWA, operational RWA and CVA RWA) plus the Market RWA under the standardised measure, less adjusted allowance for credit losses not included in Tier 2 capital and allocated transfer risk reserves.

  Unlike the BCBS, the EU, and the UK implementations, the US does not specify a detailed multi-year phase-in schedule of the output floor.

Disclosures (Pillar 3)

- **BCBS Guidelines**
  The Basel III Pillar 3 reforms significantly overhaul the disclosure regime to improve transparency, market discipline and comparability across banks by introducing a comprehensive standardised disclosure requirement covering all Pillar 1 risks, capital ratios, leverage, liquidity, output floors and RWA drivers. It uses mandatory templates and consistent qualitative tables. Banks are required to disclose key prudential metrics quarterly and full qualitative narratives annually.

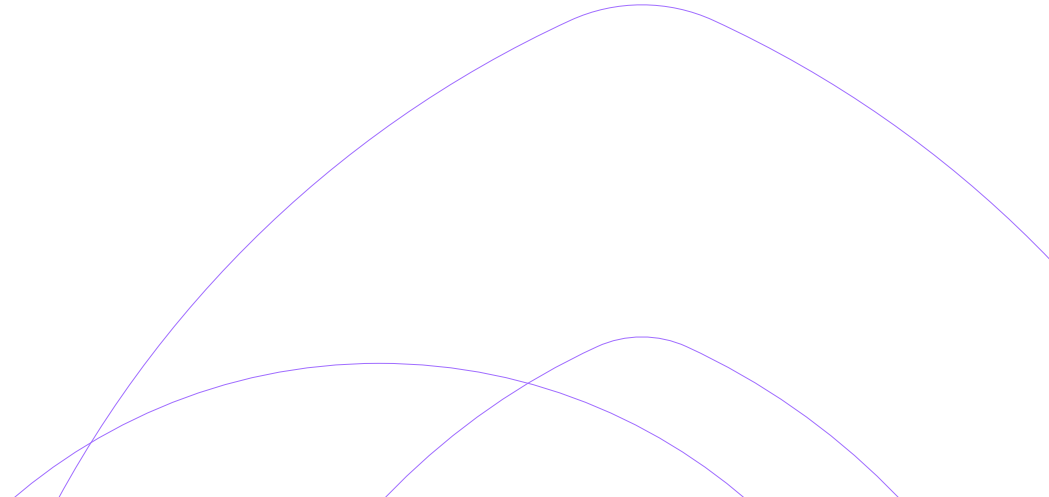
- **EU CRRIII/CRDVI**
  CRR III implements the Basel III Pillar 3 disclosure framework but goes significantly beyond the BCBS requirements. In addition to adopting the standard templates for capital, RWAs, leverage, liquidity and output floor, CRR III introduces EU-specific disclosures on ESG risks (including climate transition and physical risk KPIs), cryptoasset exposures, and shadow banking activities. These items are not included in the BCBS Pillar 3 framework.

  CRR III also embeds a proportionality regime. Large institutions (including all listed banks and those with significant cross-border activity) must disclose the full Pillar 3 package, including all EU-specific ESG, climate, crypto and shadow banking templates. Small and Non-Complex Institutions (SNCIs) benefit from simplified or reduced disclosure obligations, including fewer templates, reduced frequency, and exemptions from granular market-risk and IRB-specific reporting.

  CRR III requires that Pillar 3 disclosures be submitted to the new EBA centralised Pillar 3 data hub (P3DH). However, proportionality applies here as well: only institutions that are required to produce Pillar 3 disclosures must publish them on the EBA platform.

- **UK Basel 3.1**
  The PRA implements the Basel III Pillar 3 disclosure framework largely in line with the BCBS templates, structure and frequency requirements for large and listed institutions. These firms are expected to apply the full set of Basel Pillar 3 templates without material UK-specific deviations. The PRA also provides that large and listed institutions should disclose no less frequently than the minimum frequency prescribed in the Basel reforms and must do so using the full content and format of the corresponding Basel-aligned disclosure templates.

- **US Basel III Endgame**
  The NPR retains the qualitative Pillar 3 but proposes to move most quantitative Basel templates into supervisory reporting instead of public disclosure, materially departing from the Basel III objective of ensuring public comparability of RWAs across internationally active banks, as the NPR significantly narrows the scope of information available to market participants.



Expected impact of new rules

- **BCBS Guidelines**
  The BCBS Quantitative Impact Studies (QIS) continue to show a modest average increase in minimum Tier 1 capital requirements, though the dispersion across banks and jurisdictions is materially wide. In the March 2024 BCBS monitoring/QIS, Group 1 banks (large, internationally active institutions) recorded an average 4.9% increase in Tier 1 minimum required capital, rising to 6.0% for Global Systemically Important Banks (G-SIBs).

  Overall, banks with heavy reliance on internal models, low-default portfolios, or material trading/CVA exposures continue to experience above-average increases, driven primarily by the output floor, revised operational risk framework, and standardised credit risk constraints.

- **EU CRRIII/CRDVI**
  The EU has conducted an "EU-specific scenario" QIS alongside the transition to CRRIII/CRDVI. Results indicate that aggregate Tier 1 capital requirement increases by approximately 7.8% relative to the CRR2/CRD5 baseline once the full Basel III package and EU-specific adjustments are applied.

  The EU-wide impact is therefore meaningfully higher than the global BCBS average, driven by (1) higher reliance on internal models, making the output floor more binding, (2) a relatively faithful implementation of Basel standards for key components such as credit risk and the output floor and (3) limited compensating reductions in Pillar 2/buffer frameworks (unlike the UK's capital-neutrality adjustments).

- **UK Basel 3.1**
  According to the PRA's September 2024 near-final Basel 3.1 rules, the overall impact on UK banks is expected to be "Virtually neutral", with aggregate Tier 1 capital requirement rising by less than 1% once fully phased in (transition concluding in January 2030).

- **US Basel III Endgame**
  The US is the outlier because the proposal is being re-worked. The original proposal expects a 16% to 25% increase in capital requirements for US G-SIBs. Since then, heavy pushback from the industry has led regulators to reconsider the rules and signal a substantial recalibration.

  However, Vice Chair Michael Barr has indicated that the revisions of the 2023 NPR would aim to have an impact on capital of about 9% for G-SIBs and about 3 to 4% for other large institutions within the US$100 billion to US$250 billion total asset bucket, with the goal of achieving "capital neutrality".