Essay — Recent changes in banking regulation (EU, UK, US)

1. High-level framing — the recent wave of reform

1. Regulators globally have been finalizing/implementing the so-called **Basel III "end-game" / Basel 3.1** reforms (risk-sensitive capital, output floor, new standardised approaches), with staggered implementation timelines across jurisdictions. The Basel Committee's final framework underpins many national/regional changes. (Bank for International Settlements)
2. At the same time, jurisdictions have taken local routes: **EU** enacted the CRR3/CRD6 banking package (entered into force 2024/2025 timing), **UK** is implementing its own Basel 3.1 variant via PRA policy statements, and the **US** regulators have debated and re-calibrated Basel-style reforms and leverage rules for large banks. Timelines and exact calibration differ materially across these jurisdictions. (Finance)

2. Capital requirements — overall architecture & timing

1. **Basel III end-game** core elements:
   - Strengthened **standardised approaches** for credit, market and operational risk; revised **internal ratings-based (IRB)** usage and constraints; new treatment of **counterparty credit risk (CCR)** and **credit valuation adjustment (CVA)**; and a revised **output floor** that limits how low RWAs can go relative to standardised approaches. (Bank for International Settlements)
2. **EU (CRR3 / CRD6)**:
   - The amended EU banking package (often called "CRR3/CRD6") was published in 2024; the **CRR3 Regulation entered into force 1 Jan 2025**, with CRD6 timing for member-state transposition (directive) later (effective/transpose 2026 in many parts). Key EU changes implement most Basel 3.1 features, with some EU-specific calibrations and phase-in arrangements. (Finance)
3. **UK (PRA Basel 3.1)**:
   - The PRA has issued near-final policy statements (multi-stage) implementing Basel 3.1 elements (market risk, CVA, CCR, operational risk, and later credit risk/output floor). The PRA estimates relatively modest aggregate Tier-1 impacts for major UK firms (less than ~1% increase in Tier-1 capital on aggregate in its September 2024 statement, with transitional arrangements to 2030). The UK has tailored some calibrations to reflect domestic priorities. (Bank of England)
4. **US**:
   - Implementation in the US has been politically and technically contested. The Federal Reserve / OCC / FDIC have considered revisions to prior proposals: large bank capital and leverage rules have been re-examined (including potential easing of enhanced supplementary leverage ratio mechanics for certain activity types). Policymaking in

2024–2025 included proposals and internal reviews; some reliefs or re-proposals were discussed to reduce capital impacts compared with earlier drafts. (See Fed stress-test changes and regulator statements.) (Reuters)

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3. Capital by risk type — detailed changes & implications

3.1 Credit risk (standardised & IRB)

1. **Standardised approach overhauls**: Basel 3.1 and CRR3 significantly tighten the standardised approach for credit risk (more risk buckets, revised risk weights, more granular treatment for corporates, real estate, SME exposures). The aim: reduce reliance on internal models and increase comparability. EU adopted these changes via CRR3. (Bank for International Settlements)
2. **IRB constraints / output floor**: IRB model benefits are constrained by a stronger output floor (percentage of RWAs computed by standardised approaches) — reducing model arbitrage. EU/UK follow Basel floor approaches; US debate centered on the design and the calibration. (Bank for International Settlements)
3. **Residential & commercial real estate**: Increased supervisory focus on CRE risk (seen in stress scenarios — CRE price shocks) and higher risk-sensitivity in capital for certain property exposures. US stress testing flagged CRE as a key vulnerability. (Federal Reserve)

3.2 Market risk (FRTB and market-risk SA)

1. **FRTB implementation**: Jurisdictions continue phasing in the Fundamental Review of the Trading Book (FRTB) / market risk reforms — more conservative standardised approaches and tighter model approval paths. UK/PRA and EU have aligned with FRTB technical standards; firms face heavier model governance and internal modelling hurdles. (Bank for International Settlements)

3.3 Counterparty credit risk (CCR) & CVA

1. **New CCR treatments & SA-CCR**: SA-CCR remains the standard, with updates on add-ons and treatment of margining. CVA capital rules tightened in many rule sets and recalibrated to reduce model discretion. The PRA explicitly published packages covering CVA/CCR in its Basel 3.1 roll-out. (Bank of England)

3.4 Operational risk

1. **Standardised approach for operational risk**: Operational risk capital moved to a new standardised approach under Basel 3.1 replacing older approaches (e.g., Basic Indicator / Standardised / AMA). This generally increases capital for certain business models and reduces reliance on internal AMA models. EU/UK are implementing the new approach as part of CRR3/PRA rules. (Bank for International Settlements)

3.5 Output floor & TLAC

1. **Output floor**: A hard floor (percentage) ties RWAs from internal models to standardised RWAs; CRR3 implements a version consistent with Basel, UK aligns with PRA policy statements, and the US has considered similar constraints. Output floor timelines are phased, giving banks multi-year transition. (Bank for International Settlements)

2. **TLAC/G-SIB**: Ongoing calibration of resolution-buffer TLAC requirements for global systemically important banks — supervisors continue to monitor shortfalls and TLAC composition. BIS monitoring reports continue to highlight TLAC aggregates. (Bank for International Settlements)

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4. Provisioning & expected-loss frameworks

1. **IFRS 9 (ECL) — international / EU / UK**:
   - IFRS 9's **Expected Credit Loss (ECL)** framework (lifetime vs 12-month ECL depending on staging) remains the baseline for many jurisdictions. Supervisors (including the PRA and ECB) have issued guidance and thematic reviews to ensure consistent, robust ECL application and to guard against accounting discretion masking credit deterioration. The PRA has published thematic feedback on IFRS 9 application (Dear CFO letters, reviews). (Bank of England)
   - EU CRR3 historically included transitional relief for IFRS 9 impacts during pandemic-era transition; those transitional measures have been fading out, and supervisors expect enduring provisioning governance. (UK Finance)
2. **CECL / US GAAP**:
   - The US uses **CECL** (ASC 326) for many banks (Current Expected Credit Loss); FASB and the prudential agencies have issued implementation guidance and follow-up amendments to refine scope and application. Regulators have also updated supervisory guidance on allowances and examiners' expectations (interagency policy statements). (Deloitte)
3. **Practical effect**:
   - Provisioning models must be forward-looking (macroeconomic scenarios, point-in-time overlays, post-model adjustments). Supervisory scrutiny focuses on model governance, scenario selection, back-testing, and transparency/disclosure. (Bank for International Settlements)

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5. Stress testing (design, scenarios, supervisory focus)

1. **US DFAST / CCAR (annual)**:
   - The Fed's **Dodd-Frank Act Stress Test (DFAST)** / **CCAR** exercises continue to evolve: the **2024** supervisory severely adverse scenario explicitly stressed **commercial real estate** (40% decline in CRE prices in the severe scenario) and showed rising loss rates in corporate portfolios. The Fed's 2024 results and reports increased attention on loss rate drivers, revenue sensitivity, and capital planning. (Federal Reserve)
   - **Methodological updates**: the Fed has adjusted model inputs, capital actions allowance, and supervisory overlays year to year; banks must maintain rigorous capital planning and scenario governance. (Federal Reserve)
2. **EU / EBA stress testing**:

- The **EBA** runs EU-level stress tests and issues guidance to national authorities. Post-pandemic and post-rate-shock stress scenarios emphasize market-and-interest-rate risks, CSRBB (credit spread risk in the banking book) and liquidity pressures. EBA also publishes guidelines for ICAAP/ILAAP data and supervisory information requirements. (eba.europa.eu)

3. **UK**:

   - The Bank of England / PRA stress scenarios focus on household and corporate credit stress, CRE, and operational resilience; the PRA's stress testing expectations are incorporated into capital planning assessments. The PRA published specific policy statements for Basel 3.1 but continues to apply stress testing as a supervisory tool. (Bank of England)

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6. ICAAP / ILAAP — internal adequacy frameworks & supervisory reporting

1. **EBA Guidelines on ICAAP/ILAAP**:

   - EBA published updated guidelines on the content and reporting expected for **ICAAP** (internal capital adequacy) and **ILAAP** (internal liquidity adequacy). Supervisors require clearer documentation, stress scenarios, linkage to strategic plans, governance, and quantitative metrics. These guidelines are part of a supervisory push to standardize what authorities collect and to enable cross-firm comparability. (eba.europa.eu)

2. **Supervisory focus**:

   - Supervisors expect ICAAP/ILAAP to fully integrate new Basel 3.1 capital models, the output floor, updated liquidity metrics, and stress testing outputs. Internal model limitations and post-model adjustments must be justified and documented. (EBA & national supervisors). (eba.europa.eu)

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7. Liquidity management — LCR, NSFR and funding metrics

1. **Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR)**:

   - LCR/NSFR remain core minimums. EBA reporting and monitoring indicate EU banks generally maintain LCR > 100% and NSFR at elevated levels, but net outflows and wholesale funding sensitivity are supervisory concerns. The BIS/Basel monitoring continues to track LCR/NSFR across G-SIBs. (eba.europa.eu)

2. **Regulatory/market updates**:

   - Regulators continue to scrutinize **short-term wholesale funding**, intraday liquidity and central clearing / margining impacts. The EBA and national supervisors have issued guidance and monitoring reports to ensure banks can meet prudential liquidity buffers in stress. (eba.europa.eu)

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8. Disclosure, Pillar 3 and capital transparency

1. **Pillar 3 / disclosure updates**:
    - As capital frameworks tighten and the output floor reduces model benefits, supervisors emphasize transparent Pillar 3 disclosures so investors and counterparties can compare RWA drivers and capital adequacy across firms. CRR3 includes disclosure changes; PRA has parallel disclosure requirements for UK banks. (Deloitte)

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9. Jurisdictional comparison — quick summary table

- **EU (CRR3/CRD6)**:
    - Implements Basel 3.1 components largely as drafted by Basel Committee; CRR3 entered into force 1 Jan 2025; phased implementation and national transposition for the directive. Strong emphasis on standardised approaches, output floor, and coordinated reporting (EBA guidance). (Finance)
- **UK (PRA Basel 3.1)**:
    - A UK-specific implementation that mirrors Basel 3.1 technical content but with UK calibrations and phased policy statements; PRA estimates relatively limited aggregate Tier-1 increase (under 1% in its statement), but certain portfolios may see bigger impacts. PRA remains active on IFRS9 thematic reviews and stress testing. (Bank of England)
- **US**:
    - Implementation path more incremental and politically sensitive. Fed/OCC/FDIC reviewed earlier proposals and re-proposals in 2023–2025; stress testing remains robust (DFAST/CCAR) with heavy attention to CRE and non-interest income volatility. Regulators also considered leverage rule calibrations to avoid undue constraints on certain bank activities. (Reuters)

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10. Supervisory & market priorities driving changes

1. **Resilience and comparability**: Reduce excessive model discretion, prevent RWA arbitrage, and ensure comparable capital metrics across banks. Output floor + standardised approaches are central. (Bank for International Settlements)
2. **Liquidity fragility**: Recent market events and rapid rate moves pushed supervisors to re-emphasize LCR/NSFR monitoring and intraday liquidity resilience. (eba.europa.eu)
3. **Credit cycle forward-looking provisioning**: IFRS9/CECL frameworks and supervisory reviews highlight robust, forward-looking provisioning and governance. (Bank of England)
4. **Macro vulnerabilities**: CRE, corporate leverage, market-risk exposure and credit-spread risk in banking books are targeted in stress tests and supervisory guidance. (Federal Reserve)

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11. Practical implications for banks (model & quant teams)

1. **RWA modelling & validation**:
   - Expect re-tooling of RWA models (credit, market, operational) to align with new standardised approaches and to quantify output-floor impacts. Strong demand for quant skills: RWAs decomposition, model validation, sensitivity analysis, and scenario testing. (Bank for International Settlements)
2. **Capital planning & stress testing**:
   - Enhanced ICAAP/CCAR/ILAAP integration — capital planners need to link stress results to capital actions, capital buffers and dividend plans. Scenario design and reverse stress testing skills are sought after. (Federal Reserve)
3. **Provisions and accounting integration**:
   - Tight model governance for ECL/CECL: macro-scenario modelling, PD/LGD estimation, post-model adjustments, and auditability are critical. Recruiters seek experience with credit risk models, time-series macro links, and accounting interplay. (Bank for International Settlements)
4. **Liquidity & funding analytics**:
   - NSFR/LCR forecasting tools, behavioural run-off modelling, stress cashflow projection and intraday liquidity analytics will be in demand. (eba.europa.eu)

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12. Implementation timelines & transitional arrangements (practical calendar)

1. **Basel / CRR3 timings**:
   - **CRR3**: Regulation entered into force **1 January 2025** (with phased implementation for many measures). CRD6 directive transposition deadlines differ across member states (effective later, e.g., 2026). (Finance)
2. **UK**:
   - PRA rolled out policy statements in waves (PS17/23 etc.). Transitional arrangements to full Basel 3.1 generally phase through the late 2020s (some impacts phased to 2030). (Bank of England)
3. **US**:
   - Rulemaking timelines remain contingent on interagency coordination and further proposals; stress testing and supervisory capital assessments continue on their annual cycle (CCAR/DFAST). Watch regulator releases for final re-proposals and enactments. (Reuters)

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13. Key citations / authoritative sources (select list for readers)

- Basel Committee — "Basel III: Finalising post-crisis reforms" (BIS / BCBS). (Bank for International Settlements)

- EU Commission / CRR3 updates — "Latest updates on the banking package" (EU Finance). (Finance)
- Bank of England / PRA policy statements — PRA publications on Basel 3.1 implementation (PRA press releases and PS documents). (Bank of England)
- Federal Reserve — DFAST/CCAR 2024 results & supervisory materials. (Federal Reserve)
- EBA — Guidelines on ICAAP / ILAAP information and LCR/NSFR monitoring. (eba.europa.eu)
- IFRS 9 / CECL guidance — PRA thematic feedback (UK) and FASB / FDIC CECL guidance. (Bank of England)

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15. What to watch next (near-term signals)

1. **US regulatory rule finalizations** — Fed/OCC/FDIC moves on Basel-style capital calibrations and leverage rules (watch agency releases and Fed chair statements). (Reuters)
2. **CRD6 transposition & national discretions** — EU member states' implementation choices may create divergence in local calibrations (watch national supervisory guidance). (Deloitte)
3. **PRA implementation and supervisory reviews** — UK policy statements and thematic reviews (IFRS9, climate risk) will refine PRA expectations. (Bank of England)
