Navigating B3E in the U.S.: Strategic Imperatives for Banks

By Megan Beukelman and Cheyanne Lui

As the financial landscape evolves and regulatory frameworks adapt to new market realities, banks face the culmination of Basel III, marking a pivotal moment in global banking regulation. With the Basel III Endgame (B3E) on the horizon, financial institutions are tasked with recalibrating their existing programs of work and outlining a new delivery pathway to meet the revised rules.

Basel III, introduced in response to the global financial crisis of 2008, aims to enhance the resilience of the banking sector by bolstering the quality and quantity of capital requirements, introducing liquidity standards, and improving risk management practices. Over the years, banks have made significant strides in implementing these reforms, fortifying their balance sheets and increasing their ability to withstand economic shocks.

As Basel III reaches its conclusion, though, banks must shift their focus from mere compliance to strategic adaptation ahead of phased B3E implementation. Nowhere is this more urgent than in the U.S., where banks face phased deadline from July 1, 2025, to June 30, 2028. While the U.S. regulations continue to face strong pushback—particularly from the largest banking organizations that are most affected—this does not mean banks should sit idly by and wait. Here are several crucial steps banks should consider undertaking to prepare for B3E in the U.S.:

Unwinding aspects of the existing RWA calculation methodology: B3E changes the dual-stack, risk-weighted asset (RWA) requirements for large banks. While banks with total assets under $100 billion are typically exempt, those engaged in substantial trading activities could find themselves subject to both the existing “standardized approach” and the “expanded risk-based RWA approach”, which supersedes the advanced RWA calculation approach. The proposed expanded risk-based approach will likely be the binding constraint for most covered firms, adding more granular counterparty types with distinct risk-weighting, expanding data requirements, and increasing operational complexity. Many large banking organizations that previously invested substantial resources in internal models and advanced approaches to capital calculation will need to assess their existing infrastructure and consider the minimum B3E requirements that need to be maintained during the implementation period. This task is further compounded for global banks operating in jurisdictions where the advanced approach remains in effect. Under such circumstances, U.S. banks are likely to opt for simpler approaches in foreign jurisdictions in accordance with U.S. regulatory requirements.

Impacts on in-flight capital remediation programs: With increased regulatory demands and closer scrutiny on capital and liquidity management, numerous major banking institutions are currently engaged in extensive remediation and optimization initiatives. These long-term endeavors have established future states that may not have factored in the new B3E requirements, particularly where proposed rules diverge from international standards. Evaluating the potential impacts on these programs and seeking clarity from regulatory bodies is essential to understand the way forward. Different approaches may be necessary depending on the nature of the initiative. For example, prior regulatory penalties which overlayed punitive capital charges for rules that are muted or not specifically clarified as part of B3E could be relitigated in the new environment. At the same time, data quality initiatives that aim to address system implementation errors to components that are no longer in the framework, such as advanced internal models, should be reviewed for criticality and re-prioritization. Maintaining a rigorous book of work of capital initiatives and overlaying governance processes to enable the ongoing review and reprioritization of these over the B3E runway will be critical to mitigate wasted work and improve the return on investment in these programs.

Enhancements to data processes and controls: B3E introduces a credit risk framework that is risk-sensitive, an operational risk framework that looks at historical loss data, and a market risk framework that requires active monitoring—meeting the data demands of these new rules presents a considerable challenge. Even banks accustomed to the data-intensive nature of the advanced approach will require a substantial increase in data sourcing efforts. Where new sources of data are required, banks will need to evaluate whether these attributes are currently available or would require additional efforts to source (e.g., assessment of how a counterparty is reinvesting its cash to determine applicability of the minimum haircut floor for securities financing transactions). Where new data elements are needed, a review of existing bank processes should be undertaken to see if these can be sourced or leverage existing information (e.g., "know your customer" data) or if new processes will need to be stood up. Given the heightened focus on data, banks may find it difficult to adapt to the incremental requirements—especially if relying on outdated and fragmented infrastructure—and should therefore stand up dedicated work streams for data discovery, sourcing, and enhancements.

Implications for trading portfolios: Under B3E, we expect significant capital increases for Global Systemically Important Banks (G-SIBs) and intermediate holding companies (IHC) at all levels including market risk, credit risk, and operational risk. The Federal Reserve estimates a 16% increase to Common Equity Tier 1 (CET1) and a 20% increase to RWA for U.S. G-SIBs and IHCs. In addition to the impact on capital, banks should focus on their trading and banking book portfolios and make significant adjustments to their business models to deal with the punitive capital requirements.

As B3E approaches, banks must proactively adapt their strategies to navigate the evolving regulatory landscape and seize opportunities for innovation and growth. While big banks and industry groups continue to lobby lawmakers, the Federal Reserve has advised that the market should still prepare for broad and material changes in whatever form the final rules take. The successful execution of the updated reforms will require bank-wide collaboration in a manner that does not result in the institution holding unnecessarily higher capital. Firms should be well on the way toward establishing or expanding their program management and undertaking a gap assessment of their current capabilities related to the requirements of the new rules. This will enable a clear target operating model to address gaps and formalize workstreams to achieve compliance. With a solid change management program, banks can position themselves for sustainable success in the post-B3E era.

Note: Treliant plays a pivotal role in assisting banks during this transition. Our expertise lies in navigating regulatory changes and optimizing financial systems. Our services encompass risk assessment, capital framework standardization, and readiness planning, assisting banks in complying with the evolving Basel III requirements. With our guidance, banks can efficiently implement proposed changes, enhance risk measurement practices, and smoothly transition to the new framework, thereby bolstering their strength and resilience in the face of evolving regulations.

For more information on the key changes associated with the U.S. B3E capital reforms, please refer to:

U.S. Basel III Capital Reforms—Headline Takeaways

Update on U.S. Basel III Endgame—The Pulse Outlook 2024

Source: Federal Reserve

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