

US BASEL III ENDGAME: TRADING AND CAPITAL MARKETS IMPACT 2026 UPDATE

What is the Basel III 2026 Proposal and What Does It Mean for US Capital Markets?

In March 2026, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation published a new proposal for capital rules known as the US Basel III, based on the global minimum regulatory capital standards developed by the Basel Committee on Banking Supervision (BCBS). These rules were first proposed in July 2023. ISDA considers the 2026 proposal a constructive step forward that recognizes the importance of appropriately calibrating the amount of capital required for capital markets and trading activities. Despite this progress, several aspects of the 2026 proposal would still produce outcomes that are not sufficiently aligned with economic risk. In advance of a final rule, ISDA recommends targeted changes to improve risk sensitivity while preserving the safety and resilience of the capital framework.

To objectively assess the 2026 proposal, ISDA conducted a quantitative impact study (QIS) with input from the eight US global systemically important banks (G-SIBs). The QIS shows that the market risk portion of the framework, known as the Fundamental Review of the Trading Book (FRTB), would increase market risk capital by approximately 89% under the standardized approach (SA) applied across the full portfolio, and by approximately 30% under a blend of internal models and standardized approach that reflects current model approvals. This matters because trading and capital markets activities are central to the ability of US businesses to raise funds and manage risk. Where capital requirements are not aligned with underlying risk, the cost of market intermediation, client hedging and financing rises, ultimately affecting end users, businesses and consumers.

This note summarizes the key findings of the ISDA QIS and the principal recommendations in ISDA's comment letter to the agencies¹.

Why is this an Issue for Banks and their Customers?

Overall Capital Impact

The 2026 proposal would fundamentally change the calculation of risk-weighted assets (RWAs)² of banking organizations and, in turn, the capital banks must hold to meet both minimum capital and buffer requirements. ISDA's recommendations focus on ensuring those requirements are aligned with underlying risk. This comes on top of the substantial increase in capital since the 2008 financial crisis. For the eight US G-SIBs, common equity tier 1 capital has increased from approximately \$214 billion before the crisis³ to approximately \$1.025 trillion in 2025⁴. The 2026 proposal would also fundamentally restructure the capital stacks for the largest banking organizations.

The current capital framework imposes a dual stack approach for Category I and II banking organizations, in which those institutions are required to calculate two distinct risk-based capital ratios. One set relies on the standardized approach, which applies broadly across all banking organizations, while the other draws on the advanced approaches, which are tailored to each institution's own internal models. The binding constraint for any institution is whichever of the two calculations produces the more conservative result.

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¹ ISDA, SIFMA, IIF Respond to 2026 US Basel III Proposal, ISDA, June 18, 2026, www.isda.org/2026/06/18/isda-sifma-iif-respond-to-2026-us-basel-iii-proposal/

² Risk-weighted assets represent a bank's assets or off-balance-sheet exposures

³ Basel III Endgame: The next generation of capital requirements, PWC, April 2023, explore.pwc.com/baseliiiendgame/basel-iii-end-game-report

⁴ Common equity tier 1 (CET1) capital figures are sourced from the annual reports on Form 10-K of the eight US global systemically important banks – JP Morgan, Bank of America, Citigroup, Wells Fargo, Goldman Sachs, Morgan Stanley, The Bank of New York Mellon, and State Street—for the fiscal year ended December 31, 2025. The \$1.025 trillion figure represents the sum of each institution's reported CET1 capital as of December 31, 2025

⁵ Credit valuation adjustment is a part of the regulatory capital framework that captures the possibility of a counterparty's default. The adjustment represents the market value of counterparty credit risk

The 2026 proposal would fundamentally alter this structure by removing the dual stack requirement. Rather than maintaining two parallel calculation tracks, the advanced approaches would be retired and replaced with a single unified framework – the expanded risk-based approach (ERBA) – to which Category I and II banking organizations would be subject. The ERBA generally uses standardized methodologies across credit risk, equity risk, operational risk, market risk and credit valuation adjustment (CVA) risk. In a departure from other BCBS jurisdictions, the agencies removed the option for banks to use internal models to calculate credit risk and counterparty credit risk. Under the ERBA, banks may use internal models only for market risk.

Under current rules, the standardized approach is binding and therefore defines the minimum capital requirement for the majority of US G-SIBs. The current standardized approach does not include CVA and operational risk. As the ERBA is expected to be the binding capital constraint for most US G-SIBs, this means operational risk and CVA will become part of the binding constraint for the first time. When combined with the new capital surcharge for G-SIBs, this will be a meaningful change in the overall calibration of capital requirements for the trading book.

Trading and Capital Markets Impact

These new capital requirements, coupled with the Federal Reserve's supervisory stress test and stress capital buffers, would have a material impact on trading and capital markets activities.

The ISDA QIS found that the FRTB would increase market risk capital by approximately 89% if the standardized approach were applied across the full portfolio, and by approximately 30% under a blend of internal models and standardized approach reflecting current model approvals. A substantial share of this impact is driven by the default risk charge (DRC), which represents approximately 51% of FRTB market risk capital, according to the QIS. Targeted recalibration of the DRC and fuller recognition of hedging and diversification, as described below, would materially improve the alignment of these requirements with underlying risk.

In addition, because the ERBA becomes the binding constraint, CVA capital will be fully additive. The QIS shows total ERBA CVA RWAs of approximately **\$168 billion**. By contrast, the 2026 proposal's more risk-sensitive treatment of securities financing transactions (SFTs) and derivatives would reduce the RWAs associated with these activities to approximately 0.77 times their current level for US G-SIBs. ISDA's recommendations would further improve risk sensitivity in each of these areas.

Why do Capital Requirements for Trading and Capital Markets Activities Matter?

US capital markets are the largest in the world and remain among the deepest, most liquid and most efficient. They are central to how US businesses raise funds and manage risk. Where the capital banks must hold is not aligned with underlying risk, the cost of intermediation and hedging rises, which can push activity outside the banking system and raise costs for end users.

Put simply, the higher the capital required for a given activity, the more expensive it becomes to run that business. If capital levels aren't aligned with risks and returns aren't enough to offset capital costs, banks will be forced to either scale back from that business or raise costs. Neither is good news for end users – particularly as the business lines that will be most affected are those that are critical to financing and hedging.

Importantly, the US G-SIBs have weathered a series of market shocks, from the pandemic to Russia's invasion of Ukraine. The main challenge banks faced during these events was not the continued viability of their institutions, but the sharp reductions in market liquidity and capacity.

Recommendations

ISDA recommends:

- The US agencies revise cross-product netting under the extended standardized approach for counterparty credit risk (SA-CCR), where the proposed maturity-mismatch scaling provides no genuine hedge benefit and ignores short-dated repo netting. A hedge coverage ratio (HCR) adjustment would correct this, while retaining appropriate conservatism.
- The US agencies recalibrate the DRC through targeted fixes for equity hedges, non-US sovereign exposures, fund risk weights and the hedge benefit ratio (HBR), which would align capital with economic risk.
- The US agencies make CVA risk-sensitive by distinguishing regulated from unregulated financial counterparties, rather than treating them alike and overstating risk for regulated financials.

- The US agencies ensure a workable transition to the internal models approach (IMA) through pragmatic implementation timelines and model approvals so that firms avoid cliff-edge capital shocks and are not discouraged from deploying internal models.

Cross-product Netting Under Extended SA-CCR

The 2026 proposal introduces an extended SA-CCR framework intended to recognize risk offsets between derivatives and SFTs within qualifying cross-product master netting agreements. While the introduction of this framework is welcomed as a step toward greater risk sensitivity, the current design materially under-states the risk-reducing benefits of cross-product netting.

A key limitation arises from the proposed exposure-at-default (EAD) methodology, which blends gross standalone exposures with a cross-product netted exposure using a maturity ratio. In practice, this formulation assigns relatively low weight to the netted exposure because SFTs are typically short-dated (eg, overnight repos), while derivatives tend to have longer maturities. As a result, even fully offsetting portfolios receive only limited capital relief (8% to 16%), leading to systematic overstatement of exposure in economically hedged portfolios.

This outcome is particularly problematic given the growing use of cross-margining arrangements, which reduce initial margin requirements by recognizing offsets between repos and derivatives. Under the 2026 proposal, however, lower margin requirements can paradoxically lead to higher capital requirements, as the framework does not adequately capture the underlying reduction in economic risk.

Industry Recommendations:

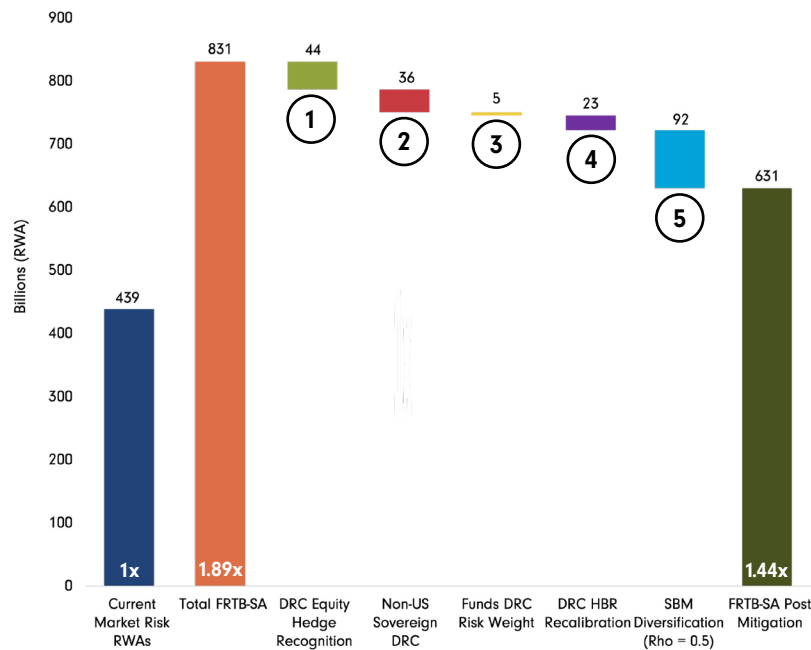
1. Adopt an HCR adjustment so the exposure calculation more fully reflects genuine cross-product netting in balanced portfolios;
2. Expand the positions eligible for extended SA-CCR to include eligible margin loans and cleared transactions.

While extended SA-CCR represents an important advance in recognizing cross-product netting, the current proposal is not sufficiently aligned with market practice or economic risk. Targeted adjustments – particularly enhancing the EAD methodology and broadening the scope of eligible transactions – are needed to ensure capital requirements appropriately reflect true counterparty exposure and support the efficient use of collateral.

Impact on Capital – QIS Results

FRTB-SA Impact

If banks were to apply the FRTB-SA across all portfolios, the increase in market risk capital would be approximately **89%**.

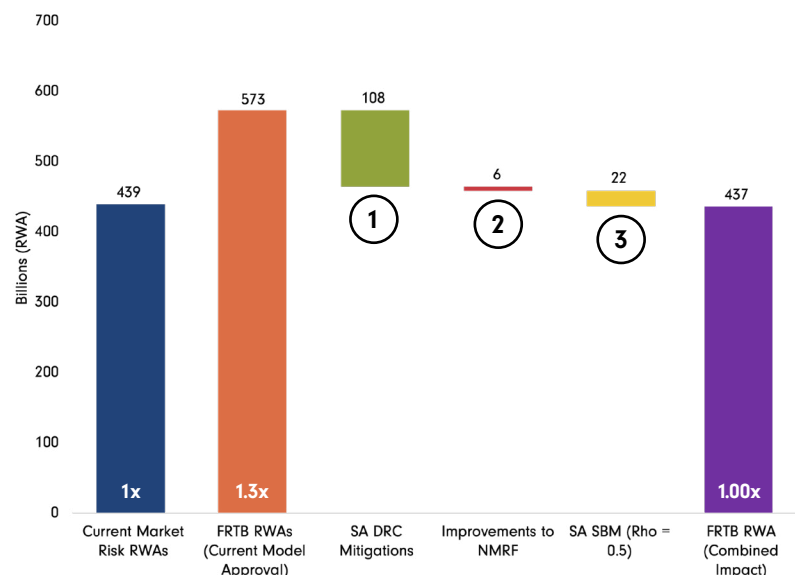


Industry Recommendations:

- 1. Equity hedge recognition in the DRC:** Permit a three-month maturity for equity derivatives exposures so that short-dated derivatives hedging longer-dated positions are properly offset (estimated \$44 billion RWA reduction).
- 2. Treatment of non-US sovereign exposures:** Exclude certain non-US sovereign exposures from the DRC – including local-currency exposures offset by local-currency liabilities and sovereigns that receive a 0% credit-risk weight (estimated \$36 billion RWA reduction).
- 3. Treatment of Funds in DRC:** Apply speculative grade instead of sub-speculative grade treatment to funds in DRC (estimated \$5 billion RWA reduction).
- 4. Recalibration of the HBR in DRC:** Improve the HBR to better recognize hedging between long and short positions (estimated \$23 billion RWA reduction).
- 5. Better recognition of diversification in the SA:** Introduce an inter-risk-class correlation parameter of 0.5 (estimated \$92 billion RWA reduction).

FRTB-IMA Impact

If banks were to apply a blend of internal models and standardized approach reflecting current model approvals, the increase in market risk capital would be approximately **30%**.

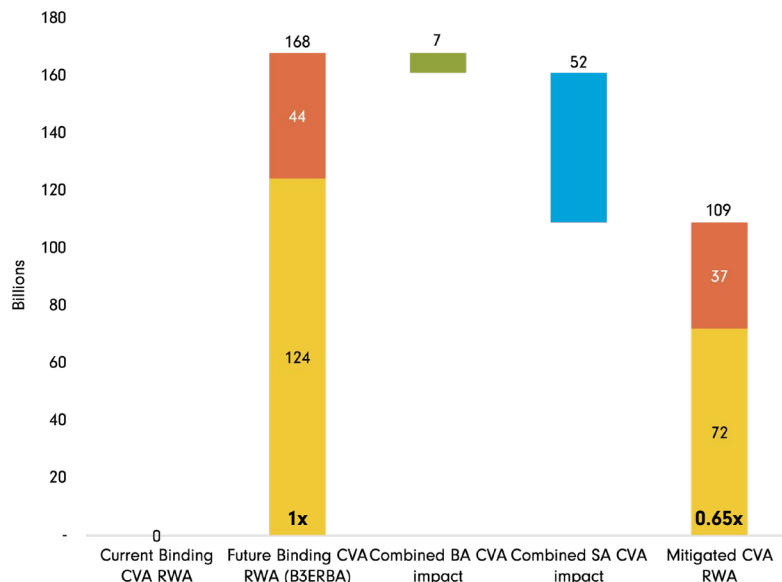


Industry Recommendations:

- 1. SA DRC mitigation items:** Given internal models cannot be used to calculate DRC, the previous SA DRC impacts should be included.
- 2. Better treatment of non-modellable risk factors (NMRFs):** Capitalize Type A NMRFs using the expected shortfall methodology only, rather than also in the stressed expected shortfall approach and either increase the back-testing multiplier from 1.5 to 1.57 or increase the liquidity horizon associated with Type A NMRFs (estimated \$6 billion RWA reduction).
- 3. Better recognition of diversification in the SA:** Introduce an inter-risk-class correlation parameter of 0.5 applied to non-modelled desks (estimated \$22 billion RWA reduction).

CVA Impact

CVA is fully additive when the ERBA replaces the current SA as the binding constraint (**approximately \$168 billion in RWAs**). The mitigations recommended by ISDA would reduce this by approximately 35%.

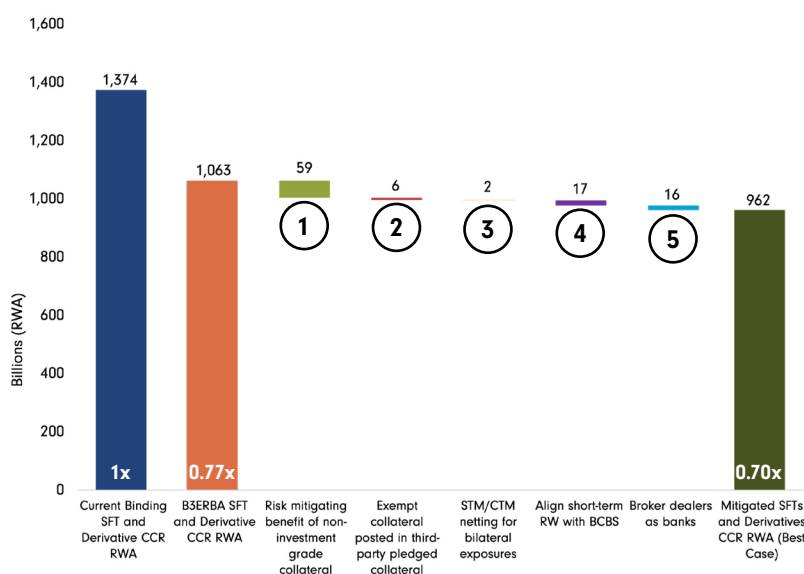


Industry Recommendations:

- 1. More granularity for financial institutions in CVA:** Distinguish between regulated and unregulated financial counterparties, lowering the risk weights for highly regulated entities to 3% (investment grade) and 8.5% (speculative grade) – estimated 14% RWA reduction for CVA.
- 2. Special purpose vehicle (SPV) repack structures:** Determine CVA risk weights based on the issuer of the underlying bonds rather than the SPV counterparty, better reflecting the economic risk (estimated 14% RWA reduction).
- 3. SA-CVA diversification:** Impose the same diversification framework as ISDA proposed for FRTB-SA (estimated 7% RWA reduction).

CCR Impact

Under the ERBA's more risk-sensitive methodology, RWAs for SFTs and derivatives would fall to approximately 0.77 times their current level for US G-SIBs, and to approximately 0.70 times with ISDA's recommended mitigations.



Industry Recommendations:

- 1. Non-investment-grade collateral:** Recognize the risk mitigating benefit in repo-style transactions (estimated \$59 billion RWA reduction).
- 2. Bankruptcy-remote collateral:** Exclude collateral pledged through third-party custodial arrangements from the exposure calculation (estimated \$6 billion RWA reduction).
- 3. STM/CTM netting:** Recognize settled-to-market (STM) and collateralized-to-market (CTM) netting for bilateral exposures (estimated \$2 billion RWA reduction).
- 4. Bank risk weights:** Align short-term risk weights for bank exposures with the BCBS framework (estimated \$17 billion RWA reduction).
- 5. Securities firms as banks:** Treat broker-dealers and other qualifying securities firms as banks for risk-weighting purposes (estimated \$16 billion RWA reduction).

About ISDA

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 1,000 member institutions from 79 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: www.isda.org. Follow us on [LinkedIn](#) and [YouTube](#).