Basel III divergence: why are standards diverging and is Europe disadvantaged?

Growing differences in Basel III implementation have intensified debate over their implications for European banks' competitiveness and the international level playing field. While panellists broadly supported preserving Basel as a common global anchor, they also highlighted scope for simplifying and recalibrating the EU framework where appropriate. The discussion therefore focused on the implications of global divergence, possible adjustments to the European prudential framework and the broader structural constraints on EU bank competitiveness.

1. Preserving the benefits of global standards in a more fragmented Basel landscape

1.1 Assessing the implications of Basel III divergence for EU competitiveness

The Chair noted that one of the three areas of focus of the Commission's July banking report was the revision of the EU implementation of Basel III. This raises the question of how Europe's Basel III implementation would change, after having implemented it very faithfully, and the implications for the international level playing field. The Commission is gathering further views, proposals and data to develop concrete legislative measures. A banking package is expected by March 2027, possibly earlier.

Panellists were invited to assess the rationale and implications of the current prudential and supervisory framework and how Basel divergence affects banks' competitiveness, both overall and for specific portfolios or activities.

1.2 Lessons from the crisis: a common anchor matters more than lower requirements

1.2.1 A common prudential anchor is essential

Drawing on his experience at the Swiss Financial Market Supervisory Authority (FINMA), the Federal Reserve, the European Central Bank (ECB) and the Basel Committee, a regulator recalled that, since 1988, Basel has aimed to harmonise minimum prudential standards, rather than national supervisory practices or Pillar 2 requirements. Its purpose is twofold: to ensure a minimum level playing field and to provide a common anchor for comparing capital adequacy across jurisdictions on an 'apples-to-apples' basis.

The global financial crisis demonstrated the importance of this anchor. Once markets lost confidence in the risk-based framework, they gravitated towards the leverage ratio. In Europe, institutions with leverage ratios below 4% were very likely to fail or require support, while those above 4% tended to fare relatively well. Renewed national fragmentation could similarly undermine confidence in the common framework and push markets back towards leverage ratios in the next cycle, to European banks' detriment. Jurisdictions should therefore implement Basel as quickly as possible. Pillar 1 cannot compensate for differences in Pillar 2, since they serve different purposes.

1.2.2 Undercutting global standards would not improve competitiveness

A regulator noted that a previous ECB exercise concluded that applying US requirements to EU banks would significantly increase their requirements. Following recent US adjustments, however, the US and EU frameworks are probably now reasonably comparable. There is no evidence that undercutting global standards improves competitiveness, nor that capital currently constrains credit. More fundamental shifts in competitive positions occur during deep crises than when the economic tide is rising. The level playing field should therefore be assessed throughout the cycle, rather than only at its peak.

1.3 Preserving global standards while simplifying their application in Europe

A central bank official observed that the global financial crisis demonstrated the value of international standards in an interconnected financial system and the need to keep jurisdictions engaged in the Basel process. Basel was originally designed primarily for internationally active, cross-border banks, but the EU extended it to all banks through the single rulebook, contributing, in the Bundesbank's view, to considerable complexity. A high-level task force identified scope for simplification, and the Bundesbank has proposed a radical simplification of the capital stacking order. This issue is also reflected in the Commission's competitiveness report and should be taken forward by the co-legislators.

Comparisons with other jurisdictions should be fact-based. The US applies a more tailored, size-based approach than the EU, while direct competition between US and European banks is limited to certain banks and markets. Europe should therefore monitor US plans carefully before deciding whether to change its own framework. Greater proportionality is particularly warranted for small and medium-sized banks and non-complex institutions. Switzerland and the UK already have specific regimes in this area. The Bundesbank supports a small-bank regime or, at a minimum, greater proportionality and reduced bureaucratic burdens.

1.4 A holistic approach to preserving Basel's credibility and reducing EU complexity

1.4.1 Growing fragmentation could undermine the global benchmark

A regulator observed that US developments illustrate the broader risk of fragmentation as jurisdictions implement Basel III differently in timing, scope and domestic adjustments. The concern is not individual changes but a gradual loss of consistency and predictability in the international framework ultimately undermining confidence. Outcomes should therefore be assessed across the framework as a whole, rather than requirement by requirement. Cross-jurisdiction comparisons are more complex than headline capital ratios suggest. Stress testing, Pillar 2, leverage ratios, buffers, supervisory practices and different tiering interact with Basel requirements to create different constraints. In Europe, the greater role of Pillar 2 may also make future capital requirements less predictable, affecting capital management, investors and market valuations.

1.4.2 The EU should preserve resilience while reducing unnecessary complexity

A regulator advised that the EU should prioritise the preservation of both the long-term benefits of consistent international standards and the resilience built over the past 15 years, which is itself a source of competitiveness by strengthening confidence among investors, depositors and other market participants. Greater divergence would weaken Basel as a common global benchmark. The EU therefore has a strategic interest in limiting regulatory arbitrage, supporting cross-border banking through a level playing field and promoting convergence through the Basel Committee and other international fora. It should also assess its own framework holistically to preserve resilience while reducing unnecessary complexity. The European Banking Authority (EBA) supports the Commission's analysis and is developing a more proportionate and transparent framework to support a competitive banking sector.

1.5 Basel divergence should be assessed by outcomes rather than differences in implementation

1.5.1 Current divergence should not be overstated

A central bank official commented that, while divergence is a risk, Basel implementation across the US, UK and EU still shows more similarities than differences. Overall compliance with the global framework remains good. Recent US proposals, including changes to Global Systemically Important Banks (G-SIB) buffers and the leverage framework, would arguably bring the US closer to the underlying Basel standard. Concerns about the absence of an output floor are also somewhat misplaced: removing the relevant modelling means that US banks would effectively be at 100% of the standardised approach, rather than the Basel floor of 72.5%, making an output floor unnecessary. Divergence needs to be monitored, but is not yet as significant as is sometimes suggested.

1.5.2 Different approaches can remain consistent with Basel if outcomes are comparable

A central bank official saw grounds for optimism. On issues such as the Fundamental Review of the Trading Book (FRTB), major jurisdictions are seeking to implement similar approaches on broadly similar timetables. Basel is a minimum standard rather than a target and deliberately leaves some areas to national regulators. Different approaches can therefore remain consistent with the framework if they produce broadly comparable outcomes. The UK's immediate priority is preparing for Basel III implementation in January 2027. A period of stability would help assess its effects. The framework should then be assessed through Basel's ex post evaluation process.

The Chair noted that public-sector panellists had broadly reaffirmed the rationale for Basel, while identifying caveats, notably complexity and proportionality, that the Commission is examining.

1.6 Regulatory convergence facilitates capital allocation within international banking groups

An industry representative noted that divergence complicates his discussions with SMBC's Tokyo head office over capital allocation to the EMEA region. Japan has already fully implemented the Basel standards. Although Japanese private-sector firms were still actively pushing back against full implementation a year ago, they have since adapted and are learning to manage the resulting divergence. However, this remains painful and costly, particularly for capital allocation within international banking groups. Basel should remain the global baseline. Japanese regulators are proud of having fully implemented the standards, an achievement that the speaker himself has also come to value. Jurisdictions should see convergence, rather than divergence, as worth preserving.

1.7 US developments do not justify an across-the-board reduction in EU capital requirements

1.7.1 The US framework is changing, but is not necessarily more lenient than Basel

An official noted that regulatory fragmentation can affect banks' competitive positions across jurisdictions, reinforcing the rationale for international standards. Significant deviations by a major jurisdiction inevitably trigger debate elsewhere over the trade-offs between competitiveness and financial stability and the appropriate response. Policy responses should begin from a careful assessment of the facts. FSI analysis, consistent with work by other European organisations, indicates that current US proposals would significantly reduce capital requirements for US banks, including G-SIBs. This is largely due to the alleviation or removal of US-specific requirements, including the supplemental leverage ratio and the specific calculation of the G-SIB buffer, alongside changes to the stress-test capital buffer. Some measures also deviate directly from Basel, including through risk weights, regulatory-capital deductions and elements of the FRTB.

Nevertheless, the resulting US framework cannot be considered more lenient than full Basel implementation.

The US proposals include a particularly strict approach to internal models, banning their use for credit risk and therefore increasing requirements sufficiently to more than offset less stringent deviations elsewhere. The absence of a Basel output floor is another deviation, but, with credit-risk internal models prohibited, such a floor would not bind any US G-SIB even if introduced.

1.7.2 US developments should therefore be used cautiously when recalibrating the EU framework

An official emphasised that applying the emerging US framework to European G-SIBs does not support the conclusion that the EU framework is significantly more stringent. The US proposals therefore do not, by themselves, justify an across-the-board reduction in capital requirements for European banks, particularly large banks. Nor does the absence of a US output floor justify eliminating or significantly reducing the EU floor, since the US ban on credit-risk internal models is more stringent in practice. This does not preclude efficiency-enhancing changes to the European framework, including measures already proposed by the Commission. The question is how the EU framework can be simplified and recalibrated where necessary, while preserving resilience and the benefits of global standards.

2. Simplifying and recalibrating the EU framework without weakening resilience

2.1 Europe should recalibrate capital requirements where they are disconnected from risk

An industry representative argued that Europe should focus on its own needs rather than follow the US and that, for unrated corporates, trade finance and speculative lending, capital requirements can be disconnected from the actual cost of risk and constrain lending and investment. This matters particularly in Europe, where banks provide nearly 75% of financing needs. 90% of EU banks' retained earnings have been absorbed by additional supervisory capital requirements, leading to higher prices, greater selectivity, fewer clients and the relocation of activities. As an illustration, Airbus obtains 50% of its financing capacity outside Europe from Chinese banks. Basel remains essential but should not be untouchable: where capital requirements are clearly misaligned with observed risk, they should be adjusted. Banks want to enable growth, not slow it.

2.2 Resilience and growth should be mutually reinforcing

An industry representative observed that some jurisdictions are applying Basel through a broader lens, taking greater account of competitiveness, growth and economic resilience. Banks must also be able to support investment, trade and economic growth. The challenge is to preserve confidence in Basel as a global standard while maintaining broadly comparable outcomes across jurisdictions. The final phase of Basel III implementation is taking place in a different economic context from that in which the agreement was reached. Resilience and growth are not competing objectives: a strong, well-regulated banking sector is a precondition for both.

2.3 Simplification and targeted recalibration can strengthen the EU framework without weakening resilience

An industry representative advised that overlaps and duplications in the framework should be eliminated and buffers no longer appropriate to Europe's current economic situation reviewed. Targeted adjustments are needed on trade finance and speculative lending. These are strategic for Europe and have a proven low-risk profile; their requirements could be adjusted as separate balance-sheet silos without threatening the system as a whole. To encourage digital investment and strengthen protection against cyber-attacks, deductions of software investments from common equity tier 1 (CET1) should be removed. Investment, rather than capital, protects against cyber-attacks. This would release at least €30 billion of CET1, corresponding to nearly €200 billion of additional financing capacity. Evidence-based adjustments that do not threaten systemic resilience should not require compensatory tightening elsewhere. Such changes would constitute monitored recalibration rather than deregulation, involving banks, regulators and supervisors.

An industry representative emphasised that Basel remains a common foundation for prudential regulation across markets, even as jurisdictions respond differently to similar challenges, reflecting domestic priorities and risks.

Simplifying domestic frameworks, particularly where requirements are duplicative or inconsistent, could enhance the effectiveness of this common global framework. Requirements should be transparent, risk-based and aligned with their intended policy objectives.

2.4 Simplifying the overall EU capital framework could deliver greater benefits than revisiting individual Basel standards

A regulator observed that the cumulative interaction of Pillar 1, Pillar 2, macroprudential buffers, Minimum Requirement for Own Funds and Eligible Liabilities (MREL), Total Loss Absorbing Capacity (TLAC) and national measures has created significant complexity. Simplifying the framework as a whole could deliver greater benefits than revisiting individual Basel standards. Simplification means better governance, greater proportionality and more coherent interaction between requirements, not deregulation. Areas where Europe has gone beyond Basel should be reviewed on an evidence-based basis to assess whether they remain justified or could be addressed more effectively, with EBA analysis informing the Commission. Targeted recalibrations may be warranted where evidence shows an imbalance between costs and benefits but should not become a default response to divergence.

A simpler, more transparent and proportionate framework could reconcile resilience and competitiveness,

strengthening banks' capacity to finance the EU's needs without undermining financial stability.

2.5 Simplification and recalibration should preserve global convergence and regulatory stability

2.5.1 Simplification and recalibration can be combined within international standards

A central bank official stated that, within the current framework, there is no need to choose between simplification and targeted recalibration, as several UK initiatives demonstrate. The voluntary 'Strong and Simple' regime for small firms simplifies Pillar 1, elements of Pillar 2A and buffers, while significantly reducing disclosure and reporting requirements without lowering standards. Three-quarters of eligible firms have joined the regime. The UK is reviewing its capital stack to make buffers more usable. Its capital review identified areas where the leverage framework made the UK an outlier, prompting adjustments within international standards that brought it closer to global standards. The Bank of England plans to consult on automatically updating hundreds of rulebook thresholds for proportionate treatment, to avoid a framework that becomes progressively self-tightening as the economy grows.

2.5.2 Lessons from divergence should ultimately be brought back to Basel

A central bank official stressed that lessons from differing national implementations should feed back into Basel through ex post evaluation. Maintaining a level playing field benefits international banks by reducing costs and facilitating cross-border operations.

An industry representative observed that excessive complexity can result in banks prioritising rules over innovation. Simplification is welcome where it promotes regulatory convergence, but consistency, clarity and stability should be preserved. Rather than making repeated 'screwdriver adjustments' to the framework, the aim should be one tangible simplification that promotes convergence.

Simplifying and recalibrating the prudential framework can support EU banks' ability to finance the economy, but regulation alone does not explain the competitiveness gap. The discussion therefore also highlighted broader structural constraints, particularly fragmentation within the EU banking market and the limited integration of European capital markets.

3. Addressing the structural constraints on EU bank competitiveness

3.1 Europe's competitiveness gap is primarily driven by internal fragmentation, not Basel divergence

A central bank official commented that Basel divergence is only a real concern where EU and US banks compete directly, which represents only a limited share of business. A greater constraint is internal EU fragmentation, including restrictions on cross-border capital and liquidity mobility, missing economies of scale and insufficient proportionality for smaller banks. The capital stacking order is a high-value target for simplification where interactions between Pillars 1 and 2, macroprudential buffers, MREL and TLAC can cause double counting, misaligned incentives and limit the availability of capital buffers in stress periods. A clearer stacking order, separation of going- and gone-concern requirements and greater capital and liquidity mobility within cross-border groups could improve efficiency without weakening resilience.

The competitiveness gap cannot be explained by minimum capital requirements alone. Bundesbank analysis shows that profitability margins in US capital markets are nine to 10 times higher than in European capital markets for the same capital operation. Addressing this gap requires broader political action, including the development of deeper and more integrated EU capital markets through the Capital Markets Union (CMU) and Savings and Investments Union (SIU), rather than changes to capital requirements.

3.2 Cutting capital requirements will not address Europe's structural competitiveness gap

A regulator stated that a slow pace of implementation risks creating detrimental fragmentation. Reducing capital requirements will not materially improve European competitiveness. Tail risks have accumulated and are now higher than before the last financial crisis, making any sacrifice of resilience a mistake. There is scope for simplification without damaging the fundamental system, as illustrated by the analogy of removing barnacles from a ship's hull without damaging the hull. Simplifying the capital stack could also bring benefits, provided aggregate capital is not reduced. The US-EU competitiveness gap largely reflects structural differences. The US has had an integrated banking market since the 1980s, alongside a massive integrated capital market and a large securitisation market, notably cash rather than synthetic securitisation, as well as common laws and consumer-bankruptcy rules. Europe should similarly improve the fungibility of capital and liquidity. Reducing Europe's capital requirements in response to perceived lighter US standards would weaken resilience while failing to address the underlying source of the competitiveness gap.

3.3 Better policy coordination and resolution funding could improve EU bank competitiveness

An official agreed on the need for simplification and proportionality but highlighted two issues that had received less attention from the panel and, to some extent, in the Commission's communication. First, better coordination is needed between micro- and macroprudential policies. Microprudential responsibilities are mainly exercised at European level, while macroprudential responsibilities remain largely national. Although they pursue different objectives, both use capital requirements as an instrument. Insufficient coordination can result in excessively high average capital levels, with adverse consequences for

competitiveness. Second, although the prudential framework for large EU banks is not necessarily stricter than in the US, European resolution requirements are more stringent than those elsewhere. MREL applies to all significant banks, whereas TLAC applies only to G-SIBs. Even for G-SIBs, MREL requirements exceed TLAC by more than six percentage points of risk-weighted assets, while eligibility requirements also differ. Reducing these requirements would require more flexible access to external funds in resolution. The forthcoming review could provide scope for a compromise bringing Europe closer to other jurisdictions. More flexible access to mutualised resolution funding could also help remove ring-fencing and support a pan-European banking system.

The Chair concluded that there is no real divergence on the ultimate objectives. The Commission will reflect the views expressed in its proposals, which will represent an initial compromise, before further compromises are reached through the legislative process.

Despite differences regarding the appropriate degree of simplification and recalibration, panellists broadly agreed on the need to preserve resilience and retain the benefits of international standards while improving the efficiency of the EU framework. The discussion also suggested that strengthening EU bank competitiveness requires addressing broader structural constraints, particularly fragmentation and limited market integration, rather than focusing primarily on capital requirements or Basel divergence.