

Sector Insights

Global Securities Research

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Basel III reset reshapes bank capital rules

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Summary

Proposed Basel III changes reduce excess capital constraints across U.S. banks. Simpler rules, lower surcharges, and lighter stress tests will likely free up capital for lending and shareholder returns. We believe the result should support improved earnings potential over time, with the greatest upside for large, diversified banks, and traditional lenders.

Setting the stage: why Basel III matters now

Bank capital rules have been in flux since 2023, when regulators first proposed a more stringent version of Basel III that would have meaningfully increased capital requirements. That proposal faced significant industry pushback and was ultimately withdrawn. In March 2026, regulators including the Federal Reserve (Fed), the Office of the Comptroller of the Currency (OCC), and the Federal Deposit Insurance Corporation (FDIC) introduced a revised framework that takes a more balanced approach while still preserving safety standards and addressing concerns around excessive capital burdens and complexity.

Even ahead of implementation, our view is that the proposal is relevant today as it reduces uncertainty around future capital requirements. This allows investors to more confidently assess capital return potential and long-term profitability across the sector. Ultimately, we believe it has the potential to support improved earnings over time and represents a shift from a defensive regulatory environment to a more balanced one.

Key takeaways

Large banks should benefit from modest capital relief.

Regional banks should gain more meaningful flexibility.

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Key timeline: What investors should watch

Proposal Announcement	First half 2026 (Completed)	Establishes direction of capital reform and initial market reaction
Public Comment Period Ends	Mid-late 2026	Potential revisions based on industry feedback
Final Rule Publication	Late 2026 / Early 2027	Confirms capital requirements and removes uncertainty
Phased Implementation Begins	2027	Banks begin adjusting capital and balance sheets
First Full Stress Test Cycle Under New Rules	2027-2028	Key test of reduced volatility and capital efficiency
Full Implementation	2028-2029	Full earnings and capital return benefits realized

Sources: Federal Reserve, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Wells Fargo Investment Institute

Simpler rules improve capital flexibility

While regulators are not stepping away from safety, the new proposal eases how capital is calculated. For large banks, we believe modest increases in required capital are more than offset by reductions elsewhere. For regional and smaller banks, requirements decline more meaningfully. Compared to prior years, banks may now be required to hold less extra capital above what is truly needed, freeing balance sheets to help support growth. This should improve capacity for lending and capital return, supporting earnings over time.

One of the key attributes of the proposal is how it simplifies the calculation used by large banks to determine the appropriate level of capital. Previously, banks had to run multiple systems, often producing overlapping or inflated requirements. New features of the proposal include fewer duplicative calculations, lower compliance costs, and more predictable capital levels. For investors, this ultimately should improve visibility into earnings and reduce volatility.

Estimated change in Common Equity Tier 1 (CET1) requirement as per proposal

Bank Segment	Approximate Net Change	Primary Drivers
Large Banks, Category I and II	4.8% decrease	Lower surcharges and lighter stress testing offset modest increases from Basel rules
Regional Banks, Category III and IV	5.2% decrease	Improved lending treatment and lower risk weights
Smaller Banks	7.8% decrease	Broad-based reduction in capital requirements

Sources: Federal Reserve, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Wells Fargo Investment Institute

Improved capital efficiency for large banks

For large banks, the relief remains modest though supportive, as baseline capital requirements increase modestly (+1.4% for category I and II), but are significantly offset by lower Global Systemically Important Banks (GSIB) surcharges (-3.8%) and lighter stress-testing impacts (-2.4%). The proposed simplification replaces the complex, dual-framework approach (i.e., Standardized + advanced approaches) with a unified Expanded Risk-Based Approach (ERBA), improving risk sensitivity and reducing capital inefficiencies. Compared to the previous method, the revised framework better aligns capital requirements with underlying risk, particularly for GSIB institutions. More accurate measurement of loan and trading exposures could improve pricing competitiveness versus non-banks, supporting gradual share gains in segments like investment-grade lending and mortgages.

Another key component of the proposal is a one-time reset of the GSIB surcharge framework, lowering coefficients to help offset the buildup from years of economic growth, while introducing gross domestic product (GDP)-linked indexing (3-year nominal average) to help ensure capital requirements evolve more closely with the size of the financial system rather than rising mechanically over time. Additionally, the treatment of short-term wholesale funding has been refined to better reflect actual funding risk. Previously, the measure incorporated RWAs (Risk-Weighted Assets) in its calculation, limiting its effectiveness as a pure measure of funding risk and introducing distortions by embedding asset-risk considerations. The revised methodology removes RWAs from the calculation and focuses more directly on funding exposure, restoring its intended weighting within the GSIB surcharge framework, thereby improving transparency. As a result, the metric provides a clearer view of banks' reliance on short-term funding and supports better alignment of capital requirements with underlying funding risk.

Better fit for traditional lending banks

While large banks generally benefit from improved capital efficiency in trading and capital markets, the proposal is equally supportive of more traditional lending models. Regional and mid-sized banks would likely benefit from more favorable treatment of core lending activities, including risk weights being tied more closely to loan-to-value ratios, that would result in lower capital requirements for well-underwritten mortgages. The proposed rule changes also improve the economics for commercial and industrial loans and offer more balanced treatment of commercial real estate. All these steps should directly improve the returns on core banking businesses, which are central to regional bank profitability. Ultimately, we believe banks with disciplined underwriting are best positioned for improved returns and increased buyback capacity.

Key risks and considerations

The outlook depends on several factors that could influence the degree and timing of benefits to the sector. The proposal is still subject to revision, and the final rule could ultimately be less accommodating than currently expected. In addition, the benefits are likely to phase in over several years, suggesting that any uplift to earnings and capital return will be gradual rather than immediate. Broader economic conditions will likely also play an important role. A softer lending environment or rising credit costs could limit banks' ability to deploy newly available capital into higher-return opportunities. Finally, the impact is not expected to be uniform across the sector. Large, diversified banks appear better positioned to benefit from changes tied to trading and capital markets activity, while regional banks, although supported by improved lending economics, remain more sensitive to credit trends and interest rate dynamics. These factors reinforce that the benefits are real but are likely to unfold gradually over time.

While the reforms are directionally supportive of the sector, the ultimate market impact will depend on the pace of implementation and final adjustments to capital requirements. Investors should closely monitor key regulatory milestones and commentary from both regulators and bank management.

Key takeaway

Trading-heavy banks should benefit as lower capital requirements reduce drag on trading and derivatives, supporting greater deployment into higher-return businesses.

Where to invest

The Basel III endgame proposal represents a meaningful shift toward efficiency over excess conservatism. We favor large, diversified banks and high-quality regional lenders, though for different reasons. Large banks are generally better positioned to benefit from lower capital drag in trading and improved capital return flexibility. Regional banks can benefit from improved economics on core lending, though outcomes remain more tied to loan growth and credit conditions. We prefer institutions with disciplined underwriting and the ability to convert improved capital flexibility into consistent earnings and shareholder returns.

Financials sector equity recommendations from Global Securities Research (GSR)

Ticker	Company name	Market cap (billions)	Price	Dividend	Dividend yield	Estimated NTM EPS	NTM P/E	Core	DSIP	Growth	Focus	High Yield	SMID	Value
C	Citigroup Inc.	\$215.0	\$124.68	\$2.40	1.9%	\$11.54	10.9x					X		X
CBSH	Commerce Bancshares, Inc.	\$7.6	\$52.01	\$1.10	2.1%	\$4.21	12.3x		X					
JPM	JPMorgan Chase & Co.	\$801.9	\$296.73	\$6.00	2.0%	\$22.81	13.1x	X	X		X			X
MS	Morgan Stanley	\$318.0	\$203.79	\$4.00	2.0%	\$12.26	16.4x	X			X	X		
PNC	PNC Financial Services Group, Inc.	\$88.7	\$219.78	\$6.80	3.1%	\$19.52	11.3x				X	X		

Sources: FactSet, Wells Fargo Investment Institute. Prices and data as of May 28, 2026. NTM = next-twelve-months. EPS = earnings per share. P/E = price-to-earnings. An "X" in the Core, DSIP, Growth, Focus, High Yield, SMID, and Value columns represents the GSR List that the company is on. Please see the following page for the List Descriptions.

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The **Diversified Stock Income Plan List (DSIP List)** focuses on companies that we believe will provide consistent annual dividend growth over a long-term investment horizon. Our objective is to provide a broad list of high-quality, industry-leading, dividend-growth companies from which an investor can assemble a well-diversified portfolio. Through consistent dividend growth, our goal is to help investors stay ahead of the wealth-eroding effects of inflation.

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