

Bank of England PRA

Appendix 1: Cost benefit analysis

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Cost benefit analysis

Introduction

1. The Financial Services and Markets Act 2000 (FSMA), as amended, requires the PRA to publish a cost benefit analysis (CBA) of proposed rules. Specifically, section 138J requires the PRA to publish a CBA of proposed rules, defined as ‘an analysis of the costs, together with an analysis of the benefits that will arise if the proposed rules are made’.
2. Where it is reasonable to do so, the PRA has assessed costs and benefits associated with the proposals set out in this consultation paper (CP). As permitted under FSMA, costs and benefits have not been quantified where they cannot reasonably be or where it is not reasonably practicable to do so. In making these judgements, the PRA has considered factors including the reliability of any resulting estimates, proportionality (in relation to the costs of sourcing necessary data from firms) and the need to use its resources economically and efficiently. Where the PRA judges that such quantification would not be reasonable or practicable, the CP describes those costs and benefits qualitatively. In some cases, the CP presents quantitative facts to support the qualitative descriptions of costs and benefits.
3. The CBA analysis has been conducted in relation to the PRA’s primary objective, and secondary objectives of competition, and international competitiveness and growth.
4. The PRA has considered the costs and benefits of the proposals relative to a baseline in which the Basel 3.1 market risk framework is implemented without the proposed changes. The assessment considers impacts on firms’ capital and operational costs, incentives to adopt or expand the use of the internal model approach (IMA), and the implications for markets, firm resilience and financial stability.
5. The PRA is required to establish and maintain a Cost Benefit Analysis (CBA) Panel under section 138JA of the Financial Services and Markets Act 2000. The PRA consulted the Cost Benefit Analysis Panel on its draft CBA. The Panel considered the PRA’s draft analysis and provided valuable feedback, which is reflected in this final CBA. The core suggestions made by the panel and the PRA’s actions as a result are:
 - **Case for action** – the CBA Panel had questions around the case for action. The Panel questioned the purpose, and whether the proposed adjustments would result in the behavioural response noted in the CBA, ie increased take-up or wider application of IMA. The Panel noted that the take up of IMA is a cost-benefit decision for firms, and there will be some large firms whose decision to adopt the advanced standardised approach (ASA) will not be impacted by these proposals. The PRA agrees that only some firms will be incentivised to take up IMA even with unnecessary barriers

removed. Therefore, it has updated the case for action to make clear the evidence provided by industry associations and individual firms in both the UK and other jurisdictions supporting the assumptions on behavioural response used in the CBA. The PRA has clarified that the behavioural response is most likely to affect the largest trading firms. The PRA has also clarified that IMA adoption costs – a driver of the behavioural response of firms – are a function of both the higher modelling requirements and the historical investment by firms in market risk management. Based on the evidence, as emphasised by the CBA panel, the CBA acknowledges that there are some firms that will continue to opt for ASA, even if there are benefits for other firms from these proposals. The PRA would welcome feedback specifically on whether, based on evidence set out in the CBA, respondents agree there is a case for making the proposed adjustments to the IMA prior to its implementation.

- **Impacts of IMA adoption** – the Panel recommended that the CBA more clearly distinguish between: (i) the direct effects of the proposals on firms already intending to use IMA; and (ii) the potential effects arising from additional firms choosing to adopt IMA as a result of the proposals. The PRA has updated the section on firms' costs to reflect this recommendation, and the section on the baseline (counterfactual) to reflect expected IMA model uptake by a small number of firms.
- **International context** – the Panel recommended that the CBA provide additional context on developments in other major jurisdictions and explain more clearly how differences in implementation may generate additional costs for internationally active firms operating in global markets. The Panel was not convinced that the draft CBA they considered provided enough justification for the view that the proposals would support UK competitiveness. The PRA has included more detail on developments in other jurisdictions and ensured the CBA reflects the uncertainty around the potential effects on UK competitiveness. The PRA welcomes feedback on whether the proposals would support the level of trading and economic activity in the UK.
- **Market and macroeconomic impacts** – the Panel recommended that the CBA distinguish more clearly between the main channels through which the proposals may affect market functioning, liquidity, firms' behaviour and financial stability. The PRA has revised the relevant sections to set out these channels more clearly and has presented evidence supporting the view that reductions in capital costs may be reflected, at least in part, in outcomes for wholesale markets.
- **Competition and distributional impacts** – the Panel noted that the proposals may affect firms differently depending on their size and business model, and this could be better reflected in the assessment. The PRA has updated the CBA to reflect more explicitly the structure of wholesale markets, including evidence on competitive dynamics in derivatives markets and the transmission of regulatory costs into market pricing. The PRA has clarified that the direct effects of the proposals would be

concentrated on firms with material trading activity and sophisticated modelling capability, and that firms continuing to rely on ASA are not expected to benefit directly.

6. The PRA has clarified and expanded aspects of the analysis in the CBA in response to the CBA Panel feedback. The PRA recognises the uncertainty of several aspects of the CBA, but on balance is of the view that the conclusions of the CBA remain valid.

The case for action

7. The Basel 3.1 market risk framework was designed to strengthen the capture of market risk in firms' capital requirements and to promote the use of more risk-sensitive approaches. A new, more risk sensitive ASA is being implemented, and serves as a credible alternative to the IMA. There are also more rigorous standards for internal modelling of market risk that must be met to use the IMA. This is a response to the view that some firms were able to achieve lower more sensitive risk weights without necessarily having high modelling standards. Where firms invest to improve modelling to reach this higher standard, the new IMA allows firms to measure risk more accurately and align regulatory capital more closely with the risks from their trading activity.

8. Emerging implementation evidence however, as firms began to prepare for the introduction of the Basel 3.1 standards, suggests that some aspects of the IMA framework may be more capital intensive and operationally burdensome than originally intended. In some cases, these features may impose material compliance and operational costs that are disproportionate to their prudential benefits. This appears to have reduced the practical feasibility of IMA for some firms and negatively impacted firms' own assessments of the costs and benefits of adopting IMA.

9. Firms, both directly and via industry bodies, have made representations to the PRA on the areas of the IMA that they believe need to be changed to lower its capital impact and improve its stability and operational feasibility. In particular, responses to CP17/25, including [the International Swaps and Derivatives Association \(ISDA\) and Institute of International Finance \(IIF\) joint response](#), and [responses from the Association for Financial Markets in Europe \(AFME\) and UK Finance](#), argued for changes to IMA, as well as the importance of international consistency. Similar representations have been made to other regulators. PRA staff have maintained an ongoing dialogue with firms and other regulators on the benefits and challenges of IMA adoption faced by firms. Those discussions are reflected in the proposals.

10. Consistent with the ASA being a robust and credible alternative to the IMA, the PRA expects some reduction in firms using internal market risk models under the new framework. The ASA provides a simpler and more standardised alternative and is designed to be prudent across a wide range of firms and portfolios. However, for firms with the most material and

complex trading activities, appropriately approved internal models can provide a more granular measure of risk, better reflecting the effects of hedging and diversification, and more closely aligning risk and capital.

11. Supervisory experience and industry feedback indicates that expected IMA uptake is much more limited than originally envisaged due to the identified issues. Only a small number of the 13 firms that have existing model approval under the current market risk rules are currently pursuing IMA approval under the new rules. The remainder instead intend to use the ASA. In cases where firms intending to use the ASA have material and complex trading activities, adjustments to the IMA framework to address the issues identified can support the development of internal models meeting the higher Basel 3.1 standard, providing a more risk-sensitive capital requirement and incentivising investment in internal risk measurement and management capabilities.

12. The decision to adopt or expand IMA as a result of these proposals will nevertheless vary by firm, and the PRA does not require firms to use IMA for particular types of portfolios. The costs incurred to implement the IMA reflect the more rigorous modelling requirements introduced as part of the new framework. That cost will be greater for firms with less sophisticated existing modelling, or where their internal modelling or systems are not easily upgraded to the new requirements. Given those considerations, the PRA acknowledges that there will be some existing IMA firms whose decision to adopt ASA will not be impacted by these proposals and so would not benefit from them. However, that does not mean that some firms that were not planning to use IMA would not benefit from the changes.

13. International developments are also relevant. International consistency for cross border activities such as trading reduces costs for globally active firms. As set out at paragraph 1.8 of the CP, major jurisdictions, including the European Union and United States, are considering or pursuing targeted changes to address areas where the market risk framework may impose higher than intended capital impacts or unnecessary operational burdens. For example, several other jurisdictions have mitigated the impact of the non-modellable risk factor (NMRF) framework at least for a transitional period.

14. The developments in other jurisdictions reflect the fact that many of the issues addressed by the proposals in the CP are not unique to the UK, but are broader challenges with some aspects of the framework. Greater international alignment, where justified prudentially, may reduce avoidable compliance costs for internationally active firms. Given that many trading firms operate across jurisdictions and intermediate activities globally, differences in implementation can also affect the relative cost of conducting those activities in different locations. Each jurisdiction will implement the Basel 3.1 requirements reflecting local conditions. However, a comparatively more restrictive framework, if not justified by prudential outcomes, could adversely affect competition and the international competitiveness of the UK economy. Over time, any resulting reduction in market depth or higher intermediation costs could have implications for investment and growth.

The baseline

15. Under the existing rules to implement the new IMA, and absent the proposed changes, uptake of IMA by firms, and scope of application when applied, is expected to be very limited. Firms would instead rely to a greater extent on ASA. As set out above, a reduction in the use of IMA relative to the existing framework is expected due to the more rigorous standards in Basel 3.1, and the improved risk-sensitivity of the ASA relative to the current standardised approach. It will also reflect considerations such as each firm's historical investment in market risk management. This is part of the design of the framework. However, to the extent that firms rely on ASA in cases where internal models would otherwise be better suited to measure risk, capital requirements may be higher and/or less closely aligned to underlying risks, potentially leading to the following consequences for risk measurement, business activities and supervision:

- **Risk measurement:** Firms' internal risk management would remain based on models, while regulatory capital would be determined using a standardised measure. In practice, this could weaken the alignment between firms' risk management, pricing and capital allocation decisions. Capital requirements may be less able to reflect some portfolio-specific features, including hedging and diversification effects. The informational value of firms' disclosures for investors and other stakeholders could also reduce as a result.
- **Business activities:** Firms may adjust business practices in response to differences between standardised and modelled capital outcomes. Firms may allocate more capital and activity towards businesses that are relatively less capital intensive under the ASA, while reducing or repricing activities that are more heavily capitalised. This could reduce the range of products and hedging services available in the UK relative to today, increase costs for users, and encourage more complex booking structures or allocation of activity across entities and jurisdictions, increasing operational complexity and making risks harder to manage.
- **Supervision:** For larger, internationally active trading firms, greater reliance on the ASA would mean a larger share of trading activity would be capitalised using a more standardised and generally less risk-sensitive approach than the IMA. In such cases, the PRA may need to rely more on supervisory judgement to assess whether firm-specific risks are adequately captured within Pillar 1 capital requirements, rather than model reviews. As set out in the PRA's statement of policy 5/15 – The PRA's methodologies for setting Pillar 2 capital, where risks are not fully reflected in Pillar 1, firms must consider whether additional capital is required under Pillar 2A. In this context, increased reliance on ASA could lead to more resource from firms and supervisors focused instead on Pillar 2A to capture firm-specific risks, rather than those resources being focused on an IMA model under Pillar 1.

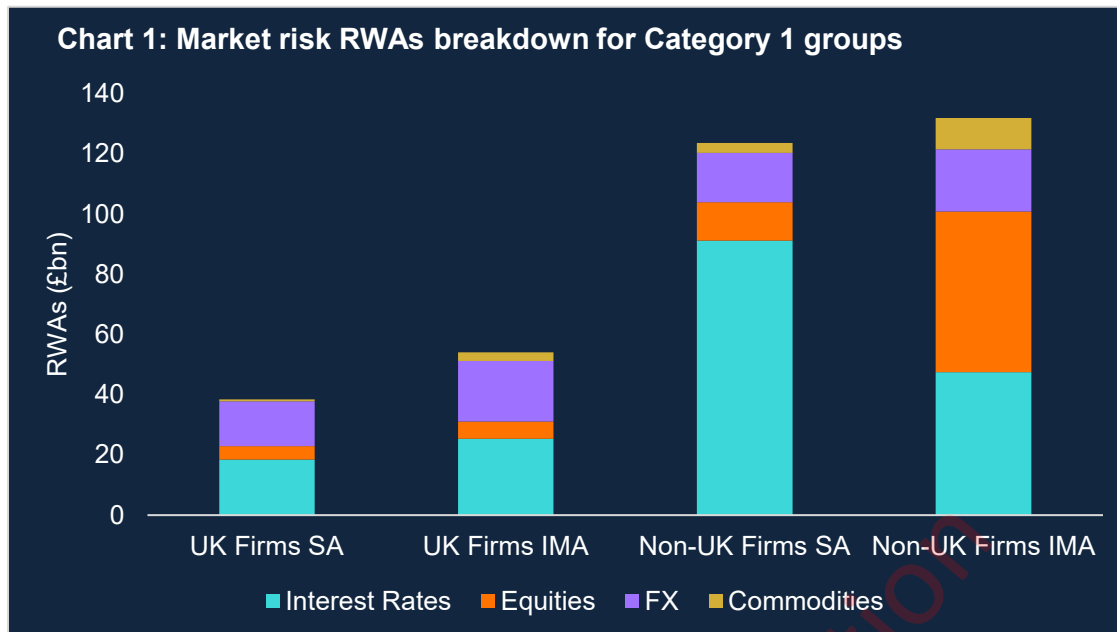
16. There may also be implications for the aggregate amount of trading activity undertaken in UK entities. Market risk rules apply to internationally active firms operating in globally competitive markets. Other major jurisdictions have proposed targeted adjustments to reduce higher than intended capital impacts or operational burdens. For example, the European Commission has proposed a range of temporary changes to the EU framework, including measures to cap the capital impact of the new framework to that calculated using today's methodologies until 2030. The US agencies published a revised Basel Endgame proposal on 19 March 2026, which included targeted permanent adjustments to reduce the capital impact and operational burden of the new IMA. These developments suggest that firms operating across jurisdictions may face differing capital and operational requirements for similar activities, which may influence business decisions.

17. Failure to address the identified issues in the PRA rules could place firms subject to those rules at a competitive disadvantage relative to those based in other major jurisdictions, including overseas firms operating in the UK through a branch. This may lead firms subject to PRA rules to reassess the provision of particular products or business lines in the UK and reduce their competitiveness in international markets. Firms with related entities outside of the scope of PRA rules could adjust booking arrangements and the location of trading activity. In turn, this could reduce the depth and liquidity of UK wholesale markets and weaken support for economic activity in the UK.

Firms and markets affected

18. The proposals primarily affect UK-authorized banks with material trading activities, in particular large and internationally active firms that operate trading desks across multiple asset classes and for which the use of internal models for market risk is a realistic option. These firms account for the majority of market risk exposure in the UK banking system. Eleven firms that undertake sales and trading activities in global capital markets generate £0.36 trillion, or more than 95% of market risk-weighted assets (RWAs) reported to the PRA. In addition, US, EU and Swiss branches generate significant market risk in the UK. As such, the direct effects of the proposals are expected to be concentrated on a relatively small number of large firms, reflecting the structure of UK trading activity.

19. Most of the business that generates market risk RWAs is done by non-UK headquartered banking groups. International firms operate through a combination of subsidiaries and branches, which may compete to intermediate similar activities from different locations. UK subsidiaries of non-UK-headquartered groups report total PRA market risk RWAs of around £250 billion compared to under £100 billion for the UK groups (Chart 1).



Source: Q4 2025 PRA regulatory returns

20. Smaller PRA firms and mutuals are not directly affected as they typically have limited trading book activity and rely on standardised approaches rather than internal models for market risk. While these firms would only benefit directly if they adopt IMA modelling, they may be affected indirectly through changes in the availability, pricing and quality of services provided by larger firms, including as customers of wholesale market services provided by other firms. Similarly, large international firms operating in the UK as a branch will, by definition, not be affected directly by these proposals. However, to the extent the proposals align with those of their home jurisdiction, this should increase competition in the UK.

21. The policies primarily affect wholesale capital markets, including fixed income, foreign exchange, equity, and derivatives markets in which PRA-regulated banks operate. In turn, wholesale markets underpin the provision of hedging instruments that are widely used by end-users across the economy. Industry evidence indicates that over 85% of large, listed companies, including a substantial majority of non-financial firms, use over-the-counter (OTC) derivatives. Such instruments are commonly used as part of routine risk management, particularly to hedge interest rate and foreign exchange risks, which together account for the majority of global OTC derivatives activity.¹ Businesses that use derivatives reduce cashflow volatility and exposure to economic risks, in turn reducing their cost of capital and increasing their investment and profitability, resulting in higher values and risk-adjusted returns.² Although based on older data, the evidence suggests that UK firms make significant use of derivatives relative to other countries.

¹ See [the ISDA uses and value of derivatives report](#) for further information.

² See, for example, [Söhnke M. Bartram, Gregory W. Brown and Jennifer S. Conrad's The Effects of Derivatives on Firms Risk and Value paper](#).

22. To the extent that the retail market for a particular product or client is competitive, cost savings due to lower capital requirements may be passed on. The PRA notes, however, that while a relatively new area of research, a number of studies have shown that although regulation may explain some pricing differences, pricing for end users is also driven by other factors, including client sophistication and rent seeking by firms.³ Where the market is less competitive, firms providing these services will have a lower cost base under the proposals, however the cost savings may not be passed on.

23. Although the savings may not be passed on fully in all cases, changes in banks' incentives or capacity to intermediate in these markets could affect the availability, pricing and liquidity of hedging services. To the extent that such services are used to manage funding costs and balance sheet risks – including for mortgage lending and other retail products – these effects could transmit indirectly to retail markets, even though those markets are not directly in scope of the proposals.

Impacts on compliance costs

24. Some proposals affect firms' compliance costs by reducing capital costs while other proposals reduce operational costs. Each of these is explored below.

Reducing capital costs

25. For firms that adopt IMA modelling as a result of these proposals, a potential benefit is lower Pillar 1 market risk capital requirements relative to the ASA. The Basel 3.1 calibration was designed such that, on average, the ASA is more conservative than internal models. Limited data suggest IMA requirements could be around two thirds of those under the ASA (prior to the proposed adjustments), although outcomes vary by firm and portfolio. For CBA purposes, the PRA has estimated the reduction in capital costs from moving from ASA to a full scope IMA approval for firms that may adopt or expand IMA usage as a result of these proposals (row 1 of the aggregate compliance costs table below, Table 2, which presents figures under different scenarios of how many firms move from ASA to IMA).

26. The proposals also reduce IMA capital requirements. In particular:

- the proposed adjustment to the non-modellable risk factor (NMRF) framework – allowing a subset of NMRFs to be incorporated within the expected shortfall (ES) model, while applying a recalibrated capital surcharge – will be more risk sensitive and reduce capital requirements, while maintaining an appropriate degree of prudential conservatism.

³ See, for example, [the IMF Working Paper on discriminatory pricing of over-the-counter derivatives](#), WP/19/100, May 2019 and [the Bank of England Staff Working Paper No. 751 on OTC premia](#).

- the proposals to extend the P&L Attribution Test (PLAT) monitoring period and adjustment the Risk Factor Eligibility Test (RFET) will also reduce the need to hold excess capital to cover potential capital volatility due to changes in the scope of model approval or application of the NMRF framework.

27. The PRA is not able to quantitatively estimate the capital impact of the proposals amending the PLAT monitoring period and RFET. However, the capital impact of the NMRF proposal can be estimated. It depends on the extent to which risk factors currently classified as NMRFs and excluded from the ES model are reclassified and incorporated into it, with a less conservative capital add-on than the current rules (Type 1 NMRFs).

28. The PRA has undertaken illustrative analysis based on available data to assess the potential impact. Given the uncertainty around the hedging benefit that reincorporating NMRFs into the ES model would provide, impacts have been assessed under a range of scenarios (Table 1). These suggest that with annual cost saving calculated with **standard cost of capital assumptions**, the following outcomes may arise:

- under conservative assumptions (low hedging benefits), capital reductions are modest and may be around 1%, equivalent to approximately £40 million;
- under central assumptions, reflecting moderate hedging effects, capital reductions are in the order of 2.5%, equivalent to approximately £80 million; and
- under more optimistic assumptions (e.g. higher hedging benefits), capital reductions could reach 4%, equivalent to approximately £130 million.

Table 1: NMRF proposals – annual cost savings

Scenario	Hedging assumption	IMA capital reduction (£m)	IMA capital reduction (% change)	Annual cost saving per firm (£m)
NMRF proposal	0%	40	1.1	1.3
	50%	80	2.5	3.0
	100%	130	4	4.7

29. These estimates are indicative and vary across firms and portfolios. For CBA purposes, as these cost reductions would apply to all firms using IMA, they are estimated for both firms that already plan to adopt IMA, and for varying levels of potential IMA adoption by more firms as a result of the proposals (row 2 of Table 2 below).

30. The PRA expects that capital reduction from the IMA-ASA diversification proposal would be time-limited as firms transition to broader IMA coverage. Actual impacts would also depend materially on firms' portfolio composition and the scope of their model permissions. The PRA has therefore not quantified the impact of this proposal.

Reducing operational costs

31. The proposals include a number of targeted adjustments intended to reduce the operational complexity associated with the IMA, particularly in areas where current requirements may impose disproportionate implementation or maintenance burden. These changes are expected to reduce both initial implementation costs and ongoing operational costs for both firms planning to use IMA, and those that may adopt IMA in the future.

32. A number of the proposed changes are expected to reduce the need for complex data sourcing, mapping and validation processes, particularly where full transparency of underlying exposures is difficult or costly to obtain. In practice, this may reduce model development and ongoing data management costs. These include:

- permitting the use of a common stress period for modellable and non-modellable risk factors calculations;
- introducing a pro-rata real price observation (RPO) requirement for new issuances;
- permitting exposures to index-tracking collective investment undertakings (CIUs) to be modelled as exposures to the underlying index, rather than requiring full look-through;
- clarifying that general interest rate risk (GIRR) internal hedges desks may use the same stress period and reduced set of risk factors as other market risk covered positions when calculating IMA; and
- allowing firms flexibility to use an alternative metric when assessing reduced sets of risk factors for ES calculations.

33. Other changes reduce the frequency and intensity of required calculations and validation processes and audit processes. This may result in lower infrastructure and operational costs, including reduced demand for data processing, storage and governance resources. This benefit may be particularly important for smaller trading desks or less complex business lines, where the fixed costs of complying with detailed modelling requirements can be a barrier to IMA adoption or expansion. In particular:

- reducing the calculation frequency for Type 2 NMRFs from daily to monthly;
- reducing the 100% look-through requirement on CIUs to 90%; and
- removing audit requirements for regulated exchanges and trading platforms.

34. The PRA has estimated the benefits of four of the more material changes described above. These are:

1. the reduction in the frequency of NMRF calculations;

2. the use of a common stress period for both modellable and non-modellable risk factors;
3. allowing index-tracking CIUs to be modelled as exposures to the underlying index; and
4. the removal of audit requirements for regulated exchanges and trading platforms.

35. The impacts were estimated using the [PRA's Standard Cost Model](#). The PRA estimates that the:

- First two (NMRF-related) changes together would result in ongoing cost savings of £200,000 to £400,000 per firm per year.
- CIU-related change is estimated to generate one-off cost savings of £20,000 to £40,000 per firm and ongoing savings of £10,000 to £40,000 per year.
- Costs associated with the removal of audit requirements for regulated exchanges and trading platforms can be applied on a per-venue basis rather than at firm level. On this basis, total savings are estimated at £10,000 to £40,000 one-off and £250,000 to £1 million on an ongoing basis, depending on assumptions regarding audit costs and the number of venues.

36. For CBA purposes, these cost reductions result from the proposals and apply to any use of the IMA. They are therefore estimated for both firms that already plan to adopt IMA, and for varying levels of potential IMA adoption by more firms (row 3 of Table 2 below). However, it is noted that these estimates are subject to a high degree of uncertainty and are based on limited information.

37. With regard to the other proposals related to operational costs, the PRA has not quantified the benefit of allowing firms to use alternatives metrics when assessing reduced sets of risk factors for ES calculations, as this is not expected to be material. The PRA also expects that clearer guidance on GIRR may reduce firms' uncertainty and associated costs; however, these effects are anticipated to be small and have not been quantified. The PRA's ability to estimate the impact of new issuances pro-rata treatment, and reduced CIU look-through requirements is limited, as impacts depend on firm-specific modelling approaches and portfolio composition. As such, the PRA has not produced a quantified estimate of the capital impact of these changes at this stage but expects them to be secondary relative to the proposals discussed in the CP.

Estimating firm impacts

38. Realisation of the above reductions in compliance costs depend on the current plans and future actions of firms. They can be separated into two groups:

- immediate reductions – ie direct reductions in capital and operational costs for firms already planning to use IMA; and

- prospective reductions – potential changes in firms’ decisions to adopt or expand the use of IMA, which in turn leads to cost reductions.

Estimating immediate reductions in operational and capital costs for firms already using, or planning to use the IMA

39. As noted above, a number of firms are in the process of seeking IMA approval under the rules finalised in PS1/26. The proposed changes will result in operational and capital cost reductions for these firms. The PRA can estimate these directly from the analysis outlined above (column 2 of Table 2). Note that the estimates do not include a reduction in capital costs as firms move from ASA to IMA, as that reduction is already assumed in the baseline for these firms. The most material change is the reduction in NMRF capital costs (£1.3 to £14.1 million), followed by operational benefits (£0.5 to £2.3 million). The analysis assumes that these firms do not adjust the scope of their model permissions as a result of the proposals. Although not separately quantified, as noted above, the proposals, including those affecting the operation of the PLAT framework, would provide additional benefits by reducing uncertainty associated with maintaining model permissions. This may reduce the need for firms to hold additional capital against the risk of losing model approval.

Estimating prospective reductions for changes in firms’ decisions to adopt IMA

40. To estimate prospective capital benefits for firms yet to adopt IMA that may move to IMA as a result of the proposals, the PRA first considers the impact of a firm fully adopting IMA on firms’ capital requirements instead of using the ASA. The median projected ASA market risk capital requirement of current (Basel 2.5) IMA firms is approximately £2.1 billion. Using the assumption that IMA capital requirements are approximately two thirds of ASA requirements highlighted above, this implies a potential reduction in capital requirements of around £0.7 billion, resulting in an annualised gross saving of approximately £19 million, based on the PRA’s standard cost of capital assumptions.⁴

41. These gross capital benefits however need to be offset against the operational costs associated with developing, maintaining and operating internal models. Large trading firms already use internal risk and pricing models, and the new requirements remain broadly aligned with the models already being used by firms. Thus, the costs would be marginal to existing internal risk management costs. But there are one-off costs for upfront investments in systems, data and infrastructure and specialist capabilities, as well as ongoing costs related to model validation, governance and maintenance. Firms would also face both one-off

⁴ These assumptions are that a £1 change in capital requirements leads to a £0.50 to £0.80 change in firms’ capital with a central estimate of £0.65; a cost of equity of 9.5% to 15.5% with a central estimate of 12.5%; a marginal cost of bank debt of 5.5%; a corporate tax rate of 25% (which reduces the net cost of bank debt by 25% to 4.1%); and a Modigliani Miller offset of 50%. For simplicity, the PRA reports only the central estimates. Using these assumptions, the calculation is $£700 \text{ million} \times 0.65 \times (12.5\% - (5.5\% \times (1-25\%))) \times 50\% = £19 \text{ million per year}$.

costs and ongoing costs associated with supervisory approval and engagement. The costs will vary by firms – firms that have more sophisticated systems and/or have recently invested in risk management upgrades may have lower IMA adoption and operational costs than those firms that have legacy systems.

42. The PRA does not have information on firms' marginal operational costs of adopting IMA, and therefore needs to make an assumption. For illustrative purposes, the PRA presents scenarios where the annualised operational costs of IMA are 80% or 90% of the benefits to capital of adopting it. Based on the estimated £19 million per year gross capital saving, this implies a net benefit, after accounting for operational costs, of between £1.9 million and £3.8 million per firm per year. These estimates are shown in columns 3 and 4 of Table 2 below for varying levels of IMA adoption by firms.

43. To estimate the potential reduction in NMRF capital costs and operational costs for firms yet to adopt IMA, the estimates calculated above are applied for varying levels of IMA adoption by firms, shown in columns 3 and 4 of Table 2.

44. Table 2, below, brings together the estimated aggregate reductions in firms' compliance costs, based on the analysis and estimates set out above. The reaction to the proposals will vary by firm, and the table below therefore provides an indication of the potential reduction in compliance costs conditional on different numbers of firms adopting IMA in response to the proposals.

Table 2: Estimated aggregate reductions in firms' compliance costs

Change	Immediate cost reduction	Prospective cost reductions	
	Status quo: 1–3 firms adopt IMA	5 firms adopt IMA	7 firms adopt IMA
	(£m per year)	(£m per year)	(£m per year)
Impact of increased IMA Adoption ⁵	NA	3.8 to 15.2	7.6 to 22.8

⁵ The lower estimates for five and seven firms assume that, absent the changes, three firms would have adopted IMA and that operational costs are 10% less than the capital benefit of adopting IMA. The upper estimates assume that, absent the changes, only one firm would have adopted IMA and that operational costs of IMA are 20% less than the capital benefit of adopting IMA. These estimates are based on the adoption of IMA for the full portfolio.

Change	Immediate cost reduction		
	Prospective cost reductions		
	Status quo: 1–3 firms adopt IMA (£m per year)	5 firms adopt IMA (£m per year)	7 firms adopt IMA (£m per year)
Impact of NMRF proposal on capital ⁶	1.3 to 14.1	6.5 to 23.5	9.1 to 32.9
Changes that impact IMA firms' operational costs	0.5 to 2.3	1.3 to 3.2	1.7 to 4.1
Total reduction in firms' compliance costs	1.8 to 16.4	11.6 to 42	18.5 to 60

Direct costs to the PRA

45. The PRA does not expect the proposals to result in a material change in its overall supervisory costs. The assessment and ongoing monitoring of internal models and firm risk management under Pillar 1 and Pillar 2A are already an established part of supervisory activity, and the proposals do not fundamentally alter the nature or scope of this work, although it may change the focus from Pillar 1 to Pillar 2A.

Impacts on firms' resilience

46. The assessment of individual policy measures and their impact on risk and firms' resilience is set out in the relevant sections of the CP. As set out, the PRA does not consider that the proposed changes weaken the overall robustness of the framework, also taking into account model approval standards and ongoing supervisory monitoring.

47. While the proposals may reduce capital requirements for some firms and portfolios, that will be because they have shown they can more accurately assess the risk of their portfolios, and capital outcomes would remain anchored to the wider prudential framework. This includes the output floor, where applicable, which limits the extent to which total capital requirements can fall relative to standardised measures. Available survey evidence suggests

⁶ These estimates are based on specific portfolios and trading activities. Actual impacts would depend on the scope of model permissions and portfolio composition. The estimate here is conservative, where firms adopt IMA fully, these impacts will likely be higher. The PRA has not included the ASA-IMA diversification change as its benefits are expected to be time-limited.

that the introduction of the Basel 3.1 market risk framework would increase overall capital requirements for UK banks by around 2% relative to pre-Basel 3.1 levels. Against this baseline, the revised framework would continue to represent an overall strengthening of market risk capital requirements.

48. Any reduction in capital is also likely to be modest relative to firms' total capital requirements and concentrated in specific elements of the framework.

49. Beyond the impact on capital requirements, wider use of IMA could support firm resilience by allowing regulatory capital requirements to better reflect underlying risks. To the extent that this improves the alignment between risk-taking and capital requirements, it could support more effective risk management and capital allocation decisions, which may in turn contribute to the stability of firms (and financial stability as a whole).

50. The proposals may also affect firms' incentives and behaviour. By reducing operational frictions and improving proportionality, they could strengthen incentives for firms with material trading activity to develop, maintain and use internal models where these can be applied robustly. This may support continued investment in risk measurement, model governance and hedging capability. More broadly, greater use of IMA may encourage firms to focus activity in areas where risks can be identified, hedged and managed more effectively, and reduce incentives to undertake activity where risks are harder to model or where capital requirements are less well aligned to underlying exposures. In cases where the ASA applies relatively high capital charges to certain products or risk profiles, firms may otherwise face weaker incentives to provide those products even where they can manage the risks prudently. A more risk-sensitive framework could therefore support a more efficient and prudent allocation of activity across products and desks. Requirements for firms to disclose information on their exposures and risk management to the market may reinforce the incentives for firms to invest in risk measurement, model governance and hedging capability and allocate capital prudently across desks.

Implications for markets, financial stability and the UK economy

51. The proposals bring a number of potential indirect impacts for markets, financial stability, and the UK economy. These include increases in supply of products to UK consumers, increases in liquidity in the UK, network effects in terms of risk management expertise clustering, and financial stability impacts, some of which were noted above as also applying at the firm level.

Firm profitability and the supply of products and services

52. As noted above, a number of firms compete in activities that generate material market risk capital requirements. These include firms whose market risk capital requirements are determined by the PRA, branches whose market risk capital requirements are set by

overseas regulators, and a number of smaller firms regulated solely by the FCA. These firms operate in competitive wholesale markets and provide trading and hedging services to a wide range of counterparties. Reduction in capital and operational costs arising from the proposals may support more efficient capital allocation. The proposals may also support the profitability of those firms that adopt IMA and their capacity to intermediate in wholesale markets. Firms whose decision to adopt ASA is not impacted by these proposals would not benefit in this way and may experience greater competitive pressure from firms that do. On the other hand, ASA firms may benefit indirectly from increased supply to the extent they are customers or counterparties of IMA firms.

53. To the extent that greater use of IMA improves the alignment between regulatory capital and underlying risks, firms' regulatory disclosures may become more informative for investors and other stakeholders.

Increased liquidity and network effects

54. In some cases, more risk-sensitive capital outcomes may affect the relative attractiveness of different trading activities and products. This may lead firms to reallocate capital towards activities where risks can be more clearly identified, hedged and managed for capital purposes. Where such changes reflect a more accurate assessment of underlying risks, they may support a more efficient allocation of activity from a prudential perspective. This could affect market depth or product availability, however, where the resulting pattern of activity better reflects underlying risks, there may be corresponding benefits for firms' resilience and for the stability of the financial system more broadly. Over time, this may also support confidence in PRA firms and wholesale markets, contributing to lower funding costs.

55. A further channel through which the proposals may affect markets relates to the potential mobility of wholesale trading activity. Evidence from supervisory engagement, firm submissions and market structure indicates that a significant share of derivatives activity is cross-border and can be booked flexibly across jurisdictions. As noted above, business is mainly conducted by international firms that have flexibility about where to conduct it. Taken together, this suggests that differences in regulatory treatment can influence where trading activity is conducted.

56. The UK accounts for a significant share of global derivatives intermediation, with activity often structured across multiple jurisdictions. This brings network effects in terms of clustering of expertise and knowledge, and provision of ancillary services in the UK. A meaningful proportion of trading activity may be sensitive to changes in relative regulatory costs, and to the introduction of new costs should UK rules be materially stricter than those of other major jurisdictions. The proposals should reduce the potential for activity to shift out of the UK and in turn reduce the potential for trading volumes and market liquidity to decline, which otherwise could increase financing and hedging costs to UK firms.

57. The PRA has not estimated the effects on the UK economy directly, because the proposals are not, by themselves, expected to be large enough to produce a measurable effect on UK-wide output. However, to illustrate the scale of activity potentially at stake, the six largest UK sales and trading subsidiaries of non-UK groups incurred £9.1 billion of staff costs in 2025. On that basis, an illustrative 10% reduction in the scale of their UK activities would imply around £910 million less in wages and bonuses paid to mainly UK-based staff.⁷ This is not an estimate of the macroeconomic effect of the proposals, but it provides an indication of the order of magnitude of activity that could be affected if business were to relocate or contract.

58. The PRA recognises that its judgement about the potential competitiveness effect of the proposals is subject to uncertainty. Given the efforts of regulators to maintain a level playing field since the publication of the Basel market risk amendment in 1996, there is limited evidence on how material differences in market risk capital requirements between the major jurisdictions would impact the location of trading activity in practice. The PRA welcomes feedback on whether the proposals would support the level of trading and economic activity in the UK.

Financial stability

59. In the shorter term, the proposals may support the UK economy by helping contain hedging and financing costs for UK firms and by mitigating adverse effects on market functioning, as discussed above. By supporting the availability and affordability of financial services used by businesses, the proposals may also help to sustain investment and risk management activity. Over the medium term, improved market functioning and resilience may contribute to the level of economic output, including through a lower risk of financial disruption.

60. As discussed above, wholesale derivatives and trading markets underpin the provision of hedging, funding and risk transfer services used by end-users across the economy. To the extent that the proposals help sustain the provision of those services from the UK, they could contribute to the scale and diversity of wholesale financial activity, including activity that facilitates investment, price discovery and the management of financial risks. By contrast, if higher relative burdens were to reduce or relocate activity, this would tend to weaken these channels, increase costs for users of these markets, and in some cases contribute to activity being conducted in less well-regulated jurisdictions or by less regulated entities, potentially increasing financial stability risks.

61. The changes could also support financial stability through their effect on firm-level resilience, as set out above. This would be expected to reduce the likelihood or severity of losses arising from market risk exposures, particularly where firms are better able to manage

⁷ PRA calculations based on regulatory returns.

risks using prudential measures that more closely reflect their underlying economic exposures.

Overall assessment

62. The PRA considers that the proposals would improve the effectiveness and proportionality of the market risk framework, while maintaining prudent standards for model approval and capitalisation. The IMA provides a more risk-sensitive measure of market risk for firms with complex, material trading activities. Certain features of the Basel 3.1 rules are unintentionally limiting the extent to which firms are investing to achieve IMA approval. The proposals would remove barriers to firms investing to adopt or expand IMA while retaining conservative treatment for risks that would be otherwise difficult to model robustly.

63. The PRA's assessment is subject to evidence gaps and uncertainties, particularly in relation to firms' future decisions to apply for IMA and the behavioural response of firms and markets. The PRA has therefore relied on assumptions to estimate potential impacts on firms' capital and compliance costs. Based on these assumptions, it is plausible that, if five firms were to fully adopt IMA based on these proposals, the annual benefits would be in the range of £11.6 million to £42 million. The PRA considers that the proposals would support firm resilience and financial stability and may reduce the likelihood of activity relocating away from the UK. While most of these effects cannot be quantified, indicative estimates suggest that a 10% reduction in activity could be associated with a reduction in UK earnings of around £0.9 billion.

64. The PRA has also considered potential costs. In principle, lower capital requirements could weaken resilience if they were not appropriately calibrated. However, the proposals retain a conservative treatment for genuinely unobservable or higher-risk exposures, remain subject to supervisory approval and ongoing monitoring, and operate within the wider prudential framework, including the output floor. In this context, the PRA does not expect any costs in terms of reduced resilience to be material.

65. On balance, the PRA considers that the expected benefits of the proposals are likely to exceed the associated costs.