

Evolution of Capital Efficiency



7TH ANNUAL CREDIT RISK MANAGEMENT FORUM

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1

Scope & Purpose (previously Executive Summary)

What is this presentation about.... And what not.

2

Basel IV Overview

Main regulatory innovations and related impacts

3

Impacts on banks

Mostly Increase Capital Requirements

4

How banks could get ready

.....or just less unready

5

Taking a broader look

Figuring out changes in market landscape

Final remarks



1

Scope & Purpose

Previously known as executive summary

- > What this presentation is about
- > and what not....



»» What is this presentation about and ...not

1 2 3 4 5

TARGET

- **Overviewing the key highlights of Basel IV requirements**
 - With a business (i.e. practitioner) approach
- **Discussing together how to figure out**
 - Potential Banks' reaction
 - Structural market changes

OUT OF
TARGET

*This presentation is neither the regulation not its summary
It is not meant to be strategic advisory but sharing of views*



2

Basel IV Overview

- Basel IV in a nutshell
- Advanced Internal Rating Models
- Standard Credit Model
- Basel IV and CRD VI / CRR3 timeline



»» Basel IV in a nutshell... or even less

OUTPUT FLOOR

RWA \geq 72.5% RWA Standardised Approach

CREDIT

Advanced IRB approach only for corporate and retail

Supplemented with floors for PD, LGD and CCF

Banks, sovereign and equity under standard approach

**TODAY
FOCUS**

OPERATIONAL

Advanced measurement Approach (AMA) replaced by a non-modeled standardized approach.

MARKET

Credit Value Adjustment to be calculated based on a standardized or a basic approach instead of internal models



Internal Rating scope only for high default portfolios

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RATING SCOPE

Restriction of Advanced IRB approach (A-IRB)

Advanced-IRB approach no longer allowed for **low- default** exposures

- banks and other financial institutions
- corporates belonging to a group with total consolidated annual revenues above €500m
- equity

Foundation – IRB approach allowed

No IRB allowed

FLOOR

Setting PD,LGD, EAD and CCF **floors** for corporate and retail

- Corporate exposures the PD floor increases to 0.05% from 0.03%
- Qualified Revolving Retail Exposures (credit cards) PD floor to 0.1%

...WITH A RELIEF

RWA calculation: removed 1.06 scaling factor

Foundation IRB: unsecured LGD lowered to 40% from 45%
(*albeit with floors for secured positions*)



Standard approach to become more risk sensitive...

1 2 3 4 5

**RESI
MORTG/
IPRE**

Risk weight depending on Loan To Value

LTV	<50%	50 - 60%	60 - 80%	80 - 90%	90 - 100%	>100%
Residential	20%	25%	30%	40%	50%	70%
IPRE	30%	35%	45%	60%	75%	105%

**CORPORATE
RATED**

AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to BB-	Below BB-
20%	50%	75%	100%	150%

**CORPORATE
UNRATED**

GENERAL CORP

Corp: 100%
SME: 85%

SPECIALISED LENDING

130% pre-operational phase project fin
100% operational phase project fin
80% operational phase (*high quality*)





... while compulsory for some asset classes

100% Equity exposed to certain legislated programmes

400% Speculative unlisted equity

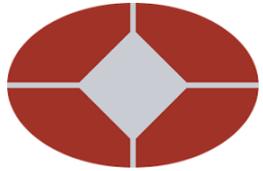
250% All other equity exposures

150% Subordinated debt and capital other than equities

EQUITY¹



»» Basel IV timeline and CRD VI / CRR3



2022



2023

TRANSITION PERIOD

2028



2025

TRANSITION PERIOD

2030



3

Impacts on Banks

- > Changes in capital requirements across geographies
- > Implied costs



» The largest impact is higher capital requirements

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Percentage Change of Tier 1 Minimum Capital requirement [%]

Bank group	Credit risk				Market risk	CVA	Op Risk	Output floor	Other Pillar 1	Total risk-based	Revised LR	Total
	SA	IRB	Sec.	CCPs								
All banks	1.2	-1.5	0.0	0.0	1.1	0.3	2.8	5.7	-0.8	8.8	-1.0	7.8
Group 1	1.2	-1.7	0.0	0.0	1.3	0.4	3.1	6.4	-0.9	9.7	-1.2	8.6
G-SIIs	1.4	-1.4	0.0	0.0	2.7	0.5	3.8	8.6	-0.5	14.8	-2.6	12.2
O-SIIs	1.0	-2.1	0.0	0.0	-0.2	0.3	2.6	5.2	-1.2	5.5	-0.1	5.5
Other	0.5	0.5	0.0	0.0	4.1	0.4	2.8	0.5	-0.7	8.0	0.0	8.0
Group 2	1.5	-0.5	0.0	0.0	0.3	0.1	0.8	2.0	-0.1	4.0	-0.3	3.6
O-SIIs	1.4	0.0	0.0	0.0	0.3	0.0	0.9	1.4	-0.2	3.7	-0.5	3.2
Other	1.6	-1.2	0.0	0.0	0.5	0.1	0.6	2.9	-0.1	4.3	0.0	4.2
Universal	1.3	-1.1	0.0	0.0	1.3	0.3	2.9	5.4	-0.8	9.2	-1.1	8.2
Retail-oriented	1.7	-0.8	0.0	0.0	-0.3	0.3	0.5	2.7	-0.3	3.7	-0.7	3.0
Corporate-oriented	-0.1	-6.5	0.0	0.0	0.2	1.1	2.6	9.7	-0.3	6.8	-0.8	6.0

Source: EBA “Basel III Reforms: Updated Impact Study” **October 2024**, based on FY23 data of 152EU banking groups



» ...that varies across bank types...

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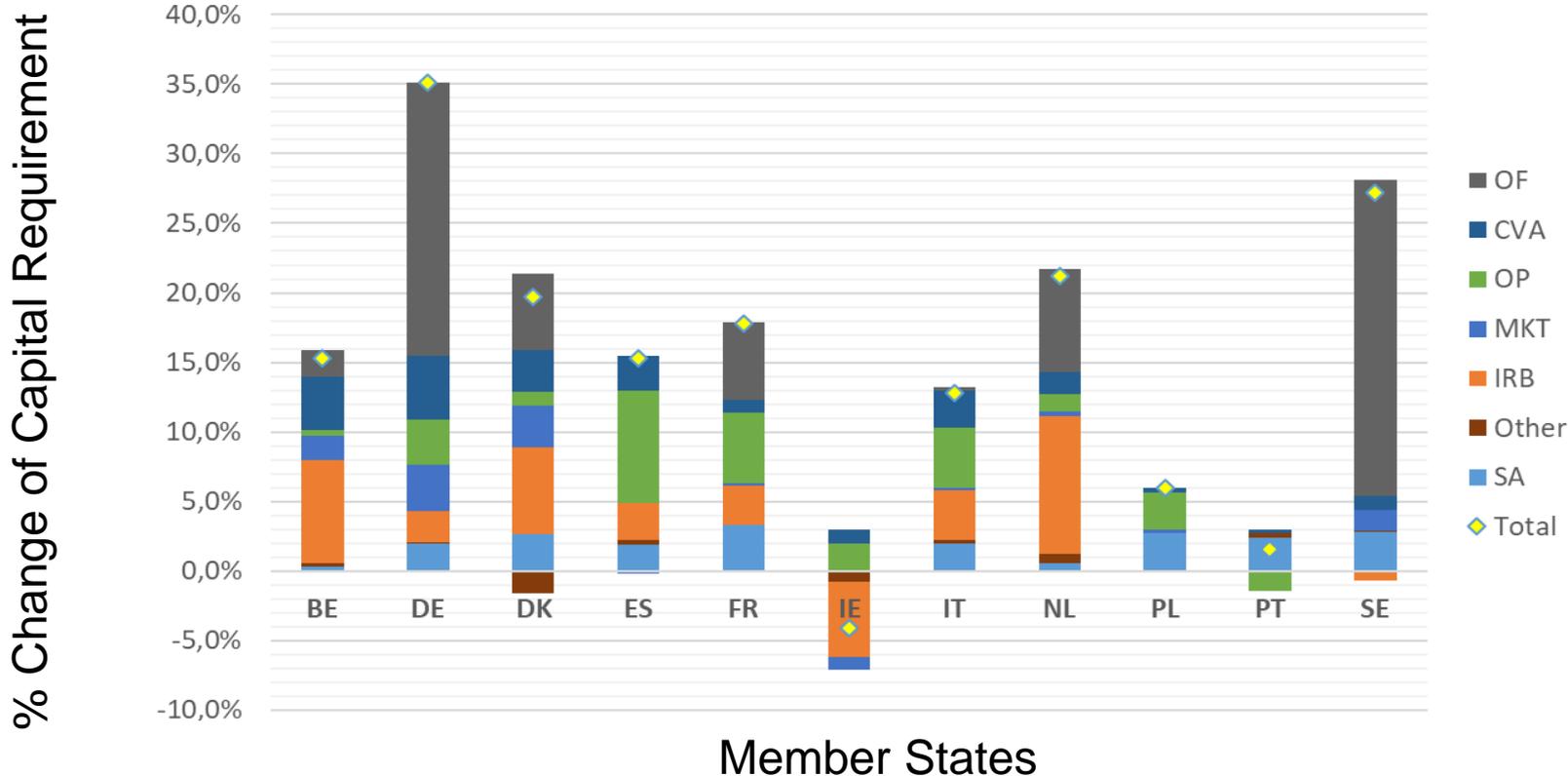
Comparison of risk-based capital ratios and leverage ratios

Bank group	CET1			Tier 1			Total capital			LR	
	CRR2/CRD5	Transitional EU-specific Basel III	Final EU-specific Basel III (2033)	CRR2/CRD5	Transitional EU-specific Basel III	Final EU-specific Basel III (2033)	CRR2/CRD5	Transitional EU-specific Basel III	Final EU-specific Basel III (2033)	CRR2/CRD5	Final EU-specific Basel III (2033)
All banks	15.9	15.3	14.5	17.2	16.6	15.7	19.7	19.1	18.0	5.8	5.8
Group 1	15.7	15.2	14.2	17.0	16.5	15.4	19.7	19.0	17.8	5.6	5.6
G-Slls	14.3	13.4	12.3	15.7	14.7	13.5	18.1	17.0	15.6	4.8	4.8
Group 2	16.6	16.2	15.9	17.8	17.4	17.0	20.0	19.5	19.1	6.5	6.5



»» ...as well as across States within EU

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» ...and across geographies

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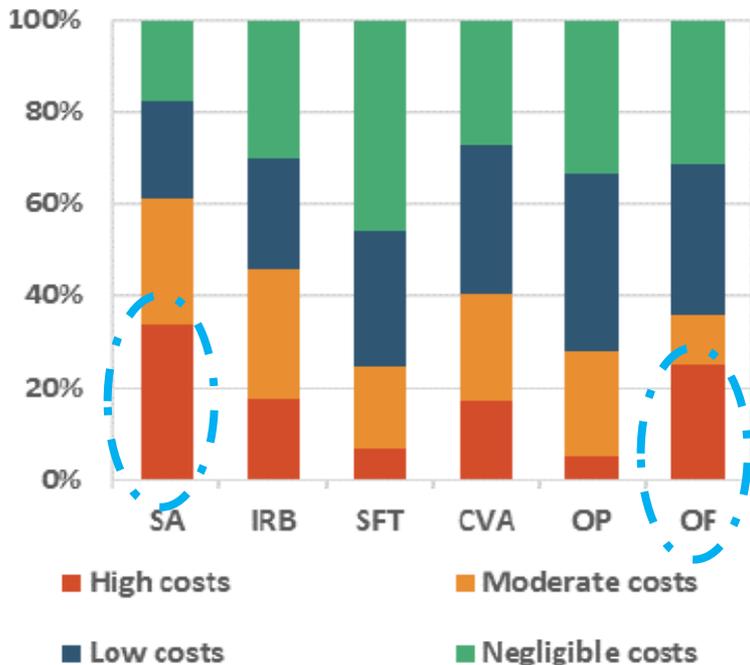
Percentage Change of Tier 1 Minimum Capital requirement [%]

	Number of banks	Total	Risk-based requirements							Leverage ratio
			Total	Of which:						
				Credit risk ¹	CVA	Market risk	Op risk ²	Output floor ³	Other Pillar 1	
Group 1 banks	112	1.3	1.0	-1.2	0.3	0.9	-0.3	1.4	0.0	0.3
Of which: Europe	41	5.0	12.8	2.1	1.7	1.4	2.7	5.3	-0.4	-7.9
Of which: AM	19	0.3	-3.2	0.5	-0.5	1.2	-1.6	-2.7	0.0	3.4
Of which: RW	52	-0.2	-3.5	-4.0	-0.1	0.4	-1.4	1.3	0.2	3.4
Of which: G-SIBs	27	0.2	-0.6	-1.1	0.3	0.8	-1.3	0.8	0.0	0.8
Group 2 banks	56	8.0	10.9	5.4	0.7	0.3	1.4	3.2	-0.1	-2.9

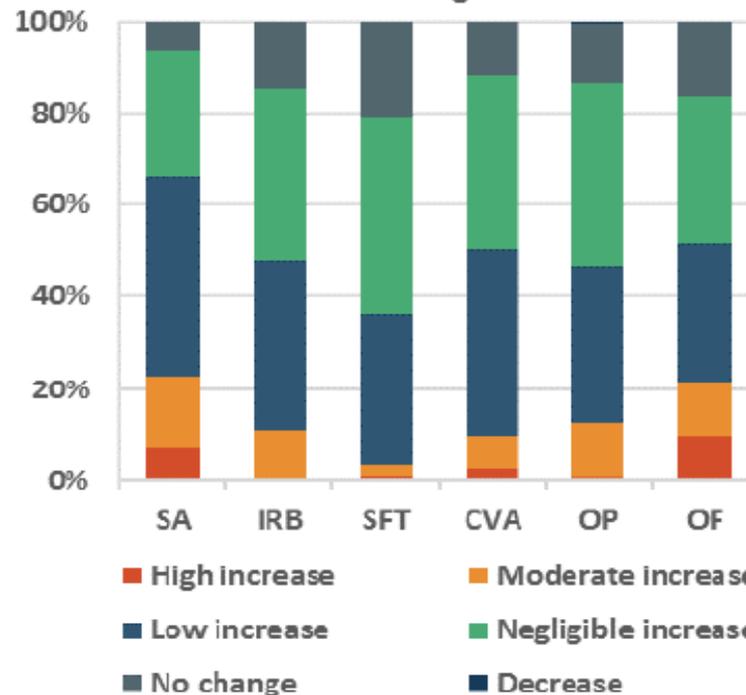
¹⁵Source: Basel Committee on Banking Supervision, Basel III monitoring exercise, October 2024, based on FY23 data of 180 banking groups

»» Basel IV implementation also implies material costs

One off costs



Recurring costs



% replies



4

How banks can get ready Or just less unready

- Review of business model
- Focus on profitable segments
- Stance on decision making process



» New regulation to trigger business model assessment

1 2 3 4 5

Reassess RWA

Calculate Capital remuneration

Rethinking business model

Focus on risk adjusted profitable segments

implementation

New rating models



Business case: new requirements for banks

SCOPE

Credit institution

Investment firms

Financial institutions¹

INTERNAL RATING

ADVANCED IRB

- **PD:** model output with floor 0.03%
- **LGD:** model output (usually 20-50%)

FOUNDATION IRB

- **PD:** model output with floor 0.05%
- **LGD:** unsecured 40%

EXTERNAL RATING

AAA to AA-	A+ to A-	BBB+ to BBB-	BB+ to B-	Below B-
20%	30%	50%	100%	150%

UNRATED

- **Quantitative Criteria:** financial soundness
- **Qualitative Criteria:** capital requirements
- **Internal Assessment.** No issue raised



Grade A	Grade B	Grade C
40%	75%	150%

»» ... leading to review of interbanking business

LENDER

Banks lending to other fin inst should

- Recalculate RWA based on the new risk weights
- Reassess the lending profitability for each product, e.g.:
 - Interbanking loan (short/medium-long)
 - bonds
- Verify if the risk adjusted profitability is adequate
- Review business strategy, e.g. shift to short term

**For some banks
risk weights
could improve**

BORROWER

Banks relying on interbank borrowing should

- Estimate their own risk weight
- Recalculate the borrowing costs of each product
- Review the funding strategy



»» Banks should take a stance on decision making processes

1 2 3 4 5

DECISION MAKING PROCESSES

Banks with IRB models have embedded them into decision making processes

- Credit underwriting
- Risk-adjusted profitability

Changes of processes

Keep PD and LGD for managerial purposes

Rely on IFRS9 parameters

Different calculation approach IFRS9- Basel
(By the way diverging trends)



»» And facing new ones



For a proper profitability assessment, it should be drilled down to customer/deal



5

Taking a broader look

Figuring out changes in market landscape



» Banks should factor in market landscape changes

1 2 3 4 5

1

NARROW INTERNAL MODEL SCOPE

Lower differences (if any) across banks on RWA for similar customers

Stronger price competition

Strengthening cross selling

Ongoing business review

2

HIGHER CAPITAL REQUIREM

Potential competitive advantage of non banking intermediaries

Lower markets shares

Reshaping business lending to such actors

Team up with fintech

Higher RWA for loans

Reduce risks

Systematic synthetic securitisations

Final Remarks

1 2 3 4 5

1

Basel IV sounds “the usual regulation” ...

2

Grasp the full range of impacts

PITFALLS

- Rely on transition period
- Fully understand all changes

- Change of capital allocation / efficiency
- Impacts on the business model

