

## European Commission Consultation on the Draft Market Risk Delegated Act

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On behalf of our members, the International Swaps and Derivatives Association ('ISDA') and the Association for Financial Markets in Europe ('AFME') welcome the opportunity to comment on the European Commission's ('EC') consultation on the draft legal text of the upcoming market risk delegated act.

We welcome the engagement with the EC and EU regulators over the implementation of the market risk standard and the commitment to ensure a level playing field and consistency in the content of the rules.

In the EU, the delegated act process has been the main tool to address FRTB implementation issues and we welcome the dual approach to introduce temporary and targeted changes and the use of a multiplier for market risk capital requirements for firms negatively impacted by FRTB implementation

There are however elements that need to be further clarified ahead of implementation, and which we have laid out below.

### **1) Trading Book/Banking Book Boundary**

The EC has specified that the multiplier is calculated using the Basel 2.5 boundary - see Article 495v (8) and recital 18. There is no explicit mention that this treatment also extends to how capital requirements are calculated, prior to the multiplier.

We note however in recital 18 that the intention is to avoid 'excessive operational complexity, including the application of multiple boundary concepts within the same institution'. Therefore, it is crucial that the implementation of the boundary is consistent to avoid unnecessary operational burden and costs for both the multiplier and the overall market risk capital requirements calculation.

In that context we very much encourage the EC to task the European Banking Authority ('EBA') to provide further clarity and to confirm its intention to continue granting relief to banks by extending the no-action letter<sup>1</sup> on the treatment of the boundary

This is particularly important to avoid additional burden in terms of how capital requirements are calculated including the output floor and operational risk<sup>2</sup>, as well as how banks should report and disclose.

In addition, banks who are not going to use the multiplier should also benefit from applying the Basel 2.5 boundary to avoid a different treatment and ensure harmonization of requirements between banks using the multiplier and those who will not. As noted in our previous response to the policy options for the market risk delegated act, banks overall remain concerned with the larger operational implementation issues associated with its application.

Article 495v (8) only refers to Article 104 but does not make any reference to reclassification (CRR 104a) and internal hedges (CRR 106). This should be further clarified.

If the CRR III interest rate risk internal risk transfer (IRT) requirements (Article 106) were to apply as of January 2027, using Basel 2.5 for Own Fund requirement, this would result in a hybrid situation where positions under the new IRT allocation would require stand-alone capitalisation. Because of the need to neutralize capital impact stemming from standalone capitalisation of IRT desk(s), this would result in additional hedging costs, which EU banks would have to pass on to their clients, making them uncompetitive. Moreover, such a hybrid outcome would introduce additional complexity for banks and supervisors and contradict the overall strive for consistency and harmonisation.

## 2) Output floor treatment, reporting and disclosure

How the boundary is defined when calculating FRTB for the output floor (OF) is not clear, and we encourage the EC and/or the EBA to specify the OF calculations in an accompanying Q&A following the adoption of the delegated act.

For a bank opting for a global multiplier, it will have to report both under Basel 2.5 and CRR3 FRTB [see Article 495v(6) in the draft delegated act legal text for reporting and Article 495v(7) for disclosure. This will add unnecessary burden.

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<sup>1</sup> <https://www.eba.europa.eu/publications-and-media/press-releases/eba-publishes-statement-confirming-its-response-new-european-commissions-delegated-act-postponing>

<sup>2</sup> This was specified in the 1<sup>st</sup> EBA clarification package following the postponement of the application of the market risk standard: <https://www.eba.europa.eu/sites/default/files/2024-08/89032d91-4cd4-47c7-9496-3954db595933/FRTB%20postponement%20-%20Technical%20issues%20and%20Supervisory%20Benchmarking.pdf>

The EC may consider ways to simplify the reporting and disclosing for banks opting for a global multiplier. by allowing banks opting for a global multiplier to comply only with the existing Basel 2.5 disclosure and reporting. Given that FRTB figures will be rescaled to Basel 2.5 figures, it makes sense to retain only the current Basel 2.5 requirements.

We understand the intention behind the use of a capital multiplier is to mitigate the impact of FRTB and align the capital impact back down to Basel 2.5 for banks negatively impacted by its implementation.

As the output floor increases during the transitional period, we believe that the EBA or EC should clarify in their guidance that the ongoing calculation for the multiplier also needs to be neutralized in such a way that it would offset the increase resulting from the output floor going up every year during the transitional period.

### **3) Structural Foreign Exchange exemption**

As per the current EBA ‘no action letters’, it should be clarified that the existing structural FX exemptions under Article 352 (2) CRR based on the current EBA Guidelines (EBA/GL/2020/09) be maintained during the transitional period.

### **4) Trading book allocation for CIUs not established/marketed in the EU**

Even under the continued application of the CRR II trading book boundary, instead of applying Article 104 CRR III, there is still another trading book issue related to CIUs that must be addressed. In contrast to the CRR II boundary, Article 325j (5) CRR III requires a banking book assignment for CIUs not complying with the conditions set out in Article 132 (3), i.e. CIUs that are not established/marketed in the EU, when calculating the FRTB market risk capital based on Article 325j (1) CRR III.

Hence for such CIUs there would still be a difference in the trading book allocation between CRR II and CRR III creating both excessive operational burden and conflicting with the intention of capital neutrality of the multiplier framework. To account for that discrepancy, it should be clarified, that Article 325j (5) does not apply during the transitional period.

**5) Inconsistency in SA DRC added hedging recognition**

There is an inconsistency between the preamble and recital (12), which references credit derivatives in the scope, and Article 495q, which refers only to equity derivatives. To account for that discrepancy, the scope of Article 495q should include credit derivatives hedged by the underlying cash instrument.

We would suggest the following amendment:

***Article 495q - Transitional provisions on the calculation of the own funds requirements for default risk under the alternative standardised approach***

By way of derogation from Article 325x(4) and until 31 December 2029, institutions may at their discretion assign:

- (a) to cash equity positions and to **cash credit positions** that hedge derivative instruments, the same maturity as the maturity of the derivative instruments they hedge;
- (b) a maturity of three months to equity derivative exposures and to **credit derivative exposures**.

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We hope you can take these elements into consideration and look forward to discussing the future permanent changes to the market risk framework in the next banking package.

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### About ISDA

Since 1985, ISDA has worked to make the global derivatives markets safer and more efficient. Today, ISDA has over 1,000 member institutions from 76 countries. These members comprise a broad range of derivatives market participants, including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure, such as exchanges, intermediaries, clearing houses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's website: [www.isda.org](http://www.isda.org). Follow us on [LinkedIn](#) and [YouTube](#).

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### About AFME

The Association for Financial Markets in Europe (AFME) represents a broad range of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks and other financial institutions. AFME advocates stable, competitive and sustainable European financial markets, that support economic growth and benefit society.