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# Prudential Regulation Authority

# Consultation Paper 17/25 – Basel 3.1: Adjustments to the market risk framework

September 2025

Industry Response

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The Prudential Regulation Authority

**Subject: Consultation Paper 17/25 – Basel 3.1: Adjustments to the market risk framework**

## Executive summary

The International Swaps and Derivatives Association ('ISDA'), the Institute of International Finance ('IIF') and our members ('the industry') welcome the opportunity to comment on the Prudential Regulation Authority's (PRA) consultation on adjustments to the market risk framework (CP 17/25). We believe the capital framework should be risk-appropriate and as consistent as possible across jurisdictions to ensure a level playing field without competitive distortions due to divergent rules. This is of particular importance for the implementation of the new Market Risk standard, the Fundamental Review of the Trading Book (FRTB).

Key jurisdictions have increasingly diverged, both in the implementation timeline and the content of the rules. The PRA has a clear means to postpone and/or adjust FRTB, which can address level playing field concerns such as delays and deviations. While some jurisdictions like Canada, Japan, China, Hong-Kong, and Singapore have proceeded with implementation, there is still uncertainty in the US on the timeline and content for implementation of the Basel III Endgame framework. Recently, the European Commission also announced it will delay implementation of the FRTB framework until 1 January 2027, citing concerns regarding the international level playing field and the impact on EU banks remaining high. As an increasing number of jurisdictions adopt the FRTB, it has become clear that the effect of the updated market risk rules is largely contingent on each bank's specific trading portfolio. Large international banks with diversified exposures are more significantly impacted, due to the limitations on portfolio diversification embedded within the FRTB framework. This underlines the importance of preserving a credible and risk-sensitive role for internal models under FRTB and where regulators should focus to address outstanding issues.

When it announced its decision at the beginning of the year to delay the implementation of the Basel 3.1 framework until 1 January 2027, the PRA stated that this was due to "the current uncertainty around the timing of implementation of the Basel 3.1 standards in the US, and taking into account competitiveness and growth considerations". Given the significant cross-border capital market activities that fall under the FRTB, divergence is a key source of concern. Additionally, certain components of the FRTB continue to pose challenges, due to significant operational complexity and excessively conservative capital requirements that do not align with the underlying economic risk. As individual jurisdictions have developed or are developing different solutions to address similar concerns with the FRTB framework, we believe that ideally this should be resolved internationally under the Basel Committee.

First and foremost, the industry unanimously recognizes that the regulatory changes proposed under the consultation are essential to address long-standing implementation issues within FRTB-SA and are a step

in the right direction. They recognise issues and concerns which the industry has consistently highlighted. However, the industry remains concerned that these proposals do not go far enough at addressing clear issues under FRTB-SA.

ISDA and IIF conducted a survey[1] to understand members' views and preferences with regards to the PRA proposals.

Our survey shows the delay for internal models approach is unanimously welcomed (14 out of 15 respondents[2]) but the industry has several issues with the approach that the PRA has taken. The FRTB-IMA delay provides time to consider changes to the framework, notably the Profit and Loss Attribution Test (PLAT) and the treatment of Non-Modellable Risk Factors (NMRFs), as well as assess any further changes in other jurisdictions. However, some members have concerns on the proposal by PRA of running in parallel FRTB-SA and the current Basel 2.5 IMA framework (this issue is considered in more detail in section **Error! Reference source not found.**). There are operational complexities related to the new trading book/banking book boundary, the uncertainty related to capital management, and level-playing field issues that still exist with FRTB-SA particularly at a time where further rule changes are expected in other jurisdictions. Importantly there are still uncertainties in the US regarding the implementation of FRTB, and the EU may introduce further changes through an additional delegated act. Mandating firms to use FRTB-SA in the UK from 2027 does not align with the PRA's stated objective in CP 17/25 to promote consistency across major jurisdictions, particularly for internationally active UK firms engaged in cross-border trading. Notably based on an ISDA paper published in 2024[3], most large international banks plan to either fully adopt FRTB-SA or apply FRTB-IMA to only part of their portfolios, transitioning the rest to FRTB-SA.

The transition of specific asset classes to FRTB-SA may impair cross-asset class hedging capabilities. FRTB-SA framework removes the diversification benefits inherent in B2.5 IMA and as a result, firms could face higher capital requirements and an increased likelihood of backtesting exceptions due to the loss of netting and hedging effects.

Furthermore, for internationally active UK firms, having different capital requirements at the consolidated group level compared to those at the local entity level—particularly in jurisdictions like the EU and the US—can create uncertainty in business decision-making. This is because the differing capital implications under each regime may lead to misalignment between group-level strategy and local entity needs.

To enable more flexibility and to address level playing field concerns, a large majority of firms (10 out of 15 respondents[4]) would favour a regulatory regime where banks could either continue to use their existing Basel 2.5 regime (both for IMA and SA) until 1 January 2028 or transition to FRTB-SA on 1 January 2027. This would mean **introducing an opt-out mechanism** for firms to defer the new trading book/ banking

[1] The survey results include responses from a total of 15 banks who are subject to UK capital requirements.
[2] These 14 banks represent 99.6% of market risk RWAs of the total market risk RWAs in the sample
[3] ISDA. *Fundamental Review of the Trading Book: IMA Adoption.* Whitepaper, July 2024. Available at: https://www.isda.org/2024/07/18/fundamental-review-of-the-trading-book-internal-models-approach-adoption/
[4] These 10 banks represent 84% of market risk RWAs of the total market risk RWAs in the sample

book boundary and FRTB-SA for up to one year, aligned with the proposed FRTB-IMA delay. We believe this option would support a more flexible and operationally sound transition while preserving regulatory integrity.

Such an approach could be accompanied by a requirement to use FRTB-SA for output floor purposes[5] and quarterly FRTB-SA reporting for the portfolio currently under the Basel 2.5 Standardised approach using existing boundary rules. This would be similar to the approach currently in force in the EU for FRTB. These proposals would reduce operational, technical, and level playing field concerns, while aligning with the spirit of Basel 3.1 implementation in the UK.

To address the operational challenges introduced by the dual regulatory regime (B2.5 IMA and FRTB-SA), we propose that the PRA adopt a flexible approach to Basel 2.5 IMA scope adjustments during the transition period - particularly for the scope involving split permissions (general and specific risks). Any approval process on Basel 2.5 IMA scope changes for scope with split permissions should remain light touch, enabling firms to manage these challenges efficiently without being burdened by extensive application procedures.

In the longer term, it is essential for the Basel Committee to thoroughly examine the inconsistencies in regulatory implementation across jurisdictions, once their final rules are set to enable the legislation to address significant divergences from Basel of relevant jurisdictions. Irrespective of the changes made under this consultation, further permanent changes are necessary.

In our response, we have laid out our recommendations and where possible quantitative analysis to support the proposals, particularly on the targeted changes proposed in the consultation document, see Table 1 below. In addition, the industry has provided further recommendations beyond the PRA's proposed changes. It is important to note that these recommendations address issues that have been consistently highlighted by the industry, and they remain critical in order to achieve better risk-sensitivity of FRTB-SA and FRTB-IMA capital metrics, reduce operational complexity of the framework, and encourage wider adoption of internal models. It is key that these adjustments are brought into the scope of the PRA's adjustments to further improve and calibrate the FRTB framework.

*Table 1 – PRA proposed adjustments with Industry recommendation response*

| | |
|---|---|
| Delay FRTB-IMA implementation to 1 January 2028 | The industry broadly supports the delay of FRTB-IMA implementation. That said, there are concerns around running FRTB-SA and Basel 2.5 in parallel including operational complexity, capital management uncertainty and level playing field issues. A large majority have indicated support for a regulatory regime where banks could either continue to use their existing Basel 2.5 regime (both for IMA and SA) until 1 January 2028 or transition to FRTB-SA on 1 January 2027. |

[5] In line with the scope of the output floor requirements in the UK detailed in point 5.25 and 5.26 of PS9/24 – Implementation of the Basel 3.1 standards near-final part 2

| | |
|---|---|
| Implement operational simplifications to the treatment of CIUs under the FRTB-SA | The industry supports the de minimis threshold for CIU trading book classification where no more than 10% of the CIU's underlying holdings would be allocated to the banking book, but opposes a rigid 90% look-through threshold, instead advocating for no threshold to apply the look-through approach (LTA) given the residual part of the fund is adequately capitalised under the fallback approach. However, further adjustments outside of these proposals are outlined in this response and are essential to ensuring that the capital treatment of CIUs remains both pragmatic and risk-aligned. |
| Introduce a permissions regime for the FRTB-SA residual risk add-on (RRAO) | The proposed permission regime for RRAO risks creating fragmentation across firms and imposing an operational burden comparable to an internal model application. This could result in uneven capital outcomes for similar exposures and add unnecessary complexity for both firms and supervisors. This also creates level playing field issues with other jurisdictions that already provide blanket exemptions; thus the current proposal does not go far enough. Exemptions for certain instruments remain the industry's preferred solution, reflecting their risk profile and hedgeability. Failing that, the regime should be clear, streamlined, and pragmatic – with simplified expectations for applications and lighter processes for minor product variations. |

# 1. PRA Proposed Adjustments to Near-Final Rules and Supervisory Statements

## 1.1. Operational Complexities of a Dual Market Risk Regulatory Regime

We welcome the opportunity to comment on the PRA's proposal regarding the continuation of the current Basel 2.5 Internal Model Approach (B2.5 IMA) in 2027, in parallel with the implementation of the FRTB Standardized Approach (FRTB-SA). While we understand the intention to support flexibility and a transitional pathway for full Basel 3.1 implementation in the UK, we need to highlight several significant operational, technical, and capital considerations for firms. These complexities make the proposed dual market risk regulatory regime difficult for firms that currently have a B2.5 IMA permission and manage complex trading book portfolios.

Running B2.5 IMA and FRTB-SA in parallel creates significant operational challenges due to the different way each framework defines the boundary between internal models and the standardised approach. Under B2.5, IMA permissions are granted along dimensions such as general/specific risk, risk type, product category, and trading location, with the remainder capitalised under the current Basel 2.5 SA (B2.5 SA). By contrast, FRTB defines the split at the trading-desk level. This misalignment means that infrastructure developed to support one framework cannot easily be adapted to support the other, requiring complex reconciliation processes and increasing the risk of double-counting capital requirements where permissions overlap (e.g., general risk on B2.5 IMA and specific risk on B2.5 SA). Additionally, the delineation of risk types as per current IMA permissions under FRTB-SA, as well as the consequences of using the Basel 3.1 Trading Book/Banking Book (TBBB) boundary alongside current B2.5 IMA remains unclear, potentially leading to inappropriate capitalization or omissions in risk capture.

We set out below some of the key complexities firms could face under the proposed dual framework:

- **Double counting of capital under split B2.5 IMA permissions:** Running B2.5 IMA and FRTB-SA concurrently introduces operational risks from segregating the scope, and risks double counting of capital – particularly for firms with partial B2.5 IMA permissions (e.g., general risk under B2.5 IMA and specific risk under B2.5 SA). FRTB-SA is not designed to capitalize specific risk alone. This issue is exacerbated for certain risk types like equities where instruments using position-specific time series can incorporate both general market risk and specific market risk, and an allocation between the two is likely to be arbitrary.

  The CP maintains the option for firms to seek permission to revoke their existing B2.5 IMA approval for a portion of the portfolio, subject to regulatory approval. However, fully transitioning specific asset classes to FRTB-SA by using such a provision, such as for equities, to FRTB-SA may impair cross-asset class hedging capabilities given the FRTB-SA framework removes the diversification benefits inherent in the B2.5 IMA. As a result, firms could face higher capital requirements and an increased likelihood of backtesting exceptions due to the loss of netting and hedging effects.

An additional example relates to securitisation instruments that are subject to mandatory FRTB-SA capitalisation under Basel 3.1, pursuant to the definition of "ineligible positions" set out in the "Applications and Definitions" section of Annex H of the PRA near-final rules. This could be interpreted that all securitisation risks must be capitalised under FRTB-SA. Such an interpretation, however, would be inconsistent with existing B2.5 IMA permissions, under which certain banks are authorised to include General Interest Rate Risk of securitisations within their B2.5 IMA, with only specific risk currently capitalised under B2.5 SA.

The consultation proposal does not provide clarity on how such circumstances are intended to be addressed, particularly in view of the fact that the FRTB-SA framework does not recognise a distinction between general and specific risk within the Sensitivity Based Measure (SBM) and the Residual Risk Add-on (RRAO); and there is a separate issuer specific 'Default Risk Charge' (DRC) capital requirement. If institutions are required to capitalise only Credit Spread Risk (CSR-Sec) and DRC under FRTB-SA, as a representative of specific risk, then it may violate the requirement to capitalise all securitisation risks under FRTB-SA. Moreover, if institutions are required to migrate the general interest rate risk of securitisations into FRTB-SA, this may result in a loss of diversification benefits for B2.5 IMA scope, as general interest rate risk is typically managed on a holistic basis for trading books.

- **Infrastructure Limitations & Operational Complexities:** Maintaining two parallel capital frameworks demands substantial investment in systems, data, and resources. This raises operational risks related to model transition, running dual business processes and regulatory reporting and requiring additional controls. For the past few years, firms have been preparing infrastructure to transition to FRTB, however such a dual stack has not been envisaged. Such a requirement would lead to disruption in now well-established transition plans. For firms intending to switch to FRTB-IMA, it implies maintaining complex infrastructure for a limited benefit during the transition period. Other firms intending to switch to FRTB-SA after the transition period would also need to maintain a parallel Basel 2.5 infrastructure for an additional year.

- **Unclear TBBB Boundary and Inconsistent Application:** The parallel use of the Basel 3.1 TBBB boundary with current B2.5 IMA adds significant complexity. Banks, having invested years in building systems for full Basel 3.1 FRTB adoption, have not planned for applying the new TBBB boundary to existing B2.5 models, which were expected to be retired. Implementing the Basel 3.1 TBBB boundary within current models demands substantial investment, gives rise to operational risk, and comes with limited benefit for a one-year transition.

  There has been insufficient industry evaluation of the risks associated with mixing old B2.5 IMA and the new TBBB boundary rules, which could conflict with ongoing B2.5 IMA permissions. This may result in trading book positions, such as unlisted equities with B2.5 IMA permissions, being reclassified to the banking book under the new boundary, disrupting macro hedges previously

recognized within B2.5 IMA. In contrast, it may result in positions being reclassified to the trading book (for example fair valued positions which are presumptively captured in the trading book under 104(6)(a) of the draft rulebook) where the scope of an IMA permission based on the B2.5 boundary is not clear, or where hedges are broken because assets are B2.5 SA and hedges are B2.5 IMA or vice versa.

It is also not clear whether the Internal Risk Transfer desk should be capitalised on a standalone basis under FRTB-SA if a firm's B2.5 IMA waiver includes interest rate risk.

- **Cross Jurisdictional Management**: Internationally active firms face challenges managing differing regulatory timelines. With FRTB going live in the EU on 1 Jan 2027 per the latest delegated act and US timelines still unclear, UK firms may need to apply multiple rule sets (Basel 2.5, Basel 3.1) for IMA and SA across entities, increasing operational inefficiencies.

- **Capital Management Uncertainty**: Firms base capital adequacy and capital management planning on expected regulatory changes. These capital plans inform business decisions. While current plans have been accounting for FRTB, the B2.5/FRTB-SA split was not anticipated. The resulting ambiguity and limitations, as elaborated in this response, would introduce capital uncertainty and volatility.

- **Governance and Control Risk:** The dual framework places additional pressure on governance and internal controls. Existing and currently planned frameworks may not be adequately equipped to manage the risks introduced.

- **Pillar 2 Charges:** The PRA's FRTB-SA proposal may allow firms to mitigate the effects of pillar 1 capitalization by allowing further offsetting of the capital being assessed under pillar 2 when deriving the pillar 2 add-on. As a result of longer liquidity horizons under FRTB-SA, higher capital charges in pillar 1 may result in lower pillar 2 capitalization. Under the CP 17/25 proposal, maintaining both frameworks complicates the ability to accurately identify the offsetting capital and potentially leads to higher pillar 2 charges.

**Industry Recommendation:**

The industry favours a regulatory regime where banks could either continue to use their existing Basel 2.5 regime (both for IMA and SA) until 1 January 2028 or transition to FRTB-SA on 1 January 2027.

Based on the current PRA proposal, this would mean introducing an opt-out mechanism for firms to defer the new trading book/ banking book boundary and FRTB-SA for up to one year, aligned with the proposed FRTB-IMA delay. We believe this option would support a more flexible and operationally sound transition while preserving regulatory integrity.

Such an approach could be accompanied by a requirement to use FRTB-SA for output floor purposes[6] . This would be similar to the approach currently in force in the EU for FRTB. These proposals would reduce operational, technical, and level playing field concerns, while aligning with the spirit of Basel 3.1 implementation in the UK.

To address the operational challenges introduced by the dual regulatory regime (B2.5 IMA and FRTB-SA), we propose that the PRA adopt a flexible approach to Basel 2.5 IMA scope adjustments during the transition period - particularly for the scope involving split permissions (general and specific risks). Any approval process on Basel 2.5 IMA scope changes for scope with split permissions should remain light touch, without needing to submit extensive applications.

[6] In line with the scope of the output floor requirements in the UK detailed in point 5.25 and 5.26 of PS9/24 – Implementation of the Basel 3.1 standards near-final part 2

## 1.2. Capitalisation of CIUs

While the industry welcomes the PRA's proposals in CP17/25, concerns remain regarding the capitalisation of CIU exposures, which are not yet fully addressed by these proposals. The industry has consistently advocated for more proportionate and operationally workable approaches to CIU capitalisation across jurisdictions[7]. The challenges which firms are currently facing continue to create undue capital impacts and operational burdens.

The PRA's proposed de minimis threshold is a welcome step toward greater pragmatism, although further refinement is needed to ensure outcomes are proportionate, risk-sensitive, and implementable. Given the dual nature of the proposal – first, to inform the trading book or banking book classification of CIU exposures, and second, to determine eligibility for the LTA – we structure our response in two parts. Although both are governed under a single threshold in the PRA proposal, the underlying objectives are fundamentally different. Applying the same quantitative threshold to both the trading book allocation of CIUs where some underlyings would be allocated to the non-trading book, and the requirement to perform a look-through, lacks a clear regulatory justification. These are distinct items with different risk and operational implications.

In the sections that follow, we first respond separately to each component of the de minimis threshold proposal. We then set out further areas where targeted adjustments are needed, along with specific industry recommendations. These refinements are essential to ensuring that the capital treatment of CIUs remains both pragmatic and risk-aligned.

### 1.2.1. Trading book classification criteria for CIUs

We welcome the PRA's efforts to clarify the treatment of CIUs under the proposed introduction of a de minimis threshold for the purpose of trading book classification. Under this approach firms must allocate CIU positions to the trading book where no more than 10% of the CIU's underlying holdings (by value) would be allocated to the banking book. However, we believe that further clarification is required on the practical application of Article 104(2)(f) and (h)[8] to ensure consistent and operationally feasible implementation.

#### *1.2.1.1. Defining fund value*

Article 104(2)(f)(i) requires institutions to demonstrate the ability to look through a percentage of the CIU's holdings measured by *"fund value"*. However, there is no clarification given on how to measure *"fund value".* The absence of a clear definition creates operational uncertainty and inconsistency in application across firms. Many funds, for example, are managed and reported using Net Asset Value

[7] ISDA. *FRTB Implementation Challenges: Capitalization of Funds.* December 2024. Available at: FRTB-Implementation-Challenges-Capitalization-of-Funds.pdf

[8] Prudential Regulation Authority. *Policy Statement PS9/24: Near-Final Market Risk Rules.* September 2024. Article 104 – "Inclusion in the trading book or non-trading book". Available at: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2024/september/ps924app2.pdf

(NAV) as the primary measure of value, which aligns with investor reporting and existing regulatory frameworks.

**Industry Recommendation:**

We recommend that the PRA confirm that the look-through threshold may be calculated based on a CIU's Net Asset Value (NAV), which is operationally aligned with how firms manage and report fund exposures. This approach is also consistent with the UK treatment of UCITS[9], where fund-level exposure limits are applied with reference to NAV.

#### *1.2.1.2. Premium listed closed-ended investment funds*

Before the transition to the Financial Conduct Authority's (FCA) UK Listed Rulebook in July 2024[10], the treatment of closed-ended investment funds with premium listings presented an ambiguity between SA/IMA rules and trading book boundary rules that risked misclassification of otherwise trading book eligible instruments. Under Articles 325az(9) and 325j(6), such funds were explicitly recognised as "equity positions" for the purposes of IMA and SA respectively. However, the trading book/banking book boundary under Article 104(2)(f) could be interpreted to require look-through or daily price and access to the mandate of CIUs, even for the premium listed closed-ended investment funds. This created a situation where a fund that is treated as equity under FRTB (SA and IMA) may nonetheless be excluded from the trading book due to the absence of look-through or access to the mandate, despite availability of daily prices, and being listed, liquid, and transparent.

More recently, the FCA has removed the term "*premium listings*" from the FCA Handbook but retained the 'closed-ended investment funds' as a separate listing category, making Article 325az(9) and 325j(6) outdated. The industry understands that this does not impact the PRA's allowance to treat closed ended investment funds as equities, and it is merely a case of rulebook misalignment with the latest FCA handbook.

Therefore, we request the PRA to clarify, either through rulebook updates or through a supervisory statement, that '*closed-ended investment funds*' listing category will replace the legacy "*premium listings*" reference within the context of FRTB. Additionally, we recommend that the PRA clarify that such funds should be eligible for trading book treatment.

[9] Financial Conduct Authority. *FCA Handbook: COLL 4.2.* May 2025. Available at: COLL 4.2 Pre-sale notifications - FCA Handbook

[10] Financial Conduct Authority. *UK Listing Rules Sourcebook.* July 2024. Available at: UKLR.pdf

**Industry Recommendation:**

We recommend that the PRA update the rulebook or provide a supervisory statement that the '*closed-ended investment funds*' listing category will replace the legacy "*premium listings*" reference within the context of FRTB. Additionally, we recommend that the PRA clarify that funds which would have previously been defined as closed-ended investment funds with premium listings, can be allocated to the trading book as they are equivalent to listed equities under article 325az(9) and 325j(6).

#### *1.2.1.3. Trading Book classification of listed CIUs*

A similar concern to those outlined in Section 1.2.1.2 arises with respect to listed CIUs. A listed CIU presents similar characteristics to listed equities in terms of being listed, liquid, and transparent instruments which are key considerations for trading book activity. Listed equities are assigned to the trading book per Article 104(6)(d), whereas listed CIUs are eligible for trading book only if they satisfy paragraphs (f) and (h) of Article 104(2). Furthermore, we note that the PRA adopted changes in its near-final rules to correctly specify that "shares or units in a CIU that is an unlisted hedge fund" must be allocated to the banking book. With this amendment, the PRA has acknowledged that listed hedge funds are eligible for the trading book, which we believe highlights that a listed instrument held with trading intent is most appropriately capitalised in the trading book.

One consequence of not allocating listed instruments held with trading intent to the trading book is that trading desks would be required to maintain both banking books and trading books for their holdings. This introduces an expensive layer of operational complexity for banks to comply with. Moreover, there are distortionary effects that come from individual transactions on such instruments becoming uneconomic, thus effectively being subject to an activity restriction.

Therefore, we recommend that the PRA clarify that such funds should be eligible for trading book treatment and consider listed CIUs as trading book instruments without requiring satisfaction of Articles 104(2) paragraphs (f) and (h).

**Industry Recommendation:**

We recommend the PRA refine the boundary to explicitly allocate listed CIUs to the trading book by amending Article 104(2) as follows:

Article 104(2)

*An institution must assign to the non-trading book instruments that are:*

*…*

*f) shares or units in an unlisted CIU, except where either:*

…

h) *derivative instruments and shares or units in an unlisted CIU that have the instruments as underlying instruments any instruments in any of points (a) to (g) as underlying instruments, provided that in the case of shares or units in an unlisted CIU, such underlying instruments in aggregate amount to more than 10% of the value of the CIU;*

#### *1.2.1.4. Daily price and access to the CIU mandate*

The requirement under Article 104(2)(f)(ii), Article 325j(1)(b) and Article 325j(5) for institutions to have access to / possess knowledge of a CIU's mandate and the CIU's reporting introduces an unnecessary operational overhead, particularly in the context of the fallback approach (FBA).

The application of a blanket conservative risk weight for SBM capitalization under the FBA is designed to be a conservative capital treatment that does not require an onboarding process for every fund traded. While access to the mandate is generally achievable, this requirement adds no meaningful risk sensitivity and instead introduces unnecessary operational complexity. Adding this operational overhead for CIU positions that may only be held for a short period or with *de minimis* net exposure, incurs unnecessary costs without providing prudential benefits.

We therefore recommend that CIU positions subject to the fallback approach should be allowed to remain in the trading book as long as firms have access to observable daily pricing based on market data (such as price volatility, liquidity, and trading volumes), meet other trading book eligibility requirements outlined in Article 104, and have the ability to trade or hedge those positions in line with their trading intent. This would ensure that the classification reflects the institution's actual risk management practices and avoids unnecessary reclassification into the banking book based solely on operational constraints.

**Industry Recommendation:**

We recommend allowing CIU positions to remain in the trading book under the FBA if daily observable pricing is available and the position is actively traded or hedged. The Near-Final rules should be amended to include the following derogation:

> *By way of derogation from Article 104(2)(f)(ii) and Article 325j(5), an institution may assign to the trading book a position in a CIU, that is held with trading intent, where the institution is able to obtain daily price quotes for the CIU and calculates the own funds requirements for market risk using the approach specified in Article 325j(1)(b)(i).*

Article 325j(1)(b) should be modified to remove the requirement to have the knowledge of the content of the mandate of the CIU where the FBA under article 325j(1)(b)(i) is applied.

Further, additional checks imposed through the cross-reference to Article 132(3) from article 325j(5), which provides granular requirements on CIU mandates and reporting to be met in order to apply any

of the trading book approaches in Article 325j(1a) or (b) shall not apply where the FBA under article 325j(1)(b)(i) is applied.

#### *1.2.1.5. Treatment of REITs / REIFs*

Real estate investment trusts (REITs) or real estate investment funds (REIFs) are designed to be liquid and give exposure to real estate without direct ownership of the real estate, therefore they should not be viewed or treated in the same way as a direct real estate holding. If REITs /REIFs are not allowed to be assigned to the trading book, it would result in a material loss of liquidity in real estate markets.

Whilst the current regulations specifically mention REITs and REIFs within Article 104(2)(c), the current drafting of (2)(h) would inadvertently capture REITs and REIFs and force them into the non-trading book if they qualify as CIUs.

**Industry Recommendation:**

We recommend permanently amending the below regulatory text as follows:

Article 104(2)

*An institution must assign to the non-trading book instruments that are:*

...

h) *derivative instruments and shares or units in a CIU that have the instruments in any of points (a) to (g) as underlying instruments, excluding shares or units in a CIU that qualifies as a Real Estate Investment Trust (REITs) or a Real Estate Investment Fund (REIFs);*

### 1.2.2. Proposed de minimis threshold to apply the look-through approach

The PRA consultation correctly notes that banks are unable to achieve perfect transparency of their CIU exposures, making it impractical to apply the LTA. The industry welcomes the permission to allocate funds to the trading book, and calculate their own funds requirements on CIU exposures, using a partial look through if they can look through some of their CIU exposures.

However, we remain concerned with the restriction to look through of at least 90% of the fund.

**Industry Recommendation:**

The industry welcomes the relief allowing CIUs to be allocated to the trading book under Article 104(2)(f)(i), and to be capitalised under Article 325j(1)(a), utilising the LTA without perfect transparency into the holdings.

However, we remain concerned that the 90% threshold for capitalisation under article 325j(1)(a) of FRTB-SA is too high. There are instances where a CIU is classified as a trading book instrument either through look-through information (considering 10% de-minimis threshold) or availability of daily prices and mandate of the funds. However, banks face operational challenges while applying LTA for capitalisation. This includes, but not limited to, availability of fund constituents but missing reference data from the fund management company (e.g. missing weights, or where underlying's name is provided but ISIN is missing); inability to price each underlying holding due to pricing limitations; or in some cases, fund management may not fully disclose underlying constituents due to confidentiality concerns, but may publish daily prices and mandate. Therefore, in principle, no threshold should be required under Article 325j(1)(a) if banks can demonstrate that the residual part of the fund is adequately capitalized – such as when the residual part is subject to the FRTB-SA fallback bucket (equity bucket 11) risk weight and a very conservative aggregation within the fallback bucket. This approach would also be more risk-sensitive than the current one, effectively treating a partially looked through fund as two sub-funds: one subject to the LTA for the fully transparent part and the other subject to the fallback approach for the non-fully transparent part[11]. An arbitrary, uniform threshold also poses the risk of funds frequently changing their capitalization method when their actual transparency rate fluctuates near the threshold, leading to large swings in RWA. Allowing banks to look through as much of the funds as is materially possible (which is their objective interest) – without a predefined threshold – would help mitigate this volatility and promote greater stability.

If the proposal to remove the threshold is not accepted, the industry suggests lowering it to 50%. This would allow banks to use the partial LTA on a broader scope.

Similarly, with respect to Article 104(2)(f)(i), there is no need to introduce a "look-through" threshold for defining boundary conditions. If a firm meets the 10% de minimis threshold outlined in Article 104(2)(h), the look-through requirement would then serve only to address operational constraints in treating CIUs in the trading book "as if held directly by the bank." Therefore, Article 104(2)(f)(i) should simply reference the "look-through" approach as defined under the trading book rules, without imposing any additional limitations in Article 104(2)(f).

### 1.2.3. Enhanced Mandate Based Approach

We welcome the improvements proposed by the PRA to help address the capitalization of CIUs, although we believe further improvements should be made to ensure that the mandate-based approach (MBA) becomes a viable alternative to the LTA. The proposed calibration remains extremely conservative and fails to consider that funds typically contain thousands of individual holdings diversified across geographies, asset classes, sectors or other attributes. Representing a diversified fund as a concentrated

[11] For example, a fund with a residual part comprising 98% – meaning almost no transparency – would be fully capitalized using a single risk weight and a conservative aggregation.

portfolio based on the lowest-quality constituents allowed by the mandate will materially misrepresent the fund's risk profile.

The idea behind the MBA is fundamentally sound. However, mandates are generally very broad in prospectuses to allow flexibility for asset managers. This is because it is impractical for managers to seek investor approval for every new investment that might fall outside of a narrower or more prescriptive mandate. Consequently, banks are unlikely to adopt the MBA in its current form as it tends to systematically overestimate risk due to the following factors:

- Regulations assume the worst-case (i.e., most risky) composition, meaning the fund must allocate positions to the maximum extent permitted by its mandate in exposures with the highest capital requirements, and then continue in descending order until the maximum loss limit is reached.
- The combination of this and the breadth of most mandates leads to a lack of realism in the assumptions banks need to make when calculating the risk weight. For example, banks might be required to assume the worst possible duration for securities in a particular sector, even if this does not align with the investment and risk profile possible for the fund, which are often subject to risk limits.
- The fund's primary strategy is described in the prospectus; given this, the MBA should be adjusted in a more economical and pragmatic way by considering this typical portfolio (rather than a worst-case scenario), as per the LTA.

Furthermore, the magnitude of the issues surrounding fund capitalization may not be fully recognized by supervisors and regulators. There is a clear disconnect between the theoretical expectations for CIU capitalization and the practical outcomes observed. This is evident from adjustments made to submitted data from 19 banks, which resulted in a capital reduction of 80% for CIUs, as noted in the EBA Basel III monitoring report[12]. A similar adjustment practice has been reported in the BIS Basel Monitoring Exercise[13], though the number of banks involved was not disclosed.

A more improved and transparent approach would involve prescribing a limited number of fund buckets specifically for CIUs, along with corresponding risk weights[14]. The enhanced MBA remains a central industry proposal that aims at fixing the issue of CIUs permanently.

**Industry Recommendation:**

We propose to enhance and simplify the MBA such that it becomes a viable alternative to capitalize CIUs. The MBA should be aligned with the LTA concept, which corresponds to the typical portfolio

[12] European Banking Authority, *Basel III Monitoring Exercise Results Based on Data as of 31 December 2023*. October 2024. https://www.eba.europa.eu/sites/default/files/2024-10/eee3e459-52f3-4fe5-a911-18f9adf1d6cb/Basel%20III%20monitoring%20Report.pdf

[13] Basel Committee on Banking Supervision, *Basel III Monitoring Report*. March 2025. https://www.bis.org/bcbs/publ/d592.pdf

[14] ISDA and SIFMA, *Basel III Endgame Addendum Comment Letter* (April 2024), https://www.isda.org/a/q8wgE/ISDA-SIFMA-Basel-III-Endgame-Comment-Letter-Addendum.pdf

strategy of the fund. The MBA can be further enhanced with new CIU buckets[15] which removes the practical difficulties of using fund mandates to derive risk weights by implementing an enhanced and transparent approach that prescribes a limited number of fund buckets specifically for CIUs, each with corresponding risk weights. This proposal would serve as a credible alternative to the LTA, offering a more capital intensive but less operationally demanding option. By specifying the risk weights and the criteria for allocating CIUs to appropriate buckets, the rules would be more practical to implement, while still allowing regulators to maintain control over risk weight calibration.

#### 1.2.4. Risk weights under the fallback approach

While still welcoming the PRA proposed amendments to the capitalization of CIUs, a further concern arises from the overly conservative risk weights of the fallback approach, which remains the only viable alternative to the LTA. CRR Article 350 already includes an MBA for CIUs. However, while the MBA remains impractical, defaulting to worst-case assumptions results in a less conservative treatment than under FRTB. For instance, under the existing Basel 2.5 SA standards:

- If a CIU is assumed to be invested in equities, the risk weight would be 8% for General Market Risk and 8% for Specific Risk, totalling 16% (as per Articles 342 and 343).
- If a CIU is assumed to be invested in credit positions, the risk weight would be 12.5% for General Interest Rate Risk and 12% for Debt Specific Risk, totalling 24.5% (as per Articles 339 and 336).

Both scenarios result in significantly lower risk weights compared to the 70% risk weight under FRTB, highlighting the excessive conservatism of the FRTB framework. Additionally, while the standardised specific risk is typically notional-based, the FRTB framework requires the calculation of sensitivity measures (e.g., interest rate- and credit spread-01 measures). This significantly increases complexity, as it necessitates the use of an internally approved valuation model.

Table 8 in Article 325ap[16] could be amended to distinguish between different risk weights within Bucket 11 ("Other sector") by introducing:

- A 70% risk weight for single equity names
- A [25% - 35%] risk weight for funds

The 25% risk weight for funds is justified by the high level of diversification typically observed in mutual funds, particularly in Undertaking for Collective Investment in Transferable Securities (UCITS), which

[15] ISDA and SIFMA, *Basel III Endgame Addendum Comment Letter*. April 2024. www.isda.org/a/q8wgE/ISDA-SIFMA-Basel-III-Endgame-Comment-Letter- Addendum.pdf

[16] Prudential Regulation Authority. *Policy Statement PS9/24: Near-Final Market Risk Rules.* September 2024. Article 325ap – "Risk weights for equity risk". Available at: https://www.bankofengland.co.uk/media/boe/files/prudential-regulation/policy-statement/2024/september/ps924app2.pdf

contrasts with the concentrated risk exposure of single equities. This recommendation remains conservative, as it is still higher than the 15% risk weight for most equity indices, in line with the 25% risk weight for certain emerging market and small-cap indices as defined in Article 325ap, higher than and the 10-20% risk weight for bond funds (e.g., HYG and LQD)[17] which can be derived by calculating a ratio of non-equity delta derived via look-through to EQ delta (fund's market value). Additionally, this adjustment would align with the upper range of the FRTB risk weight with the current PRA Rulebook's range of 16% to 24.5% as outlined above.

Alternatively, another but more conservative calibration approach would be roughly halving the 70% risk weight to 35%.

**Industry Recommendation:**

In Table 8 of Article 325ap, Bucket 11 should distinguish between the risk weights for single name equities and CIUs as follows:

| | Bucket number | Market capitalisation | Economy | Sector | Risk weight for equity spot price | Risk weight for equity repo rate |
|---|---|---|---|---|---|---|
| **Current** | 11 | ~~Other sector~~ | | | ~~70%~~ | ~~0.70%~~ |
| **Proposed** | 11[18] | Other sector – Single Equities | | | 70% | 0.70 % |
| | | Other sector – CIUs | | | 35% | 0.35 % |

### 1.2.5. Treat qualifying CIUs equivalently to existing index buckets

To recognise the diversity in risk profiles and the transparency of holdings data within the CIU market, an allowance is proposed for those CIUs that align with index risk and transparency characteristics to be treated consistently with indices. This could be achieved by introducing new criteria for CIUs that would be equivalent to the existing index criteria, such as Article 325i(2) and (3) in the Near Final rules, adjusted to reflect the specific properties and characteristics of CIUs.

[17] ISDA and SIFMA, *Basel III Endgame Addendum Comment Letter*. April 2024. www.isda.org/a/q8wgE/ISDA-SIFMA-Basel-III-Endgame-Comment-Letter- Addendum.pdf

[18] We would note that in CRR Article 325ah, the use of two risk weights within a single bucket is already implemented for CSR Bucket 8, where covered bonds are assigned risk weights of either 1.5% or 2.5%.

For CIUs, it is recommended that criteria are prescribed that if met would result in own funds requirements calculated in a manner equivalent to that of index instruments under FRTB. This would not only align CIU capital more closely with how banks manage risk and report official P&L, but also significantly reduce the computational effort and data sourcing required to apply a full LTA, allowing banks to compute a single sensitivity for a position in a CIU when calculating delta and curvature risks. Furthermore, if at least 75% of the CIU constituents fall within a single bucket, the total CIU exposure could be treated as a single-name sensitivity.

**Industry Recommendation:**

Allow CIUs that meet all of the below diversification criteria to be treated equivalently to existing Index buckets, utilising the allowance of Articles 325i(1-2).

New diversification criteria:

a) The banking organization can look through all constituents of the fund, with their respective weightings known.

b) There must be a minimum number of constituents.

c) There should be percentage limits on the concentration of fund holdings relative to a single constituent or a minimum number of constituents as a percentage of the whole fund.

d) There must be a minimum size for the fund.

Alternatively, the same index diversification criteria used in Article 325i(3) could be adopted.

### 1.2.6. Operationalisation of the capital requirements for CIU exposures under FRTB-IMA

Banks have been unable to capitalize their CIU exposures using internal models due to the stringent requirements for looking through to the individual components. The consultation partially addresses this issue by permitting banks to calculate their own funds requirements on CIU exposures under the FRTB-SA if they can look through 90% of the exposures by value (with the residual exposures being capitalized under the fall-back approach using the 70% risk weight).

We suggest that similar to the proposal for FRTB-SA, the PRA should permit banks to use this 'partial look-through approach' for FRTB-IMA. Furthermore, under FRTB-SA, banks can consider an index-based approach[19] and this same flexibility should be extended to FRTB-IMA. This would help incentivize the adoption of FRTB-IMA for portfolios containing such CIUs. Since index data is more readily available, this approach makes it easier to perform look through.

[19] Prudential Regulation Authority. *Policy Statement PS9/24: Near-Final Market Risk Rules.* September 2024. Article 325j(2) – "Treatment of Collective Investment Undertakings". Available at: Appendix 2: PRA Rulebook: CRR Firms: (CRR) Instrument [2024]

**Industry Recommendation:**

While the industry welcomes the relief provided for CIUs under FRTB-SA, we also propose applying the same partial look-through approach under FRTB-IMA, however we remain concerned with the 90% threshold currently proposed. In principle, no fixed threshold should be necessary where firms can demonstrate that the residual portion of a fund is adequately capitalised to the satisfaction of supervisors. This is particularly relevant given that the residual component would already be subject to conservative treatment under the fallback standardised approach and aggregated accordingly.

However, if the removal of the threshold is not accepted, the industry recommends lowering it to 50%. This would enable broader use of the partial look-through under FRTB-IMA, especially in cases where firms can see the material underlying exposures but are unable to fully look through a small residual portion for operational or other practical reasons.

The industry also proposes that the option under FRTB-SA to substitute a CIU tracking an index benchmark with a position in the index itself (if the annualized returns are similar) to be extended to FRTB-IMA. This would help in situations where the index can be looked through, but precise information on the CIU composition is not readily available, or where banks are unable to model each underlying constituent of the CIU.

### 1.3. Introduce a permissions regime for the FRTB-SA Residual Risk Add-On (RRAO)

The industry welcomes the PRA's proposal to introduce a permissions regime for the RRAO. This is a positive and pragmatic step that acknowledges longstanding concerns around the disproportionate capital treatment of certain products under the current framework. The ability for firms to apply for a tailored methodology where the standard RRAO charge may be excessive is an important improvement that will help reduce capital distortions for well-understood and effectively hedged instruments.

While the proposal moves in the right direction, it does not fully address broader concerns around proportional capitalisation of products and a level playing field. In particular, other jurisdictions have chosen to exempt certain instrument types from the RRAO altogether, in recognition of their hedgeability and risk profile – further detail and specific examples are set out in Sections 1.3.1, 1.3.2 and 1.3.3 of this response. The proposed UK approach, by contrast, risks fragmentation both internationally and domestically. There is a risk of inconsistent treatment across UK firms depending on whether a bank has developed the necessary methodology and internal infrastructure to obtain permission, potentially leading to uneven capital outcomes for the same or similar exposures.

In addition, the proposed permission regime risks imposing a significant operational burden that is comparable to that of an internal model application. Preparing detailed, granular methodologies, along with the appropriate level of documentation, could result in a disproportionately resource-intensive process for firms, particularly where the products in question are relatively simple or well-understood. This burden also extends to the PRA, which would need to review and assess applications in detail. To ensure the regime remains pragmatic and effective, further clarity is needed on expectations regarding the content and level of granularity required in applications. Moreover, where a firm has already received permission for a given product, minor variations such as closely related instruments using the same underlying methodology, should be subject to a notification process, rather than full pre-approval. This would reduce unnecessary friction and ensure the regime remains operationally viable, without compromising supervisory oversight.

Finally, and more broadly, it is important to note that the proposed permission regime does not address the absence of a hedge exemption in the current UK RRAO framework, this is taken into account in other jurisdictions[20]. Where well-constructed hedges materially reduce or eliminate residual risk, firms should not be penalised through higher capital charges. For further discussion of this issue, including industry views on how a hedge exemption could be appropriately applied, see Section 1.3.5.

[20] European Commission. *Regulation (EU) No 575/2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms*, consolidated version as of 9 July 2024, Article 325u(4)(c) – "Own funds requirements for residual risks." Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:02013R0575-20240709

**Industry Recommendation:**

To support a proportionate and effective implementation of the PRA's proposed RRAO permission regime, the industry recommends two key changes.

First, the industry continues to advocate for product-level blanket exemptions for certain well-understood and effectively hedged instruments, such as CMS spread options and dividend derivatives, in addition to excluding instruments with future realised volatility underlyings, such as volatility swaps, from the definition of exotic underlyings. Such exemptions would align the UK regime with international peers, promote a level playing field, and reduce disproportionate capital requirements that do not accurately reflect the underlying economic risk. Further detail and specific examples are set out in Sections 1.3.1, 1.3.2 and 1.3.3 of this response.

Second, in the event that blanket exemptions are not taken forward, the proposed permission regime should be implemented in a manner that is considerably less operationally burdensome than an internal model application. The process should be proportionate and transparent. Furthermore, where a firm has already obtained permission for a particular product, subsequent applications involving minor variations, such as closely related instruments using the same underlying methodology, should be subject to a notification process, rather than full pre-approval.

Finally, the industry requests clarification that the applications to use the RRAO permission regime can be made on an ongoing basis, as and when Banks trade new products or increase exposure to existing products, rather than making all applications before the proposed go-live date. This approach will enable banks to evaluate the RRAO on an ongoing basis and apply for products only when they are material to the bank's own funds requirements.

In the following sections, we propose alternative measures for product-level exemptions for certain well-understood and effectively hedged instruments to be introduced as per the recommendation above.

### 1.3.1. Treatment of CMS Spread Options under the RRAO framework

The industry remains concerned about the excessive RRAO charges applied to spread options, particularly Constant Maturity Swap (CMS) spread options[21]. These should be excluded from RRAO, as banks can effectively hedge them in the market.

Spread options have simple payoffs based on the spread between two maturity points on the same underlying yield curve, which is both observable and liquid. Additionally, interest rate yield curve options serve as critical hedging tools for clients such as pension funds, life insurers, corporates, and asset

[21] ISDA and AFME. *Response to the PRA CP16/22 – Implementation of the Basel 3.1 Standards*. March 2023. Available at ISDA-Responds-to-PRA-Consultation-on-Basel-3.1-Implementation.pdf

managers. Banks trade CMS spread options as part of a strategy when they offer these options to clients while simultaneously hedging their exposures using other CMS spread options. Due to the nature of these products, a perfect offset of market risk is not feasible in practice, as small and second order risk mismatches are unavoidable. Therefore, banks cannot practically apply the derogatory treatment under Article 325u(4a)[22]. This approach is not only overly conservative, but it also creates a cliff effect for very small second order risk mismatches regardless of whether a perfect hedge is practically achievable. Therefore, imposing RRAO charges on these instruments could significantly increase hedging costs for these end-users.

It is also worth mentioning that the US NPR[23] already exempts all spread option trades, including client trades. This exemption is based on the recognition that the RRAO charge is disproportionately high relative to the actual risk, which is already captured in SBM. Whilst the UK could allow for these exemptions, regulatory approval is required.

**Industry Recommendation:**

We recommend that options without path-dependent payoffs or with two or fewer underlyings be excluded from RRAO. Additionally, we urge clarification that simple CMS spread options should be classified as vanilla instruments and therefore fall outside the scope of RRAO. Exempting these instruments would prevent disproportionately high RRAO charges on hedged positions, which can significantly exceed the much lower RRAO charge applied to unhedged positions. This misalignment may discourage prudent risk management and negatively impact end-users who rely on these products for hedging.

We recommend amending the Near Final rules Article 325u(4) to include the following new paragraph (c).

Article 325u(4)[24]

*By way of derogation from paragraph 1, an institution shall not apply the own funds requirement for other residual risks, as determined in accordance with point (b) of paragraph 2 above, to an instrument that meets any of the following conditions:*

[22] Prudential Regulation Authority. *Policy Statement PS9/24: Near-Final Market Risk Rules.* September 2024. Article 325u – "Own funds requirements for residual risks". Available at: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2024/september/ps924app2.pdf

[23] Board of Governors of the Federal Reserve System, Office of the Comptroller of the Currency, and Federal Deposit Insurance Corporation. *Regulatory Capital Rule: Large Banking Organizations and Banking Organizations with Significant Trading Activity*. Federal Register 88, no. 179 (September 18, 2023). https://www.federalregister.gov/documents/2023/09/18/2023-19200/regulatory-capital-rule-large-banking-organizations-and-banking-organizations-with-significant#h-192

[24] Prudential Regulation Authority. *Policy Statement PS9/24: Near-Final Market Risk Rules.* September 2024. Article 325u – "Own funds requirements for residual risks". Available at: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2024/september/ps924app2.pdf

*(a) the instrument is listed on a recognised exchange; or*

*(b) the instrument is eligible for central clearing in accordance with Regulation (EU) No 648/2012; or*

*(c) instruments that are options without path dependent payoffs or with two or fewer underlyings (for example CMS spread options)*

### 1.3.2. Treatment of dividend derivates under the RRAO framework

The RRAO is designed to offer a simple and conservative capital treatment for any risks that are not covered by the SBM/DRC. The industry would like to raise a concern regarding the treatment of dividend derivatives under the RRAO.

The Near-Final rules does not explicitly include dividend underlyings within the scope exotic underlyings. Additionally, Article 325u(7)(d)[25] states that "dividend risk arising from instruments where the underlying is not solely of dividend payments" should not result in the instrument being classified as bearing other residual risks under CRR Article 325u(2)(b). As a result, the regulatory text suggests that it is not included in the list of exotic underlyings, consistent with the Basel framework.

In the preamble to the US NPR, the US Agencies confirm that dividend risk should not be subject to RRAO, as material risks are adequately captured under other aspects of the proposed market risk framework (see point H(7) – c(ii) excluded positions by Federal register)26.

Furthermore, CRR Article 325v(2) stipulates that "own funds requirements for the default risk shall apply to debt and equity instruments, to derivative instruments having those instruments as underlyings and to derivatives, the pay-offs or fair values of which are affected by the default of an obligor other than the counterparty to the derivative instrument itself". This implies that derivatives with dividend underlyings should fall under the scope of own funds requirements for DRC.

Since dividend underlyings will be captured in the DRC, they cannot, by definition, be classified as "exotic underlying" under CRR Article 325u(2)(a), which defines exotic underlying instruments as a "trading book instrument referencing an underlying exposure that is not in the scope of the delta, vega or curvature risk treatments under the sensitivities-based method laid down in Section 2 or the own funds requirements for the default risk set out in Section 5".

[25] Prudential Regulation Authority. *Policy Statement PS9/24: Near-Final Market Risk Rules.* September 2024. Article 325u – "Own funds requirements for residual risks". Available at: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2024/september/ps924app2.pdf

[26] Board of Governors of the Federal Reserve System, Office of the Comptroller of the Currency, and Federal Deposit Insurance Corporation. *Regulatory Capital Rule: Large Banking Organizations and Banking Organizations with Significant Trading Activity*. Federal Register 88, no. 179 (September 18, 2023). https://www.federalregister.gov/documents/2023/09/18/2023-19200/regulatory-capital-rule-large-banking-organizations-and-banking-organizations-with-significant#h-192

Additionally, we note that pricing models for dividend derivatives contribute to both SBM (Equity/Rates) and DRC charges. It is possible to model instruments with dividend underlyings in such a way that they generate equity sensitivities, which are captured in delta/vega/curvature and DRC calculations, further reinforcing the point that they do not meet the criteria outlined in CRR Article 325u(2)(a). Thus, dividend risk and other market risks from dividend derivatives are treated similarly to any other equity instrument (e.g., futures, forwards, vanilla options). Additionally, dividend risk is managed (i.e., hedged) across all instruments and should not be capitalized on a gross basis. It is also worth noting that some dividend derivatives are currently traded on exchanges, enhancing liquidity and pricing transparency.

**Industry Recommendation:**

To maintain a level playing field, we propose that dividend derivatives be explicitly exempted, aligning with the treatment in the United States, where NPR does not subject instruments with dividend risk to the RRAO.

### 1.3.3. Treatment of instruments with future realised volatility underlyings under the RRAO framework

The current UK implementation of the RRAO, as outlined in Article 325u(5)[27] of the Near-Final rules, classifies instruments referencing future realised volatility (such as volatility swaps) as having exotic underlyings. This results in these products being subject to punitive capital requirements. The industry believes this categorisation is inappropriate and not risk-sensitive.

Unlike implied volatility, which is derived from option prices and inherently model-dependent, realised volatility is an observable metric derived from the behaviour of the underlying asset. As such, the risk of instruments referencing realised volatility can be effectively hedged using standard tools available in the market. These hedges are already captured within the SBM and DRC components of the FRTB framework, meaning the risk is not residual in the intended sense of the RRAO.

Moreover, other jurisdictions have recognised the hedgeability of such products. For example, in its consultation on the FRTB Delegated Act[28], the European Commission proposed applying a zero multiplier to RRAO capital requirements for instruments referencing future realised volatility. Similarly, the draft US NPR does not classify instruments with future realised volatility underlyings as exotic underlying for RRAO. These approaches reflect a more proportionate treatment, grounded in the actual risk characteristics of these instruments.

[27] Prudential Regulation Authority. *Policy Statement PS9/24: Near-Final Market Risk Rules.* September 2024. Article 325u – "Own funds requirements for residual risks". Available at: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2024/september/ps924app2.pdf

[28] European Commission. *Targeted Consultation on the Application of the Market Risk Prudential Framework in 2025*. March 2025. Available at: https://finance.ec.europa.eu/regulation-and-supervision/consultations-0/targeted-consultation-application-market-risk-prudential-framework-2025_en.

**Industry Recommendation:**

To promote consistency across jurisdictions and ensure the UK framework remains proportionate and risk-sensitive, we recommend that instruments with future realised volatility underlying, such as volatility swaps, be explicitly excluded from the definition of exotic underlyings within the RRAO. This could be achieved by amending Article 325u(5) of the Near-Final rules as follows:

Article 325u(5)

*For the purposes of point (a) in paragraph 2, an exotic underlying shall include, without limitation, the following underlyings:*

*a) longevity;*
*b) weather; and*
*c) natural disasters; ~~and~~*
*~~d) future realised volatility~~*

### 1.3.4. Clarification on perfectly offsetting trades subject to the RRAO

The industry seeks more clarity on the identification of perfectly offsetting positions. Article 325u(4a)[29] allows RRAO exemption for instruments that perfectly offset the market risk. It is understood that a position can comprise of more than one trade. In this context, these positions would have the same economic parameters which generate offsetting market risks but could differ in their notionals.

As per the rule, it is understood that offsetting instruments/positions must eliminate intrinsic market risks of the payoff. Other risks may originate at transaction level, for example from differences in discounting due to different counterparty collateral agreements/counterparty spreads but these should not affect the RRAO exemption.

In practice, banks will offer different prices to different counterparties for the same instrument (same payoff, strikes, barriers, optionality, exotic features, maturity, underlying). The industry believes that this provision should be explicitly clarified as not being restricted to one-to-one trades but allowed for a set of trades/positions sharing the same payoff, including payoff features like strikes, barriers, optionality, exotic features, maturity etc. The risk profile of offsetting positions should be directly proportional to the notional (i.e., a trade with twice the notional size will have double the risk). In many cases, banks will take on a large trade and offset it in the market with trades of smaller size. As long as the offsetting trades are on the same instrument, banks should be allowed to partially offset the notional for RRAO purposes.

[29] Prudential Regulation Authority. *Policy Statement PS9/24: Near-Final Market Risk Rules.* September 2024. Article 325u – "Own funds requirements for residual risks". Available at: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2024/september/ps924app2.pdf

To explain further our request for clarification, we would like to distinguish between the following cases:

- **A Fully perfect offset case** is where we only have two trades where the market risk completely offsets and there is no residual risk left on the books. Both trades share the same payoff, strikes, barriers, optionality, exotic features, maturity, underlying and same notional.
- **A Partial perfect offset case** is where we have a selection of transactions that are sharing the same payoff features, with fully offsetting sources of market risks subject to RRAO, but not notional. They could be further divided into two cases:
    a. The total notional of the short and long transactions is matched, resulting in zero market risk.
    b. The total notional is not matched, resulting in some residual market risk. In this case, the portion of the notional that is matched is not different to a) above. While the remaining unmatched notional is subject to RRAO (and delta/vega/curvature/DRC) as per any other position on the book.

**Industry Recommendation:**

The industry requests clarification on its understanding that Article 325u(4a) allows the calculation of RRAO on a consolidated basis for positions having the same payoff and associated features which fully offset sources in scope of RRAO ("residual risks"), but not notional.

We recommend amending the Near Final rules Article 325u(4a) to explicitly clarify that the rule does not intend to penalize the current market practice of hedging a position with multiple trades on the same instrument:

Article 325u(4a)[30]

*By way of derogation from paragraph 1, an institution shall not apply the own funds requirement for residual risks, as determined in accordance with points (a) and (b) of paragraph 2 above, to an instrument or position where the instrument perfectly offsets the market risks of another position in the trading book, i.e. they have the exact same payoff features exposed to the same "residual risks", provided that such position is with a third party. Where the market risk is perfectly offset on a portion of the trade due to a mismatch in the notional alone, the amount subject to the own funds requirement for residual risks shall be the net notional position of the matching trading book positions*

[30] Prudential Regulation Authority. *Policy Statement PS9/24: Near-Final Market Risk Rules*. September 2024. Article 325u – "Own funds requirements for residual risks". Available at: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2024/september/ps924app2.pdf

### 1.3.5. Clarification on identification and exemption of hedges from RRAO

Whilst the industry supports the principles underpinning Article 325u, it believes that the risk reducing effects of hedges is not sufficiently recognised as it is in other jurisdictions[3132]. If the residual risk of a set of instruments in the trading book can be unambiguously removed by another set of instruments such that the combined position would not be subject to RRAO, then all the underlying instruments should be exempt from RRAO. Here, the two sets of instruments need not have exactly matching economic parameters (same payoff, strikes, barriers, optionality, exotic features, maturity, or underlying), but the combined payoff could still be replicated by vanilla instruments and hence would not be subject to RRAO.

As an example, a bond with payoff contingent on longevity could be hedged with a longevity swap hedging only the longevity risk, essentially compressing the combined position to a vanilla bond with no residual features. This treatment is consistent with sound risk management practices, where banks would typically hedge the more esoteric residual risks while actively managing market risks. As such, they should not be penalised for hedging.

The industry also recognises that there could be cases where the residual risk is not fully offset but is partially hedged – thus reducing the residual risk. Banks should still be allowed to take the benefit of these hedges by removing them as well as the corresponding portion of the notional of the original position from the RRAO.

**Industry Recommendation:**

Provide an allowance in Article 325u such that the risk reducing effects of hedges to residual risk are more effectively recognised.

Article 325u

*By way of derogation from paragraph 1, for positions in the trading book whose residual risk is either fully or partially offset by hedging instruments, the own funds requirements for residual risk would be applied subject to the below conditions:*

*(i)* *When the residual risks of positions in the trading book are completely offset by a set of hedging instruments, institutions shall not apply the own funds requirement for residual risks of these positions as well as the hedging instruments.*

*(ii)* *If the hedging instruments reduce, but do not completely offset, the residual risks of the original trading book positions, institutions may apply the own funds requirement*

[31]European Commission. *Regulation (EU) No 575/2013 of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms*, consolidated version as of 9 July 2024, Article 325u(4a) – " Own funds requirements for residual risks." Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:02013R0575-20240709

[32]European Banking Authority. *Draft RTS on the exemption from the RRAO own funds requirements for certain type of hedges under Article 325u(4a)*. December 2024. Final draft RTS on RRAO hedges.pdf

*only to the unhedged portion of the combined notional value of these positions and the hedging instruments.*

*The PRA shall grant permission to apply the treatment referred to in the first subparagraph if the institution can demonstrate on an ongoing basis to the satisfaction of the PRA that the instruments comply with the criteria to be treated as having hedging positions.*

*The institution shall report to the PRA the result of the calculation of the own funds requirements for the residual risks for all instruments for which the derogation referred to in the first subparagraph is applied.*

# 2. Industry Proposed Adjustments to Near-Final Rules and Supervisory Statements Under Advanced Standardised Approach (ASA)

## 2.1. Adjustment factor for own funds requirements under the ASA

In general, the SBM would strengthen the market risk capital framework by introducing a standardized approach to market risk within the UK banking capital framework, serving as a credible alternative to the internal models approach.

We believe that certain aspects of the SBM framework should be improved to better recognise diversification and align market risk capital requirements with common risk management practices.

To facilitate a robust assessment of diversification effects across asset classes that leverages data, we propose a concept previously submitted in response to the US NPR[33] and in response to a similar proposal[34] from the EC in their recent consultation on market risk[35]. The industry recommended incorporating a correlation parameter across risk classes within SBM, in accordance with the following formula:

$$capital\ requirement = \sqrt{\sum_b SBM_b^2 \ + \sum_b \sum_{c \neq b} \rho_{bc} SBM_b SBM_c} + DRC + RRAO$$

Under this formulation, $SBM_b$ would represent the risk class-level capital requirement for each risk class under SBM; $\rho_{bc}$ would represent a new inter-asset class correlation parameter or parameter set ('Rho Parameter').

The industry response to the US NPR advocated for the introduction of a rho parameter of 0.5, which led to an approximate reduction of 20% in SBM capital (or 10% in FRTB-SA capital). However, historical industry correlation[36] analysis across asset classes indicates that this rho value is an overestimation. As shown in Figure 1 and Figure 2, a rho of 0.5 is unnecessarily conservative, with correlations distributed around 0% and with respect to the tail scenario of actual realised correlations.

This is further demonstrated by Figure 3 and Figure 4, which illustrate that even during periods of market stress since 2008, correlation levels have remained stable without significant spikes. Correlations are

[33] ISDA and SIFMA. *Response to US Basel III NPR*. January 2024. https://www.isda.org/a/1ElgE/ISDA-and-SIFMA-Response-to-US-Basel-III-NPR.pdf

[34] ISDA and IIF. *Response to the European Commission's Consultation on the Market Risk Prudential Framework*. April 2025. https://www.isda.org/a/vgfgE/ISDA-IIF-Response-to-ECs-Consultation-on-the-Market-Risk-Prudential-Framework.pdf

[35] European Commission. *Targeted Consultation on the Application of the Market Risk Prudential Framework — 2025*. March 2025. https://finance.ec.europa.eu/regulation-and-supervision/consultations-0/targeted-consultation-application-market-risk-prudential-framework-2025_en.

[36] As the focus is correlation, historical VaR data from the industry can be used as a suitable proxy for SBM to back out the rho correlation parameter introduced. Data is obtained from public disclosures of EU & US banks' historical VaR figures from Q2 2008 to Q4 2024.

distributed around 0%. An extreme assumption – such as using the 99.9th percentile of the distribution – would correspond to calibrating rho at 30%, which is equivalent to an SBM multiplier of 0.7.

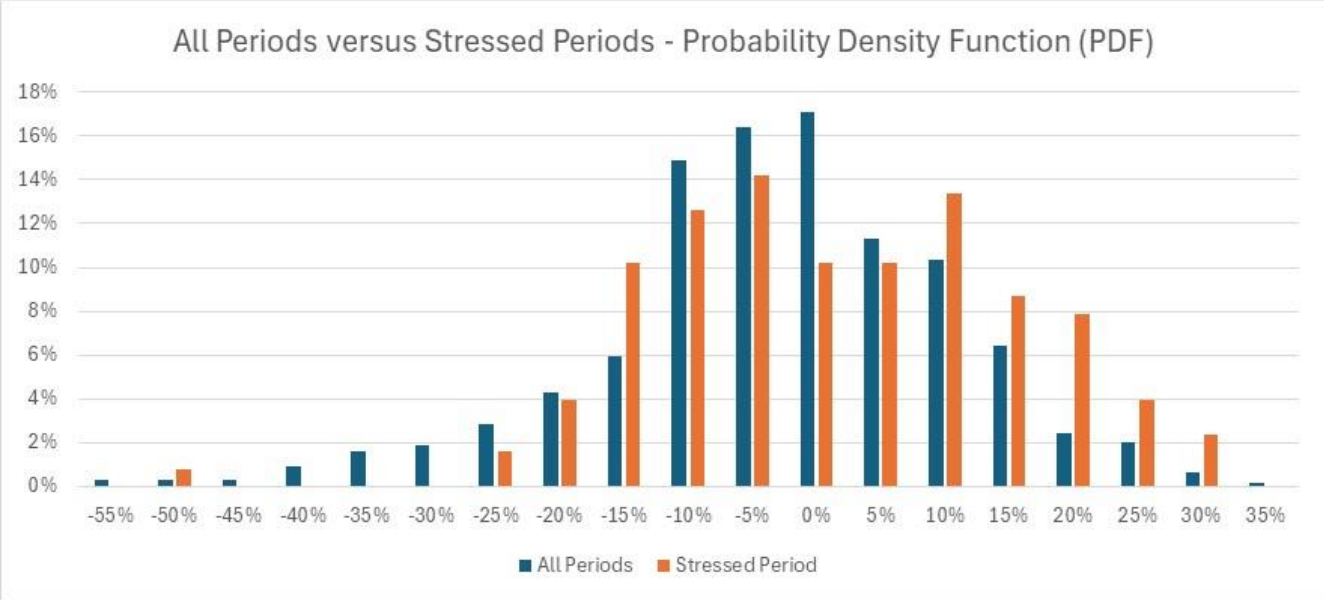


*Figure 1 - Distribution of implied rho*

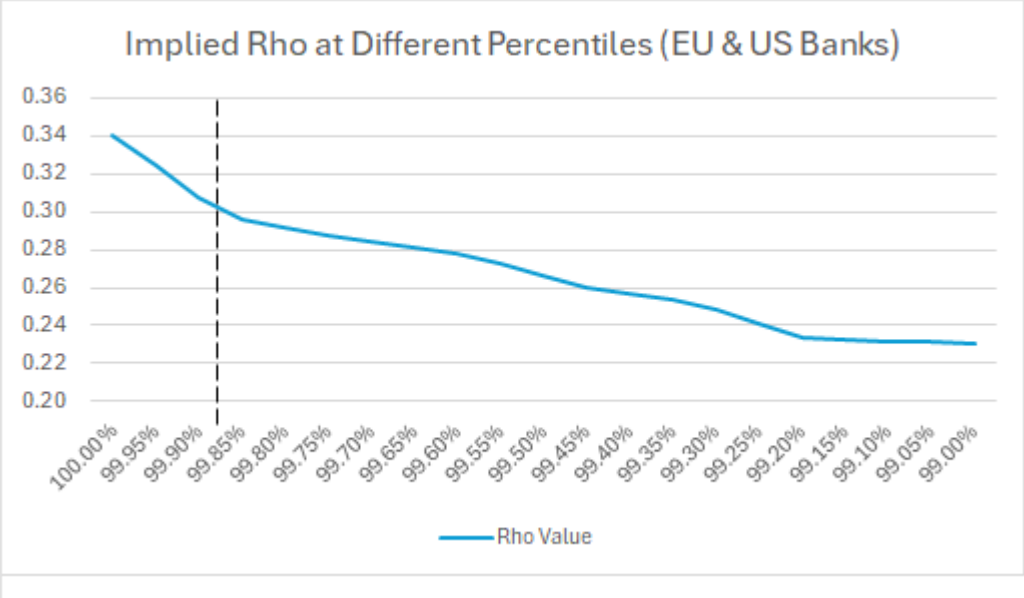


*Figure 2 - Implied Rho at extreme percentiles*

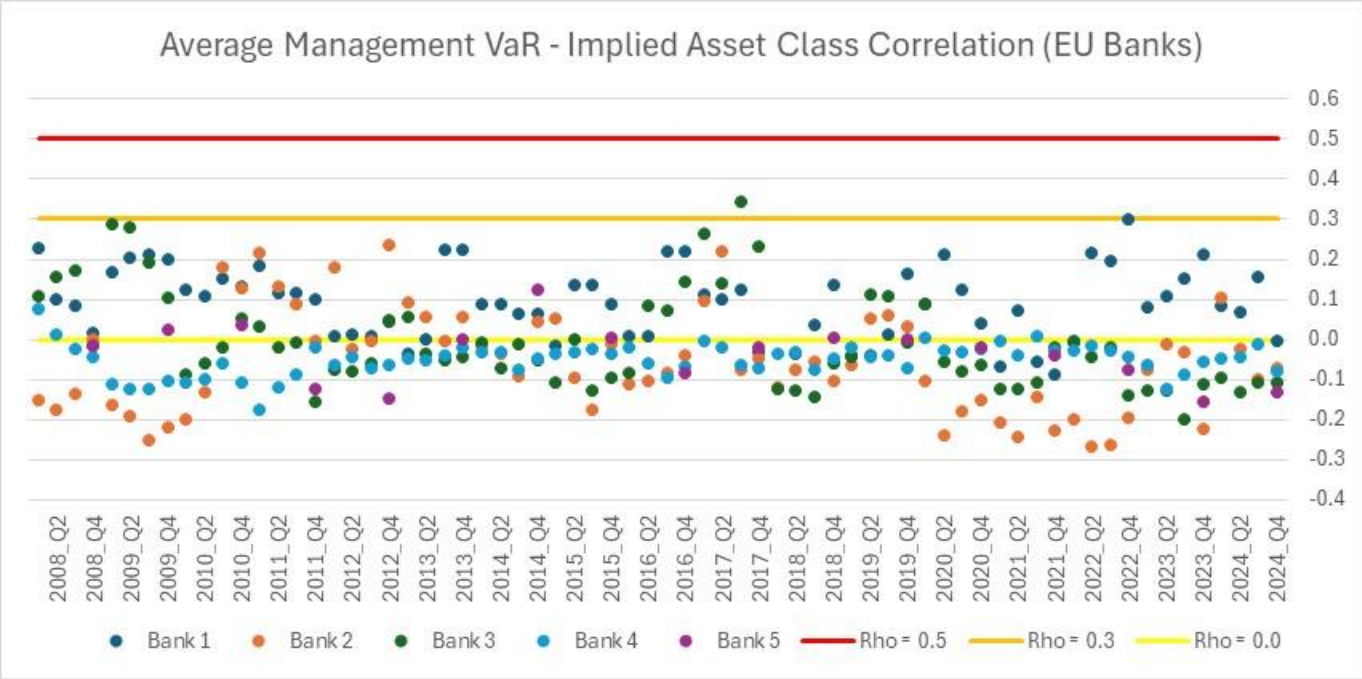


*Figure 3 - EU banks implied asset class correlation obtained from management VaR since Q2 2008*

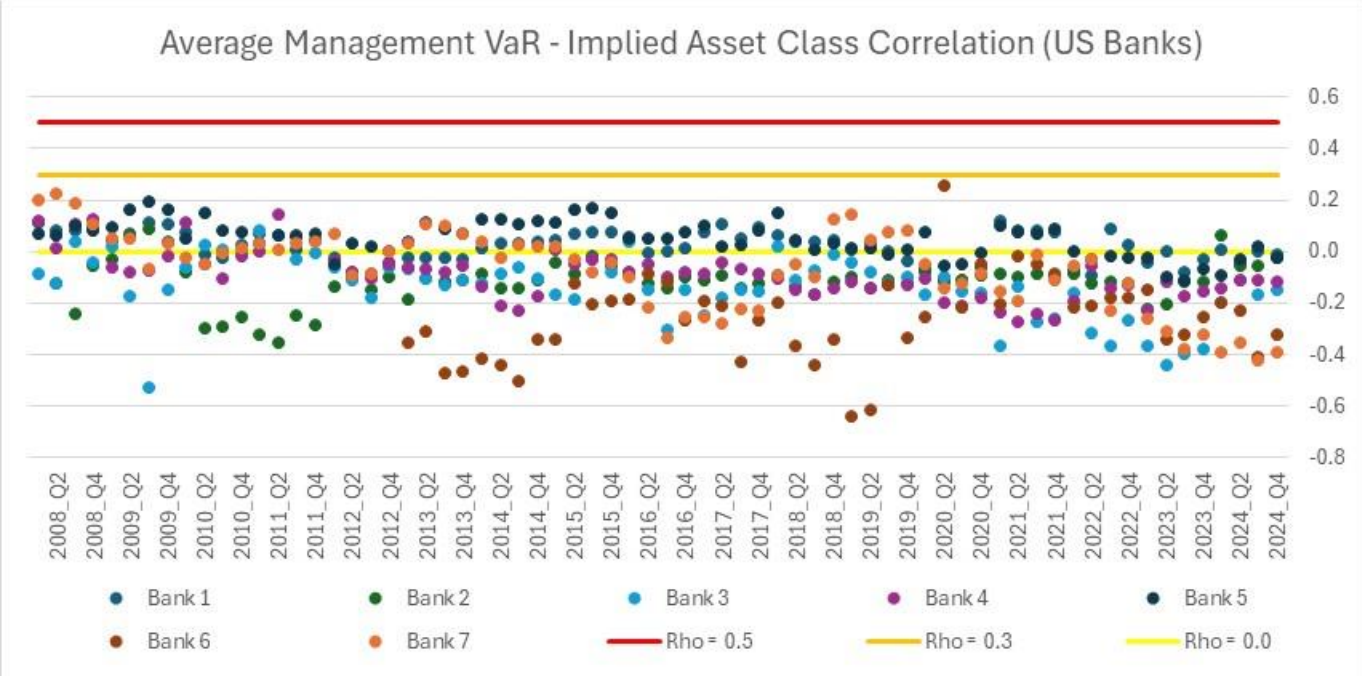


*Figure 4 - US banks implied asset class correlation obtained from management VaR since Q2 2008*

**Industry Recommendation:**

The industry recommends incorporating a correlation parameter across risk classes within SBM with a rho value of 30%[37], which remains conservative – given that this implied rho represents the 99.9th percentile of historical implied rho values since 2008 – while historical data suggests that lower rho values, and thus a lower SBM multiplier, are more typical.

The European Commission recently consulted on the option of introducing a multiplier in the FRTB-SA Framework, however, the industry encourages the PRA to consider this more risk-sensitive approach outlined above, which better reflects diversification benefits across asset classes while helping to also address level playing field concerns across jurisdictions.

The approach taken for SBM diversification also relates to the IMCC rho parameter outlined in Section 3.4.1. Both approaches acknowledge the importance of recognising diversification while ensuring that banks are not disincentivised from utilising either FRTB-IMA or FRTB-SA.

## 2.2. Allow a better recognition of economic hedges in the calculation of the capital requirements for default risk

Under the current rules, the maturity scaling of derivative exposures creates broken hedges between the hedged and hedging instruments for positions with maturities of less than one year. Full capital relief is only granted when the maturities of the hedged and hedging instruments match exactly, which does not reflect common banking practices. In reality, banks frequently roll the hedging instruments until the maturity of the hedged instrument, creating an apparent maturity mismatch for DRC purposes. However, in a default scenario, this maturity mismatch is not utilised, as banks actively manage and roll their hedging instruments to align with the maturity of the hedged instrument. It is important to note that the hedging instruments – typically cash instruments or bonds – are highly liquid, and access to them remains unaffected even as the obligor approaches a credit event. Additionally, the FRTB-IMA DRC framework offers greater flexibility, as CRR Article 325bo(3)[38] allows banks to disregard for capital purposes the immaterial maturity mismatch risk across credit positions. We believe banks should have the discretion

[37] We note that the SBM rho value of 0.3 aligns with the average of the values in the cross-asset class correlation matrix used in the ISDA standard initial margin model (ISDA SIMM®). ISDA SIMM® employs a similar formula to the cross-asset class diversification approach proposed above. However, ISDA SIMM®alone is not enough to justify the rho value of 0.3 since it has two fundamental differences from FRTB SA: (1) it does not use a fixed set of parameters and instead undergoes concentric recalibration every six months based on updated market data; (2) it incorporates product-class netting (e.g., interest rate risks from an equity trade cannot be netted against interest rate risks from an interest rate swap), which influences the calibration.

[38] Prudential Regulation Authority. *Policy Statement PS9/24: Near-Final Market Risk Rules.* September 2024. Article 325bo(3) – " Recognition of hedges in an internal default risk model". Available at: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2024/september/ps924app2.pdf

to determine whether to account for maturity mismatches under SA DRC. Aligning the treatment across both frameworks would enhance comparability, reduce capital divergence, and improve the clarity of capital requirements.

Furthermore, the assumption that positions disappear from trading books upon expiry is unrealistic, particularly for market-making desks, which routinely replenish positions as part of their trading activities. This assumption also fails to consider that trading desks and independent risk control units actively manage risk to prevent one-sided exposures from growing excessively and breaching established risk limits.

Under the Near-Final rules significant maturity mismatches arise in fixed income activities. A common example is short-term derivatives with longer-term underlying positions and corresponding hedges. To address this, we propose introducing a similar provision for credit positions as to those seen for equity positions, allowing banks to extend their assigned maturities to one year. While this would align with the equity treatment, a three-month option would not be included to maintain a conservative approach.

**Industry Recommendation:**

The industry recommends a practical approach to recognising economic hedging in DRC capital by allowing banks, at their discretion, to assign a maturity of one-year to credit instruments. This would better align the maturity of these instruments with their corresponding hedges, similar to the FRTB-IMA framework. Therefore, we recommend the below addition to the CRR.

Article 325x:

*(4a) For the purposes of paragraphs 2 and 3, an institution may assign maturity of 1 year to credit exposures, at the institution's discretion.*

### 2.3. Universal Mortgage-Backed Security (UMBS) treatment – CSR NS and DRC

In 2019, Fannie Mae and Freddie Mac launched the Uniform Mortgage-Backed Security (UMBS), a single security initiative which aims to improve market liquidity by ensuring all UMBS-eligible securities are fungible for delivery into the To-Be-Announced (TBA) market. Under this initiative, Fannie Mae and Freddie Mac mortgage-backed securities are issued using a standardised (UMBS) design, and TBA sellers can deliver UMBS issued by either agency on settlement. In a TBA trade, the seller of MBS agrees the price but does not specify which security will be delivered to the buyer on settlement.

The single security initiative led by Fannie Mae and Freddie Mac has homogenized the mortgage pool and security characteristics for UMBS, including identical guarantees of timely payment of interest and scheduled principal (55-day schedule) from the agencies. Additionally, both issuing agencies enjoy the same level of (implicit) support from the US Treasury.

The UMBS market operates on the principle of “homogeneity”, meaning one UMBS pool is interchangeable with another pool; and TBA sellers can deliver UMBS issued by either agency. As a

result, TBAs do not naturally have a single obligor, as required in CSR & DRC in SA, due to the specifics of their deliverability.

The PRA Near-Final rules are silent on UMBS. The industry understands that the relevant sections on SBM – CSR and DRC were likely written without considering the unique deliverability characteristics of UMBS and TBAs.

The rules which cover offsetting between issuers for credit spread risk and default risk (not just specific for UMBS), are identical between the Basel text, PRA text and draft US NPR[39]. However, the draft US NPR language explicitly clarified that the US proposal would allow banks to fully offset UMBS that are issued by two different obligors. The US NPR further specified that UMBS should be treated as a separate name from non-deliverable pools of Fannie Mae and Freddie Mac. This implies that, under US Basel 3 rules, UMBS securities and TBAs should be treated under a single issuer while non-deliverable Fannie or Freddie pools should be considered as distinct issuer names as they cannot be interchanged through the TBA deliverability mechanism.

The lack of clarity on UMBS netting in PRA PS9/24, versus the explicit guidance provided in the US NPR, suggests that netting across UMBS securities and TBAs may not be permissible under PRA rules. This creates a competitive disadvantage for UK domiciled banks which are active in US agency securities trading. Additionally, such a treatment would be subject to higher capital requirements that do not reflect the underlying risks of these transactions.

**Industry Recommendation:**

The Industry recommends that the PRA clarify that TBAs and deliverable pools that are eligible as UMBS should be treated as the same obligor under SBM and DRC, aligning with the relevant provisions in the US NPR.

### 2.4. Carbon trading exposures

The industry welcomes the PRA's introduction of a new carbon bucket for carbon emissions certificates, however we believe the proposed risk weight of 60% and tenor basis correlation parameter of 99% is too conservative. The appropriate treatment of carbon emission certificates is important as overly stringent capital requirements would impair the functioning of the carbon market. The CRR 3 in the EU has introduced a separate bucket for Carbon Trading under the FRTB-SA with a risk weight of 40% and the EC

[39] Board of Governors of the Federal Reserve System, Office of the Comptroller of the Currency, and Federal Deposit Insurance Corporation. *Regulatory Capital Rule: Large Banking Organizations and Banking Organizations with Significant Trading Activity*. Federal Register 88, no. 179 (September 18, 2023). https://www.federalregister.gov/documents/2023/09/18/2023-19200/regulatory-capital-rule-large-banking-organizations-and-banking-organizations-with-significant#h-192

has recently consulted on the correlation parameter proposing in the range of 99.5%-99.9%. This is aligned with the analysis conducted by ISDA[40][41].

**Industry Recommendation:**

We recommend a risk weight of 40% for the carbon trading bucket and increasing the correlation parameter for aggregating carbon trading exposures to at least 99.6%.

## 2.5. Alternative Correlation Trading Portfolio

Correlation trading instruments improve liquidity and price discovery in the corporate debt market, while also providing cost-effective hedging solutions for default risk. A reduction in access to effective hedging instruments, combined with higher hedging costs, could limit banks' ability to provide funding and risk management services to clients, ultimately slowing investment and economic expansion.

Banks remain concerned about the uncertainty surrounding the rules for the alternative correlation trading portfolio (ACTP), as well as the potential for disproportionate impacts from ACTP products. This is particularly the case if decomposition across credit spread risk (CSR) is not permitted, and the DRC decomposition approach remains unclear.

**Credit Spread Risk**

The best practice in bank risk management is to apply look through for ACTP baskets and indices, reflecting the actual underlying risks. We are concerned that CRR Article 325i(1)[42] does not permit a look through approach for ACTP. Implementing a capital treatment that excludes this approach would be inconsistent with risk management, forcing banks to manage both the economic risk and the capital footprint in separate and inconsistent processes, this can lead to capital requirements divorced from the risk. Additionally, in the absence of decomposition, it is unclear where to map the undecomposed CSR sensitivity, as no index buckets exist.

For SBM, the LTA could be achieved by allowing banks to waive the provisions in Article 325i(1)(a)(b) – *"except for a position in an index included in the ACTP [for which they shall calculate a single sensitivity to the index];"* – during the transition period for global FRTB implementation across jurisdictions. This would be consistent with Article 325ak, which does not include any index bucket, as well as with the definition

[40] ISDA. *Implications of the FRTB for Carbon Certificates*. July 2021. Available at: https://www.isda.org/2021/07/23/implications-of-the-frtb-for-carbon-certificates/
[41] ISDA. *Implications of the FRTB for Carbon Certificates: A Global Perspective.* April 2022. https://www.isda.org/2022/04/21/implications-of-the-frtb-for-carbon-certificates-a-global-perspective/
[42] Prudential Regulation Authority. *Policy Statement PS9/24: Near-Final Market Risk Rules.* September 2024. Article 325i(1) – " Treatment of index instruments and other multi-underlying instruments.", Article 325ac – "Jump-to-default amounts for the ACTP." Available at: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2024/september/ps924app2.pdf

of risk factors in Article 325n(3), which states that "*risk factors shall be all the relevant credit spread rates of the issuers of the underlying exposures of the securitisation position*", thereby implying a LTA.

It is also worth noting that the draft US NPR[43] already permits the decomposition of multi-underlying instruments under the ACTP CSR. This would ensure a level playing field even before a more comprehensive revision of the ACTP capitalisation rules can be implemented in the Near-Final rules.

**Default Risk Charge**

The rules for ACTP DRC remain unclear. While Article 325ac allows for decomposition using a valuation model in the context of DRC, it is unclear how this should be applied. To ensure transparency and consistency, we request confirmation that the DRC for all multi-underlying instruments can be calculated as follows:

a. Decomposition into single-name JTDs, assuming that only the single-name defaults, without rescaling the single-name JTDs
b. Decomposition into single-name JTD using the non-securitization supervisory LGD
c. Netting against all other exposures in the same underlying name, including single-name CDSs and decomposed single-name exposures of untranched indices
d. Bucketing of single name exposures should follow the non-securitisation approach
e. Assigning non-securitization risk weights to the netted single-name JTDs

The following example utilizes a 1st-to-default basket with notional £10MM hedged with a CDS on Name 1 with notional £5MM and illustrates why recommendations a) and b) are crucial to ensure a risk-sensitive capitalization of the ACTP:

| | 1st to default basket | | | | CDS Hedge | 1st to default basket partially hedged | | |
|---|---|---|---|---|---|---|---|---|
| **Names** | Undecom-posed JTD | Scaled Marginal JTD | Marginal JTD (100% LGD) | Marginal JTD (75% LGD) | JTD (75% LGD) | Net JTD Scaled | Net JTD (100% LGD) | Net JTD (75% LGD) |
| **Name 1** | | £3.33MM | £10MM | £7.5MM | -£3.75MM | -£0.42MM | £6.25MM | £3.75MM |
| **Name 2** | £10MM | £3.33MM | £10MM | £7.5MM | | £3.33MM | £10MM | £7.5MM |
| **Name 3** | | £3.33MM | £10MM | £7.5MM | | £3.33MM | £10MM | £7.5MM |
| **Sum** | **£10MM** | **£10MM** | **£30MM** | **£22.5MM** | **-£3.75MM** | **£6.24MM** | **£26.25MM** | **£18.75MM** |

In the table above, the first red column represents a scenario where each of the marginal single-name JTDs would be scaled proportionally so that the total sum of the decomposed JTD equals the

[43] Board of Governors of the Federal Reserve System, Office of the Comptroller of the Currency, and Federal Deposit Insurance Corporation. *Regulatory Capital Rule: Large Banking Organizations and Banking Organizations with Significant Trading Activity*. Federal Register 88, no. 179 (September 18, 2023). https://www.federalregister.gov/documents/2023/09/18/2023-19200/regulatory-capital-rule-large-banking-organizations-and-banking-organizations-with-significant#h-192

undecomposed JTD of £10MM. The second red column reflects the netting with the single-name CDS in relation to the first name.

The first amber column relates to the scenario where the unscaled marginal JTDs are calculated with a 100% LGD. The second amber column reflects the netted JTD with the single name CDS where the latter is based on an LGD of 75% for senior unsecured whereas the decomposed marginal single-name JTDs would be based on a 100% LGD.

The green columns are consistent with the amber columns with the exception that both the decomposed JTDs as well as the JTD of the single name CDS are consistently based on an LGD of 75%.

Regarding point a), scaling the JTDs would result in a significantly lower exposure (£3.33MM each in the "Scaled marginal JTD" column) compared to the actual exposure when each name defaults separately, which, without considering any recovery rate, is £10MM per name. The scaling method is arbitrary and inconsistent with the way single-name risk is managed.

Regarding point b), applying a consistent recovery assumption across both single-name and decomposed single-name exposures from multi-underlying instruments ensures an accurate net JTD representation. As per the example above, Name 1's JTD should be £3.75MM (as shown in the last green column), rather than £6.25MM as in the second amber column, which exceeds the total remaining exposure of £5MM after applying the single-name hedge. The green column is reflective of the industry recommendations mentioned under a) and b) above as it ensures accurate and consistent single-name gross and net JTD exposures.

Recommendation d) is necessary as netting per c) would remove any attachment to a particular tranche. Any single name exposure for a given name would be indistinguishable from other single name exposures and therefore the bucketing applicable to single name exposures needs to be applied.

Similarly, recommendation e) is crucial because, after netting on a single-name basis, it becomes impossible to assign securitization risk weights as no net single-name exposure can be traced to a specific instrument.

It is worth mentioning that the industry has raised the need for the decomposition of multi-underlying instruments under the DRC, particularly in discussions with the US Agencies during the Basel III Endgame consultation process.

**Industry Recommendation:**

We urge the PRA to implement the targeted revisions outlined above to the capital treatment of correlation products, aligning it more closely with standard risk management practices. Without these changes, the current capital treatment could make it economically unfeasible for banks to engage in activities that support efficiency and liquidity in the corporate debt market. In this regard, it is crucial to

make the targeted revisions related to CSR permanent and to clarify the rules for DRC to ensure transparency and consistency.

# 3. Industry Proposed Adjustments to Near-Final Rules and Supervisory Statements Under Internal Models Approach (IMA)

The industry acknowledges the additional time provided by the delay to FRTB-IMA implementation until January 2028 While this does allow the PRA to observe developments in other jurisdictions and consider opportunities for greater international consistency, it also provides a critical window to address the significant flaws within the current IMA framework. As it stands, the framework is not operationally viable for widespread adoption. Key components, such as the treatment of non-modellable risk factors (NMRFs) and the Profit and Loss Attribution (PLA) test, require fundamental revision if FRTB-IMA is to become a credible and usable option for firms.

The proposals set out in the following sections are intended to support the PRA in addressing these issues. Several of the industry recommendations suggest monitoring periods, recognising that further engagement and refinement will be required. The industry remains committed to working constructively with the PRA to develop a framework that is both risk-sensitive and implementable in practice.

## 3.1. Profit and Loss Attribution Test (PLAT) as a monitoring tool

The Industry acknowledges that the principle of the PLAT is sound, however it is widely recognized that the test is difficult to pass and operationally complex to manage in BAU circumstances which creates volatility in banks' capital requirements and therefore discourages investment in internal models.

The industry proposes to allow banks and supervisors to use the PLAT as a monitoring tool. Under this approach, all trading desks within the scope of FRTB-IMA would be deemed to meet the conditions for the green zone. Additionally, the industry acknowledges that the PLAT assessment should be conducted and reported to the competent authorities on a quarterly or semi-annual basis and supervisors should assess whether PLAT is fit for purpose, and whether it is still possible to calibrate reasonable tests that address the uncertainty and volatility in banks' capital requirements.

The PLAT is comprised of two statistical tests: the Spearman correlation test between hypothetical P&L (HPL) and risk-theoretical P&L (RTPL) time series and the Kolmogorov-Smirnov test. While the amber zone has mitigated cliff effects by removing the binary consequences of exiting the green zone, further consideration is needed regarding the potential failure of these tests. The Spearman correlation test could fail solely due to a portfolio being well-hedged. It is well known that directional desks pass the Spearman correlation test more frequently than well-hedged portfolios. Specifically, cases have been observed where desks with underlying positions and their hedges individually passing PLAT still fail the Spearman correlation test when applied to the hedged portfolio P&L time series. Hedging is intended to neutralize a portfolio's exposure to underlying risk factor movements. A well-hedged portfolio will exhibit relatively small P&L variations regardless of whether and to what degree the underlying risk factors rise or fall.

However, because the Spearman correlation test evaluates P&L ranks over 250 scenarios[44], the results may be dominated by minimal residual P&Ls left after hedging, leading to artificially low correlation levels between HPL and RTPL time series. This suggests that less well-hedged portfolios could have a higher likelihood of qualifying for FRTB-IMA eligibility than fully hedged ones. Given these implications, a rigid, automatic approach to determining a trading desk's entry into or exit from the FRTB-IMA perimeter based on the Spearman correlation test may not be appropriate.

The Kolmogorov-Smirnov test measures the similarity between RTPL and HPL distributions. However, even for large samples, it remains highly sensitive to statistical noise, particularly on days with relatively benign market moves. The primary objective of the model should be to accurately predict extreme losses under large market shocks, whereas the Kolmogorov-Smirnov test is less effective in detecting differences in the tail of the distributions.

**Industry Recommendation:**

We recommend that PLAT should be made a supervisory monitoring tool under the Internal Model Approach and provide supervisors with evidence collected from real portfolios to assess whether the statistical tests can be appropriately recalibrated or if PLAT should remain a supervisory reporting tool.

## 3.2. Capital requirements for Non-Modellable Risk Factors (NMRF)

The industry acknowledges the PRA's engagement with stakeholders throughout the evolution of the FRTB-IMA, including the NMRF framework. While we appreciate this engagement, significant challenges remain that must be addressed to ensure the framework is both operationally viable and appropriately risk-sensitive.

As currently constructed, the NMRF framework presents fundamental shortcomings. These include limited recognition of diversification, overly conservative aggregation methodologies, assumptions about cross-asset class and idiosyncratic correlations, and the calibration of asset-class-specific stress periods. Additionally, the framework's inherent procyclicality raises concerns – by discouraging the modelling of less liquid risk factors, it may lead to concentration of risk into a narrower set of modellable exposures. Collectively, these issues contribute to capital outcomes that are overly punitive and out of step with sound risk management practices.

While the industry's preferred outcome would be to replace the current NMRF framework (including RFET) with a more holistic solution, we understand that the PRA is seeking to improve the existing framework rather than revisit its foundational structure. We therefore present in the following sections a set of targeted enhancements designed to address key areas of concern. These proposals aim to preserve the prudential intent of the rules while making the framework more workable and aligned with actual risk.

[44] To calculate the Spearman correlation metric for a trading desk, banks must use the time series of RTPL and HPL from the most recent 250 trading days.

The delay to FRTB-IMA implementation in the UK provides a valuable opportunity for the PRA to monitor international developments as part of efforts to uphold a level playing field across jurisdictions and, crucially, to conduct a detailed assessment of these outstanding issues; the industry stands ready to support this effort through further engagement and technical analysis.

### 3.2.1. Calibration of rho parameter in the SES calculation

Under the current rules, the capital requirements for non-modellable risk factors (NMRFs) include an aggregation step using a 'square root rule'. This approach uses a fixed correlation parameter (rho) of 0.6 to combine measures as outlined below:

$$SES = \sqrt{\sum_{i=1}^{I} ISES_{NM,i}^2} + \sqrt{\sum_{j=1}^{J} ISES_{NM,j}^2} + \sqrt{\left(\rho \sum_{k=1}^{K} SES_{NM,k}\right)^2 + (1-\rho^2)\sum_{k=1}^{K} SES_{NM,k}^2}$$

While this aims to capture the diversification across risk factors, the prescribed rho value leads to limited diversification recognition, resulting in overly conservative capital outcomes.

Cross-asset class correlations tend to be materially lower than 0.6. Applying this higher rho to a sum of positive capital numbers, as done in the SES aggregation, naturally increases the output. In practice, this means that portfolios with a well-diversified set of non-modellable risk factors are penalised by an aggregation assumption that does not reflect their true risk profile.

The industry is concerned that this calibration fails to appropriately incentivise diversification or accurately reflect the risk reduction benefits of managing exposures across asset classes. In situations where modellability changes, due to marginal breaches of data thresholds, diversified portfolios can face disproportionately high capital requirements, not because of a meaningful increase in risk, but due to the mechanics of the aggregation.

We therefore propose that the rho parameter used in the SES aggregation be recalibrated to a lower value, such as 0.25, in line with previous industry advocacy[45]. While still conservative, this would better reflect realistic correlation levels and significantly improve the risk sensitivity of the framework. It would also help moderate some of the more punitive capital outcomes currently observed, particularly when used in combination with the alternative treatment of NMRFs described in Section 3.2.4 (i.e., the Type A / Type B framework).

Importantly, recalibration of the rho parameter should not be viewed as a standalone solution. It is one of several steps needed to improve the usability and proportionality of the NMRF framework and should be pursued in parallel with broader reforms.

[45] ISDA and SIFMA. *Response to US Basel III NPR*. January 2024. https://www.isda.org/a/1ElgE/ISDA-and-SIFMA-Response-to-US-Basel-III-NPR.pdf

**Industry Recommendation:**

The industry recommends recalibrating the rho parameter used in SES aggregation to a lower value, such as 0.25. The current calibration of 0.6 overstates correlations across risk factors and results in unduly conservative capital outcomes. While not a complete solution, adjusting rho would improve risk sensitivity and should be implemented alongside broader changes to the NMRF framework, such as the 'Type A / Type B' approach proposed in Section 3.2.4

### 3.2.2. Alignment of SES and ES windows

Operational challenges associated with the NMRF framework are significant. Banks are required to calculate a capital measure for each NMRF using a stress scenario that is calibrated to be at least as prudent as the ES-based measure used for modellable risk factors and must select a common 12-month period of stress for all NMRFs in the same risk factor class. If the bank cannot determine a stress scenario for a risk factor class or a smaller set of NMRFs acceptable to supervisors, the bank would be required to use the scenario producing the maximum possible loss as the stress scenario.

Given that the ES stress period effectively captures market stress for banks and considering the operational challenges of maintaining separate stress periods for each NMRF risk class, the rules should be revised accordingly. Utilizing different stress periods leads to a further breakdown of correlations among NMRF risk classes, compounding the already excessive conservatism in the aggregation formula.

**Industry Recommendation:**

We recommend allowing banks to use the same stress period for SES as that used for the diversified ES measure.

### 3.2.3. Calculation frequency of NMRF

The daily NMRF calculations, as required in the Basel standards, are operationally burdensome, especially since banks have indicated that NMRF calculations are not typically used as a risk management measure. Performing these calculations daily incurs significant operational costs and modelling challenges, particularly when only a few risk factors in a trade are deemed non-modellable, requiring numerous calculations for each trade – separately for ES and NMRF, and to account for different liquidity horizons of risk factors in ES. Since NMRF calculations are derived from stressed scenarios, it is expected to be relatively stable, with the stressed period calibrated quarterly and the NMRF population assessed through a quarterly RFET process. Furthermore, daily portfolio variations are already captured and monitored through risk management metrics such as VaR and backtesting against daily P&L.

**Industry Recommendation:**

We recommend a frequency of quarterly or less for NMRF calculations. In case this recommendation is not accepted by policymakers, it should not be calculated more frequently than weekly (e.g., calculated weekly, using an average of 12 weeks for the capital calculation).

### 3.2.4. 'Type A / Type B' Framework for NMRFs

The industry continues to propose the adoption of a more risk-sensitive and operationally workable alternative: a differentiated framework for non-modellable risk factors based on the data principles[46].

Under this proposal, NMRFs would be categorised into two types:

- **Type A NMRFs** would include risk factors that do not pass the Risk Factor Eligibility Test but nonetheless satisfy the underlying data principles and are available in the reduced set. These risk factors would be capitalised within the ES framework (IMCC) directly, with appropriate adjustments to reflect their reduced liquidity, even if they lack a sufficient number of real price observations. Specifically, they could be assigned a liquidity horizon one bucket higher than the equivalent modellable risk factor (capped at 120 days).
- **Type B NMRFs** would comprise risk factors that do not meet the basic data principles and would continue to be capitalised using the existing Stressed Expected Shortfall (SES) approach.

Conceptually, Type A NMRFs align with those that are currently included in VaR based models under the current market risk framework, while Type B NMRFs correspond to those excluded from these models (i.e., Risks not in VaR or "RNIV").

This differentiated treatment would help address one of the most significant shortcomings of the current NMRF framework—its failure to distinguish between marginally non-modellable risk factors and those that are truly illiquid or opaque. The proposed approach preserves prudential safeguards for illiquid risk, while enabling more risk-sensitive capital treatment for those risk factors that are, in practice, well understood and actively risk-managed.

Moreover, this framework would improve alignment between capital requirements and firms' internal risk models, support diversification recognition, and provide stronger incentives for FRTB-IMA adoption. While we acknowledge that firms would need the operational capability to support dual treatment under the ES and SES methodologies, we consider this burden manageable in light of the material improvements to capital relevance and comparability that this approach would offer.

[46] ISDA and SIFMA. *Response to US Basel III NPR*. January 2024. https://www.isda.org/a/1ElgE/ISDA-and-SIFMA-Response-to-US-Basel-III-NPR.pdf

**Industry Recommendation:**

We recommend introducing a differentiated 'Type A / Type B' approach to NMRF treatment. Specifically, risk factors that do not meet the RFET threshold but still satisfy underlying data principles should be classified as Type A and incorporated within the ES calculation, subject to adjusted liquidity horizons. Other risk factors, i.e. Type B, should be capitalised using the existing SES methodology. This approach would significantly improve the risk sensitivity and proportionality of the NMRF framework while maintaining appropriate prudential safeguards

### 3.2.5. Two-step aggregation to better recognise diversification

The SES measure does not recognize netting between long and short positions in similar risk factors and assumes the same level of correlation between NMRFs, regardless of how closely related they are to each other. In contrast, the ES-based aggregation for modellable risk factors allows for netting and uses historical correlations that tend to be higher within risk classes than across risk classes. It would be more appropriate for the SES calculation to reflect higher diversification and netting within risk classes or groups of similar risk factors rather than maintaining the assumptions of equal correlations across NMRFs. This could be achieved by restructuring the SES calculation into a two-step calculation: (i) aggregating NMRFs within a risk class or group of similar risk factors; and (ii) aggregating NMRFs (Type B NMRFs as per proposal set out in Section 3.2.4) across risk classes and groups of risk factors, reflecting a lower correlation in the calculation across risk classes and groups of risk factors, respectively.

- **Step 1**: To recognize diversification, we propose aggregating within broad risk classes or groups of similar risk factors, rather than assuming equal correlations across NMRFs. In line with the recommendation in Section 3.2.2 the stress period used for the NMRFs should align with the diversified IMCC where possible.
- **Step 2:** In Step 2, the final aggregation of the NMRF charges follows a methodology similar to the existing Basel text, with two key differences. Instead of aggregating individual systematic risk factors, we propose aggregating across the NMRF stress scenario calculated per risk class. The idiosyncratic risk factors should continue to be aggregated according to the Basel text. Secondly, we propose using the cross-asset class rho parameter proposed in Section 3.2.1 (i.e., $\rho = 25\%$):

$$SES = \sqrt{\sum_{i=1}^{I} ISES_{NM,i}^2} + \sqrt{\sum_{j=1}^{J} ISES_{NM,j}^2} + \sqrt{\left(\rho \sum_{k=1}^{K} SES_{NM,k}\right)^2 + (1-\rho^2)\sum_{k=1}^{K} SES_{NM,k}^2}$$

**Industry Recommendation:**

The industry recommends restructuring the SES calculation into a two-step aggregation process that would first aggregate NMRFs within broad risk classes or closely related groups of risk factors, and then

would aggregate across risk classes using a lower rho parameter, as proposed in Section 3.2.1. This approach would provide a more risk-sensitive and proportionate capital outcome while maintaining prudential conservatism.

#### 3.2.6. Extension of non-modellable idiosyncratic risk factors

The SES calculation currently allows the aggregation of non-modellable idiosyncratic risk factors only for credit spread risk factors and equity risk factors. In other words, banks can aggregate non-modellable credit and equity idiosyncratic residuals with a 0% correlation, but this is not permitted for other asset classes. It is recommended that banks be allowed to aggregate other types of non-modellable idiosyncratic risk factors, as the correlation between these residuals is likely to be very close to 0.

**Industry Recommendation:**

The industry recommends that banks should be permitted to aggregate non-modellable idiosyncratic risk factors beyond credit spread risk and equity risk.

### 3.3. Changes to RFET

The development of RFET data solutions by third-party vendors remains limited, resulting in a significant number of risk factors being classified as NMRFs. The industry wishes to emphasize that implementing and operationalising RFET remains extremely challenging and costly, creating a barrier to the adoption of FRTB-IMA. Below, we highlight some of the key outstanding issues within the RFET framework and propose amendments to regulatory requirements that do not offer any compliance benefit.

#### 3.3.1. Proportional data requirements for the RFET of new instruments

The RFET is designed to distinguish between risk factors that may be capitalised under the ES framework and those that must be capitalised under SES. However, in its current form, RFET is not suitable for all instruments. A particular concern arises for newly issued instruments, such as bonds, which under Article 325be of the Near-Final rules appear unable to qualify for modellability until a full 12-month real price observation (RPO) history has been accumulated – regardless of the instrument's actual liquidity or structural simplicity. The industry believes this is a disproportionate outcome and recommends that the PRA reduce this excessive conservatism and adopt a more risk-sensitive approach. Specifically, we propose that new instruments be allowed to begin their RFET observability period from the issuance date, with the number of RPOs required to pass RFET prorated over the first year. This would help avoid penalising newly issued instruments that are demonstrably liquid and frequently traded, simply due to

their issuance timing. This proposal would also alleviate level playing field concerns, aligning the UK to the treatment under the US NPR[47].

In addition to this targeted adjustment for new issuances, we also reiterate our longstanding concerns regarding the treatment of sovereign and supranational debt. These instruments, including gilts and other qualifying government and multilateral development bank bonds, typically exhibit deep and continuous liquidity and play a foundational role in market functioning. Nevertheless, the current framework requires firms to conduct full RFET checks even for these highly liquid risk factors. This introduces unnecessary complexity and compliance burden while offering little prudential benefit. We therefore propose that qualifying sovereign and supranational risk factors (in line with CRE20.7 to CRE20.15) be exempted from the RFET process and automatically recognised as modellable.

In cases where a full 12-month time series is not available for new instruments, but these instruments meet the modellability criteria based on proportional data requirements, their associated risks will be included in the ES using proxy time series, without requiring capitalisation for NMRF basis. Article 325bg(9)(c)[48] of the Near-Final rules on PLAT should clarify that the RTPL may be aligned with the HPL and fully reflect the impact of the new issuance, thereby avoiding residual noise in the PLAT for 12 months from the date of issuance.

**Industry Recommendation:**

The industry recommends that the PRA allows the RFET observability period to commence from the date of issuance for newly issued instruments. The number of RPOs required to pass RFET should be prorated over the first year of issuance, rather than requiring a full 12-month history upfront. This would enable demonstrably liquid new instruments to be treated as modellable from an earlier point, avoiding undue capital charges and aligning the UK framework more closely with developments in other jurisdictions.

In addition, the industry proposes that sovereign and supranational debt risk factors be exempted from the RFET process and automatically recognised as modellable. This adjustment would provide a significant operational simplification.

Furthermore, to avoid failing the PLAT for new instruments, Article 325bg(9)(c) of the Near-Final rules on PLAT should clarify that the RTPL may be aligned with the HPL and fully reflect the impact of the new issuance, thereby avoiding residual noise in the PLAT for 12 months from the date of issuance.

[47] Board of Governors of the Federal Reserve System, Office of the Comptroller of the Currency, and Federal Deposit Insurance Corporation. *Regulatory Capital Rule: Large Banking Organizations and Banking Organizations with Significant Trading Activity*. September 2023. Available at: federalregister.gov

[48] Prudential Regulation Authority. *Policy Statement PS9/24: Near-Final Market Risk Rules*. September 2024. Article 325bg – "Profit and loss attribution requirement". Available at: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2024/september/ps924app2.pdf

### 3.3.2. Requirement to audit third-party data providers

The Basel text in MAR31.12(3)[49] allows institutions to source prices and committed quotes from third-party vendors, trading platforms, or exchanges. When a bank uses real prices from a third-party data provider, the data provider must undergo an audit to validate its pricing information and satisfy the criteria in MAR31.14. Essentially, the Basel text distinguishes among the price information from third-party vendors, trading platforms, or exchanges.

However, Article 325be[50] of the Near Final rules introduces a divergence by classifying exchanges, trading platforms, and data reporting service providers (DSRPs) as third-party vendors. Entities such as market exchanges, trade repositories, multilateral trading facilities, and DSRPs play a crucial role in ensuring market transparency and integrity within the UK and are subject to their own regulatory standards under the supervision of the Financial Conduct Authority.

Moreover, the rules require third-party vendors – including exchanges and trading platforms – to be contractually obligated to provide verifiable price data and to undergo an independent third-party audit at least annually. Banks must also have access to these audit results and reports. As a result, if a bank independently sources data from such regulated platforms – for example, price information on listed equities or precious metals from recognised exchanges – it must still demonstrate compliance with the audit requirements and obtain access to audit reports. This requirement appears counterintuitive, given that these exchanges and platforms are already under regulatory supervision and are not contractually obligated to verify price data or perform audits for RFET compliance.

There is no principled reason to introduce a divergence from the Basel text in the UK by requiring an audit for verifiable prices sourced from venues like exchanges, trading platforms, or trade repositories – entities that are already subject to extensive regulatory oversight and supervision. Without access to the audit reports, banks may be prohibited from using data from these venues, resulting in a larger proportion of risk factors being classified as NMRFs than would have been originally anticipated during the Basel calibration.

**Industry Recommendation:**

The requirements for third-party vendor audits should not be imposed when prices are sourced from the regulated sources such as exchanges, authorized data providers and multilateral trading systems. These sources are already subject to strict regulations for their processes, systems, and controls, and they are not contractually obligated to perform audits or provide access to audit reports for RFET purposes.

[49] Basel Committee on Banking Supervision. *Minimum Capital Requirements for Market Risk*. Bank for International Settlements, January 2019. https://www.bis.org/bcbs/publ/d457.pdf

[50] Prudential Regulation Authority. *Policy Statement PS9/24: Near-Final Market Risk Rules*. September 2024. Article 325be – "Assessment of the modellability of risk factors". Available at: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2024/september/ps924app2.pdf

### 3.3.3. Non-negligible volume and bid-offer spread for verifiable price observations

Article 325be(5) also requires that verifiable price observations must come from transactions or quotations of a non-negligible volume compared to usual volume reflective of current market conditions. Additionally, it requires that the bid–offer spread of a quotation should not substantially deviate from the bid–offer spreads that reflect current market conditions.

The industry interprets the rule text to mean that real verifiable price observations must be based on transactions of non-negligible volume under current market conditions. When price observations for listed instruments (e.g., equity spot prices and precious metal prices) are sourced from regulated exchanges, they inherently reflect usual volumes in current market conditions. Trading activity for a given instrument, such as spot equity or listed options or futures, is typically concentrated in a single venue, thus representing the prevailing market conditions. This concentration is driven by the preference among market participants to trade on the venue that provides the deepest liquidity pool and the best execution price (e.g., under MiFID Best Execution[51]). The volume or transaction size of individual exchange transactions, such as spot equity or listed options or futures, is typically not significant given the instant matching of bids and offers during continuous trading sessions and the practice of splitting larger transactions into smaller tickets to minimize the impact on market prices. To quantify market liquidity, average daily volumes (ADVs) are frequently used, such as in the context of MiFID Best Execution requirements, to understand potential market impact for a given transaction size. As a result, checks against negligible volumes on real verifiable price observations are irrelevant for exchange trading. This proposal ensures that no exchange prices need to be excluded due to negligible volumes, aligning with existing practices across Risk and Finance, including time series for ES modelling or independent price verification (IPV).

Similarly, when bid–offer quotations are simultaneously sourced from an exchange's active order book for listed instruments (e.g., equity options), they inherently reflect the current market conditions on the observation date. The industry understands that the requirement to assess or monitor the bid-offer spread was introduced to prevent significant deviations in quotes from different counterparties (e.g., instances where the bid exceeds the offer) or the use of uncompetitive quotations. However, given that exchanges facilitate most of the trading in listed instruments, the order book naturally provides the most competitive quotations in current market conditions. According to exchange rules, any crossed quotations (i.e., instances where bids and offers match) are executed instantly. Furthermore, exchanges and their members are subject to stringent regulations to ensure high-quality quotations and prevent market abuse, such as quoting without the intent to trade (e.g., spoofing). As a result, when bid and offer

[51] European Securities and Markets Authority (ESMA), *Article 27: Obligation to execute orders on terms most favourable to the client*, available at: https://www.esma.europa.eu/publications-and-data/interactive-single-rulebook/mifid-ii/article-27-obligation-execute-orders

quotations for listed instruments are sourced from exchanges' order books, additional analysis on spreads is unnecessary and should not be required.

The industry acknowledges that checks on volume and bid-offer spreads are relevant for over-the-counter transactions and quotations, including observations from trade repositories. However, these requirements for exchange-based prices and quotes are operationally burdensome and do not contribute to the verification of price observations, thereby increasing the cost of implementing the RFET.

**Industry Recommendation:**

- If daily prices, such as spot equity and precious metals, are sourced from regulated exchanges, they should be considered as verifiable prices that reflect market conditions, thereby meeting the non-negligible volume requirement.
- Additionally, if two-way quotes are sourced from the exchanges for listed instruments, the bid-offer spread should be considered reflective of current market conditions.

## 3.4. Changes to ES

### 3.4.1. Calibration of rho parameter for modellable risk factors

The aggregate capital measure for modellable risk factors in the ES calculation (i.e., the IMCC measure) is calculated as the weighted average of the constrained (diversified) and unconstrained (non-diversified) ES-based measures, using an IMCC rho parameter of 0.5:

$$IMCC = \rho \times \big(IMCC(C)\big) + (1-\rho) \times \left(\sum_{i=1}^{B} IMCC(C_i)\right)$$

This approach is overly conservative and does not sufficiently take into account the benefits of diversification in the portfolio. The IMCC rho parameter serves as a regulatory discretion tool, allowing regulators to adjust the modelled capital when correlations deteriorate, and historical correlations no longer hold.

However, empirical data does not support an IMCC rho value other than 1. As shown in Section 2.1, the implied correlation across firm's VaR models remains stable even during periods of market stress. If significant volatility in implied correlations were observed, additional conservatism might be justified – but the data does not indicate such a need.

Additionally, ES already incorporates multiple levels of conservatism:

1. The ES for the reduced set of risk factors ($ES_{R,S}$) is based on the most severe 12-month period available within the observation horizon.
2. Liquidity horizons are scaled from a base horizon of 10 days.

Based on this, any weight other than 1 given to the diversified ES-based measure is overly conservative. A rho of 1.0 reflects prevailing diversification benefits without any additional assumptions. To incentivize FRTB-IMA and mitigate the multiple levels of conservatism, we propose increasing IMCC rho from 0.5 to 1.0.

**Industry Recommendation:**

The calibration of IMCC rho should be increased from 0.5 to 1.0.

### 3.4.2. Capping of liquidity horizons

Banks are required to take into account the maturity of a position in determining its liquidity horizon. If the position's maturity is shorter than one of the prescribed fixed liquidity horizons, the effective liquidity horizon would be calculated as the next longest liquidity horizon from the position's maturity. The Industry has deep concerns regarding the liquidity horizon capping to the maturity of related positions. Theoretically, the maturity cap implies that no position should be renewed beyond its expiry date. This requirement introduces unrealistic hedge breaks, negatively impacts capital and risk management, and contradicts market practices of rolling over hedges at contract maturity. Furthermore, it introduces a significant barrier to FRTB-IMA adoption for desks trading in liquid instruments and actively hedging their risks.

We would note that the US NPR[52] provides flexibility by allowing banks to consider the next longest maturity-based liquidity horizon as the 'minimum' liquidity horizon thereby allowing banks to apply a longer liquidity horizon.

If this capping requirement were mandatorily imposed, it would have undesired impacts on risk management practices, including but not limited to the following:

1. **Unrealistic hedge breaks between the same risk factors across different instruments:** For example, short-dated index options are frequently used as liquid hedges against credit exposures of longer maturity.
2. **Unnecessarily volatile capital charges even when there is no change to the true underlying risk:** For example, the maturity of certain instruments tends to cluster around particular dates (e.g., listed futures maturing on the third Friday of expiring months, or monthly equity, index, or currency option expiration dates, or IMM dates), leading to drastically volatile capital changes near those dates.
3. **Incorrect representation of risk:** For example, physically delivered futures or options would continue to carry risk exposures to relevant risk factors beyond the expiration date. If capped at position maturity, the risk on those risk factors would not be correctly captured.

[52] ISDA and SIFMA. *Response to US Basel III NPR*. January 2024. https://www.isda.org/a/1ElgE/ISDA-and-SIFMA-Response-to-US-Basel-III-NPR.pdf

**Industry Recommendation:**

Align with the draft US NPR draft to allow banks the option, but not the obligation, to consider the next longest liquidity horizon as the 'minimum' liquidity horizon. This would enable banks to apply a longer liquidity horizon beyond the maturity of the position. Alternatively, authorities may consider giving banks flexibility to develop their own methodology and opt for the longer liquidity horizon of a risk factor with appropriate justification and validation, regardless of the maturity of positions that give rise to the exposure.

### 3.4.3. Calculation frequency of IMCC

IMCC should be calculated less frequently than daily, in line with the Basel standards, considering the operational burden and computational cost introduced by the complexity of the IMCC calculation.

In the Basel text, MAR30.10[53] explicitly recognizes that internal models used to determine market risk capital requirements may differ from those used by a bank in its day-to-day internal risk management functions. As long as the core design elements of both the market risk capital model and the internal risk management model are the same, there is no requirement for the capital model to be fully recalculated each day.

Our interpretation of the Basel standards suggests that it is sufficient for the bank's daily VaR model to share the core design elements with ES to meet the "risk management use" requirements. Moreover, the daily calculation of FRTB VaR for backtesting purposes, with results reported to senior management, provides a link between daily risk management practices and internal capital models.

The near final rules are somewhat more stringent than Basel standards, particularly in Article 325bi(1)(a)[54], which states that any internal risk measurement model used to calculate capital requirements for market risk must be closely integrated into the daily risk management process of the institution. However, it does not define this requirement precisely. We believe the same interpretation as applied to Basel should also apply here.

The near final rules prescribe daily IMCC calculations. However, if the primary intent is not to align with day-to-day risk management processes, the requirement likely serves to achieve the desired averaging effect – ensuring that the capital charge represents an average of the IMCC over the preceding 60 days, enhancing stability and reducing susceptibility to manipulation. To achieve the intended averaging effect, 12 weekly numbers should be sufficient, as required in the FRTB-IMA DRC framework. Therefore, we

[53] Basel Committee on Banking Supervision. *Minimum Capital Requirements for Market Risk*. Bank for International Settlements, January 2019. https://www.bis.org/bcbs/publ/d457.pdf

[54] Prudential Regulation Authority. *Policy Statement PS9/24: Near-Final Market Risk Rules*. September 2024. Article 325bi – "Qualitative requirements". Available at: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2024/september/ps924app2.pdf

conclude that relaxing the daily calculation requirement to a weekly basis would not undermine the spirit or intended outcome of the rules.

It is important to stress that running daily calculations are significantly more complex than weekly. Daily calculations require more computational power and impose stricter requirements to ensure timely completion for daily operational processes and signoffs. Additionally, calculating ES under different liquidity horizon scenarios poses challenges for both diversified and non-diversified portfolios. Given the novelty and complexity of the new capital framework, relaxing these requirements would significantly lower the barrier to adoption for banks that are well-advanced in their FRTB-IMA implementation but need more time to productionize the operational process.

**Industry Recommendation:**

Allow IMCC calculations to be conducted less frequently than daily. Specifically, IMCC should be calculated weekly, using an average of 12 weeks for the capital calculation.

### 3.5. Actual P&L (APL) backtesting as a monitoring tool

APL backtesting at the firm- and desk-level should be a reporting-only requirement, as its primary purpose is to assess model performance rather than capital adequacy. APL includes various P&L drivers that are independent of ES models – such as intraday P&L and non-daily valuation reserve recalibration – and may even include non-market risks, such as contingent features tied to non-market events. Hence, APL backtesting is susceptible to non-model related negative aspects, which could misrepresent the performance of ES models. This could lead to unwarranted removal of trading desks from FRTB-IMA and discourage investment in FRTB-IMA model development. Instead, APL backtesting should serve as a supplementary monitoring tool, complementing the more reliable HPL backtesting process.

**Industry Recommendation:**

APL backtesting should serve as a supplementary monitoring tool.

### 3.6. Changes to Default Risk Charge (DRC)

In accordance with Article 325bl(1)[55] of the Near-Final rules, FRTB-IMA trading desks are subject to additional or incremental own fund requirements for the default risk of credit and equity exposures using

[55] Prudential Regulation Authority. *Policy Statement PS9/24: Near-Final Market Risk Rules.* September 2024. Article 325bl(1) – "Scope of the internal default risk model.", 325bm(2) – "Permission to use an internal default risk model.", 325az(4) – "Permission to use internal models.", and 325ba – " Own funds requirements when using internal models." Available at: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2024/september/ps924app2.pdf

the internal model-based DRC. Articles 325bm(2) and 325az(4) also require capitalisation under FRTB-SA if a bank no longer meets the criteria for using FRTB-IMA, including the use of the FRTB-IMA DRC model and if trading desks fail the backtesting and PLAT requirements.

Since the DRC is specifically designed to address the incremental charge for capturing the sudden jump-to-default (JTD) risk of issuers, the industry recommends that:

a) The internal model-based DRC should be treated independently from the approval to use the IMA (ES and NMRF measurement model) at the trading desk level; and
b) Banks should have the flexibility to use the regulatory-prescribed SA-DRC instead of being mandated to develop their own internal DRC model for FRTB-IMA trading desks.

The FRTB-IMA eligibility tests primarily assess performance using risk metrics versus daily P&L, rather than evaluating JTD risk, which is separately captured by a DRC model. As such, penalising the DRC model when a trading desk fails the backtesting and PLAT tests is unjustifiable.

Treating the DRC as a standalone component encourages the development of risk-sensitive DRC models, which are better able to reflect the impact of systemic defaults under stressed conditions. For instance, FRTB-IMA DRC captures default correlations across issuers and simulates scenarios where multiple issuers default simultaneously, whereas the SA-DRC uses a single default metric (i.e., the risk of individual issuers). Additionally, the internal model-based DRC better recognizes portfolio diversification than the SA-DRC. For example, the hedge benefit ratio (HBR) used in SA-DRC does not accurately reflect diversification at the desk or portfolio level.

However, while developing an internal DRC model has its advantages, certain trading desks and instruments present challenges in modelling due to complex data and valuation requirements. For example, full revaluation may require a significant computation effort, and models may require simplifications to capture the default risk of complex multi-underlying products. This also requires intensive data for correlation modelling.

To address these challenges, banks should be allowed the flexibility to choose between using the regulatory-prescribed SA-DRC or an internally developed the internal model-based DRC to calculate the incremental default risk charge.

This proposal would ensure a level playing field with US banks, where the internal model-based DRC requirement was removed in the US NPR, while still aligning with the Basel framework. Moreover, Article 325az(2) prohibits capital arbitrage, meaning banks cannot choose between the internal model-based DRC and SA-DRC based solely on which would result in a lower capital requirement.

The industry recommends that the proposals outlined above be applied as both a temporary relief measure and as a long-term solution. This would include updates to the formula for own fund requirements under Article 325ba, calculated as the sum of the following components:

1. $\min\left(IMA_{non-default} + Capital\ Surcharge + C_{non-default};\ SA_{all\ desks-\ non-default}\right)$

2. $\max\left(0;\ IMA_{non-default}\ -\ SA_{non-default}\right)$
3. $DRC_{IMA}\ +\ DRC_{SA}$

Where:

- $IMA_{non-default}$ is the non-default risk capital requirement for modelled desks;
- $C_{non-default}$ is the non-default risk SA capital requirement for non-modelled desks;
- $Capital\ Surcharge$[56] is the add-on component based on PLAT results, derived from non-default risk capital;
- $SA_{all\ desks}$ is the non-default risk charge for the global portfolio;
- $SA_{IMA\ desks}$ is the non-default risk capital requirement for modelled desks;
- $DRC_{IMA}$ is the incremental default risk charge using the FRTB-IMA DRC model;
- $DRC_{SA}$ is the incremental default risk charge using the SA-DRC.

**Industry Recommendation:**

Given that the DRC specifically addresses the incremental charge for capturing the sudden JTD risk of issuers, the industry recommends the following:

- The internal model-based DRC should be treated independently from the approval to use the FRTB-IMA (ES and NMRF measurement model) at the trading desk level; and
- Banks should have the flexibility to use the regulatory prescribed SA-DRC instead of being mandated to develop an internal DRC model for FRTB-IMA trading desks.

[56] It is worth noting that the capital surcharge component would be irrelevant if the PLAT remains a supervisory monitoring tool.

# 4. Industry Proposed Adjustments to Other Aspects of the Market Risk Framework

## 4.1. Corporate actions

Article 104(2)(a) requires unlisted equities to be classified in the banking book. There is no consideration for normal life cycle events in the equity markets, such as a delisting due to an acquisition, sale, or spinoff, when subjecting an equity to reclassification under Articles 104(2)(a) and 104a. The lack of consideration for normal life cycle events will cause a material impact both with regards to on-balance sheet positions and collateral eligibility under counterparty credit risk.

**Industry Recommendation:**

We recommend that, to avoid temporary volatility in the trading book / banking book boundary, the PRA exempt equities undergoing corporate actions from being reclassified to banking book status under Article 104a, thereby allowing the bank to keep these equities in the trading book.

## 4.2. Treatment of derivatives for treasury management

We acknowledge the PRA's proposal under Article 104(6)(a)[57] that instruments conclusively designated as being held for trading purposes under the accounting framework applicable to the institution must be mandatorily classified into the trading book. We understand the intent to align regulatory classification with accounting treatment where such designation reflects genuine trading intent. However, we propose that the PRA consider a targeted exception for treasury activities —derivatives or other instruments used for liquidity and balance sheet management—that are designated as "held for trading" solely due to fair value accounting requirements, but which are not managed as trading book exposures. The proposed exception would be similar to the carve out of SFTs for liquidity management purposes in Article 104(6)(e).

Under IFRS, for example, derivatives such as interest rate swaps, FX forwards, and cross-currency swaps are by definition "held for trading" and required to be measured at fair value through profit and loss (FVTPL) unless they are a designated and effective hedging instrument. This accounting classification does not necessarily reflect the institution's intent to trade these instruments for short-term profit or market-making purposes. In practice, many of these derivatives are executed by treasury functions to manage structural interest rate risk, currency mismatches, or funding and liquidity positions. These positions are typically held with a long-term horizon, are not subject to active trading strategies, and are not managed within the trading book infrastructure.

[57] Prudential Regulation Authority. *Policy Statement PS9/24: Near-Final Market Risk Rules*. September 2024. Article 104 – "Inclusion in the trading book or non-trading book". Available at: https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2024/september/ps924app2.pdf

The current drafting of paragraph 8 allows institutions to request a derogation from the mandatory trading book classification if they can demonstrate that the instrument is not held for one of the reasons listed in paragraph 4 and if they document each such instrument on an ongoing basis. If no exception is made for treasury derivatives, institutions will be required to apply for a series of permissions, even for standardised, recurring transactions that are clearly not held with trading intent which is a significant operational burden both for the firm and the PRA. This would result in a disproportionate compliance overhead and create unnecessary friction in the management of liquidity and funding operations.

**Industry Recommendation:**

We recommend that treasury activities are exempted from Article 104(6)(a) which states that an instrument that is conclusively designated as being held for trading purposes under the accounting framework applicable to the institution, should be assigned to the trading book.

### 4.3. Clarification on Large Exposures

The industry notes that the current Large Exposure (LE) Articles (390(3) & 390(5))[58] continue to reference the existing standardised market risk rules for the purposes of trading book issuer risk exposure calculations. To ensure clarity and consistency in implementation, the industry would appreciate clarification from the PRA on how firms transitioning to FRTB-SA should interpret and apply the LE rules in the absence of the legacy standardised market risk framework. In particular, we seek clarification on whether the PRA intends to update the LE framework to explicitly reference the FRTB-SA DRC methodology for issuer risk as specified in LEX 30.22 – 30.30[59], or whether transitional guidance will be provided to firms adopting FRTB-SA ahead of any formal LE rule amendments.

**Industry Recommendation:**

The industry requests clarification from the PRA on whether firms may continue to apply the existing LE references to the standardised rules on a notional basis for issuer risk purposes, pending formal alignment of the LE framework with the FRTB-SA.

[58] Prudential Regulation Authority. *Policy Statement PS22/21: Near-Final Market Risk Rules.* September 2024. Article 390 – "Calculation of exposure value". Available at: PRA RULEBOOK (CRR) INSTRUMENT 2021
[59] Basel Committee on Banking Supervision. *Basel Framework: LEX 30.* March 2020. Available at: https://www.bis.org/basel_framework/chapter/LEX/30.htm?inforce=20230101&published=20200327.

# Appendix A: UK CRR Typos and Drafting Errors

## A.1 Non-trading book FX HPL and APL calculation

| **Article 325a1, paragraphs (14) and (16)** | |
|---|---|
| Original Article | Proposed Change |
| 14. By way of derogation from paragraphs 9 to 12 of Market Risk: Internal Model Approach (CRR) Part Article 325bf, an institution computing the hypothetical and the actual changes in the portfolio's value referred to in Market Risk: Internal Model Approach (CRR) Part Articles 325bf and 325bg in relation to a non-trading book position which is subject to foreign exchange risk and not to commodity risk shall calculate the value of that non-trading book position at the end of the day following the computation of the value-at-risk number referred to in Market Risk: Internal Model Approach (CRR) Part Article 325bf using the value of that non-trading book position at the end of the previous day and updating its component reflecting the foreign exchange risk. | 14. By way of derogation from paragraphs 9 to ~~12~~ 14 of Market Risk: Internal Model Approach (CRR) Part Article 325bf, an institution computing the hypothetical and the actual changes in the portfolio's value referred to in Market Risk: Internal Model Approach (CRR) Part Articles 325bf and 325bg in relation to a non-trading book position which is subject to foreign exchange risk and not to commodity risk shall calculate the value of that non-trading book position at the end of the day following the computation of the value-at-risk number referred to in Market Risk: Internal Model Approach (CRR) Part Article 325bf using the value of that non-trading book position at the end of the previous day and updating its component reflecting the foreign exchange risk. |
| *[…]* | *[…]* |
| 16. By way of derogation from paragraphs 9 to 12 of Market Risk: Internal Model Approach (CRR) Part Article 325bf, an institution computing the hypothetical and the actual changes in the portfolio's value referred to in Market Risk: Internal Model Approach (CRR) Part Articles 325bf and 325bg in relation to a non-trading book position which is subject to commodity risk shall calculate the value of that non-trading book position at the end of the day following the computation of the value-at-risk number referred to in Market Risk: Internal Model Approach (CRR) Part Article 325bf of that Regulation in accordance with either of the following, provided that they use it consistently for all non-trading book positions subject to commodity risk in the trading desk: (a) an institution shall use the value of that non- | 16. By way of derogation from paragraphs 9 to ~~12~~ 14 of Market Risk: Internal Model Approach (CRR) Part Article 325bf, an institution computing the hypothetical and the actual changes in the portfolio's value referred to in Market Risk: Internal Model Approach (CRR) Part Articles 325bf and 325bg in relation to a non-trading book position which is subject to commodity risk shall calculate the value of that non-trading book position at the end of the day following the computation of the value-at-risk number referred to in Market Risk: Internal Model Approach (CRR) Part Article 325bf of that Regulation in accordance with either of the following, provided that they use it consistently for all non-trading book positions subject to commodity risk in the trading desk: (a) an institution shall use the value of that non- |

| | |
|---|---|
| trading book position at the end of the previous day and update only the components reflecting the foreign exchange and commodity risk; or (b) an institution shall use the value of that non-trading book position at the end of the previous day and update all the components the institution uses to value that non-trading book position, including those not pertaining to the foreign exchange or commodity risk broad risk factor categories | trading book position at the end of the previous day and update only the components reflecting the foreign exchange and commodity risk; or (b) an institution shall use the value of that non-trading book position at the end of the previous day and update all the components the institution uses to value that non-trading book position, including those not pertaining to the foreign exchange or commodity risk broad risk factor categories |

Rationale

Article 325a1 paragraphs 14 and 16 reference only paragraphs 9 – 12 of Article 325bf. This appears to be a drafting oversight, as paragraphs 13 and 14 are integral to the same back-testing framework.

Paragraph 13 specifies how adjustments must be valued at the trading desk level, and paragraph 14 sets out the technical elements required for computing hypothetical changes in portfolio value for back-testing. Excluding these paragraphs produces inconsistency and could lead to misapplication in practice. We therefore recommend that the reference be corrected to encompass paragraphs 9 – 14.

### A.2 RFET reference to qualitative audit requirements

| **Article 325be, paragraph (6)(d)** | |
|---|---|
| Original Article | Proposed Change |
| 6. An institution shall use a transaction or a quotation for the purpose of points (a)(ii) and (a)(iii) of paragraph 5 only if all the following conditions are met:<br>*[…]*<br>(d) the institution has verified that the third-party vendor is subject, at least annually, to an independent audit by a third-party undertaking, within the meaning of Article 325bi(1)(h), regarding the validity of its price information, governance and processes, and has access to audit results and reports, in case these are requested by the PRA. | 6. An institution shall use a transaction or a quotation for the purpose of points (a)(ii) and (a)(iii) of paragraph 5 only if all the following conditions are met:<br>*[…]*<br>(d) the institution has verified that the third-party vendor is subject, at least annually, to an independent audit by a third-party undertaking, within the meaning of Article ~~325bi(1)(h)~~ 325bi(1)(i), regarding the validity of its price information, governance and processes, and has access to audit results and reports, in case these are requested by the PRA. |

| | |
|---|---|
| For the purpose of point (d), the independent audit by a third-party undertaking shall include, at a minimum, all of the following elements:<br><br>(i) that the third-party vendor possesses the information necessary to verify that a price is verifiable in accordance with paragraph 5 of this Article, as well as the information necessary to map the verifiable prices to the risk factors for which they are representative in accordance with paragraph 7 of this Article;<br><br>(ii) that the third-party vendor is able to demonstrate the integrity of the information referred to in point (a);<br><br>(iii) that the third-party vendor has in place internal processes and a sufficient number of staff with a level of skills appropriate for the management of the information referred to in point (a); and<br><br>(iv) that, where a third-party vendor does not provide the institution with the information to verify that a price is verifiable in accordance with paragraph 5 of this Article, the third party vendor is contractually obliged to verify itself that the price is verifiable in accordance with this Article; | For the purpose of point (d), the independent audit by a third-party undertaking shall include, at a minimum, all of the following elements:<br><br>(i) that the third-party vendor possesses the information necessary to verify that a price is verifiable in accordance with paragraph 5 of this Article, as well as the information necessary to map the verifiable prices to the risk factors for which they are representative in accordance with paragraph 7 of this Article;<br><br>(ii) that the third-party vendor is able to demonstrate the integrity of the information referred to in point (a);<br><br>(iii) that the third-party vendor has in place internal processes and a sufficient number of staff with a level of skills appropriate for the management of the information referred to in point (a); and<br><br>(iv) that, where a third-party vendor does not provide the institution with the information to verify that a price is verifiable in accordance with paragraph 5 of this Article, the third party vendor is contractually obliged to verify itself that the price is verifiable in accordance with this Article; |

Rationale

We note that Article 325be(6)(d) incorrectly refers to Article 325bi(1)(h). Paragraph (h) relates to stress testing requirements and is unrelated to the audit and review obligations envisaged under 325be(6)(d). The correct cross-reference should be to Article 325bi(1)(i), which specifies the requirement for an independent review of risk measurement models by either internal audit or a qualified third party. This aligns with the intent of 325be(6)(d), which is to ensure that any third-party vendor providing price information is subject to an independent review process. The current drafting therefore appears to be a typographical oversight, and we recommend amending the reference to Article 325bi(1)(i).

## A.3 Qualitative audit requirements

| **Article 325bi, paragraph (2)(h)** | |
|---|---|
| Original Article<br><br>2. The institution shall conduct a review of its overall risk management process at least once a year which shall assess the following:<br><br>*[…]*<br><br>(h) where the review is performed by a third-party undertaking in accordance with point (h) of paragraph 1 of this Article, the verification that the internal validation process set out in Article 325bj fulfils its objectives. | Proposed Change<br><br>2. The institution shall conduct a review of its overall risk management process at least once a year which shall assess the following:<br><br>*[…]*<br><br>(h) where the review is performed by a third-party undertaking in accordance with point ~~(h)~~ (i) of paragraph 1 of this Article, the verification that the internal validation process set out in Article 325bj fulfils its objectives. |
| Rationale<br><br>This provision incorrectly cross-refers to paragraph (1)(h). As outlined in our rationale under A.2, paragraph (h) concerns stress testing and is unrelated to independent review requirements. The correct reference should again be to paragraph (1)(i). The rationale set out previously applies equally here. | |

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