

# **European Commission Targeted Consultation on the Competitiveness of the EU banking sector**

April 2026

Industry Response

## Executive summary

On behalf of our members, the International Swaps and Derivatives Association ('ISDA'), welcome the opportunity to comment on the European Commission's ('EC') targeted consultation on the competitiveness of the EU banking sector.

Safe and efficient derivatives markets play a vital role in managing risk and facilitating sound, liquid capital markets, in turn supporting and contributing to job creation and economic growth. The over-the-counter (OTC) derivatives market is a cornerstone of the global financial system, enabling corporations, governments and financial institutions around the world to manage risk, enhance returns, optimize liquidity, efficiently allocate capital and generate value.

Since the 2008 Global Financial Crisis, the EU has introduced a framework improving the management of risk and helping to mitigate systemic risk and creating further transparency, which has been beneficial to the EU financial markets. A key component of this framework are the 'trading book' capital rules, which determine the amount of capital that banks need to hold against their wholesale market intermediation business<sup>1</sup>. ISDA supports the objectives of the BCBS reform and in particular a risk appropriate capital framework.

As the EU policy mandate strives to bolster the ability of its financial markets and banking sector to grow, remain competitive and provide investment solutions in a changing global environment, new capital rules impacting trading will play a significant role and have an impact on market-based financing, liquidity provision and hedging solutions for end users in Europe. Complexity, burden reduction and simplification are also an integral part of the EU agenda.

This response offers some perspectives on why trading book capital matters for Europe, key challenges that banks currently face and some recommendations on how to address these concerns. ISDA has long advocated for calibration changes to achieve a robust and risk-sensitive framework, which is critical for deep and liquid markets.

First divergence and undue complexity in the rules need to be addressed, particularly for the market risk framework. Differences between jurisdictions in the timing and calibration of Basel III can create market distortions and added complexity for globally active banks.

Another important concern is the continued viability of internal models under the new Fundamental Review of the Trading Book ('FRTB') framework. Banks are significantly reducing their use of internal models under FRTB - an outcome which was not anticipated and where the output floor weighs in significantly in the balance. Evidence shows it can materially limit the capital benefits of internal models

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<sup>1</sup> Including providing end users such as corporates, sovereigns and institutional investors with access to capital-markets-based funding, and capital, investment and hedging solutions

and while the floor is intended to enhance consistency and comparability, it will result in a significant drop in firms applying to use more advanced techniques to calculate their market risk capital requirements. As such, we would encourage the EU to take a look at the broader impact of the output floor, also given the different approaches to implementation taken in other jurisdictions including the US.

The industry has also raised concerns over the design and calibration of the standardized approach for counterparty credit risk ('SA-CCR'), as certain parameters are outdated and inconsistently applied across regions. For example, the current value of the alpha factor is set at 1.4 which reflects a previous calibration that was designed to account for general wrong-way risk and address internal model weaknesses rather than serving as a permanent parameter for a standardized approach.

The current design of SA-CCR also treats derivatives and SFTs separately and does not recognize the risk-reducing benefits of legally enforceable netting arrangements across products, including repos and futures. This lack of recognition can result in capital requirements that significantly overstate exposure relative to economic risk.

Further consideration of cross-product netting in the SA-CCR exposure calculation would result in greater risk sensitivity while maintaining prudential safeguards. Ultimately, SA-CCR is used as an input into the leverage ratio, the large exposures framework and the output floor in certain jurisdictions and as a result, the framework needs to be reviewed at the Basel Committee level to ensure an appropriate and consistent calibration.

Finally it is also critical that new technology and infrastructure functions safely and efficiently. How we address opportunities and challenges of tokenization or other use of new technology in financial markets should not adversely affect legal and regulatory certainty or systemic stability, including settlement finality. It should also facilitate the safe and efficient management of risks, including liquidity, market and credit risk.

## EC Questionnaire

### Section 1 Banking Competitiveness in the EU and globally

#### Contribution of the banking sector to the EU economy

##### Question 1

*How is the banking sector currently supporting economic growth in the EU, and to what extent (for example, by providing loans to households and businesses, supporting innovative sectors, and helping channel investments into capital markets (including for retail investors))? How could banks do more to boost productivity and economic growth, thereby supporting the priorities of the EU and accelerating the green, digital and social transitions? Please give concrete examples and evidence.*

Wholesale banking activities are fundamental to the functioning of European and global capital markets, facilitating investments across different sectors and industries.

Market-based financing provides many benefits to the European economy:

- It allows low cost capital formation to new and existing industries that want to expand;
- It allows investors to efficiently manage their assets when their portfolio needs adjustment;
- It ensures risk is appropriately managed – for example small mortgage banks and individual mortgage takers, corporates, SMEs, sovereign issuers and investors are able to access crucial hedging solutions via wholesale markets.

Banks' wholesale and trading operations are profoundly global, and the issue of competitiveness is a key factor for consideration. This is because investors from different regions are looking for the best investment opportunities within their mandates, and securities issuers have access to finance from all corners of the world. Equally, frictionless intermediation by broker-dealer banks is at the core of liquidity formation in most markets.

Trading and derivatives will be fundamental for the EU – serving to, amongst others:

- achieve an economic renewal that delivers jobs, growth, and prosperity, including through improving the financing possibilities for European companies, and investment opportunities for Europeans. Derivatives support competitiveness by helping companies mitigate risk, by increasing market risk transparency and by lowering financing costs to support growth.
- reach its sustainability objectives with derivatives serving as a fundamental risk management tool; one that supports innovative financing solutions for green technologies and the global economy's transition from carbon
- reinforce its resilience with a focus on further developing and improving the functioning of critical European markets and market infrastructure – a goal linked to ensuring Europe's status as a standard for sound, stable regulation that underpins financial stability

Trading book capital will play a key role in Europe’s ambition to deliver on its flagship initiative - the Savings and Investment Union (‘SIU’), in particular because of its ability to impact bank business decisions to invest in certain products or segments, and/or potentially restraining lending capacity – all of which then affect banks’ ability to mobilise financing that the EU currently needs.

Looking at the banking sector’s capacity will be important as evidenced by the Draghi report on European Competitiveness<sup>2</sup>: *“The EU should also assess whether current prudential regulation, also in light of the possible upcoming implementation of Basel III, is adequate to have a strong and international competitive banking system in the EU”*

Careful assessment of the trading book prudential framework and in particular its risk-appropriateness is necessary – as there are products that attract disproportional amount of capital and as the cost increases, banks may opt to reduce or withdraw from such activities. Capital impacts need to be carefully considered against the importance of the market-making role of banks in capital markets in Europe. The intermediary role played by banks in capital markets through trading could be hampered due to an increase of capital requirements, limiting the capacity of banks to offer market liquidity and act as market-makers.

## Digitalisation

### Question 28

*In the context of the increasing digitalisation of financial services, what do you consider could enhance confidence of clients in digitally provided investment products and services, thereby influencing the dynamic of new business models?*

It is critical that new technology and infrastructure functions safely and efficiently. Industry initiatives such as the Common Domain Model (‘CDM’)<sup>3</sup> and Digital Regulatory Reporting (‘DRR’)<sup>4</sup> enable broader digitization across the transaction lifecycle. Building on these foundations, digital documentation, smart-contract execution, and digitized representations of eligible collateral, including tokenized collateral, can support real-time data sharing, consistent lifecycle processing, and cross-product workflow automation. When combined with interoperable technology platforms, these capabilities can strengthen operational resilience, reduce settlement and reconciliation risk, improve liquidity management, and reduce funding costs across the ecosystem.

We therefore welcome the opportunity to comment on the opportunities and challenges associated with tokenization and other uses of new technology in financial markets, including the prudential requirements impacting cryptoassets.

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<sup>2</sup> [https://commission.europa.eu/document/download/97e481fd-2dc3-412d-be4c-f152a8232961\\_en?filename=The%20future%20of%20European%20competitiveness%20-%20A%20competitiveness%20strategy%20for%20Europe.pdf](https://commission.europa.eu/document/download/97e481fd-2dc3-412d-be4c-f152a8232961_en?filename=The%20future%20of%20European%20competitiveness%20-%20A%20competitiveness%20strategy%20for%20Europe.pdf)

<sup>3</sup> The Common Domain Model (CDM) is a standardized, machine-readable and machine-executable model that represents financial products, trades in those products and the lifecycle events of those trades: <https://www.isda.org/isda-solutions-infohub/cdm/>

<sup>4</sup> Digital Regulatory Reporting (DRR) solution uses the open-source CDM to transform an industry-agreed interpretation of new or amended regulatory reporting rules into unambiguous, machine-executable code, making implementation more efficient and cost effective: <https://www.isda.org/isda-solutions-infohub/isda-digital-regulatory-reporting/>

In addressing these opportunities and challenges it is important that regulatory approaches do not undermine legal and regulatory certainty or systemic stability, including settlement finality; and should facilitate the safe and efficient management of risks, including liquidity, market and credit risk.

Tokenization can facilitate almost instantaneous settlement, rather than the usual T+1/T+2 or longer timeframe. This capacity offers opportunities to substantially reduce counterparty, settlement, and market risk, as well as allow for improved liquidity management, including intra-day liquidity. For instance, instantaneous posting of tokenized collateral could replace the current process of posting cash and then replacing with a money market fund (“MMF”) unit or a security, if collateral had to be moved quickly. Tokenization enables simultaneous (“atomic”) exchanges of collateral, eliminating “give before get” risks in collateral substitutions.

Market stress events in recent years like the March 2020 dash for cash and the September 2022 UK gilt crisis have underscored the important efforts by ISDA and industry participants to bring more efficiency and data standardization to collateral management processes. The exchange of collateral is one of the central regulatory efforts to mitigate counterparty credit risk and maintain the resilience of the financial system. Greater automation and data standardization will help drive efficiency and reduce risk in collateral management, as well as help reduce funding costs for market participants.

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The Basel Cryptoasset Standards<sup>5</sup> restrictive qualifications standards, combined with otherwise punitive market and credit risk capital treatments, effectively make it uneconomical for banks to meaningfully participate in the cryptoasset market.

The prudential framework for those markets should not discourage participation by imposing overly punitive capital requirements that are inconsistent with the actual risks.

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The European Banking Authority (‘EBA’) is still developing the detailed prudential classification through technical standards. We therefore recommend considering the following non-exclusive recommendations, which were included in our letter<sup>6</sup> to the BCBS last year, to improve the Cryptoasset Standard consistent with guiding principles of safety and soundness and technology neutrality:

1. *Eliminate the distinction between permissioned and permissionless ledgers for Group 1 Eligibility.* There should be no ex-ante distinction between permissioned and permissionless ledgers. The focus of regulatory supervision and treatment should be on the risk of the asset itself, not the attributes of underlying ledger.
2. *Replace classification condition 2.* Classification condition 2 of SCO 60 should be revised to place less emphasis on prescriptive ledger rules, and instead evaluate cryptoassets on their compliance with the principles of legal enforceability and settlement finality that are the spirit of the condition.

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<sup>5</sup> BCBS | SCO60 – Cryptoasset Exposures, [https://www.bis.org/basel\\_framework/chapter/SCO/60.htm](https://www.bis.org/basel_framework/chapter/SCO/60.htm)

<sup>6</sup> <https://www.isda.org/2025/08/25/joint-trades-submit-letter-to-bcbs-calling-for-recalibration-of-cryptoasset-prudential-standards/>

3. *Reconsider treatment of regulated stablecoins.* The Cryptoasset Standard should reflect a recognition that regulated and unregulated stablecoins have different risk profiles. Regulated stablecoins should be treated as eligible financial collateral.
4. *Recognize certain cryptoassets as eligible collateral.* Banks should be allowed to recognize Group 2a cryptoassets as financial collateral.
5. *Reconsider treatment of Group 2 cryptoassets.* Spot cryptoassets are increasingly traded by supervised institutions on regulated exchanges, with improving market liquidity, meaning that many assumptions underlying the design and calibration of the Cryptoasset Standard require revision. In particular, we recommend that the BCBS:
  - a. *Remove the limit on Group 2 cryptoasset exposure.* The current limit is too restrictive and does not recognize increasingly prevalent hedging practices.
  - b. *Update the hedging recognition test.* Revise the first hedging recognition test for Group 2a cryptoassets to reflect the increasing prevalence of spot cryptoasset transactions on regulated exchanges.
  - c. *Adjust the prescribed risk weight.* The risk weight for Group 2a cryptoassets should be adjusted to better reflect actual risk.
  - d. *Simplify risk factor rules.* Remove the current “cross-tenor” and “cross-exchange” rules for Group 2a cryptoassets that are no longer relevant in the more mature market and consider cross-bucket correlations consistent with other asset classes.
6. *Allow the use of market-risk and counterparty-risk internal models.* The Cryptoasset Standard should reflect a recognition that banks should be allowed to use internal market risk and counterparty risk models for cryptoassets in particular Group 2a cryptoasset, as the depth of their markets and quality of their inputs indicate their suitability for internal model treatment.

In November 2025<sup>7</sup> and March 2026<sup>8</sup>, the Basel Committee signalled that they are working on technical amendments to the final crypto rule, reflecting both how quickly the underlying blockchain technology is changing and the need to keep the capital framework evolving alongside it.

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<sup>7</sup> [Press release: Basel Committee continues to prioritise Basel III implementation, approves final principles on third-party risks and agrees to expedite targeted review of cryptoasset standard](#)

<sup>8</sup> [Press release: Basel Committee issues a consolidated version of its guidelines](#)

## The Single Market and the Banking Union

### Sovereign exposure and risk reductions

#### Question 45

*Do you consider that the EU framework on the regulatory treatment of sovereign exposure should be improved? If yes, how should this be done, and how would it affect the holdings of sovereign debt by banks?*

From a trading book perspective, an obvious inconsistency remains in the Default Risk Charge<sup>9</sup> ('DRC') between IMA and SA in relation to sovereign issuers of low risk. These include EU Sovereign issuers, covered bonds or other Sovereign issues denominated in local currency of third countries whose supervisory and regulatory requirements are considered equivalent, that give rise to significant differences in the regulatory capital charges associated, as well as their risk perception between these two approaches.

In FRTB DRC SA, exposures that receive a 0% risk weight in the credit risk SA (sovereigns, public sector entities and multilateral development banks as well as international organizations that are treated similarly to a sovereign in CRR), shall be assigned a 0% risk weight. However, in IMA, a 3bp probability of default floor applies to exposures that are risk weighted 0%. All counterparties to which a 0% risk weight applies in SA-DRC should not be subject to the PD 3bp floor in IMA-DRC.

The final CRR 3 text has addressed partly these issues by lowering the floor for sovereign to 1pbs instead of 3bps in the Basel text. The European Commission as part of its targeted relief measures to be implemented in the context of the market risk delegated act proposes "applying a 0 multiplier to the probability of default (PD) of the respective issuer/obligor" that would attract a 0% risk weight under the standardised approach for credit risk. What should be considered on a long-term and permanent basis, is to exclude from the IMA DRC scope all issuers for which some positions could be subject to a 0% risk weight under the standardised approach. This would align with the treatment adopted in the UK, noting that the UK framework applies a broader exclusion from IMA-DRC.

<sup>9</sup> Extract from [BCBS monitoring report](#) published in September 2021: The default risk capital (DRC) requirement in the Standardised Approach (SA) contributes 29.0% and 34.3% to the total standardised approach capital requirements for Group 1 and Group 2 banks, respectively. The DRC for internal models is expected to contribute 35.1% for Group 1 banks and 37.6% for Group 2 banks.

## Complexity and Effectiveness of the Regulatory Framework

### General assessment

#### Question 49

*Which type of instrument adds the most undue complexity to these parts of the frameworks*

*Please explain*

Europe's regulatory architecture is characterized by a highly prescriptive set of requirements which often creates complexity, and results in more stringent requirements in comparison with other jurisdictions. You will find below some concrete examples of gold plating in the trading book area, mostly from the L2 standards that have created further complexity in the EU regulatory landscape.

- **RTS on NMRFS / RFET in the EU market risk framework**

Concerns on the capital impact and operational complexity of the Non-Modellable Risks ('NMRF') framework remain significant, though we acknowledge and welcome that there are plans to mitigate its impact with the adoption of a third market risk delegated act this year<sup>10</sup>.

Various components of the NMRFs framework create operational challenges, such as banks' ability to calibrate the stressed period using the direct method under the Option A. The calculation proposed is particularly intensive, as it requires seeking the stress period that maximizes the SES for that asset class. It would require a replication of the whole SES calculation for each different possible period, elevating the number of revaluations to a level that is almost unmanageable.

A important source of concern is the prescriptive nature of the RTS: it is unlikely that this level of prescription will be implemented globally, leading to further fragmentation of modelling standards. Globally active banks will be required to develop separate models for different regions in the midst of an uneven playing field.

Other jurisdictions have recognized these issues and have opted for significantly less stringent requirements. The PRA in the UK has existing expectations for firms to consider capital add-ons for these types of risks, and it considers that introducing a consistent framework in rules would enhance the approach and ensure greater consistency across firms. APRA in Australia recently announced it does not plan to implement the non-modellable risk factor framework or the modelled approach for default risk capital. The US has also proposed less prescriptive requirements in that regards, similar to the UK proposals in the proposals published for consultation in March 2026.

- **RTS on SFTs in CVA risk**

The industry believes that the proposed criteria by the EBA to assess the materiality of fair-valued securities financing transactions (FV SFTs) for CVA risk do not consider many aspects of these products and will lead to disproportionate capital charges.

<sup>10</sup> We understand that in the current planning risk factors may be treated as modellable with at least two verifiable prices over the observation period. Liquidity horizons are scaled as 250 divided by the number of verifiable prices, rounded to the nearest longer liquidity horizon

As the EU has pledged to look further into burden reduction and simplification, the materiality threshold set at 5% is too punitive and will lead to unnecessary operational burden. We have noted previously to the EBA<sup>11</sup> that there already exists a threshold to assess materiality in the RNIME framework and we recommended that the threshold to assess the materiality of SFTs for CVA should also be set at 10%, to ensure consistency with the RNIME framework. The EBA has also not considered other approaches being applied in other jurisdictions including in the UK and in the US. We note that the current US NPR publication is not considering SFTs in CVA. In light of the EU SIU flagship initiative to look at the competitiveness agenda and the importance of level playing field consideration in this area, we believe that consistency with other jurisdictions on the regulatory treatment for the FV SFTs in CVA risk is important to avoid European institutions being put at a competitive disadvantage.

As the EBA draft RTS are now under assessment, we urge the EC not to endorse the RTS which has been issued well in advance given it was only mandated to be delivered by July 2026. We believe non-endorsement is necessary to preserve EU banks' competitiveness and avoid undue burden on banks. This would enable EU banks to mitigate the capital impact on SFTs activity in a context where the potential calibration of SFTs associated risk-weights under the credit risk standardized approach remains uncertain and is under review as per Article 506f

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These examples raise the question of whether a principles-based regulatory framework, complemented by genuinely risk-based supervision, offers a more effective and globally competitive alternative. Under such a model, legislators and policy makers articulate the outcomes that regulation must achieve (e.g., strong governance, robust risk management, consumer protection, financial stability), while supervisors focus their attention and scrutiny on those institutions and activities that genuinely pose material risks.

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Beyond that, a predictable, coherent and competitively sustainable regulatory framework depends on proper sequencing: Level 1 obligations should only apply once the corresponding Level 2 standards are final, clear, and accompanied by an appropriate implementation period.

When this sequence breaks, firms face uncertainty, fragmented implementation, inconsistent supervision, and costly re-engineering. More broadly, poor sequencing undermines the EU's objectives of a deep, integrated, and competitive financial system. It also weakens supervisory convergence because national authorities must fill regulatory gaps with divergent interim expectations.

In short, sequencing is not administrative detail: it is a competitiveness and stability issue.

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This challenge is rooted in the Lamfalussy framework itself. Designed to speed regulatory development and make technical rules more agile, the model divides legislation across:

- Level 1: high-level legislative acts
- Level 2: detailed technical standards (RTS/ITS) and delegated/implementing acts
- Level 3: guidelines, Q&As, convergence tools

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[https://www.eba.europa.eu/system/files/webform/webform\\_consultation\\_17116/81822/EBA\\_RTS%20on%20criteria%20to%20assess%20the%20materiality%20of%20CVA%20risk%20exposures%20arising%20from%20SFTs%20risk.pdf](https://www.eba.europa.eu/system/files/webform/webform_consultation_17116/81822/EBA_RTS%20on%20criteria%20to%20assess%20the%20materiality%20of%20CVA%20risk%20exposures%20arising%20from%20SFTs%20risk.pdf)

- Level 4: enforcement

But in practice, the system often fails in synchronisation. Level 1 provisions enter into force months (or years) before Level 2 standards are developed and adopted. This creates a predictable structural problem: double implementation.

Firms must first implement broadly drafted Level 1 requirements without knowing how they will ultimately be operationalised, and then re-implement once the Level 2 text is finalised. This becomes especially acute where Level 1 provisions are highly operational, e.g., data fields, reporting formats, risk-measurement methodologies, or governance and control expectations.

The consequences are well understood:

- Duplicative cost: systems, processes and documentation must be re-built once RTS/ITS land.
- Incoherence and divergent national implementation: NCAs fill the vacuum with interim expectations that may differ.
- Supervisory friction and legal uncertainty: firms may be assessed against draft or anticipated standards rather than the legislation currently in force.
- Cliff effects and compliance gaps: obligations arrive on the statute book before they are realistically operable.
- Reduced competitiveness: global peers in jurisdictions with simultaneous rulemaking (e.g., the US or UK) do not face these repeated rounds of re-engineering.

These problems are not new. The Commission itself flagged them as concerns as early as 2007, and they were explicitly referenced again in the Council Conclusions of 12 December 2025, recognising the need for better sequencing to support market integrity, competitiveness, and operational feasibility. Yet despite this long-standing awareness, the issue continues to materialise across multiple frameworks, with EMIR 3.0 being a particularly notable example.

The EU needs a structural, legally backed solution recognising that the Lamfalussy process cannot function effectively unless sequencing is properly enforced.

Three elements are essential:

- A clear principle that Level 1 obligations dependent on Level 2 standards cannot apply until Level 2 is finalised. This should not be left to political goodwill or ad hoc industry pressure. It should be an explicit legal rule.
- A meaningful implementation period for each Level 2 act. Firms should have sufficient time to operationalise new requirements once RTS/ITS are in place. This avoids cliff effects and supports orderly, high-quality implementation.
- A mechanism for temporary relief where sequencing breaks. Because of the Meroni doctrine, EBA in the case of prudential regulation cannot suspend or neutralise Level 1 obligations, even where these are unworkable. This leaves a structural gap during periods of delayed technical standards, transitional misalignment, unexpected market stress or technical infeasibility.

A complementary mechanism is therefore required: empowering the Commission to temporarily suspend Level 1 requirements by delegated or implementing act. This would preserve the prerogatives of the co-legislators while offering a timely tool for targeted, temporary relief.

Such a mechanism would not be deregulatory - it would be an orderly implementation tool.

It goes without saying that, to ensure legitimacy and prevent abuse, any such suspension should be subject to clear safeguards, such as being time-limited, justified and published, subject to a clear rationale, recorded transparently and accompanied by clear signals to firms and NCAs. ISDA strongly supports a reform agenda that addresses the long-standing deficiencies in sequencing under the Lamfalussy model. Proper sequencing is essential for regulatory coherence, market functioning, and global competitiveness - it is a cornerstone of a regulatory framework that is coherent, proportionate, predictable, and fit for purpose.

## Prudential Framework / Risk Sensitivity

### Question 59

*What are the areas that create undue complexity in the prudential framework, if any? What are the ways to reduce undue complexity in the prudential framework without leading to deregulation and undermining financial stability?*

Divergence across jurisdictions risks influencing banks' participation in certain market-based activities, with potential implications for market liquidity and risk-management services.

#### **Market risk**

The EU is currently trying to address level playing field and risk of divergence in the area of the market risk rules. However other major jurisdictions, such as the US, continue to evolve and there is a high risk of misalignment between the EU and other jurisdictions.

Differences in timing and calibration increase the risk of misalignment and complicate the operation of globally active institutions.

In the US, a revised proposal was issued in March, paving the way towards finalization and implementation of the rules, whilst the UK is moving ahead with a 1/1/27 implementation timeline (apart from FRTB IMA which is set to go-live as of 1/1/28) and in the EU they are considering options to mitigate the impact of FRTB through the introduction of multiple temporary scalars and/or operational relief measures (for 3 years).

ISDA has long advocated for calibration changes to achieve a robust and risk-sensitive framework, which is important to support both safety and soundness and well-functioning markets. ISDA also believes it is critical that internal models have a viable future for the calculation of market risk capital.

While the FRTB framework deliberately raises the bar for the use of internal models, operational complexity and conservatism risk materially limiting their application in practice. This would be a major change that we do not think is in line with regulators' intentions.

We have proposed certain adjustments, including reducing the stringency of the profit-and-loss attribution test and addressing long-standing issues in the treatment of non-modellable risk factors, which would ensure the continued viability of internal models under the FRTB.

More broadly, the interaction between market risk requirements and the output floor warrants careful consideration. The industry study shows that the output floor can materially limit the capital benefits of internal models for market risk, particularly for banks with relatively small trading books. The introduction of the output floor, although intended to enhance consistency and comparability, is resulting in a significant decrease in firms applying to use more advanced techniques to calculate their market risk capital requirements and instead rely on the Standardized Approach.

Ultimately, addressing these issues will require continued international coordination, including through the Basel Committee, to ensure consistent and effective implementation.

#### **Access to clearing**

In addition, ISDA would like to address access to clearing and the complexity around equivalence decisions as an additional issue.

The continued and repeated uncertainty around time-limited equivalence decision on UK CCPs since Brexit harms EU firms and runs counter to the development of the SIU. To provide markets and EU market participants with much-needed certainty, the European Commission should grant a non-time-limited equivalence decision in relation to UK CCPs. We note that the legal and supervisory arrangements of the UK currently meet all the required conditions for a non-time limited equivalence decision as set out in Article 25 of EMIR.

Preventing EU counterparties from accessing UK CCPs for a wide range of financial instruments, including for products available for clearing on UK CCPs only (e.g. some commodity derivatives or interest rate swaps) and for products with very low liquidity on EU CCPs would lead to increased fragmentation of clearing across CCPs. This will increase total initial margin posted across the system because of loss of netting opportunities. More margin posted at the system-level means, by construction, that risk has increased. EU market makers would also have less access to the global liquidity pool to balance their trade flow and will have to buy more expensive hedges from their global competitors, thereby becoming regional distributors to global banks.

The EMIR 3.0 requirement to clear a representative number of trades through an EU CCP under the Active Account Requirement (Article 7a) introduces significant operational complexity and additional costs for market participants. It obliges firms to maintain parallel clearing arrangements, closely monitor the number of trades cleared at Tier 2 and EU CCPs, and establish new stress-testing and reporting frameworks. These obligations increase risk-management burdens without delivering commensurate financial stability benefits.

In addition, EMIR 3.0. introduces new burdensome reporting requirements on EU counterparties. For example, it introduces a new requirement to report information on clearing activities at recognised third country CCPs (Article 7d) on an annual basis. While we understand that EU authorities need to be able to assess potential financial stability risks associated with clearing at third country CCPs, the scope of entities and instruments subject to the requirement appears disproportionate. The potential inclusion of non-derivative instruments, which are outside the traditional scope of EMIR, creates significant legal uncertainty and would require firms to build entirely new data sourcing and reporting systems for products not previously subject to EMIR reporting.

### **Remuneration**

EU remuneration rules create a significant competitive disadvantage for banks when compared with other jurisdictions and to rules for non-banks. The bonus cap has been particularly negative because it has resulted in a higher proportion of fixed pay in total pay, thereby raising fixed costs for firms across the cycle, including in downturns. By raising the proportion of fixed pay, the bonus cap has also meant a reduction in the proportion of remuneration that is performance-based and subject to risk adjustment (including malus and clawback).

In addition, we would note that countries that have not implemented bonus caps for bankers – like the United States, Hong Kong, Singapore, – have not faced significant risk management problems due to their pay structures.

To improve the ability of banks in the EU to attract and retain talent, ensure effective risk management, and maintain a sufficient flexible cost base, we recommend removing the bonus cap and aligning EU remuneration rules with those in other major global financial centers.

## Prudential framework / Leverage ratio

### Question 62

*Do you think that the leverage ratio framework would need improvement? If yes, do you have any suggestions as to how to improve the leverage ratio framework?*

ISDA has previously highlighted that the leverage ratio acts can impede the ability of banks to act as intermediaries in the derivatives and SFTs market.

The key objective of leverage ratio reform should be to ensure the ratio functions as a backstop to risk-based capital requirements, rather than as a binding constraint. When the leverage ratio becomes the binding constraint, low-risk, balance sheet intensive activities are disproportionately penalized, including intermediation in the government bond and repo markets that are central to market functioning and financial stability.

As an example, the safest portions of a dealer’s SFT activity—narrow matched-book repos backed by high-quality collateral—can consume a disproportionate amount of leverage capacity. The largely gross leverage exposure measure results in these low-risk transactions attracting leverage usage similar to that of riskier activities. This misalignment with economic risk can discourage participation in market-stabilizing repo intermediation.

#### **Exempting government bond and repos from the leverage exposure remain key from an industry perspective.**

During the COVID era, regulators in some jurisdictions temporarily excluded government bonds and repos from the leverage ratio (including, for example, the supplementary leverage ratio (SLR) in the US) denominator to relieve acute balance-sheet pressures and support market functioning. This demonstrates that such exclusions can serve as an effective and targeted safety valve.

Global regulators should reaffirm their authority to exempt government bonds and repos from the leverage exposure denominator in exceptional macroeconomic or market-stress circumstances. Such exemptions would complement—not replace—broader capital reforms, help ensure the leverage ratio functions as a true backstop rather than a binding constraint, and preserve banks’ capacity to intermediate in government bond and repo markets across the economic cycle.

**Expanding netting eligibility is also a key focus for ISDA** as we believe the design of the leverage ratio can be further amended to better recognize high-quality collateral.

The current standardised regulatory framework treats derivatives and securities financing transactions (SFTs) separately and does not fully recognize the risk-reducing benefits and efficiencies of legally enforceable cross-product netting agreements. In practice, banks often manage derivatives and financing transactions on an integrated basis under common close-out arrangements, particularly for client clearing and liquidity management activities. A growing focus on the efficient use of funding resources to support liquidity means these arrangements are becoming more popular, driven by client demand.

However, netting relief is typically available only under narrowly defined conditions—such as strict matching of maturity, currency, and counterparty—which significantly limits institutions’ ability to optimize balance sheet usage. We believe the standardized approach for counterparty credit risk (SA-CCR) should be amended to recognize the risk-reducing benefits of netting across products, including repos and futures.

Where such cross-product netting is legally robust and operationally effective, limited recognition can result in capital requirements that overstate exposure relative to economic risk. Further consideration of whether, and under what conditions, cross-product netting could be recognised would support greater risk sensitivity while maintaining prudential safeguards. Furthermore, we believe there is a need for global coordination to revisit SA-CCR at the Basel level. The industry has raised concerns around the design and calibration of SA-CCR as certain parameters (such as the ‘alpha factor’) are out of date and inconsistently applied across regions. The current value of 1.4 reflects an outdated 2005 calibration originally designed to account for general wrong way risk and to address internal-model weaknesses rather than to serve as a permanent parameter for a standardized approach. SA-CCR is used as an input into the leverage ratio, the large exposure framework and the output floor – for certain jurisdictions, thus a Basel-level recalibration and harmonized implementation is required to restore a level playing field.

### **HQLA 1A government bonds received as variation margin should reduce the leverage exposure**

Significant institutional end-users such as insurance companies and asset managers rely on derivatives to notably risk-manage their very large portfolio of assets. Their business model implies they can mobilise high-quality securities such as HQLA 1A government bonds much more easily than cash and therefore tend to require that their derivative exposures facing banks are collateralized by such assets instead of cash. They are thereby unduly penalised under the current rules which only allow cash variation margin to reduce the leverage exposure.

Very high-quality government bonds qualifying as HQLA 1A under the LCR and NSFR framework should therefore be treated as cash for the purpose of the LR and banks should be allowed to reduce the corresponding leverage exposure (subject to meeting the relevant eligibility criteria<sup>12</sup>) to support those clients that post it as variation margin.

### **Central bank reserves and sovereign bond treatment**

We suggest the exclusion of central bank reserves and specific sovereign bonds constituting regulatory liquidity buffers (i.e., the numerator of the Liquidity Coverage Ratio) from the leverage exposure. This proposal seeks to rectify a counterproductive interdependency between the leverage ratio and liquidity ratios. The current paradox is that a bank aiming to bolster its liquidity buffer by capturing more funding will increase its liabilities and, consequently, its assets, which leads to a leverage ratio deterioration.

Indeed, the most straightforward strategy for managing this incremental liquidity is to deposit it with the central bank, thus this balance sheet growth results in a deterioration of the leverage ratio. The inclusion of central bank reserves in the leverage ratio measure implies that a bank striving to improve its liquidity position deteriorates its leverage ratio position, which is not an appropriate incentive for liquidity management.

A comparable inconsistency affects sovereign bonds that are held within liquidity buffers, qualify as HQLA 1, benefit from a 0% risk weight under the credit risk Standardised Approach and irrespective of their jurisdiction as the LCR mandates a diversified portfolio of HQLA. Assessing these assets as leverage exposure contradicts their intrinsic function: providing immediately mobilizable liquidity during stress periods (i.e. liquidity risk reduction).

Their exclusion would yield several advantages:

- Enhanced support for the financing of the EU's real economy.

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<sup>12</sup> CRR article 429.3

- Removal of impediments to maintaining adequate liquidity in normal times and allow a better diversification of the source of funding.
- Neutralization of some adverse effects on bank profitability, especially in a negative-interest-rate or increasing inflation environment.

## Prudential framework / Output floor

### Question 68

*What are your views on the following considerations regarding the EU implementation of the output floor?*

*Please explain*

From an ISDA's perspective, there is concern that banks are significantly reducing their use of internal models under FRTB - an outcome which was not anticipated and where the output floor weighs in significantly in the balance.

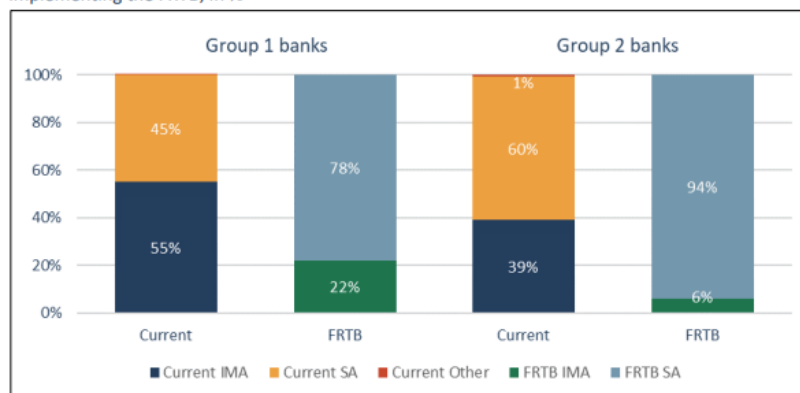
At the time of the initial FRTB consultation by the Basel Committee in 2012, most banks using internal model under the Basel 2.5 framework intended to transition to the FRTB-IMA on a like-for-like basis in terms of trading book coverage. In a global study published in July 2024<sup>13</sup>, out of the 26 banks who participated, only 10 banks intend to apply for IMA. Furthermore, those banks transitioning from the IMA under Basel 2.5 to the IMA under the FRTB only plan to do so for a very limited portion of the trading book (15-40% under the FRTB compared to an average of 85% under Basel 2.5).

In its Basel III monitoring report<sup>14</sup>, the EBA recognised that the use of FRTB IMA will be significantly reduced. Under the revised framework, the proportion of minimum capital requirements calculated using IMA will decrease from 55% to 22% and 39% to 6% for group 1 and group 2 banks respectively.

<sup>13</sup> <https://www.isda.org/2024/07/18/fundamental-review-of-the-trading-book-internal-models-approach-adoption/>

<sup>14</sup> <https://www.eba.europa.eu/sites/default/files/2024-10/eee3e459-52f3-4fe5-a911-18f9adf1d6cb/Basel%20III%20monitoring%20Report.pdf>

Figure 6: Contribution to the total market risk RWAs by each calculation method before and after implementing the FRTB; in %



Source: EBA QIS data (December 2023)

As part of this analysis, a significant number of banks that currently use the IMA under the Basel 2.5 framework plan to transition entirely to the standardized approach (SA) under the FRTB. Banks that intend to use the IMA under the FRTB generally only expect to do so for a limited number of trading desks. Some banks that plan to adopt the IMA intend to do so over a phased period, initially implementing the SA and transitioning to the IMA only once they have made a compelling business case and developed the necessary capabilities for the relevant trading desks.

The significant evolution and increased risk sensitivity of the SA under the FRTB is acknowledged, but there is a lack of incentive to implement and maintain the IMA, given the significant costs and resources required to do so.

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 why regulators should focus on addressing outstanding issues.

In the survey<sup>15</sup> that ISDA conducted when it responded to the EU targeted consultation on market risk in January 2026, 17 banks out of 31 indicated that improvements to the IMA framework would encourage greater adoption of FRTB IMA and 11 of those banks also indicated that the output floor disincentivized IMA adoption. We encourage the EC to look at the impact of the output floor with the market risk requirements, and more broadly given the different approaches taken by some jurisdictions (including the US where the recent NPR effectively removes its implementation altogether)

Some banks will be constrained by the output floor due to significantly larger credit portfolios relative to their trading footprint, which tends to dominate floor consumption. As a result, the potential benefit from the trading book capital component is generally limited and the benefits of a more sophisticated risk modelling approach are capped. It is important that the EC continues to look holistically at FRTB implementation issues.

<sup>15</sup> In total, 31 Banks have responded to the survey including EU and non-EU headquartered banks representing a total of €345bn Market Risk RWAs from the total sample.

We would also like to comment on the OF transitional arrangement relating to SA-CCR. Among the major reasons for the disproportionate impact of SA-CCR are its design and outdated calibration objectives, since the alpha factor of the formula, which increases exposures by 40%, was set at 1.4 in 2005 by the Basel Committee and was meant to be used to account for general wrong way risk and perceived flaws in internal models, not for standardised approaches.

The final CRR 3 text under Article 465, recognized the concerns that the industry raised with the impact of the alpha factor by resetting the alpha factor to 1 for a transitional period until 31 December 2029.

However, the transitional measure only applies to the calculation of SA-CCR for the purposes of the output floor RWA, whilst no measures have been taken to address calibration issues when SA-CCR is applied under the Standardised Approach (or unfloored capital risk framework), the Leverage ratio or the Large Exposures framework respectively even though there is a distinct impact in each of these areas:

- Standardised Approach (unfloored capital) RWAs: in its current design and calibration, will lead to disproportionate increases in capital requirements for banks and significantly increased costs for end-users (e.g., corporates – including SMEs, pension funds, etc.) which typically use non-cleared derivatives to hedge business risks;
- Leverage Ratio: is becoming a more biting constraint given the addition of the G-SIB surcharge, Pillar 2 requirements, Pillar 2 guidance, and notwithstanding the impact from its input into TLAC calibration. Therefore, the benefits of recalibrating alpha just for the output floor may not be achieved if the exposure measure value used in the Leverage ratio is not consistent.
- Large Exposures framework: the intent of the Large Exposures framework is to measure the propensity for concentration. The increased exposure values will reduce capacity to provide hedging products to end-users.

A simple approach would be to re-calibrate the alpha factor to 1 in the standardised approach<sup>16</sup>, as this would then feed into SA-CCR for all Standardised Approach calculations i.e. Counterparty Credit Risk including the Leverage Ratio and Large Exposures framework consistently.

The question of recalibration of SA-CCR also calls for a broader review in the Basel Committee to ensure global consistency. In the US, the alpha factor has been recalibrated to 1 on a permanent basis in relation to exposures to commercial end-users and it was not limited to the RWA output floor application only. In the UK, the PRA noted areas where data suggested the calibration was overly conservative and proposed to address that by reducing the SA-CCR alpha factor from 1.4 to 1 for exposures to pension funds and NFCs, and noted that “*a deviation from international standards was appropriate due to SA-CCR being over-calibrated relative to the IMM*”.

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<sup>16</sup> <https://www.isda.org/a/qTiDE/isda-letter-to-the-bcbs-on-sa-ccb-march-2017.pdf>

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### About ISDA

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