European Commission Targeted Consultation on the Application of the Market Risk Prudential Framework

January 2026

Industry Response

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The European Commission

Subject: Targeted consultation on the application of the Market Risk Prudential Framework.

Executive summary

On behalf of our members, the International Swaps and Derivatives Association ('ISDA'), the Association for Financial Markets in Europe ('AFME'), and the Institute of International Finance ('IIF') welcome the opportunity to comment on the European Commission's ('EC') consultation on the application of the market risk prudential framework. 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 framework known as the Fundamental Review of the Trading Book ('FRTB') for large European banks operating in wholesale financial markets.

Key jurisdictions have either gone ahead with implementation or are still considering options for FRTB implementation which has led to divergence in timing and on the content of the rules. The EC has noted in its Savings and Investments Union ('SIU') Communication[1] that preserving competitiveness and avoiding penalising banks operating at international level is a high EU priority. In that context, we welcome the EU decision[2] last year to delay FRTB to 1 January 2027. Our previous response[3][4] illustrated that a clear majority of our members supported the additional one-year delay to address level playing field issues and preserve EU banks' competitiveness.

The current situation in key jurisdictions that have not yet implemented FRTB such as the UK and the US has slightly evolved but uncertainty remains. The UK has proposed a delay of the internal model approach ('IMA') for market risk to 1 January 2028[5] and targeted changes to some aspects of the standardised approach ('SA') on the treatment of equity investment in funds and the residual risk add-on ('RRAO'). The UK Prudential Regulation Authority (PRA) has said it will publish its final rules in Q1 2026 but that rules relating to IMA will be finalised in light of developments in other jurisdictions[6]. The US process and timing to finalise and implement their Basel III end-game rules remain uncertain, although there are expectations that the US will propose new draft rules in 2026.

[1] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52025DC0124
[2] https://eur-lex.europa.eu/eli/reg_del/2025/1496/oj
[3] https://www.isda.org/2025/04/22/isda-iif-response-to-ecs-consultation-on-the-market-risk-prudential-framework/
[4] https://www.afme.eu/media/dy1j51et/afmeresponse...
[5] In effect the PRA has proposed to implement the Alternative Standardised Approach ('ASA') on 1 January 2027, while retaining the Basel 2.5 IMA permissions during the interim period of 2027
[6] https://www.bankofengland.co.uk/speech/2025/december/philip-evans-speech-at-the-international-swaps-and-derivatives

The risk of misalignment in both content and timing with these jurisdictions remains significant from an EU perspective. In a survey[7] conducted across our membership, 15 out of 31 banks, accounting for 57% of Market Risk RWAs, indicated they wish to delay FRTB implementation to ensure consistent implementation across jurisdictions and to support a level playing field and competitiveness issues. When only considering EU headquartered banks, 12 banks (out of 22) favour a delay which represents 71% of the Market Risk RWAs of EU headquartered banks

However, there are also 16 EU and non-EU headquartered banks accounting for 43% of Market Risk RWAs who wish to transition to the new FRTB framework on 1 January 2027, and have highlighted the continued operational complexities of running in parallel the new FRTB framework with the current Basel 2.5 standard. Furthermore, some banks would benefit from lower RWA under implementation and therefore, do not support a delay.

To balance these considerations, we believe a delay should be further considered, while banks should be allowed to transition to FRTB on 1 January 2027 fully if they wish to do so to address operational burdens (53% of Market Risk RWAs support such an opt in approach across the 31 banks surveyed and for EU headquartered banks, 44% of Market Risk RWAs are also in favour of this approach). The ability for the EU to delay would not only be beneficial to address information asymmetry but also ensure it is better equipped to react to developments in other regions to support consistent implementation, especially as we understand new proposals are expected from the US in 2026 and the UK will likely follow with further changes.

Banks who want to delay would be able to do so on the basis that they keep their existing Basel 2.5 regime in place.

In addition, our survey highlights that a large majority of banks[8] would be in favour of delaying the Trading Book / Banking Book boundary as banks remain concerned with the larger operational implementation issues associated with its application. A delay to the implementation of the new boundary is particularly crucial for firms that would make use of a delay to the implementation of FRTB, to ensure capitalisation remains appropriate and to avoid omissions in risk capture.

We acknowledge that the EU is more constrained in the tools it has at its disposal through a delegated act, and that a delay will only be possible through a Level 1 change.

[7] 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. 15 banks accounting for 57% of Market Risk RWAs are in favour of a delay while 16 banks accounting for 43% of Market Risk RWAs in the EU wish to transition to the new FRTB framework on 1 January 2027.

[8] 20 firms representing 63% of Market Risk RWAs from the total sample or, when considering only EU headquartered banks, 16 out of 22 banks representing 78% of market risk RWA.

In the absence of a Level 1 change, a delegated act remains the only instrument to address FRTB implementation issues. In its policy options the EC has laid out a dual approach proposing to introduce temporary and targeted changes and the use of a multiplier for market risk capital requirements for a period of three years.

The proposals in the EC's consultation to introduce amendments across SA and IMA and the introduction of a multiplier to guarantee capital neutrality for firms negatively impacted by FRTB implementation are a step in the right direction, but need to be carefully calibrated because this approach creates complexities, especially around the design and calibration of the multiplier, which remains a crude non-risk sensitive tool.

According to ISDA, AFME and IIF, there is a preference for bank-specific multiplier options versus industry-wide solutions.

We believe the multiplier option is only intended to apply after the implementation of the targeted measures and only to banks that are negatively impacted[9] by FRTB implementation[10].

To assess this, we reviewed the latest Pillar 3 disclosure data and based on available information, we determined that 14 banks out of the 31 that responded to the survey will be negatively impacted by FRTB implementation. **Among these 14 banks, option A is the most favoured option with 7 banks in support accounting for 74% of the Market Risk RWA for this sample**[11][12]. To fully achieve its primary objective and prevent any additional operational burdens, Option A must be accompanied by an extension of the EBA no-action letter related to the trading book/banking book boundary.

To address operational issues of running two systems in parallel, banks should be allowed to transition to the FRTB framework fully if they wish whilst banks who want to continue using their existing Basel 2.5 models should be allowed to do so.

As we have highlighted previously[13][14], certain components of the FRTB continue to pose challenges, due to the significant operational complexity and excessively conservative capital requirements that do not align with the underlying economic risk. These components therefore need to be addressed.

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[9] In our analysis, we recognise only those members who are negatively impacted by FRTB-SA go-live, i.e. only those who would be able to apply the capital neutrality multiplier as outlined in the EC's consultation. Using publicly available data in members' pillar 3 reports, both the FRTB-SA capital number and the Market Risk RWAs are considered. Where a firm does not publish their FRTB-SA capital, they are not considered in the analysis.

[10] The EC consultation refers to the multiplier being introduced *'for the overall market risk capital requirements that banks negatively impacted by the new rules (i.e. banks facing an increase in capital requirements for market risk) would be allowed to use to significantly limit their market risk capital requirement increases for three years.'*

[11] 74% represents the Market Risk RWA of the 14 banks that are negatively affected by the implementation of FRTB

[12] It should be noted that banks applying for IMA should have the flexibility to reduce their operational burden and apply a multiplier against FRTB-SA and for those banks that wish to apply the multiplier a cap should be applied.

[13] https://www.isda.org/2025/04/22/isda-iif-response-to-ecs-consultation...

[14] https://www.afme.eu/media/dy1j51et/afmeresponsetoectargetedconsultation...

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.

The temporary nature of the targeted amendments which would apply for up to three years, provides time to consider whether these changes should become permanent as well as other amendments to the framework. In our survey, 17 banks 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. Banks in certain jurisdictions 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.

Over the longer term, it is essential for the Basel Committee to thoroughly examine inconsistencies across jurisdictions. Irrespective of the changes made under the market risk delegated act, more permanent changes are necessary as part of a level 1 review of CRR to address long-standing implementation issues within the FRTB rules.

In our response, we have laid out our recommendations and where possible quantitative analysis to support the proposals, particularly on the targeted changes and design/calibration of the multiplier proposed in the consultation document, see Table 1, Table 2 and Table 3 below. In addition, the industry has provided further recommendations beyond the EC's proposals. 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 SA and 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 EC's adjustments to further improve and calibrate the FRTB framework.

Table 1 – Capital neutrality multiplier with Industry response

Capital Neutrality Multiplier	We recognise that the EC's proposal to introduce a capital neutrality multiplier is a pragmatic step to address level playing field issues within the constraint of the delegated act mandate. This remains a complex option. We recommend that the EC consider another delay while allowing banks to transition to FRTB on 1 January 2027 fully if they wish to do so to address operational burdens. As to the proposed options for the multiplier, there is a preference for a bank-specific multiplier vs industry wide

	options. Amongst the 14 banks negatively impacted by FRTB implementation, for whom we understand a multiplier would apply, option A is the most favoured option. However, banks who do not wish to apply the multiplier should not be required to do so and should not be required to continue running Basel 2.5 calculations, to avoid the operational issues of running two systems in parallel.

Table 2 – Internal Model Approach targeted amendments proposed by EC with Industry response

Profit & Loss Attribution Test (PLAT)	The industry proposes permanently removing the Spearman test from PLAT and using the KS test as the sole statistical measure during the monitoring period. This period should allow supervisors to evaluate whether the KS test can be appropriately recalibrated or whether PLAT should remain a supervisory reporting tool.
Non-Modellable Risk Factors (NMRFs)	The NMRF framework (including RFET) should be discontinued given the flaws in the design and disproportional capital impact. A secondary proposal seeks to introduce a surcharge to IMCC capital to reflect non-modellable risks. If these proposals are not accepted, fundamental structural changes to the NMRF framework (including RFET) are required.
Risk Factor Eligibility test (RFET)	If the proposal for the NMRF framework (including RFET) to be discontinued is not accepted, then fundamental structural changes to RFET are required. Responding to the EC's proposal: we support prorating the number of real price observations for new instruments. In addition, qualifying government and supranational debt risk factors should be excluded from the RFET process and automatically recognized as modellable.
Default Risk Charge (DRC) for sovereigns	The industry supports the EC's proposal but we seek clarification on how the 0 multiplier should be applied. The simplest solution would be to exclude the relevant positions from the scope of IMA DRC.
Treatment of CIUs	We welcome the relief provided for CIUs to apply the internal model approach, but we remain concerned with the 90% threshold. In principle, no threshold should be required if banks can demonstrate that the residual part of the fund is adequately capitalized to the satisfaction of supervisors.

Table 3 – Standardised Approach targeted amendments proposed by EC with Industry response

Treatment of CIUs	We support the EC's proposed frequency of applying the look-through approach, however, we recommend removing the 90% threshold on CIU exposures that banks must be able to look through in order to adopt the approach. In principle, no

	threshold should be required if banks can demonstrate that the residual part of the fund is adequately capitalized to the satisfaction of supervisors.
Recognition of hedges in DRC	We welcome the operational relief and additionally propose allowing banks to assign different maturities to equity derivatives and credit instruments to better match these instruments with their corresponding hedges, enhancing consistency with the IMA framework.
Instruments in scope of RRAO	The proposal is directionally positive but does not cover dividend derivatives or positions that exhibit correlation risk arising from instruments referencing indices. The industry recommends applying a multiplier of 0 to this distinct set of products.
Carbon trading exposures	We welcome the EC's proposal and recommend increasing the correlation parameter to 0.996 for aggregating carbon trading exposures as per ISDA[15] analysis.
Temporary multiplier for SA capital	We recommend introducing an FRTB SBM capital requirement multiplier of maximum 0.7[16] to better recognise diversification in line with historical industry observed correlation[17], and align with risk management. We further propose a longer-term recommendation for the EC to adopt a more risk-sensitive approach.

We also wish to highlight some errors and typos that are present in the current CRR3 (see Appendix 3) which could also be addressed as part of a corrigendum to the CRR 3 in order to align with the global standard set by the Basel Committee.

[15] ISDA. *Implications of the FRTB for Carbon Certificates*. July 2021. https://www.isda.org/a/i6MgE/Implications-of-the-FRTB-for-Carbon-Certificates.pdf

[16] Not considering various changes highlighted in this paper, this would translate approximately into a 0.85 multiplier applied to the overall FRTB-SA capital charge.

[17] Historical VaR data used as a suitable proxy for SBM to assess industry correlation, see section 2.1.5 for further details on the analysis.

Questions for stakeholders

Q1. What are your/your institution's views on pursuing the implementation of the FRTB with temporary modifications introduced by means of a delegated act, as outlined in this consultation paper?

The risk of misalignment in both content and timing with jurisdictions such as the US and UK remains significant from an EU perspective. In a survey[18] conducted across our membership, 15 out of 31 banks, accounting for 57% of Market Risk RWAs, indicated they wish to delay FRTB implementation to ensure consistent implementation across jurisdictions and to support a level playing field and competitiveness issues. When only considering EU headquartered banks, 12 banks (out of 22) favour a delay which represents 71% of the Market Risk RWAs of EU headquartered banks

However, there are also 16 EU and non-EU headquartered banks accounting for 43% of Market Risk RWAs who wish to transition to the new FRTB framework on 1 January 2027, and have highlighted the continued operational complexities of running in parallel the new FRTB framework with the current Basel 2.5 standard. Furthermore, some banks would benefit from lower RWA under implementation and therefore, do not support a delay.

To balance these considerations, we believe a delay should be further considered, while banks should be allowed to transition to FRTB on 1 January 2027 fully if they wish to do so to address operational burdens (53% of Market Risk RWAs support such an opt in approach across the 31 banks surveyed and for EU headquartered banks, 44% of Market Risk RWAs are also in favour of this approach). The ability for the EU to delay would not only be beneficial to address information asymmetry but also ensure it is better equipped to react to developments in other regions to support consistent implementation, especially as we understand new proposals are expected from the US in 2026 and the UK will likely follow with further changes.

Banks who want to delay would be able to do so on the basis that they keep their existing Basel 2.5 regime in place.

In addition, our survey highlights that a large majority of banks[19] would be in favour of delaying the Trading Book / Banking Book boundary as banks remain concerned with the larger operational implementation issues associated with its application. A delay to the implementation of the new boundary is particularly crucial for firms that would make use of a delay to the implementation of FRTB, to ensure capitalisation remains appropriate and to avoid omissions in risk capture.

We acknowledge that the EU is more constrained in the tools it has at its disposal through a delegated act, and that a delay will only be possible through a Level 1 change.

[18] 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. 15 banks accounting for 57% of Market Risk RWAs are in favour of a delay while 16 banks accounting for 43% of Market Risk RWAs in the EU wish to transition to the new FRTB framework on 1 January 2027.

[19] 20 firms representing 63% of Market Risk RWAs from the total sample or, when considering only EU headquartered banks, 16 out of 22 banks representing 78% of market risk RWA.

We consider that the Level 1 text could be amended with minimal changes to Article 461a of the CRR3[20].

In the absence of a Level 1 change, a delegated act remains the only instrument to address FRTB implementation issues. In its policy options, the EC has laid out a dual approach proposing to introduce temporary and targeted changes and the use of a multiplier for market risk capital requirements for a period of up to three years. We understand that the EC proposal is for both components to be taken forward.

The proposals in the EC's consultation to introduce amendments across SA and IMA and the introduction of a multiplier to guarantee capital neutrality for firms negatively impacted by FRTB implementation are a step in the right direction, but need to be carefully calibrated because this approach creates complexities, especially around the design and calibration of the multiplier, which remains a crude non-risk sensitive tool.

Q2. What are your/your institution's views on the temporary measures proposed for the delegated act?

The ten targeted amendments proposed to address FRTB SA and FRTB IMA are step in the right direction.

As we have highlighted in our previous responses, 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. These components therefore need to be addressed.

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 on addressing outstanding issues.

The temporary nature of the targeted amendments which would apply for up to three years, provides time to consider whether these changes should become permanent as well as other amendments to the framework. In our survey, 17 banks 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. Banks in certain jurisdictions 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

[20] Proposed text for new paragraph 2(b) of Article 461a: *'Suspending the own funds requirements for market risk set out in Part Three, Title IV, or any of the approaches to calculate the own funds requirements for market risk referred to in Article 325(1) as long as the differences between the implementation of international standards on own funds requirements for market risk in the Union and in third countries (as regards the impact of the rules in terms of own funds requirements and as regards their date of application) persist.'*

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.

Over the longer term, it is essential for the Basel Committee to thoroughly examine inconsistencies across jurisdictions. Irrespective of the changes made under the market risk delegated act, more permanent changes are necessary as part of a level 1 review of CRR to address long-standing implementation issues within the FRTB rules.

We have laid further down below our detailed recommendations for each of the ten measures proposed by the European Commission.

Q3. What are your/your institution's views on the multiplier for the capital requirements for market risk?

We recognise that the EC's proposal to introduce a capital neutrality multiplier is a pragmatic step to address level playing field issues within the constraint of the delegated act mandate.

This remains a crude, complex and non-risk sensitive option, that does not solve the fundamental implementation problems associated with FRTB implementation. This also does not take into account other developments in other jurisdictions.

According to ISDA, AFME and IIF, there is a preference for bank-specific multiplier options versus industry-wide solutions.

We believe the multiplier option is only intended to apply after the implementation of the targeted measures and only to banks that are negatively impacted[21] by FRTB implementation[22].

To assess this, we reviewed the latest Pillar 3 disclosure data and based on available information, we determined that 14 banks out of the 31 that responded to the survey will be negatively impacted by FRTB implementation.

Among these 14 banks, option A is the most favoured option with 7 banks in support accounting for 74% of the Market Risk RWA for this sample[23][24].

Q4. What are your/your institution's preferred calibration options for the multiplier and how would those address the risk of underestimating the capital requirements during the three-year period?

We believe the multiplier option is only intended to apply after the implementation of the targeted measures and only to banks that are negatively impacted[25] by FRTB implementation[26].

From the banks in our survey, **14 will be negatively impacted and option A is the most favoured option.**

To fully achieve its primary objective and prevent any additional operational burdens, Option A must be accompanied by an extension of the EBA no-action letter related to the trading book/banking book boundary.

[21] In our analysis, we recognise only those members who are negatively impacted by FRTB-SA go-live, i.e. only those who would be able to apply the capital neutrality multiplier as outlined in the EC's consultation. Using publicly available data in members' pillar 3 reports, both the FRTB-SA capital number and the Market Risk RWAs are considered. Where a firm does not publish their FRTB-SA capital, they are not considered in the analysis.
[22] The EC consultation refers to the multiplier being introduced *'for the overall market risk capital requirements that banks negatively impacted by the new rules (i.e. banks facing an increase in capital requirements for market risk) would be allowed to use to significantly limit their market risk capital requirement increases for three years.'*
[23] 74% represents the Market Risk RWA of the 14 banks that are negatively affected by the implementation of FRTB
[24] It should be noted that banks applying for IMA should have the flexibility to reduce their operational burden and apply a multiplier against FRTB-SA.
[25] In our analysis, we recognise only those members who are negatively impacted by FRTB-SA go-live, i.e. only those who would be able to apply the capital neutrality multiplier as outlined in the EC's consultation. Using publicly available data in members' pillar 3 reports, both the FRTB-SA capital number and the Market Risk RWAs are considered. Where a firm does not publish their FRTB-SA capital, they are not considered in the analysis.
[26] The EC consultation refers to the multiplier being introduced *'for the overall market risk capital requirements that banks negatively impacted by the new rules (i.e. banks facing an increase in capital requirements for market risk) would be allowed to use to significantly limit their market risk capital requirement increases for three years.'*

To address operational issues of running two systems in parallel, banks should be allowed to transition to the FRTB framework fully if they wish whilst banks who want to continue using their existing Basel 2.5 models should be allowed to do so.

1. Measures to phase in and / or operationalise the own funds requirements calculation under the Internal Model Approach (IMA)

1.1. EC Proposals Under the Internal Model Approach (IMA)

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

The industry supports the European Commission's assessment that credit institutions have faced challenges in consistently meeting PLAT requirements for many desks where they seek to use internal models. Additionally, we agree that failing PLAT creates volatility in banks' capital requirements and discourages investment in internal models.

The industry supports the targeted operational relief measure, allowing credit institutions and supervisors to use the PLAT as a monitoring tool. Under this approach, all trading desks within the scope of IMA would be deemed to meet the conditions for the green zone, with the monitoring period extending until 1 January 2030. Additionally, the industry acknowledges that the PLAT assessment should be conducted and reported to the competent authorities on a quarterly or semi-annual basis as specified in the European Commission consultation.

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 (KS) 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. As highlighted in previous industry responses[27], the Spearman test frequently fails for well-hedged portfolios due to its sensitivity to small residual P&L variations. In practice, this can result in hedged portfolios being more likely to fail the test than directional ones, creating counterintuitive outcomes and undermining the objective of risk management.

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[28], 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. Given these well-documented shortcomings, the industry considers that the Spearman correlation test should be permanently removed from the PLAT.

[27] ISDA & IIF. *ISDA/IIF Response to EC's Consultation on the Market Risk Prudential Framework.* April 2025. Available at: ISDA-IIF-Response-to-ECs-Consultation-on-the-Market-Risk-Prudential-Framework.pdf

[28] 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 KS test would therefore become the sole statistical test of PLAT. Although the KS test has its own limitations – notably sensitivity to statistical noise during benign market conditions – it is conceptually more aligned with the objective of assessing whether a model adequately captures the distributional properties of a desk's P&L. Using the KS test alone during the monitoring period would allow supervisors to gather meaningful evidence and assess whether it is still possible to address the uncertainty and volatility in banks' capital requirements, while avoiding the distortions generated by the Spearman test.

Industry Recommendation:

The industry recommends permanently removing the Spearman correlation test from PLAT, given its structural shortcomings and its tendency to penalise well-hedged portfolios. During the proposed three-year monitoring period, the KS test should function as the sole statistical test of profit-and-loss attribution, reported on a quarterly or semi-annual basis as set out in the consultation.

Throughout the monitoring period, supervisors should collect evidence to determine whether the KS test can be appropriately recalibrated or whether PLAT should remain a supervisory reporting tool rather than a binding eligibility condition for IMA. The use of PLAT as a pass/fail criterion should not be reinstated unless empirical evidence demonstrates that the KS test can deliver stable, risk-sensitive and proportionate outcomes.

1.1.2. Phase-in of the capital requirements for Non-Modellable Risk Factors (NMRF)

The industry acknowledges that the limited development of third-party vendor solutions has contributed to a larger proportion of risk factors being capitalized as NMRFs than initially anticipated when Basel calibrated the FRTB standards. However, fundamental issues within the NMRF framework – particularly regarding the aggregation of risk factors[29] – result in a general lack of diversification recognition, rendering the framework impracticable. Other aspects of the NMRF framework are problematic including the assumptions on correlations between non-modellable idiosyncratic and non-modellable non-idiosyncratic risk factors and the calibration of stress periods specific to each asset class. Additionally, there is concern about the procyclical nature of the NMRF framework, which may discourage effective risk management by concentrating risk across banks' portfolios and the broader financial system into a smaller set of risk factors. Overall, the multiple levels of conservatism inherent in the NMRF framework have contributed significantly to the lack of IMA adoption observed across the globe.

[29] A fundamental issue with the SES calculation is that it 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. Appendix 1 provides an analysis using hypothetical portfolios illustrating how the NMRF framework is not fit for purpose.

The European Commission's proposal to apply a flat stressed expected shortfall (SES) multiplier of 35%-45%[30] over a three-year period would provide some relief but ultimately serves as a temporary fix rather than addressing the underlying issues with the NMRF framework. Given its deficiencies – such as its lack of risk management utility, the loss of diversification and proxy hedging between modellable and non-modellable risk factors, and the capital uncertainty it creates – we believe the NMRF framework in its current form is unworkable. For these reasons, the NMRF framework should be temporarily discontinued and replaced with a solution that incorporates all risk factors that meet the data principles into IMCC, with performance assessed through back-testing. During this period, policymakers should conduct a more thorough review of the prudential treatment of less liquid risk factors. Additionally, the RFET framework should be temporarily discontinued, as it imposes an undue burden on banks to collect real price observations (RPOs) and results in an excessive number of risk factors being deemed non-modellable. We note that based on feedback received by the banks, the NMRF framework (including RFET) does not contribute to any improvements in the risk management framework. Since NMRF is a key driver of low IMA adoption, we strongly urge policymakers to develop a more effective alternative.

The flat SES multiplier serves as an alternative to delaying the full implementation of the NMRF framework. However, depending on the FRTB implementation timelines in the US and UK, this could create a temporary imbalance where EU banks must run RFET and calculate SES while banks in other jurisdictions do not. Therefore, if the primary proposal for temporarily discontinuing the NMRF framework is not accepted, and to maintain a level playing field with non-EU jurisdictions whilst acknowledging the constraints of the delegated act, the industry recommends that a more risk-sensitive approach is adopted, without the burden of running RFET or calculating SES, by applying a temporary multiplier on the IMCC measure.

Industry Recommendation:

While the NMRF framework was introduced to ensure the prudent capitalization of risk factors that fail to meet the RFET, the numerous issues associated with it suggest that the NMRF framework (including RFET) should be temporarily discontinued while regulators assess its suitability. During this period, the IMCC capital calculation and backtesting should include all risk factors that meet the prescribed data principles.

If the primary proposal is not accepted, banks will be required to compute and include a surcharge for non-modellable risks in their own funds requirements. While efforts to address the excessively punitive RWA impact from the NMRF component is a step in the right direction, we believe the European Commission's proposal to apply a flat multiplier to SES capital does not sufficiently align with risk. A

[30] While we encourage the European Commission to adopt a more risk-sensitive approach by applying a multiplier to IMCC, we would note that the 35%-45% flat SES multiplier is comparable to the impacts from a collection of other amendments to the framework including reducing the correlation parameter in the SES aggregation formula from 0.6 to 0.25, extending non-modellable idiosyncratic risk factors to asset classes other than credit or equity, aligning the SES and ES stress windows, and improving the netting within risk classes or groups of similar risk factors.

similar capital impact can be achieved in a more risk-sensitive manner, without running the operationally burdensome RFET, or calculating SES which is a flawed and an operationally costly measure.

As a secondary proposal the industry recommends introducing a temporary multiplier on the IMCC measure, specifically applying a factor $(1+\alpha)$ to $IMCC$ while removing SES from the capital formula entirely – within the aggregate (non-DRC) capital requirement for approved trading desks[31]:

$$C_A = \max\{(1+\alpha)\cdot IMCC_{t-1}; m_c \cdot (1+\alpha)\cdot IMCC_{avg}\}$$

where m_c is the backtesting multiplier for FRTB, typically set to 1.5. While definitive studies on this approach remain limited and would be difficult to conduct, preliminary indications suggest that selecting an α of 0.2 is justified[32]. This is based on the premise that the European Commission's proposed lower bound of 35% reflects the non-risk sensitive nature of NMRF, and the desire to address it. In this proposal, IMCC capital and backtesting would include all risk factors that meet the prescribed data principles, even if some of them do not pass RFET.

If, and only if, the above proposal to discontinue the NMRF framework (including RFET) is not accepted, we strongly urge policymakers to develop a more effective alternative. More fundamental changes to level 1 text are required to make the framework workable. Whilst the proposals outlined in the following subsections mean to improve the risk-sensitivity of the NMRF framework, further operational considerations, including amending the calculation frequency and the alignment of stress windows, are outlined in section 1.2 of this response. In addition to these recommendations specifically on the NMRF calculation, fundamental changes are also required to the RFET, as outlined in Section 1.1.3.

Importantly, these proposals should not be viewed in silo, but instead holistically to achieve the appropriate outcome and ultimately incentivise model adoption. They are all needed to improve the usability and proportionality of the NMRF framework (both RFET and SES) and should be pursued in parallel with broader reforms.

1.1.2.1. Calibration of rho parameter in SES calculation

Under the current rules, NMRF capital is aggregated using the square-root formula with a fixed correlation parameter (ρ = 0.6). While intended to capture diversification, this calibration provides limited diversification benefit and produces overly conservative capital outcomes. Cross-asset-class correlations are typically well below 0.6, and applying such a high ρ to strictly positive capital numbers inflates SES

[31] See Appendix 2 for additional details on the alpha multiplier.

[32] Basel Committee on Banking Supervision. *Revisions to the Basel III Framework*. Bank for International Settlements, March 2025. https://www.bis.org/bcbs/publ/d592.pdf
Based on the latest Basel monitoring report, SES capital accounts for 21.3% of the FRTB IMA charge for Group 1 banks, while modelled capital represents 40.9%. Applying the European Commission proposed flat multiplier of 35%-45%, the SES-to-IMCC ratio would range from $\frac{21.3\%\times 35\%}{40.9\%} = 0.18$ to $\frac{21.3\%\times 45\%}{40.9\%} = 0.23$.

charges. As a result, diversified portfolios can face disproportionately high capital when modellability changes, even when their underlying risk has not materially increased.

To address this, we propose recalibrating ρ to a lower value, such as 0.25, consistent with prior industry advocacy[33]. This would remain conservative but better reflect realistic correlations and improve the framework's risk sensitivity. It would also help moderate currently punitive outcomes, especially when combined with the other proposals outlined within this section.

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.

1.1.2.2. Two-step aggregation to better recognise diversification

The current SES measure does not allow netting between long and short positions in similar risk factors and applies a uniform correlation across all NMRFs, regardless of their proximity. By contrast, the ES-based aggregation for modellable risk factors allows netting and uses historical correlations that are typically higher within than across risk classes. To better reflect diversification, SES should recognize greater netting within risk classes or groups of similar risk factors rather than assuming equal correlations across all NMRFs. We propose restructuring SES into a two-step approach:

Step 1: Aggregate NMRFs within each risk class or group of similar risk factors, allowing diversification benefits. As recommended in Section 1.2.4, the stress period for NMRFs should align with the diversified IMCC where feasible.

Step 2: Aggregate the resulting per-risk-class NMRF stresses using an approach similar to the Basel framework, with two modifications:

- Aggregate across risk-class-level NMRF stress scenarios rather than individual systematic risk factors; and
- Apply the cross-asset-class correlation parameter as outlined above (ρ = 25%).

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

[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

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 1.1.2.1. This approach would provide a more risk-sensitive and proportionate capital outcome while maintaining prudential conservatism.

1.1.2.3. 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.

1.1.3. Proportional data requirements for the RFET of new instruments

The RFET determines which risk factors are capitalised under ES and which fall under SES. In its current form, RFET imposes a substantial operational burden on banks to source and evidence real-price observations and results in too many risk factors being classified as non-modellable. As a result, and as discussed in Section 1.1.2, the industry maintains that the NMRF framework (including RFET) should be discontinued due to its fundamental flaws. If this proposal is not accepted, and in the longer term, the industry strongly urges the Commission to adopt more fundamental changes to the Level 1 text which are required to ensure a risk-sensitive and proportionate NMRF framework. These broader reforms need to be viewed holistically rather than in isolation.

There are also several operational improvements for the RFET that would materially reduce the burden on firms without requiring Level 1 change, as set out in Section 1.2.5, these include:

- Amending requirements such that third-party vendor audits should not be imposed when prices are sourced from the regulated sources
- Clarifying the definition of non-negligible volume and bid-offer spread requirements for real-price observations (RPOs) sourced from exchanges

However, recognising the constraints of the delegated act and responding directly to the European Commission's proposal, the industry supports the view that RFET is not suitable for all instruments. Under the current rules, newly issued instruments cannot qualify for the internal model approach during their first year, regardless of their liquidity or simplicity.

We therefore welcome the proposal to start the observability period for new instruments at issuance and to prorate the required number of RPOs in the first year. Extending this approach to new reference rates and commodity markets is also a positive step, reflecting prior industry advocacy[34].

Nonetheless, the industry continues to consider that the observability process for sovereign (including EU government) and supranational bonds introduces unnecessary complexity and imposes an operational burden on banks for markets that are already deep and liquid. We therefore maintain that qualifying government and supranational debt risk factors (as per CRE20.7 to CRE20.15[35]) should be excluded 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 12(3) of the EBA RTS on Backtesting and PLAT[36] 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.

Industry Recommendation:

The industry maintains that due to its fundamental flaws, the NMRF framework (including RFET) should be discontinued. If this proposal is not accepted, and in the longer term, more fundamental changes to the Level 1 text are required to ensure a risk-sensitive and proportionate NMRF framework.

However, recognising the constraints of the delegated act, the industry welcomes the European Commission's proposal to prorate the number of RPOs for new instruments and issuances, as well as its extension to new reference rates and commodities, which reflects prior industry advocacy and promotes global consistency with the US NPR.

In the spirit of simplification and proportionality, the industry continues to recommend that qualifying government and supranational debt risk factors be excluded from the RFET process and automatically recognised as modellable. This would provide a meaningful operational simplification.

[34] ISDA & IIF. *ISDA/IIF Response to EC's Consultation on the Market Risk Prudential Framework.* April 2025. Available at: ISDA-IIF-Response-to-ECs-Consultation-on-the-Market-Risk-Prudential-Framework.pdf

[35] Basel Committee on Banking Supervision. *Calculation of RWA for Credit Risk*. June 2025. Available at: CRE20 - Standardised approach: individual exposures

[36] European Banking Authority. *Final Draft Regulatory Technical Standards on Backtesting and Profit and Loss Attribution (PLA) Requirements* (EBA/RTS/2020/02). Available at: https://www.eba.europa.eu/sites/default/files/document_library/EBA-RTS-2020-02%20Final%20draft%20RTS%20on%20Backtesting%20and%20PLA%20requirements.pdf

Finally, to ensure consistency in treatment for new issuances, Article 12(3) of the EBA RTS on Backtesting and PLAT should clarify that the RTPL may be aligned with the HPL and fully capture the impact of new instruments for the first 12 months after issuance, thereby avoiding residual noise in the PLAT and unnecessary capitalisation under NMRF.

1.1.3.1. Industry proposed criteria for the modellability of risk factors

As noted previously, the operational adjustments and European Commission proposals under the delegated act alone cannot resolve the structural limitations of the current NMRF framework (including RFET). As a result, and as outlined in Section 1.1.2, the industry proposes discontinuing the NMRF framework. A genuinely risk-sensitive and proportionate NMRF framework requires a more fundamental redesign of modellability. Against the backdrop of the proposals in Section 1.1.2, and if the proposal to discontinue the framework is not accepted, the industry's long-term proposal for RFET is to replace the current approach with the following:

- For risk factors with at least two transactions in the past year, consider them modellable with a liquidity horizon equal to $\frac{250}{Number\ of\ RPOs}$, rounded to the nearest liquidity horizon in the prescribed set (i.e., 10, 20, 40, 60, or 120 days).
- These risk factors would still need to satisfy the data principles and data validation for inclusion in ES.
- SES would be retained for any other risk factors which do not meet the minimum RPO requirement or do not meet the data principles.
- This methodology would replace the two modellability requirements outlined in Article 1(1) of the EBA RTS[37].

This approach properly recognises risk factors that are modellable but illiquid by assigning an appropriate liquidity adjustment, rather than classifying them as non-modellable and subjecting them to the punitive SES capitalisation. It enhances risk sensitivity, avoids cliff-effects, and removes the disproportionate capital outcome caused by marginal breaches.

To illustrate this proposal, consider the example of a risk factor that has 7 RPOs in the past year, and whose original liquidity horizon per the ES table is 20. Under the current rules this risk factor would be considered non-modellable and capitalized under SES. Under this industry proposal, the risk factor would be considered modellable given the number of RPOs is greater than (or equal to) 2. Therefore, the risk factor would be included in the ES calculation with a liquidity horizon of 40, i.e.

[37] European Banking Authority. *Final Draft Regulatory Technical Standards on Criteria for Assessing the Modellability of Risk Factors under the Internal Model Approach (IMA) under Article 325be(3)*. March 2020. Available at: https://www.eba.europa.eu/.../Final draft RTS on Risk factor modellability.pdf

$$max\left(LH\left(\frac{250}{7}\right), 20\right) = 40.$$

Industry Recommendation:

To achieve a risk-sensitive and proportionate NMRF framework the industry recommends that the current RFET be replaced with a graduated, liquidity-sensitive modellability methodology as outlined above. Under this approach:

- Risk factors with at least 2 RPOs in the past year would be deemed modellable, with a liquidity horizon calibrated as a function of the number of RPOs.
- SES would apply only to those risk factors that fail to meet the minimum RPO threshold or the data principles.
- This approach would replace the binary modellability requirements in Article 1(1) of the EBA RTS.

This recommendation should be pursued as part of the broader set of structural reforms described in this response.

1.1.4. Phase-in of the own funds requirements for default under the internal default risk charge (DRC) model for sovereign issuers

The industry agrees with the characterization that the default risk charge for exposures to sovereign issuers under the market risk internal model approach yields more conservative results than the market risk alternative standardized approach, creating a discrepancy between the two frameworks and leading to regulatory arbitrage.

We support the commensurate treatment of positions under IMA-DRC that qualify for a 0% risk weight under the standardized approach for credit risk. However, the European Commission's consultation 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. It is not clear what this proposal means in practice, as sometimes the exposures subject to the 0% risk weight of the standardised approach for credit risk applies to specific positions (typically local currency issuances as referred in CRR article 114(4)) rather than at the issuer/obligor level. This creates ambiguity. For example, a European Union’s member state issuer may have euro-denominated issuances attracting a 0% risk weight, but issuances in other currencies would not. Typically, the PDs are calibrated at the issuer level, and if a portfolio includes a mix of such positions, it is unclear how the 0 multiplier should be applied.

Nevertheless, the simple and preferred option, that should be considered on a long-term and permanent basis, would be 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.

In addition, the industry supports the following refinements to IMA-DRC (see Section 2.1.1 for more detail):

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

Treating the DRC as a standalone component encourages the development of risk-sensitive internal models that better capture systemic default dynamics under stress. This proposal would also ensure a level playing field with US banks, where the internal model-based DRC requirement was removed under the US NPR, while still broadly aligning with the Basel framework.

Industry Recommendation:

While the industry supports the intention of the European Commission, the industry would like to highlight that in the event of multiple issuances of a particular issuer and where only some exposures are eligible for 0% risk weight, the PDs would need to be adjusted only for issuances eligible for 0% risk weight. This can be achieved by treating such issuances as two separate exposures each with a unique PD value in the IMA DRC calculation and similarly splitting the JtD in the SA DRC each with a unique risk weight.

Furthermore, the simplest and long-term solution would be to exclude the relevant issuers from the scope of IMA DRC and capitalise them under the alternative standardised approach framework.

1.1.5. Operationalisation of the capital requirements for Collective Investment Undertaking (CIU) exposures under the alternative internal model approach

The European Commission consultation correctly highlights that banks have been unable to capitalize their CIU exposures using internal models due to the stringent requirements for weekly look through to individual components. The consultation addresses this issue by (a) permitting banks to apply the look through approach (LTA) on a quarterly basis, (b) allowing banks to calculate their own funds requirements on CIU exposures under the alternative internal model approach if they can look through 90% of the exposures by value (with the residual exposures being capitalized under the alternative internal model approach using the risk weight specified for the default option under the alternative standardized approach), and (c) allowing banks to use a supervisory approved conservative methodology.

The industry supports objective (a), as it provides the necessary relief for banks to effectively deploy the alternative internal model approach for CIU exposures. We also support objective (c), as it allows for a sensible approach to be proposed. However, it is unclear how helpful option (b) will be, given the 90% threshold. We elaborate more on the issues surrounding this arbitrary threshold and the justification of our industry recommendation to remove this threshold in Section 2.1.1.

We would also suggest that, similar to the way FRTB-SA permits the substitution of a CIU with a well-tracked index under CRR Article 325j(2)[38], this same flexibility be extended to IMA. This would help incentivize the adoption of IMA for portfolios containing such CIUs. Since index data is more readily available, this approach makes it easier to perform look through.

Industry Recommendation:

While the industry welcomes the relief provided for CIUs to apply the internal model approach, we remain concerned with the 90% threshold specified as part of objective (b).

In principle, no threshold should be required if banks can demonstrate that the residual part of the fund is adequately capitalized to the satisfaction of supervisors. If the proposal to remove the threshold is not accepted, the industry suggests a threshold of 50% for objective (b), as this would allow banks to use the alternative internal model approach for the majority of funds where they can look through the material underlying positions but are unable to look through a small residual portion due to operational or other reasons. We elaborate more on the issues surrounding this arbitrary threshold and the justification of our industry recommendation to remove this threshold in Section 2.1.1.

The industry also proposes that the option under FRTB-SA, as outlined in CRR Article 325j(2)[39], to substitute a CIU tracking an index benchmark with a position in the index itself (if the annualized returns are similar) be extended to IMA. This would help in situations where the index can be looked through, but precise information on the CIU composition is not readily available.

1.2. Industry Proposals Under the Internal Models Approach (IMA)

1.2.1. Recognising diversification in the aggregation of IMA and ASA capital

A key structural issue within the current market risk framework is that the capital requirement for desks capitalised under the IMA is simply added to the requirement for desks capitalised under the ASA, without any allowance for diversification between the two. As a result, the framework does not meaningfully incentivise banks to seek incremental IMA approval. When only a limited number of desks are capitalised under the IMA, the combined capital requirement remains largely unchanged relative to an entirely SA-based calculation, meaning the benefits of internal modelling cannot be realised gradually.

[38] 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 325j(2) – "Treatment of collective investment undertakings." Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:02013R0575-20240709

[39] 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 325j(2) – " Treatment of collective investment undertakings." Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:02013R0575-20240709

Ensuring that IMA remains viable as a proportionate and risk-sensitive approach is an important consideration in the implementation of FRTB. A framework in which IMA only becomes beneficial once a large proportion of desks are modelled does not reflect the way banks typically sequence internal model applications or manage model validation capacity. A more risk-aligned aggregation method would allow banks to expand model coverage over time while maintaining an appropriate level of prudence.

Industry Recommendation:

The industry recommends that the Commission adopt a revised method for aggregating IMA and ASA capital requirements that better reflects the contribution of modelled desks to overall risk. The approach should allow capital benefits to arise proportionally to the amount of exposure that is modelled, supporting the incremental and risk-aligned expansion of IMA coverage. By restoring a clear and consistent relationship between the degree of model approval and the resulting capital requirement, such an adjustment would help maintain the viability of internal models within the CRR III framework.

1.2.2. Changes to Default Risk Charge (DRC)

In accordance with CRR Article 325bl(1)[40], IMA trading desks are subject to additional or incremental own fund requirements for the default risk of credit and equity exposures using 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 IMA, including the use of the 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 IMA trading desks.

The 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.

[40] 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 325bl(1) – "Scope of the internal default risk model.", 325bm(2) – "Permission to use an internal default risk model.", 325az(4) – "Alternative internal model approach and permission to use alternative internal models.", and 325ba – " Own funds requirements when using alternative internal models." Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:02013R0575-20240709

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, 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 CRR Article 325ba[41] and the EBA RTS on backtesting and PLAT requirements[42], 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;

[41] European Commission. *Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and amending Regulation (EU) No 648/2012*. Consolidated version of 9 July 2024, Article 325ba – "Own funds requirements when using alternative internal models." Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:02013R0575-20240709

[42] European Banking Authority. *Final Draft Regulatory Technical Standards on Backtesting and Profit and Loss Attribution (PLA) Requirements* (EBA/RTS/2020/02). Available at: https://www.eba.europa.eu/sites/default/files/document_library/EBA-RTS-2020-02%20Final%20draft%20RTS%20on%20Backtesting%20and%20PLA%20requirements.pdf

- $Capital\ Surcharge$[43] 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 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 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 IMA trading desks.

1.2.3. Calculation frequency of IMCC and NMRF

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[44] 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.

CRR3 is somewhat more stringent than Basel standards, particularly in Article 325bi(1)(a)[45], which states that any internal risk measurement model used to calculate capital requirements for market risk must be

[43] It is worth noting that the capital surcharge component would be irrelevant if the PLAT remains a supervisory monitoring tool.
[44] 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
[45] 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

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.

CRR3 prescribes 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 IMA DRC framework. Therefore, we 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 IMA implementation but need more time to productionize the operational process. We believe such improvement would be a sensible permanent change and could be implemented through a delegated act as a targeted operational relief measure.

In the event that the NMRF proposals in Section 2 are not accepted, we would like to enact operational changes to the NMRF framework including changing the frequency of NMRF calculations. 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:

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

For SES, while we recommend suspending the framework, if it were to be retained for monitoring purposes, a frequency of quarterly or less would be appropriate. In case this recommendation is not

325bi(1)(a) – " Qualitative requirements." Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:02013R0575-20240709

accepted by policymakers and SES continues to be used in the capital calculation, it should not be calculated more frequently than weekly (e.g., using an average of 12 weeks for the capital calculation, similar to the IMCC recommendation).

1.2.4. Alignment of SES and ES stress windows

If the industry proposals in Section 2 are not accepted, the operational challenges associated with the NMRF framework would still remain. Banks would be 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:

As an interim relief measure, we propose allowing banks to use the same stress period for SES as that used for the diversified ES measure.

1.2.5. Changes to RFET

As noted in the European Commission consultation, the development of RFET data solutions by third-party vendors remains limited, resulting in a significant number of risk factors being classified as NMRFs. While the industry broadly supports the Commission's proposal on RFET, we wish to emphasize that implementing and operationalising RFET remains extremely challenging and costly, creating a barrier to the adoption of 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.

1.2.5.1. Requirement to audit third-party data providers

The Basel text in MAR31.12(3)[46] 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

[46] Basel Committee on Banking Supervision. *Minimum Capital Requirements for Market Risk*. January 2019. Available at: https://www.bis.org/bcbs/publ/d457.pdf

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 2, sub-paragraph 5 of the EBA RTS on Criteria for Assessing Risk Factor Modellability – mandated under CRR Article 325be(3)[47] – 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 EU and are already regulated by the European Securities and Markets Authority (ESMA).

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 EU 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 EBA RTS 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.

[47] European Banking Authority. *Final Draft Regulatory Technical Standards on Criteria for Assessing the Modellability of Risk Factors under the Internal Model Approach (IMA) under Article 325be(3) of Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR2)*. 27 March 2020. https://www.eba.europa.eu/sites/default/files/document_library/EBA-RTS-2020-03%20Final%20draft%20RTS%20on%20Risk%20factor%20modellability.pdf

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

Article 2 of the EBA RTS[48] 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 are sourced from regulated exchanges, they inherently reflect usual volumes in current market conditions. Trading activity for commonly traded listed instruments - for example spot equities, listed options and listed futures (non-exhaustive) – is typically concentrated on 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[49]). The volume or transaction size of individual exchange transactions 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 EBA RTS 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

[48] European Banking Authority. *Final Draft Regulatory Technical Standards on Criteria for Assessing the Modellability of Risk Factors under the Internal Model Approach (IMA) under Article 325be(3) of Regulation (EU) No 575/2013 (Capital Requirements Regulation – CRR2)*. 27 March 2020. https://www.eba.europa.eu/sites/default/files/document_library/EBA-RTS-2020-03%20Final%20draft%20RTS%20on%20Risk%20factor%20modellability.pdf

[49] 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 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.

1.2.6. Changes to ES

1.2.6.1. 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 5 of the SA section of our response, 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 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.

1.2.6.2. Capping of liquidity horizons

The CRR3 requires banks 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. We have 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 IMA adoption for desks trading in liquid instruments and actively hedging their risks.

We would note that the US NPR[50] 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.

[50] 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 EU rule 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.

1.2.7. 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 IMA and discourage investment in 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.

2. Measures to phase in and / or operationalise the own funds requirements calculation under the Alternative Standardised Approach (ASA)

2.1. EC Proposals Under the Alternative Standardised Approach (ASA)

2.1.1. Operationalisation of the capital requirements for Collective Investment Undertaking (CIU) exposures under the alternative standardised approach

The European Commission consultation correctly notes that banks are unable to achieve perfect transparency of their CIU exposures, making it impractical to apply the look through approach (LTA) on a monthly basis for capital purposes. The industry welcomes the European Commission's proposal, which provides some operational relief by allowing banks to apply the LTA on a quarterly basis. However, for a number of mutual funds, the LTA even on a quarterly basis remains a challenge.

Separately, the industry welcomes the permission to calculate their own funds requirements on CIU exposures using a partial look through if they are able to look through some of their CIU exposures. However, we remain concerned with the restriction to look through of at least 90% of the fund. There are instances where a CIU is classified as a trading book instrument either through look-through information or availability of daily prices and mandate of the funds. However, banks face operational challenges while applying LTA for capitalisation.

The comprehensive look through of funds is primarily hindered by the identification of over the counter (OTC) holdings, with data quality issues posing a secondary challenge. The representation of OTC positions lacks standardization among asset management firms, often resulting in descriptions that are insufficient for representative bookings. However, while banks may not have complete details on certain instrument characteristics (e.g., maturities or strike prices) necessary for pricing and LTA application, they do have qualitative information regarding the fund composition, such as asset class and weighting within the fund. It is expected that the residual part will consist of exposures to several asset classes, contributing to a diversified mix of positions. In addition, a small proportion of the residual part is expected to suffer from data quality issues provided by mutual funds, such as listed instruments without International Securities Identification Numbers (ISINs) or matured instruments. There are also cases where banks may be unable to price certain underlying holdings due to pricing limitations, which can further constrain the extent of look-through.

In addition to these operational constraints, it is important to recognise that banks do not typically decompose CIUs into their underlying positions for risk management purposes. CIUs are generally monitored and managed as aggregated exposures with their own observed behaviour, volatility, and risk characteristics. For many funds – particularly those with thousands of holdings, including OTC derivatives and dynamically adjusted strategies – full look-through is not only burdensome but also misaligned with how these exposures are risk-managed in practice. In effect, the look-through becomes a capital-specific requirement with limited value for internal risk management or prudent oversight. Requiring banks to

implement and maintain granular look-through frameworks therefore imposes a significant ongoing cost, without a commensurate improvement in risk sensitivity. Allowing institutions to look through exposures only to the extent that is operationally achievable and cost-efficient, without a predefined threshold, would better align regulatory expectations with established risk management practices while avoiding unnecessary implementation burdens.

In principle no threshold should be required under Article 325j(1)(a) when banks capitalize the residual part of the fund using the most penalizing FRTB-SA fallback bucket (equity bucket 11) risk weight and a very conservative aggregation within the fallback bucket. For the residual portion, this proposal leads to the same conservative treatment and capital implications as the fallback treatment currently prescribed when the full fund is not looked through. Additionally, 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[51]. This ensures that overall capital requirements are aligned with the current rule intentions, even where transparency is incomplete due to operational limitations. Ultimately banks have a natural incentive to maximise transparency without the need for an externally imposed threshold.

An arbitrary, uniform threshold 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 which are not linked to the actual risk of the underlying. 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.

Additionally, the industry seeks clarification on the requirement of Article 325j(3)[52] for its application on options on CIUs. Typically, an institution can, subject to the challenges discussed elsewhere in this document, apply a look through treatment to delta, curvature and DRC. However, look through of CIU vega is not practical or consistent with the risk management of such positions. If an institution is required to apply look through treatment to CIU vega whenever the delta/curvature/DRC is looked through, it will mean in practice that institutions are not able to utilise the look through approach at all, neither partially nor fully. This will result in the single equity treatment being applied across the board for such CIU positions and consequently extremely high, uneconomic RWA requirements.

Treating vega as a single sensitivity, when performing look-through delta and curvature, would be consistent with Article 325i(1) which describes the treatment of sensitivities under the look-though approach for multi-underlying instruments, which would also include CIU options, in addition to index

[51] 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.

[52] 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 325j(3) – "Treatment of collective investment undertakings.", 325i(1) – "Treatment of index instruments and other multi-underlying Instruments." Available at: https://eur-lex.europa.eu/.../EN/...

options. This would allow look through treatment of only the delta/curvature/DRC components for CIU options and therefore more economically reasonable capital treatment.

Industry Recommendation:

The industry welcomes the relief allowing CIUs to apply the LTA a) on a quarterly frequency and b) without perfect transparency. However, we remain concerned with the 90% threshold specified under objective (b).

In principle, no threshold should be required under Article 325j(1)(a) when banks capitalize the residual part of the fund using the most penalizing FRTB-SA fallback bucket (equity bucket 11) risk weight and a very conservative aggregation within the fallback bucket. If the proposal to remove the threshold is not accepted, the industry suggests lowering it to 50% for objective (b). This would allow banks to use the partial LTA on a broader scope.

In the longer term, the industry highlights the need to also consider another approach as described in Section 3.2.2.1 of this document ("Enhanced Mandate Based Approach"). Recognizing the short timeline of this consultation and issuance of the delegated act, a reduction of the CIU risk weight under the Fall Back Approach should be considered, as explained in Section 3.2.2.2.

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

We welcome the European Commission's proposal to recognise economic hedges in the calculation of 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, equity futures or bonds – are highly liquid, and access to them remains unaffected even as the obligor approaches a credit event. Additionally, the IMA DRC framework offers greater flexibility, as CRR Article 325bo(3)[53] allows banks to disregard for capital purposes the immaterial maturity mismatch risk across equity and credit positions. We believe banks should have the discretion to determine whether to account for maturity mismatches under SA DRC. Aligning the

[53] 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 325bo(3) – " Recognition of hedges in an internal default risk model." Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:02013R0575-20240709

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.

For equities, the current rules allow cash equities in the DRC capital calculation to be assigned a maturity of either three months or one year. Article 325x(4)[54] of the UK FRTB rules extends the three-month maturity assignment to equity derivatives to remove uneconomic maturity mismatches.

Beyond equities, significant maturity mismatches also 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, 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 three months to equity derivatives and one-year to credit instruments. This would better align the maturity of these instruments with their corresponding hedges, similar to the IMA framework. We believe that the below amendment to the CRR should be made on a permanent basis.

Article 325x:

(4) For the purposes of paragraphs 2 and 3, the maturities of the derivative contracts shall be considered, rather than those of their underlyings. ~~Cash equity exposures~~ An institution shall ~~be assigned~~ assign a maturity of either one year or three months, to cash equity exposures and may assign a maturity of three months to equity derivative exposures, in each case at the institution's discretion.

(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.

[54] Bank of England. *Policy Statement PS9/24 – Implementation of the Basel 3.1 Standards: Appendix 2*. Prudential Regulation Authority, September 2024. https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2024/september/ps924app2.pdf

2.1.3. Phase-in of the capital requirements for specific instruments in scope of the residual risk add-on (RRAO) charge

We welcome the European Commission's proposal to remove RRAO charges for:

- Instruments with future realised volatility as an underlying, such as variance swaps; and
- Options exercisable on a finite number of dates, such as Bermudan options; and
- Options on the difference between two constant maturity swap rates (CMS) in the same currency.

We agree with the Commission's rationale that these instruments should be excluded from RRAO, as banks can effectively hedge them in the market, and we welcome the extension of this proposal to include CMS spread options following previous industry advocacy.

However, the industry remains concerned about how these exemptions apply in practice and therefore seeks clarification on their implementation. Within the consultation, proposals 8a) and 8b) apply a 0 multiplier for RRAO to instruments having future realized volatility as underlying and Bermudan options having multiple, finite exercise dates, as long as they attract RRAO only because of the reasons listed. The industry notes both types of instruments could still qualify for the Other RRAO (0.1% RW) charge under Article 325u(2)(b)(i) due to other reasons. For example, both are also non-vanilla replicable – their payoffs cannot be replicated as a finite linear combination of vanilla options with a single underlying. In the case of Bermudan options, their payoffs are also path-dependent as a result of the multiple exercise dates. The industry understands that the regulatory intent of the 0 multiplier is to exempt instruments like Volatility swaps (which have future realized volatility as underlying) and Bermudan options from RRAO charge – both the 1% charge under Article 325u(2)(a) and the 0.1% charge under Article 325u(2)(b)(i). The industry would appreciate clarification that non-vanilla replicability and/or path dependency as a result of the nature of their payoffs would not cause the instruments to attract a 0.1% RRAO charge.

Beyond the scope of these three exemptions, the industry would like to raise a concern regarding the treatment of dividend derivatives under the RRAO. The RRAO is designed to offer a simple and conservative capital treatment for any risks that are **not covered by the SBM/DRC**. CRR Article 325u(5) mandates the EBA to draft Regulatory Technical Standards (RTS)[55] to clarify the scope of exotic underlyings. Specifically, the EBA is tasked with examining whether longevity risk, weather, natural disasters, and future realised volatility should be considered as exotic underlyings[56].

However, neither the CRR nor the RTS on the RRAO explicitly includes dividend underlyings within the scope of exotic underlyings. Additionally, Article 3(e) of the RTS states that "dividend risk arising from a derivative instrument whose underlying does not consist 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 list of exotic underlyings in CRR Article 325u(5) and the guidance in the RTS suggest that it is not included in the list of exotic underlyings, consistent with the Basel framework.

[55] European Banking Authority. *Final Report on Draft RTS on RRAO*. October 2021. Available at: https://www.eba.europa.eu/.../Final Report on draft RTS on RRAO.pdf.
[56] Article 1 of Commission Delegated Regulation (CDR) 2022/2328 on the RRAO confirms this scope.

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)[57].

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 underlyings" under CRR Article 325u(2a), which defines exotic underlying instruments as "trading book instruments referencing an underlying exposure that is not in the scope of the delta, vega or curvature risk treatments under the SBM laid down in Section 2 or the own funds requirements for the default risk set out in Section 5".

The US NPR exempts instruments without path dependent payoffs or having two or fewer underliers from the Other RRAO (0.1% RW) charge. The industry believes that this is a clean and principles-based approach to RRAO exemptions. It potentially broadens the scope of RRAO exemptions, and not having the same included in the delegated act potentially leaves European Banks at a disadvantage. The industry would also like to note that instruments meeting the conditions are covered in the Delta/Vega/Curvature and DRC where relevant. They are also usually hedged by banks, even if not perfectly back-to-back. Hence exempting these instruments would prevent disproportionately high RRAO charges on hedged positions due to grossing of hedges, 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. Hence, the industry recommends that the US language be incorporated in the delegated act.

Industry Recommendation:

Acknowledging the confines of the delegated act, the industry seeks clarity on the practical application of the 0 multiplier, particularly in cases where an instrument might otherwise fall under Article 325u(2)(b)(i) despite being listed for exemption. In addition, to maintain a level playing field, we recommend that dividend derivatives be added to the list of instruments within the scope of targeted relief measures, with a multiplier of 0 applied in the RRAO capital requirements.

In the longer term, the preferred and more risk-aligned approach is to exclude positions that are options without path dependent pay-offs or with two or fewer underlyings. Exempting these

[57] 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, 64129 (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

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.

Therefore, we recommend amending Article 325u(4) to include the following new paragraph (d).

Article 325u(4)

By way of derogation from paragraph 1, institution shall not apply the own funds requirement for residual risks to an instrument that meets any of the following conditions:

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

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

(c) the instrument perfectly offsets the market risk of another position in the trading book, in which case the two perfectly matching trading book positions shall be exempted from the own funds requirement for residual risks.

(d) instruments that are options without path dependent payoffs or with two or fewer underlyings.

Further to the concerns outlined above regarding the scope of instruments captured by the RRAO, the industry also wishes to highlight an additional area where the current rules may result in the unintended inclusion of products. In particular, the industry remains concerned about the treatment of options on indices, which face similar issues relating to disproportionate RRAO capital charges and divergence from other jurisdictions.

2.1.3.1. Extending exemptions from RRAO charge for options on indices

Article 325i(3) raises conditions under which options will be exempt from the RRAO charge, provided all conditions are met. While most of these conditions seem reasonable, the requirement that 10% of the index constituents must be below 60% of the total market capitalisation can lead to undesirable consequences. Additionally, this condition diverges from other jurisdictions, increasing level playing field concerns.

As an example, in February 2025, the S&P 500 index breached the 60% threshold, causing OTC options (including plain vanilla options) on the index to be subject to a RRAO charge (0.1% of the gross notional amount). It is worth noting that this was the only criterion that was not met, highlighting an unintended consequence of the regulation. The result is a disproportionate impact on very liquid instruments tied to the most liquid and widely recognised index in the world.

Industry Recommendation:

The industry recommends that the RRAO exemptions be further aligned with other jurisdictions, such as the US and UK. This could be achieved by exempting from the RRAO charge positions that exhibit correlation risk arising from instruments referencing indices. We believe that this Industry recommendation should be made on a permanent basis.

2.1.4. Carbon trading exposures

The industry welcomes the European Commission's proposed changes, which appear to be informed by analysis conducted by ISDA[58] on the correlation parameter for aggregating carbon trading exposures. The analysis showed that the appropriate range should be between 99.5% and 99.9%, rather than the current 99%.

Industry Recommendation:

We recommend increasing the correlation parameter for aggregating carbon trading exposures to at least 99.6%. We believe that this industry recommendation should be made on a permanent basis.

2.1.5. Temporary adjustment factor for own funds requirements under the alternative standardised approach for market risk

In general, the sensitivity-based method (SBM) would strengthen the market risk capital framework by introducing a standardized approach to market risk within the European banking capital framework, serving as a credible alternative to the internal model approach.

We welcome the European Commission's proposal to introduce a multiplier to the FRTB Standardised Approach, and we note the important clarification in this consultation that the adjustment is intended to apply specifically to the SBM. Whilst we also acknowledge the Commission's stated rationale for the multiplier (namely, to mitigate potential level playing field distortions arising from uncertainty around international implementation timelines), we believe it is crucial to ensure that any temporary adjustment does not obscure the underlying structural issues with the current SBM design. In particular, the current design continues to have limited diversification recognition and has a tendency to overstate risk for portfolios that are otherwise well-hedged from a management perspective. While the proposed multiplier provides short-term relief, it remains temporary in nature and is not, by itself, a risk-sensitive long-term solution. We therefore believe that a more effective approach would be to enhance specific elements of

[58] ISDA. *Implications of the FRTB for Carbon Certificates*. July 2021. https://www.isda.org/a/i6MgE/Implications-of-the-FRTB-for-Carbon-Certificates.pdf

the SBM framework to better capture diversification effects and to ensure that capital outcomes remain aligned with sound 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[59]. 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; ρ_{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[60] 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 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.

[59] 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

[60] 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.

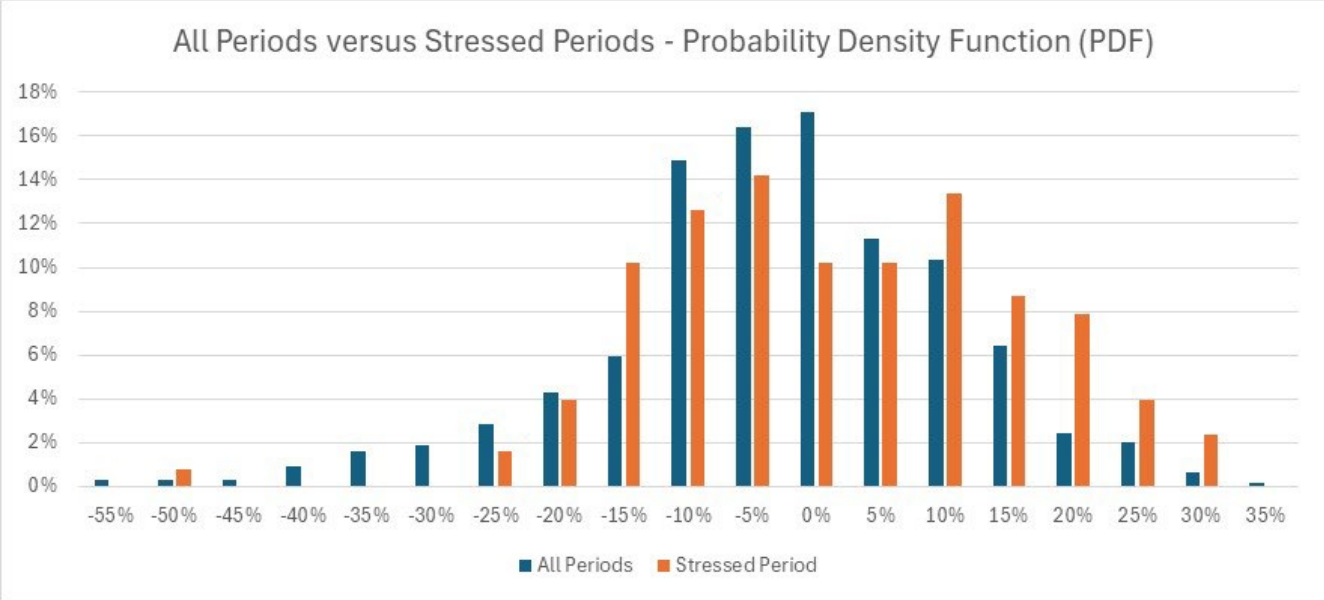

Figure 1 - Distribution of implied rho

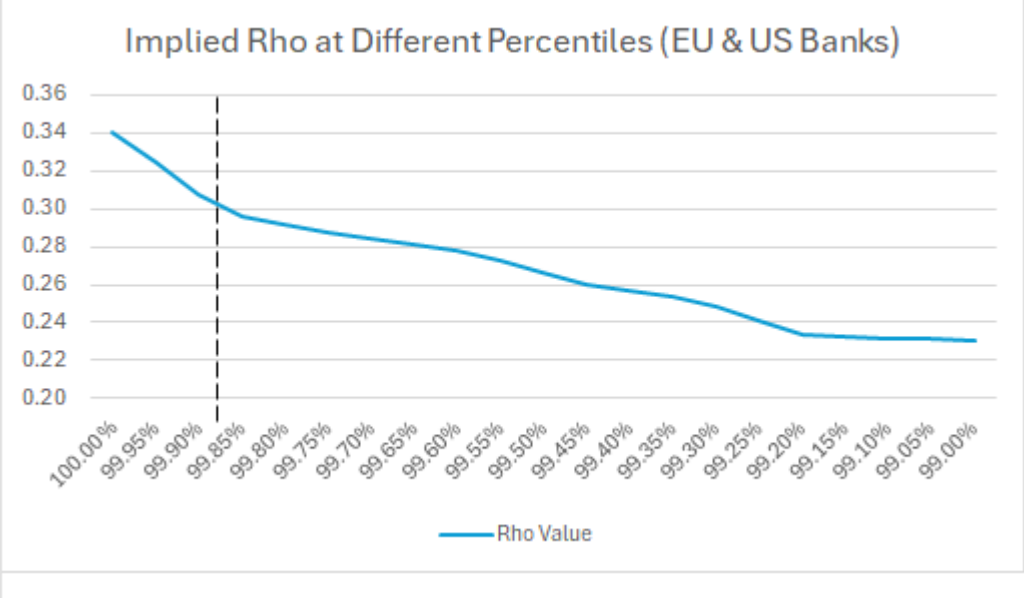

Figure 2 - Implied Rho at extreme percentiles

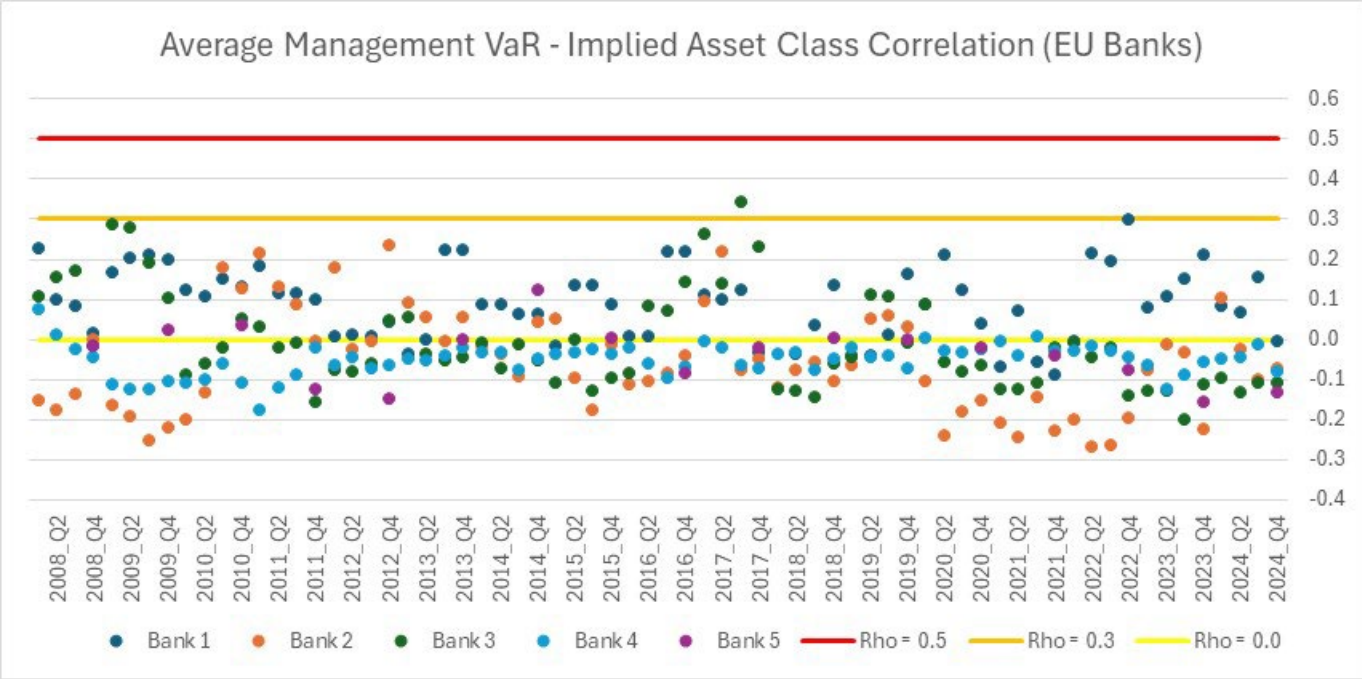

Figure 3 - EU banks implied asset class correlation obtained from management VaR since Q2 2008

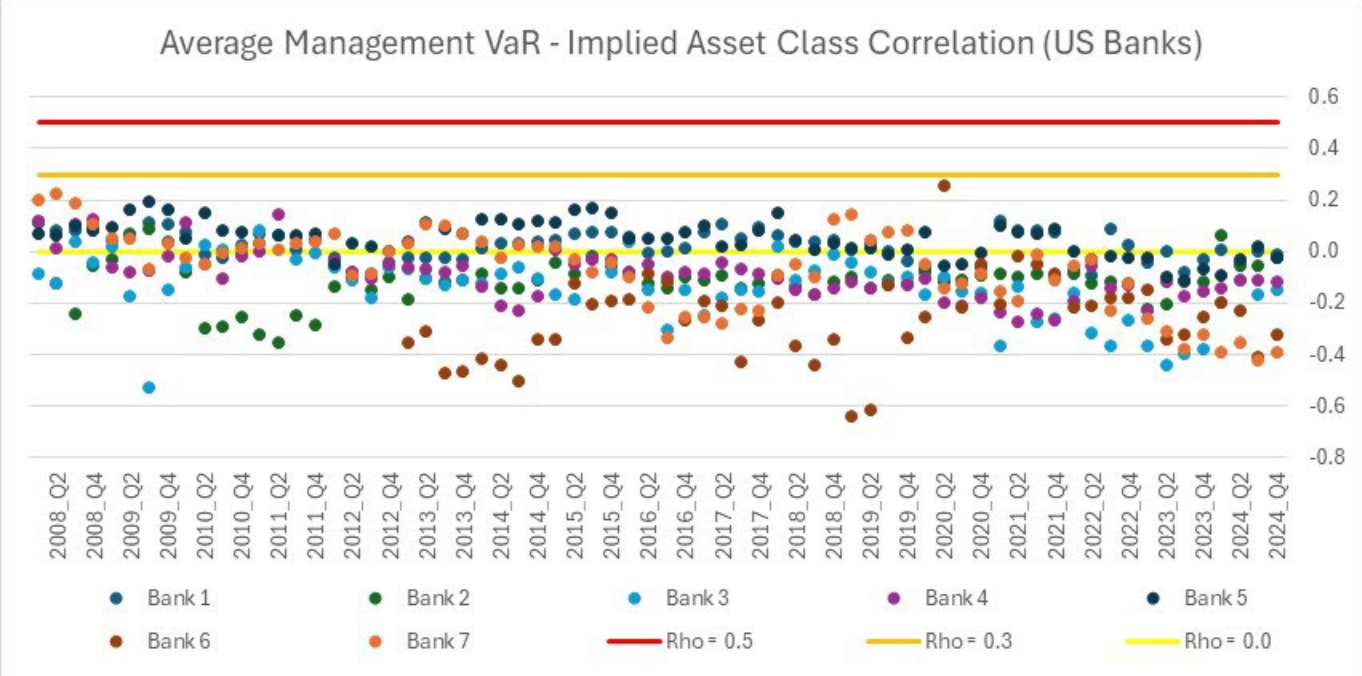

Figure 4 - US banks implied asset class correlation obtained from management VaR since Q2 2008

Industry Recommendation:

The industry recommends introducing an FRTB SBM capital requirement multiplier of **maximum 0.7**[61]. This corresponds to the reduction in SBM capital using an SBM rho value of 30%[62], 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.

In the longer term, the industry encourages the European Commission to consider the more risk-sensitive approach outlined above, which better reflects diversification benefits across asset classes while also addressing level playing field concerns across jurisdictions. Until such time, the scalar approach should remain in place on a permanent basis.

The approach taken for SBM diversification also relates to the IMCC rho parameter outlined in 3.1.1.1. Both approaches acknowledge the importance of recognising diversification while ensuring that banks are not disincentivised from utilising either IMA or ASA.

2.2. Industry Proposals Under the Alternative Standardised Approach (ASA)

2.2.1. Changes to Collective Investment Undertakings (CIUs)

2.2.1.1. Enhanced Mandate Based Approach

We must highlight that no improvements have been made as part of the European Commission consultation to the mandate-based approach (MBA) as a viable alternative when the look through approach (LTA) is impractical[63]. 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 portfolio based on the lowest-quality constituents allowed by the mandate will materially misrepresent the fund's risk profile.

[61] Analysis was performed using the hypothetical portfolios identified in by ISDA Analytics™ solution.

[62] 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.

[63] This comment does not include the Swiss Financial Market Supervisory Authority case where the 50% risk weight has been introduced in cases where LTA is possible but not practicable.

The idea behind the MBA is fundamentally sound. Given the broad nature of most fund mandates, determining an appropriate risk weight becomes impractical. Consequently, banks are unlikely to adopt the MBA in its current form as it tends to systematically overestimate risk due to the following factors:

- Mandates are generally broad in prospectuses to allow flexibility for asset managers, making it impractical to seek investor approval for every new investment that might fall outside the mandate.
- 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 these two factors creates ambiguity regarding the assumption banks need to make when calculating the risk weight. For example, banks would be required to assume the worst possible duration for securities in a particular sector, even if this does not align with the actual investment profile of the fund.
- 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[64]. A similar adjustment practice has been reported in the BIS Basel Monitoring Exercise[65], 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[66]. The enhanced MBA remains a central industry proposal that aims at fixing the issue of CIUs permanently.

An additional delay will certainly provide us with valuable time to effectively develop a fair and economically sound approach that will help us maintain the level playing field. However, if the postponement is not granted, a proposal for a less conservative fall-back approach would be greatly appreciated.

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

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

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

Industry Recommendation:

As a long-term measure, enhance and simplify the mandate-based approach such that it becomes a viable alternative to capitalize CIUs.

Additionally, the MBA should be aligned with the LTA concept, which corresponds to the typical portfolio strategy of the fund. The MBA can be further enhanced with new CIU buckets[67] 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.

2.2.1.2. Risk Weights under the Fall-Back Approach

To provide immediate relief within the delegated act, the industry proposes reducing the risk weight applied to diversified funds, thereby avoiding the overly conservative 70% risk weight currently applied.

Notably, 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:

- 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 and the booking of hypothetical positions in valuation systems.

[67] 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

Table 8 in Article 325ap[68] 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 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)[69] 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 CRR'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%. Given the high level of caution previously expressed by European regulators on this matter, defaulting to such a conservative risk weight would be acceptable as a temporary relief measure.

Implementing this temporary relief measure would help prevent an unnecessary spike in capital requirements until a more risk-aligned mandate-based approach becomes available.

Industry Recommendation:

In Table 8 of Article 325ap, which can be amended by the delegated act since it is "pursuant to the delegated act referred to in Article 461a", Bucket 11 should distinguish between the risk weights for single name equities and CIUs by applying a scalar of 0.5 to equity Bucket 11 risk weight for CIUs as follows:

[68] European Commission, *Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on Prudential Requirements for Credit Institutions and Investment Firms*, as amended by Regulation (EU) 2021/558, Article 325ap – "Risk weights for equity risk." Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:02013R0575-20250101

[69] 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

	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[70]	Other sector – Single Equities			70%	0.70 %
		Other sector – CIUs			35%	0.35 %

2.2.1.3. Remove the standalone aggregation for the Fall-Back Approach

Under the FBA, the risk associated with a CIU is allocated to the "Other" bucket, which incurs the most conservative risk weight of 70%. Risk factor aggregation is performed by summing the absolute weighted sensitivities for each risk factor to derive the "Other" bucket exposure which is then aggregated with zero inter-bucket correlation. This approach is overly conservative, as it fails to recognise any diversification among the constituents of the fund, which is unlikely for many funds.

The EU adds an extra layer of conservativeness in CRR3 Article 325j(1a)(b) when aggregating the risks of the portfolio and FBA CIUs. This additional conservatism stems from a standalone aggregation treatment that simply adds the FBA capital requirement of each CIU to the portfolio's own funds requirement, thereby decoupling the CIUs under FBA from the rest of the risk class-specific own funds requirement for delta/vega:

EU CRR3:

$$\sqrt{\sum_b K_b^2 + \sum_b \sum_{c \neq b} \gamma_{bc} S_b S_c} + \sum_J K_J$$

Where

K_b = bucket-specific sensitivity for buckets 1-13 (bucket 11 does not contain any CIUs under FBA); and

[70] We would note that in CRR Article 325ah, the use of two risk weights within a single bucket is already implemented for CSR Bucket 10, where covered bonds are assigned risk weights of either 1.5% or 2.5%.

K_j = CIU risk-weighted sensitivity for CIUs under the FBA.

Other jurisdictions & BCBS:

$$\sqrt{\sum_b K_b^2 + \sum_b \sum_{c \neq b} \gamma_{bc} S_b S_c}$$

Where

K_b = bucket-specific sensitivity for buckets 1-13; CIUs under FBA are included under bucket 11 along with everything else in bucket 11.

Industry Recommendation:

The additional layer of conservatism in the EU FBA could lead to a significant increase in the required capital. The existing conservative approach of applying a large risk weight and zero correlation for the "Other" bucket should be sufficient to ensure safety and soundness, without the need for separate aggregation. Furthermore, standalone aggregation is not mandated in the Basel rules. Therefore, we recommend removing the standalone aggregation requirement on a permanent basis, as per the below amended CRR text.

Article 325j (1a)(b)

For the purposes of the approaches referred to in paragraph 1, point (b) the institution shall:

…

(b) for all positions in the same CIU, use the same approach among the approaches set out in paragraph 1, point (b), to calculate the own funds requirements. ~~on a stand-alone basis as a separate portfolio;~~ Additionally, for positions utilising the approach set out in paragraph 1, point (b)(ii), to calculate the own funds requirements on a standalone basis as a separate portfolio.

2.2.1.4. Trading book classification criteria for funds under the Fall-Back Approach

It is a requirement for banks to have knowledge of the content of a CIU's mandate to apply the trading book treatment when using the look through approach (LTA), mandate-based approach (MBA) and the fall-back approach (FBA). Whilst this obligation is sensible for the LTA and MBA, it is disproportionate for the FBA, which is already calibrated conservatively and utilised by banks that cannot deploy the LTA or the MBA.

Fund mandates are often purposefully broad to provide flexibility to fund managers. While the mandate essentially defines broad parameters such as the fund's overall strategy, objectives, and constraints, in practice a fund might never hold certain eligible investments covered by its mandate.

Adding this operational burden for CIU positions that may only be held for a short period or may not be held at all, incurs unnecessary costs without providing prudential benefits. This requirement contradicts the spirit of the trading book, where turnover of CIU positions may be high.

Accordingly, CIU positions when subject to the fall back approach should be allowed to remain in the trading book as long as firms have daily pricing based on observable market data, such as price volatility, liquidity, and trading volumes and the ability to trade or hedge those positions as per their trading intent, rather than being forced into the banking book due to unnecessary operational demands.

Industry Recommendation:

Permanently remove the requirement for banks to have knowledge of the content of a CIU's mandate when classifying funds into the trading book which are subject to the fall back approach. The requirements for applying the look through approach and mandate-based approach would mandate the bank to determine the composition or mandate of the fund, as applicable. Whereas the fall back approach already prescribes punitive SBM and DRC capital requirements treating the whole CIU as a single name equity exposure with no diversification benefit, therefore should not be subject to additional residual risk add on requirements.

The CRR text should be amended to include the following derogation:

By way of derogation from Article 104(8)(b), 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) and Article 325j(1a).

Article 325j(1a) should be modified as follows:

For the purposes of the approaches referred to in paragraph 1, point (b), of this Article the institution shall:

(a) apply the own funds requirements for default risk set out in Section 5 and the residual risk add-on set out in Section 4 to a position in a CIU, where the mandate of that CIU allows it to invest in exposures that shall be subject to those own funds requirements. ~~when using the approach referred to in paragraph 1, point (b)(i), of this Article the institution shall consider the position in the CIU as a single unrated equity position allocated to the bucket 'unrated' in Article 325y(1), Table 2; and~~

(aa) when using the approach referred to in paragraph 1, point (b)(i), of this Article, the institution shall apply the own funds requirements for default risk set out in Section 5 and consider the position in the CIU as a single unrated equity position allocated to the bucket 'unrated' in Article 325y(1), Table 2; and

Article 325j (5) should be modified as follows:

An institution may use the approaches referred to in paragraph 1(a) and 1(b)(ii) only where the CIU meets all of the conditions set out in Article 132(3). For the purpose of these approaches, where the CIU does not meet all of the conditions set out in Article 132(3), the institution shall assign its positions in that CIU to the non-trading book.

2.2.1.5. 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 EU CRR, adjusted to reflect the specific properties and characteristics of CIUs.

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). We believe that this industry recommendation should be made on a permanent basis.

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.

2.2.2. 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.

Post-2008 crisis, market participants have significantly simplified correlation trading portfolios and enhanced risk management frameworks. Being able to handle more complicated financial products is an important element of supporting financial markets and there is significant client demand for these products in the European market, which represent a growing segment.

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.

Correlation trading continues to represent an important and active segment of global credit markets, supporting risk transfer, liquidity, and macroeconomic resilience. Recognising this, the industry has jointly developed a detailed white paper – *The Impact of the FRTB on Correlation Trading*[71] – which outlines the significance of the correlation trading market, provides global industry recommendations, and illustrates how regulatory clarity and alignment across jurisdictions would help maintain liquidity and ensure capital requirements remain risk-appropriate.

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)[72] could be interpreted to not permit such a look through approach (LTA) for ACTP. Implementing a capital treatment that excludes this approach would be inconsistent with the true risk, forcing banks to manage both the economic risk and the capital footprint in separate and inconsistent processes, leading to excessive capital requirements

[71] ISDA, *The Impact of the FRTB on Correlation Trading,* October 2025. Available at: The Impact of the FRTB on Correlation Trading – International Swaps and Derivatives Association

[72] European Commission, *Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on Prudential Requirements for Credit Institutions and Investment Firms*, as amended by Regulation (EU) 2021/558, Article 325i(1) – "Treatment of index instruments and other multi-underlying instruments.", Article 325ac – "Jump-to-default amounts for the ACTP." Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:02013R0575-20250101

divorced from the actual underlying 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 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[73] already permits the decomposition of multi-underlying instruments under the ACTP CSR. This relief would ensure a level playing field even before a more comprehensive revision of the ACTP capitalisation rules can be implemented under EU law.

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, so that the sum aligns with the JTD of the undecomposed multi-underlying instrument
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 as per article 325y(3)
e. Assigning non-securitization risk weights to the netted single-name JTDs

The industry's white paper[74] further outlines the rationale for this approach to calculating DRC, drawing on a quantitative example to demonstrate.

[73] 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

[74] ISDA, *The Impact of the FRTB on Correlation Trading,* October 2025. Available at: https://www.isda.org/2025/10/07/the-impact-of-the-frtb-on-correlation-trading/

Industry Recommendation:

We urge the European legislators 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.

2.2.3. Changes to the RRAO framework

2.2.3.1. Clarification on perfectly offsetting trades subject to the RRAO

The industry seeks greater clarity on the interpretation of perfectly offsetting positions for the purposes of Article 325u(4)(c)[75], which provides an RRAO exemption where instruments fully offset market risks. It is understood that a "position" may consist of multiple trades, and that trades forming an offsetting set should share the same economic payoff characteristics (such as underlying, maturity, strikes, barriers, optionality, exotic features etc.) even if their notionals differ.

In practice, instruments with identical economic payoffs can be transacted with different counterparties, which may result in differences in discounting due to different counterparty collateral agreements/counterparty spreads. These valuation-related differences do not alter the intrinsic economic risks of the payoff and should not be considered in determining whether positions are perfectly offset for RRAO purposes.

In particular, recognising discounting differences as a barrier to offsetting would artificially inflate RRAO capital requirements for positions that are economically hedged, despite only minor valuation-level divergences. It could also generate cliff effects where collateral terms change, abruptly moving positions from being fully offset to attracting RRAO. Such outcomes would not reflect underlying market-risk exposures.

The industry therefore considers that "perfectly offsetting" should be interpreted as requiring the elimination of the intrinsic market risks relevant for RRAO ("residual risks") by trades with identical economic payoffs on a per unit basis.

[75] European Commission, *Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on Prudential Requirements for Credit Institutions and Investment Firms*, as amended by Regulation (EU) 2021/558, Article 325u – "Own funds requirements for residual risks." Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:02013R0575-20250101

Industry Recommendation:

The industry requests clarification that Article 325u(4)(c) permits the calculation of RRAO on a consolidated basis for positions that share the same economic payoff and associated features, and that fully offset the residual risks in scope of RRAO, even where the positions differ in notional size.

2.2.3.2. Clarification on identification and exemption of hedges from RRAO

The industry supports the principle underpinning Article 325u(4a)[76] and the associated RTS[77] to identify and exclude hedging instruments booked solely to hedge residual risk of trading book positions from the own funds requirements for residual risk. However, the industry believes that the RTS does not recognise the risk reducing effect of these hedges as it only removes the hedging instruments (with severe constraints attached) and not the original instruments from residual risk add-on.

The industry believes that 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.

In addition, the industry also believes that the criteria and categorisation of the hedging instruments defined in the RTS makes it very cumbersome and impractical to implement in practice. We recommend

[76] European Commission, *Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on Prudential Requirements for Credit Institutions and Investment Firms*, as amended by Regulation (EU) 2021/558, Article 325u – "Own funds requirements for residual risks." Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:02013R0575-20250101

[77] European Banking Authority. *Final Report on Draft RTS on RRAO*. October 2021. https://www.eba.europa.eu/sites/default/files/document_library/Publications/Draft%20Technical%20Standards/2021/RTS%20on%20residual%20risk%20add-on/1022462/Final%20Report%20on%20draft%20RTS%20on%20RRAO.pdf.

that the RTS be re-proposed, after taking into consideration the proposed amendments to Article 325u(4a) as below. We also believe that applying a sunset clause by specifying an expiry date to the derogation defeats the purpose of recognising sound risk management practices, and the article should be a permanent derogation rather than a temporary one.

Industry Recommendation:

Amend Article 325u(4a) such that it recognizes the risk reducing effects of hedges to residual risk more effectively. The industry also recommends that the RTS be re-proposed after taking into consideration the amendment proposed below and that the derogation be made permanent.

Article 325u(4a**)**

~~*By way of derogation from paragraph 1, until 31 December 2032, an institution shall not apply the own funds requirement for residual risks to instruments that aim solely to hedge the market risk of positions in the trading book that generate an own funds requirement for residual risks and are subject to the same type of residual risks as the positions they hedge.*~~

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

The competent authority 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 competent authority that the instruments comply with the criteria to be treated as having hedging positions.

The institution shall report to the competent authority 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.

2.2.4. Risk Weights for FX & GIRR vega exposures

The industry would like to draw the European Commission's attention to the mis-calibration of FX and GIRR vega risk weights, an issue that has been raised previously[78] but remains unaddressed. FX and Interest Rate options are actively used by European corporates for risk hedging, however these markets are already dominated by non-EU banks. Further restrictions of EU banks' activity in this segment undermines the European strategic autonomy agenda.

The FRTB SA rules set risk weights to capture vega risk (sensitivity to change in the underlying volatility) in Foreign Exchange (FX) and Interest Rate (IR) instruments. In the CRR III, the risk weight is set to 100%, across the term structure, leading to material RWA increase under SA.

The 100% RW is not commensurate with shocks observed during stress periods. 100% RW for a long vega position is equivalent to the volatility reducing to zero, which is unrealistic. Indeed, as evidenced by the two charts below, even extreme changes in volatility (e.g. those corresponding to 99th percentile of moves or to average move above 97.5th percentile) are well below 100%. Note that this analysis considers regulatory liquidity horizons (e.g. 40 day moves for FX and 60 day moves for IR vols respectively). This analysis has been done for major currencies and currency pairs and a range of tenors from relatively short dated to long dated.

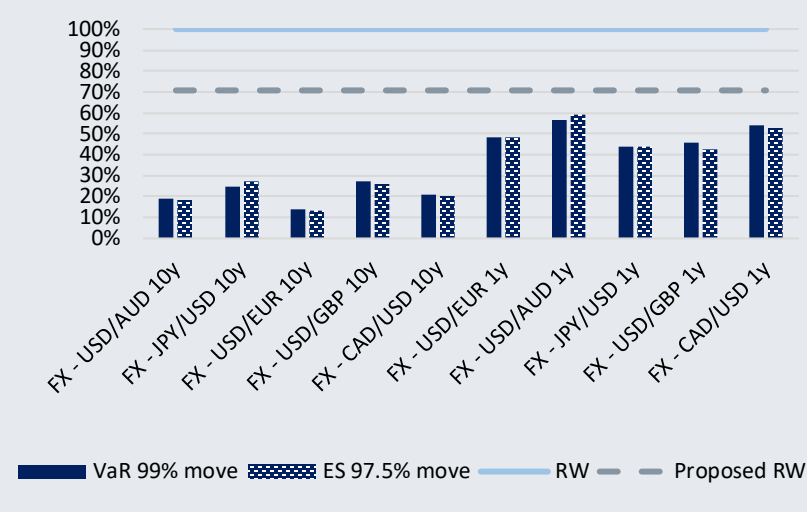

Figure 5 - Realised changes (40 days liquidity horizon) in FX option volatility over 10-year window

[78] AFME, *AFME Response to the EC targeted consultation on the application of the market risk prudential framework,* April 2025. Available at: https://www.afme.eu/...

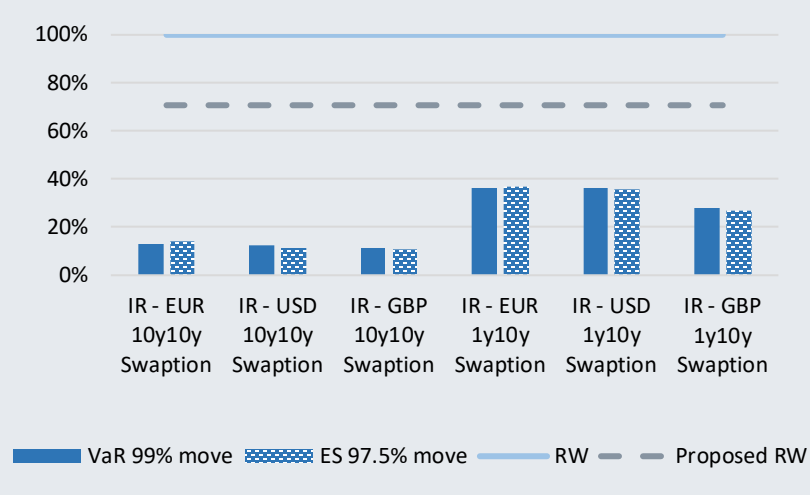

Figure 6 - Realized changes (60 days liquidity horizon) in IR option volatility over 10-year window

This overly conservative calibration penalises long dated vega exposure, which is typically driven by real economy client demand, especially in the major currencies like the ones included in the charts above. As can be seen from the analysis, risk weights of 40-60% would be more in line with historical moves, and even that is quite conservative for long-dated exposure. However, a more risk sensitive model would recognize the difference in behaviour of long and short dated exposures and introduce a term structure in vega risk weights (as is already the case for e.g. GIRR delta).

To demonstrate why this matters, consider the fact that long-dated vega exposure is typically hedged with more liquid, shorter-dated vega exposure. Due to the fact that moves in long-dated volatilities are typically larger than those in short-dated ones (again as evidenced by the charts above), the economic hedge is typically in unequal amounts. In other words, a lower quantity of short-dated vega risk is required to hedge the long-dated vega risk.

This economic hedge is in fact penalized by FRTB SA, as the net position appears "open" under the SBM rules. For a bank to achieve a reduction in their capital requirement under the current rules, it would have to source an equal amount of short-dated vega to their long-dated vega, which would introduce real P&L risk, and would not be prudent or likely within the bank's risk appetite. Thus, current rules suffer from the lack of risk sensitivity and introduce conflicting incentives where capital management conflicts with actual risk management.

Industry Recommendation:

As a more fundamental change, the industry recommends introducing term structure to FX and GIRR vega risk weights and re-calibrating them to be in line with historical moves (in the 40-60% range).

As a temporary measure, the industry recommends reducing the vega RW to reflect the true sensitivity to volatility per average tenor, especially for major and most liquid currencies and currency pairs.

This can be achieved for FX and IR by dividing their 100% RW by $\sqrt{2}$ in CRR Article 325ax(2)[79], as done for special currency pairs in the context of delta RW (BCBS 21.44/21.88[80]) and in CRR Article 325ae(3)[81] for IR and FX delta RW. The vega RW for FX-IR would then become 70.71%

In the delegated act, the change can be implemented by setting a factor of 0.7 (i.e. $1/\sqrt{2}$) for this risk type for qualifying currencies and currency pairs.

To keep CVA RW consistent with Market Risk, a corresponding change would be needed in CRR Articles 383k(5) and 383n(4)[82].

[79] European Commission, *Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on Prudential Requirements for Credit Institutions and Investment Firms*, as amended by Regulation (EU) 2021/558, Article 325ax – "Vega and curvature risk weights." Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:02013R0575-20250101

[80] Basel Committee on Banking Supervision, *MAR21 – Standardised Approach: Sensitivities-Based Method*, July 2024. Available at: https://www.bis.org/basel_framework/chapter/MAR/21.htm

[81] European Commission, *Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on Prudential Requirements for Credit Institutions and Investment Firms*, as amended by Regulation (EU) 2021/558, Article 325ae – "Risk weights for general interest rate risk." Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:02013R0575-20250101

[82] European Commission, *Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on Prudential Requirements for Credit Institutions and Investment Firms*, as amended by Regulation (EU) 2021/558, Article 383k – "Risk weights for interest rate risk", Article 383n – "Risk weights for foreign exchange risk." Available at: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:02013R0575-20250101

3. Industry Proposals for the Trading Book / Banking Book Boundary

3.1. 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 do not specifically mention real estate investment trusts or real estate funds, the general exclusion of "real estate holdings-related instruments" in Article 104(3)(b) would inadvertently capture such exposures and force them into the non-trading book. It should be noted that this has been addressed across other jurisdictions, where amendments have been made to specifically address this issue, thus increasing level playing field concerns within the industry.

Industry Recommendation:

We recommend permanently amending the below regulatory text as follows:

Article 104(3)

Institutions shall not assign positions in the following instruments to the trading book:

a) *Instruments designated for securitisation warehousing*

b) *Real estate holdings-related instruments other than holdings in real estate investment trusts or real estate funds*

...

f) *Derivative contracts and CIUs with one or more of the underlying instruments referred to in points (a) to (d) of this paragraph, excluding CIUs that are real estate investment trusts (REITs) or real estate funds*

3.2. Collective Investment Undertakings (CIUs) with Banking Book Underlyings

Funds may include a small percentage of alternative assets, such as real estate, which are not eligible for inclusion in the trading book. Under the CRR rules, if a fund contains banking book positions, the entire fund is classified under the banking book.

We believe that banks should be allowed to include certain de minimis compulsory banking book instruments in the trading book, provided they are managed as part of an integrated trading strategy alongside similar instruments already in the trading book.

We note that the PRA's CP17/25 consultation proposed the introduction of a de minimis threshold for the purposes of trading book classification. This was introduced in recognition that the diversity of CIUs and the variability of their underlying investments could otherwise create cliff effects in the allocation of funds between the trading and non-trading books. Small changes in a CIU's composition could lead to disproportionate reclassification and capital impacts. Introducing a similar threshold within the EU framework would help reduce volatility in CIU allocation, while ensuring that the boundary between the trading and non-trading book remains clear and consistent, without imposing unnecessary operational burden on firms.

Industry Recommendation:

We recommend introducing a materiality threshold that will allow CIUs to remain in the trading book if they hold only an immaterial amount of banking book holdings. In the EU, the materiality threshold for UCITS[83] limits investments in a single entity to 10% of NAV. Applying a similar 10% threshold for CIUs would not only account for immaterial banking book holdings in CIUs but also mitigate RWA volatility that can arise from the movement of CIUs or corresponding hedges between the trading and banking books due to exogenous changes in the characteristics of CIU constituents, such as corporate actions in the case of listed equities.

Additionally, the CRR currently restricts the use of the LTA or MBA for third-country overseas funds, leading to a 1,250% risk weight due to reclassification to the banking book. These restrictions should be removed, as they are not included in comparable jurisdictional frameworks (e.g., UK PS 17/23[84]). Maintaining these restrictions would limit the ability of EU banks to invest in third-country funds.

We believe that this Industry recommendation should be made on a permanent basis.

[83] European Parliament and the Council of the European Union, *Regulation 49 (1) (a) of the European Communities (Undertakings for Collective Investment in Transferable Securities) Regulations (2003)*, https://service.betterregulation.com/document/93183

[84] Bank of England. *Policy Statement PS9/24 – Implementation of the Basel 3.1 Standards: Appendix 2*. Prudential Regulation Authority, September 2024. https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2024/september/ps924app2.pdf

Appendix

1. Hypothetical Portfolio Analysis

To demonstrate that the NMRF framework is not fit for purpose, we constructed a realistic hypothetical scenario involving two portfolios, each comprising multiple asset classes. The base portfolio includes a mix of long and short positions across several asset classes: interest rate delta, interest rate volatility, equity spot, equity volatility, credit indices, foreign exchange spot, and foreign exchange volatility risk factors. In this portfolio, all risk factors are assumed to be modellable. The extended portfolio expands upon the base portfolio by incorporating additional risk factors, including exposure to more foreign exchange currencies, interest rate curves and volatility surfaces, credit indices, credit default swaps, and equity spot. This extended risk factor set is used to generate two modellability scenarios: one where all risk factors in the extended portfolio are modellable and another where all risk factors in the extended portfolio are non-modellable.

Adding the extended portfolio with all modellable risk factors results in a marginal capital increase of **59.6%** compared to the base portfolio. However, if the same extended portfolio risk factors are considered non-modellable, the marginal capital increase rises to **308.1%**. While this outcome is specific to the chosen risk factors, different portfolios of risk factors could yield significantly different marginal impacts.

Analysing portfolios of single asset classes reveals a range of potential outcomes. For instance, consider a hedged portfolio consisting of mid-maturity equity single-name and index volatility exposures, alongside longer-dated positions. If the longer maturities fail RFET becoming non-modellable and leaving the ES capital with broken hedges – the marginal ES capital increase would be **52.5%**. Expanding from the base case to the full portfolio, incorporating non-modellable risk factors, results in a **288.9%** marginal increase.

Applying a similar framework to CDS and CDX risk factors, the initial marginal ES capital increase would be **43.6%**, with a **167.8%** increase when accounting for the full portfolio where NMRFs are capitalized under SES. For swaption volatilities, the initial marginal ES capital increase would be **23.7%**, rising to **211.5%** for the full portfolio under SES capitalization.

This highlights the inherent challenge of calibrating a flat multiplier and underscores the fundamental flaws in the NMRF framework – the model itself fails because the NMRFs lack sufficient time series data and cannot be included with other risk factors, creating a self-contradictory loop. The following sections provide additional details on the hypothetical portfolios.

Introduction

The NMRF framework is designed to address risk factors with low recent liquidity, as indicated by limited real price observations. In the calculation of NMRF capital, an ES is calculated for each risk factor on a standalone basis (i.e., standalone ES), and these values are then aggregated using the prescribed formula. In contrast, the broader FRTB IMA framework calculates risk on a group-level basis – either by asset class, liquidity horizon, or at the portfolio-level. This analysis evaluates the effectiveness of the formula used for aggregating NMRFs and compares it with alternative approaches.

The NMRF framework likely exists in its current form because regulators may not trust empirical correlations for risk factors with low liquidity. Bucket-level ES is calculated using historical simulation, which incorporates these empirical correlations. In the group-level ES framework, when calculating the P&L for a given scenario (where a scenario spans 10 consecutive business days), the returns for all risk factors are used to calculate and aggregate the P&L. Therefore, if two risk factors move in opposite directions in a scenario, this offsetting is taken into account in the portfolio's overall P&L for that scenario.

However, when a risk factor is difficult to observe, it is challenging to allocate a return to a specific business day, as the return might be attributed to a nearby date. As a result, empirical correlation can become unreliable, and thus, the capital derived under group-level ES approach might also be uncertain. Standalone ES removes the reliance on these empirical correlations.

We observe that the ES calculation takes us from returns space to P&L space. The returns space refers to the change in time series levels for each scenario, independent of the portfolio. In contrast, P&L space is portfolio-specific, capturing the change in the portfolio's P&L resulting from shifts in risk factor levels.

The NMRF aggregation formula includes a rho parameter of 0.6, which specifies a 36% correlation among the standalone ES. This correlation is specified in P&L space rather than in returns space, eliminating the need to make any assumptions about risk factor correlations. However, an assumption is made regarding the correlation between P&Ls, or at least between ESs. Thus, this implicitly assumes a certain portfolio composition or, at a minimum, the portfolio's relationship to the risk factors. Notably, the ES() operator, when applied to a P&L vector, consistently selects a signed tail of P&L. As a result, any hedging or offsetting effects between P&Ls associated with different risk factors will be overridden.

In this analysis, we show the impact to a diversified portfolio with a richness of asset classes and risk factors. However, we note that it is a small portfolio compared to the balance sheet of a bank. The incremental effect of an additional risk factor on a portfolio's ES measure typically diminishes with increasing portfolio size. In practice, the impact of treating NMRFs as modellable (or using ES) is likely to be greater than the estimates presented here. The table below shows the effect of portfolio size on different aspects of FRTB IMA and the likely impact on the sample portfolio:

Capital Calculation Approach	Impact of Portfolio Size	Likely Impact on Sample Portfolios
Expected Shortfall (Unconstrained)	Only 6.25 (=2.5%*250) tail days are considered, meaning that if a new risk factor does not experience significant volatility on those days, the ES remains unchanged. As a result, the marginal impact of adding a new position tends to diminish as portfolio size increases.	For small portfolios, the ES measure will be highly conservative compared to real-world portfolios.
IMCC	Multiple ES calculations are applied, incorporating **tails** for each asset class and liquidity horizon. However, the same diminishing effect is expected as for	For small portfolios, the IMCC measure will also be conservative relative to real-world portfolios.

	unconstrained ES, albeit at a slower rate.	
SBM	SBM does not account for diversification across asset classes or between risk types (e.g., delta and vega). It relies on a limited set of correlation parameters and does not apply a single tail. However, correlations exist within risk measures. As portfolio size increases, the marginal impact of a new position does not decrease as significantly with increasing portfolio size (as compared to unconstrained ES and IMCC).	For small portfolios, the SBM measure will be slightly more conservative than real-world portfolios.
SES	SES only allows diversification through the root sum squared approach, where each new risk factor has its own tail and SES. As a result, the marginal impact of a new position does not decrease as significantly with increasing portfolio size.	For small portfolios, the SES measure will be relatively less conservative than other capital measures when compared to real-world portfolios.

This analysis assumes that each risk factor has an underlying true time series, even if it is classified as non-modellable. In this context, the non-modellable treatment serves as a counterfactual element in our analysis. While a true time series may not always be identifiable in practice, a direct comparison of approaches is only possible when such a time series is available.

Our analysis is based on a simplified version of a 'real life' portfolio, accounting for diversification and risk factors from multiple asset classes. We start with a broad and diverse 'base' portfolio and then extend it to include additional risk to risk factors that industry feedback suggests are sometimes non-modellable. We compare capital for the extended portfolio under the assumption that the additional risk factors are modellable against the capital when they are not modellable, using various approaches to NMRF capitalization. To make the results clearer and without loss of generality, all results are 'normalized' so that the capital requirements for the 'all-modellable' baseline is 100.

Preliminary Review

Single-asset portfolios have been reviewed independently to assess capital impact under simplified and stylized scenarios, including:

- Long only
- Short only
- Long and Short (equal parts and randomly allocated)
- Long and Short positions designed to hedge risk and capital

These scenarios were repeated across standalone portfolios that only included CDS curves, swaption volatilities and equity volatilities, aiming to examine characteristics of the SES charge in comparison to IMCC.

The supporting data for our preliminary discussion is provided below. Note that these are generated using the prescribed setting rho of 0.6 and account for all other aspects of the current framework (e.g., 1.5 scalar of IMCC, liquidity horizon scaling of IMCC and SES, etc.).

We find that for these stylized, single-asset portfolios, the IMCC and SES charges are broadly similar, as risk is concentrated and directional. In certain cases with high empirical correlations between the selected risk factors (where the current setting of the rho parameter underestimates), SES is found to even be lower than IMCC. However, when portfolios are no longer directional and include a mixture of long and short positions, we begin to see the drawback of SES – as the NMRF charge is designed to select individual tails it becomes overly punitive compared to IMCC and appears to incentivize firms to not diversify their risk. The below table shows the results for long only, short only, and randomly long/short portfolios:

Single-Asset Comparisons: IMCC vs SES (Normalized)				
Asset Class	**Position Types**	**All IMCC**	**All SES**	**Impact**
Swaption Volatilities	*All Long*	100	102	2
	All Short	100	132	32
	Randomly Long/Short	100	208	108
CDS Curves	*All Long*	100	65	-35
	All Short	100	45	-55
	Randomly Long/Short	100	167	67

When we extend our analysis by reconstructing the same single-asset portfolios to include hedging positions that are deliberately 'broken' across IMCC and NMRF, we observe a significant capital penalty. This is due to the dual impact of IMCC losing its risk-reducing positions, combined with the NMRF charge being more conservative than IMCC. This further demonstrates that the NMRF charge fails to incentivize diversification of risk.

The below table shows results for the hedged portfolios. It compares scenarios where all risk factors are modellable, all risk factors are non-modellable, and hedges are split deliberately (with modellable and non-modellable risk factors hedging one another):

Single-Asset Comparisons: Hedged Positions in IMCC vs SES vs Split (Normalized)					
Asset Class	**All IMCC**	**All SES**		**Split**	
		Capital	**Impact**	**Capital**	**Impact**
Equity Volatilities	100	350	250	389	289
CDS Curves & Indices	100	220	120	268	168
Swaptions	100	286	186	312	212

From Preliminary Analysis to 'Real World' Portfolios

This preliminary analysis illustrates the key driver of conservatism in NMRF: the fact that individual 'tails' are taken per risk factor, and that any correlation applied occurs in P&L space, or more precisely ES space, taking the absolute value of P&Ls.

Based on this observation and theoretical considerations, one can infer that the more complex and diversified a portfolio is, the more conservative the SES charge will become. The analysis on the diversified portfolio illustrates this point empirically.

The main results of our study, presented further below as the 'diversified' portfolio case, bring these issues to the fore. The correlation assumption embedded in the NMRF aggregation is found to be excessively conservative when applied to a broad and diversified portfolio.

Ironically, NMRF appears to be fit for purpose only for those types of portfolios not generally deemed to need internal models (i.e., small, concentrated, and directional).

Data Inputs for Diversified Portfolio

Portfolio Type	Risk Class	Risk Factor Group	Risk Factor Names
Diversified Portfolio	Credit Spread	CDS Single Name	• Senior unsecured CDS with maturity of 5-years across 44 banks/industries
		CDX Index	• CDX indices composed of IG, HY, and EM with different maturities
	Interest Rates	IR Vol	• 7*7 maturity pairs of EUR ATM swaptions vol, covering short- and long-term maturities • 7*7 maturity pairs of USD ATM swaptions vol, covering short- and long-term maturities • 5*6 maturity pairs of JPY ATM swaptions vol, covering short- and long-term maturities • 5*5 maturity pairs of CNY ATM swaptions vol, covering short- and long-term maturities
		IR Delta	• LIBOR USD • LIBOR EUR • AIBOR (AED)
	Equity	EQ Index	• SPX, CAC, etc.
		EQ Single Name	• AAPL, AMZN, BAC, etc.
		EQ Vol Index	• SPX Implied Volatility with maturities across 1-year to 30-years
		EQ Single Name Implied Volatility	• AAPL, AMZN, HSBC, and ULVR with maturities across 1-year to 30-years
	FX	FX Spot	• GBP, EUR, SEK, AUD, JPY, CNY, MXN, BRL, AED versus USD
		FX Vol	• EUR, GBP, CNY, and JPY with maturities across 1-week to 1-year

Details of the Diversified Portfolio Case Study

Two portfolios containing multiple asset classes:

i. Base: IR Delta, IR Volatility, Equity Spot, Equity Volatility, CDX, FX Spot, FX Volatility

ii. Extended: Base and additional currencies, additional indices and single-names in IR Delta, IR Volatility, CDX, CDS, and Equity Spot

Risk positioning: Combinations of long and short

Modellability scenarios: Base is always modellable

i. All of extended risk factors deemed modellable

ii. All of extended risk factors deemed non-modellable

Purpose: We are trying to assess the impact of multiple liquidity horizon mappings and asset classes on IMCC and SES. Here, we examine how different methodologies affect portfolios containing liquid risk factors across multiple asset classes, as well as potentially non-modellable risk factors. The proportion of SES to IMCC in this study aligns with various industry assessments in the Pillar 3 disclosures.

Findings:

- When certain risk factors become non-modellable, the sum of IMCC and SES is significantly higher than in an all-modellable scenario
- In large portfolios, adding potentially non-modellable risk factors to IMCC has a limited effect on overall risk drivers.
- However, capitalizing these factors separately under SES captures each possible tail event, making the standalone capital charge particularly severe.
- This effect is exacerbated when risk factors that could offset each other are capitalized independently under SES, as no offsetting is allowed

Portfolio Setup

Base Portfolio	Number of Risk Factors	Sensitivities	Base Portfolio
EQ Index Spot	4	200	Modellable (M)
EQ Index Vol	5	+/-200	M
IG CDX 5Y	1	12	M
IR Risk Free (1)	8	-200	M
USD IR Vol	49	+/-0.6	M
EUR IR Vol	49	+/-0.3	M
FX Spot (1)	4	-2000	M
FX Vol (1)	14	+/-200	M

Extended Portfolio	Number of Risk Factors	Sensitivities	Extended Portfolio (Modellable)	Extended Portfolio (Non-Modellable)
EQ Single Name Spot	10	200	M	Non-Modellable (NM)
EQ Single Name Vol (mid-maturities)	20	+/-200	M	NM

IG/HY/EM CDX 3Y/5Y/10Y	6	+/-7	M	NM
Corp CDS	44	+/-0.6	M	NM
Sov CDS	10	0.6	M	NM
IR Risk Free (2)	4	-200	M	NM
JPY IR Vol	30	+/-0.5	M	NM
CNY IR Vol	25	+/-0.5	M	NM
FX Spot (2)	6	-2000	M	NM
FX Vol (2)	14	+/-200 (assign)	M	NM

Diversified Portfolio Impacts

Modellability Scenario	Capital Measure	Start	End	Capital
Base Portfolio	**IMCC (Modellable)**	7/2/2019	6/15/2020	**2,062**
	1.5*IMCC (Modellable)	7/2/2019	6/15/2020	**3,093**
Base + Extended Portfolio **[All Modellable]**	**IMCC (Modellable)**	11/20/2019	11/3/2020	**3,291**
	1.5*IMCC (Modellable)	11/20/2019	11/3/2020	**4,937**
	Marginal Impact on Capital	N/A	N/A	**1,844**
	Marginal Impact on Capital %	N/A	N/A	**+59.6%**
Base + Extended Portfolio **[Base Modellable & Extended Non-Modellable]**	**LH-Scaled SES (rho=0.6)**	7/8/2019	6/19/2020	**9,528**
	MRF + NMRF (Incl. *1.5) (rho=0.6)	N/A	N/A	**12,621**
	Marginal Impact on Capital	N/A	N/A	**9,528**
	Marginal Impact on Capital %	N/A	N/A	**+308.1%**

Single Asset Class Hedged Portfolio Impacts

Modellability Scenario	Capital Measure	Equity Vols (Index & Single-Names)		
		Start	End	Capital
Base + Extend All Modellable (Hedged)	**IMCC (Modellable)**	5/17/2019	4/30/2020	**1,380**
	1.5*IMCC (Modellable)	5/17/2019	4/30/2020	**2,070**
Base Only (Broken Hedges)	**IMCC (Modellable)**	3/27/2020	3/11/2021	**2,105**

	1.5*IMCC (Modellable)	3/27/2020	3/11/2021	**3,158**
	Marginal Impact on Capital	N/A	N/A	**1,087**
	Marginal Impact on Capital %	N/A	N/A	**+52.5%**
Base + Extend Non-Modellable	**LH-Scaled SES (rho=0.6)**	12/2/2019	11/13/2020	**4,894**
	MRF + NMRF (Incl. *1.5) (rho=0.6)	N/A	N/A	**8,052**
	Marginal Impact on Capital	N/A	N/A	**5,982**
	Marginal Impact on Capital %	N/A	N/A	**+288.9%**

Modellability Scenario	**Capital Measure**	**Credit (CDX and CDS)**		
		Start	**End**	**Capital**
Base + Extend All Modellable (Hedged)	**IMCC (Modellable)**	9/30/2011	9/13/2012	**502**
	1.5*IMCC (Modellable)	9/30/2011	9/13/2012	**754**
Base Only (Broken Hedges)	**IMCC (Modellable)**	10/3/2011	9/14/2012	**722**
	1.5*IMCC (Modellable)	10/3/2011	9/14/2012	**1,082**
	Marginal Impact on Capital	N/A	N/A	**329**
	Marginal Impact on Capital %	N/A	N/A	**+43.6%**
Base + Extend Non-Modellable	**LH-Scaled SES (rho=0.6)**	6/13/2011	5/25/2012	**936**
	MRF + NMRF (Incl. *1.5) (rho=0.6)	N/A	N/A	**2,018**
	Marginal Impact on Capital	N/A	N/A	**1,264**
	Marginal Impact on Capital %	N/A	N/A	**+167.8%**
Modellability Scenario	**Capital Measure**	**Swaption Vols (USD, EUR, JPY, CNY)**		
		Start	**End**	**Capital**
Base + Extend All Modellable (Hedged)	**IMCC (Modellable)**	5/29/2019	5/12/2020	**527**
	1.5*IMCC (Modellable)	5/29/2019	5/12/2020	**791**

Base Only (Broken Hedges)	**IMCC (Modellable)**	9/4/2019	8/18/2020	**653**
	1.5*IMCC (Modellable)	9/4/2019	8/18/2020	**979**
	Marginal Impact on Capital	N/A	N/A	**188**
	Marginal Impact on Capital %	N/A	N/A	**+23.7%**
Base + Extend Non-Modellable	**LH-Scaled SES (rho=0.6)**	4/2/2019	3/16/2020	**1,486**
	MRF + NMRF (Incl. *1.5) (rho=0.6)	N/A	N/A	**2,465**
	Marginal Impact on Capital	N/A	N/A	**1,673**
	Marginal Impact on Capital %	N/A	N/A	**+211.5%**

2. Replacing SES with a recalibrated ES

Regulatory bodies and the industry broadly recognize that current SES capital levels are excessively high relative to the underlying risks, rendering the FRTB IMA unviable. For trading desks with models that have passed internal model validation standards and have achieved supervisory approval, non-modellable risk factors would be expected to be relatively less important than those that are modelled. Similarly, the capital charge for non-modellable risks should be appropriately calibrated and be materially lower than the capital for modelled risks. The inability to model and precisely estimate the capital for these non-modellable risks does not change the principle that, in aggregate, their capital charge should be a fraction (less than 1) of the corresponding modellable capital. However, the European Commission's flat multiplier does not accurately capture this reality, and simply applying a scalar to reduce the SES capital will not resolve the core issue. Instead, regulators should directly enforce this constraint on the capital for the non-modellable risk factors of a portfolio (*P*) relative to the capital for the modellable risk factors of the portfolio as follows:

$$SES_{constr}(P) = \min\left(\alpha \cdot ModellableCapital(P)\ , SES(P)\right). \quad (1)$$

We have calibrated an appropriate level of SES capital based solely on IMCC, while the reported information from the NMRF framework may serve to augment the supervisory process.

The final capital calculation as specified in MAR33.41 would therefore be reflected as follows:

$$C_A = \max\left\{IMCC_{t-1} + \min(\alpha \cdot IMCC_{t-1}, SES_{t-1})\ ; m_c \cdot IMCC_{avg} + \min\left(\alpha \cdot m_c \cdot IMCC_{avg}, SES_{avg}\right)\right\} \quad (2)$$

instead of the currently written:

$$C_A = \max\left\{IMCC_{t-1} + SES_{t-1}; m_c \cdot IMCC_{avg} + SES_{avg}\right\} \quad (3)$$

If *SES* becomes a reporting-only requirement, the final capital calculation can be further simplified to follow the format of other proposed targeted revisions, applying only simple scalars, as follows:

$$C_A = \max\{(1+\alpha)\cdot IMCC_{t-1} + 0\cdot SES_{t-1};\ m_c\cdot(1+\alpha)\cdot IMCC_{avg} + 0\cdot SES_{avg}\}. \quad (4)$$

In this formulation, *IMCC* is scaled by $(1+\alpha)$ and *SES* is scaled by 0.

3. CRR3 OJ Typos and Drafting Errors

<attached separately>

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