EUROPEAN CENTRAL BANK
EUROSYSTEM

ECB staff contribution to the European Commission's targeted consultation on the application of the market risk prudential framework

The European Central Bank (ECB) welcomes the European Commission's targeted consultation on the application of the market risk prudential framework. Over the past year, several episodes of spiking volatility have highlighted the existence of growing pockets of risk in trading activities. The turbulence surrounding specific events, including for example the episode of significant volatility in April 2025,[1] has exposed vulnerabilities in terms of correlation risk and basis risk. On these occasions, traditional assumptions which underlie market risk models failed to account for abrupt market shifts. In addition, the ECB has observed increasingly complex market dynamics and evolving deal structures which bundle risks in ways that can challenge transparency and current risk management practices. Also, the increased reliance on cross-margining means that interconnected positions across asset classes can become more susceptible to cascading margin calls during periods of elevated stress. Furthermore, recent episodes of heightened market risk (evidenced, for example, by the widening of the implied volatility skew and of credit spreads, as well as the dislocation of basis trades) have demonstrated the role played by the interdependency between banks and other market players – including non-bank financial intermediaries – in this area. These risks continue to warrant supervisory attention.

Against this backdrop, the ECB wishes to share the following observations on the questions raised in the consultation.

Question 1. 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 implementation of the Fundamental Review of the Trading Book (FRTB) will have significant benefits in terms of added sensitivity and enhanced risk management. The FRTB, which was agreed as part of the Basel III standards, constitutes a comprehensive enhancement of the framework for calculating market risk compared with the previous approach under Basel 2.5. Furthermore, the advanced standardised approach (FRTB-ASA), which is due to be applied by the majority of banks in the EU, makes the framework far simpler for banks and supervisors alike and will allow for significant efficiency gains.

[1] Which led to a 30 point increase in the CBOE Volatility Index (VIX) and a 70 point increase in the Merrill Lynch Option Volatility Estimate (MOVE).

Further delaying the implementation of the FRTB would come with clear costs from a risk management and operational perspective. These costs outweigh the advantages of a further delay – namely allowing more time to assess and respond to the implementation in other major jurisdictions. Indeed, further delays, especially if they are decided on a year-by-year basis, would continue to deprive banks and supervisors of clarity regarding the path to implementation, thereby placing them in an uncertain situation. By contrast, a three-year period of stability in the applicable market risk framework, as proposed by the Commission, is the option preferred by the ECB as it would allow time to focus on implementation and enable effective planning of supervisory activities.

The maintenance and remediation of internal models currently used by banks has been deprioritised on account of the upcoming implementation of the FRTB. In addition, banks are currently required to run comprehensive reporting on FRTB-ASA in parallel to calculating their market risk requirements under the Basel 2.5 approach. This comes with a clear operational cost. Consequently, the prevailing uncertainty may lead banks to delay investments in market risk management, which is especially concerning during periods of elevated risk.

The proposal put forward in the consultation to have the FRTB enter into force in the EU on 1 January 2027 is therefore welcome. The ECB strongly supports the Commission's intent in this regard.

The ECB shares the view that maintaining a global level playing field in the application of internationally agreed standards is important. Trading activities are among the areas where European banks compete most directly with banks in other jurisdictions.

Calculations based on the regulatory reporting of banks supervised by the ECB suggest that the impact of the full introduction of the FRTB would be concentrated in a subset of institutions, mostly G-SIBs, for whom it would be significant relative to current market risk capital requirements, while being largely neutral for the majority of banks.[2] Five significant institutions would see their CET1 ratio decrease by more than 50 basis points after the FRTB is introduced, while five would see it increase by more than 50 basis points, driven by the change in risk-weighted assets (RWAs) for market risk. The five banks experiencing the largest absolute increase from full FRTB implementation would see their RWAs for market risk increase by approximately 86% on average, within a range of 48% to 198% in relative terms. These banks account for 25% of the total market risk RWAs of all banks supervised by the ECB. For the 15 next most impacted banks, which account for a further 30% of the total market risk RWAs of banks supervised by the ECB, the relative increase in market risk RWAs would average around 36%. However, it should be recalled that market risk RWAs constitute a small share of overall RWAs – 4% on average across all banks supervised by the ECB (this also holds true for the most impacted banks). The full implementation of the FRTB would

2 These numbers are based on Q2 2025 supervisory reporting data, as well as the most recently available impact assessments for planned FRTB-AIMA desks performed by ECB Banking Supervision. The numbers assume that banks which have applied for FRTB-AIMA permissions will implement FRTB-AIMA for the relevant trading desks on 1 January 2027.

lead to an absolute increase of 0.8% in the total RWAs of all banks supervised by the ECB and an average increase of 3.5% for the five most impacted banks.

The impact assessment of the FRTB from a capital perspective also needs to consider the effects of the proposed targeted amendments, as well as possible risk management actions by banks to adapt to the framework. Indeed, while reducing the capital impact of the FRTB and maintaining the level playing field vis-à-vis other jurisdictions that have not currently implemented the FRTB, the targeted amendments proposed by the Commission would have the effect of reducing the headroom to absorb possible shocks. This would imply a possible loss in resilience and increased vulnerability to contagion effects in phases where the pockets of heightened risk mentioned above materialise. Furthermore, the impact figures listed above assume a static balance sheet and ignore possible risk management actions to adjust to the new framework.

Question 2. What are your/your institution's views on the temporary measures proposed for the delegated act?

The ECB believes there is room to make these proposed amendments more risk-based and sound without adversely affecting the Commission's objective of maintaining a level playing field with other jurisdictions. In this regard, the ECB wishes to share the following observations, echoing its reply to the previous Commission consultation on this topic.[3]

With regard to internal model-related requirements, the ECB agrees with using the Profit and Loss Attribution Test (PLAT) as a monitoring tool only, on the understanding that banks work on remediation in the event of highly concerning results. Postponing the application of capital add-ons for banks which do not meet the PLAT requirements should not unduly relieve banks from performing their usual risk management activities. In this case, this would imply taking the necessary steps to work towards appropriate remediation in cases where severe shortcomings have been identified.

The measures regarding the Risk Factor Eligibility Test (RFET) could be too far-reaching in their current form. If the relief applies to new instruments, this could in theory extend to all new highly complex derivatives – even though they would likely not meet the RFET on a risk factor basis. It would therefore be preferable to limit this relief measure to new risk factors. In addition, it should be clarified that the relief only applies to risk factors that are new for the banking industry as a whole, rather than for a specific bank which might simply be launching activities in these risk factors or products.

With regard to collective investment undertakings (CIUs), the ECB continues to consider that the proposal allowing banks to carry out the look-through on a

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3 See ECB staff contribution to the European Commission's targeted consultation on the application of the market risk prudential framework.

quarterly basis for material exposures under both FRTB-AIMA and FRTB-ASA, rather than on a weekly basis as currently foreseen in the Capital Requirements Regulation (CRR), is too far-reaching. A quarterly look-through would not be sufficient to adequately capture the underlying risks of CIU exposures, nor would it be in line with general expectations on sound risk management. It could also incentivise quarterly window dressing for prudential capital requirements. Furthermore, as a supervisor the ECB expects banks to have in place sound risk data aggregation and data infrastructure capabilities, including for market risk, which should allow a more frequent look-through (in addition, technological progress makes such capabilities far less expensive). The ECB believes level playing field concerns regarding the requirements applicable to CIUs are sufficiently addressed by the proposal to allow banks to calculate their own funds requirements on CIU exposures with a partial look-through if they are able to look through at least 90% of the CIU exposures.

Given that the cumulative impact of the proposed amendments could be disproportionate for some banks and significantly water down the regulatory intent of introducing the FRTB, it may be necessary to apply a floor to the total possible reduction of market risk RWAs from which banks can benefit. In particular, situations should be avoided where the targeted amendments lead banks which initially faced increases in capital requirements under the FRTB to ultimately face lower capital requirements.

Question 3. What are your/your institution's views on the multiplier for the capital requirements for market risk?

Question 4. 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?

The consultation proposes a multiplier mechanism which would aim to cap increases in capital requirements for market risk which certain banks could experience even after application of the proposed amendments to the initial framework. Given the potentially significant impact of the proposed amendments, and considering likely management actions to adapt bank portfolios to the new rules, the ECB does not expect that many banks would be subject to this multiplier. An industry-wide multiplier would be best adapted to a situation where a large number of banks would face an impact of relatively similar magnitude, as it would ensure consistent relief across the market. However, given that the aforementioned impact analysis points to this not being the case, a bank-specific approach allowing the calibration of the multiplier to be tailored to the expected capital impact of the FRTB on each bank seems better adapted to the actual situation once the targeted amendments have been applied. This would point to options a) or b).

Out of the two bank-specific options, the ECB considers option b) – a static multiplier – preferable. As noted in its response to the previous consultation, the

ECB favours an approach to multipliers which prioritises simplicity and avoids the complexity inherent in more granular adjustments. With this in mind, a properly constructed point-in-time calibration would seem preferable to performing ongoing periodic recalibrations. In addition, this approach would have the advantage of enabling banks to decommission their Basel 2.5 models, which are being less well maintained in view of the upcoming implementation of the FRTB. Avoiding the daily calculation of Basel 2.5 models would also significantly reduce operational costs and further contribute to simplifying the regulatory framework.

Each of the proposed multipliers would raise implementation challenges and could in theory have distributional effects within the banking sector. As regards option b), the initial calibration would in theory take place on the basis of the banks' current portfolios, which fall under the former trading book/banking book boundary. Yet banks would move to the new boundary requirements when implementing the FRTB on 1 January 2027. Furthermore, banks' hedging strategies are currently steered against existing metrics and would likely be adjusted to align with the FRTB framework once it comes into effect. In order to address these possible discrepancies, it could make sense to calibrate the multiplier *after* the FRTB comes into force (i.e. after 1 January 2027) and allowing for sufficient time for management actions and possible re-bookings to be reflected in the data. Furthermore, calibrating the multiplier according to a single point-in-time value could lead to an unrepresentative calibration or incentivise window dressing behaviour. Such concerns might be addressed by using the average of market risk own funds requirements over the course of the previous few months as a calibration point. This would strengthen the transitional regime without adding undue complexity.

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For specific terminology please refer to the ECB glossary (available in English only).