

Answers of the European Financial Congress¹ in relation to the European Commission's consultation on the application of the market risk prudential framework²

Methodology for preparing the answers

The answers were prepared in the following stages:

Stage 1

A group of experts from the Polish financial sector were invited to participate in the survey. They received the EC's consultation document and the consultation questions translated into Polish. The experts were guaranteed anonymity.

Stage 2

Responses were obtained from experts representing:

- banks
- consulting firms,
- the academia.

Stage 3

All the responses were collected, anonymised and the survey project coordinator prepared a draft synthesis of opinions submitted by the experts. The draft synthesis was sent to the experts participating in the survey with the request to propose modifications and additions as well as marking the passages they did not agree with.

Step 4

On the basis of the responses received, the final version of the European Financial Congress' answers was prepared. The final version of the answers was translated into English and submitted to the European Commission.

¹ The European Financial Congress www.efcongress.com is an independent think tank focusing on economic and financial issues. Its goal is to engage in debate on the security and stability of the financial systems as well as sustainable economic growth of the European Union and Poland. The EFC is run by the Centrum Myśli Strategicznych.

² https://finance.ec.europa.eu/document/download/6cf2082e-753c-4859-b7be-cd77a886a9d1_en?filename=2025-market-risk-prudential-framework-consultation-document_en.pdf

Answers of the European Financial Congress to consultation questions

Q 1

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

According to the consulted entities, maintaining the competitiveness of European banks against other regulatory regimes is extremely important. Therefore, postponing the date of application of the modified own funds requirements for market risk through a delegated act is fully justified.

This solution allows the main objectives of the modification to be maintained. On the one hand, it fulfills the strategic objective of the Basel Committee – it strengthens market risk management principles, and on the other hand, it reduces the risk of EU banks losing competitiveness as a result of delays or deviations in the implementation of FRTB in other key jurisdictions. This approach should mitigate the effects of asymmetric implementation and enable a smooth transition to full implementation.

There are several arguments in favor of the proposed approach:

- It prevents a situation where some provisions are suspended and banks operate in uncertainty as to the development of their tools and business decision-making rules.
- It avoids the pointless maintenance of two parallel methods for calculating market risk capital requirements.
- It counteracts the effects of the globally unharmonized implementation of the FTRB and, in particular, supports the efforts of European banks that have already implemented the Alternative Standardized Approach (ASA) for capital requirements measurement in their systems for reporting purposes. Without this support, European banks would find themselves at a disadvantage compared to their competitors, particularly those in the US and the UK, where FRTB rules are either not yet in force or are being introduced with delays or derogations.
- Finally, supplementing the implementation of the FRTB capital requirement calculation with the proposed changes does not require excessive work. This makes it possible to implement the necessary solutions within the expected deadlines.

In summary, the European Commission's proposal is appropriate in the current situation. Further delays by the European Commission in implementing FRTB as a binding capital requirement for banks could undermine the sector's confidence in the rationale behind the reform of market risk management and capital measurement. However, regardless of the positive assessment of the proposal, it should be

remembered that it assumes that the implementation of FRTB will be globally synchronized in three years. Otherwise, after the end of the transition period, banks from EU countries could find themselves in a worse competitive position than banks from countries that still do not implement FRTB.

However, the concerns expressed by some experts cannot be ignored, as the use of temporary solutions in such a key area as capital requirements maintains regulatory uncertainty, which has a negative impact on banks' strategic planning. Temporary mitigating measures only delay the problem of higher capital burdens compared to banks in other jurisdictions, without eliminating it, while leaving considerable uncertainty as to the stability of the regulatory and legal environment.

The stability and competitiveness of the European banking system requires permanent, targeted solutions. In this context, there is doubt as to whether the three-year period envisaged in the consultation document will be sufficient to develop a target legal framework ensuring global harmonization of requirements in this area, which was one of the objectives of the FRTB. These doubts are all the more justified when we consider the time it took to develop the current version of the requirements (the first version of the FRTB was published by the BCBS in 2012) and the time that has elapsed since the 2008/2009 financial crisis, which the FRTB is intended to prevent.

Q 2

What are your views on the temporary measures proposed for the delegated act?

According to some banks, the proposed temporary measures largely concern advanced methods and selected specific elements of risk positions. Therefore, they are likely to have a very limited impact on small and medium-sized banks.

Large banks welcome the proposed measures, highlighting the following issues in particular:

- The solutions presented seem to be heading in the right direction, although the steps taken to improve the situation of European banks on the international market could be more decisive.
- The proposals concerning ASAs, in particular those presented in points 6, 7, and 9, are an appropriate response to market conditions and should therefore be permanent.
- Changes to RRAO (point 8) should evolve towards sensitivity-based methods for instruments with a continuous payout profile (excluding binary and barrier options from this approach); the UK proposals are a good reference point for further changes.
- The proposed temporary measures are appropriately targeted and proportionate. They address areas that have proven to be operationally difficult or

overly burdensome (including the PLAT test, NMRF, data requirements for new risk factors, and CIU transparency). They may facilitate the implementation of the target regulatory solutions while maintaining an appropriate level of prudence.

- The process of arriving at the target solution through a properly calibrated adjustment factor is a good solution. Further postponements of the implementation dates would likely halt the design work on the implementation of FRTB due to concerns about new changes, and therefore the use of multipliers seems to be a better solution from the point of view of finalizing the project.
- Proposal 10 in the Annex concerning a temporary coefficient of 0.9 applied to the results of the SBA measurement under the new ASA FRTB method is justified. Similarly, the analogous proposal for a temporary coefficient of 0.9 for the simplified method used by banks with small trading portfolios is also justified.
- During the transition period, care should be taken to ensure that the effects of the reduction in capital requirements remain appropriate and proportionate, regardless of the model used by the institution to calculate the requirements, and to ensure that the temporary and permanent changes in the calculation method do not encourage a radical change in the institution's trading portfolio profile.

Q 3

What are your views on the multiplier for the capital requirements for market risk?

The multiplier reducing capital requirements for market risk during the transitional period allows for a temporary limitation of the expected increase in capital requirements resulting from the implementation of FRTB. This solution maintains regulatory credibility while partially and temporarily compensating for imbalances between market participants resulting from implementation differences in individual jurisdictions.

It is important that banks calculate their capital requirements according to new methods (in the context of large Polish banks: the ASA method), but the final requirement may be multiplied by a specific factor of less than one. This solution will enable the rapid implementation of the new regulation as a binding, rather than merely reporting, capital requirement in Pillar I, but the application of the multiplier will temporarily cushion the increase in capital burdens for institutions active in the treasury and investment banking market.

The mechanism specified in Article 461a of the CRR is intended for a strictly limited time frame (up to three years) and is conditional in nature – it is addressed only to banks most affected by the increase in requirements. This structure makes the multiplier an extraordinary solution that does not undermine the credibility of the regulatory framework. Capital requirements would remain at a level that at least reflects the current level resulting from the CRR provisions (according to Basel 2.5).

The design of this solution must therefore prevent potential underestimation of risk. It is therefore essential to calibrate the multiplier appropriately so that it only limits the “surplus” requirement resulting from the asymmetry of FRTB implementation, but does not reduce capital below levels adequate to the actual risk incurred by banks. With such calibration caution, the multiplier will fulfill its role as a transition period buffer without disrupting the long-term goal of strengthening banks' resilience to market risk.

It is also important that the end of the transition period does not result in an initial capital shortfall. Banks should therefore increase the adjustment factor gradually to prevent a sudden, sharp increase in capital requirements. It would therefore be advisable to increase the ratio gradually so that on the first day after the end of the transition period it is equal to 1.

Q 4 What are your preferred calibration options for the multiplier and how would those address the risk of underestimating the capital requirements during the three-year period?

When calibrating the multiplier, it is important to bear in mind both the possibility of underestimating capital requirements during its period of operation and the potential reduction in the competitiveness of regulated financial institutions by establishing a relatively higher requirement than that applied by unregulated institutions. The calibration of the multiplier could use historical data on the size of the capital requirement, taking into account those resulting from the regulation, as well as a comparison of the capital requirement situation and the development and conduct of business between regulated and unregulated institutions. It is advisable to strive for a balance between conservatism, which encourages the earliest possible introduction of capital requirements, and enabling the development and maintenance of the competitive position of European banks in international markets.

With regard to the individual options proposed in the consultation document, it should be noted that expert opinions are divided on this question. According to the prevailing view:

- Option A appears to be the most comprehensive, but in fact leads to a delay in the implementation of FRTB. Given the suggested costs and degradation of the model, this method is not worth pursuing.
- Options B, C, and D seem to be the best. They offer the possibility of phasing out the currently used calculation tool and transitioning to the FRTB method, which better reflects risk sensitivity. In addition, approach B takes into account the specific characteristics of individual entities.
- Option E (suggestion): It seems that for banks not planning to use the FRTB-IMA method, a good solution would be to modify approach A. Banks could continue to use dual calculation for the next three years and could calculate RWA in

accordance with FRTB-SA. This approach would be most similar to that used by the Bank of England.

Therefore, among the proposed multiplier calibration options, option C should be considered preferable in terms of effectiveness and simplicity of operational implementation, possibly in combination with approach B as a hybrid solution. Option C or a combination of options C and B – if properly designed – will achieve the objective of avoiding an underestimation of capital requirements during the three-year transition period, while minimizing the operational burden on banks and supervisors. At the same time, after calibrating the multiplier according to these methods, it would be possible to end the parallel calculation of Pillar 1 capital requirements according to the existing rules (according to CRR / Basel 2.5).

Both of the above options have a common advantage: they are relatively straightforward to manage compared to option A, which would require continuous, periodic recalculation of the multiplier on a quarterly or annual basis. The preferred option C would involve central calibration, on a one-off basis, based on aggregated data from the banking sector (e.g., as part of a cyclical QIS study). Potentially, it is worth considering separate calibration of the multiplier for the population of banks migrating from the current standard method to the ASA method and banks migrating from the current internal models method (under Basel 2.5) to the ASA method. The simplicity of method C does not negate the sensitivity of the capital requirement measurement to increased risk—a fixed multiplier will be applied to the changing FRTB exposure, so if a bank increases the level of market risk in its trading book, the absolute amount of the requirement will increase accordingly.

Option B assumes individual calibration at the level of individual banks and may therefore be better suited to the risk profile of the institution. It is therefore worth considering the possibility of the bank choosing option B if the common uniform multiplier from option C inadequately reflects the market risk profile of the bank's trading book and thus increases the capital requirements under the FRTB.

The implementation of the multiplier under option C would result in an average increase in requirements, while option C+B would result in a more precise limitation of the increase in requirements and would ensure that no bank would be chronically undercapitalized in relation to the risk it incurs, but also that no bank would be forced to raise excessive capital before the FRTB becomes a global standard. This solution would give the sector time to adapt to the new regime, while allowing supervisors to monitor the effects and possibly adjust their approach before the end of the three-year period, when there will be more data and clarity on the implementation of the FRTB in the US and other regions. All this means that, from the point of view of financial stability and a level playing field internationally, these options can be seen as reasonable.

At the same time, it is important to mention the dissenting opinion expressed by some experts. They emphasize that there are significant differences between banks in the European Union, including Poland, in terms of the specific nature of their

trading books and the current implementation of capital requirement calculations. Applying a uniform multiplier to all institutions would not neutralize the impact of FRTB implementation for some banks, while at the same time generating the risk of underestimating capital for others. For this reason, the appropriate method would be to apply a multiplier calibrated individually for each bank.

Due to the high operating costs associated with the need to maintain parallel IT and reporting infrastructures in FRTB and Basel 2.5 versions for the next three years, periodic calibration of the multiplier is not the preferred method. A one-off calibration of the multiplier, as proposed in point B), or an alternative calibration method tailored to the specific characteristics of individual banks (point E)) would be appropriate. However, if the intention is to maintain capital requirements at the level indicated by the Basel 2.5 approach, the most effective and efficient method is to maintain Basel 2.5 as the leading method for calculating capital requirements for the next three years and to temporarily suspend reporting in the FRTB format.