EPTA response to the FCA Engagement Paper: Market risk capital requirements for FCA investment firms

10 February 2026

EXECUTIVE SUMMARY

The European Principal Traders Association (EPTA) represents Europe's leading Principal Trading Firms. Our members are independent market makers and providers of liquidity and risk-transfer for markets and end-investors across Europe and the UK. EPTA works constructively with policy-makers, regulators and other market stakeholders to ensure efficient, resilient, and trusted financial markets in Europe.

EPTA welcomes the opportunity to comment on the FCA's engagement paper on the Market Risk Review under IFPR and supports the FCA's objectives to foster wholesale trading, strengthen market liquidity, and lower barriers to entry for specialised trading firms.

Collectively, our members play a vital role in ensuring efficient and resilient markets, supporting price discovery, enabling risk-management and productive investment by end-investors, and helping to absorb shocks during periods of stress.

The current IFPR market risk regime, essentially anchored to Basel-derived banking rules, is not suited to firms that do not take deposits nor provide bank-like services to clients and which operate solely with their own capital and with no public backstops. This misalignment has unduly constrained liquidity provision during increased demand for liquidity due to heightened geopolitical risk, volatility, and divergent monetary policies.

A revised prudential framework should reflect the actual risk of *harm* posed by specialised trading firms such as the Principal Trading Firms in EPTA's membership and be guided by proportionality, alignment with economic capital, and scalability, supporting both new entrants and the growth of established firms to support the UK capital market and ultimately growth in the wider economy.

To ensure proportionality and given the diversity of liquidity provision undertaken by PTFs, EPTA considers that firms should have access to a range of market risk methodologies, subject to conditions set by the FCA.

The final framework should deliver a simplified, risk based approach for new entrants, while providing a more advanced, risk sensitive regime for more mature firms and those with more complex trading books. In this regard, EPTA suggests the following principles:

- **Proportionality**: Requirements should reflect harm to the market for investment firms that deal on own account while not holding deposits nor providing bank-like services to clients, with the ultimate objective that capital should not be higher than what is necessary to enable an orderly wind down.

• **Alignment with economic capital**: Requirements should embed as much as possible metrics that firms already employ for risk management purposes and which neither overstate the risk of the trading book across exchange traded and OTC financial instruments, nor create unintended incentives (such as increasing risk in order to reduce regulatory capital)

• **Accessibility and scalability**: The market risk framework should support healthy competition and market participation by allowing all firms including new entrants to adopt a proportionate simplified approach, while enabling larger and more mature firms to use more advanced risk-sensitive methods

In this regard, EPTA supports a baseline approach package comprising a recalibrated K-NPR, a recalibrated margin-based approach (K-CMG) , and a model covering non-centrally-cleared portfolios (e.g., the OTC SIMM model), complemented by an internal model option with risk-sensitive calibration and simplified governance.

While the Net Capital (NCR) model has merit, as evidenced by its successful application in the US, this model would require broader changes to MIFIDPRU. Additionally, a simplified FRTB variant could also be explored in our view. The sensitivities-based method, repurposed K-TCD, and weighted liquidity exposure method do not appear, at this stage, to offer superior alternatives.

We would support, therefore, for the FCA to adopt a tiered approach: near-term, implementing straightforward and high-impact improvements first, while as a second step considering deeper structural changes that could be implemented at a later stage.

1.Introduction

EPTA welcomes the opportunity to comment on the FCA engagement paper on the Market Risk Review under IFPR.

EPTA supports the FCA's objective to explore alternative approaches to market risk capital requirements that could foster wholesale trading, enhance market liquidity, and reduce barriers to entry for specialised trading firms, such as the Principal Trading Firms (PTFs) in EPTA's membership.

As the FCA notes, current market risk capital requirements for UK investment firms which deal on their own account are derived from the banking regime under Basel, with significant elements still based on the UK Capital Requirements Regulation (UK CRR). This approach is globally unique: none of the leading international capital markets jurisdictions outside the UK and EU apply a banking-style regime to non-systemic financial firms that do not take deposits, do not undertake business on behalf of clients, or engage in lending, underwriting, maturity transformation or other banking activities.

EPTA observes that the miscalibration of the current market risk framework (which materially overstates the market risk) has unduly constrained the capacity and willingness of PTF market makers to provide liquidity—particularly during periods of high volatility. This directly undermines the critical role that our members collectively play enabling price discovery, risk management and productive investment into markets, reducing costs for investors and pensioners, and acting as a shock absorber at time of market stress.

EPTA, therefore, strongly welcomes the FCA's commitment to an ambitious review and recalibration of the IFPR market risk regime as it applies to specialised trading firms such as the PTFs in EPTA's membership. We note that the FCA's ambition fully aligns with the tenets of the UK Government's Financial Services Growth and Competitiveness Strategy, which explicitly highlights adjusting the IFPR market risk rules as a key area to ensure the competitiveness of UK capital markets. As the Growth Strategy recognises, this is a critical component of a reform agenda to ensure UK capital markets support British businesses to grow and invest and facilitate in delivering prosperity[1].

Principal Trading Firms acting as market makers collectively play an indeed vital role in diversifying market structures and meeting rising liquidity demand, which recently has been amplified by heightened geopolitical risks, increased volatility and divergent monetary policies globally. When demand for intermediation exceeds dealers' capacity, market dysfunction can emerge. Regulatory frameworks that constrain PTF market makers' ability to supply liquidity risk intensifying this pressure during periods of stress. A tailored prudential framework that appropriately reflects the specific risk of harm posed by these firms is therefore essential to maintaining a dynamic and resilient liquidity ecosystem.

Given their global operations, EPTA members at group level have had to allocate capital to jurisdictions that better support liquidity provision and we have consequently witnessed a worrying trend of some PTFs giving up their MiFID licence to trade on non-EU/UK markets a reallocating capital and resources to non-EU/UK operations. We therefore welcome the FCA's willingness to consider prudential frameworks used in other mature markets, such as the US Net Capital Rule (NCR), to ensure the UK remains globally competitive.

[1] UK Government, Financial Services Growth and Competitiveness Strategy (July 2025) (p40-41).

The FCA's Engagement Paper rightly recognises that non-systemic investment firms pose less risk to financial stability than banks. Principal Trading Firms do not undertake business on behalf of clients, take no deposits, and perform no underwriting or maturity transformation (with short term deposits and long-term lending). Their activities are funded with their own capital, not the public's money, and they operate without access to central-bank liquidity or public backstops (including bailout).

Prudential standards for non-systemic investment firms should be harm-based and should not aim for a zero-failure regime, but rather enable orderly wind-downs, taking a stronger gone-concern perspective to policy formation. Therefore, EPTA strongly supports, as per Section 2.7 of the Engagement Paper, that capital requirements should address risks from both a going concern perspective (through the K-factors) and a gone concern perspective (for example, through the fixed overheads requirement (FOR). We note that regulatory capital, being inherently defensive, is only one element of protection against trading losses, with effective risk management providing the first line of defence.

Due to the tight timeframe, EPTA has provided high-level qualitative comments on the proposed options and stands ready to provide detailed, data-supported feedback once the most appropriate options have been identified by the FCA. This will help ensure that the final framework is ultimately properly calibrated and achieves its intended objectives in practice. As always, the detail will be critical.

It is also important to note that the benefits of each option will depend significantly on the final combination selected. An option that appears appropriate in isolation may lose its effectiveness when assessed as part of a broader package. The final framework should deliver a simplified, risk-based approach for new entrants, while providing a more advanced, risk-sensitive regime for more mature firms and those with more complex trading books. In this regard, EPTA suggests the following principles:

Guiding Principles for a Revised IFPR Market Risk Framework

- **Proportionality:** Requirements should reflect harm to the market for investment firms that deal on own account while not holding deposits nor providing bank-like services to clients, with the ultimate objective that capital should not be higher than what is necessary to enable an orderly wind down.
- **Alignment with economic capital:** Requirements should embed as much as possible metrics that firms already employ for risk management purposes and which neither overstate the risk of the trading book across exchange traded and OTC financial instruments, nor create unintended incentives (such as increasing risk in order to reduce regulatory capital)
- **Accessibility and scalability:** The market risk framework should support healthy competition and market participation by allowing all firms including new entrants to adopt a proportionate simplified approach, while enabling larger and more mature firms to use more advanced risk-sensitive methods

EPTA has not ranked the options outlined in the Engagement Paper, but instead provides comments on the changes required to ensure that any model is aligned with the guiding principles set out above.

As a general concept, EPTA believes that the resulting framework should combine elements of the options presented in the EP to form a baseline approach "package" that ensures full coverage of all asset classes and allows for recognition of diversification benefits (multiple GCMs or CCPs) when needed. This baseline approach should be calibrated to ensure an orderly wind down and be supplemented by an internal model option, which remains the only approach capable of achieving full alignment with economic risk.

It is essential, however, that this new baseline approach is appropriately calibrated to support broad adoption by firms. Internal model applications should stem from a genuine strategic choice, not from deficiencies in the baseline approach. This is necessary to avoid creating a floodgate of applications driven solely by calibration shortcomings.

Finally, given the breadth of the potential changes and depending on the approach ultimately adopted, the FCA may wish to adopt a tiered approach, prioritising the most straightforward and simple amendments outlined below, while allowing itself additional time for the assessment and design of the more fundamental reforms at a later stage (e.g. the Internal Model).

Our further comments on each option are set out below.

2. Comments on the options

Option 1 Amend the existing standardised approach.

Question 2: What specific feedback do you have on continuing to use the current market risk standardised approach within our rules? Are there particular provisions that could be improved and if so, how?

K-NPR is well understood and straightforward to implement operationally, however it was originally designed for credit institutions that pose higher potential harm to the market.

K-NPR also lacks risk sensitivity leading to the material overstatement of market risk, particularly across certain asset classes. The prescribed percentages are often overly conservative, and the absence of meaningful netting mechanisms penalises hedging strategies, especially in fixed income, commodities, and cross currencies positions, resulting in disproportionate capital charges. Some EPTA members have also noted that the more risk-sensitive options available within the NPR framework (such as the interest rate sensitivity model) can be difficult to obtain in practice. In addition, K-NPR also does not include provisions for newer asset classes, such as crypto assets, and will therefore require updates for clarity.

The proposal to apply discount factors for investment firms could be an effective way to promote wholesale trading and lower barriers to entry. Principal Trading Firms without a significant market footprint would have minimal impact on the wider market in the event of failure, however reducing their capital burden would improve market liquidity. That said, rather than applying a discount to certain types of firms, EPTA believes it would be more appropriate to adjust the risk weights in the K-NPR calculation across the board e.g., reducing the equity general/specific risk charge from 8% to 4%.

This approach would achieve the same policy objectives while providing a clearer departure from CRR rules, which were designed for banks, and reinforcing that the adjusted K-NPR is a tailored regime for investment firms that better reflects the specific harms they may pose. The degree of recalibration will need careful assessment but should aim to align risk weights as closely as possible with firms' economic capital, thereby encouraging broad adoption of the framework and supporting continued participation in the market.

EPTA recognises that this option offers the advantages of simplicity, familiarity and potentially the swiftest adjustment to the framework, while also requiring comparatively fewer FCA resources. This option therefore has merit and could be part of a baseline approach "package" (see our comments in other options) provided firms retain the ability to opt for other more risk sensitive approaches.

With respect to specific provisions within K-NPR that could be improved, the most significant enhancement relates to the treatment of debt instruments (Article 334 – 340 of the UK CRR). This asset class exhibits the largest divergence between regulatory capital requirements and actual risk, driven by the use of notional amounts as the measure for exposure (values that are considerably higher for debt instruments than for most other asset classes) and the absence of netting within the maturity ladder calculation. As a result, firms can face situations in which they must increase the actual risk of their portfolio in order to reduce regulatory capital requirement, which runs directly counter to the objectives of the prudential rules.

Suggested improvements to better align regulatory capital requirements with underlying risk would include the following:

Debt Instruments

- **Amend Article 331(1)** to permit the use of the sensitivity model for bonds, not only derivatives. This would allow firms to manage the entire interest rate book on a consistent basis.
- **Amend Article 331(2)** to allow offsetting for positions in bonds which similar economic characteristics (i.e., not only derivatives). Bonds of the same currency and issuer, with similar coupons and residual maturity within three months, should be eligible for offsetting.
- **Simplify the own funds requirement** by reducing the charges applied to matched weighted positions across different zones, which are currently set out in Article 339(9)(f) and 340(7)(c). The 150% charge for matching between zone 1 and zone 3 is overly punitive and not economically justified. As positions age, a matched position between zones 3 and 2 may migrate to a zone 3-1 match (as the zone 2 bond rolls into the zone 1), triggering a large spike in capital requirements despite no change in underlying risk, and potentially even a reduction in risk as the maturity shortens by one day. This is a counter intuitive and distortive outcome. Reducing the own funds requirement for matched positions in Article 339(9) to 8% would align the treatment with the general risk treatment for other asset classes and better recognise the hedging strategies typically used by market makers along the term structure. At present, poor recognition of hedging results in disproportionate and excessive market risk requirements.

  In Article 339, Table 2, remove the third column that differentiates coupons below 3% to simplify the calculation. The current bucket structure is unnecessarily complex, including unintuitive ranges (e.g., >3.6 ≤ 4.3 year

Options

- Under K-NPR, when applying the delta-Plus approach to calculate non-delta option risk capital charges, firms compute gamma risk by aggregating the individual gamma impacts for each underlying.
  - Critically, only the absolute value of the negative (short) aggregate gamma position is taken into account for the own funds requirement. Positive (long) gamma is disregarded entirely.
  - For firms trading options on correlated underlyings, the current K-NPR rules provide no netting benefit, even though market risk is naturally limited by the correlated nature of underlying price moves. This results in capital requirements that significantly overstate the true level of risk.

Commodities

- **Article 361** – remove the requirement to demonstrate efforts to implement an internal model for calculating own funds requirement for commodities risk.
- **Article 361(a)-** Significant commodities business should just be calibrated as having DTF in relation to commodities of over a certain amount or as a percentage of DTF.

Other

- **For CUIs** where the look-through approach is not available, the fallback approach is overly punitive, applying a 40% charge

EPTA also highlights additional considerations that should guide the recalibration:

- Offsetting of cash settled products referencing the same underlying even when listed on different venues (e.g., ICE ESTR vs CME ESTR), consistent with current NPR rules.
- Offsetting of cash settled products referencing rates that are closely matched, for example within 15 basis points or with similar repricing timescales, aligned with K-NPR provisions
- Tiered netting thresholds for highly correlated products:
    - Products with correlations of 90% or higher should receive full offset, aligned with existing UK CRR commodities rules.
    - Products with lower correlations (e.g., 75%) should receive partial offset, such as for, sugar vs. refined sugar.
    - The tiered approach should likewise apply to other asset classes, such as closely matched equity indices or similarly highly correlated instruments.

<u>Option 2: A margin-based approach</u>

Question 3: What specific feedback do you have on the use of the current K-CMG?

EPTA notes that the question is framed around the CMG although we understand that under current rules, the margin model also includes CCP models.

EPTA strongly supports the use of a margin-based approach as it is robust, risk sensitive, well understood and aligned with firms' existing risk management practices. Such a margin-based approach will be an important component for inclusion in a baseline approach "package." However, in its current form, K-CMG requires recalibration to be operationally viable for investment firms.

The current calibration of K-CMG, particularly the high-water mark and 1.3 multiplier, materially overstates risk and creates adverse incentives during periods of market stress. By significantly inflating capital requirements at precisely the wrong time, it discourages firms from remaining active in stressed markets, thereby reducing liquidity when it is most needed. EPTA therefore believes that the 1.3 multiplier should be removed and that the high watermark should be replaced with an averaging mechanism. This would be partially aligned with the EBA's recommendations on K-CMG as set out in the final report on the review of IFR (EBA/Rep/2025/29).

The rationale for removing the scalar and replacing the high-water mark with an average is as follows:

- **Material overstatement of risk:** EPTA's analysis demonstrates that existing K-CMG significantly overstates risk relative to actual loss exposure, by factors ranging from five to nearly one hundred (EPTA can provide supporting evidence). This level of conservatism goes well beyond prudential objectives. As the FCA notes in the Engagement Paper, the aim of prudential regulation is not to operate a "zero failure" regime. Trading firms are not banks: they do not hold deposits and would have limited impact on market integrity should they fail.
- **Robustness of underlying margin models:** The margin models underpinning K-CMG are produced using internal models developed and maintained by regulated and supervised investment firms and credit institutions acting as clearing members. These institutions that have strong incentives to ensure accuracy and conservatism of these models, given their direct exposure to client default risk.
- **Strong regulatory and supervisory safeguards:** The use of K-CMG is subject to the requirement that margin calculations by clearing members comply with the UK version of article 41 of Regulation (EU) No 648/2012 ("EMIR") as amended by Regulation (EU) 2019/834. These requirements apply to systemically important institutions, including CCPs, and have been extensively tested over time. As a result, margin is determined using rigorous methodologies that already function as a de-facto prudential backstop. Moreover, the use of K-CMG remains subject to supervisory approval, ensuring an appropriate level of regulatory oversight.
- **Mitigation of procyclicality and amplification effects:** Recalibration of K-CMG would help address observed practices whereby clearing members increase margin requirements at short notice, often through adjustments to multipliers, stress scenarios, or non-market risk add-ons (such as liquidity, concentration, or other overlays). These increases are not always proportionate to changes in underlying market risk, and the interaction with the K-CMG multiplier and high-water-mark mechanism further amplifies their impact.
- **Reduced disincentives during stress:** The high-water-mark mechanism creates an unintended disincentive for firms to remain active during periods of market stress, as abnormal margin peaks permanently elevate capital requirements. This incentivises firms to reduce activity during stressed conditions in order to avoid locking in higher capital floors, thereby exacerbating liquidity shortages.
- **Operational simplicity and speed of implementation:** Consistent with EPTA's observations on K-NPR, the K-CMG approach offers clear advantages in terms of simplicity, familiarity, and speed, representing the most efficient route to recalibrating the baseline framework.

Note that although investment firms calculate and monitor their risk on an intraday basis, computing K-CMG or K-NPR on an intraday basis is challenging for several reasons:

1. K-CMG is calculated using clearing margin given. Margin is calculated at the end-of-day by CCPs and prime brokers. Intraday calculation of K-CMG would require firms to replicate the margin model used by these entities. As margin methodologies are not publicly disclosed, replication is extremely difficult, if not impossible.

2. K-NPR presents similar challenges for firms trading options. Under Article 329 of the CRR, for delta-adjusting options, firms must use the delta provided by the relevant exchange. Exchanges do not publish intraday deltas, and firms may only compute their own delta if explicitly permitted by the competent authority. Without the necessary reference data, intraday calculation of K-NPR is therefore not feasible. Building intraday tools to calculate K-NPR is a significant operational lift and would pose higher barriers to entry to new trading firms, which is not the objective of this review.

Question 4: What suggestions do you have for how a margin-based approach might be applied to portfolios that are not centrally cleared?

At present, firms that need to offset positions across multiple clearers or that trade OTC products are required to revert to the adjusted K-NPR model. EPTA believes it is important that the FCA retains this option to ensure full product coverage. However, EPTA also considers that the principal limitations of K-CMG—namely its lack of coverage for all instrument types and its failure to recognise hedging and diversification where firms operate across multiple clearers or CCPs—could be addressed through an expanded margin-based framework.

EPTA identifies two complementary ways in which margin-based approaches could be applied to portfolios that are not centrally cleared:

First, margin-based methodologies could also be applied to selected OTC portfolios, particularly in circumstances where a prime broker effectively assumes a role similar to a clearing member by contractually assuming settlement and performance obligations. Risk models aligned with the margin requirements set out in UK EMIR Article 41 and recognised in MIFIDPRU 4.13 generally provide a more granular and economically relevant measure of market risk for investment firms than the standardised K-NPR methodology. Furthermore, these approaches allow exchange-traded and OTC positions to be assessed on a portfolio basis, offering a more accurate view of overall risk exposure.

Second, the limitation could be addressed through the use of a model that meets appropriate regulatory standards. One potential option is the ISDA SIMM model for OTC portfolios[2]("SIMM") that could provide a robust and risk-sensitive solution for OTC and mixed portfolios. While EPTA members primarily trade exchange-traded derivatives and therefore have more limited direct experience with OTC margin models, SIMM offers several advantages:

- The model is independently maintained by ISDA and is widely used across both banks and trading firms globally.
- The model has been rigorously tested and reviewed by global regulators and benefits from on-going semi-annual calibration.
- Multiple vendors[3] are licensed to provide SIMM model services to firms, including services that supply independent risk and sensitivity data, thereby reducing operational and governance burdens for investment firms.
- SIMM delivers a risk sensitive calculation, in contrast to simpler haircut-based approaches such as K-NPR or NCR, although its 10-day holding period calibration for OTC products may be punitive for listed instruments.
- It addresses a key constraint of K-CMG by recognising hedging and diversification across portfolios, including where firms operate across multiple clearers.
- The model provides coverage across all asset classes, including cash instruments, exchange traded and OTC derivatives, and more complex instruments like convertible bonds and crypto assets.
- It entails materially lower data and governance burdens compared to an internal VaR model.

Accordingly, EPTA proposes that the set of the eligible margin models for K-CMG be expanded to include both margin calculated at clearing member/CCP margin and OTC margin calculated using SIMM. Investment firms could then elect to use a combination of margin at clearer and OTC SIMM, or poten-

[2] https://www.isda.org/a/C8RgE/ISDA-SIMM-The-Trusted-Standard-for-Initial-Margin-Calculations.pdf
[3] https://www.isda.org/2016/09/15/isda-simm-licensed-vendors/

tially to apply SIMM or other eligible margin methodology across the entire trading portfolio. This would enable a consistent and risk sensitive capital framework across all products types, regardless of where they are traded.

Such an approach would also better align regulatory capital requirements with firms' economic capital management, as trading firms already manage liquidity and risk through margin. Leveraging an established industry model would facilitate implementation, reduce regulatory burden, and lower operational costs for both firms and the FCA.

EPTA would welcome the opportunity to engage further with the FCA to undertake a more detailed qualitative and quantitative assessment, including its scope, calibration, and appropriate safeguards, to determine whether this approach is appropriate.

<u>Option 3: An internally modelled approach</u>

Question 5: Would you support maintaining the current internal model approach if it was possible to find a proportionate way to incentivise its use? If so, how could this be achieved, and what sort of regulatory backstops would you suggest?

EPTA strongly supports the inclusion of an internal model (IM) option as a valuable alternative to the standardised approach. However, EPTA members consider that the current calibration of the internal model framework, based on VAR, is excessively conservative and can result in capital requirements that materially exceed firms' actual risk profiles.

This conservatism arises from the cumulative nature of the framework, whereby capital is calculated as the sum of VaR and Stressed VaR with a 99% confidence level, scaled by the square root of 10 to produce a 10-day holding period. The requirement to include both Stressed VaR and VaR is disproportionate to the risks posed by investment firms, particularly given that VaR is already based on a 10-day holding period, 99% confidence level, and subject to supervisory multiplier of between 3 and 4. As a result, the framework can lead to overly punitive outcomes that are not commensurate with the underlying risks. EPTA therefore believes that the multipliers should be reduced or removed, to demonstrate a clear departure from the banking regime, and to establish a more tailored framework for investment firms.

In addition, internal models were traditionally designed for large banking groups and pose significant operational challenges for smaller investment firms. The use of internal models necessitates extensive governance and oversight arrangements, including independent validation units, model risk management functions, large quantitative teams, comprehensive documentation and extensive back testing. These requirements are particularly onerous for VaR based models, which rely on complete position reference data, historical time series of prices and sensitivities, yields curves, convexity measures, and detailed P&L attribution.

Taken together, the combination of conservative calibration and significant operational challenges help explain why, to our knowledge, no FCA regulated investment firm currently holds internal model approval, and why similar outcomes have been observed across the EU.

EPTA therefore considers that a more proportionate approach is warranted. This could include a simplified internal model framework for investment firms, incorporating streamlined governance with reduced documentation, back testing and procedural requirements. In such a framework, supervisory attention would focus on ensuring that firms have a sound understanding of their models and effective internal oversight, rather than on meeting banking-style requirements.

In addition to lighter documentation at initial approval, a more efficient change management process would significantly reduce the ongoing operational challenges. For example, a notification-based process for model updates, where firms demonstrate that appropriate internal validation has been performed, would materially reduce the burden of maintaining an internal model. This would also reduce unnecessary pressure on the FCA resources and ensure timely approval of model changes.

In this context, EPTA would also support the use of an established VAR model operated by a third-party provider, with the provider responsible for verification and performance assessment. This approach could further mitigate operational challenges while maintaining robust risk management standards. It could also be envisaged that internal-model applications undergo an independent audit prior to submission. This would help streamline the process for the FCA and accelerate overall approval timelines.

With respect to regulatory backstops, investment firms are already subject to fixed overhead requirements and wind down cost as capital floors. Introducing an additional market risk specific backstop would add unnecessary complexity (requiring firms to run multiple calculations simultaneously) when the aim of the new framework should be simplification and proportionality. Given that the overriding prudential objective for investment firms based on the risk of harm is an orderly wind down, the wind down cost already provides an appropriate and effective backstop.

Question 6: What other techniques beyond VaR are in use within industry for ongoing management, monitoring and quantification of market risk? And what type of qualitative considerations are important?

EPTA members note that scenarios analysis is also widely used in risk management and could serve as an alternative to a VAR model. EPTA would be pleased to provide further details should this approach be considered.

In addition, EPTA believe that the following qualitative considerations may also be relevant:

- Introducing product liquidity tiers or thresholds to better reflect holding periods in stressed market conditions, with higher weightings applied for longer holding periods.
- Assessing trading volumes (and resilience) across the economic cycle.
- Differentiating between listed, exchange traded instruments and OTC products to reflect market liquidity.
- Instruments with substantial historic data have a lower degree of uncertainty in stressed periods which should be considered when quantifying market risk.

<u>Option 4 A Net Capital Rule (NCR) approach</u>

Question 7: If you see an overall benefit in adopting a net capital rule approach, including a limit on the financial leverage of the trading book, please explain what that may be?

As highlighted by the FCA, the Net Capital Rule—modelled on the US framework—is conceptually aligned with the policy objective of addressing the potential harms posed by firms that do not hold client assets. Under this approach, financial requirements are designed to ensure that firms maintain sufficient liquid balance sheet resources to meet obligations to creditors and counterparties. This approach has the benefit of being long established and proven robust, relatively simple to implement with limited data needs and complex computations.

However, EPTA members note that the NCR is fundamentally another haircut-based model, with no clear advantages in terms of risk quantification compared with the current standardised approach. The main benefit of NCR in the US and other jurisdictions arises because it replaces *all* other prudential requirements, making the framework simpler for firms to operate under, i.e., no separate liquidity reporting, wind-down cost assessments, or Pillar 2 requirements. In the UK, where these elements would remain in place, the NCR would not deliver the same regulatory efficiency or simplification. However, if the FCA were to consider making broader changes to MIFIDPRU to align with the US framework, which EPTA would support, then there could be significant benefits for investment firms in embedding the Net Capital Rule.

<u>Option 5: A sensitivities-based method</u>

Question 8: What are your views on applying a sensitivities-based approach to calculating market risk? How might such an approach be tailored or simplified for investment firms?

Although risk-sensitive, FRTB is overly complex and would require considerable time and effort for investment firms to understand and operationalise the framework. It would also create barriers to entry for new firms, as FRTB is not widely implemented outside the UK/EU for non-credit institutions. However, EPTA members may also support in principle a simplified version of FRTB subject to further assessment. This could be part of a tiered approach, where the FCA prioritise first the most straightforward and simple amendments outlined above.

<u>Option 6 Repurposing K-TCD for exposure to price risk</u>

Question 9: Do you have any suggestions on how the relevant elements of K-TCD could be repurposed to capture the market risk within a trading book?

EPTA sees no clear advantages from a repurposed K-TCD compared with an adjusted K-NPR. Further time and data would be needed to assess its viability, but given current constraints, this is not a preferred option.

<u>Option 7: A weighted liquid exposure method</u>

Question 10: Could the weighted liquidity risk of a portfolio form a basis for calculating market risk capital requirements? If so, what suggestions do you have for developing such an approach?

Although conceptually interesting, this option risks conflating market risk with liquidity risk, and data availability across all instruments would present a significant challenge.

<u>Other considerations</u>

Question 11: Are there other possible options for calculating market risk or other related issues, such as the definition of the trading book and the calculation of K-CON, that we could consider? If so, please provide details.

Permanence of capital

EPTA supports introducing greater flexibility in the permanence requirements for regulatory capital by allowing a defined portion of shorter-term capital to qualify. This approach would better reflect the dynamic nature of market-making activities, which are characterised by liquid and short-dated positions. Recognising these features within the prudential framework would enhance firms' ability to intermediate market flow, quote tighter spreads, and contribute to market stability during periods of stress. It would also widen the pool of eligible capital available to new entrants and recently established firms, supporting ecosystem diversity, competition, and overall market resilience. In this context, a modified capital model, adapted to the specific characteristics of trading firm business models, could be appropriate.

EPTA would also support a more dynamic inclusion of interim unaudited profits as loss absorbing capital for investment firms market risk. the FCA could consider allowing interim unaudited profits to qualify as Tier-2 capital without the need for profit verifications. This would provide more flexibility to trading firms to grow, without sacrificing stability as only 25% of capital requirements can be covered by Tier 2. This would also enhance the competitiveness of UK firms, as it would bring regulatory capital line with other international regimes where interim profits are not deducted from capital resources (like the US).

In addition, certain items (such as provisions for discretionary bonuses) should be eligible to be added back to interim profits as loss absorbing capital, to the extent that any subsequent trading losses would naturally reverse these items.

Thresholds based on balance sheet:

To the extent that any market risk framework relies on balance sheet thresholds, it is important to acknowledge that balance sheet size does not necessarily reflect risk—particularly for PTF liquidity providers who are unable to net positions due to limitations in accounting standards. In this regard, we note that US GAAP includes specific provisions for market makers that allow netting in a way that more accurately reflects their actual risk exposures. Against this backdrop, we invite the FCA to consider whether a net asset basis, similar to the approach used for asset managers under the K-AUM, would provide a more appropriate measure. In addition, any thresholds introduced should be subject to periodic review to ensure they remain appropriate and aligned with actual risk.

Consistency of the supervisory framework

EPTA notes that the current review is focused on market risk. Any changes to the Pillar 1 framework aimed at capturing harm-related risks or supporting orderly wind-down should be reflected in the broader supervisory framework (including Pillar 2 and ICARA). This alignment is essential to ensure that the benefits of the market risk review are not undermined by inconsistencies across the wider supervisory regime.