REFINITIV EXPERT TALK

Challenges still lie ahead as FRTB implementation stalls

While Canada leads the way for implementation, all other jurisdictions are falling behind due to difficult requirements on both the standardised (SA) and internal models approaches (IMA) to the Fundamental Review of the Trading Book (FRTB).

Refinitiv's recent webinar on FRTB implementation, FRTB: are banks ready to be compliant? explored how banks are managing the challenges of fragmented timelines, the use of the IMA and how global banks are solving the implementation of the SA. The panel also explored why controversy surrounds the risk factor eligibility test (RFET), as well as the fundamental data challenges associated with the regulatory implementation of FRTB. Lisa Regan, head of the Europe, Middle East and Africa (EMEA) sales team for Refinitiv's Data Solutions Business, was joined by Hany Farag, senior director and head of risk methodology and analytics at Canadian Imperial Bank of Commerce; Volker Wellman, risk and resource manager at BNP Paribas; and Fausto Marseglia, head of product management for FRTB and regulatory propositions at Refinitiv, an LSEG business.

FRTB implementation timelines and challenges of fragmentation

As it became apparent early on that banks were not going to meet the official deadline of 1 January 2023, implementation timelines have shifted somewhat over the past few years. These fragmented timelines have clearly created challenges within the industry. With local jurisdictions able to set their own timelines, we're seeing fragmentation across the European Union and the UK and even more so across Asia-Pacific (APAC), with timelines ranging between 2024 and 2025. The US has not yet published any timelines or interpretation of the rules, which is becoming an increasing concern for local banks.

The overall result of fragmented timelines is that no-one wants to implement FRTB earlier than anyone else. Each jurisdiction is basing its timeline on what other jurisdictions are doing. Additional challenges include greater uncertainty as regional players aren't clear on implemented dates. Fragmentation is also leading to further interpretations of the rules, which ultimately can increase the complexity of implementation.

The EU is working towards a deadline of January 2025, though with possible delays. But in order to be ready for such a timeline – and due to the nature of the requirements – banks operating in Europe actually need to have production-quality data running through their whole systems starting January 2024. With 12 months of back-data required, this means that implementation mode within Europe must begin as soon as possible.

With regard to the IMA, applications need to be submitted by the middle of 2024 – and these need to come with production data attached. Programmes in Europe need to be at a good implementation stage already in order to comply with application deadlines.

Canada's implementation is ahead of all other jurisdictions, since the local regulator takes the view that Basel III reforms are critical to implementation and should be completed as soon as possible. Banks operating in Canada is currently working towards a live date of November 2023, with first reporting due January 2024. Banks are working with the regulator in Canada to work out the process for approvals, as there are certain minimum requirements for the SA. All Canadian banks are also working towards an SA, with some working towards the IMA.

Challenges in implementing the SA

One of the key challenges to implementing the SA comes down to the granularity and elaborate nature of reference data required. The SA requires banks to have a parallel reporting structure to that currently used and reconciling the two can be a major challenge.

The other pain point for global clients is the treatment of equity investment in funds. Current regulation for measuring risks on equity investments requires banks to have access to the mandate of the fund, but getting that access is complex and the data may not always be accurate or up to date.

Challenges in implementing the IMA

The challenges to implementing the IMA differ from those challenges noted for implementing the SA. These challenges essentially align with moderating risk factors across a variety of categories.

Non-modellable risk factors interact with pricing in a unique way that requires a more sophisticated research programme to capture the savings between the IMA and the SA. The IMA is calibrated for a 30–35% reduction target, which is not simple – it requires much more research and work across multiple asset classes.

Additionally, the FRTB IMA requires that a number of processes be completely re-engineered, aligning market data, risk factors and so on − once completed, the outcome is around 20–50 times more new data generated daily. So, managing this data is where the real challenge lies. If something goes wrong, the turnaround time to rectify issues is extremely short, creating a real operational burden on the bank.

Banks need to find a way to balance the various risk factors. In order to achieve this, they need to put the right people with the right skills in place. Implementation is very costly and might not bring additional savings to the banks. Determining which desks go to IMA is not something that has been finalised and remains an ongoing process. Yet these need to be submitted to the local jurisdictions now in order to get the approval process under way for the IMA regime. As a result, a number of banks are deciding to go with the SA instead, only later to reevaluate and move to the IMA.

RFET challenges

RFET presents some of the biggest challenges in this space – particularly the quantity and quality of data needed and the divergence of regulation across jurisdictions.

On the data side, it is understood that banks will need to source the data required for these new processes from vendors. Further data management challenges will likely accompany this, meaning they'll need to have the right infrastructure in place and consistent ways to manage it. In addition, sourcing and testing the vendors and the quality of their data can take time.

As the EU is still in the early stages of implementation, it has more time before the regulation goes live to find solutions to these key challenges, even if additional ones arise along the way.

Concerns over vendor data

It is inevitable that banks will need to turn to vendor data, so questions will arise as to how best to assess this data's validity. Vendors essentially need to provide assurance that their data is valid and fulfils all regulatory requirements. Vendors must also adhere to audit requirements, as laid out by the regulators, to sell data to the industry. Vendor auditability is very important, though this may hinder access to some smaller numbers and can pose problems if a bank relies too much on a single vendor. These are all key issues for banks to be aware of as they move forward with implementation.

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