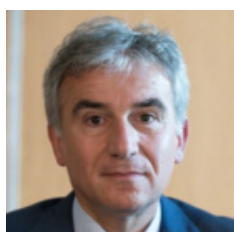


THE HARMONISATION OF FRTB DATA COMPLIANCE REQUIREMENTS BY LOCAL JURISDICTIONS IS CRUCIAL



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Fausto Marseglia leads the product management function for a number of regulatory propositions, including FRTB. He is responsible for defining and building new and innovative business propositions around financial regulations and compliance. Marseglia has more than 20 years of experience in the financial services and capital markets industry. He joined Thomson Reuters in 2002 as head of Reuters Consulting, Italy/Greece. Since then, he has covered different regional and global roles in consulting, professional services and industry solutions functions. Marseglia has a degree in computer science.

Banks face uncertainty over changing responsibilities under the Fundamental Review of the Trading Book (FRTB), but potential jurisdictional divergence on new requirements for data vendors could add greater complexity to the roll-out of these new rules.

Banks were given a temporary reprieve on the road to FRTB compliance after the Basel Committee on Banking Supervision pushed implementation back to January 2023. The new requirements aim to tighten criteria for measuring market risk exposure by reconsidering the scope of the trading book and improving the quality of the data and calculations banks use when measuring market risk exposure.

While banks may see an increase in capital requirements because of the new rules, it remains to be seen how different interpretations of the rules by local regulators could impact market complexity.

Sourcing data under FRTB

The data element of FRTB is particularly important for banks using the internal models approach (IMA) to calculate market risk for some or all of their activities. The IMA allows banks to design their own models for market risk exposure calculations, but requires users to conduct a liquidity test – the risk factor eligibility test (RFET) – to ensure there is sufficient activity in the inputs used in these internal models.

The RFET element of FRTB will be one of the biggest challenges banks need to solve under the new regime. The test aims to identify modellable risk factors for IMA use, with those not eligible resulting in a higher capital charge for those banks. But to run the test, banks will need to source a huge amount of trading information.

For many banks, however, it may be difficult to source sufficient quantities of trading information internally to generate the volume of data needed to pass the test. This is particularly true for over-the-counter (OTC) products – non-public trades that are also unlikely to be well covered in terms of internal trading information.

As a result, vendors expect to play a critical role in helping banks comply with the RFET, says Fausto Marseglia, Head of Product Management, FRTB and Regulatory Propositions at Refinitiv. “Many banks’ data infrastructure is quite old and composed of legacy systems,” he continues. “In those cases, it might be cheaper to buy data from vendors rather than to invest money and resources in extracting that data from internal applications.”

Under the new rules, data sourced externally from vendors to satisfy the RFET must be transparent and needs to come from providers that are audited annually. This will add another layer of compliance for banks purchasing this information from third parties. However, the likely impact of this particular requirement will remain unclear until there is further information from local regulators about their interpretations of audit requirements for data vendors.

Tracking jurisdictional interpretations

While local jurisdictions continue to work on these interpretations, the market must wait for the full picture to form of how certain FRTB elements will impact specific regions. Any potential for differences between the various interpretations is a cause for concern for banks – particularly those operating across multiple jurisdictions. Regulators worldwide are at various stages in the development of their own approaches to FRTB, but so far the European Union has provided the most solid details of how it will implement the Basel Committee’s rules.

Taking a phased approach, the EU implemented reporting requirements initially under the second Capital Requirements Regulation (CRR II), followed by capital requirements under the [CRR III directive](#), published in October 2021. In addition, the European Banking Authority’s (EBA’s) [March 2020 Regulatory technical standard \(RTS\) on criteria for assessing the modellability of risk factors under the IMA](#) has outlined the EU’s plan for RFET compliance.

The EU’s interpretation of the regulations lays out the criteria for determining risk factor modellability within its jurisdiction and providing information on how to determine whether a price is verifiable. It also defines the requirements for verifiable prices to be considered representative when it comes to risk factors. With each regulatory jurisdiction expected to outline its own interpretation of the rules, any differences provide potential for jurisdictional divergence and additional complexity for the market. Indeed, some of the EU’s interpretations could be classed as more restrictive than the original Basel Committee rule, which has already caused concern among market participants.

“The EBA RTS introduces some elements of divergence to the [Basel Committee] text that could be a concern for banks – specifically those with a global footprint that are required to comply to the RFET in jurisdictions outside of Europe,” Marseglia confirms. “One of these elements is the definition of a committed quote, which, [according to] the EBA interpretation, requires both a bid and an ask price to be eligible for the RFET.”

Indeed, this is a much more restrictive interpretation of the Basel Committee text, which [defines a committed quote](#) as ‘a price from an arm’s length provider at which the provider of the quote must buy or sell the financial instrument’.

“[The EBA interpretation] risks significantly reducing the universe of eligible quotes available to banks in the EU,” Marseglia explains. “For example, in markets where bonds and OTC products are traded – and ones based on the request-for-quote protocol – a committed quote includes only a bid or an ask price. Also, the pre-trade transparency rules under MiFID II [the second Markets in Financial Instruments Directive] do not require that quotes have both a bid and an ask price.”

Addressing data vendor compliance

The market may also see a similar issue play out in relation to new data compliance requirements. The Basel Committee definition of the compliance requirements that need to be fulfilled by data vendors covers the validity of the real price observations delivered by vendors and the need for independent vendor audits.

But, as with other elements of FRTB, the EBA gave more detailed instructions in its March 2020 RTS around compliance for data vendors. In the EU, banks that use vendor data must verify that the vendor is subject to an audit, at least annually, by an independent third party. This check should examine price information validity, governance and processes. These banks must be able to access the audit results and reports, according to the RTS.

The RTS goes into further detail about the audit procedure, providing a checklist of four criteria that must be satisfied. These relate to price verification and the integrity of that information, as well as internal processes, staffing levels and skills in relation to information management.

Harmonising on jurisdictional interpretations

As regulators in other major financial markets – such as the US and the UK – have not yet published their interpretations of the rules, banks have no option but to wait and see if there will be jurisdictional divergence on FRTB. “In addition to creating uncertainty and adding complexity to the regulatory outlook, such divergence could mean those firms with subsidiaries in multiple jurisdictions will face even more complicated FRTB requirements,” Marseglia says.

Furthermore, when it comes to the role of data vendors, these jurisdictional differences could lead to increased costs, which will be fed through into the wider market. This will certainly impact banks that need to source additional data to satisfy the RFET. “Local jurisdictions should consider harmonising their rules in these areas,” Marseglia says. “This will avoid adding an extra layer of complexity to a regulatory regime that has already become much more complex than its predecessor.”

Read more

Further information on [Refinitiv's take on FRTB](#).

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