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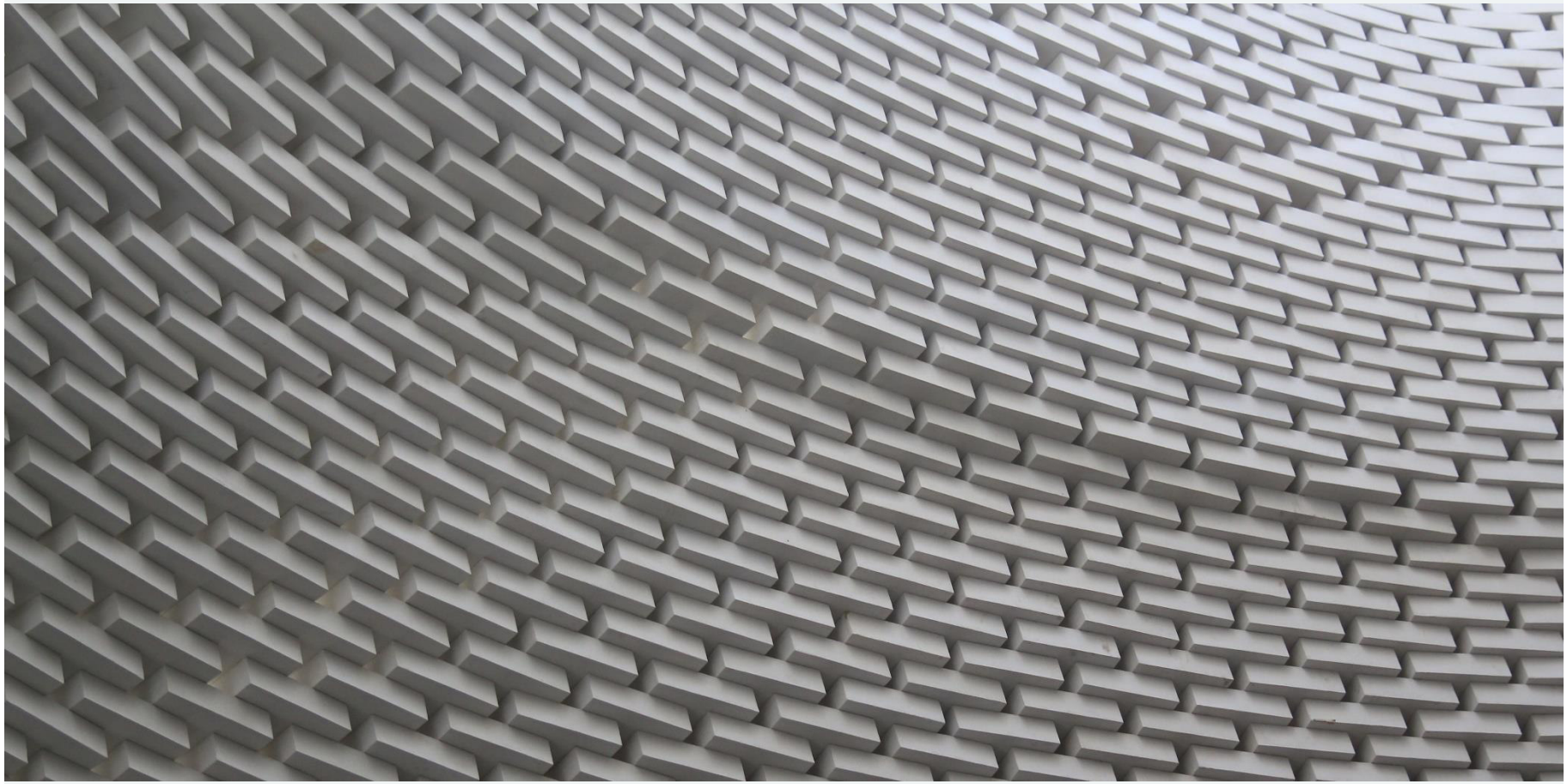

FRTB: Harnessing Synergies Between Regulations

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FRTB: Regulatory Landscape

Synergies Between Regulation

Banks should exploit commonalities within FRTB and similar regulations to ensure efficient development of FRTB frameworks.

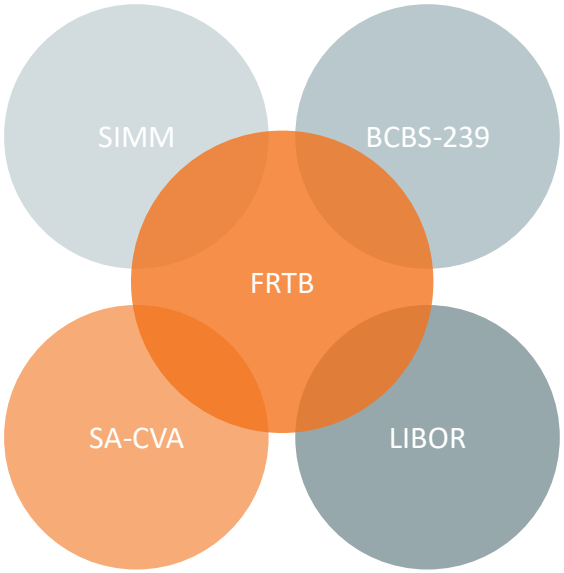
Despite a delay of one year, many banks are struggling to be ready for go-live in January 2023. Alongside the FRTB timeline, banks are also preparing for other important regulatory requirements and deadlines which share commonalities in implementation.

SIMM

- Initial Margin (IM) is the value of collateral required to open a position with a bank, exchange or broker.
- The Standard Initial Margin Model (SIMM), published by ISDA, sets a market standard for calculating IMs.
- SIMM provides margin requirements for financial firms when trading non-centrally cleared derivatives.

BCBS 239

- BCBS 239, published by the Basel Committee on Banking Supervision, aims to enhance banks' risk data aggregation capabilities and internal risk reporting practices.
- It focuses on areas such as data governance, accuracy, completeness and timeliness.
- The standard outlines 14 principles, although their high-level nature means that they are open to interpretation.



SA-CVA

- Credit Valuation Adjustment (CVA) is a type of value adjustment.
- It represents the market value of the counterparty credit risk for a transaction.
- FRTB splits CVA into two main approaches: BA-CVA, for smaller banks with less sophisticated trading activities, and SA-CVA, for larger banks with designated CVA risk management desks.

IBOR

- Interbank Offered Rates (IBORs) are benchmark reference interest rates.
- As they have been subject to manipulation and due to a lack of liquidity, IBORs are being replaced by Alternative Reference Rates (ARRs).
- Unlike IBORs, ARRs are based on real transactions on liquid markets rather than subjective estimates.

FRTB: Synergies With Current Regulation

SIMM and BCBS 239

Existing SIMM and BCBS 239 frameworks and processes can be readily leveraged to reduce efforts in implementing FRTB frameworks.

SIMM

The SIMM methodology is very similar to the Sensitivities-based Method of the Standardised Approach of FRTB. Synergies should be utilised to reduce the effort required for FRTB implementation.

Synergies

- The overarching process of SIMM is very similar to the Sensitivities based Method (SbM), including the: identification of risk factors, calculation of sensitivities and aggregation of results.
- The outputs of SbM and SIMM are both based on delta, vega and curvature sensitivities.
- SIMM and FRTB both share four risk classes (IR, FX, EQ, and CM). However, in SIMM, credit is split across two risk classes (qualifying and non-qualifying), whereas it is split across three in FRTB (non-securitisation, securitisation and correlation trading).
- For both SbM and SIMM, banks should be able to decompose indices into their individual constituents.

Recommendation

- Leverage the existing sensitivities infrastructure from SIMM for SbM calculations.
- Use a shared risk factor mapping methodology between SIMM and FRTB when there is considerable alignment in risk classes.
- Utilise a common index look-through procedure for both SIMM and SbM index decompositions.

BCBS 239

Many of the FRTB data requirements are already fulfilled by BCBS 239. Banks that have implemented BCBS 239 should use their BCBS 239 processes to support their FRTB implementation.

Synergies

- BCBS 239 requires banks to review IT infrastructure, governance, data quality, aggregation policies and procedures. A similar review will be required in order to comply with the data standards of FRTB.
- The BCBS 239 principles are now in “Annex D” of the FRTB document, clearly showing the synergy between the two regulations.
- The quality, transparency, volume and consistency of data are important for both BCBS 239 and FRTB. Improving these factors allow banks to easily follow the BCBS 239 principles and decrease the capital charges of non-modellable risk factors.
- BCBS 239 principles, such as data completeness and timeliness, are also necessary for passing P&L attribution under FRTB.

Recommendation

- Use BCBS 239 principles when designing the necessary data frameworks for the FRTB Risk Factor Eligibility Test (RFET).
- Support FRTB traceability requirements and supervisory approvals with existing BCBS 239 data lineage documentation.
- Produce market risk reporting for FRTB using the risk reporting infrastructure detailed in BCBS 239.

FRTB: Synergies With Future Regulation

SA-CVA and LIBOR Transition

The IBOR transition and SA-CVA will become effective from 2023. Aligning the timelines and exploiting the similarities between FRTB, SA-CVA and the IBOR transition will support banks to be ready for all three regulatory deadlines.

SA-CVA

As the SA-CVA and the Sensitivities-based Method of FRTB are almost identical in construction, there are a number of clear synergies between their implementations.

Synergies

- Four of the six risk classes in SA-CVA (IR, FX, EQ, and CM) are identical to those in SbM. SA-CVA however uses a reduced granularity for risk factors compared to SbM.
- The SA-CVA capital calculation uses a similar methodology to SbM by combining sensitivities with risk weights. There are additional considerations required for the SA-CVA calculations.
- SA-CVA incorporates the same trade population and metadata as SbM.
- Capital requirements must be calculated and reported to the supervisor at the same monthly frequency as for the market risk standardised approach.

Recommendations

- Combine SA-CVA and SbM risk factor bucketing tasks in a common methodology to reduce overall effort.
- Isolate common components of both models as a feeder model, allowing a single stream for model development and validation.
- Develop a single system architecture which can be configured for either SbM or SA-CVA.

IBOR Transition

Although not a direct synergy, the transition from IBORs will have a direct impact to the Internal Models Approach for FRTB and eligibility of risk factors.

Synergies

- As the use of IBORs are discontinued, banks may observe a reduction in the number of real-price observations for associated risk factors, due to a reduction in market liquidity.
- It is not certain if these liquidity issues fall under the RFET exemptions for systemic circumstances, which apply to modellable risk factors which can no longer pass the test.
- It may be difficult for banks to obtain stress-period data for ARRs, which could lead to substantial efforts to produce and justify proxies.
- The transition may cause modifications to trading desk structure, the integration of external data providers, and enhanced operational requirements, which can all affect FRTB.

Recommendations

- Investigate how much data is available for ARRs, for both stress period calculations and real price observations.
- Develop any necessary proxies which will be needed to overcome data availability issues, as soon as possible.
- Calculate IBOR capital consequences through the existing FRTB engine.

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