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Insights

Basel Committee on Banking Supervision Publishes Final Rules re: Fundamental Review of the Trading Book

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On January 14, 2016 the Basel Committee on Banking Supervision published final rules related to the Fundamental Review of the Trading Book (“FRTB”). Each member country, including the United States, will have to consider how it will give effect to the FRTB framework.

The FRTB rules were intended to create consistency in the treatment of market risk across global markets and will, in most cases, result in higher capital requirements. Notably the FRTB rules will increase capital requirements for trading book securitizations across the board as compared to existing Basel 2.5 rules.

Under current trading book capital rules advanced approaches banks can calculate capital for trading book securitization exposures using either the standardized approach or an internal ratings-based approach. Current capital rules also require banks to calculate capital using the SFA or SSFA to determine default risk and value at risk methodology for determining market risk.

Under the FRTB framework, all banks must use a revised standardized approach. This revised standardized approach includes three components to compute capital for trading book exposures:

1. a default risk capital charge;
2. a credit spread shock capital charge, which replaces the market risk charge; and
3. a residual risk add on.

The required capital charge resulting from the use of this formula is expected to increase capital at least 20% from current levels. The FRTB rules become effective January 2019 with a compliance date of December 2019.

For more information on the FRTB rules, please click here.