

Implementation of FRTB in Hong Kong

January 2021



Overview of FRTB

The global financial crisis of 2007 and 2008 revealed significant weaknesses in the market risk capital (MRC) framework. To achieve a more robust framework, the Basel Committee on Banking Supervision (BCBS) issued a series of Consultation Papers (CPs) known as The Fundamental Review of the Trading Book (FRTB).

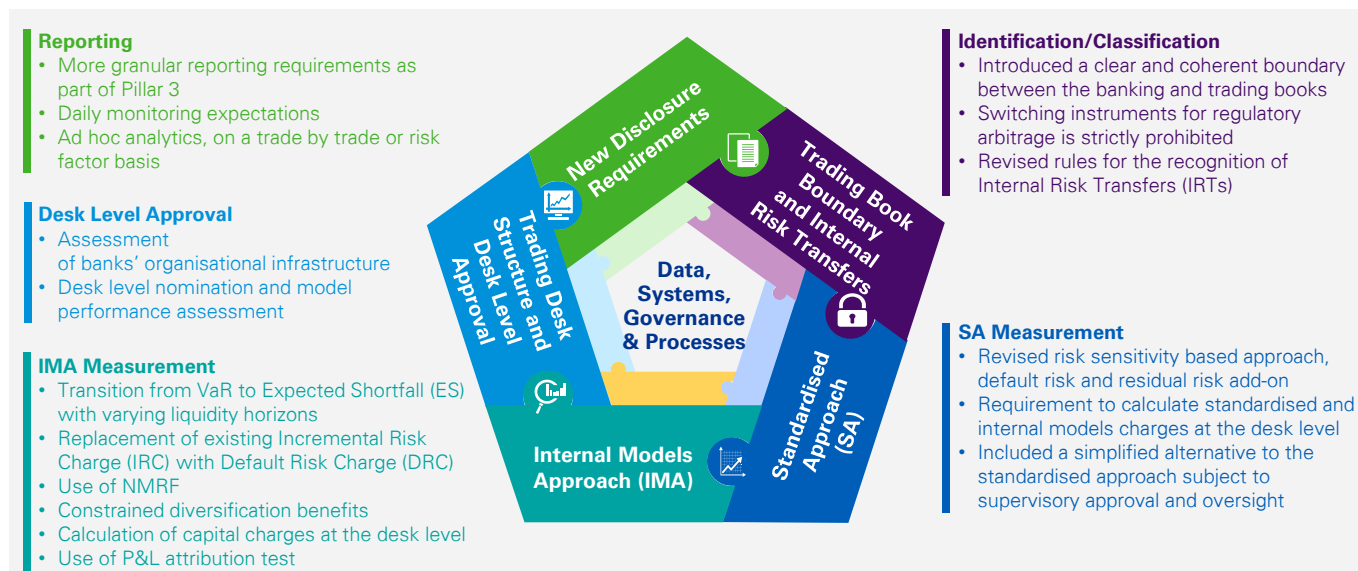
After a number of iterations since the first CP in 2012 and the revised standards in 2016, **the BCBS issued its final 'minimum standards for market risk capital requirements' (often referred to as FRTB) on 14 January 2019.** The new requirements propose material changes to the way banks determine the capital required to support their trading activities. The main changes to the 2016 revised standards are:

- Revisions to the scope of application of the framework;
- Recalibration of the standardised approach (SA) to market risk;
- The introduction of a simplified standardised approach;
- Amendments to the profit and loss attribution (PLA) framework;
- Amendments to Non-Modellable Risk Factors (NMRF);
- Revisions to the trading desk requirements; and
- A one year transitional period (during 2022) for the implementation of part of the Internal Models Approach (IMA).

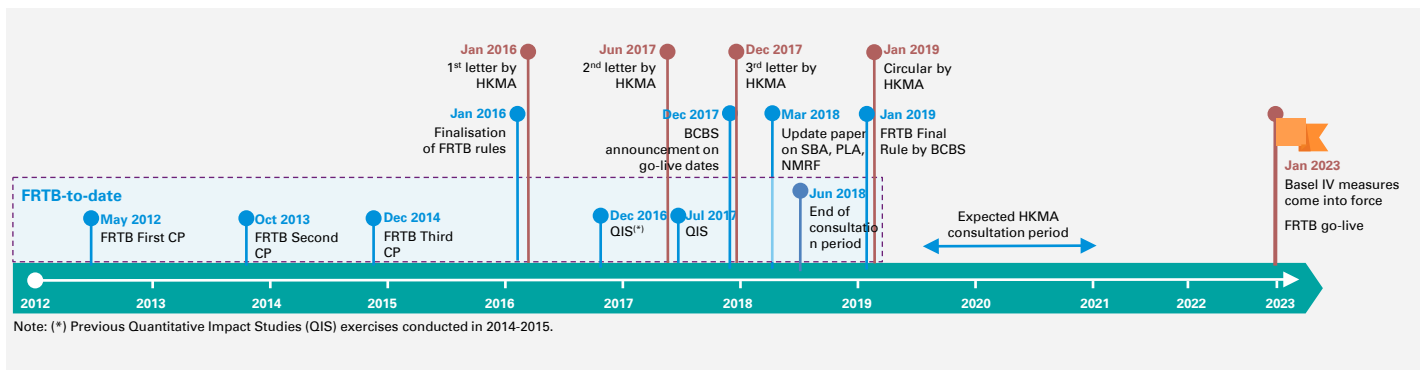
The newly proposed framework will require a significant overhaul to banks' current internal systems, processes and infrastructure. Particularly for banks using IMA, market risk capital charge will need to be calculated at the trading desk level. The timeline to implement the changes required to meet the new FRTB requirements will be in parallel with a number of other regulatory programmes across Front Office, Risk, Finance and IT departments. FRTB will require extensive enhancements in data and analytics, infrastructure and systems for trading desk approval processes, model governance, ongoing P&L attribution and more granular reporting requirements.

The final rules

The Hong Kong Monetary Authority (HKMA) published a circular on 17 January 2019 and is expecting to closely follow the BCBS standards. **The HKMA plans to align the local implementation with the latest BCBS timetable (i.e. 1 January 2022 as previously communicated in 2017), and issue a consultation paper in the second quarter of 2019. The HKMA requested locally incorporated banks to perform a quantitative impact study in Q2, 2020. Due to COVID-19 the HKMA has postponed the effective date of FRTB by 1 year to 1st January, 2023 for reporting purposes.** The FRTB final rules mainly focus on the five aspects below:

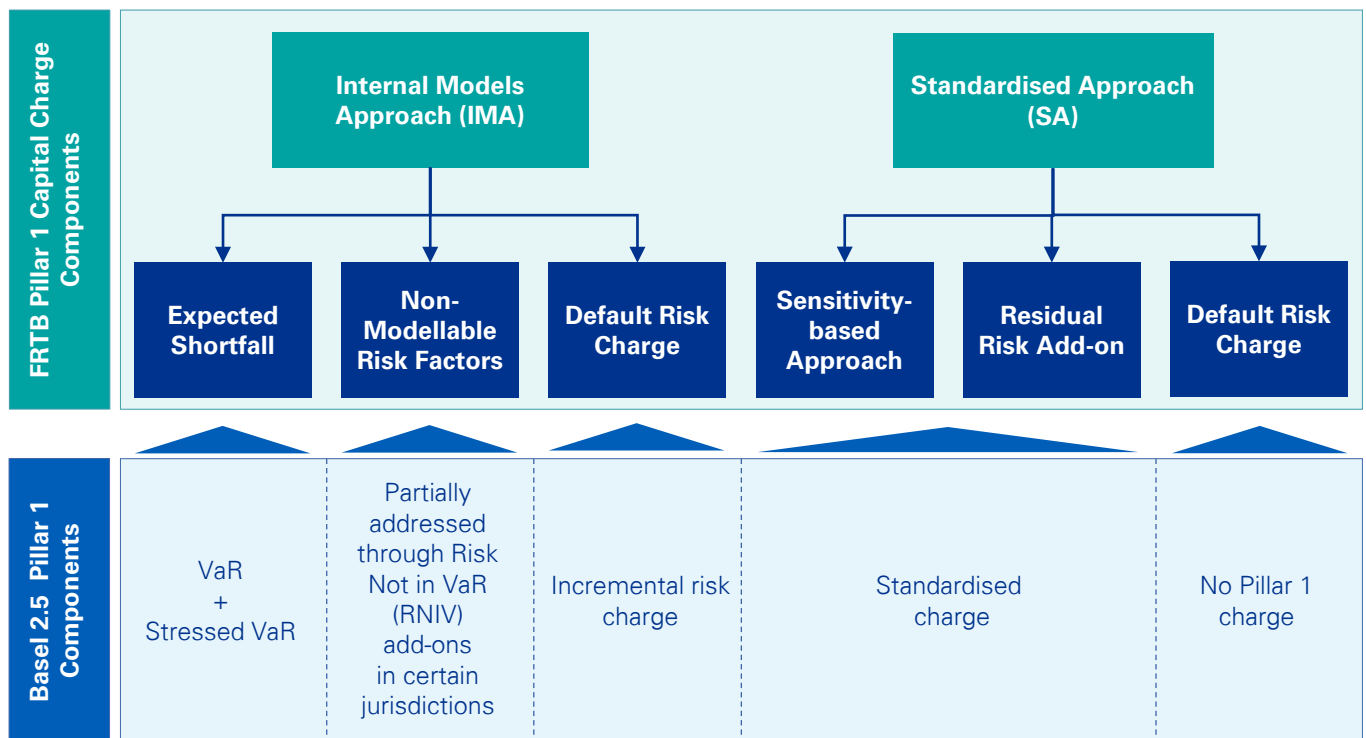


FRTB - Supervisory timeline



Market risk capital components under FRTB

The chart below provides an overview of the market risk capital charge components under FRTB and a comparison to the components under Basel 2.5. It is important to note that under FRTB, the SA will act as a “floor” to the IMA. Banks now need to perform standardised calculations using the revised approach at the trading desk level and as if they were a standalone regulatory portfolio.

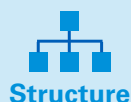


Key facts on adopting FRTB



Capital

- The BCBS quantitative impact study (QIS) based on December 2017 data indicated that banks that use the standardised approach exclusively are expected to see a weighted average of a **30 percent** increase in capital requirement, while the expected impact on banks that use the internal models approach is an increase of **20 percent**. Furthermore, banks that use the simplified alternative approach to the SA are expected to see a **57 percent** increase in capital requirement



Structure

- Restructure businesses across Markets, Treasury and Banking Book
- Heterogeneous impacts on individual products and markets
- Significant impact on transfer pricing and inter-desk transfers



Implementation

- Banks will need to consider upgrading and/or consolidating trading platforms
- Most banks will need to implement new Risk Engines and enhance P&L validation processes



Size and Scale

- Large global banks could expect to incur costs of up to **USD 200 million** for FRTB implementation. Small to medium banks will incur lower costs but the project scale will still be sizeable
- Banks estimate a **18 to 24 month** implementation timeline
- Banks expect a **6 to 12 month** parallel run period

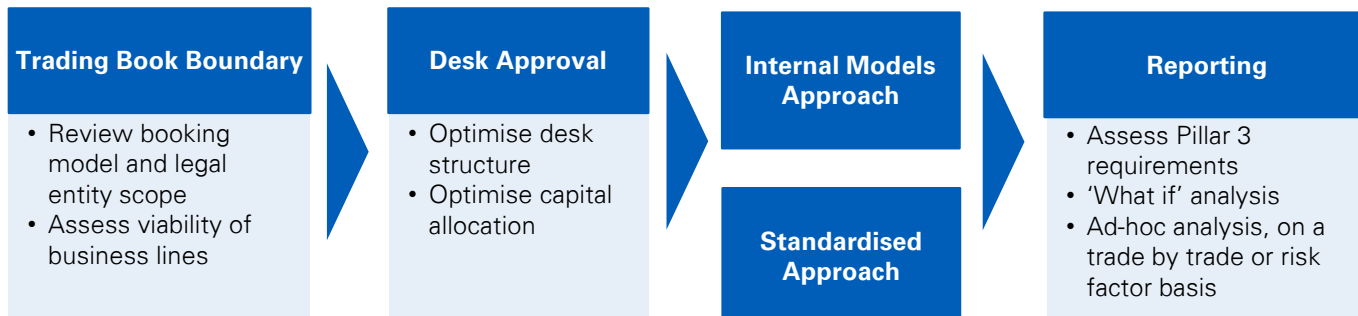
Next steps

As banks prepare and implement FRTB, it can be viewed as an opportunity to improve the overall risk management framework, including governance, risk measures, data infrastructure, internal models, reporting and ongoing monitoring.

Given the complexity and wide spectrum of the new rules, banks should begin to plan for their implementation efforts in advance towards the expected effective deadline of 2023. There are a number of key suggested steps (as shown on the right) for banks to take in order to prepare for the parallel run prior to 2023.

Governance and Processes

- Gap analysis between Current State and Target Operating Model (TOM)
- Integration with BAU exercises and other regulatory initiatives
- Revision of policies and procedures; enhancement of key processes (e.g. new product approval)
- Communication and senior management governance



Data and Systems

- Data infrastructure and analytics
- Data taxonomies and streamlined data management
- System automation

Client-tailored approach

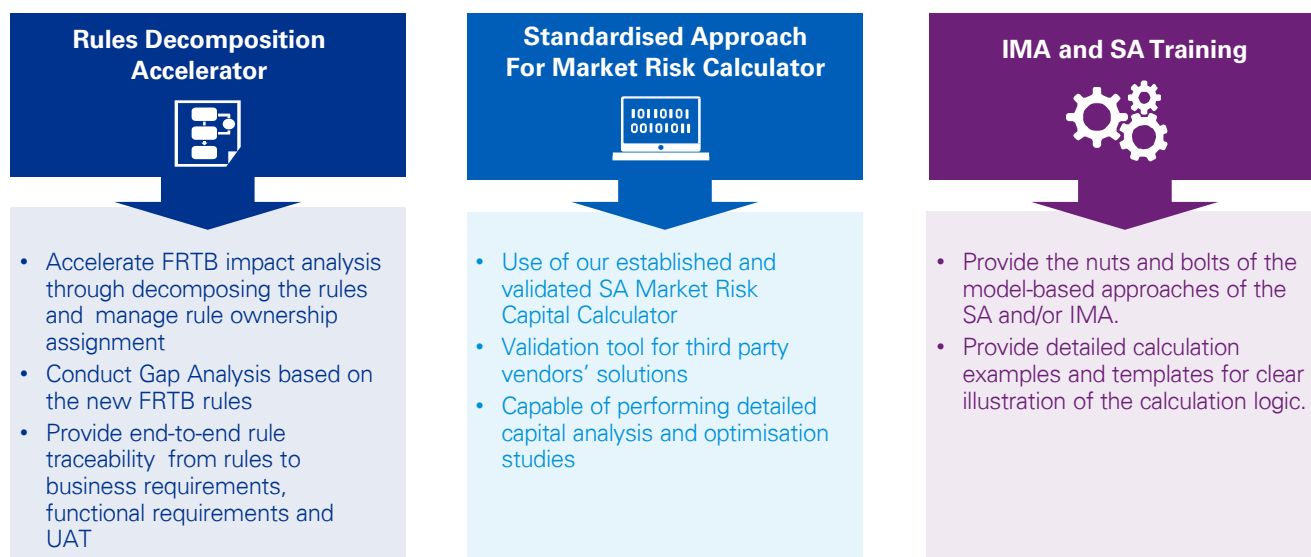
The FRTB requirements for large banks differ from those for small and medium banks. For this reason, KPMG has a range of supporting options depending on the size of your institution and the maturity of your current status. For example:

- Banks with small trading books or vanilla products are more likely to choose the standardised approach.
- Banks with strong foundational capabilities may be required to build an SA/IMA engine and desk optimisation.
- Banks with an embryonic FRTB programme but less mature in foundational capabilities may need support in setting up the systems and building calculation engines.
- Banks that have not yet initiated an FRTB programme would benefit from the end-to-end support of the FRTB transition.

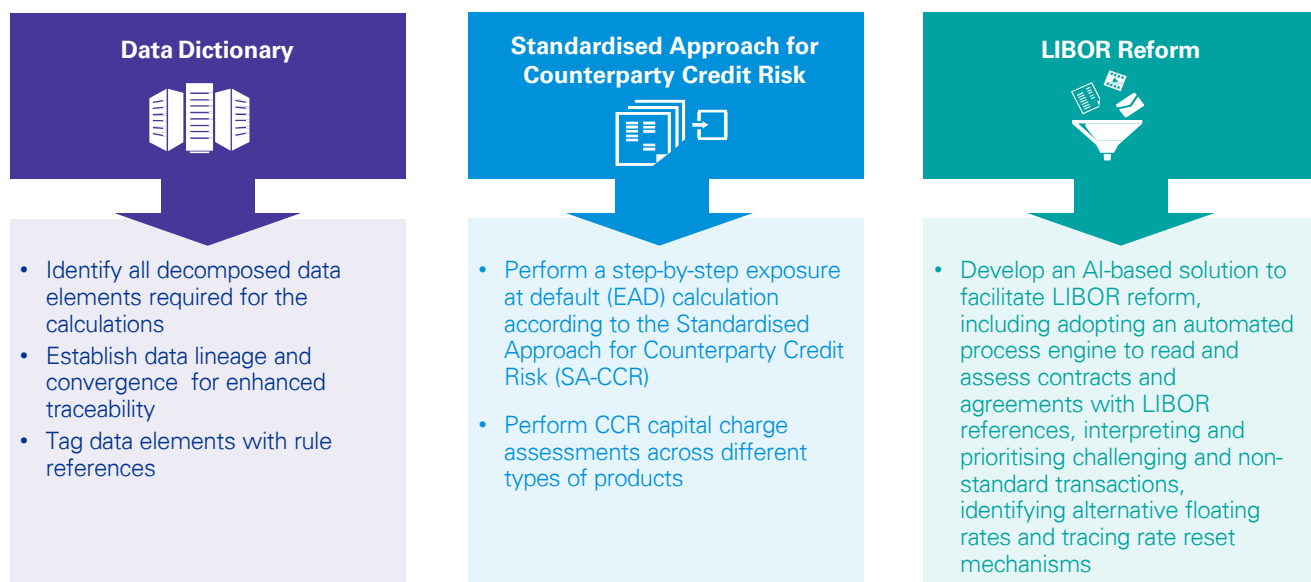
KPMG Accelerators

KPMG has a leading role in interpreting FRTB rules and establishing best-in-class programmes. We have a dedicated local team and a global working group, which has a firm footing in the market. We actively participate in contributing market insights, white papers and training on FRTB.

KPMG offers a suite of solutions to help you navigate FRTB implementation. Below are the examples of accelerators we have developed:



Other than the above-mentioned accelerators, KPMG has a number of solutions designed for other relevant regulatory exercises, including a data dictionary for regulatory reporting, SA-CCR and LIBOR reform.



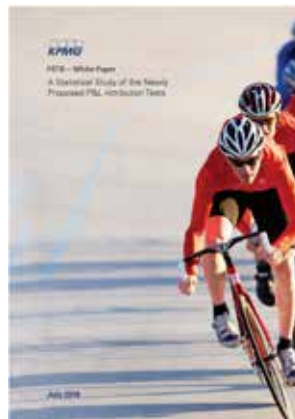
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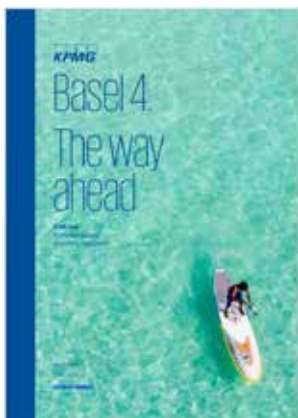
Basel 4: The way ahead - Market Risk

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FRTB - White Paper A Statistical Study of the Newly Proposed P&L Attribution Tests

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Basel 4: The way ahead - CVA Risk

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FRTB - White Paper Impact of the FRTB consultative paper on IMA & NMRF capitalization

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