



TOPICS:

Market risk

SOURCE:

International Swaps and Derivatives Association

ISDA: Modernizing the FRTB - A Global Blueprint for Market Risk Reform

- This ISDA report addresses the implementation **challenges and reform opportunities related to the Fundamental Review of the Trading Book (FRTB)**, a key component of the Basel III framework for market risk. The FRTB was designed to rectify weaknesses exposed during the global financial crisis by introducing a more risk-sensitive capital framework. It includes both a **Standardized Approach (SA)** and an **Internal Models Approach (IMA)**, yet global implementation has been inconsistent, leading to market fragmentation, regulatory arbitrage, and operational burdens for banks.
- The ISDA underscores **the risk of diverging national approaches**, which complicate cross-border risk management and distort competitive dynamics. Banks operating in multiple jurisdictions face duplicative frameworks, increasing complexity and compliance costs. Additionally, overly conservative rules for exposures such as funds and non-modellable risk factors (NMRFs) have led to capital charges misaligned with actual risk,

undermining both the intent and utility of the FRTB.

- Preserving **internal models** is a focal concern. ISDA advocates for recalibrating the IMA to ensure its continued viability, emphasizing the importance of risk-sensitive, proprietary modeling. Key proposals include refining the Profit-and-Loss Attribution Test (PLAT) and Risk Factor Eligibility Test (RFET) to reduce unnecessary volatility and improve model accessibility. ISDA also recommends reforms to NMRF aggregation rules and recognition of portfolio diversification benefits under the IMA.
- Regarding the **Standardized Approach**, the report highlights inefficiencies in the treatment of collective investment undertakings, residual risk add-ons, and maturity mismatch within the default risk charge. ISDA proposes adjustments to better align capital requirements with economic reality and risk-reduction strategies. Additionally, the report calls for improved recognition of diversification within the SA to ensure it functions as a credible and risk-aligned fallback.