Julia: **Hello and welcome to a DerivSource Podcast. I'm Julia Schieffer, the founder and editor of DerivSource.com.**

We've covered FRTB, or the Fundamental Review of the Trading Book, in various articles recently, but in this particular podcast we're exploring the data and operational challenges that firms face, as well as the resources required as they prepare to comply with these new market standards.

With me today I have Aude Schonbachler, Financial Services Partner at Oliver Wyman, and also Ben Molyneaux, Manager Finance and Risk Practice at Oliver Wyman as well.

Welcome to the podcast Aude and Ben.

Aude: Hi Julia. Thanks a lot for inviting us today to speak about FRTB, that's a subject that's very close to our hearts these days. We do a lot of work on it.

Ben: Hi Julia. Good to be here. Thanks for having us.

Julia: **So, my first question for you is that it's my understanding that preparing for FRTB will require significantly more resources and system restructuring than originally thought by the industry. In your views what are the biggest challenges that firms face as they prepare for compliance?**

Aude: I think that's a very true statement, that FRTB will require more and more resources going forward and that in our opinion and discussing with our clients there have been some kind of underestimation maybe of the mentality of the change to happen and how big effort will be furnished by the banks.

In terms of challenge what we see as a the major one coming in to the picture is definitely more on the operational side. FRTB is a regulatory reform that will touch on methodologies but much more beyond than that it will have very large implication in the way the banks set up their trading activities going forward. Because it will mainly cause to switch the monitoring of trading capital from portfolio level, as we had until nowadays under the VaR regime, to a desk level.

So all of sudden for the major actors of the industry you need to switch from an environment where instead of for instance doing one reporting at the end of the day, if you are a large institution you will have close to 100 desks under FRTB where you're going to have to produce about 100 reports instead of one at the end of the day.

There's a major shift in the amount of calculation to be performed, the amount of reporting and analysis to be performed. And as you can imagine this creates a lot of need for additional IT system change, but also bringing new people who can follow up with the new monitoring requirements and analysis requirements.

An extra aspect of the operational challenges that institutions always have to consider is about the implication with regards to the trading resources and the pure human capital consideration. FRTB is creating the need to define some new functions. So, a bank will have to elect a new desk head per FRTB desk so there will be the need to designate those new desk heads on the trading floor and there will be a need for a much stronger environment to monitor the data and the analytics. In some institutions that will translate in the definition of the new role of the global data officer for instance. These are the considerations but do not translate directly in to the requirement.

Also, something very important for the bank to think ahead. They will typically take a good one year and half to two years to become implemented as there are some compensation considerations and that is certainly an extra effort that needs to be taken into account on top of everything else which is necessary for the implementation.

Julia: **Focusing on systems in a little bit more detail, to comply with FRTB, firms will undoubtedly have to update existing systems, and of course with this comes challenges related to the management of data. How do you see firms tackling data management requirements related to FRTB compliance?**

Ben: Yes, that's absolutely right. So I think in addition to what Aude was just saying in terms of firms looking at making formal roles and formal structures around a chief data officer or people dedicated to looking after this. Really the problem with FRTB is that in previous versions of this regulation you could just about get away with having some patches in your data or having to do some work arounds. I think now, particularly with the P&L attribution test which has been introduced you really can't get away with that sort of "papering over the gaps" approach anymore, you need to have a fully aligned front to back data, particularly when it comes to a historical timeseries. This is forcing a new effort between front office and risk to collaborate on this kind of issue but also the standard for what good looks like has certainly been raised by an order of magnitude. I think one other particular problem that firms are having around data for FRTB is getting more transparency about what's trading in the market and this is relating to non-modellable risk factors, because now firms are penalised with additional capital charges if they can't observe a given type of trade happening in market more than 24 times a year.

In that space in terms of additional transaction data and visibility of what kind of assets are being actively traded, some vendor solutions have emerged which allow firms to fill that gap, and one which Oliver Wyman has been working on in collaboration with IHS Markit is the FRTB Modellability Service to try and address some of these data issues and give people improved modellability results as a consequence.

So, I think it's going to be a combination of improving internal structure at an organisation, but also more reliance on third party data providers and vendors to plug the ever-increasing data requirements under FRTB.

Aude: Just to add to Ben's point on the need for front to risk to back alignment of the calculation under FRTB which is one of the biggest challenges actually of this new regime. On top of the data framework where there is a need for consistency in the data between front, risk and finance, there is also a need that is created in terms of the better alignment in the pricing functionality between these three departments. And as Ben was mentioning, that creates the need for several institutions to rethink their IT infrastructure.

We recently performed a survey with leading industry participants on their progress on FRTB. And it happens that this redesign of IT architecture is really at the heart of their programme at this point in time. Just to give you an overview: for about one third of the survey participants, they told us that because of FRTB, but also in the spirit of all the new regulations coming on the trading activities, they are currently undertaking fundamental re-design of their IT architecture. For the rest of the survey participants, the plan is now to leverage what they already have, not going to differ for the "big bang", but rather try to leverage your existing system, but they all recognise that there will be a need for material investments into their IT architecture to be able to pass the Advanced Approach under FRTB as much as possible.

Julia: **Looking ahead to the rest of the year, what will be the biggest focus for most firms in the in 2017 as they continue their preparations for FRTB?**

Aude: I can see two major areas of focus, and Ben will be likely to complete after me. The first one I think it keeping the good progress that has been done on the methodology over 2017 but also on top of that, the banks should start performing much more impact analysis at a desk level.

So far, all the impact analyses that were done for industry surveys for regulatory reviews were much done on some assumptions in each institution. And now we see a need, and also a willingness, for the most advanced institutions to start running some pile-ups on some kind of tactical architecture. What would be the impact of FRTB at a desk level, so in the kind of business as usual first implementation condition, to get a better grasp at what's going be the area that has impact going forward in the new FRTB world.

It's about accelerating over 2017, the building of those tools that are going to help each bank have a better view of post-implementation, what's going to be my new capital charge at a desk level, and that also helps them for the rest of the program to prioritise a little bit more effectively.

So, by looking at what would be the end capital number in an FRTB world, then it is easier to decide, (eg:) "for this desk the capital charge would be very high. I think that if I prioritise my efforts in terms of collecting the additional data, refining pricing models to better pass the eligibility test, I've got a chance to pass them and given the materiality of the position, that should be a priority effort for me". Whereas another desk were possibly the materiality of the RWA charge in FRTB is lower, or "I know that it's going to be difficult to get the data to pass the eligibility test, then it's going to be a *priority 2* or *priority* 3 in my programme".

So, we do see the need, but although this desire from the banks to get more hands-on in the impact analysis and not many predicting the real data to be able to qualify themselves.

The other challenge I can see an area of focus this year is about securing the budget and the resources for FRTB, especially in a situation where the final status is still not totally on the paper; we are still waiting for some clarification from the regulator in terms of what's going to be the final rules. There's still a little bit of discussion in terms of when is going to be the go live date - 2020 or 2021 - depending on the geographies we hear different noises.

In this context where are still some parts of the regulation that are not totally clear, there is still a need for the programme manager as a programme sponsor to really carry the voice of FRTB, make sure they can secure enough budget, enough resources to keep pushing the effort for 2017, given the amount of work that needs to be done.

Ben: Absolutely agreed. If I can just echo what Aude said there in terms of trying to move away from your assumptions and your impact studies and try to move towards some real data. I think getting that assurance and getting that additional granularity to the desk level, that's going to be critical to making decisions so that's where banks should be prioritising their efforts this year.

Julia: Thank you, I think that's an excellent point to end on.
Aude and Ben, thank you for sharing your insight with us today in this podcast.

Ben: Thanks for having us.
Aude: Thanks Julia. It was a pleasure.

Julia: **As always, listeners, you can find more information on this topic and the full transcript via our podcast show notes page on DerivSource.com Thank you for listening. Join us next time.**