CRE Finance Council
The Voice of Commercial Real Estate Finance

Fundamental Review of the Trading Book (FRTB)

FRTB Implementation Moving Forward…Slow but Steady

Last updated: August 7, 2018

Executive Summary

- **Basel Standards and US Rulemaking:** The Fundamental Review of the Trading Book (FRTB) is a section of the Basel III standards that applies to most phases of the securitization market, including warehousing, sale, and secondary trading. It was finalized by the Basel Committee on Banking Supervision (BCBS) in 2014 and is targeted for implementation in 2022. Rulemaking in the U.S. has yet to begin, but a proposal could be published as early as 2Q 2018.

- **CMBS Treatment:** The FRTB requires that all banks holding CMBS in trading accounts must use the so-called "standardized approach" (SA), instead of internal models, to assess risk-based capital requirements. As a result, even advanced approaches banks are compelled to apply the more prescriptive SA.

- **Operational Requirements Also Massive:** The FRTB requires that banks acquire a robust set of capabilities for segmenting exposures into risk factors before assessing capital requirements. This aspect of the rule reportedly challenges banks as much as the increased capital requirements.

FRTB QUICK FACTS

- Under the FRTB, market participants estimate that capital requirements for CMBS will be greater than two times that of equivalent loan portfolios.

- Capital requirements may also equal two times the market value of CMBS bonds, implying that some tranches could lose more than their value in certain cases.

- CMBS delinquency rate continues to fall, breaking through 4.00% in June 2018 to 3.95%.

- Under the FRTB regime, CMBS is treated similarly to subprime RMBS and esoteric structures, which appears to be aggressive considering the comparatively better CMBS loss history versus these other sectors during the financial crisis.

- A coalition of trade associations has requested that the regulators release their calibration methodologies in order to understand the basis on which CMBS and other products have been treated unfavorably.

CREFC Resources

- Letter to US Banking Agencies regarding Basel IV, 11/18/2016
- CRE Associations Basel IV Letter to US Agencies, 12/2/2016
- Joint Associations Letter to Basel Committee regarding Capital Floors, 3/27/2015
- Joint Trades Letter to Basel Committee regarding the Treatment of Securitization, 8/12/2014
- Submission to International Regulatory Task Force on Securitization, 7/25/2014

For further Information, visit CREFC's Resource Center at: https://www.crefc.org/library

Potential Solutions

- **Rep Hollingsworth's Anti-Gold-Plating Rule Can Address the Issue, In Part:** Rep. Trey Hollingsworth (R-IN) sponsored legislation in 2017 intended to allow Congress the right to question US regulators when over-shooting BCBS requirements in home country rulemaking. CREFC supports the bill on its face but also as a means of muting potential competitive disadvantages. The bill, however, may not fully address situations when the international BCBS standards themselves impose outsized regulatory burdens. In this case and others, CREFC members must work with domestic regulators to recalibrate specific requirements.

CREFC Policy & Strategy

- Based on a survey of all CREFC members conducted in May 2017, stakeholders in the CMBS sector are united in their push back on additional capital requirements for CMBS, especially given the lack of justification for these new requirements.

- ***Recommendation:*** CREFC members generally agree that the regulators should provide justification for their calibrations and that the Basel Committee should reconsider the treatment of CMBS under the FRTB.

Additional Background & History

- **Part of a Much Larger Set of Rules:** The BCBS adopted the final measures related to Basel III on December 7, 2017. While the FRTB standards were adopted in 2016, this latest event both clears the way for US rulemaking and complicates that phase. FRTB implementation must be coordinated with requirements adopted more recently, particularly with the BCBS's new capital floors. Because the BCBS also pushed back conformance by a year to 2022, the US regulators have some leeway in timing. Yet, the FRTB framework is considered to be highly disruptive to trading and securities businesses, suggesting that the industry should be allowed ample time to comment.

- **Intent of Rule/Bigger picture:** The FRTB and the related rule that addresses CMBS and other securities in the investment book are intended to offset the risks that regulators perceive to arise out of the structuring inherent in a securitization, asserting that it reduces transparency. In order to offset the structuring risk, they assess an additional capital charge to that required for whole-loan CRE portfolios (non-securitized loans). The additional capital is intended to offset the so-called reduced transparency and greater complexity of CMBS and other securitizations.

  Additionally, the broader revisions to Basel III adopted by the BCBS in December 2017 shift the risk-based capital regime toward standardized methodologies in an attempt to reduce the variance in outcomes across jurisdictions and to align capital allocation for similar portfolios in different countries. In other words, BCBS was concerned about potential liberties some countries might have been taking in allowing their banks to use internal models to assess capital that in fact did not meet Basel thresholds. The move to more prescriptive, standardized modeling formulae should minimize the ability of aggressive banks or lenient supervisors to game the Basel system.