

Navigating Regulatory Uncertainty in 2025

Leveraging advanced technology and best practices in risk management to address evolving compliance challenges

Introduction

As we move deeper into 2025, regulatory demands are anticipated to remain a pressing concern for capital markets participants. Questions linger over how and if the current regulatory landscape might change due to US President Donald Trump's new policies that favor bank deregulation. Time will ultimately tell.

For now, firms across the globe are poised to continue contending with complex, evolving regulations such as the Markets in Financial Instruments Regulation (MiFIR) and the Fundamental Review of the Trading Book (FRTB). These frameworks are introducing updated rules, diverse go-live timelines, and substantial compliance challenges. To navigate this terrain effectively, financial institutions must keep tight control over risk to remain proactive and nimble to change. They must also prioritize investments in robust technological solutions and risk management practices that help them address evolving regulatory requirements.

Coping with the Current Regulatory Landscape

While the new US administration may phase out some regulations, many financial experts believe such changes will primarily affect rules still in development, leaving existing regulations largely intact. "Our take is that existing regulation will not see a significant rollback," said Stuart Plesser, a senior director monitoring US banks at S&P Global, in a recent Global Finance article¹. Thus, firms are likely to continue focusing on compliance

with the major regulations we are seeing today, including MiFIR, which seeks to bolster transparency and integrity within financial markets, and FRTB, which focuses on creating a standardized and risk-sensitive framework for trading book capital requirements.

Key Regulations to Address in 2025

Markets in Financial Instruments Regulation (MiFIR): MiFIR focuses on improving market transparency, investor protection, and overall efficiency in financial markets. As an extension of the MiFID II framework, it enforces stricter reporting requirements and trading obligations, particularly for over-the-counter (OTC) derivatives.

In 2024, changes were introduced to MiFIR aimed at strengthening market data transparency. This move has provided market participants with better access to the market data necessary to invest in financial instruments and helps increase the global competitiveness of the EU's capital markets. In 2025, firms will need to ensure that they are capable of meeting more stringent reporting guidelines and trading obligations introduced by the most recent iteration of MiFIR guidelines.

Fundamental Review of the Trading Book (FRTB): FRTB represents a comprehensive overhaul of trading book capital rules, requiring banks to adopt more rigorous approaches to market risk measurement. Firms must choose between the standardized approach (SA) or the Internal Model Approach (IMA), both of which entail significant operational and compliance challenges.

The phased adoption of FRTB across major jurisdictions—including the US, EU, and UK—illustrates the regulatory landscape's complexity. For example, only ten banks globally have committed to implementing the IMA due to its stringent requirements. These institutions recognize the potential capital savings and improved risk management offered by the IMA, but face challenges in securing supervisory approval and maintaining compliance.

If a bank's internal model fails to comply with IMA standards, it may be compelled to switch to the SA, which is generally less risk-sensitive and often results in higher capital charges. The increase in capital requirements when moving from IMA to SA can be substantial. For instance, estimates suggest² that the FRTB SA to FRTB IMA capital ratio by risk classes ranges from 1.5x to 1.8x, with corresponding percentages exceeding 76% and 50%, respectively.

Regulators may need to reconsider elements of the IMA to encourage broader adoption, while ensuring it achieves its intended risk management objectives.

Basel III and IV: In 2025, regulatory bodies are continuing to enforce stringent capital and liquidity requirements, such as those outlined under Basel III and Basel IV frameworks. Banks must now contend with substantial funding costs due to stricter regulations.

Many firms are finding Funding Valuation Adjustments (FVA) to be a helpful tool in complying with Basel regulations. FVA accurately incorporates the cost of funding derivative positions into pricing and risk management. While FVA is not a Basel requirement, many firms view it as a valuable enabler, helping them optimally allocate capital, and manage risk more efficiently.

Under Basel III, banks must maintain sufficient capital and manage liquidity risks, which FVA addresses by reflecting the true funding costs of uncollateralized or partially collateralized trades. By properly accounting for these costs, banks can optimize their funding strategies, improve capital efficiency, and ensure compliance with leverage ratio, liquidity coverage ratio (LCR), and net stable funding ratio (NSFR) requirements. This alignment may help to reduce regulatory capital charges and enhance risk transparency.

Challenges in Meeting Requirements

Capital markets firms traditionally grapple with a few core challenges as they strive to meet regulatory demands in the current landscape:

- **Sourcing Data for Relevant Risk Factors:** Obtaining accurate and comprehensive market data remains a significant hurdle. Firms must ensure that their data sources are reliable and up-to-date to support compliance efforts.
- **Building Robust Calculation Infrastructure:** The infrastructure required to process large volumes of data and perform complex risk calculations is both resource-intensive and technically demanding. Many banks' in-house systems struggle to keep up with these demands.
- **Generating Trustworthy and Explainable Outputs:** Regulators demand outputs that are not only accurate, but also transparent and replicable. Firms must demonstrate a clear understanding of their risk sources, validate their models, and establish control over the processes of generating these figures.

Addressing Regulatory Demands

Coping with upcoming regulatory demands boils down to proper preparation. Financial institutions can adopt several strategies to position themselves to adapt to evolving requirements and uncertainty.

- **Adopting Advanced Models for FRTB:** While the IMA may offer lower capital requirements, its adoption is hindered by the need to generate numerous calculations daily to measure capital requirements, as well as complying with stringent supervisory approvals, which can be revoked at any time if the bank fails the required risk tests. To encourage wider adoption, particularly in the US, regulators may refine the IMA framework, emphasizing its superior risk management benefits compared to simpler methodologies like the Standardized Approach (SA).
- **Strengthening Standard Initial Margin Model (SIMM) Implementation:** Regulators are increasingly focused on improving stress testing frameworks to address tail risks and adapt to changing risks, including counterparty credit risk (CCR). In 2024, the ISDA updated its SIMM methodology (version 2.7) and expects participants to adopt new versions promptly. Additionally, in 2025, the European Banking Authority (EBA) has outlined plans³ to enhance data infrastructure and introduce a central validation function in an effort to strengthen data management and ensure robust data infrastructures among participants.

- **Enhancing Funding Valuation Adjustment (FVA) Models:** More banks are realizing the value that FVA brings to the table in a compliance setting, particularly with regard to Basel's capital requirements. Precise FVA modeling enables banks to allocate funding costs accurately and mitigate liquidity risk, helping to simplify compliance efforts, while aiding the firm in maintaining profitability.
- **Embracing Technological Innovation:** Investments in advanced analytics, artificial intelligence (AI), and cloud-based platforms can streamline data processing, risk modeling, and compliance reporting. These technologies also offer scalability and agility, enabling firms to adapt to future regulatory changes efficiently

Regulatory Outlook 2025

The regulatory landscape for 2025 is marked by both complexity and uncertainty. Frameworks such as MiFIR, FRTB, and Basel guidelines impose significant compliance challenges, but also help foster resilience within financial markets. However, with the emergence of a new U.S. political administration, speculation surrounds whether certain regulations may be delayed or eliminated altogether.

To ensure that financial institutions are poised to handle any range of regulatory changes or uncertainty that come their way, they should prioritize cross-functional collaboration among risk, compliance, and technology departments and systems. Establishing integrated governance structures can help ensure that regulatory initiatives are implemented holistically, minimizing the risk of non-compliance. Another essential priority will be investing in advanced analytics and technologies, and adopting best practices in risk management, that can support firms in agilely navigating the rapidly evolving regulatory landscape.

¹Global Finance Magazine, Can Trump Fulfill Promise on Bank Deregulation?

<https://gfmag.com/economics-policy-regulation/trump-banking-financial-cryptocurrency-deregulation/>, December 26, 2024.

²SIFMA, Understanding the Proposed Changes to the US Capital Framework,

<https://www.sifma.org/resources/news/blog/understanding-the-proposed-changes-to-the-us-capital-framework/> August 28, 2023.

³European Banking Authority (EBA), Work Programme 2025,

<https://www.eba.europa.eu/sites/default/files/2024-09/a5bce431-7793-4b75-bd07-d5741c961fbe/EBA%20Work%20programme%202025.pdf>, September 2024.



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