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BCBS 239 Compliance

A catalyst for gaining
competitive advantage

Introduction

Background

One of the fundamental lessons learned from the financial crises which occurred from 2007 onwards was that information technology (IT) and data architectures within and across banks were inadequate to support the broad management of financial risks. Many banks were unable to aggregate risk exposures and identify concentrations quickly and accurately at a group level, across business lines and between legal entities. Banks were unable to manage and monitor their material risks properly as a result, something which seriously impaired their ability to take adequate, effective and

timely risk decisions. This has significant consequences for the banks themselves and for the entire financial system.

In response, the Basel Committee on Banking Supervision (BCBS) issued *Principles for Effective Risk Data Aggregation and Risk Reporting* (BCBS 239) to enhance banks' risk data aggregation capabilities and internal risk reporting practices.

Regulation

BCBS 239 presents a set of principles aimed at strengthening banks' governance frameworks, enterprise-wide risk data aggregation capabilities and internal

risk reporting practices. In turn, effective implementation of BCBS 239 is expected to enhance risk management and decision-making processes at banks. The principles provide descriptive guidance on the infrastructure and capacities that banks should have in place to improve the management of data and risk reporting. Banks are expected to be compliant with all principles, which are summarised in the table below, simultaneously and at all times.

Summary of BCBS Principles for Effective Risk Data Aggregation and Risk Reporting

| | |
|---|--|
| Governance and Infrastructure | <ul style="list-style-type: none"> • Robust governance structures should underpin risk data aggregation and reporting. • The bank's Board and senior management must understand deficiencies in internal controls and aggregated data. • Organisational boundaries must be overcome so risk data can be accurately aggregated across business lines, jurisdictions and legal entities in a timely manner. • Systems must support risk data aggregation and reporting, including – critically - during times of stress or crisis. |
| Risk data aggregation capabilities | <ul style="list-style-type: none"> • Banks must demonstrate the ability to generate accurate and reliable aggregated risk data, and largely through automated solutions in order to minimise errors. • The capabilities will also need to meet all on-demand and ad hoc reporting scenarios in a timely manner, including during crisis situations and in response to supervisory requests |
| Risk reporting practices | <ul style="list-style-type: none"> • Banks must ensure that reconciled, validated and accurate risk reports are presented to the appropriate stakeholders in a timely manner to support the decision making process. • The reports must cover all material risk areas within the organisation and be understandable for recipients. • All material gaps or weaknesses are well understood and factored into the decision making process. |
| Supervisory review, tools and cooperation | <ul style="list-style-type: none"> • Supervisors will review and monitor banks' compliance with the principles and use appropriate tools to ensure deficiencies are addressed in an effective and timely manner. • The supervisor should have the ability to restrict growth in a bank's risk-taking activities should it have concerns about data deficiencies. |

BCBS 239 places significant emphasis on data governance and promotes investment in frameworks and strategies to show improvement in banks' stewardship of critical data, and to ensure governance around end-to-end data and reporting management is established and adhered to at all time. Banks' data and IT architects must shift focus from solely functional analysis models to an approach whereby the sustained volume, velocity, timing and variety of data that is aggregated and processed produces meaningful measures of banking risks including regulatory compliance risks.

BCBS 239 has the potential to significantly impact banks' data and reporting management processes including:

- Financial Reporting (FINREP) and Common Reporting (COREP);
- IFRS9 and Pillar 3 disclosure requirements;
- Revisions to CRD IV, CRR and BRRD;
- MIFID II;
- EMIR;
- Stress Testing; and
- The SREP Process.

BCBS 239 was effective from 1st January 2016 for Global Systemically Important Banks (G-SIBs) while Other Systemically Important Banks (O-SIBs) are expected to be compliant three years after the date they become designated.



Competitive advantage

BCBS 239 sets clear expectations that banks will have adequate and robust data and reporting infrastructure, frameworks, policies, processes and controls in place to ensure banks can withstand a range of adverse scenarios including a surge in business volumes and potential crisis situations.

Effective and consistent implementation of BCBS 239 underpins sound risk management practices and decision-making processes, enhances the infrastructure for reporting material information (particularly that used by the Board and senior management to identify, monitor and manage risks), thus improving the resilience of the overall management system and potentially providing banks with a competitive advantage.

The business benefits of improved data aggregation and reporting go far beyond regulatory compliance. It can

- drive structural cost reductions, reduce losses through a simplified portfolio of data repositories and a faster time to market, as well as minimising the costs associated with poor-quality data (such as reporting that requires constant remediation);
- enhance the infrastructure for reporting key information, particularly for Board and senior management;
- improve the decision-making process throughout the organisation by enhancing the management of information across legal entities and at the group/consolidated level;
- reduce the probability of regulatory fines due to unreliable and untimely submission of returns;

- reduce the probability and severity of losses resulting from risk management weaknesses due to data inefficiency;
- improve transparency and outcomes of regulatory scrutiny and inspections;
- support strategic and holistic decision-making on risk appetite, therefore improve banks' risk return profile;
- improve management efficiency and the speed at which information is available;
- improve the organisation's quality of strategic planning and the ability to manage the risk of new products and services;
- improve cross-sell and client profitability through pricing, risk management, accurate quantification models, faster onboarding; and
- enhance capabilities of risk management quantifications that may result in the reduction in capital requirements and a profound liquidity and funding profile.

At a minimum, one thing is certain - poor quality, incomplete and inconsistent data and reporting is likely to put a serious strain on a bank's relationship with its supervisor and will lead to further scrutiny and challenge in respect of the effectiveness of risk management and governance processes in general.

Unlocking both the business and operational value of improved data governance, aggregation and reporting is the key to delivering results and achieving competitive advantages from the sizeable investments that BCBS 239 requires.

Compliance challenge

Despite significant investment in compliance and IT infrastructure in recent years, few are fully equipped to meet the requirements of today's regulatory environment and fast changing digital financial market in an automated and sustainable way, and yet regulations relating to timely and accurate reporting to regulators continues to increase.

Financial institutions of all sizes struggle to capture, master, and deliver data for risk and financial reporting. Financial institutions are still hampered by manual data collection, cleansing, and reconciliation processes, incomplete or inconsistent counterparty information, opaque definitions in respect of data quality, or weak quality controls. In addition, different risk types require data with varying degrees of granularity, further complicating issues of data consistency and quality. Such persistent weakness in banks' risk data aggregation and reporting capabilities stem from a variety of factors, including the following:

- **Insufficient data and reporting governance**

Insufficient data and reporting governance and controls is one of the most significant deficiencies within the banking system. This is most notable in the areas of data management frameworks and processes, dictionaries and taxonomies of risk data repositories as well as risk data ownership and responsibilities over the attendant quality controls.

- **Reliance of manual processes**

Siloed and legacy IT systems can force businesses to rely heavily on manual processes and interventions for producing reports unreliably and inconsistently. And in the same way that IT infrastructure tends to be inadequate in times of stress, manual workarounds can break down and inhibit a banks' ability to generate timely and accurate ad hoc data reports in crisis situations.

- **Volume and velocity of data and reporting**

Today's banks face competitive pressures that have management seeking more, faster and better information and knowledge in order to develop data-driven strategic insights and strategic plans. At the same time, regulators are also demanding more information either systematically or on an ad hoc basis as well as increased transparency and clear accountability.

- **Persistent data silos**

The challenges banks face in the areas of data governance, aggregation, and reporting have complex origins, but a principal cause is the proliferation of information silos within organisations. IT systems and applications have been developed and deployed over time to automate individual functions across multiple lines of business, geographic regions, and legal entities. As a result, Banks possesses multiple-layers of IT platforms that were built for dealing with increasing new regulations and requirements in a quick-fix manner, further complicating the issue.

- **Legacy systems**

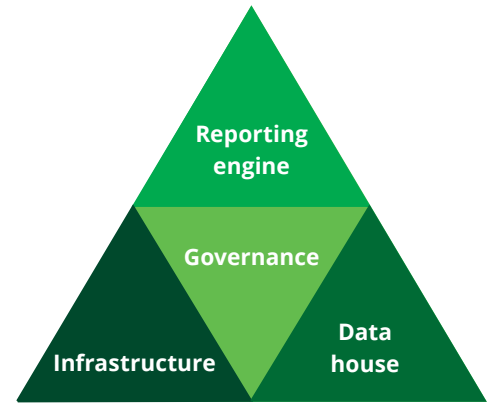
Banks' legacy systems usually do not integrate easily with one another or with newer systems, which leads to fragmented IT systems and applications. This further creates heterogeneous data sources, types, and formats within banks' data and reporting infrastructure. Furthermore, the rapidly growing volume of data required for risk modelling and reporting complicates most banks' data architectures.

Supervisors observe that making improvements in risk data aggregation capabilities and risk reporting practices remains a significant challenge for most banks. This is because IT systems, data and reporting processes require significant investments of financial and human resources with benefits that may only be realised over a prolonged period of time. We estimate that GSIB banks have a typical budget of between 100 and 150 million euro for the next three to five years, with O-SIBs having budgets of between 40 million and 80 million over the same time period. Aligning with BCBS 239 simultaneously is a lengthy and complex process, and we estimate that banks are budgeting for a minimum of 18 month to three years in order to be fully compliant. These are certainly very significant figures, warranting utmost care and strategic foresight to steer investments in a value-based way. Indeed, some banks are looking beyond the direct regulatory demands and complexity, considering how to leverage their investments and drive strategic opportunities, rather than just improving data and reporting capabilities. In short, they are focusing on uncovering what could drive the most value for their investment.

Strategic approach

As discussed above, it is clear that banks generally no longer view adhering to BCBS 239 as simply a compliance exercise. Most banks' management teams understand the need for a fundamental transformation in approach and have initiated projects, or amended existing projects, to ensure compliance with BCBS

239. Industry outreach has indicated that banks are dedicating significant resources to completing projects in this regard. The figure below illustrates some of the key themes that banks are concerning with and have in place significant resources for facilitating their projects.



| | Diagnostic assessment | Compliance design | Solution design | Solution development | Solution implementation | Post implementation review |
|---|---|--|--|---|---|----------------------------|
| Governance framework & quality assurance | Regulatory reporting control framework | Internal MIS reporting control framework | Data governance framework | IT & Data infrastructure governance framework | New product acquisition framework | |
| | Corporate data standard | Data & Reporting approval process | Reporting disclosure standard | Data & reporting validation framework | Data & reporting reconciliation framework | |
| Reporting production | Reporting acquisition framework | Reporting data specification | Reporting production framework | Reporting validation | Reporting exception management process | |
| | Reporting manual intervention process | Reporting interface management framework | Reporting reconciliation | | | |
| Data aggregation framework | Data Sourcing | Analytical data supporting framework | Data validation | Data exception management process | Data aggregation & processing | |
| | Data dictionary and taxonomy | Data reconciliation | | | | |
| IT and Data infrastructure | IT & data infrastructure Management framework | Data inventory management framework | Data verification management framework | Data profiling & cleansing management framework | Data architecture management framework | |
| | Data security management framework | | | | | |

Key lessons we have learned from financial institutions that have either fully implemented or initiated solutions, are outlined below:

Diagnose and examine banks' data and reporting architecture, capabilities and governance weakness at the outset

of the project by conducting enterprise, risk and business-wide gap assessments. Emphasis is focused on the observed weaknesses in complying with infrastructure requirements and banks' persistent inability to improve in this area, to determine whether the complexity of banks' IT architecture may have reached an unmanageable level and to consider reducing the complexity of their systems to aggregate risks in the required manner. Effective implementation of BCBS 239 goes beyond a compliance checklist approach, board and senior management in the bank should be able to determine their roadmap and strategy for achieving full compliance in line with their business strategy and risk management framework.

Strengthening data and reporting management governance framework, perceived to be

a quick fix solution. Establishing an enterprise-wide data governance structure is critical to the overall implementation of BCBS 239 program including defining roles and responsibilities, data ownership, end-to-end data and reporting governance frameworks and policies, along with process, procedures and controls.

Banks do not necessarily need to have one all-encompassing data and reporting model or a new infrastructure. Rather, there should be a robust end-to-end data and reporting governance framework and enhanced automation around all finance and risk related data and reporting management. Given the scale of most banks' existing IT infrastructure that comprise hundreds of applications deployed over thousands of physical servers this may be better addressed by automation and data ownership.

Enhance analytics capability and automated reporting. Today's business decision-making processes are under increasingly pressure of lack of 'knowledge' rather than 'data', which hinder banks' ability to tap data analytics and automation to improve their competitive advantage.

Upgrading existing IT infrastructure may prove to be more cost efficient for some banks. Appropriate assessment is a key to determine its capability and adaptability. Transforming an existing IT landscape is a long-lasting process, particularly developing high-quality yet tractable frameworks. Effective data management and reporting capabilities rest on bank's IT infrastructure, therefore a 'smart' IT architecture and infrastructure should not only be able to maintain and bridge with significant legacy systems and migration, but also possess capabilities of live and ad-hoc data function and reporting.

A high-degree of 'short-sight' risk in execution are highlighted by supervisors, it is possible that, in some circumstances, tactical mitigants, a short and quick approach, may be used to meet supervisory expectations of compliance over the near term, while longer-term projects are being pursued. However, neither long-term projects nor the use of short-term mitigants are excuses for non-compliance. It is important to emphasise quality over timeliness; that is, it is more important to ensure that banks develop high-quality infrastructure rather than resorting to "band-aid" solutions to meet the implementation deadline.

Independent evaluation of compliance should be carried out by an independent party when the implementation has completed to ensure all criteria have been met, deficiencies have mitigated and a full compliance has achieved.

Phased and piloted approaches are adopted by most institutions. Banks are cascading the scope of the effort down to individual legal entities or single material risk level to start the project and execute a full-scale implementation thereafter.

Establish a holistic 'data house' that managed by Chief Data Officer (CDO) who's responsible for combining accountability and responsibility for data governance, data protection and privacy, data quality and data life cycle management, along with the exploitation of data assets to create strategic value.

Conclusion

The benefits from aggregating risk data and processing go far beyond regulatory compliance, strategic implementation of BCBS 239 will create a common language that encourages unprecedented alignment between risk and finance, drive banks towards transforming their risk management practices to respond better to economic distress. It ultimately helps banks to reap the full benefits the BCBS 239 investment through effective corporate governance practices, therefore resulting in enhanced profitability and competitive advantage.

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