WHITE PAPER

‘Future-proofing’ Compliance: Lessons for Global Banks from a Visionary Regulator.

Even as the global banking regulatory landscape witnesses rapid evolution, since the last few years India’s primary regulator, the Reserve Bank of India (RBI) has been diligently dispensing some of the most critical compliance and risk regulations. Though there has been considerable opposition from the financial services industry, most regulations have invariably been implemented in some fashion or the other.

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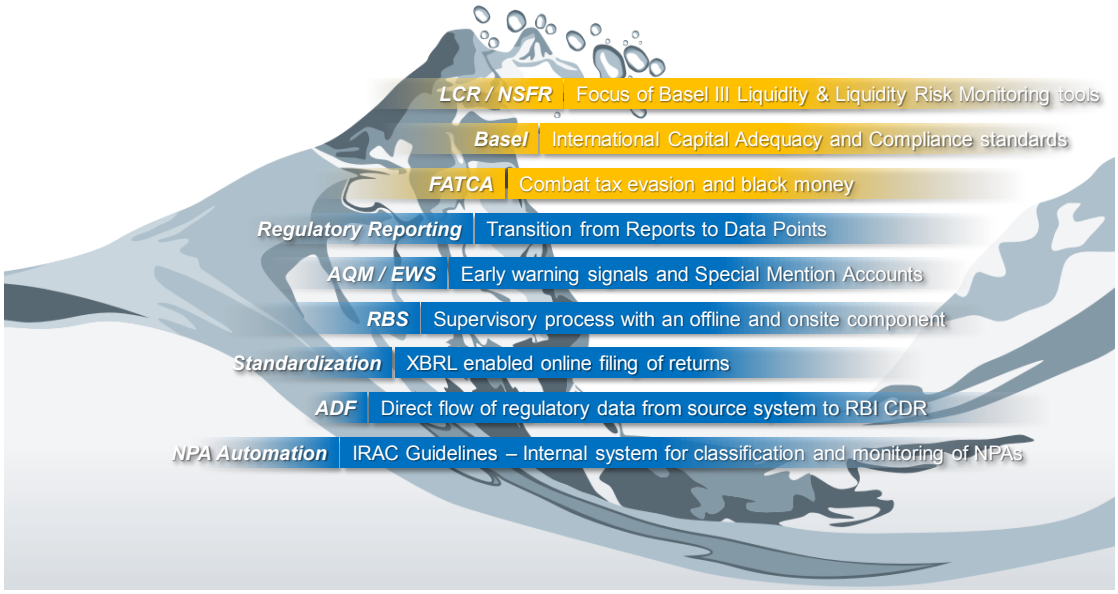
A key point here is that during the initial phases of the regulatory wave, the RBI first introduced local measures (including data stabilization measures) and then focussed on global initiatives such as FATCA, Basel III and LCR/NSFR. The primary motivation was to first stabilize the banking industry internally and prepare banks to reach a level where complying with global initiatives meant leveraging the implementation efforts previously invested for local measures.



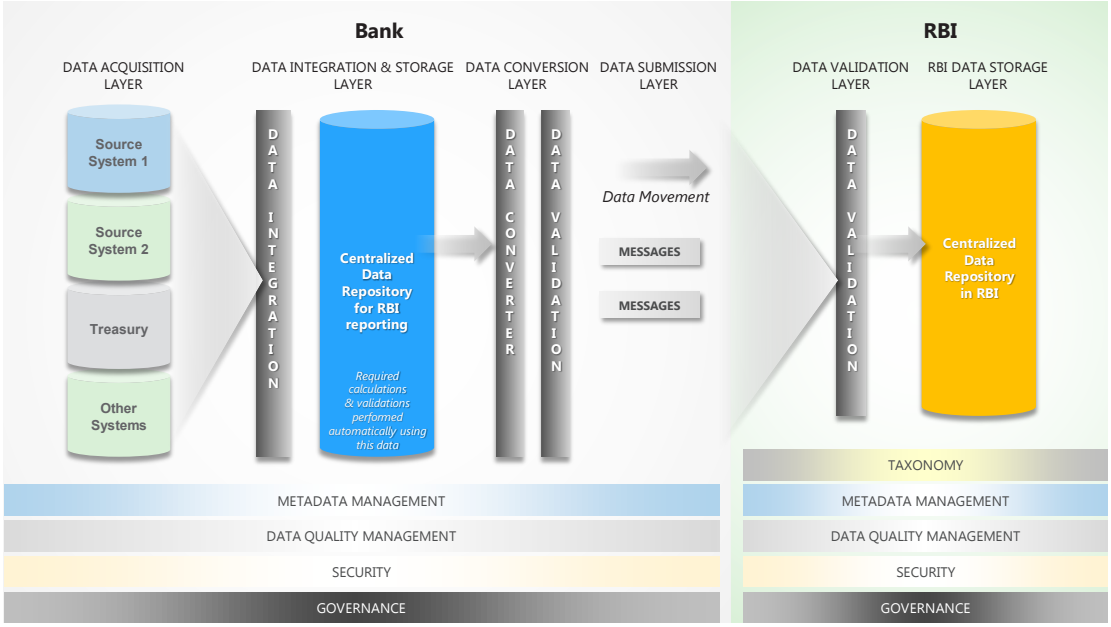
Wave of Indian regulations during the last 7 years.

By introducing regulations in a phased fashion, the regulator played a visionary role in strengthening the financial stability of the banking sector – by progressively assessing the banks' maturity levels first, before ushering in newer and challenging global regulations. Currently, banks in emerging but dynamic economies such as Africa, the GCC and South-East Asia are faced with the same dilemma – that of having to comply with overwhelming and demanding global regulations. If the India story can be appreciated as an example of a proven best practice in regulatory compliance, then it becomes fundamental for banks in emerging economies to stabilize locally first before moving to a global regime.

This article analyses the Indian regulator's vision by using Automated Data Flow (ADF) as an example and how it helped banks lay the foundation to becoming 'compliance-proof'.

ADF: From paper to paradigm.

In an 'approach paper' published in 2010, the RBI asked banks to build a Central Data Repository (CDR), for data to flow in automatically from all of the bank's source systems. The automation was to ensure that the data required for RBI mandated regulatory reports is fed seamlessly from bank's source systems, eliminating manual intervention in the process. At the time, most Indian banks were manually preparing and submitting these reports to RBI, with serious redundancies and inaccuracies in the process. With a multitude of source systems, over 200 reports and regulatory scrutiny at each juncture of the data flow, ADF seemed virtually impossible.



Conceptual architecture for automating data submission to the regulator.

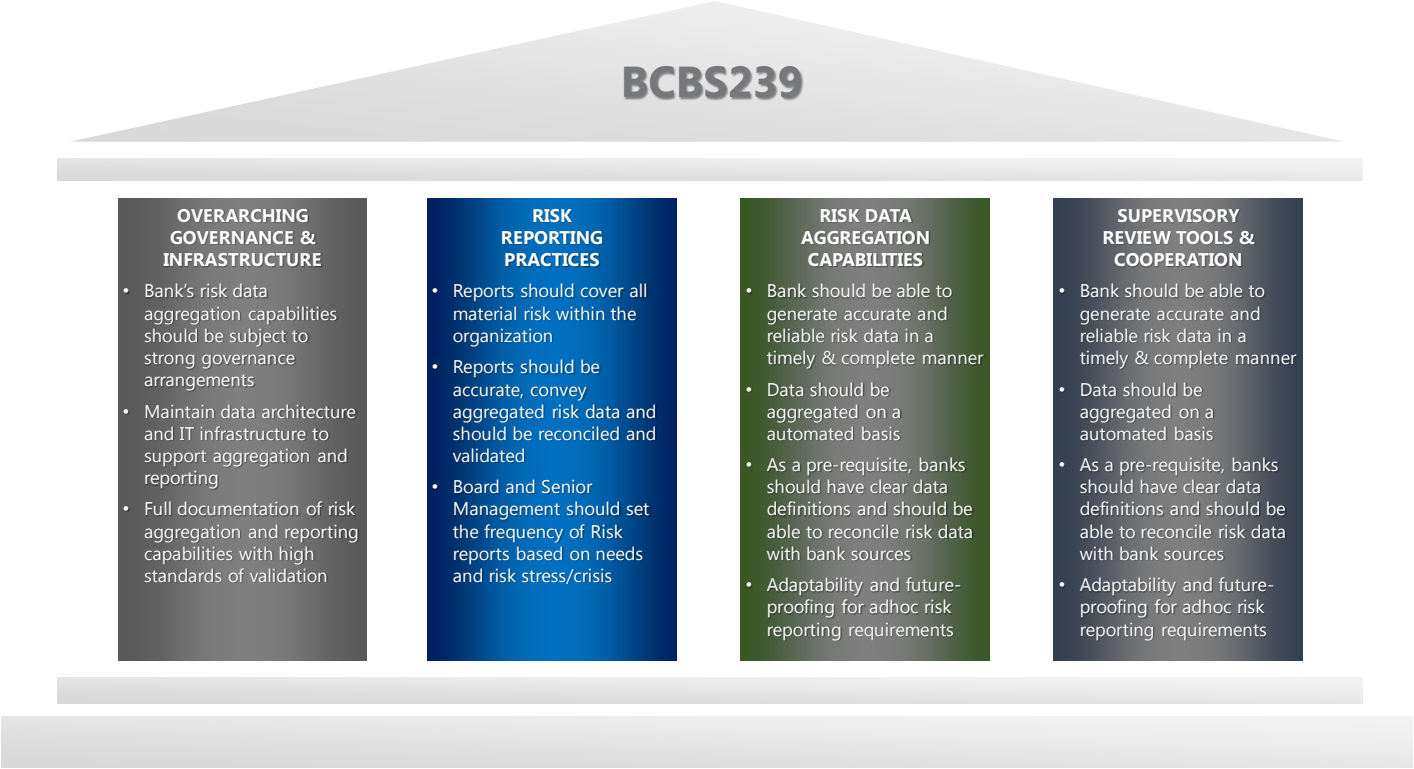
The brilliance of RBI's approach paper was not just about the recommendation (of automating data flow from source to report generation). It was about the deep analysis and roadmap it provided in terms of the 'hows' and 'whys' of implementation. The paper also suggested two approaches - a standard one for banks with little or no infrastructure for automation; and a variable approach for banks with some automation already in place. In addition, for an industry in in its nascent stages of evolution in terms of data, defining the data acquisition, data integration, data conversion and submission layer, also helped the banks substantially to create an achievable roadmap.

It is almost five years since ADF came about and most Indian banks are at an advanced stage of achieving compliance. They have already begun submitting automated reports either using in-house capabilities or via solution vendors. Moreover, the regulation itself has evolved further with the introduction of XBRL submissions to further reduce redundancies and operational errors.

BCBS 239: Going beyond principles.

One of the lessons learnt from the financial crisis was that banks had woefully inadequate data and systems to manage and report risk. Most banks lacked quality data and minimal risk information, for instance concentrations at industry and banking group level. These issues, especially during turbulent times dramatically increased the chances of failure.

Basel Committee on Banking Supervision (BCBS) 239: Principles for Effective Risk Data Aggregation and Risk Reporting (commonly referred to as the 14 Principles of BCBS 239) was introduced primarily to enable banks with better risk data aggregation and reporting capabilities. An important point to note here is that BCBS 239 is only applicable to G-SIBs (Global Systematically Important Banks) and suggested that national supervisors apply the principles to D-SIBs (Domestic SIBs).



The four pillars of BCBS 239.

BCBS 239 focusses on four areas: Overarching Governance and Infrastructure, Risk Data Aggregation Capabilities, Risk Reporting Practices and Supervisory Review Tools. The underlying requirement remains same – Data. The regulation requires that banks get "Risk" data equipped and move from a fragmented business level/entity level/system level approach to a more consolidated level aggregation and reporting. Also, it requires banks to reconcile risk reports with source data.

The regulation is only a set of principles and does not provide a specific approach to achieve an end state for reporting capabilities.

Let's examine the BCBS 239 principles vis-à-vis RBI's ADF guidelines.

	BCBS 239 Principles	Mapping with RBI's ADF
OVERARCHING GOVERNANCE AND INFRASTRUCTURE	**Governance**	› Proposed Returns Governance Group (RPG) and Data Governance Group (DGG). › RGG should have representation from areas related to compliance, business and technology. › DGG, for the returns submission process, must consist of members from IT, Compliance department and each of the business groups owning the data within the bank.
	Data Architecture and Infrastructure	› Recommends a standard and a variation approach based on bank's level of maturity. › Provides clear and concise end state for data flow - › Data Acquisition → Data Integration → Data Conversion → Reporting
RISK DATA AGGREGATION CAPABILITIES	**Accuracy and Integrity**	› The Data Conversion Layer performs validations on data to ensure accuracy of returns. › RBI also envisages to move to XBRL submission which in turn would result in accuracy of reports. › "Dictionary" of concepts as mentioned in BCBS 239 is essentially the combination of business rules and master data proposed by RBI.
	Completeness	› Data acquisition layer will ensure higher data quality and higher coverage of source data by the systems. › Since RBI mandates an end state which has complete automation of returns, the data required needs to be complete, irrespective of on-balance sheet or off-balance sheet.
	Timeliness	› The availability of data elements may be matched with the frequency prescribed by RBI for the relative returns.
	Adaptability	› Centralized Data Repository will have a wealth of data that can easily be leveraged by the bank for internal reporting purposes. › For ad hoc requests, if the data is readily available in the repository, the data conversion layer can be used to create the ad-hoc data/requests directly. › If the data is not found in the repository, the additional data element must be sourced for future use.
RISK REPORTING CAPABILITIES	**Reporting Accuracy**	› RBI requires banks to provide detailed audit trail to cover the entire submission process. The audit trail must provide the ability to re-create the return if required in a controlled manner and also offer itself to detailed audit functions. › Some common validations like basic data checks, format and consistency validations, abnormal data variation analysis, reconciliation checks, exception report, etc. would be required to be done at Data Acquisition Layer.
	Comprehensiveness	› There are 223 RBI mandated reports for banks which include risk reports such as: Large Exposures, Structural Liquidity, Country Exposure, Interest Rate Sensitivity, Modified Duration, CAPAD, etc. › The coverage of reports under ADF is comprehensive with enough focus on Risk. › RBI also initiated the Risk Based Supervision wherein risk related data points have to be submitted to RBI on a frequent basis.
	Clarity and Usefulness	› The report coverage under ADF has been defined keeping utility in mind. › RBI also requests banks with ad hoc reports during audits. › Most banks have leveraged the same ADF infrastructure for internal management and board level risk reporting.
	Frequency	› The reporting frequency for each report is pre-defined by RBI. › The frequency of data extraction from source is dependent on the frequency of report
	Distribution	› With a harmonized metadata in the bank at the data integration & storage layer a smooth communication and distribution within the organization can be achieved.
SUPERVISORY REVIEW TOOL AND COOPERATION	**Supervisory Review**	› Clear supervisory guidelines defined for RRG (Returns Governance Group) for each layer of submission process. › Offers 3 models for Data Governance and Process Review namely Process Based, Subject Area Based and Region Based Models.
	Remedial Actions and Supervisory Measures	› RBI requires the banks to define a detailed change management process. › Change management process to be defined for either changes initiated by RBI for the returns or changes in the source systems/business.
	Home/Host Cooperation	› Although this is irrelevant from RBI's local regulatory reporting, RBI does not interfere with submission requirement of local banks with foreign subsidiaries/branches.

The need for strategic, comprehensive and implementable guidelines.

While both regulations require banks to automate the process of data aggregation, there are certain fundamental differences.

An approach paper v/s principles. While BCBS 239 is a set of 14 principles which theoretically every bank should follow for data aggregation and reporting, it does not provide an implementation roadmap for banks. On the other hand RBI took a step forward by providing an implementation roadmap with clear guidelines on data acquisition, integration, conversion and submission.

RBI published ADF as a 'consultative' paper primarily to reduce the consulting spends by banks before implementing a holistic automated reporting solution. Currently, most of the G-SIBs are still behind the curve on BCBS 239 due to the time spent by these banks to understand the regulations rather than implement the solution. But India was a completely different situation as RBI not only published the guidelines, but also included a clear end-state along with the implementation methodology.

Data and report coverage. BCBS 239 is risk aggregation and risk reporting focussed, whereas ADF focusses on the whole gamut of data. For example, priority sector lending reports or branch statistics report is a part of Indian Regulatory Reporting which come under ADF. All the data acquired for regulatory reporting in an automated fashion can be easily utilized for higher level risk reporting and analysis (risk modelling, scenario analysis, stress testing, etc.) So the overall coverage of reporting, data extraction and conversion is much more in ADF when compared to BCBS 239.

Target coverage. The target coverage for BCBS 239 is only G-SIBs which are already at a mature stage in terms of data aggregation. But ADF doesn't differentiate between the target audiences in terms of size. All scheduled commercial banks in India have to mandatorily comply with ADF requirements.

New banks, which acquired banking licences recently, too have to provide a clear roadmap for ADF implementation. So, the clear mandate from RBI is to bring all banks to a common end-state data infrastructure. Viewing it from a bank's perspective, a bank in the initial phases of technological advancement might not even have enough data in its source systems to cater to the reporting requirements, which makes ADF implementation a tedious and lengthy process. So, it was RBI's accelerated thinking which culminated into an extensive ADF approach, which caters to all banks irrespective of technological maturity.

Future-proofing. Technically BCBS 239 impacts only the large banks (G-SIBs) whereas ADF is applicable to all banks in India irrespective of size and structure. But regulations such as Basel, FATCA or for that matter domestic regulatory reporting, are applicable to all banks of all sizes. Since BCBS is a framework mandated only for the G-SIBs, smaller banks would not adhere to same and for every new regulatory requirement have to think of a new solution or implementation methodology. On the other hand, ADF being forced into all scheduled commercial banks, has already prepared these banks in terms of data requirements and thus would help them fasten the process of complying with any new local or global regulations.

Can banking regulators in emerging economies do an ADF?

Published well before BCBS 239, RBI's ADF approach paper not only covered all the principles of BCBS 239, but also had the vision to accommodate smooth transitioning into newer regulatory realms. ADF's coverage is not limited to just Risk data aggregation and reporting but covers all aspects of compliance and risk, which makes it a much more comprehensive reporting requirement.

ADF is now a mandatory requirement for all Indian banks irrespective of size or technological maturity. This makes it a cumbersome process for banks in the initial phases of technological advancement. But since an end state has been specified, banks have no choice but to completely automate the process right from data acquisition through to report submission. Undoubtedly a game changer in the Indian banking regulation space, ADF has helped Indian banks prepare themselves for future regulations (whether local or global).

RBI's visionary mandate was two pronged: stabilizing the country's banking sector to prepare for stringent global regulations and force banks to create a data ecosystem in preparation for future regulatory requirements. Regulators in other emerging economies could very well take a cue from RBI's far-sightedness and strengthen not only the nation's banking ecosystem but also the banks. This may seem overambitious and unnecessary on the face of it, but it will definitely deliver immense benefits in the long term, like it has for one of the world's progressive economies.

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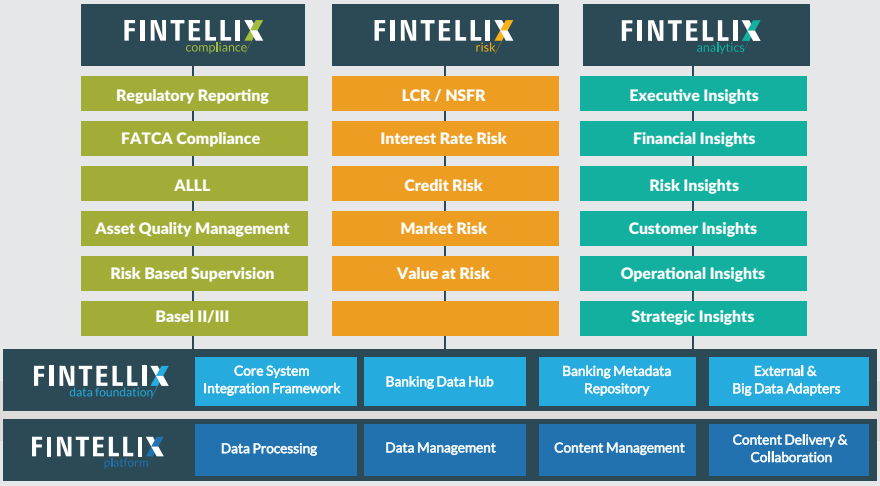

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