The challenging requirements of regulatory reporting for financial institutions

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Vlerick Policy Paper Series, workshop proceedings

Today's topic: The new regulatory framework that followed the crisis of 2008 has huge implications for financial institutions. Complying with all the new rules is challenging for banks and insurance companies.

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On the side of banks, the CRD IV Package within the Single Supervisory Mechanism sets minimum standards with respect to capital ratios, capital quality and liquidity management. In this context, banks within the Eurozone now need to report to the ECB and show that they comply with these standards. The European Banking Authority (EBA) has been mandated to set up uniform reporting requirements for all banks in the EU, under a regulation called 'ITS on supervisory reporting' (Implementing Technical Standards on supervisory reporting). These requirements present a considerable additional burden to the already demanding data and systems needed to be compliant with the International Financial Reporting Standards (IFRS), as emphasized by the European Banking Federation (EBF)(1).

The good news is that these requirements should ensure a full harmonization of prudential reporting requirements among banks within the EU, which should facilitate life for banks, active in several member states. It remains however an open question if local supervisors will restrain from asking supplementary information, specifically in non-EURO member states. Besides the regular reporting, banks are confronted with specific demands, such as stress testing, AQR reporting, or any other information which the supervisor considers necessary to fulfil its supervisory tasks. As this information needs to be delivered on sometimes short notice, they put an additional pressure on reporting departments and are challenging to achieve an acceptable data quality. Furthermore, not only the micro prudential supervisor is imposing reporting. Also the monetary authority, the macro prudential supervisor, the ESRB, public statistical services, tax authorities, market conduct supervisors, deposit guarantee schemes, resolution authorities, etc. can ask for additional information, which is often overlapping with other reporting, but which has to be delivered in a different format and timing.

In addition, with these requirements come other regulatory constraints that relate to reporting. As an illustration, BCBS 239 principles imposed strong constraints on the capacity of banks to aggregate risk data. On a rather short timeline (3 years between 2013 and

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2016), banks had to adapt their governance systems, IT infrastructures, reporting tools and internal control mechanisms to make sure they comply with these principles. Data security and privacy are other issues that also arise with newly introduced reporting requirements.

Insurance companies are facing the same issues: disclosure requirements is one of the pillars of Solvency II, and the European Insurance and Occupational Authority (EIOPA) is working on a harmonized EU-wide reporting format to ensure a consistent implementation of European regulatory and supervisory frameworks. And as insurance companies are increasingly considered as potentially "systemically important" institutions, additional reporting requirements are to be expected.

One important source of difficulty for financial institutions is the fact that these reporting requirements are ever changing. In December 2013, the EBA published a final draft Technical Standards on metrics for monitoring additional liquidity. Since then, every year the EBA issues updates and revisions on these standards. And insurance companies face the same obstacle: the EIOPA plans the release of one reporting taxonomy per year. It is therefore essential for both banks and insurers to always make sure that they are up-to-date on the latest revisions of data reporting requirements.

These requirements take a significant part into the tsunami of new regulations that followed the crisis. As a result, compliance officers become the hottest areas of financial recruitment, as indicated by the Financial Times (2). Banks massively recruit compliance profiles. And the role of compliance staff members is increasing within banks. Financial institutions rethink the role of the compliance department within their organization also in charge of compliance with regulatory reporting.

Some of the issues discussed during this workshop were:

- How can supervisors and regulators organize the requirements in a more efficient and effective way?
- How can banks and insurance companies deal with the constant evolution of these requirements?
- What role should the compliance department play in product and business development?
- Which IT solutions are available to reduce the reporting burden and improve the data quality?
- How should banks and insurance companies adapt their internal organization?

The workshop was based on 4 introductions by professionals from the financial businesses, consultants or regulators. After each introduction followed a Q&A, and the workshop was closed with a panel discussion. The introductory remarks were presented by:

- Wilfried Wilms, Senior Policy Advisor of European Banking Federation (EBF)
- Gino Coene, Industry Leader Risk Management at SAS
- Ruben Olieslagers, Head of Capital and Business Management at BNP Paribas Fortis
- Giancarlo Pellizarri, Head of Supervisory Statistics Division at ECB

The challenge of regulatory reporting for banks

Wilfried Wilms (EBF) pointed to the fact that banks have to produce reporting for different purposes: financial reporting (IFRS), supervisory reporting, statistical reporting, transaction reporting and many other types of reporting at local level. Even within the supervisory reporting, banks have to report to up to 7 different regulatory or supervisory authorities at EU level (Eurostat, EU legislator, European Banking Authority, European Central bank,

European Systemic Risk Board, European Securities and Market Authority, Single Supervisory Mechanism). Each of these authorities organizes regular reporting streams, but can also ask for ad-hoc reporting when the authority wants more detailed information.

"What if the one holding the trigger, is using various visors?" Wilfried Wilms, EBF

The main issue is a lack of coordination: they each use their own criteria and definitions, own level of detail, own calendars and own technical formats. The consequences are many duplications and overlaps and extreme difficulty to automate the data collection process.

Even where the EU tries to get to full harmonization, for example by mandating the European banking Authority to build a "single rule book", local supervisors do not hesitate to ask for supplementary reporting. On top of that, the "single rule book" only concerns regulatory reporting, while statistical reporting remains out of scope.

> "*One single rulebook? There is a huge risk of national regulators saying Thank you, but this is not what we need."* Giancarlo Pellizarri, ECB

Specifically small and less complex banks have increasing problems to comply with the multitude of requirements. In May 2016, Commissioner Hill confirmed his efforts "to be more ambitious about reducing reporting and disclosure requirements where it's appropriate", but it remains to be seen if this will be possible. On the contrary, regulatory authorities continue to ask for even more detailed information and up to transaction level data, as the proposal of AnaCredit by the ECB illustrates.

Can IT bring a solution to the increasing reporting requirements?

Gino Coene (SAS) explains the complex chain of reporting: from Data Preparation to Data Collection, to Data Quality Check, to Allocation of data to reporting cells, to Report Validation, to Report Generation and finally to send reports in due form. A fully integrated IT framework to produce the reports is possible, but is expensive and requires years of preparation. The data Point Model, proposed by EBA is a possible way forward to such architecture but will take a lot of time.

> "*First, you have to put a logic into place to filter your information.*" Gino Coene (SAS)

Any reporting tool should have 10 features according to Gino Coene:

- Able to define capture rules to collect information
- Able to define allocation rules of information to cells
- Able to feed and visualize information in the Data Point Model

- Able to do variance analysis on changes over time to check the numbers
- Able to drill down the underlying information for a cell
- Able to manually adjust
- Have a workflow support to track progress in delivering reports
- Generate the supervisory format (XBRL, XML, XL,…)
- Produce user friendly output

The system should consist of two parts: a regulatory reporting tool for all reports, and a regulator specific configuration. Regulatory updates should only impact the second part.

There is an increasing trend to integrate risk and finance reporting, building a single source of data for all reporting requirements. Furthermore there is a shift of focus from reporting templates to "data & process management". The industry will have to live with the fact that supervisors will increasingly ask for more granular data, which could lead to concerns about confidentiality. As a consequence it is essential to have a specialized regulatory compliance team to cope with the ever increasing complexity.

The dream of reporting confronted with the reality

Ruben Olieslagers (BNP PF) describes the practical challenges in a bank to comply with the reporting rules in a bank. A large number of reporting has to be made, and cross border banking groups have to cope with several regulatory regimes, each with its own specific reporting definition. The existing processes and systems are not adapted to cope with these new reporting demands, which lead to multiple data sources, data types and data formats and potential problems with data quality.

The reporting becomes specifically challenging in a number of cases:

- When the regulation accepts a "faze in", but the market expects immediate implementation
- When the exact form of some ratio's still needs to be set, but the banks already has to implement a calculation (for example the leverage ratio)
- When rules and reforms are conflicting or overlapping (for example Basel III versus IFRS).

In order to reduce the pressure on reporting requirements, there is no other solution than:

- To be involved at an early stage when regulators develop new requirements
- To be willing to reduce or close certain activities if reporting burden becomes too expensive
- To bring the necessary skills together and use a project approach
- To accept ad hoc solutions in a first stage
- To dedicate extra resources to reporting

IT solutions are welcome but sometimes complex to build because of legacy systems. On top of that, IT resources in a bank are limited. Outsourcing/Off shoring is sometimes the easiest way forward.

> *"We need to break with the concept of different reports by different departments that don't talk to each other."* Ruben Olieslagers, BNP PF

In general, need for awareness and commitment at the highest level to regulatory and reporting issues is essential. The CDO (Chief Data Officer) should play an important role in

defining the priorities and resources. It has to be understood that regulatory information can also support Business Decision Making.

The regulatory point of view

Giancarlo Pellizarri (ECB) is well aware of the complexity of the reporting processes. Data Quality is of the utmost importance. As Head of the Supervisory Statistics Division of the ECB, he explains the efforts of his department in checking the data quality of all received reports. The framework for checking data quality is the BCBS (Basel Committee on Banking Supervision) regulation 239.

> *"Can you imagine any other type of organisation being sloppy on reporting chunks of €25.000?"* Giancarlo Pellizarri (ECB)

The ECB Data Quality Framework checks the accuracy and reliability of data, the completeness, the punctuality, the consistency, the plausibility and the stability of the received reports. Very often, simple checks point already to insufficient data quality provided by banks.

The ECB bank supervisory statistics will be further developed in the future with more details and tools and functionalities for analytical purposes. That will potentially require more data also.

The process of streamlining reporting requirements from different supervisors/regulators should be encouraged, but we have to be aware that different authorities have different needs and concerns, leading to differences in data requirements. In general, there is a fundamental difference between statistical and supervisory reporting. Statistical reporting is essentially based on a bottom up approach while the supervisory reporting is more top down. A supplementary problem is that streamlining requires clear and identical definitions of concepts. So for example statistics about options could be based on nominal value, market value, model value, etc.

In the future, the reporting requirements will further evolve and concepts such as interoperability of data, integration of data and need for transparency will become more important, but data quality remains a corner stone of good reporting and remains a challenge for banks.

More cooperation among banks

During the general discussion, several participants wondered if more cooperation among banks would not bring more efficiency and reduce costs, for example by mutualizing part of the reporting chain. While this was considered an interesting idea, the complexity should not be underestimated as it requires agreement about very precise standards.

> "*This individual approach is good for consultants, but what can we gain if we do things collectively?*" Ben Coumans, Ageas

Also the block chain technology was considered as an interesting potential tool to increase the efficiency of reporting, but it is probably still too early to implement.

> "*What if several best solutions don't talk to each other? Could a blockchain be reviewed as a solution to share ledgers?"* Gino Coene, SAS