A THOMSON REUTERS FINANCIAL & RISK WHITE PAPER

BCBS 239 – THE STARTING LINE, NOT THE FINISH

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"Few industries have the reach and impact that finance does. People may choose not to own a car, be lucky enough to avoid hospitals, or never take a flight. But just about everybody deals with finance in one way or another – which explains why in the aftermath of the financial crisis, calls for change were loud and impossible to ignore."

Yet financial services is not the only industry to have adopted new practices following unanticipated events. Other industries have used crises of various sorts as a springboard for change, and their efforts could serve as a model for financial services firms as they prepare for the future.

Recent cases within the motor vehicle industry, such as safety problems faced by Toyota and GM and Volkswagen's emissions scandal, have forced companies to operate very differently in their processes and handlings of incidents.

Banks too have been forced to change practices that pushed some to the brink of collapse during the financial crisis. Regulators are mandating change in the way firms manage risk and compliance and are driving timelines. However, putting new processes in place will take time and money. Banking is no stranger to crisis, and this is not the first time the industry has been forced to change. After the banking failures of the great depression, the tighter rules imposed delivered a stronger and more resilient industry that went on to fuel America's postwar boom. This time around, there will also be positives to counter the unintended consequences of regulation.

Change imposed from outside can enable an industry to transform, giving impetus to invest in the future. Whilst the regulations impact the world's systemically important banks first, ultimately national regulations will follow to address shortcomings seen in domestically important institutions.

BCBS 239: THE RULES

As the financial crisis unfolded, how many banks could tell at the push of a button what their aggregate risk exposure was to Lehman Brothers or Bear Stearns as the financial crisis emerged? Operating with hundreds of platforms, using siloed datasets for different business lines and with no common identifiers or asset definitions, it took many firms weeks to determine their full, corporate level of risk exposure. Fast-forward to today and there are teams still unravelling the consequences of these particular banking failures. This is precisely what the Basel Committee on Banking Supervision is seeking to address.

BCBS 239 is designed[1] to remedy the risk data aggregation and risk reporting failings exposed during the crisis. Due to take effect in January 2016, it introduces a set of 14 best practice principles spread across four closely related topics:

- **i) Overarching governance and infrastructure**
- **ii) Risk data aggregation capabilities**
- **iii) Risk reporting practices**
- **iv) Supervisory review, tools and cooperation**

The goal is to enhance a bank's risk management and decision processes, data quality, flexibility and agility when it comes to risk aggregation at a corporate level. To do this, banks need to capture and aggregate risk data across business lines and legal entities, and not only demonstrate the ability to perform effective and regular risk management, but also to conduct ad hoc risk assessments (e.g., of critical credit, market and liquidity positions and exposures during times of stress and crisis). For some organisations, achieving compliance will entail a fundamental review of their data structures, processes and systems.

According to the Basel Committee, banks "should establish integrated data taxonomies and architecture across the banking group, which includes information on the characteristics of the data (metadata), as well as use of single identifiers and/or unified naming conventions for data including legal entities, counterparties, customers and accounts." This signals the importance of holistic, enterprise-wide data management to deliver the accuracy and integrity of aggregated risk data, required to produce the required risk reporting during times of stress or crisis.

[1] *Principles for effective risk data aggregation and risk reporting*, BCBS, released in January 2013

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—Basel Committee

Robust governance and oversight of banks' risk data, systems, policies and procedures is a central plank of the regulation. Currently, risk data stakeholders often sit across disparate parts of the organisation, including risk management, finance, IT and data operations. In response, many institutions have appointed a Chief Data Officer to own overall data governance across the firm.

So what are the opportunities?

OBSTACLE COURSE OR HURDLES?

Complying with BCBS 239 is a substantial and complex undertaking that calls for a strategic, enterprise-wide approach to the way banks handle their data governance, lineage and architecture. Meeting the requirements is turning out to be harder than first thought. A recent Basel Committee survey[2] found that 14 systemically important global banks believe they will not be ready for the 2016 implementation deadline, up from 10 in 2013.

Meeting the requirements is not optional – but there are many ways to achieve it. As with most things, outcomes are influenced by attitudes. If BCBS 239 is seen as an onerous intrusion into an already complicated business, the solutions put in place to meet it may end up meeting benchmarks without fostering a deeper change in the way a bank does business. Banks need to adhere to the letter of the law, but it is the spirit of the law that creates the opportunities.

The challenges individual banks face will vary depending on what systems they already have in place. Firms that can already aggregate risk at a corporate level have a head start. Those running risk-management processes along business lines, using multiple, siloed and unconnected databases, will struggle to manage data, hampering efforts at corporate or regional risk exposure analysis. For these firms, compliance will demand architectural, infrastructural, cultural, organisational and process changes.

" The benefits of being able to slice and dice risk data across the firm are relatively untapped due to the complexity of banking systems and databases."

The benefits of being able to slice and dice risk data across the firm are relatively untapped due to the complexity of banking systems and databases. In addition, aggregating data for risk reporting will open up opportunities to proactively use this data to drive better business decisions to better manage risk, allocate capital or identify fresh business opportunities.

" Having access to the full spectrum of data representing business activity across the corporation will allow organisations to gain insights never available to them before."

The key is to use the mandate as an opportunity to build a business infrastructure to serve the future. Having access to the full spectrum of data representing business activity across the corporation will allow organisations to gain insights never available to them before.

[2] *Progress in adopting the principles for effective risk data aggregation and risk reporting*, BCBS, January 2015, http://www.bis.org/bcbs/publ/d308.pdf

BASEL GOALS ARE THE RECORD TO BEAT

By seeing BCBS 239 as the starting line and not the finish line, banks will not only be better prepared to handle future market events, but will be able to do business differently. Some of the benefits are:

BETTER DECISION MAKING

Having a comprehensive assessment of risk exposures across legal entities and at a consolidated corporate level will allow banks to conduct flexible and effective stress testing, risk analysis, strategic planning and resource allocation, and better anticipate problems and opportunities. Making vital information available faster will enable a more rapid and reliable response in a future crisis.

PERFORMANCE IMPROVEMENT

Accurate and timely risk data aggregation and reporting generates important insights for management about the internal performance of individual employees, business lines and the firm as a whole. This can aid increased efficiency and profitability.

ENHANCED CUSTOMER SERVICE

Generating more detailed and comprehensive views of customer activities, organisations can better understand and serve their clients and improve customer service.

ROBUST RISK MANAGEMENT

Effectively identifying, monitoring and managing risks throughout the organisation allows banks to take faster remedial action where required, and reduce the probability and severity of losses.

CAPITAL EFFICIENCY

A recent EY report[3] notes that banks with risk management deficiencies may come under more intense supervisory focus, and become subject to more onerous capital set-asides and limits on their risk-taking activities.

STREAMLINE MULTIPLE COMPLIANCE PROJECTS

The EY report points to links and capability overlaps between BCBS 239 and other regulatory reporting and disclosure initiatives, such as global stress testing exercises, the Basel Committee's Fundamental Review of the Trading Book and the UK's Senior Manager Regime. By crafting a strategic, coordinated risk data aggregation and reporting framework to comply with BCBS 239, banks will be well-positioned to meet many of their other regulatory responsibilities and avoid making siloed, duplicative investments.

VALUE INCREASE

The ability to identify and consolidate exposures across the enterprise should make organisations more financially and operationally stable. According to the Basel Committee's report: "Strong risk management capabilities are an integral part of the franchise value of a bank. Effective implementation of the Principles should increase the value of the bank."

[3] *BCBS 239 Risk data aggregation and reporting: A practical path to compliance and delivering business value*, Ernst & Young, February 2015, http://www.ey.com/Publication/vwLUAssets/EY-bcbs-239-risk-data-aggregation-reporting-AU/$FILE/EY-bcbs-239-risk-data-aggregation-reporting-AU.pdf

TRAINING REGIMES – YOU GET OUT WHAT YOU PUT IN

Many banks today have a wealth of information, in places that are hard to access with different labels and mismatching categorisations. Firms know what questions they want to ask about business trends and performance, but getting to the answers is tough. By implementing the standards and common taxonomies required by Basel, supported by a robust and integrated data architecture, banks will be finally able to access and analyse consistent data that has for so long eluded them, even combining it with external sources, such as social media sentiment analysis.

Data management is a team sport and each team member has a role. It all falls apart if the baton is not passed correctly, or if the performance in one of the events is substandard. Data needs to be consistently managed, right across the firm. Fragmented approaches to data management will not get you across the finish line. Adoption of an enterprise approach to aggregating and managing risk, instead of siloed legacy databases that do not talk to each other, supported by a robust and integrated data architecture using consistent data across the institution is more likely to succeed.

It is clear that firms cannot afford to compromise on data quality and process. Risk management shouldn't be run on spreadsheets using internal trade price values. The principles stress the need for accuracy and integrity, completeness, timeliness and adaptability for good reason (see below). Any data errors or inconsistencies will translate into downstream (often exacerbated) risk inaccuracies. This could compromise a firm's ability to meet the risk-reporting practices set out by the regulation and leave it exposed to unforeseen and unmanaged risks, or unaware of potential opportunities. Understanding the lineage and life cycle of data becomes paramount. Meanwhile, tight reporting turnaround times – which are especially pronounced during stress/crisis situations – demand rapid access to up-to-date datasets, supported by automated processing and reporting workflows.

Click here for Marion's blog and video.

BCBS 239 RISK DATA AGGREGATION CAPABILITIES

"Banks should develop and maintain strong risk data aggregation capabilities to ensure that risk management reports reflect the risks in a reliable way." To this end, the Basel Committee set out the following principles:

Principle 3
Accuracy and Integrity – A bank should be able to generate accurate and reliable risk data to meet normal and stress/crisis reporting accuracy requirements. Data should be aggregated on a largely automated basis so as to minimise the probability of errors.

Principle 4
Completeness – A bank should be able to capture and aggregate all material risk data across the banking group. Data should be available by business line, legal entity, asset type, industry, region and other groupings, as relevant for the risk in question, that permit identifying and reporting risk exposures, concentrations and emerging risks.

Principle 5
Timeliness – A bank should be able to generate aggregate and up-to-date risk data in a timely manner, while also meeting the principles relating to accuracy and integrity, completeness and adaptability.

Principle 6
Adaptability – A bank should be able to generate aggregate risk data to meet a broad range of on-demand, ad hoc risk management reporting requests, including requests during stress/crisis situations, requests due to changing internal needs and requests to meet supervisory queries.

HOW YOUR DATA PROVIDER CAN HELP

In this globalised and regulatory-driven age, the emphasis must be on sourcing trustworthy data inputs from independent partners that can provide the requisite scope, reliability and capacity for auditing that will ease banks' compliance obligations and optimise their operating efficiencies.

Robust pricing and reference data are a major part of the equation. Any oversights or miscalculations can become magnified once the data is aggregated at a corporate level, creating potentially dangerous distortions in reported risk exposures. Similarly, using standard data identifiers and classifications wherever possible, such as Legal Entity Identifiers (LEIs) and common instrument codes, will better help banks accurately aggregate information from their different business lines.

Therefore, banks should seek an established and experienced enterprise content provider able to offer:

- High-quality, timely and comprehensive front-to-back content coverage to meet business activity, risk, regulatory, compliance and audit needs
- Consistent content across feeds, applications and desktops
- Experience in real-time and non-streaming content provision
- Commercials geared towards enterprise usage
- Deep understanding of the regulations and a proven ability to provide content ready for regulatory reporting
- Responsive service and support models

Ultimately, BCBS 239 may seem like another onerous requirement with which already overstretched banks will need to comply. The obligations are challenging, and meeting the January 2016 implementation date is increasingly proving a struggle. Yet in the race to comply, banks should not lose sight of the opportunities.

Meeting the minimum requirements to satisfy the immediate regulatory need should be seen merely as a starting point. Banks that take a longer-term, strategic approach – by leveraging a strong data architecture fed by high-quality data from trusted sources – will be well-placed to optimise their capital usage and operating efficiencies, improve their stability, uncover opportunities for enhancing their business and customer service, and drive future growth and profitability. Truly a goal worth the effort.

INGREDIENTS FOR SUCCESS

- **Quantitative expertise** – With a comprehensive understanding of complex structured products and state-of-the-art, derivative-valuation techniques.
- **Comprehensive coverage** – Access to large amounts of market data, advanced modeling capabilities and numerical methodologies.
- **Complete transparency** – The entire derivatives valuation process with capability to audit the market-data inputs, modeling choices, calibrated model parameters, numerical methodologies and product cash flows. Scenario analysis under alternate market conditions is also needed.
- **Comprehensive risk measurement capabilities** – Includes counterparty risk [the production of credit value adjustment (CVA), debt-value adjustment (DVA), funding-value adjustment (FVA), potential future exposure (PFE), value-at-risk (VAR), etc.]; collateral CVA and Greeks.
- **Dedicated support** – Provides rapid and easy-to understand responses to customer queries, including help with price challenges.
- **Timely delivery of valuation reports**.
- **Most up-to-date market data** – Supported with stringent quality control checks.

ABOUT THOMSON REUTERS

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ABOUT THE AUTHOR

Marion Leslie is the Managing Director of two key sectors within the Risk Group of Thomson Reuters Financial & Risk business unit: Thomson Reuters Pricing and References Services (business), which delivers award-winning pricing and cross-asset reference data services to financial subscribers globally, and Thomson Reuters Enterprise Risk Management, a leading provider of regulatory content, solutions and services for the banking, financial services and insurance industries.

In prior roles Marion has run global technology and content teams. Most recently, Marion was the Global Head of Instrument and Pricing Content, creating highly valued content for the equity, fixed income, commodities & energy, foreign exchange and money markets, supported by a team of 1,500 experts in 26 countries worldwide.

Marion spent nearly four years in India, creating a start-up in Bangalore, building the Thomson Reuters office from scratch to 2,000 employees across multiple functions, and was an executive board member of Reuters India Private Ltd.

Marion was the winner of the Award for Achievement at the 2014 Women in Banking and Finance Awards. She is a champion of talent and diversity and has pioneered analysis and approaches to developing global talent into senior roles.

Marion is also:
Member of the ESMA Consultative Working Group for the Market Data Reporting Working Group.

Chair of the London Women's Forum, an exclusive network for senior women working within the financial services industry in London.

Non-executive director for the UK Hydrographic Office (a Government Trading Fund).

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