'Future-proofing' Compliance:

Lessons for Global Banks from a Visionary Regulator (Part I)

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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. In a two part series, BFSI Vision brings you the views of Sourav Sekhar, Lead Consultant, Product Management & Strategy, Fintellix Solutions.

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 focused 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."

LCR / NSFR Focus of Basel III Liquidity & Liquidity Risk Monitoring tools
Basel International Capital Adequacy and Compliance standards
FATCA Combat tax evasion and black money
Regulatory Reporting Transition from Reports to Data Points
AQM / EWS Early warning signals and Special Mention Accounts
RBS Supervisory process with an offline and onsite component
Standardization XBRL enabled online filing of returns
ADF Direct flow of regulatory data from source system to RBI CDR

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'.

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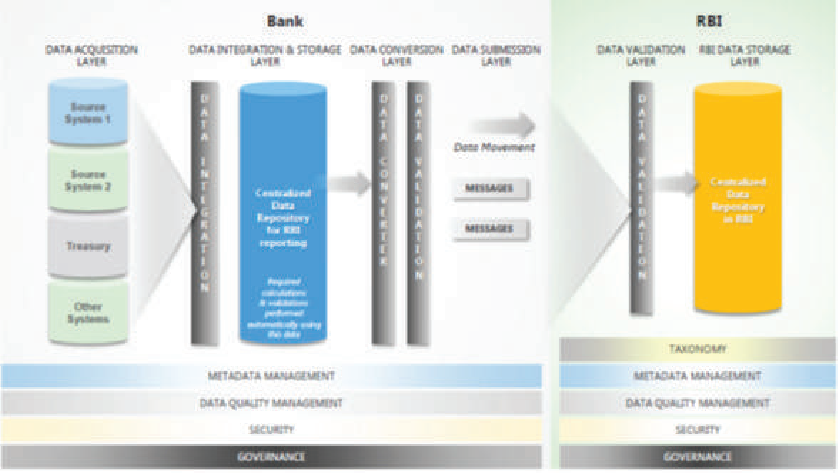
ADF: From paper to paradigm.

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.

> **By introducing regulations in a phased fashion, the regulator played a visionary role in strengthening the financial stability of the banking sector**

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).

- Data should be aggregated on a automated basis
- As a pre-requisite, banks should have clear data definitions and should be able to reconcile risk data with bank sources
- Adaptability and future-proofing for adhoc risk reporting requirements

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.

In the next part we will examine the BCBS 239 principles vis-à-vis RBI's ADF guidelines. ■