Bridging The Gap: Solving the Challenge of Compliance & Data Governance

Banks are struggling to keep up with the data demands of regulators. New global regulations require Bank Compliance groups to provide greater transparency and dissemination of data including daily reporting, quarterly health checks, and annual stress testing. Banks are working hard to comply with these regulations and to remediate gaps in their data but most have not built the foundation of data governance required to align compliance policies with data governance, ownership and accountability. Frameworks and methodologies for data management and integrated systems architectures only take financial services firms so far. More novel approaches including the implementation of compliance and data management centers of excellence and new system architectures for record storage and retrieval should be key elements of any transformation effort.

Navint Partners, LLC and BE Global Advisors
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Overview

Challenged by the complexity and scale of regulatory change, global banks must commit and execute against new regulatory standards, making compliance and data governance an integral part of their internal management framework. Incorporating complex regulations into day-to-day operations is no small task for global banks of any size. The reporting requirements of Dodd-Frank Title VII, the Volcker Rule, the Federal Reserve Enhanced Prudential Standards and the Basel Committee on Banking Supervision Rule 239 (BCBS 239), make it imperative that banks implement strong compliance and data governance processes including:

- Advisory support to interpret applicable laws, rules, and regulations and to ascertain data requirements
- Implementing policies that ensure data usage, ongoing data ownership and accountability
- Methods for communicating global and local compliance principles, standards and procedures that address data requirements
- Surveillance and monitoring programs to test the processes and ensure that data is captured correctly
- Employee training focused on applicable laws and regulations, and the laws underlying data management and reporting requirements

Regulatory Pace Quickens

Regulators are demanding increased transparency to make market surveillance easier which makes life much more complicated for global banks. Data quality and integrity are key challenges. In many cases, the existing infrastructure of banks may not capture the data required.

As an example, new regulations require banks to capture metadata to track data production and usage for risk modeling and regulatory reporting. Existing legacy platforms may not support this level of data traceability and just capturing metadata doesn't fully solve the problem. To satisfy the regulatory requirements, banks will need to be able to connect metadata from one data set (structured and unstructured data) to another.

All of this demand on data is fueling increased risk for global banks due to the potential for serious errors in regulatory reporting and recordkeeping. Compounding this situation, within the next year new global regulations will drive additional demand for transparency and increased granularity of data across the enterprise.

Improved Compliance, Increased Sophistication

Firms need to be aggressive in complying with new regulatory demands and reporting. Tactical efforts to remediate gaps in data, improve data management (including the alignment of compliance policy to regulations), and the definition of data ownership are critical, but time is running out. Regulatory oversight is increasing and regulators expect more robust strategic data management processes to be in place when they perform monitoring and audits.

As reported widely in April 2015, a U.S. independent monitor cited a large international bank for moving too slowly to fix some of its compliance problems. The report came out as the bank committed to hiring thousands of staffers to overhaul its controls in the wake of

the $1.9 billion settlement. Other large global banks are under similar orders by regulators to improve compliance, such as remediation of lax anti-money-laundering controls.

Global banks are dealing with regulatory complexity by restructuring business and IT along new lines, but the organization isn't getting flatter, less complex or simpler. In Impact Study 2015 – survival guide for banks: the battle of sophistication, Dr. Sven Ludwig, senior vice president, risk management and analytics, SunGard, writes: "The materialization of significant changes within the banking system is on the horizon. While it is widely known that banks have to change, there is no common knowledge of how the financial markets are evolving. Though many industry participants are under the impression that the banking sector is becoming simpler, the opposite is the case. Moving forward we foresee a battle of sophistication."

The battle of sophistication will be waged against new data requirements sourced from disparate sources across the organization. Global banks will be forced to adapt their data management infrastructure and to adopt new compliance and data governance processes to meet this challenge.

Increased Compliance Pressures, New Skills Required

A key problem is how the rate of regulatory change and the compliance-driven data reporting requirements are placing unprecedented pressure on Compliance groups. Compliance, which traditionally supports regulatory and risk management functions, must become adept at translating rules and regulations into current and future data requirements.

Compliance lacks experience at defining detailed data and reporting requirements. They are structured to produce compliance policies and standards not detailed specifications for data and reports. A lack of subject matter knowledge around data governance and management compounds this problem and makes it even more challenging for Compliance to be effective at interpreting the onslaught of new regulations.

While Compliance groups are leaders when it comes to conduct and procedural changes, Compliance teams rarely have specialists that focus on data. Simply put, compliance groups have yet to develop the skills and experience necessary to determine current and future data requirements from the new and proposed rules impacting their organizations.

Compliance Means Complex Systems and Data

Global banks have very complex business software and systems with highly distributed data and complex architectures. Legacy systems located on-premises, in the cloud, and across partner networks do not easily integrate with each other or with other new systems. Often this leads to multiple instances of manual data integration, movement, transformation, and delivery to handle archived reference data stored in internal repositories or externally with data storage vendors.

The fractured data environment increases the complexity of the technology infrastructure of global banks making it more challenging to support the broad range of regulatory data needs. Managing the integration of core data across hundreds of applications requires a tremendous amount of investment of resources. Estimates of the cost to take the first step of sourcing the required data have

exceeded $10 million according to industry sources.

Database architects understand how to modify and extend data models for reference, customer on-boarding, and financial trade ledger data. They have cut their teeth with the many heterogeneous data sources, types, and formats required by the organization and with the rapidly growing volumes of data. The issue is not that banking operations will continue to require data that spans multiple systems, types, and repositories. The issue is that data architects must develop environments that capture, record, store and protect data in a manner that meets compliance and regulatory requirements, while at the same time making the data accessible for the day-to-day operations of the business.

A lack of flexibility in legacy data models, including the ability to aggregate data or carve out specific data sets embedded in global models may limit a global bank's ability to meet new regulations. In the worst case, data models may need to be completely re-built to address the new rules.

Centralized sources of data with high levels of integrity that can be shared easily and well-designed data models that provide flexibility and accessibility are minimum requirements for effective data management. However, currently deployed data models and data repositories are rarely flexible enough to address the reporting needs of the organization or the sophisticated and rapidly growing regulatory reporting requirements.

A Kingdom For Transparency

Within the next year, global regulators will be demanding even more transparency and increased granularity of data and regulatory reporting across the enterprise. For example, banks will be expected to identify data and records by unique legal entities (legal entity identifiers). Banks will also need to cross-reference external and internal identifiers to help regulators piece together financial markets data.

Recently, we have seen the impact that the Dodd-Frank Act and Federal Reserve data aggregation principles have had on a global bank's infrastructure. Consider the Enhanced Prudential Standards issued by the Federal Reserve (Reg YY or Intermediate Holding Company) in February 2014. The primary objective of the Reg YY is to reduce systemic risk in the financial system. Banks subject to Reg YY are taking steps to ensure they are better positioned to withstand the next financial crisis. Under theses rules, banks must aggregate risk data across multiple lines of business, systems, and legal entities so it can be reported efficiently to bank regulators, as well as, to their Board of Directors. The rules also require banks to capture metadata to identify and trace the lineage of data production and usage for risk modeling and regulatory reporting.

A recent regulation issued by the Treasury Department in January 2015 requires banks to maintain specific records related to Qualified Financial Contracts (QFCs). The QFC must be in electronic form and be capable of being made available to regulators within 24 hours of request. Although not specifically required by the rule, the 24-hour period for requests necessitates that banks update and store records daily, something they likely do not do today.

The QFC rules also require banks to identify particular types of credit default clauses that reside inside agreements that may be in various

structured or unstructured formats. These records must be linked to transactional data for reporting. Identifying these clauses and reporting them within 24 hours will be extremely difficult for many banks.

Adapt to Change

"It's not the strongest of the species that survives, nor the most intelligent that survives. It is the one that is most adaptable to change" – Charles Darwin

The absence of a comprehensive framework for compliance and data management give rise to a series of noncompliance risks and potential data inconsistencies across the organization. It's commonly accepted that the costs of compliance will only continue to increase over time and the penalties for failing to meet the data governance and records management regulations may be severe.

Banks may have formulated an approach to data management in recent years, but the intersection with Compliance may not be in place. Banks must be proactive, building out their compliance-driven data governance and records management model now, or they may never be able to keep up with the ever-growing demand on data. Banks that have started likely need to escalate their efforts to meet stringent deadlines or face penalties. Banks that haven't started need to move rapidly and begin the effort in earnest

A well-designed and well-structured compliance and data management governance model, and systems architecture framework will help to limit the data risk that banks face, as well as, improve overall corporate reporting performance.

Compliance Driven Solutions

The proposed new rules and those already imposed by regulatory bodies present a sizable challenge to affected companies, impacting virtually all data, regardless of format or storage media. In addition, the regulations require that data be identifiable, retrievable and reportable to a request often within a 24-hour period. Banks must define the data requirements, align compliance policies and assign ownership to data. They must design and deploy accurate data stores that can support the retrieval of structured and unstructured data currently held in any number of legacy systems.

These compliance and data management driven solutions require banking data at both the meta and atomic level. They also require a single source of reference data, updated in real time as new information becomes available. A comprehensive solution requires the storage, retrieval and management of structured data as well as unstructured documents aligned to meet regulatory requirements.

A complete solution requires a systems architecture and data model, supporting hundreds of data sources used across the bank including:

- Day-to-day operating decisions and reporting
- Live data feeds from third-party providers
- High-risk, heavy compliance banking operations such as currency trading, real-time portfolio evaluation, and derivatives management
- End-of-day market-to-market/value-at-risk compliance calculations.

The Single Source Design

There are any number of ways to design and integrate a whole host of enterprise applications supporting banking operations and reporting. The optimal solution is a "single source" or “golden source” of data. One emerging approach to create a "golden source” of information is data virtualization. The goal is to create a trusted repository for regulatory compliance reporting, tracking proprietary operational data such as from trading, and broader operational decision-making and reporting.

A few global banks have fully embarked on such an investment, and early analysis indicates a consolidated data retrieval architecture using data virtualization is a leading best practice approach.

Embrace Data Ownership and Accountability

Centralizing data is not enough. Firms must identify data required for regulatory requirements and develop their data taxonomy with accurate ownership assigned to the individuals responsible for creating, augmenting, storing and retrieving data.

But, firms are not very good at assigning ownership to data. For instance, the native capture of data is usually a front office role, but typically they feel they don't own the data. When data is not well defined, it becomes difficult to assign ownership.

Undefined data ownership will also impact a Bank's ability to comply with the Fed's proposed QFC rules. To meet QFC rules, banks will first need to automate and operationalize the tagging and identification of credit clauses deeply buried within lengthy client agreements. Then banks must apply business logic that interprets the impact of the credit clauses on the firm's solvency. Finally, the banks need to package up all of this information to provide it to the regulator within 24 hours.

The technology required to comply with the QFC rules does exist today. Firms can take advantage of OCR applications that will index documents and tag sections of agreements accordingly, assigning tags to structured transactional data. Still, firms must create taxonomy to define and classify the record as a QFC, assign ownership, and capture metadata, or they will not be able to provide linked data to the regulator within 24 hours.

Solving a Complex Problem

Certainly a comprehensive and well-designed functional and technical solution using leading approaches to data virtualization or centralized storage and retrieval is the foundation for meeting and exceeding bank operating and regulatory reporting needs.

Nevertheless, there is more to the story and more to solving this complex business problem. Our approach, informed by years of experience working with global banks and banking operations, also takes into account innovative approaches, such as the Compliance and Data Management Center of Excellence (CDM CoE).

Resolving the changes required to address regulatory demands often means looking beyond the functional organization and focusing on integrating the entire enterprise. The CDM CoE framework is more than a group of specialists who are very data-centric and data-skilled. A properly defined CDM CoE recognizes the unique functional differences between the responsible and accountable parties, such as data managers as well as the banking operations, regulatory reporting, and

compliance teams. Don't put these groups in competition for investment, attention, and control. Establish a CDM CoE environment where they benefit by working together to solve the complex needs driven by regulatory requirements. Said another way, the CDM CoE gets the bank's Chief Data Officer and Chief Compliance Officer teams working together. A collaborative team, which seeks to understand current and future regulatory data and reporting requirements, develops new regulatory scenarios and innovate new solutions.

Developing and delivering business solutions (people, process and technology) requires an integrated approach, which calls for an integrated organization, one that is aligned to support a standard set of business goals and metrics. A CDM CoE enables Data Geeks and Compliance Geeks to collaborate through a matrix organization that increases collective understanding and work output in a forum focusing attention on the possible scenarios a global bank might face in the coming years. A well-designed CDM CoE will use structured approaches and methods including leading practices from inside and outside banking. The CDM CoE positions the organization to handle the big, meaty issues that will challenge not just the business but also the Financial Services industry more broadly.

Creating this alignment and moving past the idea stage requires the broad participation of the enterprise and the commitment of leadership to drive the organizational transformation. We are entering an era where the entire company must grow, adapt and embrace change. Understand how individual efforts align to achieve improved results. How groups are interconnected to serve the best interests of the bank, regulators, and customers.

Stay tuned, in a future white paper, Navint Partners and BE Global Advisors will expand on the objectives and benefits of deploying a CDM CoE to meet the challenges in global banking operations.

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About Us

Navint Partners is a different kind of management consulting firm, blending unique industry experience and innovative thinking to address clients' business challenges in imaginative ways. Navint is the right partner for organizations facing business transformation and regulatory change. We help our clients build bespoke project teams that deliver sustainable environments that can adapt to the evolving business and regulatory landscape.

BE Global Advisors is a boutique consulting firm that focuses exclusively on advising Financial Services companies on regulatory matters. Our experts help clients adapt to the evolving regulatory environments through end-to-end change management and process improvement capabilities across front, middle and back-office functions. BE Global Advisors offers a practical, risked-based approach to data governance and recordkeeping to help ensure that data is accurately created, stored and retained as required by regulators.

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