Decoding Regulatory Reporting

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Building a better working world

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1. Background

Across the Financial Services industry, there is an increase in organizational responsibilities due to additional reporting and data requirements from regulator. This is resulting into organizations, especially the ones with legacy systems, limited resources and efficiency targets, re-think on their current operating models. As the finance function evolves, new challenges have emerged in the regulatory reporting space impacting organizational priorities and agenda. To effectively respond to these challenges the organisations need resources with the necessary skill sets to support automation efforts, data analytics and new regulatory reporting requirements.

2. Global regulatory trends

2.1. Key Reporting Requirements

Banking Regulatory Authorities aim to ensure transparency and standardization in regulatory reporting across Financial Institutions via Capital Requirements Directives (CRD IV/CRD V). The EU (European Union) led Liquidity returns, Common Reporting (COREP) and Financial Reporting (FINREP) help regulators fulfil their supervisory purpose by collection of all key granular information related to regulatory capital requirements and IFRS financial reporting.

EBA/UK PRA REGULATORY REPORTING FRAMEWORK

Liquidity Reporting

Banks are required to report solvency situations via liquidity returns:

- LCR (Liquidity Coverage Ratio)
- NSFR (Net Stable Funding Ratio)
- ALMM (Additional Liquidity Monitoring Metrics)

CO REP

Banks are required to report capital adequacy through below returns returns:

- Own Funds
- Credit & Counterparty Credit Risk
- Market Risk (including CVA)
- Operational Risk
- Prudential Valuation
- Large Exposures
- Leverage Ratio

FINREP

Banks are required to report going concern information through submission of below templates:

- Assets
- Liabilities
- Deposits
- Loans & Advances
- Derivatives
- Payments, Settlement, Custody & Clearing

January '14
Regulator: EBA & UK/ PRA
Regulation: COREP & FINREP

March '15
Regulator: EBA
Framework: Liquidity
Regulation: ALMM

October '15
Regulator: EBA & UK/ PRA
Framework: Liquidity
Regulation: LCR

April '16
Regulator: UK/ PRA
Framework: Liquidity
Regulation: ALMM

June '19
Regulator: EBA & UK/ **PRA Framework:** Liquidity
Regulation: NSFR

Source: EBA website & PRA website

The EU Liquidity returns are primarily driven by prescribed reporting templates on Liquidity Coverage Ratio (LCR), Net Stable Funding Ratio (NSFR), Asset Encumbrance (AE) and Additional Liquidity Monitoring Metrics (ALMM). These liquidity returns enable the regulator to analyze the liquidity position of banks to meet both short term and long-term obligations along with the restrictions applied on the use of non-cash collateral and financial assets held by banks.

COREP's objective is to increase transparency in regulatory reports for capital and risk by requiring reporting banks to disclose granular data on credit, market, and operational risk along with capital adequacy ratios. COREP has four key areas of focus in terms of regulatory reporting:

- Standardize multiple reporting requirements across supervising authorities
- Central data repository to improve understanding, identification, and management of risk
- Enable analysis through standard information to predict trends and conduct peer reviews
- Facilitate data sharing in effective manner with impacted regulators and authorities

FINREP develops uniform reporting requirements on financial information in accordance with International Financial Reporting Standards (IFRS) or local GAAP, as applicable., to achieve efficient regulation. Therefore, FINREP would be required to be updated whenever the underlying accounting standards and guidance is updated. Uniform reporting requirements ensure data availability and comparability and hence facilitate a proper functioning of regulatory supervision. This is particularly important for regulators which rely on comparable data from competent authorities to perform their prudential, regulatory, and supervisory objectives.

2.2. Current Approach

Currently, most of the global banks have their regulatory reporting production function managed by their GICs (Global Inhouse Centres) that gather and process the necessary information from the respective regions (onshore), prepare consolidated returns at the Group level in addition to respective legal entity level, perform analytical reviews and MI packs and identify red flags, if any.

At the start of each quarter or relevant period end, typically group instructions are issued from onshore to the GICs covering uniformity and consistency of the approach adopted, timelines, materiality thresholds for variance analysis, posting adjustments and focus areas to be noted.

The base information to produce regulatory reports are extracted from the respective source systems including GL where required, which would then be reconciled and adjusted as required, and compared with the information received from the region to ensure accuracy and completeness. There is combination of standard and adhoc adjustments that gets posted based on inputs from the onshore team.

2.3. Challenges and Areas of Improvement

Operational

Banking groups consisting of more than one legal entity are required to report on a consolidated as well as standalone basis which may have implications on their data reporting processes due to different regulatory reporting formats.

Generally, the specific return is populated based on the templates provided with explanations for material variances sourced from the respective regions (e.g. EMEA or APAC). However, often there are inconsistencies in the formats in which information is shared by the regions, the explanations provided for key variances are inadequate and data quality issues are either not identified at the regional level or not highlighted.

The offshore teams as part of producing and submitting the regulatory returns end up performing a series of reconciliations between various source systems used for the regulatory books and records along with reconciliation with the GL system to ensure completeness and accuracy of data. While reconciliations are performed at a granular level, the ability to perform a root cause analysis of the reconciliation breaks is something that needs to be improved upon. This is even more critical given the standard operating procedures and split of roles and responsibilities that often tends to assign reconciliations and root cause analysis to the offshore teams.

Further, since the variance analysis is consolidated and reviewed by the offshore teams in India, due to a combination of the stringent reporting timelines and the underlying changes in businesses, there is a significant amount of dependency on the onshore teams to provide necessary explanations causing delays and inefficiency in the reporting process.

All these issues may lead to posting of numerous adhoc manual adjustments at the Group level when finalising the respective regulatory returns. A very high dependency on onshore teams for root cause analysis may also potentially question the remit and competencies of an offshore team's roles and responsibilities as the same may not be consistent with the policies and procedures in place.

Resourcing

In terms of skill sets considered for managing the regulatory reporting activities offshore, a combination of strong understanding of financial reporting and capital adequacy is considered essential. Data analysis skills are in high demand as regulators. Niche skills around application of regulatory requirements on OTC (over the counter) derivative products to arrive at specific capital requirements (such as counterparty credit risk, market risk) continue to gain a lot of momentum in India. This coupled with strong remediation experience on addressing the pain points of such global regulatory reporting processes through a combination of both functional and automation skill sets is gaining increased traction in India due to cost competitiveness and presence of relevant skill sets.

Given budget constraints to hire additional FTEs to work on large scale remediation and change programs, this presents a unique opportunity for consultants to support such large global banks and their captives to drive the remediation and change programs.

In order to avoid any key person dependencies both at offshore and onshore on such regulatory reporting work, it helps if management reviews the level of knowledge and adequacy of the resources available both within the offshore team and the onshore team to review and challenge of the processes and provide CRD IV regulatory expertise.

Technological

The primary focus for global banks over the past few years is to drive various data initiatives for improving data quality by having central data warehouses and improving standardization. However, data capture issues are expected to persist without strategic automation initiatives. Organizations are exploring building in-house automated solutions and leveraging third-party tools to develop more robust intra-report reconciliations.

There is a huge focus on adoption of enablers like cloud computing by large global banks to address the complex regulatory reporting requirements for various jurisdictions across Europe, US, and APAC (Asia Pacific). Data for some of these returns is not available directly from the source systems and as a result such returns are prepared manually and are prone to human error and involve intensive effort. This results in additional tasks like integration with existing systems and processes, additional funding, selecting suitable technology and implementations of changes.

Governance

Given the stringent timelines and repetitive nature of regulatory reporting, only a high-level analytical review is generally performed by management. Moreover, while regulatory reporting is a significant aspect of an organization's reporting function, the governance and control over the quality of reporting is an area that requires renewed focus.

Since the accuracy and completeness of regulatory reporting is equally pivotal, it is critical that organizations have a detailed SOP in respect of this function specifically highlighting controls in respect of maker-checker reviews, adjustment posting and treatment of reconciliation breaks. Maintaining detailed checklists and issues log, ensuring data quality, maintaining repository of key observations and comments by the regulator, conducting periodical trainings, circulation of updates etc are some of the best practices that may help an organization in strengthening the governance of the regulatory reporting function.

Regulatory compliance

While organizations have invested time and resources in developing the regulatory reporting function, it is equally critical that the compliance of all the requirements is ensured. Following are some of the lapses that may result in a potential non-compliance:

- Updates in the requirements are not considered
- Incorrect interpretation of the requirement
- Inconsistent application across various regions
- Non availability of data resulting into inadequate reporting.

In order to avoid such lapses, it is important that an organization periodically reviews the regulatory requirements, updates the systems as necessary and involves experts in the domain that may assist in enhancing the function to achieve the desired objectives.

3. Indian regulatory trends

3.1. Key Reporting Requirements

Recent liquidity crisis in the NBFC sector has triggered much wider concerns over the liquidity problems in Non-Banking Finance Companies (NBFCs) and in a bid to address some of the structural issues, Reserve Bank of India (RBI) has come up with amendment in guidelines on the liquidity risk management framework for NBFCs to help restore confidence in the sector in the long run. RBI published guidelines for all non-deposit taking NBFCs with asset size of 100 crore and above, systemically important Core Investment Companies and all deposit taking NBFCs irrespective of their asset size (except Type 1 NBFC-NDs2, Non-Operating Financial Holding Companies and Standalone Primary Dealers).

RBI REGULATORY REPORTING FREAMEWORK

Liquidity Reporting

Banks are required to report solvency situations via liquidity returns:

- ALM (Asset Liability Management)
- IRS (Interest Rate Sensitivity)
- SDTL (Short Term Dynamic Liquidities)
- LCR (Liquidity Coverage Ratio)
- SLR (Statutory Liquidity Ratio)
- NSFR (Net Stable Funding Ratio)

ADF reporting

Banks are required to report capital adequacy via these returns:

- Capital Adequacy Return
- CRILC main Return
- Statutory Auditor Report
- Stress Testing
- Large Exposures

Proforma reporting

Banks are required to report going concern information via such templates:

- RBCs - Important financial and prudential parameters
- Overseas Investment Details
- Statement of sale and purchase of shares and debentures (NRI & FII)

January '00
Framework: Liquidity (ex- LCR NSFR)
Regulation: ALM, IRS, SDTL
Coverage: Banks

March '02
Framework: Liquidity (ex-LCR)
Regulation: ALM, IRS SDTL
Coverage: NBFCs

January '13
Framework: Capital Adequacy (Basel 3)
Coverage: Banks

January '15
Regulator: LCR
Framework: Liquidity
Coverage: Banks

September '16
Framework: Proforma Report (IN AS)
Coverage: Banks

December`20
Regulator: LCR
Framework: Liquidity
Coverage: NBFCs

December`21
Framework: Liquidity
Regulation: NSFR
Coverage: Banks

Source: RBI website

The RBI has already established a required regulatory reporting framework for banks to report capital adequacy numbers covering capital resources and capital requirements using the ADF (Automated Data Flow). These requirements primarily cover credit risk, operational risk, and specific counterparty requirements on derivative trades. There is heightened focus on digitalization, seamless availability of data and expectation around faster response time from the banks and NBFCs for adhoc information and be-spoke reports sought by the regulator.

Below are some of the important changes introduced by RBI on liquidity reporting for NBFCs[1].

Granular Buckets and Tolerance limits

- 1-30 days' time bucket in the Statement of Structural Liquidity is segregated into granular buckets of 1-7 days, 8-14 days, and 15-30 days
- The net cumulative negative mismatches in the maturity buckets of 1-7 days, 8-14 days, and 15-30 days shall not exceed 10%, 10% and 20% of the cumulative cash outflows in the respective time buckets.

[1]vide circular no RBI/2019-20/88 DOR.NBFC (PD) CC. No.102/03.10.001/2019-20 dated 04 November 2019

Liquidity Rik Monitoring Tools

- NBFCs shall adopt liquidity risk monitoring tools/ metrics to capture strains in liquidity position, if any
- The monitoring tools shall aim to cover a) concentration of funding by counterparty/ instrument/ currency, b) availability of unencumbered assets that can be used as collateral for raising funds; and, c) certain early warning market-based indicators, such as, book-to-equity ratio, coupon on debts raised, breaches and regulatory penalties for breaches in regulatory liquidity requirements. The Board of NBFCs shall put in place necessary internal monitoring mechanism in this regard.

Adoption of "stock" approach to liquidity

- NBFCs shall mandatorily monitor liquidity risk based on a "stock" approach to liquidity in addition to measurement of structural dynamic liquidity.
- The monitoring shall be by way of predefined internal limits as decided by the Board for various critical ratios pertaining to liquidity risk. Indicative liquidity ratios are short-term liability to total assets; short-term liability to long-term assets; commercial papers to total assets; non-convertible debentures (NCDs) (original maturity less than one year) to total assets; short-term liabilities to total liabilities; long-term assets to total assets; etc.

Extension of liquidity risk management principles

- The principles of liquidity risk management to extend to Off Balance sheet and contingent liabilities, stress testing, intragroup fund transfers, diversification of funding, collateral position management, and contingency funding plan.

Introduction of Liquidity Coverage Ratio (LCR)

- The objective of the LCR is to promote the short-term resilience of the liquidity risk profile of financial institutions. LCR is introduced in NBFC sector due to rating downgrades and debt defaults by several NBFCs and a need for stronger asset liability (ALM) framework.

LCR to be maintained by **all deposit taking NBFCs** and **Non-Deposit taking NBFCs with asset size of INR 5000 crores,** starting from December 1, 2020 as per the below timelines

When Asset Size is more than INR 5000 crores and less than INR					
From	December 1, 2020	December 1, 2021	December 1, 2022	December 1, 2023	December 1, 2024
Minimum LCR	30%	50%	60%	85%	100%

When Asset Size is more than INR 10,000 crores					
From	December 1, 2020	December 1, 2021	December 1, 2022	December 1, 2023	December 1, 2024
Minimum LCR	50%	60%	70%	85%	100%

Source: RBI website

- NBFCs are required to disclose information of LCR every quarter. For the year ended March 31, 2021, NBFCs should present simple averages of monthly observations over a period of 90 days in annual financial statements.

With effect from financial year ending March 31, 2022, the simple average shall be calculated on daily observations.

3.2. Current Approach

Unlike Banks, NBFCs are still in the process of developing specialised in-house regulatory teams and more so for Liquidity Reporting.

Also, since regulatory reporting process are not very mature in the NBFC space, data compilation and report preparation for LCR are done manually. This is an area where there will be immense opportunities for large and mid-sized NBFCs in the near term to embark on automation initiatives to streamline their regulatory reporting obligations.

3.3. Challenges and Areas of Improvement

Given the ongoing pandemic, there is significant focus on liquidity reporting, both externally by regulators and internally by senior management with escalated pandemic response decision making. In the upcoming months, as the society and economy begin to heal and restore back to normalcy, significant lessons will be learned on the importance of preserving cash (High Quality Liquid Assets) and managing the asset liability mismatch. These coupled with the NPA risk to the exposures NBFC has from its SME borrowers will directly impact the future liquidity reporting decisions.

Hence, creating a current-state, end-to-end process timeline to identify and mitigate the key challenges of liquidity reporting roadblocks is pivotal.

Operational

Liquidity reporting is a complex process. Often, the best processes require manual adjustments and coordination across various functions of an organization (e.g., regulatory reporting, finance, and treasury, data governance and risk management, etc). A robust operating model can support clearly defined roles and responsibilities, as well as the governance and controls around the reporting process. Treasury typically owns metric results for LCR, while ownership of data accuracy and quality differs between institutions. Additionally, a change management team can provide critical support to address continuously evolving regulatory requirements and associated reporting logic changes.

Moreover, sourcing of undrawn commitments and off-balance-sheet exposures typically requires coordination with risk management business teams, since not all liquidity parameters are calculated in one place.

Technological (Data Quality)

While the requirement for liquidity reporting is applicable to Banks for a long time, such reporting is newly introduced to the NBFCs. Hence, ensuring data quality is critical to such reporting.

Data sourcing is a frequent challenge for liquidity reporting for NBFCs. Data must be enriched with processing and allocation logic during transformation to allow for repeatable, daily data retrieval. Data elements are frequently not entered correctly at the point of data capture, since those responsible are not aware of the downstream impacts of overlooked data fields. This can be solved through training trade-capture team members on the purpose of each data field in liquidity reporting. Controls and validations need to give confidence that the liquidity risk data are representative of an organization's position. The sophistication of controls must be commensurate with balance sheet volume and volatility

Governance

Organizations are focused on establishing a control environment that ensures that data is correctly originated, aggregated and transformed. Currently NBFCs may not have established data governance activities, including policies, procedures, standards, accountability policies, data review processes and materiality standards.

Interpretational

The primary liquidity reporting requirements are laid down in the RBI circulars. However, in the absence of detailed guidelines and clarifications on the finer aspects of the computations, the application of such requirements is subject to interpretation by individual NBFCs. As a result, there are mixed practices across the sector, for example:

- Whether to consider contractual tenure or an expected tenure for the lending portfolio?
- Whether inflows from all the loans (except defaulted ones) to be considered or only for those which are not over-due?
- Whether bank balance to be reckoned as per the books of accounts or as per the bank statement?

Hence, an organization's cash flow methodologies and assumptions must be clearly documented and consistently applied. These may further be benchmarked with the leading industry practices both within India and globally and be revisited periodically based on prevalent economic situation.

4. Our point of view

The following themes may be considered by FS GCCs, Indian banks and NBFC over the next 6-12 months.

1. Data quality and governance:

As global banks move towards Basel 4 compliance in 2022, the focus on data quality, data lineage and governance from their FS GCCs will become increasingly important to inspire the required confidence both onshore and amongst the global regulators like the UK PRA (Prudential Regulatory Authority), EBA (European Banking Authority), Swiss FINMA (Financial Markets Authority) and the US Fed. In the context of Indian banks, the focus remains on quality and availability of data prompting the need for banks to have comprehensive enterprise-wide data marts to flexibly make available any adhoc information sought by RBI at any given point in time.

2. Increasing use of automation:

Global banks are relying more heavily on offshore resourcing models, increasing automation of regulatory report production to support the ever-increasing production and reporting processes. These changes combined with increased location flexibility due to work from home policies, have triggered organizations to review and reassess their reporting structure. In addition, heightened regulatory focus on data quality has resulted in significant efforts to improve data quality and efficiency throughout the end to end regulatory reporting data life cycle. In India there is a regulatory mandate by RBI for banks to automate the Non-Performing Assets (NPA) classification process to proactively identify and manage the systemic risk posed by bad loans.

3. Evolving use of technology enablers like cloud computing:

There is a rapidly increasing focus on adopting cloud computing across most of the global banks for processing their complex and voluminous regulatory reporting requirements. Adoption of cloud computing requires a clear strategic vision on where banks need to be over the next 3-5 years and requires huge investment on the IT infrastructure followed by embedding the regulatory reporting activities with the help of techno-functional professionals with strong domain knowledge of finance and regulatory reporting.

4. Opportunities in the regulatory reporting space in India:

On the other hand, the regulatory reporting requirements in India are evolving keeping in mind the current focus within the Financial Services sector and the challenges faced by market players including banks and NBFCs. The introduction of liquidity reporting requirements for NBFCs is likely to benefit all relevant stakeholders and has resulted in ample opportunities for large and mid-sized NBFCs to undertake sustainable automation initiatives to address RBI's short term and long-term reporting requirements on liquidity. The use of cloud computing is also evolving amongst large banks to begin with followed by NBFCs.

5. Data analytics:

Firms should look to automate and streamline their existing regulatory reporting processes and achieve efficiency targets along with addressing data quality and granularity issues. Emphasis on digital agenda will enable teams to leverage advanced analytic tools and decrease manual intervention. While the global banking captives are ahead of the curve in terms of end to end automation initiatives being undertaken on the back of mandate received from the group headquarters, NBFCs in India need to strategically consider the long term value in automating their existing regulatory reporting processes. Banks in India are on track to automate their end to end processes on finance, treasury, and regulatory processes and will need to maintain this momentum to address on-going regulatory expectations from RBI.

6. Upskilling and talent retention: Global regulatory reporting requirements of large international banks and their corresponding production and reporting activities from offshore captives will increasingly witness more and more traction from India considering the immense talent pool developed in these areas over the past decade.

Identifying the right skill sets and automation tools required to proactively address the on-going regulatory changes both globally and in India will continue to be important for global shared services firms and Indian banks and NBFCs. The COVID-19 pandemic has resulted in numerous regulatory reporting BAU (business as usual) as well as change and remediation functions to be moved to India by large global banks. Such movements have resulted in tremendous opportunities in India for adding value to organization's transformational journey through digital solutions with existing talent pool in regulatory reporting.

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