Regulation & Standards

Special Report

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Editor's Letter

The Seeds of a Turnaround

In the Q&A with Dilip Krishna, a director at Deloitte, in this special report on Regulation & Standards, the regulatory expert portrays the financial industry's efforts on regulatory compliance as "uneven." As a result, Krishna says, data management could have been improved if it weren't for a typical "tactical" approach to addressing each piece of regulation as it comes up.

In the Virtual Roundtable in this report, however, HSBC's Chris Johnson does see some progress happening when it comes to efforts to upgrade data management processes, especially those spurred by regulatory compliance needs. Asset data usage and accountability is being extended directly to asset owners, who must answer to regulators evaluating their data content. The bar for data quality is rising, in terms of completeness, accuracy and transparency, Johnson says.

Nonetheless, even with these driving forces, the industry still must devote more resources to address their demands, as SIX Financial Information's Jacob Gertel observes. Before even deciding what resources should be designated, multinational corporations must figure out the differences in requirements from country to country, for rules such as Basel III and Solvency II. Readiness depends on local regulations and the ability to get compliance in each market.

AIFMD, the Alternative Investment Fund Managers Directive, is adding to the complications, partly by generating more classification data to indicate geography, asset type, issuer, ratings and legal entity identifier (LEI), according to Johnson. Although AIFMD is similar to Solvency II and US Form PF requirements, European markets may have specific and different corollary rules based on AIFMD for their market participants to follow.

All is not lost, despite the apparent weight of tasks resulting from these regulations, as Johnson says the required new data content, and its quality and governance, is driving increased complexity, and bringing necessary attention to how firms can manage data that has grown organically but without consistent standards. Since the data fabric is entwined deeply in the infrastructure, long-term investment is required and will deliver "lasting improvements," he says. Providers and institutions, Gertel adds, must build systems so new requirements can be introduced more easily.

These insights, as a whole, point to the possibility that regulations have caught the attention of data managers at major global financial institutions enough to get them thinking about taking actions to make compliance easier. It's carrying out such actions that remains a challenge.

Yours sincerely,

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FEATURES

NEWS

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Strategy and Tactics

Regulations are not quite the spur that their architects intended, says Deloitte's Dilip Krishna, who sees harmonization as still distant

Will the various regulations, including EMIR, MiFID II, Basel III and Solvency II, produce better data management as a result? Why or why not?
While these regulations could improve the quality of data management across the banking, securities and insurance industries, financial institutions' efforts as a whole have been uneven. Some institutions have taken a tactical approach to solving for each regulation, which usually means that it is difficult to take advantage of solutions for one regulation to simplify the response to. Other institutions have simply had too much regulatory change too fast to consider strategic choices.

Dilip Krishna, Deloitte

Is the industry well prepared for compliance over the next several years? Does readiness differ depending on the size of firms?
Institutions that have put in strategic solutions in place will have a better chance of meeting new compliance needs. Size does matter. Larger firms find it more difficult to be strategic due to their scale. Smaller firms that have had the vision to invest in such solutions are better positioned. Large firms have been more successful in addressing particular aspects of their operations, however, and may find efficiencies in those areas.

Is there enough harmonization of regulation worldwide, between regions? Is more consistency necessary?
Harmonization across regions is certainly a goal of regulators worldwide, but is far from being achieved. In fact, harmonization across different regulations within jurisdictions – and sometimes even within that same regulation – remains a significant issue. As a result, firms are forced to spend valuable time resolving inconsistencies, while regulators are unable to achieve the comparability across reports that they need.

News

Industry Addresses Solvency II Readiness

With a firm deadline of January 2016 for compliance with Solvency II, the European Union directive on capital adequacy and risk management for insurers, the financial services industry is now addressing the data management demands of the regulation.

Although implementing a change in data operations such as that needed for Solvency II can take up to two years, which would extend past the compliance deadline, some firms will take advantage of all the time available, says Paul McPhater, chief operating officer of enterprise software at Markit, the data services provider. "Sometimes the effect of a slip in a deadline is expansion to fill the gap," he says. "The impetus to update legacy systems has caused problems with insurers trying to get data, get it in shape and into a format so they can report it."

Solvency II affects asset management firms as the insurance industry generates a lot of their funds, so they can benefit by being prepared for compliance, says John Randles, Dublin-based CEO of Bloomberg PolarLake, the enterprise data management (EDM) services unit of the data provider.

The time required to implement Solvency II compliance measures depends on the size and structure of the firm, notes Andrew Melville, senior vice president and head of EMEA insurance product and strategy at Northern Trust. "The message is 'start now,'" he says.

Michael Shashoua

DTCC, Swift Top Ranking of LEI Infrastructures

The Depository Trust & Clearing Corporation (DTCC) and Swift, which are partnered to provide legal entity identifiers (LEIs) in the US, have been named as most comprehensive in the first quarterly ranking of LEI infrastructures by the Tabb Group consultancy.

"We are pleased to have been recognized as the leading LEI provider globally," says William Hodash, managing director, business development, DTCC. "We remain committed to ensuring the Global Markets Entity Identifier meets the evolving needs of regulators and market participants alike, by providing high-quality legal entity reference data."

Michael Shashoua

Regulation & Standards: Keeping Fit for The Future

Inside Reference Data gathers leading data professionals to discuss their responses to the latest industry regulations, and the impact of these changes on the sector in general

Have industry operations matured when it comes to compliance with EMIR and MiFID II, as well as Basel III and Solvency II? Are there gaps remaining in operations?

Chris Johnson, head of data management, HSBC Securities Services: Data management operations across the industry are undergoing a significant upgrade in order to meet regulatory requirements. First, there is a requirement to extend asset data usage and accountability directly to asset owners, who are answerable to the regulators for the data content. Second, they require a raised bar for data completeness, accuracy and transparency, which in some cases might be beyond what is available today. Third, the new regulations stipulate specific data content that is new to the market and is not always readily available (although data vendors now offer products to support several of them).

Jacob Gertel, senior project manager, legal and compliance data, SIX Financial Information: The various regulatory requirements are requesting the financial industry to allocate a lot of resources to achieve compliance in the areas of IT, as well as ensuring adequate reporting and control processes and much more. For multi-national corporations, complexity is increased by the fact that different national regulators are introducing the international requirements differently locally, such as Basel III and Solvency II. From a vendor perspective, we see different readiness levels within our client base, depending on the local requirements and implementation phase. Some clients are relying on external software providers that are themselves not ready yet.

The core operational gaps that seem to exist are the lack of resources as a result of the similar timing of regulations, and then data integration and availability, which ultimately results in reporting gaps. The financial industry will be required to close the gaps upon the effective date of the national and international regulatory requirements, such as January 1, 2016 for Solvency II.

> "On a strategic level, the financial industry should have adequate processes and systems to deal with the regulatory requirements"
>
> *Jacob Gertel, SIX Financial Information*

What has been the impact of AIFMD on data operations? Has it required significant additional and different work than the other recent new regulations?

Johnson: AIFMD reporting requirements become most complex when the following factors arise: proportion of unlisted instruments traded; the fund manager's outsourced operating model; and the use of leverage.

AIFMD requires specific new geography and asset type classifications along with issuer, ratings and the legal entity identifier (LEI). AIFMD reporting requirements have some similarities with Solvency II and Form PF, both in terms of content and in the accountability being placed on the asset managers and by extension their service providers to complete an aggregated return. AIFMD reporting requirements are set by ESMA but additional local requirements may apply.

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Gertel: As with many of the recently introduced regulations, AIFMD forces financial institutions to modify their business process and reporting to comply with the requirements. Also, from a vendor perspective, AIFMD demands significant data changes and efforts to be made in order to ensure accurate and complete data.

One of the most challenging, yet most important aspects is to provide data concerning the fund managers and funds that have the "EU Passport." This data can be acquired either from the EU regulator ESMA or from the local regulators that maintain the so-called "Notifications" data. Vendors have to put in place an adequate process to ensure the gathering of the data through an ongoing contact with the various regulators, combined with correct mapping to the data universe and in high quality.

To introduce the data, both the vendor and the customers must have the appropriate data structures in place. We, as a vendor, already have the experience with such regulatory data—for example, we have a similar process concerning the Fatca GIIN.

From the instrument perspective, we will flag the instruments according to the AIFMD Annex VII (Asset Type Typology for all Exposures Reporting) by using existing data structures, which will allow the customers to implement the data easier into existing data structures.

Are these regulations, collectively, driving improvement in data management? Are they increasing the complexity required for data management?

Johnson: The stipulated new content, quality levels and governance requirements are driving improvements. There is an increase in complexity, but the regulations are shining a spotlight on an area of the industry that has grown organically with very few data content standards. Streamlining, simplification and consistency are only possible if firms can agree on additional standards (i.e. beyond the LEI and the ISIN). The existing data fabric is heavily woven into the infrastructure, with deep foundations, requiring long-term investment in skilled resources and specialist governance, along with industry collaboration, to deliver lasting improvements.

Gertel: The new regulatory requirements are requesting us to ensure an appropriate data coverage, together with an on-going assurance of the data quality. Therefore, indirectly the regulations are contributing to the improvement of data management and the scope of the data offered to the customers. Furthermore, the on-going contact with the different regulatory bodies will help in the implementation of future regulatory changes and new regulatory requirements that might come with short implementation time to the entire industry. At first sight, it might seem that the regulations keep increasing the complexity, but with the right business approach, vendors and financial institutions are encouraged to build their systems in a way that any additional requirement can be introduced easier and with existing data structures.

What strategic benefits can be derived, or are being derived, from new data operations efforts made in response to these regulations?

Johnson: The LEI is already helping by providing certainty of counterparty identification. However, genuine straight-through processing can only become possible if data standardization is instilled uniformly across the end-to-end investment process. Several attempts have been made to deliver faster settlement times historically, but such solutions can only function properly once unique identifiers for instruments are agreed and implemented. This ISIN does not provide the necessary granularity for this. Some firms are now taking the view that utilities and managed services will help to deliver data standardization, but this would depend on agreed content standards that are compliant, consistent and affordable.

> **"The regulations are shining a spotlight on an area of the industry that has grown organically with very few data content standards"**
>
> *Chris Johnson, HSBC*

Gertel: On a strategic level, the financial industry should have adequate processes and systems to deal with the regulatory requirements. Where possible, the financial industry should cooperate with vendors in the data area and on core banking software providers that have already the expertise and ability to deal with the regulatory requirements. This will allow the industry to concentrate on the business strategy and business activities —in a turbulent international business environment. Such partnerships will reduce the implementation burdens and ensure an on-going compliance.

Chris Johnson, HSBC

Have identifier standards efforts, namely the legal entity identifier, complicated matters or helped support regulatory compliance through data operations?

Johnson: The LEI adds complication at first because existing entity codes cannot be superseded until it has been fully rolled out. The LEI expansion is now being accelerated by the requirement for issuer LEIs (required for Solvency II, from 2015 where available and likely to be needed for MiFID II from 2017).

There are significant challenges to ensure all securities issuers realize they must obtain their LEI(s) and in turn for the major data vendors to update their issuer reference data. Other new reference data fields logically require standardization, but there is no central industry body actively driving such standardization.

Gertel: The LEI is an important identifier that supports companies to be compliant with the regulatory requirements. The LEI will not only be used in different reporting obligations, but, will also help companies have better KYC information about their customers—such an identifier will allow the companies to clearly identify their customers and their counterparties. Furthermore, the LEI can be used as a link to any other data related to the institution—any instruments issued by the company, any financial data and corporate actions, or any other identifiers and classifications, such as the FATCA GIIN, NACE and much more.