Executive summary

The purpose of this white paper is to investigate the impact of regulations on data governance, and articulate that there is a regulatory necessity for effective data governance over and above best practice. A lack of data governance has the capacity to undermine the integrity of an organization, and with sanctions and fines reaching record highs, seriously impact its prosperity and future. Yet, data quality and data governance is still the ‘elephant in the room’ for many firms.

Data governance is an organic activity since system and business requirements change over time. Like any discipline, data governance requires consistent improvement to remain competent. Data quality should be controlled and improved on an ongoing basis, as inferior data so often equates to poor outcomes. However, there are still challenges within the industry, such as lack of data content and data standards which must be tackled urgently and collaboratively. Additional frustration is frequently caused by a lack of clarity in final regulations and delays in the legislative process.

The good news is that the investment in data and technology for regulatory change, as with all data governance projects, can realize other positive benefits for firms through enhanced data analytics and client reporting at minimal incremental cost.

Introduction

This paper aims to dispel the myth that data governance is solely about best practice, and clarify that it is, and will even more so become, a regulatory requirement. One crucial lesson learned from the 2007 global financial crisis was that many firms’ data governance processes and data architectures were inadequate to effectively manage financial risk. Consequently, the regulators intend to embed data quality, integrity checks and ownership into business as usual for financial institutions.

Rarely does a day go by without a story about a new regulatory fine or legal action against a major asset manager, insurer or bank hitting the headlines. Financial services, like other industries, have suffered problems and on occasions incidents of corporate misconduct. But, by historical measures, the regulators current incursion on financial institutions is unprecedented. We read almost daily in the media rhetoric about the quantity of impending regulation, phrases like tsunami and avalanche are two of the Editors favorites. According to the regulators, firms are too big to fail and apparently some are too big to manage their risks.

Data Governance is at the forefront of regulators’ concerns, and many of the current regulatory changes can trace their origins back to the G20’s commitment to “tackle the less regulated and more opaque parts of the financial system”. Furthermore all of these new regulations chant the same mantra: to reduce systemic risk, increase transparency, and promote market integrity within the financial system.
“It is important that firms ensure they have the resources to meet the challenges of documentation for data management purposes and the ensuing data governance requirements...”

There is, and will continue to be, a huge amount of regulation pertaining to data governance. However, it has not been given the focus it deserves as firms manage to “get by” or concentrate their priorities and resources elsewhere. We will demonstrate that data governance needs to be put into action in the form of coordinated initiatives and board-level sponsored projects, as the potential regulatory sanctions in the current highly-charged political environment are enormous. This is not a time for procrastination, any delays in the regulations such as those we have seen in Solvency II, Dodd Frank, and FATCA are just deferrals. The legislation is still occurring whether six months or a year later.

Data is the oxygen in the body of regulatory change. Firms must project which data items will be required, even if the regulations are still in draft, and start working on solutions as soon as practically possible. Such detailed analysis of reporting requirements will provide the key to understanding what new data content is needed, along with early action to reduce the chance of missing regulatory deadlines and lead to a less disruptive implementation.

Commercial advantages are also possible if data challenges are identified early and tackled holistically and cohesively within the firm. In addition, good governance of IT infrastructure to support new data fields and to normalize data across systems allowing consolidated reporting will also be required. In particular, regulatory reporting will need to be able to demonstrate that data content is accurate, complete and appropriate. Totaling these challenges together with the increasing regulatory burdens on the industry and more demanding client reporting requirements, the case for pioneering a strategy in data governance is clear.

Why the regulators’ focus on data governance?

It can be argued that it is precisely a lack of data governance that has led to the current assault of regulation. Some areas of the industry were guilty of regulatory complacency and it was probably also the case that regulators had focused their own limited resources on weaknesses other than data governance prior to the financial crisis. Within a few days of the insolvency of Lehman Brothers in 2007, it became clear that many banks, asset managers and asset owners were unable to calculate with any degree of certainty their issuer or counterparty exposures. This problem stemmed from a lack of consistent issuer and parent issuer data, and a lack of coherent counterparty identifiers and information. Some firms resorted to spreadsheets and pivot tables in an attempt to calculate their risk exposures.

Certainly from the IMAP Thematic Review, the UK regulator believes that the industry has not invested in data governance measures to a sufficient level. Couple this with recent and impending regulations, such as Solvency II and MiFID II, and the regulators have already surmised that many firms lack adequate data governance processes and, at times, the actual data itself to make informed decisions about risk, and will therefore legislate accordingly. Indeed, as these quotes from the UK regulator from the Solvency II data reviews found:

“Data management appeared to be one area where firms still have comparatively more to do to achieve the likely Solvency II requirements.”

And that: “Few firms provided sufficient evidence to show that data used in their internal model was accurate, complete and appropriate.”

Data governance and financial services have long been entwined, but in recent years the focus has shifted to asset and reference data. Fifteen years ago the industry was primarily concerned with the theft of personal data on unencrypted laptops, with numerous examples of retail banks and even the defense services losing devices containing individual’s personal details. Subsequently, the scandals of Enron, Worldcom, Tyco, and...
Arthur Andersen followed relatively swiftly by the data retention policies of Sarbanes Oxley to remedy those accounting deficiencies. More recently, in response to the financial crisis, the focus is now on asset reference and master data within risk and compliance systems to ensure accurate risk and exposure reporting to the board, regulators, and investors.

Since the 2007 financial crisis, the regulations being established are not conducive to flexibility or compromise, and the magnitude of regulatory interference will only increase. Firms need to get used to this austere regulatory atmosphere as it will remain for the foreseeable future. As Martin Wheatley, Chief Executive of the UK’s Financial Conduct Authority, recently remarked: “One of the big risks if history is any guide, is that economic recovery gives way to over-confidence. And over-confidence gives way to lobbying by firms who want to unpick regulatory reform.”  

What do the financial regulations say about data governance?

“The area of market data in terms of quality, format, cost and ability to consolidate is key to sustain the overarching principle of MiFID as regards transparency, competition and investor protection.”

The buy-side is coming under increased scrutiny of the regulators which had previously been reserved for banks and the sell-side. There is now a realization that some buy-side firms will be deemed as systemically important financial institutions by global regulators and, as a result, be subject to enhanced regulatory oversight and intrusive supervision. The banks have already been subject to numerous large scale regulatory changes in recent years, and it would be remiss to overlook what those regulators have legislated regarding data governance.

Data quality is the biggest challenge to comply with Basel III. The technical issues include data availability, data completeness and data consistency to calculate the new capital and liquidity ratios. Last year the Bank of International Settlements released the Basel Principles for Effective Risk Data Aggregation and Risk Reporting, it states its expectations regarding data governance, architectures and completeness:

1 Governance
“...risk data aggregation capabilities and risk reporting practices should be subject to strong governance arrangements...”

2 Data architecture and IT infrastructure
“...should establish integrated data taxonomies and architecture across the banking group, which includes information on the characteristics of the data (metadata)...”

3 Accuracy and Integrity
“...should have a “dictionary” of the concepts used, such that data is defined consistently across an organization”

4 Completeness
“Supervisors expect data to be materially complete, with any exceptions identified and explained.”

5 Timeliness
“...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.”

Additionally, the Proposal for a Regulation of the European Parliament and of the Council on prudential requirements for credit institutions and investment firms, documents the requirements for data governance for the implementation of the Basel proposals in the EU. It tells us that an institution must have in place a process for vetting data inputs which must include “an assessment of the accuracy, completeness and appropriateness of the data.”

Of more direct and immediate concern to the buy-side, the Alternative Investment Fund Managers Directive (AIFMD) holds management responsible to ensure that adequate controls are in place, and that risk management decisions have been based on “reliable data.”
“Decisions taken by the risk management function are based on reliable data, which are subject to an appropriate degree of control.”\textsuperscript{16}

Similarly, the Markets in Financial Instruments Directive (MiFID) recognizes that the quality, cost and accessibility of market data is critical to the overall success of the Directive. The ability for firms to format and aggregate the data as necessary is also acknowledged, and MiFID has been keeping a watchful eye on any business practices, such as availability of data or non-discriminatory access to licenses, which would impinge on its objectives of transparency, competition and investor protection\textsuperscript{17}. The Directive highlights that: “The area of market data in terms of quality, format, cost and ability to consolidate is key to sustain the overarching principle of MiFID as regards transparency, competition and investor protection.”\textsuperscript{18}

Solvency II\textsuperscript{19} advances these criteria further; in fact it is the regulation that has been most prescriptive when it comes to data governance. Article 82 of the Directive stipulates that insurers must “have internal processes and procedures in place to ensure the appropriateness, completeness and accuracy of the data used in the calculation of their technical provisions.” And again in Article 121, the mantra since adopted by other regulators and now synonymous with data governance is reiterated: “Data used for the internal model shall be accurate, complete and appropriate.” In 2009, The European Insurance and Occupational Pensions Authority (then the CEIOPS) produced 22 pages of Standards for Data Qualities\textsuperscript{20}, documenting very precisely what it meant by appropriateness, completeness and accuracy of data. To date, this is the most comprehensive guidance any regulator has produced concerning data governance and should be on the reading list of every data owner or data manager.

In addition, Solvency II looks to raise the responsibility of data quality and data management right up to the board level, and introduces data lineage which refers to the ability to prove that the values presented in management or regulatory reports are derived from a compliant process and compliant data, that there is processing history and an audit trail. Indeed, the lack of data ownership at a senior level has disappointed the UK regulator, in a thematic review they explained: “We witnessed little challenge or discussion on data quality at board level. We expect issues and reporting on data governance to find a regular place within board and committee discussions. Firms need to ensure that adequate and up-to-date quality management information is produced. It is important that the board has the necessary skills to ask probing questions.”\textsuperscript{21}

Unimpressed by firms’ first attempts, the Financial Services Authority went back to firms the following year more specifically to review data management on the following criteria:

1. Approach to managing data
2. Implementation of the data policy
3. Understanding the data used
4. Controls over data quality
5. IT environment, technology and tools

Firms were asked to demonstrate how they planned to meet the data management requirements for Solvency II. The critical findings from the previous review appeared to have been superseded by a more conciliatory tone, but there were still many firms who were struggling to embed their data governance frameworks and culture across the organization: “Some firms were unable to articulate what ‘accurate’, ‘complete’ or ‘appropriate’ meant in practice and were therefore unable to assess data quality effectively.”\textsuperscript{22}

The Bank of England Prudential Regulatory Authority (PRA), who have superseded the FSA as Supervisor for Solvency II, continue to monitor progress with insurance companies on their data governance programs, most recently holding industry workshops in April and May this year. The PRA clearly recognizes that data governance is a key ingredient to the overall success of Solvency II, and has an expectation that firms will continue to dedicate resources to this discipline: “Some firms built their data directory without a clear understanding of what they were going to use it for other than to meet regulatory requirements.”\textsuperscript{23}
Conclusion

RIMES advocates that the governance of data has to be put into action in the form of coordinated initiatives and board-level sponsored projects, as the regulatory fines and sanctions in the current political environment are substantial. Successful data governance programs rely on more than just processes and frameworks; they are also about changing culture, technology and people.

Consequently, with many regulatory projects being mandatory and relying so heavily on data, be it transaction data to be reported to a regulatory body, or market reference data utilized within the trading decision, an effective firm-wide approach is vital to any change management project. We can now observe an increased and more direct relationship between the strategic direction of regulatory change and business strategy, particularly with regards to data and its governance. Likewise, at an international level, we can see that regulations are slowly evolving towards a common framework with the themes of investor protection, transparency, systemic risk, capital adequacy and tax collection as priorities.

There is value in data quality. Furthermore, there are tangible business advantages to employing best practices and complying early. For the sake of efficiency, firms must achieve downstream product benefits; the addition of multiple new reference data fields into an organizations infrastructure will have a major impact on the existing end to end business process. Firms must not comply just for the sake of a particular regulatory report, but encourage downstream business units such as client reporting to look at the new data sets available and consider how they might enhance their product offerings to benefit clients and increase revenues.

It is essential that firms identify the synergies and interdependencies between the various regulations and be strategic to avoid ‘digging up the road’ repeatedly with remediation projects. Critically, they must engage actively in the consultation processes and plan projects from the draft regulations, not wait for the final legislation as that would reduce the available project time and lead to a lack of coordination. There are still data governance challenges within the industry, such as lack of standards and data content, which must be tackled urgently and collaboratively. Additionally frustration is caused by a frequent lack of clarity on final rules and delays in the legislative process, not to mention national flavors of international laws which can lead to procrastination and regulatory fatigue.

In the next paper in this series, we will review the data items that are crucial to fulfill the new regulations and discuss the infrastructure, technology, data retention periods and the economics of data governance.

For References see page 7
How RIMES can help
The RIMES Data Governance Service allows for the creation of a directory of data fed from both RIMES' and the client’s systems. This directory will enable reports to be generated in support of the governance process. While governance is a journey each firm has to make in a large part by its own efforts, there is now a framework upon which firms can build and out of which they can generate their master report as well as control, usage and fund usage reports.

About RIMES
To make the best investment decisions on behalf of their clients, the buy-side relies on benchmark and reference data. This data invariably comes from a number of originators – all with different terms of use – and has diverse applications. As business needs evolve, so does the volume and complexity of this data. To maintain a level of control, a structured method of data governance is essential.

The RIMES managed data service can help you create a strong data governance structure. In 1996, we set out to help meet the challenging specialist data needs of buy-side institutions. We now serve over 250 clients in 40 countries. For years we’ve been leading the pack when it comes to providing managed data services, giving our clients highly customized data over the internet through the use of cloud technology.

What sets us apart is that we understand both sides of the coin: the requirements of investment managers but also their clients', the asset owners. We develop on-going relationships with our customers, who trust our flexible and fully managed data service to care for their data day after day. Your data on RIMES is constantly being managed and tracked, the right way.

Data rarely comes without strings: contact RIMES to learn more about how we can help you manage all your benchmark and reference data needs.

Find out more Contact us to find out more about how RIMES can help you achieve success with data management: www.rimes.com/contact-map

The RIMES Data Governance Handbook
To get a copy email marketing@rimes.com

Read more at www.rimes.com/what-we-do
References

1 G20 2009 Pittsburgh Summit: http://www.g20.utoronto.ca/2009/2009communique0925.html#system


3 BNP Paribas is in settlement talks with the U.S. regulators over multiple sanctions violations in the last decade. The final fine is expected to be as much as $10 billion.

4 Ibid p.6 §3.2

5 Ibid p.8 §3.14


9 Ibid p.19 Principle 1

10 Ibid p.7 §33

11 Ibid p.8 §37

12 Ibid p.9 §43

13 Ibid p.9 Principle 5


15 AIFMD is the European Directive governing the management and marketing of all non-UCITS managers and funds domiciled in or sold throughout the EU.


17 Article 30 of the Markets in Financial Instruments Regulation, the regulatory appendage to the update of MiFid, had stipulated that benchmarks, such as equity indexes, must be provided to all market participants on a non-discriminatory basis. The article was subsequently deleted by the European Parliament during negotiations.


23 Ibid P.12 §4.24