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AUTOREK

THE REGULATORY REPORTING HANDBOOK 2023

Regulatory updates, key trends and data challenges

THE REGULATORY REPORTING HANDBOOK 2023

REGULATORY UPDATES, KEY TRENDS AND DATA CHALLENGES

The list of complexities associated with regulatory reporting continues to grow year-on-year. While reporting obligations have always been onerous for firms, market volatility, evolving supervisory expectations and inflationary pressures will only magnify the challenge in the months and years ahead.

Changes in these areas will certainly place an increased compliance workload on organisations, but new changes also bring new opportunities. Regulated firms from all sectors of finance would benefit from a richer understanding of today's regulatory reporting landscape if they are to stay ahead of the curve.

In this paper, AutoRek and CBS Consulting offer a round-up of regulatory changes and a comprehensive deep dive into the challenges of regulatory reporting in 2022/2023. Split into three sections, we cover:

1) Summary of regulatory updates
2) An inside look at regulatory reporting challenges within banks and fintechs
3) The financial data management challenges of regulatory reporting

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Regulatory Update

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CONSUMER PROTECTION

Investment Firm's Prudential Regime (IFPR)

The Investment Firm's Prudential Regime is the UK's equivalent of new EU prudential regulations (Investment Firms Regulation and Investment Firms Directive). The UK was a major contributor to EU legislations prior to Brexit, which explains why new IFPR regulations bare many similarities to European regimes introduced in 2021.

New regulations place prudential demands on firms to ensure they maintain sufficient capital to allow for an orderly wind-down of their business. IFPR also introduces intervention points at which firms must alert the FCA when capital resources drop below prescribed levels.

One of the more significant changes introduced by IFPR are new K-Factor requirements, which create an own funds requirement specific to the nature and complexity of a firm and its business operations. For larger firms with more propositions, calculation requirements are likely to be particularly onerous. Significant reporting obligations are also live for firms and have been since Q1 2022.

Another challenge brought about by IFPR is the ICARA process. Many firms will recognise this as similar to ICAAP. ICARA is a risk management process for firms to monitor and identify potential causes of harm to their business and includes an annual submission to the FCA via the MIF007 – ICARA questionnaire. Firms should review the adequacy of their ICARA process on an annual basis and document the outcome.

The new prudential regime also introduces the MIFIDPRU Remuneration Code. At the highest level, this requires in scope firms to ensure their remuneration policy and practices are clearly documented. The FCA has provided a Remuneration Policy Statement template to assist firms in detailing their policy.

A fourth Consultation Paper is expected from the FCA in Q4 2022, which will include ESG disclosures, own funds CRR copy-out and integration into MIFIDPRU.

Operational Resilience

Operational Resilience has been a top priority for the FCA in recent years. The regulatory push for greater resilience ensures firms can withstand shocks and still deliver key services to clients. Following multiple consultations, the final rules came into effect on 31st March 2022.

Under new rules, firms must identify their important business services and map those to the people, processes and technology required to deliver those services. In doing so, the FCA expect firms will be able to identify potential vulnerabilities in key areas and then plan to address them.

Firms are required to set impact tolerances to define at which point disruption would cause harm to consumers and/or markets. Following this, firms must implement scenario testing to assess how far they can remain within impact tolerances in the event of disruptive scenarios. A three-year transitional period is now in place until March 2025, during which time firms should remain within set impact tolerances.

By introducing new rules for Operational Resilience, the FCA clearly expect that firms continue developing and learning from disruptive events. As part of this, firms should conduct a "lessons learned" exercise following scenario testing or actual disruptions. Details of these exercises should be maintained in self-assessment documents, which should also include evidence of any actions taken.

The EU's Digital Operational Resilience Act (DORA) pursues a similar aim: ensuring financial services organisations can withstand technology threats like cyber-attacks. At present, DORA remains in the early stages and was provisionally agreed by the European Council in May 2022. We can expect this to be operational in 2024.

FCA Consumer Investment Strategy

The FCA has introduced a three-year Consumer Investment Strategy to reduce potential harm to consumers in financial markets. Although the strategy is far-reaching and covers many regulatory updates, the common aim is to enable consumers to invest with confidence.

Below, we summarise three key regulatory

updates as part of this strategy.

1) Consumer Duty

In July 2022, the FCA published final rules and guidance for Consumer Duty. New guidelines aim to set clearer, higher standards for consumer protection, placing the circumstances and objectives of consumers at the heart of financial services.

Fundamental to new Consumer Duty regulations is the introduction of a new Principle for Business affecting in scope firms: 'A firm must act to deliver good outcomes for retail customers'.

As firms are fundamentally obliged to meet this principle, it represents a material concern.

In addition to the new Principle for Businesses, Consumer Duty also introduces rules related to four outcomes considered by the FCA as essential for a positive firm-consumer relationship:

- Products and services
- Price and value
- Consumer understanding
- Consumer support

Consumer Duty also introduces further, cross-cutting rules for more clarity around the FCA's expectations under the new principle. Specifically, these rules require a firm to:

- Act in good faith towards retail clients
- Avoid foreseeable harm
- Enable retail clients to pursue financial objectives

For new and existing products open to sale or renewal, rules become effective from 31st July 2023; for closed products and services, there is an additional 12 months to prepare for the go-live of rules in July 2024. In most cases, there is significant work required for firms to be ready.

While this timeline may appear to offer a period of grace, the FCA has been clear in their expectation that firms should use the whole of the implementation period to prepare. Firms must demonstrate progress as and when asked. Boards should also approve an implementation plan by the end of October 2022, maintaining oversight of its delivery thereafter.

2) Financial promotion rules for high-risk investments

To further enhance consumer protection, the FCA has issued finalised rules regarding financial promotion of high-risk investments. Published on 1st August 2022, new rules address the growing number of consumers investing in risky products, many of which do not match their risk appetite. Tighter rules seek to tackle the ease with which consumers, especially online, can simply 'click-through' to investments without full knowledge of the associated risks.

New rules require firms to ensure products and

clients are well matched and remain so throughout the product lifecycle. This includes a notable tightening of appropriateness assessment rules and a requirement to receive ongoing attestations from consumers to confirm there have been no material changes in this regard.

Among other changes include the requirement for clear and prominent risk warnings and the prohibition of incentives to invest in high-risk products, for example refer-a-friend schemes. Rules on risk warnings become effective from 1st December 2022, with all other aspects of new regulations effective from 1st February 2023.

3) Improvements to the Appointed Representatives regime

The FCA has published finalised rules and guidance for improvements to the Appointed Representative regime (3rd August 2022). As a further strand to Consumer Strategy, the FCA aim to make authorised firms more responsible for their Appointed Representatives, who of course are not authorised by the FCA. Enhancing consumer protection is the rationale here.

New requirements for authorised firms include:

- Enhanced oversight of Appointed Representatives
- Assess and monitor the risks presented by Appointed Representatives
- Annually review data on the activities, business and senior management of each Appointed Representative
- Provide 30 days' notification to the FCA in advance of engaging new Appointed Representatives
- Report complaints and revenue data for each Appointed Representative to the FCA annually

Requirements include a material focus on data collection and reporting and will be used by the FCA as part of their ongoing analytical work for the targeted supervision of principal firms. New rules and guidance in this area are effective from 8th December 2022.

Market Abuse

Since January 2021, the onshored UK Market Abuse Regulation (MAR) has been in place following the UK's departure from the EU. MAR ensures that UK firms are subject to broadly the same regulations as their EU counterparts.

Amendments to UK MAR were made in June 2021. Changes include:

- Extending disclosure requirements affecting dealings by persons discharging managerial responsibilities (PDMR)
- Amendments to requirements for maintaining insider lists for both issuers and persons acting on their behalf
- Increasing the maximum sentence to 10 years (up from seven) for insider dealing and market manipulation

In January 2022, the European Securities and Markets Authority (ESMA) published updated guidelines for the delayed disclosure of inside information in relation to prudential supervision.

Official translation of the guidance was published in April 2022 and has been effective since June 2022. Updated guidelines add certain legitimate cases for issuers delaying public disclosure of inside information, aiming to assist decision-making in accordance with MAR.

On 14th July 2022, Implementing Technical Standards for the application of MAR regarding the format of insider lists was published in the Official Journal. This update came into force on 3rd August 2022, making changes to SME growth market issuers by limiting the listed persons with regular access to inside information. New rules also made these issuers exempt from requirements to keep insider lists in electronic format.

ESMA also called for evidence on 29th July 2022 around pre-hedging. Currently, there are mixed views on pre-hedging with some competent authorities receiving reports of suspicious activity. Consequently, ESMA has sought the views of key market stakeholders to assist in developing guidance for what would constitute MAR-compliant activity. The deadline for responses was 30th September 2022.

Conduct

The FCA issued Policy Statement PS22/5 in May 2022 to confirm final changes to the handbook in relation to their power to cancel or vary permissions granted to regulated firms. Previously, the regulator had to wait 12 months before removing or varying the permissions of approved firms carrying out none of the regulated activities for which they were permitted.

Following the Financial Services Act 2021, the FCA can act more efficiently by varying or removing permissions immediately, without the firm applying for variation or providing consent.

Elsewhere, in line with the phased roll out of the Senior Managers & Certification Regime (SM&CR), HM Treasury consulted during 2021 on extending the regime to incorporate Financial Market Infrastructures (FMIs). The proposal to extend SM&CR aimed to enhance the accountability of senior managers and to improve governance at systemically important firms, including:

- Central Counterparties (CCPs)
- Central Securities Depositories (CSDs)
- Credit Rating Agencies (CRAs)
- Recognised Investment Exchanges (RIEs)

HMT issued their consultation response in July 2022, confirming their intention to create SM&CR for CCPs and CSDs, while retaining the option to further extend across CRAs and RIEs in the future.

This option will be through an SM&CR "Gateway", allowing the Government to extend the regime proportionally across firms.

The power to extend SM&CR across FMIs will be introduced as part of the Financial Services and Markets Bill 2022. It will be 2023 before this receives Royal Assent.

Financial Crime

In July 2022, HM Treasury published their response to consultation feedback regarding proposed amendments to the Money Laundering, Terrorist Financing and Transfer of Funds Regulations 2017. The amendments propose changes to bring regulations in line with Financial Action Task Force standards.

Amendments include:

- Applying funds transfer requirements to cryptoassets
- Granting rights to AML/CTF supervisors to view Suspicious Activity Reports
- Making account information service providers exempt from the AML regime

Most amendments will be effective from September 2022, except for the application of the funds transfer requirements to cryptoassets, which will be effective a year later.

HM Treasury also concluded their review of the UK's AML/CTF regulatory and supervisory regime, releasing a report in June 2022. The review focused on systemic, regulatory and supervisory effectiveness, with subsequent consultations expected to assess identified proposals.

Cryptoasset businesses have been in scope for the UK Money Laundering Regulations since early 2020 and are supervised by the FCA for AML/CTF as a result. However, from August 2022, any person who acquires 25% or more control in an authorised cryptoasset business must be prior approved by the FCA. To do so without approval is a criminal offence.

AMLD6 has been in place for EU firms since July 2021, introducing a list of 22 specific predicate offences for money laundering. The latest directive also increased the minimum sentence for money laundering offences (from one year to four years) to bring consistency across EU member states.

Following the Russian invasion of Ukraine and the sanctions imposed on Russian businesses and individuals, UK and EU firms have faced significant challenges in day-to-day business operations. The FCA has provided materials and guidance to support firms and to help them understand their obligations when holding sanctioned assets and exiting their business with sanctioned persons.

"We remain ever more vigilant to actors preying on consumer's vulnerabilities and are intervening at our fastest pace ever against problematic financial promotions"

NIKHIL RATHI, CHIEF EXECUTIVE, FCA

Post-Brexit Developments

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POST-BREXIT DEVELOPMENTS

UK FSMB

The UK Financial Services and Markets Bill (FSMB) 2022 has completed its second reading in Parliament. This wide-ranging bill sets out a future regulatory framework for the UK, facilitating a clear shift away from the relatively complex onshored EU legislation by allowing HM Treasury to modify and, hopefully, simplify legislation for the UK market. Significant change will affect a number of markets, including:

Cryptoassets

- Stablecoins will be regulated for the first time. Their value will be pegged to a conventional fiat currency such as GBP or USD, reducing volatility compared to pure cryptocurrencies such as Bitcoin. The bill will require issuers of stablecoins used as a means of payment to be licensed by the Financial Conduct Authority (FCA). This is likely to place stablecoins and their providers under greater scrutiny and introduce new reporting obligations

Prudential standards

- The Government wants to reform Solvency II, aiming to reduce the risk margin insurers are required to include in their technical provisions by taking account of the additional cost of transferring liabilities to a willing third party. Reforms will widen the range of assets available for the matching adjustment applied

to liabilities with predictable outflows (e.g., under annuities), and change the calculation of the fundamental spread, which reflects the risk of default or downgrade presented by matching adjustment assets.

Capital Markets

- HMT will give the FCA power to frame waivers from post-trade transparency requirements by replacing Article 4 of the onshored Markets in Financial Instruments Regulation (MiFIR), as well as the rulemaking power over pre- and post-trade transparency requirements for both fixed income instruments and derivatives.

Critical third parties (CTPs)

- While technology services such as cloud computing and data analytics bring multiple benefits, increasing sector reliance on a small number of key third parties creates concentration risk across the market. The Bill seeks to counteract this by implementing HM Treasury's recent policy paper on CTPs.

  This includes express power to censure persons designated as CTPs where they breach rules made by the FCA, PRA or Bank of England in connection with the services they provide.
- Changes will also implement the broad powers of direction, information gathering and investigation set out in HM Treasury's paper. However, proposals will not bring the main cloud services providers into the UK regulatory perimeter.

Financial Promotion Regime

- The Bill requires authorised persons that approve financial promotions prepared by third parties without UK authorisation to obtain specific permission from the FCA. These changes should prevent firms with only a nominal footprint in the UK from promoting riskier products to UK customers without adequate levels of control or oversight.

Access to cash

- Despite the increasing popularity of digital payments, many still rely on cash. The Bill will require the Treasury to publish a policy statement concerning cash deposit and withdrawal services. The Treasury will need to designate certain firms, including current account providers meeting certain criteria, as firms providing those services with a view to maintaining access to cash services.
- This aligns with recommendations made following the Treasurys' 2021 consultation on access to cash

Protecting against authorised push-payment (APP) scams

- The UK Payment Systems Regulator (PSR) must prepare and publish a requirement for customer reimbursement in cases of payment orders that the Regulator considers should qualify for reimbursement.

MiFID II

In November 2021, the European Commission published its proposals to amend MiFIR and MiFID. Proposed changes have already received consultation, with a response expected from the European Commission in due course. Proposals will also be subject to legislative review and, as Member states have 12 months to implement final changes, it will not be effective before 2024.

Changes include:

- ESMA to select a consolidated tape provider for all asset classes
- Changes to the pre- and post-transparency regimes
- The prohibition of payment for order flow
- Changes to the scope of share trading obligation and trading obligation

ESMA also issued a consultation on 7th July 2022 to review MiFID II product governance requirements. These requirements are a key element of the MiFID II investor protection framework, requiring firms to act in the best interests of clients at all stages of the product lifecycle.

Proposed within the guidelines are the following:

- The practice of identifying a target market per cluster of products instead of per product
- Periodic review of products including proportionality
- Identifying any sustainability objectives that products are compatible with
- Determining a suitable distribution strategy

Consultation responses were accepted until 7th October 2022, with ESMA expecting to consider responses and issue a final report in Q1 2023.

EMIR

Post-Brexit, the European Market Infrastructure Regulation (EMIR) was onshored into UK legislation. UK EMIR imposes reporting requirements on all entities entering a derivative contract (including those outside of financial services) to improve transparency and reduce risk. Rules will apply indirectly to non-UK firms trading with UK firms. UK EMIR also sets out organisational, conduct and prudential standards for Central Counterparties (CCPs) and Trade Repositories (TRs).

Entities that enter derivative contracts, including interest rate, FX, equity, credit and commodity and emission derivatives, must report contract details to an FCA registered TR. This includes counterparty name, country of incorporation/ domicile and Legal Entity Identifier (LEI) along with the transaction type, value, quantity and settlement date of the trade(s). It is known as a 'double-sided' regulation because both counterparties must submit a report of the trade and use the same Unique Transaction Identifier (UTI)

"The weight of regulation should be commensurate with the level of risk but moving away from the one-size-fits-all approach mandated by MiFID will be complex and it will need assistance and input from industry"

SARAH PRITCHARD, EXECUTIVE DIRECTOR, FCA

OTC derivatives subject to a mandatory clearing obligation must be cleared via a CCP. For bilateral OTC derivatives not cleared by a CCP, firms must implement a risk mitigation framework with operational processes and margining.

HM Treasury confirmed that the UK will bring new EMIR reporting obligations into law, including:

- Requirements for CCPs to do so on fair, reasonable, non-discriminatory, transparent and commercial terms (FRANDT requirements).
- Requirements for TRs to reconcile and validate the data reported to them and for orderly transfer of data to other trade repositories.

The onshored UK EMIR REFIT also brings amendments to UK EMIR into legislation, aiming to make the regime more proportionate for some firms. Key changes include:

- SFCs (Small Financial Counterparties) are exempt from the clearing obligation, while remaining subject to risk mitigation obligations.
- Non-Financial Counterparties (NFCs) are subject to reduced clearing obligations.
- The exemption from the clearing obligation for Pension Scheme Arrangements (PSAs) is extended by another 4 years for UK and EEA PSAs.
- A streamlined reporting regime, including mandatory delegation to FCs when facing an NFC, and exemption from reporting requirements for intragroup transactions when one of the counterparties is an NFC.

LIBOR Transition

As a temporary transitional measure, the FCA put a synthetic LIBOR in place for a limited number of cases. It is unlikely that synthetic yen LIBOR will extend past the end of 2022, and the FCA is seeking views on retiring one-month and six-month synthetic sterling LIBOR by the same deadline. Views on when to retire three-month sterling synthetic LIBOR will be via a public consultation in Q3 2022.

By the end of June 2023, reliance on US dollar LIBOR will end and UK regulators will work closely with international counterparts to monitor any new use of US dollar LIBOR, aiming to remove dependencies on legacy contracts by the same deadline.

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Payments

03 // PAYMENTS

Safeguarding

The FCA has placed greater emphasis on safeguarding over the past two years, after the pandemic accelerated demand for digital payments.

In July 2020, the regulator published guidance on safeguarding and prudential risk to offset pandemic-induced disruption by bolstering firms' safeguarding arrangements. It made this permanent in November 2021 to protect customers and keep the industry stable.

Recent updates from the FCA state that firms must accurately calculate and report capital requirements and resources, both on an ongoing basis and when requested by the regulator. Not only will senior managers need to review capital resources regularly, but firms must also create effective procedures to identify, monitor and report any risks to which they might be exposed.

In addition, the FCA expect firms to:

- Maintain records that demonstrate compliance with requirements
- Appoint an appropriate individual to oversee procedures
- Keep records that distinguish what relevant funds and assets are held for each client and that distinguish them from the firms' own funds and assets

Payment Services Directive 3

Following a series of consultations on the

"Businesses are reminded that adequate safeguarding measures are a pre-requisite for being granted and retaining an authorisation for the provision of payment and e-money services"

FCA, PAYMENT SERVICES AND ELECTRONIC MONEY HANDBOOK.

outcomes from PSD2 and emerging market issues, a 3rd Payment Services Directive is now anticipated by mid-2023. The exact content of PSD3 remains speculative; however, the EBA's Opinion on PSD3 (published in June 2022) may give a strong indication of the areas likely to have an impact on banks, EMIs, PIs and an ever-widening group of technology providers and merchants. These include:

- Extending Open Banking into Open Finance (i.e., other types of accounts, such as mortgages & pensions).
- Introducing common standards for APIs and ensuring dedicated interfaces are available to Third Party Providers (TPPs).
- Merging PSD2 with EMD2 (E-Money Directive) to reduce arbitrage between regulations and ensure solutions are technology agnostic.
- Changes to capital requirements and liquidity buffers for EMIs and PIs, potentially changing

capital calculations and increasing capital reserves requirements.

- Changes to Secure Customer Authentication (SCA) for Merchant Initiated Transactions (MIT), refunds and use of 3rd-party technology.
- New criteria and reporting for banks where PI/EMI banking facilities are refused.

Markets in Crypto Assets (MiCA)

The EU has now approved the full legal text of the Markets in Crypto Assets Regulation (MiCA) and it will now be put before the EU Parliament for approval. It is expected to be published early 2023 before taking effect sometime in 2024.

Some key highlights are:

- Any Credit institution, Crypto-asset Service Provider (CASP) or Investment Firm that provides custody services will have new requirements to protect consumers wallets and will become liable in case of loss, unless they can prove that the loss arose from an external event beyond its reasonable control.
- New measures to prevent insider dealing, unlawful disclosure of inside information and market manipulation related to cryptoassets, in order to ensure market integrity.
- Actors in the crypto-assets market will be required to declare information on the environmental impact of their consensus algorithms, however, there is no explicit ban on proof of work.
- ESMA will be tasked with maintaining a public register of non-compliant entities providing crypto-asset services.
- Issuers of asset referenced tokens (ART) must ensure effective and prudent management of the reserve of assets, including ensuring the holders are always granted redemption rights and that the reserve of assets is operationally segregated from the issuer's estate and from the reserve of assets of other tokens.
- National competent authorities can withdraw authorisation if the ECB issues an opinion that the ART tokens pose a serious market threat.

04

ESG

04 // ESG

Banks, insurers, and asset managers have reported on Environmental, Social and Governance (ESG) metrics for several years. But keeping up with ESG regulatory developments has proven a sizeable challenge for firms. Below, we summarise the key development relevant to ESG reporting.

The SEC propose new ESG requirements in the U.S

In May 2022, the Securities and Exchange Commission (SEC) released a proposal requiring firms selling ESG funds to report information in "structured data language" to facilitate better comparability across funds.

Additional disclosures like financial impact metrics and disaggregation of expenditure metrics will require enhanced disclosures, control statements and mandatory assurance. More broadly, firms claiming to consider ESG factors in their investment strategies must disclose the overall carbon footprint of their portfolios. Adhering to new requirements will necessitate new datasets, processes and controls.

ESG development in the UK

1) TCFD reporting becomes mandatory for 1,300 U.K firms

For financial years starting after 6th April 2022, reporting based on TCFD (Task Force on

Climate-Related Financial Disclosures) metrics is now mandatory for more than 1,300 of the largest financial firms in the U.K. Much like SEC requirements, additional data sourcing and improvements will remain a key challenge for TCFD-based reporting.

Many companies have already responded by transitioning ESG data and reporting teams into finance departments, hoping that the same rigour can be applied to ESG metrics as to financial information disclosures.

2) Net zero transition plans

The FCA and HMT are working together with the Government's Transition Plan Taskforce to form regulatory expectations for disclosure by listed companies and regulated firms (and banks in particular). The Taskforce was launched in April with a two-year mandate to develop a 'gold' standard for private sector transition plans.

The Climate Financial Risk Forum, jointly established by the PRA and FCA, will complement this work by establishing industry working groups to define disclosure, data and metrics and scenario analysis.

More information on emerging obligations is expected throughout Q4 22 and Q1 23.

3) Sustainability & Disclosure Requirements (SDR) & Investment Labelling

The FCA issued a discussion paper in 2021 on SDR for certain asset managers and FCA-regulated asset owners, such as pension schemes. The paper proposes standardised definitions of sustainable investment labelling for:

- Consumer-facing disclosures for investment products
- Client and consumer-facing entity and product level disclosures

The FCA is also exploring how to introduce rules for Financial Advisers. A consultation paper is expected in Q4 2022.

4) FRC Stewardship Code

The Financial Reporting Council, which regulates auditors, accountants and actuaries, reported the 2nd round of successful applicants to the Stewardship Code in March 2022. The Code is intended to improve the accuracy and quality of financial reporting to investors.

Applicants must provide a Stewardship report to evidence compliance with the Code's Principles in the previous 12 months, demonstrating the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries. The overall aim here is to create sustainable benefits for the economy, the environment and wider society. The deadline for applications to the next round is in Q4 2022.

"We need to adopt a holistic and cross-cutting approach to ESG issues if we are to deliver efficiently on the outcomes we are targeting. This requires staff training and awareness, processes and systems, and high-quality data and intelligence across our regulatory functions"

FCA, ESG STRATEGY

Complete data now central to the EU taxonomy

The EU Taxonomy came into force on 12th July 2020, imposing disclosure requirements for companies with regards to the environmental aspect of ESG. The taxonomy provides a classification system of all sustainable activities.

On May 25th, the European Commission said that investment firms managing ESG-promoted funds must declare that the fund has zero alignment with the taxonomy if the necessary environmental objective data is missing. In further comments, the Commission said that investment firms can only declare a fund's taxonomy-alignment when reliable data is available.

The ISSB release exposure draft

The International Sustainability Standards Board (ISSB) released its exposure drafts on 31st March 2022. The draft standard outlines requirements for disclosures over climate and general ESG reporting. New standards are expected to be adopted under UK law by 2024 or 2025. A key requirement of new exposure drafts is for sustainability reporting to be connected to and complement financial statements.

05

CBS Insights: Regulatory Trends

05 // CBS INSIGHTS

REGULATORY TRENDS

CBS is seeing some clear trends in the actions of the UK's financial services regulators:

Extending the regulatory perimeter

As the Financial Services ecosystem continues to grow, regulators are increasingly having to re-adjust their focus and supervisory powers onto previously unregulated firms, such as technology providers and crypto firms. Both the FSMB and the Discussion Paper from BoE, PRA and FCA on Critical Third Parties (CTP) to the UK Financial Sector signal imminent changes for those firms that HMT may designate as CTPs, such as cloud services, PaaS providers and infrastructure providers. Currently, it falls to regulated firms to use material outsourcing and impact tolerance regimes to mitigate against risk of these firms failing. CTP will likely extend supervisory authority to this new group of firms directly, obliging them to set, test and report against minimum resilience standards.

Post-Brexit divergence

We are starting to see divergence between EU and UK legislation now. Whilst supervisory outcomes and strategic market objectives remain broadly aligned, the UK's decision not to implement MBI (Mandatory Buy-In) as part of CSDR is one small example of such a divergence. With the FSMB, however, the UK Government makes a far greater statement in this regard as it sets out the future regulatory framework for the UK. The

UK Government intends to address regulatory complexity compared to EU regulations and, for firms operating solely in the UK, this is a positive change. However, for firms that operate in both the UK and EU/EEA, there is a risk this introduces further complexity and potentially additional reporting requirements.

Digital regulatory reporting

Following the Dear CEO letter in Q1 2021, the BoE, PRA and FCA launched a transformation programme for data collection as they move towards Digital Regulatory Reporting. The initial focus has been on dual regulated firms, but this will shift to solo regulated firms throughout the rest of 2022. Dual regulated firms were advised of initial use cases and potential investment requirements in Q2 2022.

As regulators become more data-led, we are likely to see more enforcement activity arising from reporting over the next 12-24 months. Regulators remain concerned with data quality across all reporting regimes as they are making more use of that data in both firm and market supervision. To deal with this, firms will need better services and tools to deal with the increasing complexity of reporting, including in the remediation space as well as for current and future reporting responsibilities.

CBS Insights: An inside look at regulatory reporting in the Banking sector

Within the banking sector, we see clients increasing investment in both regulatory advice and in managing their data assets. This is a significant ongoing challenge, particularly for those that operate across multiple jurisdictions and need to support more than one reporting regime. For those that have grown by acquisition, there are additional legacy systems and data repositories being brought into the technology landscape, making golden data sources and data flows more challenging to identify and manage. The drive to engineer spreadsheets and end-user computing applications out of the regulatory reporting processes has never been higher.

CBS Insights: An inside look at regulatory reporting trends in Fintechs

Some fintech clients are falling within the regulatory perimeter for the first time, meaning financial investment normally channelled towards customer-facing product features now needs to be redirected towards back-office systems and reporting tools. For some early-stage scaleups focused on growing market share, this presents a difficult reprioritisation of resources. However, those fintechs that have successfully scaled had one thing in common: they all overcame that reprioritisation challenge in order to maintain the licence to operate.

Unencumbered by legacy systems (for now), many fintech clients are able to respond quickly to technology and data challenges; however, the competition for regulatory expertise is fierce as the whole sector faces similar levels of change and regulatory deadlines. For this reason, many growing fintech clients continue to rely on external advisors and partner with specialist platform providers.

"Many firms' legacy systems continue to have inherently inconsistent source data that has not been touched since the data was captured at the time of the transaction. This means the full set of data we ask for isn't always available".

BANK OF ENGLAND, TRANSFORMING DATA COLLECTION FROM THE UK FINANCIAL SECTOR

AutoRek Insight: Financial Data Management Challenges

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AUTOREK INSIGHT: FINANCIAL DATA MANAGEMENT CHALLENGES

The financial data management aspect of regulatory reporting has always presented a challenge to firms. But legacy systems, data quality issues and a lack of collaboration between firms and regulators has intensified the challenge in recent years.

Regulators continue to highlight regulatory reporting as an area for improvement. Only last year, the senior manager for data collection transformation at the Bank of England said that, going forward, 'we're not waiting ten years and thousands of resubmissions for the data that we need'.

Similarly, a PRA letter openly criticised the fact that 'multiple firms did not treat the preparation of their regulatory returns with the same care and diligence that they apply to financial reporting shared with the market and counterparties'.

In our experience, there are ten financial data management challenges that firms face in the regulatory reporting process.

1 – Insufficient governance

A robust governance framework has a large part to play in regulatory reporting and ongoing compliance. For example, new rules under Operational Resilience and Consumer Duty reinforce the importance of governance at the board and senior levels.

Culture and behaviours, policy and procedures, systems, controls and assurance are all key components of effective governance, together with active horizon scanning on emerging regulations and effective interpretation.

Submitting accurate reports to the regulators is only possible when these underlying governance factors are in place.

Key questions for firms to ask include:

- Do we understand what regulatory changes are imminent and how they affect our business model?
- Can we link regulatory rules directly onto our processes, controls, prescribed responsibilities and risks?
- Do our senior managers have effective oversight and controls in place?
- Are there clear lines of sight and delegation?
- Is compliance embedded in our cultures and procedures?

Addressing these questions is much tougher for larger, more siloed organisations.

2 – poor integration of the technology ecosystem

Many organisations work with multiple different systems that are poorly integrated with one another. As a result, firms have multiple different data feeds in different formats – all held together through spreadsheets and complex macros.

Firms with a poorly integrated tech stack lack a single, consolidated view of their financial data. Before submitting reports to regulators, staff must perform lots of manual work extracting data from a range of disparate systems. This is no easy task, especially considering the primary purpose of these systems is not to support regulatory reporting.

3 – lack of automation

As regulators continue to push for higher levels of automation, manual processes remain an ongoing challenge for firms. In some surveys, 87% of firms point to manual processes as the main reason for making recurring adjustments for regulatory reporting purposes.

Organisations without automated control frameworks rely on manual intervention – a challenging task considering processes include many internal and external interfaces. Particularly as data volumes grow, the risk of error is always present.

Firms should bear in mind that regulators continue to monitor those with manual processes closely. In the UK, the PRA expects firms with spreadsheet-based financial controls to ensure 'appropriate documentation of key processes, risk and control assessments, judgements, and assumptions, as well as robust processes and controls'.

Likewise, regulatory reporting best practice in the US dictate that firms with manual processes should 'establish internal controls to compensate for the weaknesses inherent in the manual data collection process'.

4 – inadequate reconciliation disciplines

As the complexity of regulatory reporting increases year-on-year, superior reconciliation processes will form the cornerstone of effective financial data management. Regulators continue to investigate the standard of reconciliations further to tease out issues.

Following a recent review of regulatory reporting, the Bank of England recently stated:

'Given the size and complexity of the reporting landscape, there are sometimes thousands of data points that can, and should, reconcile. Participants found this was often hard to do. Large firms struggled to ensure the same data point tallied when it was submitted as part of multiple reports. Users of the data said at times they wondered which data to trust, after they struggled to identify the cause of difference between seemingly similar data points'.

Ultimately, poor reconciliation and financial control procedures affect data integrity. With each data source, data should be validated before matching or reconciliations take place. Without an automated solution, firms waste time and effort identifying and remediating duplicates, errors and inconsistencies.

By reducing the "noise" in reconciliations, firms can instead focus efforts on important issues like the interrogation and resolution of true exceptions and breaks.

5 – no clarity on the golden source

Identifying relevant data and extracting it from core systems is only the first step in an effective regulatory reporting process. Firms need a golden source of truth on their data, which is only possible with effective disaggregation and enrichment. Unfortunately, we often find that firms struggle in this regard.

Disaggregating and enriching data is critical for complete and accurate reporting: disaggregation allows firms to split bulk items into their lowest levels of granularity, while enrichment allows firms to amalgamate and consolidate data feeds further (for example with FX rates, static client data, stock codes, account IDs, legal entities, location and asset classes).

The above greatly simplifies reconciliation and reporting processes, allowing firms to pinpoint breaks, identify why they have occurred and resolve them efficiently. This is a key aspect of long-term risk mitigation and driving out operational inefficiencies.

Not only do regulators compare regulatory returns on a like-for-like basis, but they also cross-validate data contained in multiple reports to check for completeness of information. As such, it is imperative that firms establish a golden source of data for regulatory reporting purposes.

6 – in-house solutions

A common issue with regulatory reporting is that firms adapt their IT ecosystems as they expand or as the industry changes. For those with homegrown, self-built solutions, this invariably creates gaps in the IT systems supporting core workflow. Operational teams must then find ways to bridge gaps by building their own data sets and, as a result, companies are left with data that is stale or unavailable for decision-making.

While in-house solutions have proven a popular choice over the last decade, we find that managing these systems raises many complexities for firms: continually adapting homegrown systems – which were not built with change in mind – to meet an evolving regulatory landscape is a substantial and time-consuming task. This is an especially pertinent issue today, where all regulations go through multiple iterations after the initial go-live.

We also find that firms reliant on in-house systems are more likely to struggle with data transparency, data lineage and issue management. Organisations in this position leave themselves open to enforcement action. To overcome this, it is essential for the code within systems to be completely flexible and scalable.

7 – legacy systems

Legacy is an issue that pervades all sectors of finance. But the problem is particularly acute for regulatory reporting, where firms often build operational systems on older technology.

A recent report from the Bank of England stated that:

'many firms' legacy systems continue to have inherently inconsistent source data that has not been touched since the data was captured at the time of transaction. This means that the full set of data we ask for isn't always available'.

Until firms address legacy issues, they will have to populate regulatory reports with data that originated from outdated systems. Consequently, data can be a decade old and fall short of modern requirements. Things become even more difficult when trying to capture, extract and process additional data fields required for regulatory reporting.

8 – inaccurate or stale Management Information (MI)

Financial organisations cannot make informed, data-driven decisions without accurate MI to support them. The ability to generate and utilise accurate MI has a large part to play in demonstrating effective oversight. This is especially true when considering regulatory processes.

Real-time, meaningful MI available at a glance should be a goal for all firms across the financial sector. However, what often happens is that MI

takes firms days to prepare, meaning it is always out of date when presented. This makes the continuation of MI from one month to the next even more of a challenge.

The lack of meaningful MI is symptomatic of the most common problem underpinning the regulatory reporting landscape: lack of data control. Regulators expect firms to have full knowledge of their underlying data, with effective, efficient and integrated controls in place. Real-time management information and reporting will be a critical step here.

9 – gaps in the audit trail

A comprehensive audit trail is paramount to regulatory reporting. Not only is this essential for identifying and rectifying errors, but firms will also need to demonstrate to regulators that a robust control regime is in place.

Achieving ongoing compliance requires the ability to attach and store documentary evidence, such as documented roles, responsibilities and key procedures. This is not a one-off exercise: processes and controls should be regularly reviewed and updated in a way that is transparent.

Firms that encounter the most problems with audits are those with spreadsheet-based controls. The ease with which data can be deleted or manually updated presents a real concern over the integrity and completeness of actions taken within the audit trail.

10 – regulatory complexity and misinterpretation

An effective regulatory reporting processes requires collaboration between regulators and the firms they oversee. At times, this has proved difficult as there is a natural barrier between organisations providing data points and the authorities scrutinising them.

Problems arise because the regulations themselves are open to interpretation – not only by organisations, but by consultants and auditors too. It is this lack of clarity that creates confusion and adds to the cost of compliance as firms need to call on subject matter experts (SMEs) to help. However, finding technical experts who have operational and regulatory experience is a significant challenge.

Firms that struggle most are those that fail to document their interpretation of guidelines. Organisations will be in a much stronger position if they have a fully documented, pragmatic application of a new or changing requirement, rather than dismissing them as not applicable without due consideration or governance.

07

The Bottom Line

07 // THE BOTTOM LINE

AutoRek

Firms clearly face many challenges around regulatory reporting, especially when it comes to financial data management. As the eyes of regulators focus increasingly on these issues, firms will no doubt be considering what automation solutions can support their regulatory reporting processes.

AutoRek is an award-winning financial data management platform, trusted by a comprehensive list of blue-chip organisations across the breadth of financial services. The software delivers a fully configurable solution to help firms meet the many challenges of data management, reconciliation and reporting, all of which are central to helping our clients meet their regulatory obligations. The platform's rules-driven engine helps our clients meet the many challenges presented by regulatory reporting in the following ways:

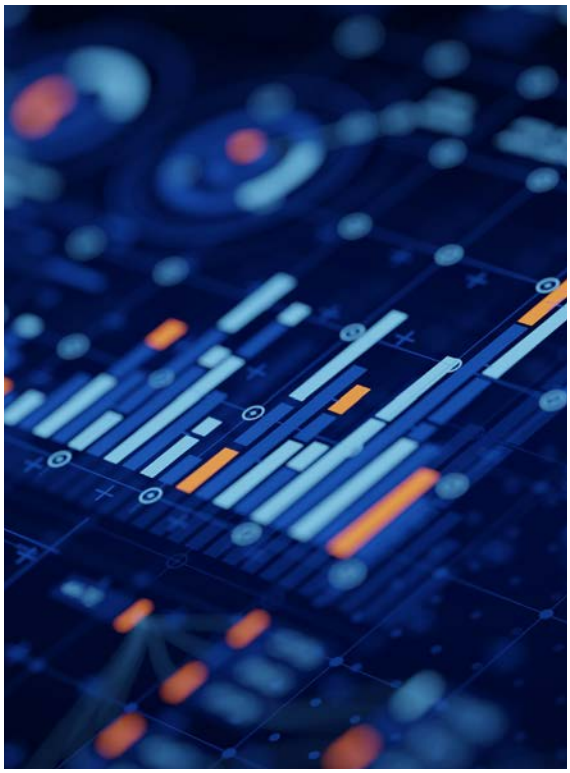
- Ingestion and consolidation of data from multiple source systems into a single, digestible format for ease of reconciliation and reporting
- Leveraging end-to-end automation to remove error-prone manual intervention
- Enrichment, aggregation and disaggregation functionality to ensure data is captured and at the level required for calculation, reconciliation and reporting purposes

- Front-end configuration, easily adaptable to incremental changes resulting from new regulation, new data sources and ongoing business process refinements
- Rich, real-time dashboards displaying key datapoints, alerts and trends for immediate oversight of data exceptions and irregularities
- Insightful and automated report generation and data extracts
- Robust control functionality including maker/checker rules using Case Creation logic and workflow management
- Full audit history of all actions taken on the platform with secure and active archiving

CSB Consulting

Keeping up to date on current and emerging regulation is an essential and existential challenge for all firms in the FS sector and particularly for those operating across multiple jurisdictions. Understanding the impact of regulations on the business model and delivering the associated change projects places a strain on investment budgets and internal resources

CBS Consulting is a leading and highly respected change specialist within the UK Banking and Retail sectors. We manage and deliver technology, regulatory and operational change for established and new challenger banks, fintechs and retailers – from core product platforms and new digital channels to payments and risk applications, with all the integration in-between. Our wealth of experience and market insight allows us to help clients evaluate, prioritise and select the right balance of strategic initiatives – empowering the delivery of their goals with increased confidence and efficiency.



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Grant has spent the last 20 years working with global banks, challenger banks, fintechs, regulators and market infrastructure operators, leading and delivering complex, mission-critical change programmes. With a background in both technology and economic development, he has also advised on economic and competition policy development throughout Europe and Asia, and is an experienced mentor to founders of scale-up businesses

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THE REGULATORY REPORTING HANDBOOK 2023

Regulatory updates, key trends and data challenges

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