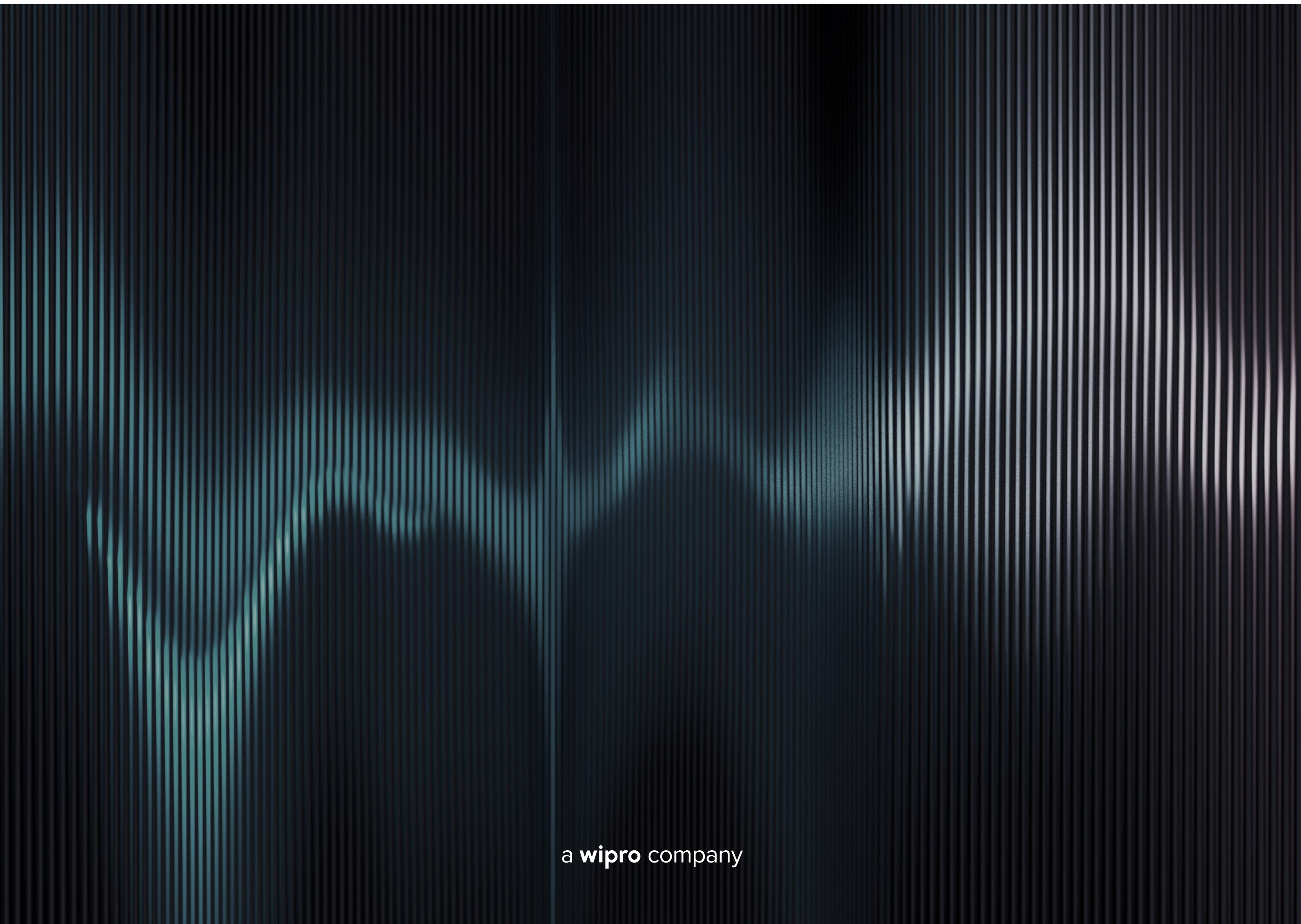
CAPCO

OPTIMISING REGULATORY CHANGE

A CFO PERSPECTIVE



SPEED READ

- As the banking industry continues to grapple with a multitude of risk and capital regulations, Chief Financial Officers (CFOs) are finding their role has expanded, with their new remit including regulatory implementation, data governance, and end-to-end process change.
- CFOs are advised to quickly adapt to this new set of responsibilities, as it presents them with a significant opportunity to take the lead in defining business and operational strategy.
- Currently, CFOs are facing a diverse set of challenges across the three pillars of their responsibilities: Custodial, Transformation, Strategy.
- The combination of these challenges creates a 'triangle of tension' for CFOs who are consistently balancing customer (business/portfolio strategy), operational (risk & reporting) and stakeholder (internal business function) responsibilities whilst delivering transformation in a changing environment.
- Given these challenges, we believe they should consider the following:
    - Tracking and aligning delivery of regulatory requirements across regional regulators on a global basis
    - Leading in collaboration with CIOs and Business leaders to maximise RWA optimisation via Portfolio Strategy
    - Conduct materiality analysis to prioritise high impact initiatives
    - Utilising new data and analytics technologies to improve accuracy of reporting and regulatory submissions.

INTRODUCTION

The role of the CFO is changing. As the Banking industry continues to grapple with a multitude of risk and capital regulations, CFOs are finding their role has expanded. Where the traditional CFO was concerned primarily by custodial and operational finance tasks feeding the financial assessment of the business, today they are required to be custodians of the risk appetite of the bank (along with the Chief Risk Officer and Head of Compliance). This new remit encompasses regulatory implementation, data governance, and the end-to-end change process. As such, CFOs are now spending more time driving regulatory strategy, organizational transformation, data analytics, and operational digitization such as cloud-based reporting and calculation accuracy.

CFOs are advised to quickly adapt to this new set of responsibilities, as it presents them with a significant opportunity to take the lead in defining a business and operational strategy that is more adaptable to the changing role of a bank within the current economic cycle and to the prospect of further regulation. In this paper we explore the expanded role of the CFO, the challenges they are facing, and what they should consider going forward.

BACKGROUND

The seismic impact of the Basel Accords and IFRS reporting, coupled with the ongoing revisions and specific regional requirements (such as the European Banking Association's Model Repair Package), has committed banks to an almost constant state of transformation, with COVID-19 further adding to the implementation headwinds as deadlines approach for regulations such as Capital Requirements Regulation (CRRII) and Fundamental Review of the Trading Book (FRTB).

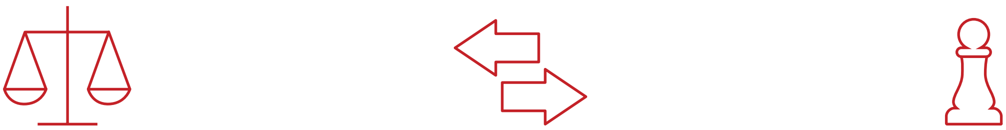
Moreover, the broader impacts of COVID will shake up the traditional banking business model. The pandemic has effectively accelerated the timeline for change – the progression of the digital economy, the shift in employment patterns, and the move away from the traditionally stable credit customer will now happen earlier than previously anticipated. As such, a bank will have to reassess its capacity and criteria for lending, impacting the capital allocation. In short, the foundations of the economy upon which so many capital decisions are made has shifted.

Throughout the post financial crisis transformation process, the internal Finance division has seen an expansion in its scope of responsibilities, which now include risk, regulatory and reporting compliance, data governance as well as IT development and implementation (most notably cloud migration). This increase in remit is driven by the Finance division's central position within the organisation and the risk and capital management process, with oversight and influence over RWA methodology, data, and reporting requirements. It should be acknowledged that the Finance and Risk departments need to work closely together for the effective management of capital.

This shift has underscored the importance of the CFO in the transformation process, whose role now encompasses strategy development, process optimisation, on top of the more traditional fiduciary and custodial responsibilities. The CFO now need to take a leadership role in defining the transformation and future state, deciding which initiatives to prioritise based on their 'value' (ROI/RWA impact), providing forward momentum in constructing the end-to-end process flows, and aligning internal and external stakeholder responsibilities.

CHALLENGES

Whilst the CFO (and Finance division as a whole) are critical to the delivery of the regulatory change and transformation processes. As figure 1 shows, they are currently facing a diverse set of demands and challenges across the three branches of their responsibilities.



Custodial

Financial Oversight
Regulatory Responsiveness
Reporting Standards
Governance Compliance

Transformation

Stakeholder Aligment
Technology Implementation
Data Transformation

Strategy

Cost Allocation
Value Enchancement

Figure 1: Thematic Challenges faced by the CFO

Custodial

1. **Financial Oversight:** Discharging effective oversight of the bank's financial position has been central to the CFO's role as a steward. However, ensuring reporting and control compliance, as well as adequate risk mitigation, has become more challenging as the business complexity has increased. Overlapping regulatory requirements at a global and regional level, coupled with the differing operating models and business cultures, has made it harder to apply good judgement and effectively consolidate and manage risks.

2. **Regulatory Responsiveness:** Existing and new regulations are not only subject to interpretation (at both a local regulator and institutional level), but are open to industry consultations, and subsequent revisions. As such, swiftly responding to ongoing regulatory updates and revisions, with the associated material impacts on requirement and future state definition, has become critical for Finance functions.

3. **Reporting Standards:** With the increase in scope of business operations, and product range across both traded and banking books, ensuring full reporting transparency and accuracy at a global and regional level has become more complex given the conflicting regulatory requirements, and data restrictions.

4. **Governance & Compliance:** With the overlapping nature of regulatory disclosures, and the ongoing waterfall of updates, governance models are in an almost constant state of transition. The ideal future state is a compliance framework that can handle the growing complexity of the global business operations, whilst being more nimble in respect of future regulatory changes. However, given the issues on stakeholder alignment and future state definitions, this ideal target become increasingly difficult for CFOs, who often find themselves building on shifting foundations.

Transformation

1. **Stakeholder Alignment:** Aligning internal and external stakeholder interests and strategy across businesses and regions is essential to enterprise execution. As banking operations continue to expand and increase in complexity, it is becoming harder to establish and maintain accountability amongst stakeholders. This creates a poor foundation for delivering strategic and operational change, with the greatest impacts falling on the Finance functions, given their central position in the end-to-end process.

2. **Technological Implementation:** The acceleration in digitization in the wake of COVID-19 has further exacerbated the speed and importance of the technological transition. Managing business risks and implementation costs associated with adopting these new technologies, including third party vendors, has become increasingly difficult due to growing scale and complexity of global business operations.

3. **Data Transformation:** Understanding data; defining Critical Data Elements (CDE), aligning data ownership and accountability between businesses, and ensuring regulatory enforcement across global operations is a constant challenge. The problem has been exacerbated by the shift to cloud calculation and reporting, with more stringent requirements from certain regulations such as FRTB, which specify market and computational data.

Strategy

1. **Cost Allocation:** Given the multi-faceted nature of the CFO's role, to be an effective operator, balancing costs of compliance with risks and product/service offerings is critical to long term success. However, with limited budgets and an expanding remit this is becoming problematic and forces the CFO to make tough choices regarding business focus, which are often based on crude materiality metrics.

2. **Value Enhancement:** With the number of ongoing regulatory initiatives at both a global and regional level, cost, resource, and time allocation have become increasingly stretched, with an acute risk of non-compliance. It is therefore essential that the priority of transformation initiatives is driven by 'value enhancement' such as ROI and capital charge reductions, to ensure optimal resource allocation.

The prioritisation of these challenges will depend on the size and scope of the institutions in focus, with certain banks choosing to prioritise some based on their specific business operations, and the materiality of the change requirements.

What is clear though is that the combination of these challenges creates a 'triangle of tension' for CFOs who are consistently balancing customer (business/portfolio strategy), operational (risk & reporting) and stakeholder (internal business function) responsibilities whilst delivering transformation in a changing environment. Figure 1 below highlights these three considerations, respectively reflecting the custodial, strategic, and operational aspects of the CFO's role.

The CFO, and the wider Finance function, must often make tough choices regarding which initiatives to prioritise while being cognisant of potential material impacts both on business development and the bottom line. This can create internal strife between functions and across regions, as stakeholders push for a bigger slice of the limited resources available.

Figure 2: 'Triangle of Tension' that CFOs face

With the current volume of regulatory scrutiny showing no signs of abating in the coming years, CFOs need to reconsider their strategy if they are to be successful in meeting the demands of their newly expanded role, and ensuring their organisations remain competitive.

CONSIDERATIONS

Given the multi-faceted nature of the CFOs responsibilities, we believe there are significant opportunities for them to play a bigger role in the strategic development of the operating model, which will help their custodial and fiduciary duties. As such, with the challenges laid out above, we believe they should consider the following:

1. **Defining cross-border regulatory requirements:** Whilst regulatory initiatives can often change or be amended following industry consultations (for example, Basel and the EBA Repair Package) and are open to interpretation[1], having clarity on regulatory definitions and/or RWA requirements is a critical foundation for effective implementation. A lack of clearly defined working assumptions can lead to parallel implementation streams across regions and businesses, potentially with conflicting goals and targets. This can complicate and delay interlocks when it comes to future state definition and, by extension, planning and budgeting.

   Given Finance's central position within the transformation process, shouldering the cost and delivery impacts of undefined future state, it is critical for the CFO to spearhead the regulatory requirement definition at both a global and regional level. This is particularly important given Finance's shift to cloud-based reporting solutions, and the use of external vendors which without clearly defined requirements, can be a costly and misaligned endeavour.

2. **Aligning businesses on the future state:** When designing the future state of end-to-end processes, banks often have conflicting views between businesses and regions, this is especially true of institutions with significant overseas operations (e.g., in APAC and/or MENA). With much of the data flow, methodology revisions and reporting expansion falling on Finance, CFOs have a perfect opportunity to take the lead by shifting to a cross-border perspective in developing an end-to-end process, which will establish a strong foundation for future regulatory revisions. The clarity in ownership will also assist in defining data ownership, and aligning governance and controls oversight, which has traditionally been splintered amongst businesses and regions, but remains a key critical enabler.

3. **Materiality analysis to prioritise high value initiatives:** With so many regulatory initiatives and limited resources (not to mention timelines to meet), transformation teams find it difficult to prioritise the deliverables with the most material impacts on RWA, ROI and even regulatory credibility. Given their intimate knowledge of the internal businesses, CFOs and the Finance division are best placed to assess the marginal value of a new initiative, not just to the ROI and P&L, but in terms of cross-supporting other regulatory deliverables such as data governance and reporting, and even the time required for implementation.

   To improve the resource allocation, CFOs should aim to create competition between the initiatives, removing the dependency on traditional basic financial controls to allocate CAPEX. This will lay the foundation for the CFO to review these projects post implementation, and then decide which subsequent initiatives to fund or defund. To maximise the effectiveness of this though, Finance needs to set a performance benchmark to act as a gauge, one that looks at returns over a period, and which uses an expanded set of metrics such as reporting accuracy, business/regional expansion (driven by realigned business strategy), and even capital reductions to form a revisable baseline.

1. As specified in the original Basel text regulatory initiatives are subject to interpretation by regional regulators and institutions.

4. **Utilising new technologies:** As Banks operations have continued to expand across both Banking and Trading books, the structure of operations has become more complex. CFOs should take the initiative to employ new technologies, especially as the drive to digitize the operational and custodial processes intensifies. By leveraging such technologies for processing transactions and integrating data, CFOs can more easily derive insights into business strategy, reduce the costs of traditionally resource intensive processes, and increase the bank's competitiveness.

5. **Leading in collaboration with CIO/business leaders to maximise RWA optimisation via portfolio strategy:** Given the increasing impacts of capital and liquidity requirements on ROI, and the expanded Finance remit, CFOs have a strong basis to begin leading on portfolio and business strategy. With their centralised position, CFOs have the right blend of expertise and influence to collaborate and lead in strategic decisioning. This in turn will better position Finance for future regulatory implementation, rather than having requirements dictated by internal stakeholders.

WHAT NEXT?

Given the above we would recommend that a CFO takes the following steps:

1. Create a clear plan of priorities based on materiality, which can be shared across the functions to set a delivery plan for future implementation.

2. Look to build a multi-faceted team which understands the broader technological and strategic changes required of the finance function and the bank.

3. Work closely with the Risk function to optimise capital and reporting processes, addressing the underlying data challenges, and defining a 'golden source'.

4. Optimise the use of time to focus on what the financial and regulatory positions are telling you and consider, and how this could support effective board oversight, across business and regional deployments.

CONCLUSION

In summary, banking regulation continues to radically change the industry landscape at every level, and institutions need to move away from the idea of a static business model, and instead become more adaptive to maintain their competitive edge. Given their central position within the organisation, and intimate understanding of the entire end-to end process, CFOs are best placed to take the lead on defining the future state. In turn this will help the Finance function, whose role has now significantly expanded.

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ABOUT CAPCO

Capco, a Wipro company, is a global technology and management consultancy specializing in driving digital transformation in the financial services industry. With a growing client portfolio comprising of over 100 global organizations, Capco operates at the intersection of business and technology by combining innovative thinking with unrivalled industry knowledge to deliver end-to-end data-driven solutions and fast-track digital initiatives for banking and payments, capital markets, wealth and asset management, insurance, and the energy sector. Capco's cutting-edge ingenuity is brought to life through its Innovation Labs and award-winning Be Yourself At Work culture and diverse talent.

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