CAPCO

STAYING AGILE IN A CHANGING REGULATORY LANDSCAPE:

FRONTRUNNING THE NEW NORTH AMERICAN SWAP DATA REPORTING UPDATES

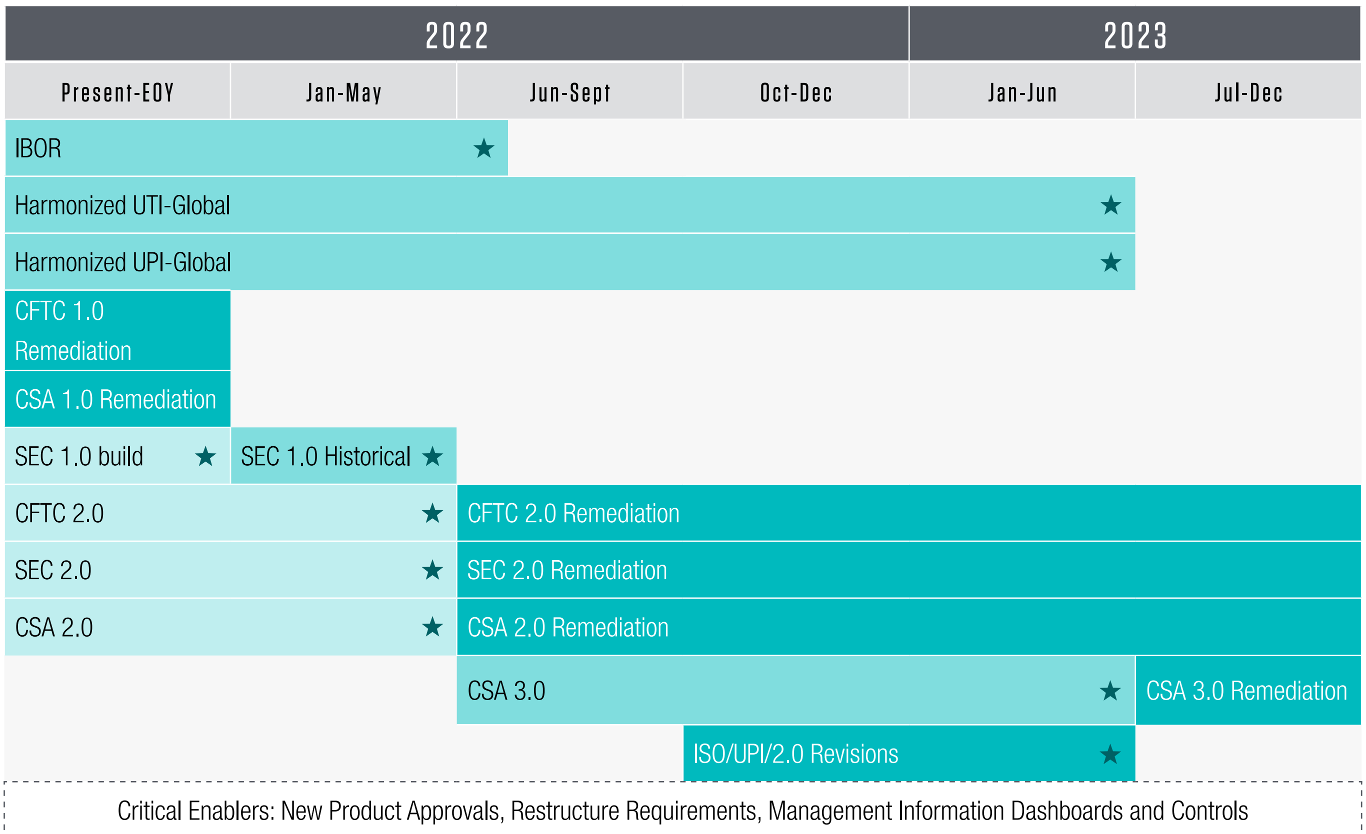
a wipro company

SPEED READ:

- Between now and 2023, CFTC 2.0, CSA 3.0, SEC 2.0, and IBOR updates will launch, bringing a host of new guidelines for swap dealer repositories (SDR)
- Firms will have to remediate errors within a seven-day window or else face escalation with potential fines and reputational risk
- To stay ahead of the coming regulations while maintaining quick remediation times, firms must implement agile methodology into their regulatory reporting framework in conjunction with simplifying their data streams that lead to reporting layers

NORTH AMERICAN REGULATORY ROADMAP:

Over the next two years the following implementations are expected in regulatory reporting



*Assumptions:

- CFTC/CSA/SEC 2.0 go live in May 2022
- ISO & UPI go live in May 2023
- UTI Squad operational till all mandates go live with Harmonized UTI
- CSA New Rules go live in May 2023

With an increasing focus on data accuracy, transparency, and reporting from regulators, firms must be more introspective and proactive to ensure no risks fall between the cracks. Over the next two years, firms must be proactive by incorporating agile methodology into their regulatory and compliance control frameworks in anticipation of CFTC 2.0, SEC 2.0, IBOR, and eventually CSA 3.0. One critical aspect of the new reporting standards about swap data reporting comes from the CFTC where reporting counterparties must reconcile their books and records against reports provided by a swap data repository (SDR). In the event of a discrepancy, firms will have seven business days to correct the error or omission. Firms will need to integrate agile methodology into their regulatory reporting frameworks to amend discrepancies between front-to-back office systems within such a short window. While many firms have successfully implemented select agile concepts in the past, robust agile delivery models are severely lacking across the board. This article will discuss some of the challenges that firms can expect in the next two years and steps an organization can take to protect itself from regulatory risks by remaining agile.

CHALLENGES

The administration change in the United States brought with it a higher level of regulatory scrutiny. In the president's "American Families Plan," he revealed that ongoing tax enforcement efforts will raise over $700 billion in the next decade. To facilitate this, the president proposed giving regulatory bodies an additional $80 billion in funding and increased regulatory authority.

The increase in regulatory oversight is expected to increase scrutiny on the timelines, accuracy, and completeness of regulatory reporting across the industry. As regulatory bodies and Global Trade Repositories invest materially in personnel and technical analytics, leading to an increasingly sophisticated oversight capability, reporting capabilities should be assessed to ensure a firm's front-to-back data processing and reporting process is flexible enough to meet the tightened regulatory obligations compliance framework.

This will be a challenge for financial institutions with lacking cross-regime collaboration. Previously, firms have implemented their reporting offices as isolated and global teams deployed to fix present problems. This approach lacks the integration that an integrated and successful regulatory office needs to function with such quick turnaround times. Organizations can often lack the ability to distribute management resources quickly and effectively across the company; often management resources are tied into these individual teams which hampers their ability to respond quickly to regulatory change. This challenge is only exacerbated as many firms use multiple data feeds for each asset class in their front-office systems, which creates discrepancies when this data reaches back-office reporting layers.

EFFECT

It's no secret the effects of Dodd-Frank are continuously being felt in the financial services industry, and this increased level of oversight is only increasing pressure on firms. Since 2008, well over $321 billion in fines have been levied at financial institutions, with North American banks accounting for a whopping 63% ($204 billion) of the total. Between 2019 and 2020, FINRA posted a 43% jump in fines, increasing from $40 million to $57 million. Banks that incur governmental fines quickly see their operations suffer; these banks undergo loss of future business from reputation risk and the need to set aside capital to account for potential future fines, which dampen business growth opportunities. It is also estimated that the cost of compliance, including labor and technology, will rise by 10-20% in the coming years. It is clear financial services firms must remain vigilant, as the waters will only continue to roughen, but how can they remain nimble in such a strict and evolving environment?

1. https://www.nytimes.com/2021/04/27/business/economy/biden-american-families-plan.html
2. https://www.reuters.com/article/us-banks-fines/banks-paid-321-billion-in-fines-since-financial-crisis-bcg-idUSKBN1692Y2
3. https://www.questce.com/finra-fines-increase-by-43-in-2020/

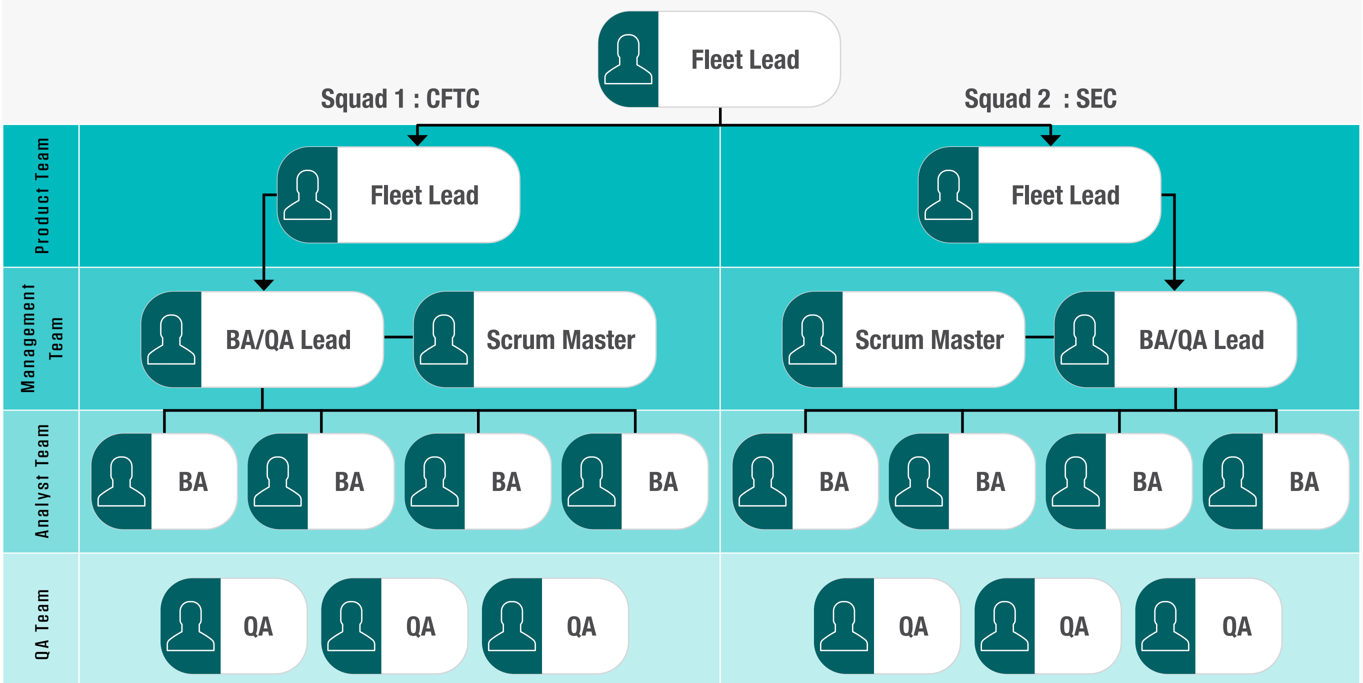
DIRECTION

While these coming regulatory risks are multifaceted, organizations should consider a measured approach to evolving with the regulatory environment. Depending on the scope of change required, financial institutions should consider partial agile transformation at the minimum. Currently, the financial services industry lags behind other industries in terms of the speed and accuracy in their front-to-back office integration. Organizations need to transform their management strategy away from sluggish, waterfall methods to help integrate a robust data feed to eliminate reporting discrepancies. From our experience, 82% of organizations indicated their culture is at odds with agile values and concepts. Furthermore, 40% of firms say they lack skills/ experience with agile methodologies. This does not bode well for the next two years, where coming regulatory changes will require organizations to address discrepancies in their reports within a short, seven-day time window.

An agile framework to manage change might look something like this:

Proposed Team Structure

Sample proposed team structure showing 2 agile squads each focussed on delivery of a specific regulation. Each squad is made up of product owners, BA's, QA's managed by a fleet lead and scrum masters to implement & deliver end to end regulatory solutions.



- **Fleet Lead** – Manages multiple squads focused on different regulations
- **BA/QA Lead** – support BA and QA in delivery and solution; senior management reporting
- **BA** – liaise with IT, front office, RTB, compliance to develop solutions & requirements
- **QA** – Create test plans, test scenarios and perform software testing

- The regulatory change team can be organized into agile squads; each squad responsible for a specific regulation to manage change across different teams (Technology, Operations, Compliance, BU) with oversight from product owners and solution champions.
- Part of the core functions of the regulatory change team includes managing new business requirements, rule changes, strategic changes, and breaks identified through the control framework.
- Each squad has Product Owner, Scrum Master, BAs, Dev, and QA with a mission statement and KPIs aligned to a regulation/book of work which they are measured against.
- These agile squads will take a top-down approach, working closely with front-office systems to ensure data efficacy with an updated technology architecture. To enable this transformation, front office teams will also be organized into agile squads for resource sharing purposes.
- When a firm designs their organizational structure in such a way, key benefits emerge:
- Easier coordination between upstream front-office systems and regulatory systems
- Alignment of agendas and goals
- Change implemented in one regulation can be introduced with minimal effect on other regulations through cross-regime collaboration and with engagement of solution champions (Product SMEs)
- A single downstream data feed will reduce reporting discrepancies while freeing up talent to focus elsewhere

As discussed, most firms are either not implementing agile methodology or inconsistently applying the core concepts that drive efficient results. implementing it poorly. To successfully integrate agile into an organization, there needs to be an accompanying culture shift away from standard, waterfall thinking. The firm needs to shift its focus from individuals to teams. Streamlined teams with distributed resources can respond quickly to mitigate regulatory risks without being held back by individual discrepancies. Following this, the firm should implement iterative reviews, demonstration, and testing with compliance and regulatory operations. Establishing a cross-functional, integrated risk and regulatory function with dedicated support from legal, compliance, and operations will instil an organization-wide agile approach to drive timeliness, accuracy, and completeness.

WE'VE BEEN HERE BEFORE

As an organization, Capco has helped a myriad of different clients implement effective regulatory change frameworks and governancemanagement practices while simultaneously updating and streamlining technological architecture to ensure both speed and accuracy. To illustrate this, we have included the following case study from a past partner, a Tier One Investment Bank undergoing CFTC Remediations.

CLIENT CASE STUDY

BACKGROUND

Title VII of Dodd Frank went live on May 2013 and required real time reporting (P43) and creation and continuation reporting (P45) to CFTC for OTC derivatives across all asset classes. The client's internal control process and internal audit (Conducted 2016) found issues in trade and transaction reporting that resulted in under-reporting, over-reporting and misreporting. Issues were shared with the regulator (NFA) in March 2019. The client's compliance has committed to showing meaningful progress by 2020.

OUR APPROACH

As part of a larger client initiative, managed service contract, Capco agreed to remediate a list of critical priority 1 and 2 CFTC issues. Assumptions, risks, dependencies, and success criteria were clearly defined.

Capco had a team of BA's (9), product owners, scrum masters, and a PMO as part of an overall agile squad to complete delivery by Q2 2020.The team is responsible for analysis and grooming of user stories working in conjunction with CFTC RTB, Compliance, and IT. The BA team was split into 2 workstreams to address issues in the client's reporting system and upstream (front office systems across different asset classes).

Apart from analysis, the agile squad (scrum master, PO's and agile PMO) managed the overall project and supported development, testing, and production issues.

Fixes applied upstream would require coordination due to impact cross-regulation impact on EMIR, ASIC, HKMA, MAS etc.

RESULTS & EFFECT

Remediation of CFTC regulatory reporting issues identified through an internal audit and control process allowed the client team to show steady progress to the regulators (NFA)

Issues of under-reporting, over-reporting, or misreporting of daily client positions to DTCC were rectified. This is applicable to new and existing trades across asset classes.

Fixes applied upstream (front office systems) were strategic. Changes would be applicable to the new GTRS & DTCC re-architecture as well.

NEXT STEPS

For the firms that have yet to position themselves ahead of CFTC 2.0, SEC 2.0, IBOR, and CSA 3.0, it's not too late. The go-live for these regulations is happening in early 2022, but remediations are expected to continue into 2023. This is the perfect opportunity for your organization to transition away from waterfall by implementing more agile squads into your regulatory reporting offices. compliance offices. Creating a consistent feed of information from your front to back-office is one piece of the puzzle but acting on that information is the real challenge. Through implementing agile methodology, firms can successfully remediate their books within a 7-day window, as well as front-run potential issues before they occur. Should your firm need assistance implementing agile methodology and controls, or simplifying the technology stack to create a robust data feed, we encourage you to reach out to our subject matter experts below to see how they can help lead a successful agile campaign at your organization.

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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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