

Underestimating the risk data challenge

The Basel Committee on Banking Supervision is pressing banks to clean up their act when it comes to risk data. This is a commendable and long overdue initiative, says David Rowe, but supervisors might not understand the magnitude of the task

Last September, I commended the Basel Committee on Banking Supervision for its plan to raise the industry's risk data standards (*Risk* September 2013, www.risk.net/2289094). Three months later, the committee produced its initial report, looking at the progress made towards its *Principles for effective risk data aggregation and reporting*,¹ published at the start of last year.

Several themes recur throughout this progress report, which is based in part on the banks' self-assessments of their compliance with these 11 principles. The industry's lowest scores were for 'data architecture and IT infrastructure' and 'adaptability'. Two requirements for which compliance was especially poorly rated were 'customisation of data' and 'ad hoc data requests'.

Perhaps more surprising was the relatively low self-assessment for compliance with the 'accuracy and integrity' principle. Compliance with the 'timeliness' principle was also rated badly, being dragged down by a poor rating on the requirement for 'capabilities of rapidly producing risk data in stress situations' (*Risk* February 2014, www.risk.net/2325333). Clearly, this last requirement could be viewed as relating to limited adaptability.

The progress report also notes concerns about the rigorosity of the self-assessments. Many respondents appear to have focused exclusively on data at group level, for example, failing to focus on data for material business units or entities within the group. Directly related to this narrow focus, many people concentrated on reports to senior management and the board while ignoring the quality of those to middle management. Thirdly, many responses focused only on reporting for market and credit risk, largely ignoring areas such as operational and liquidity risk. Finally, few banks offered details on how they defined the materiality of, or their tolerance for, manual intervention as opposed to automated procedures.

The report speculates that stretching the acceptable role of human fixes may have been used to justify higher compliance ratings than are realistic. The report also notes that many banks indicated greater compliance with the principles for risk reporting than with the corresponding data aggregation principles, even though the former are heavily dependent on the latter.

Having worked for nearly 30 years in and around the interface between information technology and bank risk reporting, little in this report is

surprising. The picture it paints is of institutions with fragmented data and systems ranging across organisational, geographical and product segments.

Since the advent of Basel II around the turn of the millennium, massive efforts have been devoted to extracting, analysing and reporting risk data for regulatory and internal risk management purposes. These systems generally work fairly well to meet established and well-defined requirements. They are weak, however, in being able to adapt quickly and effectively to product innovations, the addition of new systems of record – through mergers and acquisitions, for instance – and to changes in the structure of required metrics.

The essential weakness of these systems is fragmented, complex and broadly inconsistent data storage conventions (*Risk* March 2014, www.risk.net/2328564). Many low-level details do not have readily accessible metadata that allows easy identification and indexing. Rather, these details are buried in structural conventions embedded in complex table designs and inconsistent field names.

The Basel Committee has done the industry a service by formulating comprehensive principles for achieving effective risk data aggregation and risk reporting, but I fear it has failed to grasp the full scale of the problem. Over the past 20 years, banks have been compelled to meet several regulatory challenges. They had to develop value-at-risk models in the 1990s, implement operational risk assessments after 2000 and deploy major stress-testing capabilities after 2008, for example.

In demanding full compliance with the January 2013 paper by the start of 2016, the committee seems to believe the fundamental problem can be solved by an effort of similar scope and cost. This simply is not true. The thoroughly dysfunctional state of enterprise data has developed over the past 30 years. Only a root-and-branch transformation of the underlying data architecture, based on thor-

oughly modular self-describing documents, will provide the foundation for banks to adhere fully with the principles.

While significant improvements can be made along the way, my forecast is that a complete solution will take at least a decade. Whatever else it does, the Basel Committee should not let even the best banks declare victory on January 1, 2016 and assume the problem is solved. **R**



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¹ See www.bis.org/press/p130109.htm