

September 19, 2012

Mr. Stefan Ingves,  
Chairman  
Basel Committee on Banking Supervision  
Centralbahnplatz 2  
Basel, Switzerland

**Re: Comments on the Basel Committee's Consultative Document on *Principles for Effective Risk Data Aggregation and Risk Reporting***

Dear Chairman Ingves:

The Global Financial Markets Association (GFMA), the Institute of International Finance (IIF), the International Banking Federation (IBFed), and The Clearing House Association L.L.C. (TCH – and together, the Associations)<sup>1</sup> are grateful for the opportunity to comment on the Basel Committee's consultative document on *Principles for Effective Risk Data Aggregation and Risk Reporting* (the "Principles"). We would like to commend the Basel Committee, particularly its Standards Implementation Group Taskforce on Systemically Important Bank Supervision (the Taskforce), for the collaborative approach they have taken in developing the principles. We believe that this approach promotes improved understanding of the perspectives of both the official and the private sectors, and hence is quite productive. We also appreciate that the Basel Committee has considered industry comments raised at the meeting with the Taskforce last April, including those raised in a follow-up letter to that meeting.

In particular, we appreciate the use of a principles-based approach to the consultative document. As we mentioned in our prior letter to the Taskforce, firms have different business models and use different systems, making prescriptive guidelines particularly on IT and MIS specifications inappropriate.

Having said that, let us offer additional views and comments on the consultative document. Our general comments immediately follow, while comments on the main sections of the consultative document are discussed right after.

*Industry's commitment to the goals of the consultative document*

As the consultative document correctly pointed out (paragraph 4), the Associations recognize the benefits of improving banks' risk data aggregation capabilities and, accordingly, banks are working toward that goal. We are therefore supportive of the aim of the consultative document,

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<sup>1</sup> Please see Annex for description of the Associations

to ensure that continued progress is made in strengthening banks' risk data aggregation capabilities and risk reporting practices.

At the same time, we recognize the concern of the Basel Committee that enhancements in banks' IT systems, risk data and reporting processes might receive slower-track treatment because they require significant investments of financial and human resources for long-term benefits. We would like to point out, however, that new regulations have required and continue to require banks to make substantial changes and additional investments in their data and IT systems (see IIF-McKinsey report on *Risk IT and Operations: Strengthening Capabilities*, June 2011, and IIF-Ernst & Young report on *Progress in Financial Services Risk Management*, June 2012). The development schedules, therefore, do not reflect lack of recognition of the benefits of enhancements in IT, risk data and reporting processes for internal risk management purposes, but rather the many competing priorities created by the multiple new regulations (e.g., data reporting requirements arising from Basel III rules, recovery and resolution plans, FSB G-SIB Templates, COREP, FINREP, FATCA, IFRS, U.S. GAAP, etc., all of which need to be coordinated as we discuss below) – as well as business-model changes -- that firms must meet, all of them making demands on the same limited resources. Compliance with new regulations, including the accompanying reporting requirements and the corresponding changes in IT infrastructure, could also lead to operational risk issues that must be managed carefully (see article on Operational Risk and Regulation (July 2, 2012), *Coleman warns of stability dangers from regulatory reforms*).

Moreover, as the above-cited reports establish, managements and boards clearly recognize the necessity of improved risk IT and data capabilities and are proceeding within practical constraints to improve them. While it is impossible to predict the future, the official sector's perception that the sense of priorities created by the crisis may fade is mitigated by governance and risk-management changes that have already been implemented, by the heightened responsibilities of boards and senior management, and by other aspects of enhanced supervision and newly proposed and implemented regulations that the G20 and FSB have mandated.

#### Application of the principles

We believe that the application of the Principles to a given firm should be agreed on a group level with the home supervisor, in consultation with the relevant supervisory college if need be, and applied on a consistent basis throughout the group. As discussed further below, the implementation of the principles will require significant cost to firms, hence this should be fully coordinated at the group level to avoid duplicative or possibly inconsistent requests from home and host supervisors.

#### Implementation issues

The 2016 deadline for implementation of the Principles is generally acceptable if viewed in isolation. However, as noted above, meeting the total requirements of the numerous pending regulatory, financial and tax reporting and related IT requirements could take longer than three years. With respect to the assessment that would start in 2013, it should first focus on firms' project plans to comply with the Principles and not simply an assessment of implementation of the Principles.

Paragraph 18 basically leaves the implementation, and hence the interpretation, of the principles to national supervisors. Paragraph 19 only mentions that the BCBS Standards Implementation Group (SIG) will track G-SIBs progress towards complying with the principles (and

the effectiveness of the principles and whether enhancements are necessary), but not whether national implementation is consistent. The Associations believe that harmonized implementation of these principles across jurisdictions should be part of the SIG mandate in order to ensure a level playing field and consistent achievement of supervisory goals.

### ***Overarching governance and infrastructure***

The consultative document clearly recognizes the legal obstacles to cross-border sharing of information (see footnote 9 and paragraph 23). Such obstacles will have an impact on banks' ability to meet the proposed principles, and are clearly beyond an individual bank's IT ability to remedy. Official-sector action is therefore required to remove these obstacles. However, in doing so, confidentiality of any client or commercially sensitive data that would become more readily available to supervisors must be ensured. The Associations stand ready to assist as best they can on this issue. There are examples of mutual legal assistance treaties and other international agreements developed to provide frameworks within which confidential information can be shared among authorities for specific purposes. The Society for Worldwide Interbank Financial Telecommunication ("SWIFT") EU-US information sharing agreement is a recent example showing the direction that could be taken with respect to confidentiality issues.

Regarding Footnote 10, we believe the key is for a firm with multiple data models to have robust and effective reconciliation procedures, regardless of whether it is an automated process or a combination of automated and manual processes. We suggest therefore deleting the word "automated".

The last sentence of paragraph 21 should be clarified to read that the board and senior management approve the "risk data aggregation and risk reporting *framework*". The word "framework" is missing; thus, the paragraph could be interpreted as requiring a more detailed level of approval without this clarification.

Paragraph 23 requires that boards be "fully aware" of any limitations on data aggregation. Is the intent of this paragraph to push for more than just a "be informed" standard, but to require boards to push for full coverage of any limitations? This seems to be an inappropriate standard for boards. Banks' boards should focus on board-level, strategic or critical issues, i.e. issues that can damage their firms, and not on points of detail with limited likely impact. A central tenet of good corporate governance is the distinction between the board's responsibility for *oversight* of the business and affairs of the banking organization and management's responsibility for day-to-day *operations* of the banking organization. A board that involves itself in the organization's day-to-day operations could reduce its ability to perform its general oversight role effectively and potentially compromise its independence. It is important for board members, shareholders, management, and those government officials charged with overseeing banking organizations to recognize and understand this crucial distinction between oversight and management (for a more complete consideration of this distinction, see The Clearing House Association's *Guiding Principles for Enhancing Banking Organization Corporate Governance* (June 6, 2012) ("Guiding Principles") (available at <http://www.theclearinghouse.org/index.html?f=073631>)). Insistence on "full awareness" by the board of any limitations on data aggregation could divert boards' time from more pressing issues facing their firms and from boards' primary responsibility of providing strategic guidance and direction. We strongly suggest, at a minimum, that wording be changed to say boards should be "fully aware" of any *material* limitations on data aggregation *capabilities*.

Paragraph 22a suggests that an independent validation unit with specific IT, data and reporting knowledge may be better positioned to perform the review of the bank's risk data aggregation capabilities and risk reporting practices. The BCBS should clarify the thinking behind this and, depending on the intent, explain why internal audit would not suffice (given the general requirements of independence under which audit departments operate). It is important for firms that another layer or expense not be unnecessarily created. In addition, internal audit teams often have subject matter experts in areas such as IT. It would thus be unnecessary and indeed counterproductive in many instances to have such a unit where internal audit has the requisite capabilities.

### ***Risk data aggregation capabilities***

Paragraph 28(c) requires reconciliation of risk data to accounting data, as well as sources and books of record. The use of the term "reconciliation" may imply a higher standard than intended or that can actually be achieved in all cases. Risk sensitivities of market-risk factors, for example, may not be readily reconcilable to financial statements or other sources. In addition, risk data produced by models generally cannot be traced back to specific accounting data, except perhaps for some of the raw data inputs. The Basel Committee should recognize this and modify the language in paragraph 28(c) as follows: "Processes to check the completeness and accuracy of risk data including reconciliation where appropriate should be in place."

While paragraph 28 (d) indicates firms should "strive towards" a single authoritative source for risk data, there may be circumstances where it is more efficient and equally effective for firms to implement one single database for each risk type or business, with appropriate bridging capabilities for aggregation purposes, especially given all the other development programs firms must implement over the next few years.

We agree with paragraph 29 about the need to define data consistently across the organization. However, it would greatly help banks achieve this goal, and hence improve their risk data aggregation capabilities, if the official sector would also coordinate and standardize the various official sector data initiatives and reporting requirements. While this would not solve the problem of inconsistent regulatory and internal reporting (which is impossible to do given differences in internal reporting practices among firms), it could lessen the regulatory burden on firms and, to the extent possible, might lead to some alignment between regulatory and internal reporting.

This same issue is being raised in connection with the FSB's "data gaps" project. Coordination and standardization are clearly essential to minimize duplication, unnecessary cost and operational risk, and the possible confusion that can arise from inconsistencies. The Basel Committee is urged to coordinate this initiative tightly with the work of the FSB and other new data-gathering initiatives, such as the revisions to the European COREP and FINREP that are anticipated, and possible initiatives of the US Office of Financial Research and similar bodies.

Paragraph 35 states that "Supervisors expect banks to affirm that their data is materially complete, with any exceptions identified and explained." We do not think it would be reasonable for banks to make such an affirmation given that an exhaustive list of risk data components that ought to be collected and the concept of "materially complete" are both not defined. We suggest therefore revising the wording as follows: "Supervisors expect that banks have in place robust data

completeness checks to ensure that material data completeness issues are assessed and addressed appropriately.”

While it is ideal for a bank to build systems that can generate data within a timeframe that would meet whatever reporting frequency is required during a stress or crisis period, as Principle 5 contemplates, this could be disproportionately costly or divert resources from other priority developments. It would be quite hard to anticipate the frequency (not to mention the specific content) necessary for internal reporting during a crisis because all situations are different, except that it would likely be more frequent than under normal conditions. So, having a system that is flexible enough to meet any and all reporting frequencies during a crisis would entail significant and probably disproportionate cost that would divert resources from other worthwhile goals (and create developmental risk).

Hence, the use of a reasonable level of approximation where quick responses are necessary during a crisis should be allowed. Under stressed circumstances, snap-shot, reasonable approximations are likely to be just as useful (and perhaps more useful) as formal aggregations of information, which would be produced in the ordinary course of business. Such indications of acceptable approximation should be incorporated in the “adaptability” points enumerated under Principle 6. Approximation may be suggested by the reference to “flash’ summary reports”, but it would be helpful to have a specific discussion that recognizes the acceptability of approximating risk information when the need arises to produce information quickly under stressed circumstances. If thought necessary, the Basel Committee could provide non-limitative examples of cases where use of approximations would be appropriate. Such examples would ensure that banks and supervisors have consistent general understanding of the appropriate use of approximated information. Different types of exposures may engender different requirements (e.g. trading exposures vs. credit exposures). We would be happy to discuss examples.

Paragraph 38(a) lists as one of the critical risks the aggregated credit exposure to a large corporate borrower on the supervisory watch list. We do not understand what this “supervisory watch list” is. Would this be different from the list of borrowers and counterparties that is included in the FSB Common Data Template? Ideally, there should be flexibility in this principle because, for very good reasons, the lists of counterparties that banks monitor for internal risk management purposes may be somewhat different than those reviewed for supervisory purposes. The essential point here is that a complete view of all exposures to top counterparties can be aggregated on a regular basis and in times of stress.

### ***Risk reporting practices***

In Principle 7, a distinction should be made between periodic risk reporting and urgent, ad-hoc risk reporting under a stress or crisis situation. A goal of full accuracy is appropriate for periodic risk reporting, but urgent, ad hoc reports should have a different threshold of accuracy. As mentioned above, the Principles should specifically recognize that approximations are acceptable and necessary where rapid response is required in a stress or crisis situation.

The standards of accuracy reflected in Principle 7 should make it clear that they allow for reasonable approximation under appropriate circumstances, as discussed above. While reports should insofar as possible “accurately” and “precisely” convey aggregated data and reflect risk in an

“exact” manner, taken literally this principle could end up obstructing rather than furthering sound risk management (see generally “*Guiding Principles*”).

Paragraph 45 states that supervisors expect that a bank’s board and senior management should establish accuracy and precision requirements for both regular and crisis reporting. While boards may be able to endorse such requirements on the basis of a recommendation from senior management, *establishing* the requirements would demand too much technical involvement by the boards. As mentioned above, it is important for the board to focus only on strategic and critical issues and not take part in the details of management. We propose the language be changed to make clear that the boards and senior management must take measures to assure that management has established robust processes and protocols that provide for accurate and complete reporting for normal business and crisis conditions.

The idea of establishing accuracy requirements analogous to materiality standards used for accounting purposes as set out in paragraph 46 is a sound one, and the Associations would appreciate the opportunity to contribute to that process. It should be noted that, taken literally, the language of the principle (“precisely”, “exact”) would be at odds with sound and proportionate accuracy standards established under this paragraph.

Paragraph 50 makes references to “forward looking” reports. While we understand the reasons for this paragraph, it should be qualified by reference to the procedures set out in paragraph 49 for adaptation to the specific firm’s business model and risk appetite. We recommend, however, that the emphasis should be on sensitivity or scenario analyses and stress testing, which are more useful in anticipating and managing potential impact of stress events, rather than on forecasts. Cross-reference to other bodies of supervisory guidance may be helpful as well.

The Associations agree with paragraph 53 that it is important that the board ensure that it is asking for and receiving relevant information that will allow it to fulfill its governance mandate to understand the risks to which a firm is exposed.

With respect to frequency of reports, we note again that paragraph 59 should allow for appropriate levels of approximation for reports with short deadlines, especially intraday reports, during a crisis. Moreover, it should be made clear that paragraph 59 relates only to credit, market and liquidity position or exposure reports that are relevant to managing risks in a crisis.

### ***Supervisory review, tools and cooperation***

Paragraph 63 states that supervisors may test a bank’s compliance with the Principles through occasional requests for information to be provided on selected risk issues. While we understand the need to monitor and gauge banks’ compliance with the Principles, it should be seriously considered whether or not the approach envisioned would add undue burden on banks, while providing little if any benefit to and perhaps take a significant time away from actual internal risk reporting and management. Any such testing exercises should be planned carefully with other regulatory exercises, such as mandated stress testing, or be recognized as being part of the overall supervisory and examination process, to avoid multiple demands in constrained time periods. Additionally, the use of Internal Audit reports and monitoring should be considered to supplement regulatory oversight of these issues.

Another way to address the above concern might be to view a bank's compliance with the FSB Common Data Template for G-SIBs as demonstrating the appropriate level of data aggregation capabilities.

With respect to Principle 14 on home/host cooperation, it will be important, given the costs, operational risks, and impacts on available resources of data demands, that any requirements imposed by the Principles, and any remedial actions that may be required, be undertaken on a fully coordinated basis, to avoid disparate, duplicative or possibly inconsistent requests, which would be costly to the firm and potentially confusing to regulators. This is implied, somewhat obliquely, in the Principle itself, but not expressly described in the explanatory paragraphs. As mentioned above, we recommend strong home-supervisor leadership on these issues.

Once again, we appreciate the opportunity to comment on the consultative document on risk data aggregation and risk reporting. Should you have any questions on the issues raised in this letter, please contact the undersigned ([dschraa@iif.com](mailto:dschraa@iif.com), [sally.scutt@bba.org.uk](mailto:sally.scutt@bba.org.uk), [simon.lewis@afme.eu](mailto:simon.lewis@afme.eu), [david.wagner@theclearinghouse.org](mailto:david.wagner@theclearinghouse.org)) or Jermy Prenio ([jprenio@iif.com](mailto:jprenio@iif.com)).

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## **Annex**

### *GFMA*

The Global Financial Markets Association (GFMA) brings together three of the world's leading financial trade associations to address the increasingly important global regulatory agenda and to promote coordinated advocacy efforts. The Association for Financial Markets in Europe (AFME) in London and Brussels, the Asia Securities Industry & Financial Markets Association (ASIFMA) in Hong Kong and the Securities Industry and Financial Markets Association (SIFMA) in New York and Washington are, respectively, the European, Asian and North American members of GFMA. For more information, please visit <http://www.gfma.org>.

### *IIF*

The Institute of International Finance, Inc. (IIF) is a global association created in 1983 in response to the international debt crisis. The IIF has evolved to meet the changing needs of the international financial community. The IIF's purpose is to support the financial industry in prudently managing risks, including sovereign risk; in disseminating sound practices and standards; and in advocating regulatory, financial, and economic policies in the broad interest of members and foster global financial stability. Members include the world's largest commercial banks and investment banks, as well as a growing number of insurance companies and investment management firms. Among the IIF's Associate members are multinational corporations, consultancies and law firms, trading companies, export credit agencies, and multilateral agencies. All of the major markets are represented and participation from the leading financial institutions in emerging market countries is also increasing steadily. Today the IIF has more than 450 members headquartered in more than 70 countries.

### *IBFed*

The International Banking Federation (IBFed) was formed in March 2004 to represent the combined views of a group of national banking associations. The countries represented by the Federation collectively represent more than 18,000 banks with 275,000 branches, including around 700 of the world's top 1000 banks which alone manage worldwide assets of over \$31 trillion. The Federation represents every major financial centre and its members' activities take place in every time zone. This worldwide reach enables the Federation to function as the key international forum for considering legislative, regulatory and other issues of interest to the global banking industry.

### *TCH*

Established in 1853, The Clearing House is the oldest banking association and payments company in the United States. It is owned by the world's largest commercial banks, which collectively employ over 2 million people and hold more than half of all U.S. deposits. The Clearing House Association L.L.C. is a nonpartisan advocacy organization representing—through regulatory comment letters, amicus briefs and white papers—the interests of its owner banks on a variety of systemically important banking issues. Its affiliate, The Clearing House Payments Company L.L.C., provides payment, clearing, and settlement services to its member banks and other financial institutions, clearing almost \$2 trillion daily and representing nearly half of the



automated-clearing-house, funds-transfer, and check-image payments made in the U.S. See The Clearing House's web page at [www.theclearinghouse.org](http://www.theclearinghouse.org).