INTRODUCTION

REPLY AVANTAGE

Since the release of the BCBS239 Principles in 2014, the European Central Bank (ECB) has been urging European banks to comply with these Principles.

These Principles cover three main topics:

- Overarching governance and structure,
- Risk data aggregation capabilities,
- Risk reporting practices (often referred to by the ECB as 'RDARR').

However, achieving compliance with the Principles has been a challenge for many Significant Institutions (SIs) (and, to be fair, Less Significant Institutions, or LSIs), as they must integrate necessary changes as an improvement to their operating model, rather than just as another remediation program.

Although the deadline for full compliance was January 1, 2016, it is fair to say that some work is still ongoing in most SIs to achieve full compliance.

In 2017, the ECB conducted a thematic review at over 25 SIs and found that many struggled with achieving full compliance with the Principles. Key weaknesses were identified in areas such as Governance (Principle 1), Data Architecture and IT Infrastructure (Principle 2), Accuracy and Integrity (Principle 3), and Adaptability (Principle 6).

Compliance with the BCBS 239 Principles remains a top priority for the ECB as highlighted in the SSM Supervisory Priorities (2023 – 2025) and more recently in speeches by the Chair and Members of the Supervisory Board of the ECB.

As at the end of 2022, the number of outstanding supervisory measures issued by the ECB in relation to BCBS 239 remained broadly unchanged compared to 2018, i.e. approximately 600 supervisory measures.

This is significant considering the ECB's supervisory priorities for 2023 – 2025 and the increased focus by the ECB on qualitative measures to drive change, in particular to improve banks' governance structures and risk management frameworks

Therefore, it is anticipated that the ECB will take action on three fronts as mentioned in their Supervisory Priorities Work Programme (1):

"… for example, on risk data aggregation and reporting, banks with adequate risk data aggregation and reporting capabilities are still the exception and full adherence to the BCBS 239 [P]rinciples has yet to be achieved. This is despite the intensity of supervisory pressure in recent years and the large number of findings that have been identified."
Enrico Enria, Chair of the ECB Supervisory Board, 28 March 2023

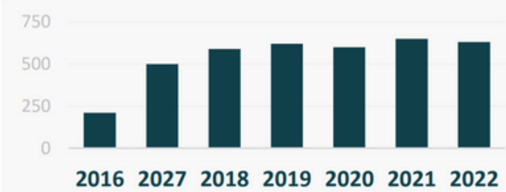

Figure 1: Total open supervisory measures regarding RDAR

Source: SSM Supervisory Priorities for 2023 – 2025, Supervisory Reporting Conference 2023, Mario Quagliariello, Director, Directorate Supervisory Strategy & Risk, ECB, 26 April 2023

"Clear qualitative measures with time-bound milestones for remediation are the most effective tools to use in the first instance."
Elisabeth McCaul, Member of the ECB Supervisory Board, 17 April 2023

- They will enhance their "supervisory expectations related to the implementation of [the] Principles." This could involve issuing additional Guidelines to offer greater clarity and assurance regarding enforceability.
- They will conduct a "horizontal analysis across Joint Supervisory Teams (JSTs) and/or On-Site Inspections (OSIs) for banks exhibiting persistent shortcomings."
- They will expand the "OSI campaign on risk data aggregation and reporting" that was initiated in 2022.

1 For quotes and additional details, refer to Section 2.2.2 within the SSM Supervisory Priorities (2023 – 2025).

Governance and Accountability

The 2022 Supervisory Review and Evaluation Process (SREP) results revealed only a marginal improvement in internal governance scores, with 73% of banks scoring an unsatisfactory '3' (down from 77% in 2021). The ECB highlighted internal governance and risk management as areas of heightened concern for ECB Banking Supervision in the Aggregated Results of SREP 2022. It is noteworthy that over 85% of banks in the following three business models received a score of '3' (diversified lenders, retail and consumer credit lenders, universal and investment banks). Effective governance remains a priority for supervision, and it is expected that progress will be made in various aspects, including the composition, collective suitability, and oversight role of bank boards. The ECB places increased emphasis on the responsibility of the board of directors in fostering a risk-aware culture and steering necessary strategic changes. Key decisions related to investment priorities, budget setting, risk data aggregation capabilities, and risk reporting practices are expected to be made by the board. Specifically, directors are expected to validate critical data elements for the organization and enable effective risk assessment. This expectation is exemplified by ECB's Supervisory Board Decision SB/20/144/12, which focuses on a subset of BCBS239 Principles, namely supervisory data reporting: “In terms of good governance, there should be an adequate level of accountability of banks’ senior management in the processes related to supervisory data reporting, production and transmission.”

In the context of BCBS239 Principle 1 on Governance, the challenges faced by SIs in the Eurozone vary depending on their business models and whether they are headquartered in the Eurozone or a sub‑group of a third-country banking group. The following include some illustrative challenges observed amongst SIs (not a comprehensive list):

1 Board composition
Ensuring the board comprises skilled individuals capable of effectively overseeing data capabilities.

2 Risk culture
Instilling a culture that prioritizes risk management and data governance throughout the organization, with accountability at all levels.

3 Data accuracy and timeliness
Striking the balance between accuracy and timeliness, as outdated risk data is as unhelpful as a rear-view mirror for driving decisions

4 Data consistency
Establishing consistency across internal and external risk and finance reporting.

5 Data relevance
Incorporating new data sources to stay pertinent, such as climate risk or country risk. For example, recent events in Ukraine served as a wake-up call for many banks, revealing previously unnoticed exposures to Ukraine through dependencies on third- and fourth party entities, like IT development centres. This resulted in sudden disruptions to critical applications due to the overnight discontinuation of essential maintenance or development capabilities.

6 Role of the CDO
Clearly defining the responsibilities of the Chief Data Officer (CDO), ensuring well documented processes and an auditable data trail.

BCBS239 in the wider Context of Digital Transformation strategies

The ECB's second supervisory priority for the period 2023-2025 centres around addressing digitalization challenges and enhancing the steering capabilities of management bodies. This priority effectively establishes a connection between the governance aspects discussed on page 2 and the necessary data capabilities required for effective steering. The ECB has observed that bank boards frequently overlook the integration of ICT strategies into their overall business strategy and investment priorities, highlighting a need for greater consideration in this area of planning and execution.

Several SIs have faced challenges in effectively steering these critical aspects, often due to a lack of focus or expertise. Many SIs have delegated the overall responsibility of their 'BCBS 239 Programme' solely to the IT department, with minimal or no involvement from the Business side. In hindsight, many of these 'BCBS 239 Programmes' have prioritized tooling and engineering over the essential business rationale.

"The lack of IT expertise in banks' boards […] is concerning in the context of the need to effectively manage banks' digital transformation strategies"

Elisabeth McCaul, Member of the ECB Supervisory Board, 17 April 2023

"In order to properly assess risks, banks need reliable data. They are a fundamental precondition for the strong governance structure and comprehensive risk management framework necessary to support adequate decision-making. However, risk data aggregation and risk reporting (RDARR) remains an area of persistent concern."

Elisabeth McCaul, Member of the ECB Supervisory Board, 17 April 2023

This has resulted in insufficient consideration of crucial factors such as timely and reliable information for decision-making purposes and the support of forward-looking risk management capabilities through robust data aggregation.

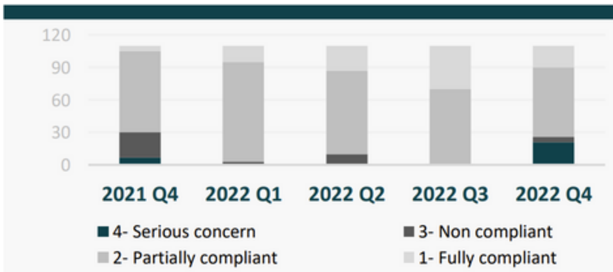

Figure 3: Individual Data Quality Indicator (DQI) Distribution (111 SIs)

Source: Aggregated Data Quality Tables – Fourth Quarter 2022, ECB

Shifting focus to the specific deficiencies in risk data aggregation and reporting, The ECB has established a strategic objective for banks to address longstanding shortcomings and establish robust and efficient frameworks for risk data aggregation and reporting.

This objective aims to facilitate effective steering by management bodies and meet the expectations of supervisors, even during challenging times such as a crisis.

During the recent ECB Supervisory Reporting Conference on 26 April 2023, the ECB showcased the evolution of Data Quality Indicators (DQIs), which assess the quality of supervisory reports submitted by SIs. The presentation revealed a notable increase in the percentage of SIs with a DQI score of '4' (indicating serious concerns).

The frustration expressed by the ECB in light of these results is understandable, especially when considering that the data being assessed in the DQI is likely the most meticulously curated data within the banks (this data is the foundation for the quarterly supervisory reports).

Moreover, recent developments in the macroeconomic and geopolitical landscape have further emphasized the critical role of data integration and reporting. In order to proactively identify potential risks to their capital and liquidity positions, banks and their boards must have access to timely and reliable information, especially during challenging circumstances. Ms. McCaul's statement in April 2023 echoed this sentiment, raising essential questions about the ability to assess and mitigate risks without sufficient and trustworthy data on exposures, key risk data, and internal control results.

CONCLUSION:
BE PREPARED !

> "How can risk be assessed and mitigated if the board and management do not have reliable data to guide decisions on basic things such as exposures, key risk data or key information about internal control results? How can effective challenge be provided without sufficient data?"
> **Elisabeth McCaul, Member of the ECB Supervisory Board, 17 April 2023**

It is evident that even after five years since the completion of their thematic review, the ECB still considers compliance with the BCBS239 Principles as a significant challenge for European banks. Many aspects of BCBS239 remain on their priority list for the current three-year supervision cycle.

As the ECB seeks to enhance its supervision framework and address deficiencies in a more streamlined manner, the pressure on banks and their boards will only escalate.

This is exemplified by the recent and upcoming BCBS239 OSIs and by the possible issuance of Guidelines by the ECB, which might provide further clarity and have a higher level of enforceability in the Eurozone compared to the BCBS239 Principles.

In conclusion, banks must remain vigilant and proactive in meeting the requirements of BCBS239 to ensure effective risk management and regulatory compliance.

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