BANK OF ENGLAND
PRUDENTIAL REGULATION AUTHORITY

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Dear CEO,

**Thematic findings on the reliability of regulatory reporting**

In October 2019, we sent a letter reiterating our expectation that all banks and building societies submit complete, timely, and accurate regulatory returns.[1] The integrity of regulatory reporting is essential for us to advance our primary objective to promote the safety and soundness of PRA-authorised firms.

Since October 2019 and as part of our ongoing focus on this area, we have asked firms to demonstrate how they deliver regulatory reporting of appropriate quality and also commissioned a number of reports from skilled persons (covering credit and market risk returns at larger firms) under Section 166 of the Financial Services and Markets Act 2000. The reviews required skilled persons to opine on governance arrangements, systems and controls to produce the returns, the schedule of key interpretations, and to provide an assessment of the accuracy of the returns. This letter provides feedback on common findings from these reviews and our wider supervisory work.

Overall, we were disappointed to find significant deficiencies in a number of firms' processes used to deliver accurate and reliable regulatory returns. It was clear that multiple firms did not treat the preparation of their regulatory returns with the same care and diligence that they apply to financial reporting shared with the market and counterparties. For some firms, there had been a historic lack of focus, prioritisation, and investment in this area.

We expect all firms to submit reliable and accurate regulatory returns[2] and for the regulatory reporting process to receive no less rigour than financial reporting. The findings of our work demonstrated there is an increased risk of material misstatements from firms who did not meet our expectations. We therefore set out our most material findings in this letter covering governance and ownership, controls, and data and investment. Our expectations for next steps including how firms should act upon these findings are outlined at the end of this letter.

## 1. Governance and Ownership

Senior accountability and ownership is fundamental to the production and integrity of a firm's financial information and its regulatory reporting[3]. The relevant senior manager should be empowered to have overall oversight of the effectiveness of front-to-back processes and cross-functional processes to ensure the delivery of accurate and reliable regulatory returns.

We found instances where responsibilities were dispersed across multiple individuals and teams, and delegated too far down the organisation. This issue was heightened in some cases where firms had complex and fragmented end to end processes (eg from trade capture to regulatory reporting), which often meant there was a poor understanding and documentation of the entire process. This can result in reliance being placed on certain teams, with little oversight of their role, accountability or independent assurance work carried out. We expect responsibilities to be clear for those involved in all stages of the end to end regulatory returns process. This should be supported by robust processes, including

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1 Available at: https://www.bankofengland.co.uk/prudential-regulation/letter/2019/reliability-of-regulatory-returns.

2 See Fundamental Rule 7: https://www.prarulebook.co.uk/rulebook/Content/Part/211136/30-11-2015.

3 Prescribed Rule 4.1(9) of the Allocation of Responsibilities is responsibility for the production and integrity of the firm's financial information and its regulatory reporting under the regulatory system.

independent testing and validation, with the use of Internal Audit where appropriate, to ensure regulatory returns are reliable and accurate.

Finally, we observed instances of poor governance around key regulatory interpretations including a lack of basic documentation, periodic reviews, and/or appropriate sign-off. In many cases, these interpretations and judgements relating to our requirements have been hard coded into firms' systems – this can be problematic should these interpretations no longer be suitable or if the factors on which the interpretations are based change. In these instances, we expect firms to: i) undertake work to identify the key interpretations and judgements; ii) validate these interpretations and judgements; and iii) correct them where appropriate. When errors are identified for any reason after submission of the returns, firms should review the impact and resubmit where there are material errors.

**2. Controls**

Firms' governance arrangements for regulatory returns must be supported by an effective and robust control framework. We identified a number of gaps in end to end processes for regulatory returns, such as insufficient controls around models, End User Computing (EUC) and a lack of reconciliation checks for errors. We expect operating models to be clearly documented with effective controls at each stage of the process. Poor documentation led to a lack of understanding of both the controls and their effectiveness, and ultimately errors in reporting. This was exacerbated by the high degree of manual intervention in the end to end processes for regulatory returns.

<u>Models</u>

Regulatory reporting can be highly dependent on models. Whilst the skilled person reviews did not look at the design, development, and appropriateness of approved models, they did observe deficiencies in the control environment around models. We were disappointed by several instances of poor record keeping of original model documentation including applications, their approval and a full chronology of model changes that require regulatory approval or notification.

<u>Spreadsheets</u>

For many firms, their regulatory reporting process involves spreadsheet controls. Spreadsheets carry an inherent risk of error because of their vulnerability to over-writing and therefore require appropriate documentation of key processes, risk and control assessments, judgements, and assumptions as well as robust processes and controls. The reviews found that not all firms had a sufficiently robust control environment in place for the purposes of generating reliable and accurate returns. For example, some firms had not formally registered working files as EUCs and had no programme of ongoing reviews of the underlying logic.

<u>Reconciliations</u>

Reconciliations are an essential element of generating reliable regulatory returns, and we observed unsatisfactory reconciliation disciplines across a number of firms. We expect firms to have a formal and comprehensive process reconciling regulatory flows to appropriate records, including the general ledger, for every submission cycle.

**3. Data and Investment**

Our review highlighted that many firms have not prioritised investment in regulatory reporting, leading to reduced capacity and capability compared with financial reporting. Focus is often placed on implementing tactical fixes rather than strategic ones. In particular, a lack of strategic investment at some firms has led to outdated reporting system infrastructure and the need for significant manual intervention to fill data and system gaps. This in turn leads to a higher risk of data errors and misstatement of returns.

The reviews found that firms must also place greater focus on robust sourcing of data, for example to support allocation of assets between exposure classes. This should be supplemented by clear governance and sign off when incomplete data is used.

Where firms invested in data they had a simpler and more efficient infrastructure, requiring less manual intervention. Fewer data errors leads to better outcomes and enables firms to make more effective and efficient use of their data in the longer-term.

**Next Steps**

We will follow up with relevant firms on specific findings from their skilled person reviews. We expect firms' remediation plans to be strategic, appropriately resourced, and address the root causes of those issues.

Given the importance of robust regulatory returns, we expect all banks, designated investment firms and building societies to consider the findings in this letter and any work they may need to do to remediate applicable issues, in order to improve their governance, controls, and data related to regulatory reporting.

As part of our ongoing focus on the integrity of regulatory reporting, we will continue to use a range of available options including further skilled person reviews. We would also note that, where individual firms fall short of our expectations, we will consider the full range of supervisory responses and enforcement powers at our disposal.

If you have any questions about the contents of this letter, please contact your usual supervisory contact.

Yours Sincerely,

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