

New Regulatory Body Promoted to Standardize Financial Data

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Bank CEOs, CFOs and risk officers may soon have another regulatory body to worry about. A small group of statisticians and economists has voluntarily formed a group to lobby for a "National Institute of Finance" to standardize and analyze data for the proposed systemic risk regulator. The idea is not part of the Obama financial reform plan. But the group is making headway fast.

The idea, hatched in February and pitched to officials in the past few weeks, has garnered interest from the SEC and FDIC, as well as on Capitol Hill. Language is being drafted by a staff member associated with the Senate Banking Committee, but she says it's in the early stages and has not been discussed with any member of the Senate. Advocates of the idea have not yet approached the House Financial Services Committee.

One potential sponsor is Sen. Jack Reed (D-R.I.), the committee's third ranking member who chairs its subcommittee on securities and sits on its financial institutions subcommittee. Reed has been particularly vocal on how the systemic risk regulator will operate and collect data. Reed already has introduced legislation, [the Private Fund Transparency Act of 2009](#), that would in part give the SEC authority to collect data from hedge funds and investment advisers.

The statisticians and economists who promote the National Institute of Finance call themselves the Committee to Establish the NIF (CE-NIF). The NIF's duty would be to standardize transaction-level data to be reported by financial institutions, map counterparty exposures in near real-time, and apply sophisticated modeling programs to support the systemic risk regulator, to whom it would report, says CE-NIF member Arthur Small, an associate professor of Applied Economics and Finance at Penn State University.

CE-NIF takes no position on which agency should oversee systemic risk and is "not dogmatic" about the standards - they'd be set in consultation with industry, Small says. But CE-NIF is convinced a non-political, independent authority is needed to improve risk management by banks and regulators.

"You've got to have the fundamentals of data in place if you're going to provide oversight and analyze risk. And they're not in place," agrees CE-NIF member Michael Atkin, managing director of the Enterprise Data Management Council. EDMC is a non-profit business forum that promotes core data integration standards and studies best practices in data management. Regulators are stuck using old technology not integrated with each other. "The crisis, while bad for the world, has been really good for data management. When it's standing there in front of you, you better take advantage when you can."

How Individual Banks Could Benefit in the Long Run

Financial institutions also could greatly benefit from such standardized reference data and definitions, agrees CE-NIF member Rob Casper, managing director and global head of reference data at Morgan Stanley in New York. Without common data standards, it often is difficult to unwind counterparty agreements and understand costs and exposures.

Depending on size and complexity, some institutions could save tens of millions if not hundreds of millions of dollars per year if commonly coded standards were used in financial transactions. This includes coding legal contracts, financial instruments, term sheets and public offerings, Atkin adds. This way, vendors, institutions and regulators would not need to reconcile the information over and over again.

"It makes a heck of a lot of sense to do it once when the data is created instead of hundreds of times," Atkin says.

There is a "cacophony of data babble" in financial institutions, Small agrees, citing traders who create their own spreadsheets, merged banks with different data systems and the mixed use of technologies. But few financial institutions have attempted to standardize data due to its enormous upfront cost and long ROI for a function that no business unit wants to support financially or operationally.

"Models the banks are using to calibrate risk simply don't have the data they need to understand the likelihood of these events," says Small, who studies extreme weather events. "The financial regulators and those charged with systemic risk don't have the data and analytic tools they need." Without this information, "the promise that this systemic risk regular can actually do its job is a hollow promise," he says, describing the standardized data feed as an "electronic cc" of the financial system. "Regulators do collect warehouses full of data, but it's in all kinds of different formats. It is data confetti."

"Go back to last September and consider the scene with Paulson, Bernanke and Geithner as they were considering whether to bail out Lehman Brothers," Small says. "There's nothing in the public record that suggests they had any serious capability to understand what would happen if they bailed them out or let them fail. How would the rest of the [financial] network react? They were working on educated guesswork. On this crucially important decision, they were flying blind."

Questions Raised about CE-NIF, EDMC Overlap

CE-NIF's most prominent member is Allen Mendelowitz, a director of the Federal Housing Finance Board and former managing director of the GAO. He and three other founding members (all professors) conceived the plan during an industry workshop about the financial crisis in February for regulators and statisticians, sponsored by the OCC. A fifth founding member soon joined the planning process: Small, whose father was a longtime Iowa

Democratic legislator who ran for the Senate against incumbent Charles Grassley (R-Iowa) in 2004.

"We're a small band of brothers and sisters," says Small. "We are not a big think tank with an enormous endowment. We're a bunch a guys who got together and started calling our contacts. It's miraculous we have gotten as far as we have." CE-NIF now comprises 27 members, including top risk and technology specialists at Morgan Stanley, SunGard, Merrill Lynch and IBM, including IBM's global director for financial markets. Small says such contacts have helped open doors for CE-NIF in Washington, D.C.

NIF's goals are nearly identical to those of the EDMC, which is sponsored by IT vendors, such as IBM and SunGard, and whose board includes officers of several money center banks, including Citibank, JPMorgan Chase, Merrill Lynch and Barclays. As a result, there has been concern that CE-NIF is a front to help money center banks avoid more onerous regulation by cozying up with vendors, Small allows.

But Small says CE-NIF has not received financial or material support from any commercial organization. Its volunteer members pay its costs out of their own pockets. And while the overlap of interests make CE-NIF and EDMC natural allies, they are not working together, except that Atkin is part of each group and has donated the use of EDMC's public relations firm, Small says. In addition to Atkin, [four of CE-NIF's 27 members](#) work or used to work for organizations that are [members of EDMC](#): Merrill Lynch, Reuters, SunGard and IBM.

Atkin agrees that data standardization will benefit IT vendors that "should be smiling broadly because management of data means you need system integration. They would provide the tools, capabilities, integration," and make a lot of money doing it. Even so, EDMC is "focused on the objective of data management, not the interests of any one [organization, even though] they all look at their own strategic self interest."

EDMC's goals are "impossible without a mechanism like NIF," Atkin says. Neither organization takes a position on regulation, except they both say it would be enhanced with data standardization, and neither is "going to change any bit the regulatory oversight that's coming," he adds. The EDMC board listed on its website also includes John Bottega, chief data officer for the Federal Reserve Bank of New York.

"There have been whispers that this is some industry sponsored scheme to head off more onerous regulation of the financial services industry. It is not," Small adds. "We are not being backed by the industry. Whoever is in charge of systemic risk will need this capability." The NIF would not have any supervisory regulatory authority, Small adds - except the ability to demand that banks provide data and agreements in a standardized format, generally in real time.

NIF's focus would be on larger institutions because they have the most complicated internal risk management challenges and that is where systemic risk concentrates, Small says. But smaller banks also would need to participate - perhaps through third-party data management firms

such as SunGard - so NIF could fully identify counterparty risk and emerging issues, such as subprime mortgages.

“What we hope to get out of this is a financial system that doesn't collapse now and then,” Small says. “I think this is the most important project I will work on in my entire life. I am at the creation of something that is very important.”