

“Global” Bank Regulation — Stranded in the U.S.?

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Three years after the financial crisis began, U.S. regulators are taking the first steps toward issuing rules for global banks — developing standards. The standards work is detailed, tedious and time-consuming — think years, not months — and necessary for a global industry whose business is almost entirely electronic.

American regulators are working on a timeline set in some areas by the Dodd Frank legislation. European regulators, who are under no such immediate pressure, have done nothing so far. So will the result be global standards or just new rules for the U.S. banks?

New financial industry standards efforts are underway in two areas — legal entities and data.

By July 8, the Office of Financial Regulation (OFR) will choose the organization(s) to develop a Legal Entity Identifier (LEI) and maintain the database. The leading contenders are thought to be SWIFT, the international banking organization which has the backing of the International Organization for Standardization (ISO) and the Depository Trust and Clearing Corporation, (DTCC)

And last week the Commodity Futures Trading Commission (CFTC) announced an advisory subcommittee on data standardization.

For both financial firms and for regulators, single globally adopted standards for firms and transaction types is the goal. The single standard allows a bank to monitor its counterparty risks globally, streamlines back office processing and reduces costs in data management.

On May 3, SIFMA and 12 other trade associations released “Requirements for a Global Legal Entity Identifier (LEI) Solution” outlining an industry consensus perspective on how the LEI system should work and requirements for the future potential LEI provider.

A representative from a New York investment bank told a SIFMA securities industry conference this month how a single LEI could help her firm monitor its exposure by product and counterparty. (SIFMA rules stipulate that these discussions are on background.)

“We do contingency stress testing. We take a large trading partner and look at all our positions and ask what happens if the counterparty goes bankrupt, what do we have to do to close down those positions? It is very hard to do across all the products we transact with some of our largest partners...We can do it today, but it ends up being quite a difficult process and often needs manual intervention to look across all the products and asset classes.”

The LEI is just a simple code but provides the first step of identification, she added.

While firms have built their own legal identifiers, but a single standard maintained by a third party would reduce costs and eliminate the need to translate the information from system to system, said another panelist.

“You can leverage the information across different processes and run risk and other types of business intelligence if all your systems are speaking the same language.” Now back office staff spend four to five hours a day cleaning up data. It would also simplify regulatory reporting and provide regulators with a better view of what is happening across the world.”

If this is such a great idea, why haven't the banks created a universally accepted identifier on their own?

Paradoxically, because it is so important, firms have already developed their own identifiers, explained Michael Atkin, managing director of the Enterprise Data Management (EDM) Council. Last week he was named to the Commodity Futures Trading Commission (CFTC) Technology Subcommittee on Data Standardization.

“The banks all did their own point solutions. Then there wasn't a business case for redoing all that to achieve global alignment. Most companies operate in narrow parameters — the curse of the short view. Compulsion by regulators is the only way to overcome that. With their task of systemic oversight, they need comparability of legal entity identification.”

However, so far only the United States has taken any action to require a global identifier. At SIFMA, a U.S. Treasury representative talked of flying to Europe for talks, but so far no regulator in Europe or Asia has publicly endorsed the American effort. So the result could be that banks operating in the U.S. use the identifier while continuing to use their own internal identifiers in their other operations. Unless Europe mandates use of the American identifier, and that is confirmed by legislation in the 27 member countries, banks will have a difficult business case to undertake the expensive conversion to a single global standard.

“Without a common, unique code and standards for all the information that regulators would like to associate with it, many of the benefits described in the business case for a firm or global regulators will be difficult to obtain,” said a consultant who works in this area. “Firms will simply add the LEI to an ever growing list of ‘nice to have’ cross reference indicators.”

In standards, as Mies Van Der Rohe said about modern architecture, less is more. One standard is good, two standards do not constitute an improvement.

In the U.S., the new identifiers should be operational within 36 months, said Atkin.

Three years to get around to addressing the issue and another three years to fix it? While that may sound slow to someone from outside finance, Atkins with 10 years experience in working with data management issues sees it differently.

“This is a ridiculously short time. Firms have been scrambling to understand the data relationship, then align to address the issues in the midst of 320 regulations coming out with Dodd Frank, and the data infrastructure wasn’t even on the agenda.”

Data is boring, but it is fundamental to understanding a bank’s positions, its liquidity and its exposure risks by counterparty, currency, interest rates, credit, and geographies. With data in its raw form, rather than aggregated up through layers of assumptions and bank’s proprietary reporting structures, risk managers and regulators can drill down to see for themselves who holds what risks.

Only recently have these data issues made their way up to senior management, said Atkin. After all, the higher you go in a bank the more issues executives are responsible for, and data just hasn’t been one of them. Now senior executives and regulators understand the relationships between data and risk management and oversight.

He thinks caution is required, because getting the data right is so important.

“We want to make sure it is done correctly, globally and in alignment with practical reality. We don’t want to rush though the base-line infrastructure. Regulators are under short-term pressure; we want them to slow down.”

PJ Di Giammarino, CEO of the London-based financial technology think tank, JWG, said the process of developing standards has shown a lack of leadership by the global regulatory community. The Office of Financial Regulation (OFR) in the U.S. has turned the process of developing requirements and short-listing a vendor over to SIFMA before the regulatory requirements have been agreed.

“The nuts and bolts of regulatory reform are all over the shop floor and no one knows what we are trying to build. It’s a massive challenge and everyone is afraid to admit it is their job to take it on. Without practical, hands-on review of how we intend to use the identifier for the business of making global decisions on the riskiness of trades, positions, clearing arrangements, net stable funding ratios and counterparty exposures the good data efforts led by the US will quickly become irrelevant. ”