Time to Feed the Beast

Financial companies are overhauling their data infrastructures just as new systemic risk regulatory requirements are kicking in.

By Katherine Heires

Among the Dodd-Frank Wall Street Reform and Consumer Protection Act’s many, still emerging and evolving contributions to financial services regulation are two acronyms of great risk management portent: FSOC and OFR. The Financial Stability Oversight Council is the panel of top regulators headed by the Secretary of the Treasury that is charged with identifying and responding to systemic risks, in part through information sharing and collection. For the latter responsibility, FSOC has said it will rely heavily on Treasury’s new Office of Financial Research “to collect information from certain individual financial companies to assess risks to the financial system, including the extent to which a financial activity or financial market in which the financial company participates, or the financial company itself, poses a threat to the financial stability of the United States.”

Like many aspects of Dodd-Frank implementation, the OFR is in place but still under construction, with key deadlines looming in July, a year after the act was signed into law. The OFR is in place but still under construction, with key deadlines looming in July, a year after the act was signed into law. The dialogue has been building in intensity since well before Dodd-Frank was enacted last year. In 2009, for example, the Committee to Establish the National Institute of Finance (CE-NIF), a coalition of academics, executives, former regulators, technologists and consultants, began pressing an argument for the kind of research mission that the OFR was eventually mandated to pursue.

At the same time, financial institutions have been waking up to the need to overhaul and upgrade their increasingly complex mazes of databases, data management systems and infrastructures. Besides bringing greater clarity and transparency to their internal processes, these systems will ultimately have to feed the systemic regulator’s prodigious information appetite.

Now a host of experts and analysts, including many who joined in the CE-NIF or supported its principles, are advising risk professionals to be actively involved in the data management discussions at their firms, because the formation of data governance committees, establishment of standards and practices and selection of information technology all have a direct bearing on the risk function and the demands it faces for accurate and timely assessments in support of business strategies.

“This is an opportunity for risk managers to step up and become leaders in the drive for good data management practices,” asserts Clifford Rossi, a veteran risk manager who is now executive in residence at the Center for Financial Policy at the University of Maryland’s Smith School of Business. Data is “the lifeblood of everything that goes on in financial firms,” says Rossi, and without risk managers’ input, they and their firms could get caught in a “dragnet of data requirements” imposed by regulators.

“The greater degree to which risk managers get involved in the these standardization activities, the better for them—it’s an unparalleled opportunity to help build the data infrastructure that they rely on every day,” adds Michael Atkin, managing director of the Enterprise Data Management (EDM) Council, an organization based in the Washington, D.C., area that has sought to represent financial industry interests in discussions about data standards, definitions and best practices.

“Shame on us,” says Atkin, “if we blow this opportunity to create the underlying infrastructure that feeds every risk process within every financial institution.”

A Grip on Governance

According to Stamford, Connecticut-based research firm Gartner’s 2010 Financial Services Data Management Survey, just 28% of banks and investment services firms have a single data governance unit that spans the enterprise. Another 37% have multiple data governance units based on data type; 21% have multiple governance units based on geography; and 14% have no data governance unit at all.

On a more hopeful note, in the Gartner survey of some 250 financial services companies in Europe and the U.S. in the fourth quarter last year, 43% said they would have “a single data governance unit across the entire organization” within 18 months.

Mary Knox, Gartner’s banking and investment services research director, is concerned that risk managers will either stay on the sidelines or be stymied by the lack of central governance over data management, which is a legacy of firms’
The Office of Financial Research, which will support systemic risk monitoring as spelled out in the Dodd-Frank Wall Street Reform and Consumer Protection Act, has both supporters and detractors. Those favoring it say that OFR’s data standardization initiative will produce long-term cost savings, while financial firms’ improved data will enable better tracking of trades and other trial-making. The proponents are internal risk management, modeling and analytics being enhanced; rogue traders and Ponzi schemers more easily detected; and transactions including complex derivatives reported electronically and comprehensively.

Critics, however, warn of problems in the OFR’s implementation. They say for example, that massive aggregation of financial institutions’ data will be costly, requiring major technology investments by the companies facing these additional compliance burdens as well as by regulators in need of both analytical capabilities and staff to make sense of all the data. Some do not see a logical connection between the collection of data and detection of risk. Others wonder how this US-sponsored effort will be effectively coordinated around the globe.

One senior risk manager favors an alternative to data standards and aggregation as a first step toward systemic risk monitoring. Hans Helbekkmo, senior vice president, enterprise-wide risk at Union Carbide Corp. of Caifornia, remarks that “data anarchy,” as massive volumes of mission-critical data, no longer subject to centralized controls, are distributed and processed in countless personal computers, laptops, smart phones and handheld appliances. The mechanics of how the OFR will operate remain unclear, but its purposes are spelled out, starting with standardization of how the vibrations are starting to build up,” says Allan Grody, president of Credit Risk Management. Other questions of how effective a single U.S. agency can be in bringing about data and risk management improvements on a global basis are being raised.

No Shortage of Ideas

For its part, OFR explains on its Treasury Department Web page that it aims to coordinate with regulators both domestic and abroad and has stated its support for an international group, the International Capital Stability Committee, or ICFS, “It is finding that Dodd-Frank says they are going to create a universal identifier, but they are only one national regulator. Who gives them the right to create an international standard for the global financial industry?"

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DATA & POLICY

Pros and Cons of the OFR

The scope of systemic risk is both quantitative and qualitative, and therefore subject to a complex process on the definition and interpretation. The CE-NIF, however, notes there is general agreement on some broad components: The impact of financial institutions on the economy; financial linkages and feedback; forward-looking risk sensitivities, especially related to stressful events; margins, leverage and capital adequacy for individual and institutional investors; and concentrations of exposures, especially relative to market liquidity.

“Not having a systemic risk indication system is like sitting on a volcano, knowing that at some point, your firm will be blown up,” observes Stephen Englund, senior vice president of product strategy at New York-based EDM company GoldenSource Corp. “It’s no longer the province of a few data geeks, but of chief risk officers and other members of top management who do not want to be the next large financial firm to fail because they did not have a good sense of their exposures.”

GoldenSource, Asset Control and other vendors and advocates of EDM systems often struggled to sell their vision of streamlined, holistic data management – until the crisis hit. Now, says Englund, “We don’t have to do the basic [EDM] education anymore.”

“All of these firms have grown disparate systems – equity trades are in one, fixed income in another, and OTC derivatives are on spreadsheets,” notes Dan Simpson, CEO of Cadar, a London-based competitor in the EDM space. “They have all the data, but it’s in seven different places in various shapes and formats, and so the challenge is in connecting all the dots and knowing your counterparty exposure and eventually, achieving a holistic view. It becomes even more difficult when firms operate across many different jurisdictions, on a global basis.”

Convergence of Interests

What’s more, regulators and regulated alike are hampered by a “marked lack of data anarchy,” as massive volumes of mission-critical data, more long-term subject to centralized controls, are distributed and processed in countless personal computers, laptops, smartphones, and handheld devices. The OFR explains on its Web page that it aims to coordinate with regulators both domestic and abroad and has stated its support for an international group, the International Capital Stability Committee, or ICFS, “It is finding that Dodd-Frank says they are going to create a universal identifier, but they are only one national regulator. Who gives them the right to create an international standard for the global financial industry?"

Material pertaining to OFR on CE-NIF’s Web site highlights the problem by noting that in September 2008, the U.S. on the brink of a Depression-like breakdown, Treasury Secretary Timothy Geithner until February of this year. Since then a team that included Adam Lavine, Treasury’s acting director for research and quantitative studies in domestic finance, and, as of late April, Richard Berner, former chief U.S. economist at Morgan Stanley, were filling the void while awaiting the appointment of a director of the newly formed agency. The mechanics of how the OFR will operate remain unclear, but its purposes are spelled out, starting with standardization of how the vibrations are starting to build up,” says Allan Grody, president of Credit Risk Management. Other questions of how effective a single U.S. agency can be in bringing about data and risk management improvements on a global basis are being raised.

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The suppliers vary in terms of experience and breadth of offerings, Kuo points out. Goldman Sachs, for one, markets EDM Suite, a platform capable of consolidating securities masters and counterparty masters across an organization. Dublin, Ireland’s PolaLake is touting “a truly disparate technology-based and a unique combination of XML, streaming, storage and semantic Web,” which it says translates into faster data aggregation, loading, data queries and on-boarding of data feeds.

**Choices of Models**

“There is a growing marketplace of firms that provide reference management platforms, with firms such as Asset Control and GoldenSource providing a specified data model with their solution,” says Kuo. “Other vendors such as Cadis will accept whatever data model or models you want to use for reference data management, and newer entrants such as PolaLake, SmartCo and Kingland offer more modularity in their approach to data management.”

“Because each firm is different and has unique legacy issues, there is really no one, right model or technology approach for data management,” states James Woltenholme, director, capital markets of Hewlett-Packard Enterprise. “A platform that provides a centralized system or one that offers a more modular or flexible approach to data management can work, and we have seen both.” HP recently acquired a data management platform, now called HP Intelligence Center, which will aggregate data on market, credit and operational risks across multiple divisions of a firm, leading to an enterprise-wide view of risk. Atkin of the EDM Council notes that even without a standard in place, many firms have already been addressing legacy and inter-entity issues. This makes sense because a large financial institution may work regularly with 500,000 to 800,000 business entities, and identifying and verifying all those database entries is no small task. HP’s ambition can be leveraged, too, he says, to improve data quality.

“Risk managers are the natural and right people to push for better data quality and management,” says Asprey, adding that many have to demonstrate to regulators that they have a robust data management framework and generate accurate risk reports.

**Leadership Masters**

Hiring a data tsar is right for the data standard and the regulatory oversight that will come with it. Sponsorship from top-level management is a key element, according to Dan Simpson of Cadis. A data tsar or chief data officer may be put in charge, but the objective is to get business and technology people, including the CRO and COO, working together. “In the past, data management was strictly an IT function, but in the current environment, the collaborative approach is what works,” says Simpson. Rick Enfield, product business owner at Asset Control in New York, says it’s an advantage to let the business side take the lead, so as not to lose focus on strategic concerns and competitive advantage. “If the effort is driven from the IT perspective, you can lose perspective, while having a business-led effort you bring back into business focus,” he says.

Jon Apsyro, director of strategic consulting at Trillium Software, a Billerica, Massachusetts-based provider of data quality and validation software, says, “Who actually oversees a data management project changes from firm to firm, but to be successful, you need some kind of executive-level sponsorship, data governance board or steering group.” He says he often sees at big commercial banks “centers of excellence” to manage large data projects, overseen by a head of data quality from the business side of the organization. Also represented are risk teams and central operations divisions.

“Risk managers are the natural and right people to push for better data quality and management,” says Asprey, adding that many have to demonstrate to regulators that they have a robust data management framework and generate accurate risk reports.

**For all the uncertainty and complexity surrounding data standardization and compliance, improved systemic risk management could yield substantial benefits at the micro level as well.”**

**Data Questions for Risk Managers**

At the Financial Information Management Association Reference Data Conference in March in New York, Diane Good, head of risk systems and projects at HSBC, presented the following checklist of questions to help chief risk officers and risk managers advance their firm-wide data management efforts:

**Governance**

Does the firm have a unified plan for data management planning? Do you have a strategic roadmap that permits proper changes to be made over time?

**Sponsorship**

Who is accountable for data management efforts? Who will address the critical question, How good does it have to be? Do you have consensus for proceeding with a risk data rethink or update? Is everyone at the table participating in all the various areas of risk, plus finance, treasury, IT and the lines of business? Do you have a data governance charter in place to address questions about responsibilities?

**Operations**

Are you addressing the challenge of integrating data across mergers and acquisitions?

**Projects**

Are you addressing the challenges inherent in the legacy of M&A activity and a P&L investment focus? What capabilities will be needed next, and will my platform be able to support them?

**Quality**

Is your data “fit for purpose,” and can you demonstrate that?

**Source**

HSBC

**For MORE DATA & POLICY: Consultant Allan Grody on systemic risk analysis.**