Senator Reed Sponsors Legislation Creating Executive Agency to Collect Data on Systemic Risk

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Senator Jack Reed has introduced a bill creating an executive agency to collect and standardize data on financial firms and their activities to aid and support the work of the federal financial regulators. The National Institute of Finance Act of 2010, S 3005, would provide the financial regulators with the data and analytic tools needed to prevent and contain future financial crises by developing tools for measuring and monitoring systemic risk. The logic behind the legislation is that it makes no sense to pass legislation creating a systemic risk regulator when there are no standardized tools for measuring systemic risk.

A key member of the Banking Committee, Senator Reed is also Chair of the Securities Subcommittee. He is working with Senator Gregg on the derivatives piece of the financial reform bill.

The Institute would not only develop the metrics and tools financial regulators need to monitor systemic risk, it would also help policymakers by conducting studies and providing advice on the impact of government policies on systemic risk. Thus, the Institute would be required to provide independent periodic reports to Congress on the state of the financial system. This will ensure that Congress is kept apprised of the overall picture of the financial markets.

The Institute would be headed by a Director appointed by the President for a 15-year term and a board of directors composed of the Treasury Secretary and the Chairs of the SEC, CFTC and other federal financial regulators. The Director could not concomitantly serve as Chair of the SEC or any other financial regulator. The Institute would be funded through assessments on the financial firms required to report data to the Institute.

The Institute is broadly authorized to require financial firms to report all data and information necessary to fulfill the responsibilities of the Institute. It can require reporting on a global basis from the financial firms organized in the United States. The Institute can also require reporting of US-based activities by foreign financial firms. The legislation empowers the Institute to enforce and apply sanctions on all financial firms that fail to report the requested data.

According to Senator Reed, the crisis revealed that federal financial regulators do not have the appropriate tools or knowledge to address risks that cut across different markets and sectors of the financial system. While the financial regulatory reform legislation moving through Congress is an important step in filling this huge regulatory gap by establishing centralized systemic risk oversight, he reasoned, any new regulatory structure will be ineffective unless also equipped with a strong, independent, and well-funded data, research, and analytic capacity to fulfill its mission.

At the behest of Senator Reed, the National Academy of Sciences conducted a study and found that the U.S. currently lacks the technical tools to monitor and manage systemic financial risk with sufficient comprehensiveness and precision. The Academy also found that market efficiency, in addition to regulatory capacity, would be enhanced by improved intelligence about what is going on in the system as a whole. Existing capabilities are not a sufficient foundation for systemic risk management.

The legislation would provide for the new Institute to house a data center that would collect, validate and maintain key data to perform its mission, including a central database to map the interconnections between financial institutions, along with details on their transactions and positions, and their valuation of their assets and liabilities. By working with banks and other firms to standardize the format of such data and by providing standard reference data, such as databases of legal entities and financial products, the Institute would reduce the costs to regulators and financial institutions from the currently fragmented and disorganized systems used to collect and store such information.

The Institute would also contain a research and analysis center to develop the needed metrics and then measure and monitor systemic risk posed by individual firms and markets. The Institute would house some of the country's most-well-respected researchers to collect and analyze the data needed to understand what is happening in the financial markets, to conduct investigations of market disruptions, and to work with regulators to identify new and dangerous trends. It would conduct and help coordinate applied research on financial markets and systemic risk, a field that is not well-represented right now at the Federal Reserve or within other regulatory agencies.

The legislation is also an effort to implement a recommendation of the Counterparty Risk Management Policy Group, which called on the financial industry to move rapidly toward real-time reconciliation and confirmation of financial transactions. Industry experts believe that this change would yield substantial benefits to firms individually, to the financial services industry, and to the economy as a whole. **Achieving this goal would not be possible, however, without industry-wide adoption of common standards for coding and handling financial transaction data. Despite the clear benefits of data standardization and despite years of effort, the financial services industry has not been able to make meaningful progress towards the goal of universal adoption of uniform, consistent standards for data handling.**