

Rt Hon John McFall MP
Chairman, UK Parliament Treasury Committee
7 Millbank
House of Commons
London SW1P 3JA

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Via email: humblel@parliament.uk

Dear Mr. McFall,

I am the CEO of JWGW, a financial services think-tank which works with regulators, investment firms and their information technology supply chain to help determine how the right regulations can be implemented in the right way.

Since 2006, JWGW has worked with over 100 financial institutions, 12 trade associations and 50 technology vendor firms. We have been actively engaged with the European Commission, level three committees, the FSA and EU, UK and international trade associations and standards groups.

In order to aid your committee's inquiry into proposals for European macro and micro prudential financial regulation, I would like to share some of the findings from our recent research on the rather large challenges inherent in establishing global regulatory oversight.

Getting macro prudential oversight right

Despite calls for the G20 to conduct a cumulative impact assessment before agreeing a path forward, the newly-minted Financial Stability Board (FSB) appears to be engaged in a regulatory 'race to the top', which pits the rule makers both against each other and against the banks in a bid to build a macro view of systemic risk. Of all the proposed regulatory changes, macro prudential oversight (MPO) is the most ambitious yet, we believe, the least understood.

The implication of the G20's 93-point action plan for investment firms is that they must now extract more data from more sources on both an ad hoc and a periodic basis. That data must be scrutinised and retained for longer periods of time, and possibly shared more widely.

For the regulators, this poses an enormous data quality challenge. Individually, each regulator needs to be able to make sense of the information it has asked for and then share a common understanding across jurisdictions which have different languages, laws, tax codes, cultures and business systems. Effective supervision relies on uniform translation of oversight information which must be captured, aggregated, normalised, validated, enhanced, analysed and reported over long periods of time.



There must be a clear consensus of what information is necessary and sufficient for successful oversight, agreement of what 'good quality data looks like' and agreement on how that information should best be transmitted. Without this common understanding between market participants, we run a real risk of managing risk via the information systems rule of "garbage in, gospel out" where computed results become the unquestionable truth.

In order for the global regulatory community to get the right data with the appropriate level of quality, they will need to agree procedure manuals to guide and inform firms about what information standards are to be used under which circumstances. According to analysis from the European Commission supporting the proposed Omnibus Directive (2009/0161), there are in excess of 50 missing technical standards that are required to effectively share the information required by the CRD, MiFID, MAD, AML and eight other existing EU financial services regulations.

These standards will not be easy to implement as there are currently many differing ones being used by firms and vendors. As you may be aware, different firms have different naming conventions for their reference data, a point which emerged during the Lehman's fallout as firms scrambled to discover their total exposure to each legal entity. There are also different methods of describing financial instruments which may be equally idiosyncratic.

To complicate matters further, recent regulatory policy initiatives are now asking for detailed reporting of what may be ambiguous concepts, i.e., those that have slightly different meanings for each segment of the market. For example, a retail bank may focus on its customers, whereas an investment firm will think of counterparties. Each will need a naming convention to describe what, in each case, is a legal entity, but which is characterised for the purposes of the business relationships in different forms and tracked in different formats. JWG's investigations have revealed that there is a growing commonality of requirement for data to be connected and shared, not only internally, but externally too as more visibility is requested by the Supervisory Colleges, European Supervisory Agencies, the European System of Financial Supervisors, and European Systemic Risk Board.

Sticking with the customer reference data example JWG's membership is concerned about the operational implications of:

- ▶ FSCS requirements for 'single customer view' (i.e., PS09/11)
- ▶ Large exposure requirements to track 'economic interconnectedness' (CEBS CP26)
- ▶ Liquidity requirements for funding (i.e., PS09/16 FSA 053) or funding concentration (i.e., FSA 051)
- ▶ Carbon Reduction Commitment reporting by asset owner (CRC Order 2010)
- ▶ Living will information (e.g., BCBS cross-border CP re lists of counterparties).

The full picture of all the regulations is far more complex and its implications are of real concern.

In addition to the requirements of specific regulations, overarching arrangements which are robust, practical, efficient and integrated need to be put in place. Information sharing must be possible within the EU, from outside its borders and throughout the members of the G20. While the focus might be on the EU, it must be remembered that regulators and agencies in other countries may also need to access and use the information. In turn, their information will need to be accessible to the EU regulators in a form which is readily understandable.

The impact of the current approach

Whilst the industry is already engaging in the discussion of how to align its view point, the complexity, speed and technical difficulty of creating an integrated picture of risk is mind boggling.

Resources are being wasted as both firms and regulators devote man years to solving these problems in silos. The traditional methods of agreeing detailed technical standards and quality measures are being



overridden by the need to comply with unrealistic timelines. Often, existing policy-focused associations do not have the skills, time and resources to present the views of their memberships. Aggressive targets are forcing corners to be cut and common business rules, data requirements and infrastructure capabilities are not fully understood. In the absence of meaningful guidance, and despite scarcity of resources, every major firm is deploying scores of analysts in an isolated and uncoordinated fashion to define requirements, engage the infrastructure, negotiate with vendors and scope solutions. Across Europe alone, there are hundreds of players that need to coordinate their implementation roadmaps to make the omnibus work.

Without a clear mandate to establish an understanding of 'what good macro prudential oversight looks like' at senior level within the firms, the FSB, the International Monetary Fund, the European Commission, the FSA and global standards bodies, we could well find ourselves overwhelmed by the data tsunami of 2010. This storm might prevent the fulfilment of the G20's commitments and force difficult discussions between the taxpayers, their representatives and the financial services supply chain as:

- ▶ Businesses suffer from bad policy (e.g., excessive liquid asset buffers, regulatory capital)
- ▶ Compliance costs increase (e.g., more reporting, fines)
- ▶ Business is disrupted (e.g., regulatory projects, inability to complete growth projects)
- ▶ Resources are strained as cutbacks have imposed operational stresses
- ▶ The cost to the consumer goes up (i.e., pension funds suffer, businesses funding remains challenging) as a result of the banks' increased costs of complying with these new requirements
- ▶ There is global uncertainty as intensive regulatory locations lose out through regulatory arbitrage.

We feel that it is important to draw breath now and clearly articulate the problems we need to solve and the solutions for the industry to practically implement the required changes.

Moving the dialogue forwards

Both the costs and the benefits of this initiative could be large but we need a realistic vision, blueprint and timeline. Our research has identified the major strategic questions and tactical challenges to any oversight strategy and is summarised in the Appendix. We are now in a position to ask the right questions - we know what we don't know. However, we are currently unable to give full, considered solutions to any of these 'known unknowns' and this presents a real implementation risk to the EU's plans.

At the extreme, overcoming the practical hurdles to building a macro prudential system could require a fundamental restructuring of how the industry's information assets are developed, maintained, owned and paid for. Even if the requirements for MPO can be agreed upon, there are countless vested interests in play at national, regional and global levels. If MPO is to succeed, a proactive approach to aligning the many stakeholders must be underway by early 2010.

The world has been scorched by the financial crisis and is keen to see new fire prevention methods put in place quickly. We hope that a high profile committee like yours will take a lead in raising the awareness of these issues and call upon the authorities at national, European and international levels to develop a better understanding of the roadmap and what 'good looks like' at the end of the journey.

There is a real risk that if we get this wrong, not only will the world be engulfed by faulty data, but we will further damage an already weakened industry and MPO will be branded as a failure politically, to be tossed aside until another crisis forces a renewed focus somewhere down the line. Rather than letting the responsibility fall to a few organisations who happened to start first, it would benefit the industry, and the global economy as a whole, to engage in an adult discussion - involving all who would be affected - about how to reach a comprehensive, efficient and effective solution.

Hundreds of man years effort from real domain experts in the leading banks is required to get this right. Having worked with the firms, the regulators, the supply chain and the industry associations, JWG has



observed the individuality of multiple data silos - in all types of organisations - leading to real difficulties in addressing the challenges of reporting or responding to the request for new levels of data interconnectedness. We believe that JWG is well placed to facilitate some joined-up thinking which might have real economic and administrative benefit at a later stage.

We recognise that these are busy and challenging times but we feel that taking some time now to enter into structured dialogue would be of real benefit to all parties. We would, of course welcome the opportunity to explore these issues in more detail.

Yours sincerely

PJ Di Giammarino
CEO



Appendix: The macro prudential oversight roadmap checklist

Topic	Strategic question	Tactical challenge
What has the G20 asked for?	<ul style="list-style-type: none"> ▶ Who owns the vision? ▶ What is the mission? 	<ul style="list-style-type: none"> ▶ What are the key milestones?
What does it mean?	<ul style="list-style-type: none"> ▶ What is the purpose of systemic oversight? ▶ Do we have an agreed definition of the objectives? ▶ What changes are implied to the infrastructure by introducing it? 	<ul style="list-style-type: none"> ▶ What are the service levels required across the supply chain to make MPO work? ▶ What explicit legal mandate is required to ensure all the actors complete their objectives and what will be the penalties of non-compliance?
The problem	<ul style="list-style-type: none"> ▶ What is the definition of a systemic risk in practical terms: what factors are we looking for? 	<ul style="list-style-type: none"> ▶ What information flow is needed to detect such a risk: what data and to whom? ▶ How will we know the data is of high enough quality to support MPO requirements? ▶ What is the right governance structure to get us to an effective solution?
The barriers	<ul style="list-style-type: none"> ▶ What is a 'good enough' view of a systemically important firm's risk? ▶ Do we require validation of a firm's systemic risk data, information architecture and governance against some sort of standards? ▶ How should these same standards be applied to the regulators? 	<ul style="list-style-type: none"> ▶ What information is needed from whom, to whom and by when? ▶ How should quality measures be established, maintained and enforced? ▶ How should the many standards be created in a way which fosters and encourages their rapid adoption and success?
Risks/costs	<ul style="list-style-type: none"> ▶ How much does the G20 want to spend to get this right? ▶ What is a realistic timeline? ▶ How will we know when we get there? 	<ul style="list-style-type: none"> ▶ What costs and benefits will each stakeholder in the supply chain incur or reap? ▶ How and when will they incur or reap them?
The roadmap	<ul style="list-style-type: none"> ▶ What is the right blueprint: how will the information be shared throughout the marketplace? ▶ When is the implementation deadline and how much will all this cost? ▶ How is the implementation programme monitored and controlled? 	<ul style="list-style-type: none"> ▶ What combination of new standards and reports is necessary and sufficient to ensure that adequate quality data is available for the purposes of MPO? ▶ What group of people is best suited to create these new standards and report?

Source JWG analysis from "The G20's roadmap to macro prudential oversight", published November 2009