

Testimony of Mr. Thomas F. Price
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Subcommittee on Security and International Trade and Finance

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I. Introduction

Chairman Bayh, Ranking Member Corker, members of the subcommittee, good afternoon. My name is Tom Price, and I am a Managing Director of the Securities Industry and Financial Markets Association (“SIFMA”).¹ Thank you for allowing me to submit my statement for the record. My testimony will focus on the information requirements for effective systemic risk regulation and what SIFMA is learning about how a future systemic risk regulator can work with the industry to get the information needed to identify and control potential systemic risks.

We believe that a systemic risk regulator needs to address aggregated interconnected risks in order to forestall a system-wide dislocation. In order to understand this issue, we have launched a study to pinpoint the information that a systemic risk regulator will need to identify and manage systemic risk, how that differs from the current state of reporting, and how to address information gaps. The project is based on a series of interviews with US and international regulators and a range of

¹ SIFMA brings together the shared interests of securities firms, banks and asset managers. SIFMA’s mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public’s trust and confidence in the markets and the industry. SIFMA works to represent its members’ interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

regulated entities, including US and international banks and buy and sell side firms. Although establishing a definitive conclusion before completing the project would be premature, we have some initial observations we would like to share with the subcommittee.

II. Current Information Reporting & Systemic Risk Regulation

Our current project aims to understand what information will be necessary for effective systemic risk regulation and to map ways of improving communication between market participants and the regulatory community. SIFMA supports the creation of a systemic risk regulator that has the authority to obtain the information and tools to identify weaknesses and systemic risks in the overall financial system and take mitigating action before they become problems that can imperil the market as a whole. We believe that effective systemic risk regulation will combine macro-prudential regulation of financial markets with micro-prudential oversight of certain firms.

Improving information sharing and reporting is not simply a question of scaling up reporting requirements – a broad range of balance sheet and trading book information is already reported to regulators. However, the data as it exists in the system may not always be viewed effectively in identifying potential systemic risks. For example, a diversified global bank holding company files separate reports to the SEC, CFTC, FDIC, the Federal Reserve, the OCC, and foreign regulators, often in different formats. Yet each of these reporting procedures only captures a slice of the bank's exposures and looks

mainly at the micro-prudential risk of that specific institution, not the greater macro-prudential risk in connection with the financial system as a whole. Although some programs currently exist to monitor systemic issues, such as the Supervisory Capital Assessment Program (the “Stress Tests” organized by the Federal Reserve in the spring of 2009) and the Shared National Credit Program (a program to track credit quality in syndicated loans), they only examine parts of systemic risk landscape. In contrast to these limited programs, effective systemic risk regulation will act on the possibility that a crisis in a single firm, product, or market could lead to a breakdown in the wider financial system.

The challenge we are addressing is how to identify information a systemic risk regulator will need to understand the macro-prudential risks to our financial system. This includes leveraging existing information, data, and communications links such as regulatory reporting, databases in clearinghouses and other industry utilities, and firms’ management information systems. We are approaching this from two directions. First, by speaking with a broad range of US and international regulators on what information they need, information they are currently collecting, and whether these are the most important metrics to determine systemic risk. Second, by meeting with broker/dealers, bank holding companies, insurance companies, asset managers, hedge funds, exchanges, and industry utilities on how to best deliver this information to regulators.

III. Initial Observations – Regulatory Scope, Data Reporting, & Infrastructure

In our discussions to date, a range of approaches to systemic risk information data analysis and reporting have emerged, including stress tests, reverse stress tests, trade repositories, and data warehouses, as well as additional models or variants of these models which will emerge as we continue our research. Each model has different costs and benefits, as well as underlying complexities about analytic capability, information storage and transmission capabilities, and data standardization and quality. The models are not mutually exclusive and a solution could combine aspects of different models or all of the models depending on what is best suited to certain products or markets. However, at this point no conclusions can be drawn.

Two approaches are driven primarily by analysis carried out in-house by firms. Stress tests, like the SCAP conducted in early 2009, use scenario analysis to measure the impact of adverse scenarios on firms' P&L and capital position. The SCAP approach relies on firms' to run their own internal models based on a set of macro economic stresses and test parameters provided by regulators. The results are analyzed to produce a complete, comparable picture of the health of the financial system. The reverse stress approach uses a similar process of testing the impact of adverse scenarios using firms' internal models. However this approach requires firms themselves to identify scenarios that would have a material impact on the marketplace and describe to regulators the precautions they would take to minimize these risks. Regulators then compare the impact of a given scenario across different firms.

Alternatively, trade repositories and data warehouses both feature the creation of central hubs for information which the regulator then uses to analyze systemic risk issues. In both cases the regulator has access to a wide range of data from all market participants but will need the analytic tools to identify and monitor systemic risk. The difference between these two models is that the trade repositories approach aims to create a range of repositories holding position level and market data, drawn from existing reporting by firms and utilities. The data repositories approach would involve the creation of a new, standardized data and reporting architecture, with substantially greater costs and lead time as the bulk of this complex system would need to be built by both regulators and firms.

We have also identified a key role that current financial system infrastructure and nodes like counterparty clearing parties (CCPs) and repositories have in identifying and controlling connectivity and its associated risk. Some organizations have suggested that improving the efficient and reliable operations of infrastructure can be very effective in reducing systemic risk by promoting transparency and reducing counterparty risk. The concentration of financial market activity which flows through a limited number of nodes such as clearing firms and other utilities make them a useful resource to understand risk in the system. By aggregating information on a broad range of trading activity, positions, and market trends, regulators could tap into these nodes to track trends across the entire system. However, the concentration created by shifting these activities from many

companies to just a few nodes introduces riskiness to the CCPs and raises the threat the failure of a utility could pose for the system as a whole.

IV. Conclusion

SIFMA continues to work on a final report that will describe each of these systemic risk models in detail. We anticipate the report will identify new alternatives and challenges to systemic risk regulation as our interviews proceed. We would welcome the opportunity to discuss our findings with the subcommittee once our project is complete.