

**Testimony of Richard Berner, U.S. Department of the Treasury
House Financial Services Subcommittee on Oversight and Investigations
Hearing on “Oversight of the Office of Financial Research and the Financial Stability
Oversight Council”
July 14, 2011, 2:00pm**

Introduction

Chairman Neugebauer, Ranking Member Capuano and Members of the Subcommittee, my name is Richard Berner. I recently joined the U.S. Department of the Treasury as Counselor to the Secretary, advising him on financial matters. The Secretary has asked me to help him set up the Office of Financial Research (“OFR” or “Office”). In that capacity, I am pleased to testify on the mission of the OFR, on the progress we have made in launching it, and on the initiatives that we have underway to achieve our objectives.

History

First, some background. The financial crisis made clear that the regulation and oversight of the financial services industry was deficient in many respects. Regulators underestimated the extent of leverage and maturity mismatch. We overlooked threats to financial stability that spread horizontally across interconnected institutions and markets. Nonbank financial institutions and activities were inadequately regulated. Consequently, we underestimated the size of risk and the way shocks could spread across the financial system and impair its functioning, with severe consequences for the economy.

Likewise, the crisis also revealed the deficiencies in the data available to monitor the financial system. Financial data we collected were either too aggregated, too limited in scope, too out of date, or otherwise incomplete. Regulators and policymakers thus lacked the timely and accurate

EMBARGOED UNTIL DELIVERY

information needed to monitor emerging threats to financial stability, to develop tools needed to mitigate them, and to respond to events during the crisis. The crisis demonstrated the need to reform the data collection and validation process, and that standardizing the way we describe financial data would be critical to improving their utility to regulators and market participants.

Mandate and Mission

The Dodd-Frank Act addresses many of these shortcomings. It created the Financial Stability Oversight Council (“FSOC” or “Council”) to identify and respond to threats to the stability of the U.S. financial system and economy and to promote market discipline. It also created the OFR to function as a shared provider of data and analysis for the FSOC and its member agencies.

The OFR is working diligently to satisfy its statutory mandates and mission:

- To collect data on behalf of the Council, and to provide them to the Council and member agencies;
- To standardize the types and format of data collected and reported;
- To perform applied and essential long-term research; and
- To develop tools for risk measurement and monitoring.

As Dodd-Frank requires, the OFR will not duplicate efforts that already exist in the Federal financial regulatory community. Rather, the OFR will leverage existing resources in information, research, human capital, and technology whenever possible in order to enhance existing capabilities and to reduce existing overlap among FSOC members. Put simply, we aim to create the “connective tissue” needed to fill gaps in both information and analytics.

I am pleased to report that we are making significant progress towards these objectives. In my testimony today, I will discuss how the OFR's plans and projects already underway will further that progress. First, I will discuss OFR's work on improving financial data. Next, I will discuss the Office's research strategy. I will conclude my testimony with an update on important tangible aspects of building the Office: staffing, and information security.

Improving Financial Data

On data, the OFR's promise is to collect and make available, to regulators and to the public, more and better financial data while reducing the regulatory reporting burden. That's a tall order, but three aspects of the OFR's approach will in our view make that promise a reality. First, as I have already discussed, the OFR will not duplicate data collection efforts; rather it will fill in the information gaps in the regulators' data toolbox I described earlier. Second, the OFR will collaborate with and provide data services to Federal financial regulators, creating economies of scale, lowering operating costs, and eliminating redundant reporting requirements across the regulatory system. Finally, and most important, the OFR will promote standards for financial data that will make it easier for firms to link and aggregate information at a variety of levels for a variety of needs. As a result, they will be able to use the same basic data both for reporting to regulators and for managing their business.

Benefits of Data Standardization

Standardization is important for improving the quality and transparency of financial data. It will make for more consistent and complete reporting, so data available to regulators will be more accurate, more comparable across firms and industries, and easier to use. Data standards will

EMBARGOED UNTIL DELIVERY

also facilitate firm risk management, because risk managers will be able to aggregate individual transactions and positions into a complete and accurate picture of the enterprise. They will improve market discipline by giving market participants a more transparent picture of firms' activities. Finally, standardization will improve the ability of regulators to respond quickly as needed to new developments that could affect financial stability.

A linchpin for data standardization is the legal entity identification (LEI) initiative, which is moving forward quickly with support from both the industry and global regulators. In November of 2010 the OFR team launched and sought public comment on a public-private initiative to create a global standard for uniquely identifying parties to financial transactions. This will improve the abilities of regulators and firms to manage counterparty risk, assure the integrity of business practices, and lower processing costs for financial transactions. For example, an international group of securities regulators and supervisors of payment and settlement systems recently recognized the value of an LEI in identifying risks in derivatives transactions, a key contributor to the recent crisis.

In the United States, the OFR is working with the SEC and CFTC to ensure that a new LEI standard will help satisfy their requirements for swap transaction reporting, and FDIC needs for its resolutions work. We are also working with U.S. and foreign financial regulators to define consistent requirements for the LEI, including an acceptable operating model and governance structure. This is a good example of the way the OFR is facilitating collaboration and consistency across the members of the FSOC and international regulators.

EMBARGOED UNTIL DELIVERY

The private sector and International Organization for Standardization (ISO) have made significant progress in advancing the LEI initiative. Key financial trade associations and their members formed a global coalition to solicit input from various market participants, debate and produce a common set of requirements for an LEI, and develop a recommendation to provide to regulators for potential solution providers. This coalition published their recommendation this week. That work and their continued dedication will propel the initiative forward. ISO—which has deep expertise in developing standards for the financial sector and has broad international representation from industry and regulators—is part of the solution that financial trade associations recommended. ISO has put forward a new standard called ISO 17442 and is moving forward in implementation so as to be consistent with public and private requirements.

We believe that a multilateral forum, such as the Financial Stability Board, could bring these work streams together and establish a dialogue among regulators and industry to establish a global LEI embraced by all. We are working to make that a reality.

We see the LEI initiative as a template for future standardization efforts. Given the positive response from domestic and international industry and officials, we have begun looking at other ways in which the OFR could encourage data standardization – such as across financial instruments -- which will allow for less costly and more accurate data collection.

Data Collection

The Dodd-Frank Act lays out broad principles and gives appropriate authority to the OFR for data collection. We will be thoughtful in interpreting those principles and we will exercise that

EMBARGOED UNTIL DELIVERY

authority responsibly. Collaboration with FSOC member agencies to determine the scope and format for data collection and to eliminate redundancies is critical.

Let me be clear: The OFR will not collect data for the sake of collecting data; rather the scope of the data we collect will be driven by the analytical frameworks developed to address policy needs. Where there are gaps preventing us from conducting that analysis, the OFR and FSOC member agencies will determine how to fill them efficiently.

Work to identify such data gaps is already underway. Staff at the OFR and FSOC member agencies are cataloguing data used and collected by financial regulators. The results of this project will help the OFR, the FSOC, and its member agencies identify data gaps and potentially redundant data calls. With this information, we will be better able to coordinate, simplify, and harmonize future data collection in a manner consistent with the President's Regulatory Review Executive Order. Going forward, the FSOC Data Committee will be the venue for discussions of data-related issues in the FSOC, where member agencies will lay the groundwork for future projects to improve access to and the quality of financial data.

Research

The OFR will prosecute our research agenda in support of its statutory requirements. The OFR will produce, promote and sponsor financial research aimed at developing the analytical tools we need to assess threats to financial stability. The OFR is supporting the work of the FSOC in assessing potential risks and by providing data and analysis in support of the FSOC's work to develop further guidance regarding determinations of whether nonbank financial companies

should be subject to supervision by the Federal Reserve and heightened prudential standards.

The OFR is working to establish forums and networks to allow experts within and outside the regulatory system to contribute to its mission. Later this year, the OFR and the FSOC will host a conference that brings together top academics in finance, economics, and computer science along with members of industry and the regulatory community to discuss systemic risk monitoring and potential responses. The OFR is working to establish fellowship and visiting scholar programs.

In addition to its research on topics related to financial stability, the OFR will work with academia and the private sector to promote best practices in risk management through publications and forums.

Building the Office

Staffing

First, the search for an OFR Director is ongoing. In the absence of a Director, the Secretary of the Treasury has authority to direct the planning and implementation of the Office. The Secretary is actively engaged in that effort and, as his advisor, I meet with him and other senior leadership regularly to report progress and receive direction.

In the meantime, the high level of talent among the first employees of the OFR is an important measure of our progress. We are hiring professionals with deep industry experience in data management, technology, and risk management to establish the OFR Data Center, the organization's operations arm. As I noted earlier, that arm will be responsible for standardizing reporting, developing data, analytical tools and IT solutions to support the work of the OFR's research arm, the Council, and its member agencies. Their extensive industry experience will

EMBARGOED UNTIL DELIVERY

help ensure that the organization will collect data in a systematic, structured, and non-duplicative way, with clear benefits to and inputs from industry and regulators.

Two examples are John Bottega and Dessa Glasser. Mr. Bottega is Chief Data Officer for the Markets Division of the Federal Reserve Bank of New York, and he recently joined the OFR on assignment as Senior Advisor to assist in establishing the OFR Data Center. Mr. Bottega has over 30 years of experience managing and transforming reference data functions and is a recognized thought leader in the data management field. Ms. Glasser is the OFR's Chief Business Officer and is responsible for information standards, business analysis, project management, relationship management, and data administration. Ms. Glasser has over 20 years of experience in the financial services industry, including risk management, business development, analytics and systems. Ms. Glasser holds a Ph.D. in Economics and is widely published in fixed income and equity analytics and portfolio management. Both Mr. Bottega and Ms. Glasser have extensive experience building organizations with significant data and analytical needs.

We also are making progress in establishing the OFR's research team, which will include academics and analysts from a variety of disciplines. The interdisciplinary research team will add significant capacity to the Council's ability to measure and analyze both factors contributing to and threats to financial stability.

Mark Flannery, who recently joined as Senior Advisor, is an example of the research talent helping to build the Research and Analysis Center. Professor Flannery is the Bank of America

EMBARGOED UNTIL DELIVERY

Eminent Scholar in Finance at the University of Florida. Healso has extensive experience building research teams in the public sector and in evaluating risks in the financial system and developing policy responses at the FDIC and the Federal Reserve Bank of New York.

Information Security

The OFR will adopt information security measures that are consistent with current best practices in both government and private industry. We are well aware of the threats to data security from the “black hat” hacker community. Preserving the security and integrity of OFR’s data is a mission-critical objective that we are prosecuting in three basic ways.

First, the OFR is developing policies on post-employment restrictions. By limiting where an OFR employee may work after separation, dependent on their access to sensitive information while employed by the OFR, these policies will prevent misuse of valuable and confidential data.

Second, the OFR is developing robust governance policies and protocols that include rules restricting use of data and information systems as well as systems of controls for issuing and monitoring user-level permissions for data accessible to the OFR.

Third, the OFR is establishing information systems that protect data from unauthorized outside access and limit OFR employees’ access to sensitive information consistent with their responsibilities. Systems to ensure the integrity of data will be in place and tested well before the OFR collects any sensitive information. We are looking at alternative approaches to

EMBARGOED UNTIL DELIVERY

organizational design that could include the complete physical separation of systems and processes designated for handling confidential information from those for handling non-proprietary information.

We will not compromise our data security goals, and are prioritizing our efforts to achieve them in a cost-effective way.

Conclusion

Mr. Chairman and members of the Subcommittee, the Dodd-Frank Act created the OFR to help the FSOC promote financial stability and limit the effects on the nation's economy of financial crises. Better data and analysis cannot prevent financial shocks, but we believe our efforts will help policymakers and market participants understand their origins, and thus help reduce their frequency and magnitude. Those efforts will continue to deliver on our mandate to improve the quality, integrity, and availability of financial data and to promote and produce research that helps us identify and address threats to financial stability.

Thank you for your attention and I will be happy to answer any questions.