



The Financial
Services Club

Capital Markets Chamber



This house believes the nuts and bolts of systemic risk are in
our toolbox

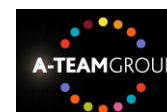
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The Financial Services Club is a private networking club for financial professionals that focuses on the future of financial services through the delivery of high quality and in-depth research, analysis, commentary and debate.

Established in 2004 with regular meetings in London, Edinburgh, Dublin and Vienna, the Financial Services Club provides a platform for practitioners, regulators and industry leaders to meet, network and discuss the future of our industry.

Our white papers, research and meetings are published in full on our website www.fsclub.net for members, with summaries available through our official blog at www.thefinanser.com.

"When a meeting, or part thereof, is held under the Chatham House Rule, participants are free to use the information received, but neither the identity nor the affiliation of the speaker(s), nor that of any other participant, may be revealed".

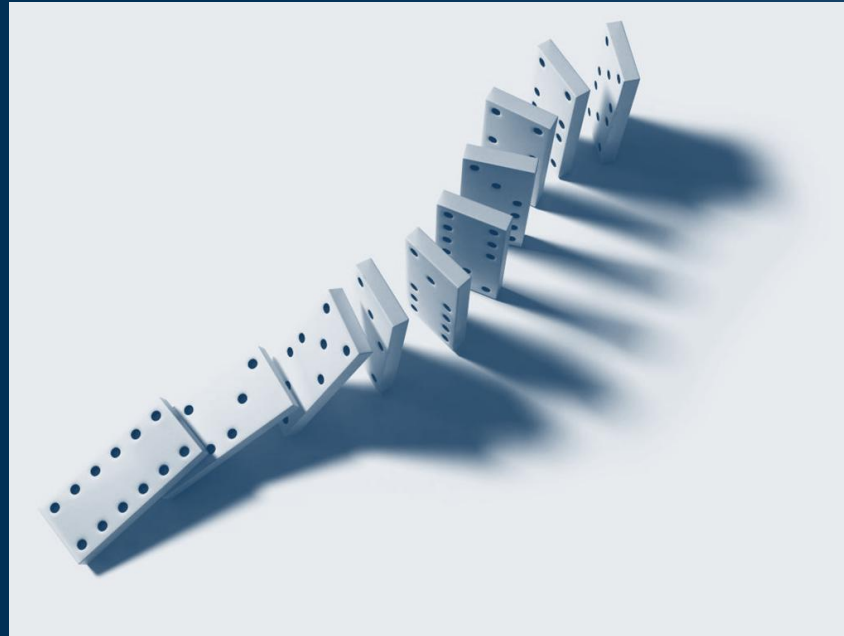
The world-famous Chatham House Rule may be invoked at meetings to encourage openness and the sharing of information. ... with the aim of providing anonymity to speakers and to encourage openness ...

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A debate on what it will take to manage systemic risk right



Systemic Risk Control

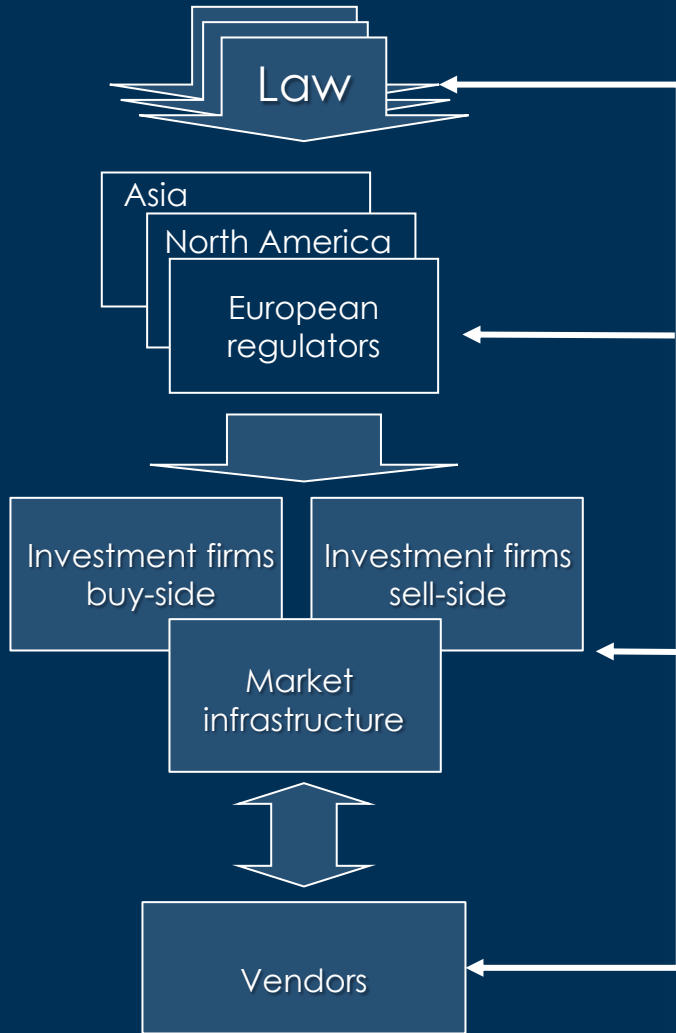


JWG research summary





JWG: an independent think-tank



We seek to be recognised by regulators, financial institutions and technology firms as the independent analysts to help determine how the right regulations can be implemented in the right way



- Mapping the operational heat from 250,000 pages of FS regulations
- Mirroring, shaping, defining global standards
- Facilitating regulator, firm and supplier collaboration

Limited company with unique IP. Revenues derived from membership fees and research projects

Making sense of financial service regulation since 2005



2010 research focus



Trading (2006)

Analysing global market infrastructure regulatory change



Reference data (2008)

ISO MPG, AFME, FOA



Risk (2008)

Global risk implementation priorities



Systemic risk (2009)

Plumbing research with FS KTN and TSB



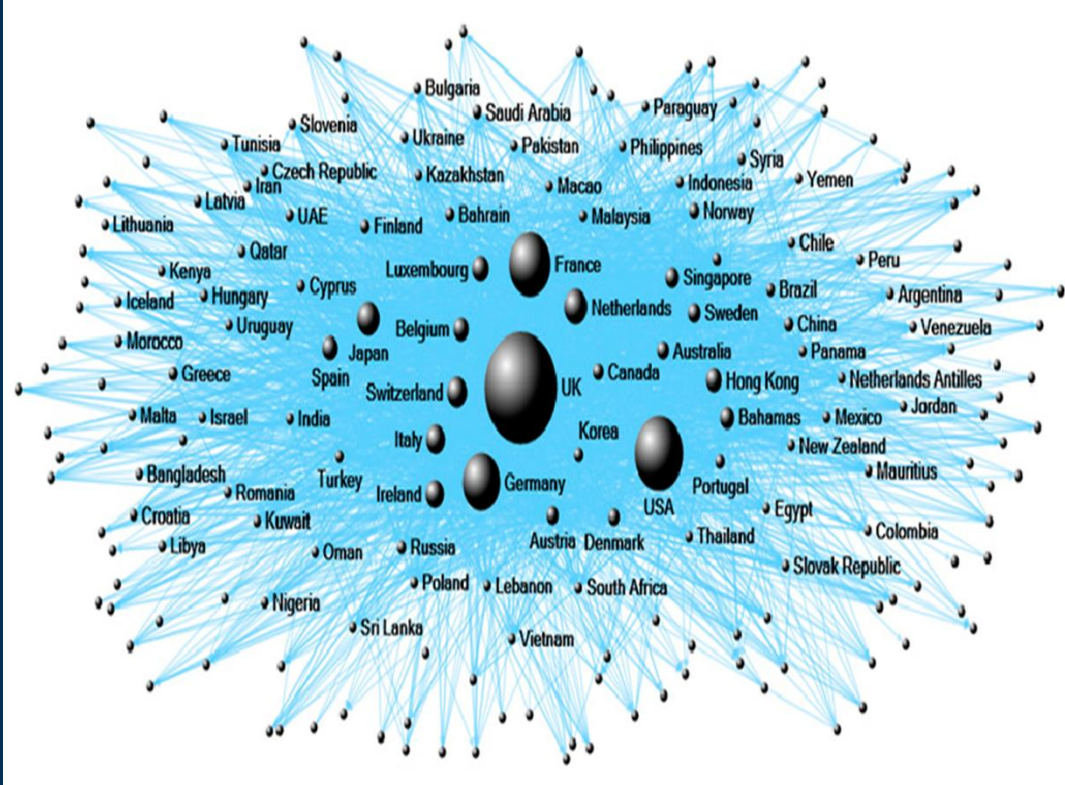
Summary

- ▶ **We are only beginning** to understand how to control systemic risk
- ▶ A new control framework is required to equip supervisors with the tools they needed before the crisis but **didn't have**
- ▶ A better understanding of the system leads to better prudential policy and a safer system: After two years of talk, **action is required now**
- ▶ **New focus, engineering, approaches and governance** are required to avoid high cost, bad policy decisions based on false **assumptions**
- ▶ The **entire industry** needs to be involved in the solution and without collaboration our attempts will be inefficient, costly and misaligned
- ▶ The **benefits** of overcoming the barriers **will outweigh the cost**

We need to rethink, redesign and retool our method of controlling 'the system'



Systemic risk: what are we trying to do?



Source: IMF "Staff Estimates" Integrating Stability Assessments Under the Financial Sector Assessment Program into Article IV Surveillance: Background Material 24/9/10

Notes: Lines between jurisdictions reflect the connections between their respective banking systems. The size of the spheres represents the volume of their external interbank assets and liabilities.

- ▶ Monitor a complex, innovative and **dynamic system**
- ▶ Map the extent and nature of **interconnectedness** between and across firms and countries
- ▶ Identify the **vulnerabilities** and **transmission** paths from inside (endogenous) or outside (exogenous) firms
- ▶ Ensuring availability/ **quality of data**
- ▶ Understand the **resilience** of the financial network or system

We are only beginning to understand what is required



This is a hot topic

“Compliance of individual banks with prudential regulations **does not assure** the stability of the system as a whole” *IMF: 24/9 Modernising IMF surveillance*

“it is essential **that tools are developed** which increase the **shock-absorbing capacity** of systemically important financial institutions and lower their contribution to systemic risk. ”
ECB: 29/9 Jean-Claude Trichet: Keeping the momentum for financial reform

“The ESRB shall...develop **a common set of quantitative and qualitative indicators** (risk dashboard) ... *The ESRB should elaborate a colour code in order to allow interested parties better to assess the nature of the risk.*” *EU Parliament: 22/9 Omnibus texts adopted*

“... one of the basic prerequisites for an effective macro-prudential function is the **availability of a comprehensive set of information** on the financial system that can be used for the detection and assessment of systemic risk. ... the national supervisors and national statistical authorities have the **obligation to cooperate closely** with the ESRB”
ECB: 29/9 The establishment of the European Systemic Risk Board – challenges and opportunities

“This more holistic view of risk requires a regime of coordinated macro- and micro-prudential regulation, supported by an **effective, efficient and consistent supervisory programme.**”
AFME: 24/9 Prevention and Cure: Securing Financial Stability After the Crisis

The US FSOC met this month for the first time – 50 days until ESRB launch



Why focus on the engineering?

- ▶ Lots of focus on intellectual debate and policy points, but **little on the practical**
- ▶ **'Quick fixes'** assumed for problems with long lead times
- ▶ Significant **G20 disconnects** in information management approaches: US, EU, UK, Asia?
- ▶ **3 UK consultations in process:** TSC, HMT, FoB all which need to align with the EU approach
- ▶ The UK is at the frontline – it has an opportunity to shape the solutions but **waiting for someone else will only make it worse**

Analysis Report
Published by JWG

Achieving supervisory control of systemic risk

Are we building the right systemic risk information highway for Financial Services?

A report commissioned by the Financial Services Knowledge Transfer Network

Knowledge Transfer Network
Financial Services

20 September 2010

ParadigmRisk

JWG
Making sense of financial services regulation

There needs to be a complete rethink in the way we approach systemic risk



What needs to be done?





How should we manage risk information?

Current Assumption

Required Shift

The consequences of getting it wrong are limited



Decisions based on 'Garbage in, Gospel out' (GIGO) could be catastrophic ... and high cost

There is 1 number and a single approach for systemic risk



A diverse toolkit of models and measures is required that provides different, yet comparable views

We have the right data



Existing data sets need to be supplemented

Data is easily accessible, and cheap



Investment in infrastructure by supervisors and the industry – tariff models needed

Data is of good quality



Models won't work without the right standards and quality metrics

Local solutions are good enough



Systemic problem means a global solution

Either top-down or bottom-up mandates will work

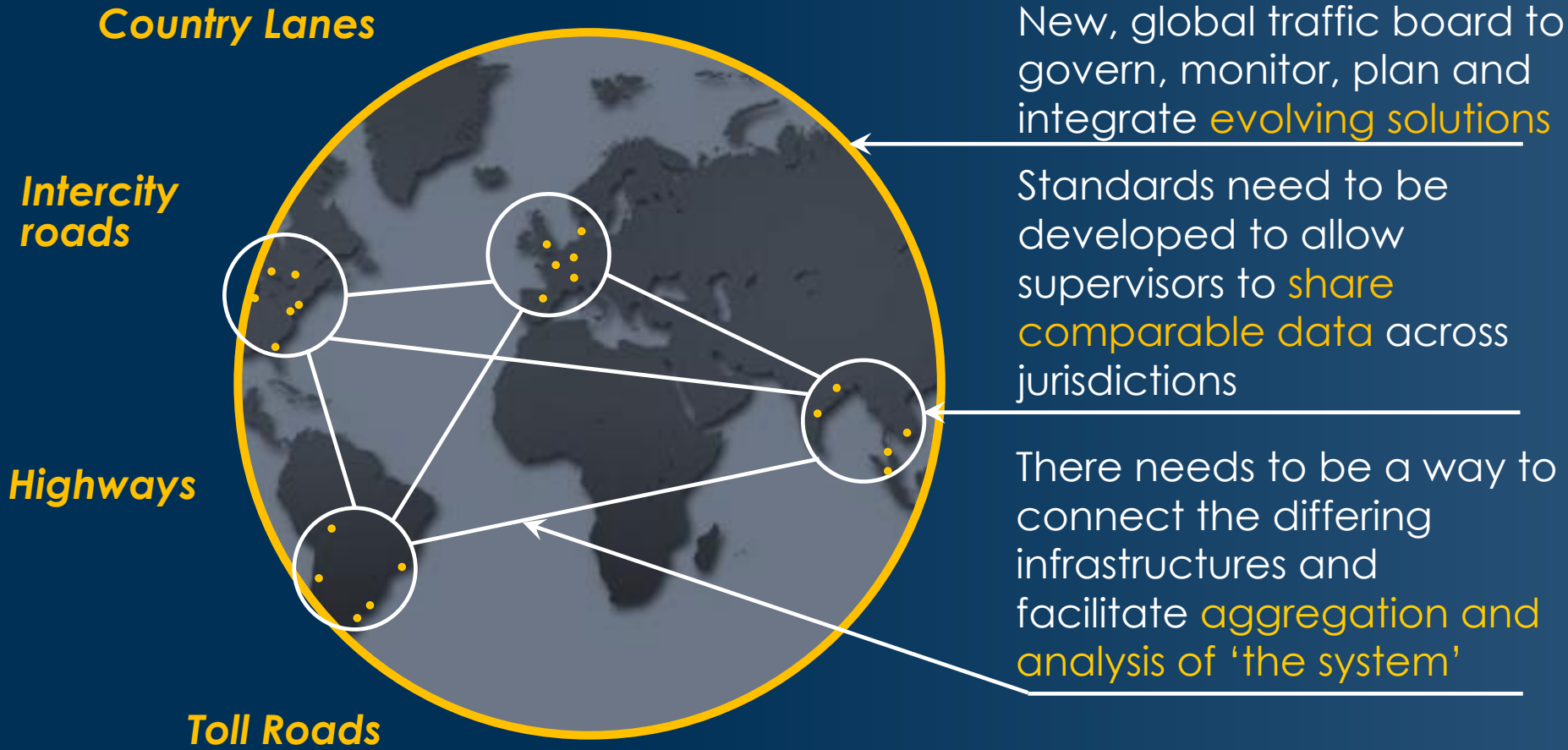


Collaboration and consensus between academics, firms, regulators and supply chain

New focus, engineering, approaches and governance is required



What does a highway look like?



To be successful, an agile and adaptive monitoring system is required



What are the barriers?

Disclosure

- Regulatory data standards
- Quality, linkage, context
- Secrecy, data protection
- Signalling
- Feedback
- Guilty knowledge

Governance

- Operating model
- Platform design
- Standards
- Resourcing

Cost & commercials

Operating model objectives

- Model requirements
- Capabilities specification
- Blueprints and roadmaps
- Cross-silo collaboration
- History requirements

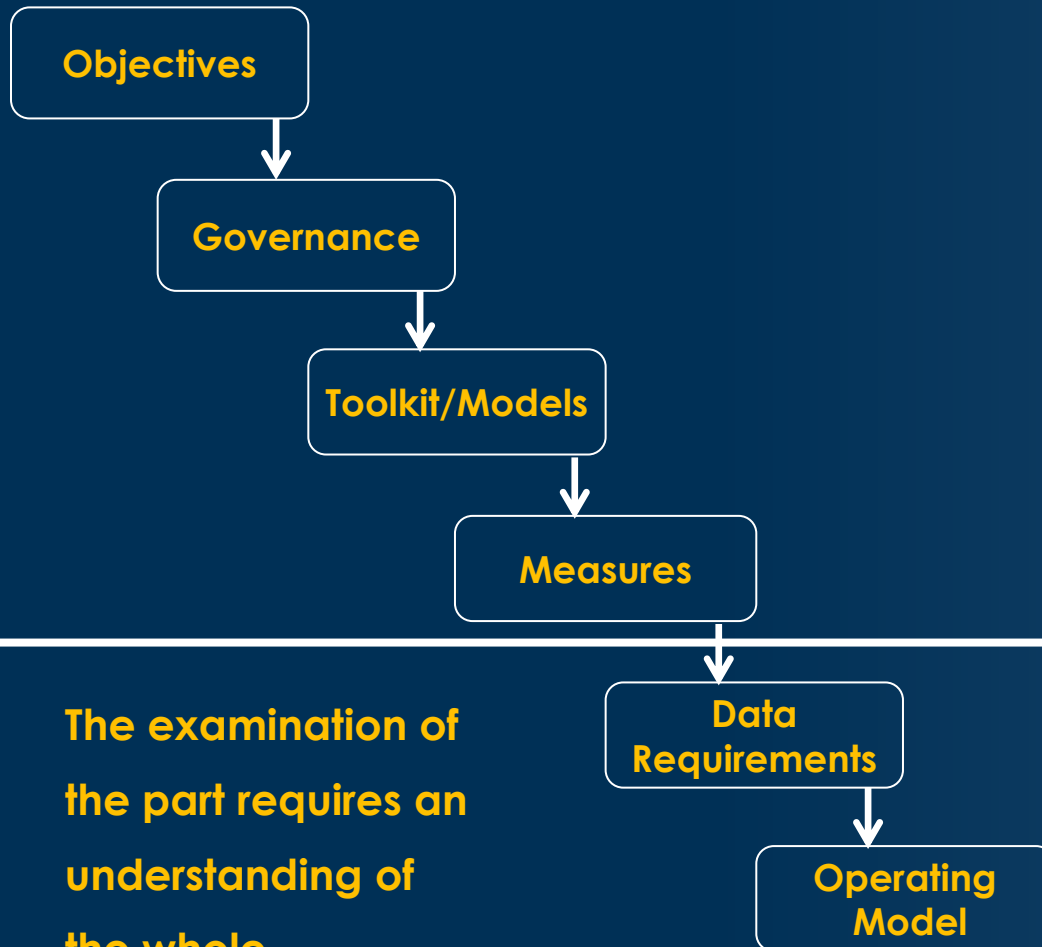
Harmonisation

- Legal frameworks
- Tax regimes
- Measures and metrics
- ISO standards

Any workable blueprint will need to engineer solutions to these key issues



How will we get there?



- ▶ For what **purpose** should a control framework be?
- ▶ **Who** will be in control and accountable?
- ▶ What **functionality** is required?
- ▶ What **metrics** and linkage between them?
- ▶ What **quantity** of information? What **quality**? What **history**?
- ▶ What **people, processes, technologies** make it happen?

There needs to be an end to end view of the design requirements



Who could engineer the solution?

Operating model

- Model requirements
- Policy guidance
- Regional and international commonality
- Data procurement policy

Platform design

- Capabilities specification
- Operating procedures
- Measures and metrics
- Procedure design

Standards

- Reference libraries
- Transmission protocols
- ISO standards
- Minimum requirements

UK

Supervisor, Firm, Academic

Supervisor, Firm

Supervisor, Firms, ISO, IOSCO

Global

ISO, IOSCO, CGFS, FSB, BCBS, IASB, Academia, IASB

Supervisor, Firm

Europe

ESAs, BoE, ESRB, Firms, Academia, IASB

ESAs, Firms, ISO, IOSCO

Appropriate bodies need to be accountable for delivering a roadmap



What does this mean to you?

**Investment firms,
their suppliers,
trade bodies,
and technical
associations**

- ▶ If you might be a systemically important firm, **this is your problem**
- ▶ Policy makers won't stop – **you ought to help** shape their answer into a good one
- ▶ **Waiting for someone else to solve the problem will only make it worse** as you won't be sure your issues are reflected in either the debate or the solution
- ▶ **You need to explain the problems** in clear, well-articulated ways
- ▶ You will need to **collaborate with regulators to define requirements and scope solutions.**

**Politicians,
regulators and
supervisors**

- ▶ The problem will continue to **distract supervisors from attending to the risks** they are meant to be controlling
- ▶ An incorrect analytical approach may do **more damage than good**
- ▶ Solutions will be **costly, late and inefficient** without clear decision-making mandates
- ▶ **More resources** will be required at supranational, regional and member State levels
- ▶ **A clear roadmap of 'what good SR oversight looks like' is required now**

**Research
community,
academics, and
funding agencies**

- ▶ You will need to **make new friends** in other disciplines and develop multi-disciplinary and cross-disciplinary approaches
- ▶ You will need to increase engagement levels with the back-office and corporate functions to **better understand how the industry works**
- ▶ More effort will be required to **define and promote the practical utility** of your research
- ▶ **Funding models and prioritisation mechanisms** need to change.

Paradigms must shift for policy makers, supervisors, firms and academics

- **Why can't we just Google systemic risk data?**
- **What does a good systemic risk control platform need to do?**
- **What is the gap between a systemic risk platform and what we have today?**
- **Who would need to be involved in creating a global platform?**
- **How quickly can we stop the next crisis?**

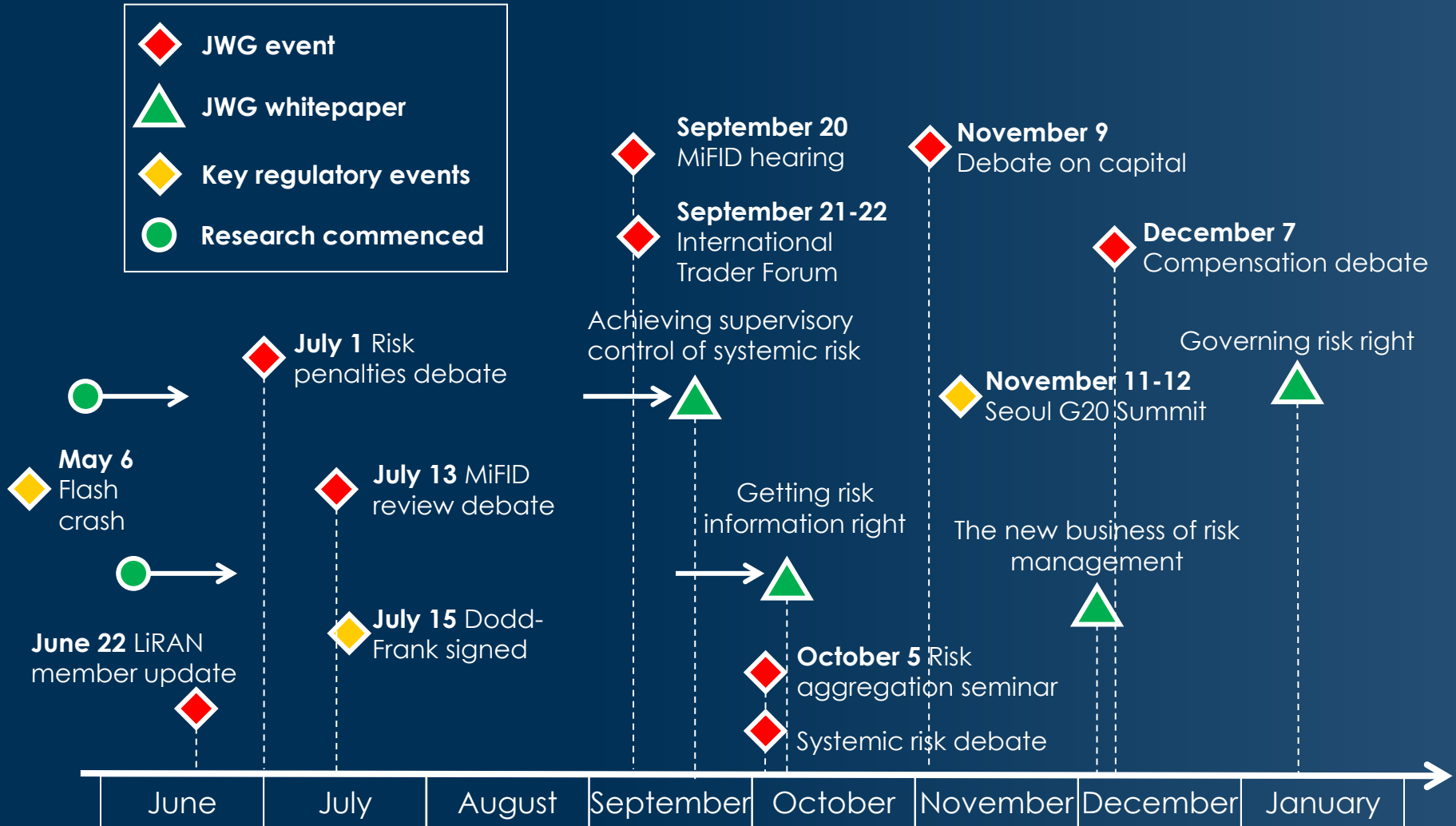
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What do YOU think?

Date	Debate
9 November	This house believes greed, not fear will drive Goliath's thirst for data. A debate on the banks' readiness for new risk regulation
7 December	This house believes the bonus Grinch will be beaten by the market. A debate on the market impact of new compensation schemes



The JWG risk research timeline





Thank you

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Customer Data Management Group

www.The-CDMG.eu



Liquidity risk

www.liran.eu



Systemic risk

<http://www.jwg-it.eu/syrig>



Trading

<http://www.jwg-it.eu/techsig>

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