Office of Financial Research Created Under the Dodd-Frank Wall Street Reform and Consumer Protection Act: Frequently Asked Questions

Q: What is the Office of Financial Research (OFR)?

A: In the years leading up to the crisis, policymakers and investors lacked sufficient data to anticipate emerging threats to financial stability or assess how shocks to one financial firm could impact the system as a whole.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) established the OFR within the Treasury Department to improve the quality of financial data available to policymakers and facilitate more robust and sophisticated analysis of the financial system. To execute these functions, the OFR has two primary operational centers: a Data Center to standardize, validate, and maintain the data necessary to help regulators identify vulnerabilities in the system as a whole, and a Research and Analysis Center to conduct, coordinate, and sponsor research to support and improve regulation of financial firms and markets.

These data and analytical capabilities will help policymakers and regulators, including the new Financial Stability Oversight Council (FSOC), promote financial stability and enhance market discipline. It will also help financial firms, which currently rely on multiple data standards and systems, to realize cost savings, transactional efficiencies and operational simplicity.

Q: What will the OFR do?

A: The OFR will improve the quality of financial data and provide analytic support to the FSOC and its members by:

- <u>Conducting financial analysis in support of the FSOC and its member agencies.</u> Prior to the crisis, no one regulator was focused on promoting financial stability and enhancing market discipline. The FSOC, with the support of the OFR, fills this regulatory gap. The OFR will support the FSOC and FSOC members by providing critical information and analytical tools they need to anticipate and respond to future emerging vulnerabilities.
- <u>Standardizing financial reporting requirements.</u> Common standards for data will make it easier to sort through and organize data. This will allow for more meaningful analysis of potential vulnerabilities in the financial system. It will also improve the ability of individual firms to assess their own risks and improve market discipline by making it easier for external investors to assess the condition of individual firms.
- <u>Developing a reference database.</u> The OFR's Data Center will develop and publish key reference databases that are easily accessible to the public. The databases, among other things required by the Dodd-Frank Act, will identify common data formats and standards that firms and regulators can adopt to promote efficiencies and better risk analysis.
- <u>Maximizing data efficiency and security.</u> The OFR will coordinate with regulators, both domestically and internationally, so that it relies primarily on information that is already available, in accordance with the Dodd-Frank Act. Coordination will also facilitate data sharing among agencies and mitigate reporting burdens on financial firms. Safeguarding the privacy and confidentiality of the data it possesses is a statutory mandate for the OFR and the office is adopting strong IT security measures and policies to fulfill that responsibility.
- <u>Producing regular reports to Congress.</u> The OFR must, as required by the Dodd-Frank Act, annually report to Congress on threats to the financial system and on its key research and analysis findings.

Q: How will the OFR cooperate with the FSOC and financial regulators?

A: The primary function of the OFR is to support the FSOC and its member agencies in fulfilling their duty to promote financial stability and enhance market discipline. To do so, the Director of the OFR will work closely with the Chairperson of the FSOC (the Secretary of the Treasury). The OFR will also serve as a data and research resource for the FSOC and its member agencies, as well as work with those agencies to reduce reporting burdens and increase market transparency.

Q: How will standardization of financial data improve oversight and reduce costs?

A: The problem of monitoring systemic risk is closely related to the risk management challenge that individual firms face. To monitor risk in the financial system, positions in thousands of diverse financial products, involving thousands of individual financial firms, have to be aggregated across the entire financial system in ways that are meaningful. Standardizing the way financial transactions are reported, and the consistent use of robust reference data on the key characteristics of individual financial instruments and counterparties, can greatly facilitate this process for regulators and individual firms alike.

The OFR will, in consultation with relevant stakeholders, develop standards for financial data and publish reference databases of financial entities and instruments that will be made available to the public. As mandated by the Act, data security and confidentiality will be a top priority for all of the OFR's data activities, including the publication of the reference databases. These reference databases will also likely be used by market participants.

The industry-wide standards for financial data and reference data bases will help the FSOC to monitor systemic risk and improve the efficiency and efficacy of risk management, reporting and other business functions at individual financial institutions. These actions will enhance both supervision and market discipline by giving both supervisors and market participants better visibility into the risks that individual financial firms take.

Q: What is a Legal Entity Identifier (LEI) and what does the OFR's Statement of Policy say?

A: A Legal Entity Identifier (LEI) is a number that identifies a legally separable business entity that engages in financial transactions. Currently there is no universally used LEI in the financial industry. During the recent financial crisis, the lack of a high quality industry-wide identification scheme for financial counterparties made it difficult for financial firms to quickly assess their risk exposure in case of a default by one or more of their counterparties. This inability to quickly and accurately assess risk presented a serious problem for the regulators who were responding to the crisis.

In separate proposed rules approved November 19, 2010, the CFTC and SEC each proposed that market participants would be required to use unique legal entity identifiers produced by or on behalf of an internationally-recognized standard-setting body, if and when such a system is established, for all of their regulatory reporting of swap and security-based swap transactions. Underscoring the need for timely creation of such a system, the CFTC proposed rule provides for a decision by CFTC, prior to the implementation date for CFTC's final swap data reporting rule, concerning whether an international identification system meeting requirements set forth in the proposed rule is then available.

On November 23rd the OFR released a Statement of Policy related to the standardization of such legal entity identifiers, indicating that, if a new robust system produced by or on behalf of an internationally-recognized standard-setting body, is established by mid-2011, the OFR intends to require its use in all data reported to the OFR.

The establishment of a new LEI system will be an important step in improving the quality of financial reporting, thereby helping regulators identify and analyze risks to the financial system. Through this policy statement, the OFR is signaling its desire to coordinate within the regulatory community in reaching out to industry, which we believe can craft a solution that will work for both public and private purposes. The OFR welcomes comments on its Statement of Policy which can be submitted through regulations.gov.

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