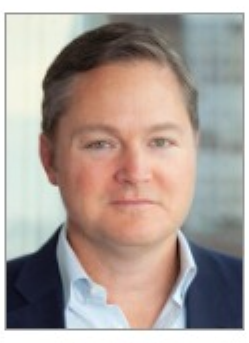
Expert Analysis

Financial Data Act Pushes Reporting Protocol Into New Era

By *Craig Clay* · Listen to article



Craig Clay

Law360 (March 3, 2023, 5:04 PM EST) -- Anyone who works with financial regulatory agencies knows that the reporting system must be modernized, especially when it comes to standardized financial data reporting.

Just consider the epic financial regulatory oversight created by the Dodd-Frank Wall Street Reform and Consumer Protection Act and, more specifically, those focused on mitigating risk and creating financial stability.[1] While these reforms led to more stable financial markets, the financial data collected is stored in outdated, document-based formats, which lack clear transparency, standardization and accountability.

This exemplifies why modernizing financial data regulatory reporting is so necessary. It will bring transparency while supporting the growing promise of so-called RegTech solutions, like artificial intelligence and machine learning. And with that comes high-quality, consistent and comparable financial data for the government, investors and all stakeholders.

For some time, this modernization has eluded the industry, but that's about to change, thanks to the Financial Data Transparency Act.

On Dec. 23, 2022, President Joe Biden signed it into law as part of the National Defense Authorization Act.

In the works for over a decade, the FDTA will help drive the long-overdue transformation in financial data regulatory reporting and compliance, making information more easily accessible, transparent and consistent for regulated entities, regulators and the public. This provision is a win for investors, businesses and the government.

Until now, U.S. financial regulators have operated with an outdated document-based reporting system that doesn't use an agreed set of data standards for organizing the information taken in by various agencies.

The result is years of paper, PDFs and plain text documents that contain mountains of unstructured data. Due to this mishmash approach, any attempt to analyze and compare data is largely done manually and is prone to delays, errors and omissions.

As a result, investors face an uphill battle to access actionable information that they can use to make informed decisions, regulators struggle to tap into timely and transparent data analytics to pinpoint patterns, which can then be used to influence key policy decisions, and taxpayers lack transparency into how our government functions.

FDTA to the Rescue

The FDTA will replace the documents used today with commonly tagged elements for government data already collected by seven of the financial regulatory member agencies that comprise the Financial Stability Oversight Council.

These include the U.S. Department of the Treasury, Federal Reserve, Consumer Financial Protection Bureau, U.S. Securities and Exchange Commission, Federal Deposit Insurance Corporation, Federal Housing Finance Agency and National Credit Union Administration Board.

The new law will require shifting from paper-intensive forms and proprietary formats to new interoperable reporting standards and open-source data formats that support structured data. The FDTA also calls for the use of standard language definitions and consistent data fields, which include a nonproprietary legal entity identifier.

Benefits of the FDTA

The biggest benefit is transparency, which will in turn enable the government, industries and people to work together more effectively and make stronger, more informed financial decisions.

Now, when companies file with any of these agencies, they will use standard language definitions and consistent data formats, including a common identifier for the information reported to regulatory agencies, such as transactions and financial products and instruments.

This legal entity identifier is an important element that is long overdue. The Office of Financial Research stated that the 2008 "financial crisis underscored the need for a global system to identify financial connections, so regulators and private sector firms could better understand the true nature of risk exposures across the financial system."[2]

The FDTA also calls for a focus on discoverability or searchability. It specifically requires all entities to leverage existing reporting processes that adhere to fully searchable and machine-readable nonproprietary data formats such as iXBRL and XBRL, which the Financial Accounting Standards Board states "deliver human-readable financial statements in a machine-readable, structured data format."[3]

At this point, it's worth highlighting the importance of consistent identifier codes. The Data Coalition states that "[r]egulatory filings should use consistent identifier codes for entities and other concepts, allowing firms to quantify exposure to an entity or product, markets to aggregate all data on a given entity, and regulators to avoid Madoff-style silo failures."[4]

As for formats, the coalition states that "[r]egulatory filings should also use structured data formats so that data flows into databases without manual re-entry. Structured data formats would allow filers to automate disclosure, markets to digest financial information cheaply reducing filers' costs of capital, and regulators to use analytics to find fraud, risk, and irregularities."

One final FDTA benefit worth noting is that once financial regulatory reporting is standardized, open data will replace document-based formats, which will enable RegTech applications to republish, analyze and automate. It's a safe bet that once in place, we will begin to see greater use of both regulatory and emerging technologies like AI and advanced analytics, which will benefit everyone.

For example, regulators will be able to use AI to ingest and analyze huge volumes of data to quickly identify possible incidents of financial risk. As for investors, they will be able to identify investment opportunities based on larger volumes of data to provide clients with more informed and immediate recommendations.

These scenarios illustrate the impact the FDTA will have on the regulatory reporting process. But it's important to note that we're not there yet.

Over the next two years, agencies, including the SEC, will be called on to create new reporting standards and secure approval. Once completed, they will have two years to implement the standards. That's when we will see the FDTA's original intent become a reality and witness the benefits that come to investors, businesses and government organizations.

Craig Clay is president of global capital markets at Donnelley Financial Solutions.

Disclosure: The author's firm lobbied for the passage of the FDTA before it was approved by Congress.

[1] https://obamawhitehouse.archives.gov/economy/middle-class/dodd-frank-wall-street-reform.

[2] https://www.financialresearch.gov/data/legal-entity-identifier-faqs.

[3] https://www.fasb.org/page/PageContent?pageId=/staticpages/what-is-xbrl.html&isstaticpage=true.

[4] https://www.datacoalition.org/page-18218.

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