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Towards a common financial language – speech by Andrew Haldane

In a speech drawn from a paper presented at the Securities Industry and Financial Markets Association's (SIFMA) Legal Entity Identifier Symposium in New York, Andrew Haldane – Executive Director for Financial Stability and member of the Financial Policy Committee – considers the benefits of finance adopting a common language that he believes "…could transform both itself and its contribution to wider society." The paper is written jointly with two Bank colleagues, Robleh Ali and Paul Nahai-Williamson.

Haldane explains that the recent financial crisis exposed failures in the information systems of many firms, with few having the means to aggregate quickly information on exposures and risks. This hindered effective consolidated risk management, which proved terminal for some firms. And he notes that such problems were even more acute across firms, contributing "…importantly to failures in, and seizures of, many of the world's core financial markets."

These failures lead him to consider what finance can learn from other industries that have made progress in improving their information systems. He takes as his principal examples product supply chains and the World Wide Web. For both, the adoption of a common language has delivered huge improvements in system resilience and productivity. Haldane says that there are no technological barriers to a similar transformation in finance, driven by the introduction of Legal Entity Identifiers and Product Identifiers. He says together these "…are key building blocks of a new common financial language…" and describes four potential benefits that might flow from their adoption.

First, there could be improvements in risk management in firms. He points to the fragmentation of data infrastructure that has exposed systems to human error and complicated the process of risk aggregation, highlighted in particular around the failure of Lehman Brothers. He says: "Missing inventories and mistaken counterparties could be all but eliminated if financial firms' information systems spoke in a common tongue."

Second, there could be improvements in risk management across firms. He says that at the time of Lehman's failure no data existed to monitor meaningfully the network risk its failure might impose. Progress has been made, however, with the Financial Stability Board orchestrating the development of measures of bilateral exposures and reinforcing resilience by mandating the most systemic firms to hold larger capital buffers. But Haldane argues, "…complete counterparty data, collected according to common standards, would enable a much more accurate calibration of the financial interconnectivity of key financial nodes."

Third, he argues mapping the financial network could be comprehensively improved, both in terms of granularity but also timeliness. He contrasts the current challenge as akin to predicting the weather, with more information allowing more accurate forecasts. And just like meteorologists, he suggests regulators could use a resulting risk map to issue warnings or stress-test the impact of extreme financial events.

Finally, he says a common financial language could help lower barriers to market entry in banking and "…might even begin to erode the too-big-to-fail problem through market forces." He describes how some musicians have successfully by-passed record labels by selling their works directly to the public via the internet. Haldane suggests innovations in commercial peer-to-peer lending, again using the web as a conduit, could make some bank functions surplus to requirements. "An information web, linked by a common language, makes that disintermediated model of finance a more realistic possibility."

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