

## RISK AND REWARDS

What exactly constitutes mission critical information and how have recent market events affected the area of risk management? SunGard's senior risk management think tank roundtable provided some answers.

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Marc Meyer, vp Solutions at SunGard Adaptiv



The financial services industry has witnessed an unprecedented rate of growth over the last five years and the development of increasingly complex asset classes has had a significant impact on institutions' risk profiles. One need only look at the financial pages of most national and international newspapers to see the high risks that are posed by failing to keep up with this fast paced rate of change. To explore the risk related issues, SunGard, the global leader in software and processing solutions for the financial services industry, gathered a number of respected names in risk management for a senior industry roundtable. These included:

Kanwardeep Ahluwalia, Chief Risk Officer, Europe and Asia, at Bear Stearns, Ted Macdonald, Managing Director, Risk Management Investment Banking, at Dresdner Kleinwort, David Stevens Managing Director, Head of Global Markets Risk and Capital Management Group, at Deutsche Bank, and Barbara Leach-Walters; Head of Group Credit Policy and Analysis, at Royal Bank of Scotland

All discussed their institutional and personal experiences, as well as their perspectives on the future of risk management.

### RISK SYSTEM EVOLUTION

The first topic up for discussion was the issue of risk system evolution and panellists' particular experiences of systems planning and budgeting. The panel agreed that, regardless of the institution involved, it is important to recognise

that discussions about systems can easily be ineffective without well defined implementation requirements. Systems planning and budgeting is a difficult exercise and senior management involvement in defining priorities within budget limitations is a critical first step in the process.

Discussions about risk with regards to monoline insurance companies have been rampant in the market over the last few months and many institutions are still assessing their exposures and the pricing they should use for those exposures. Until recently this had been a fairly sleepy sector of the market and it had been standardised with some fairly routine business practices. In the current market, however, this sector has been shaken up and all sorts of questions have been raised. Most notably: "What consolidated monoline exposure via municipal bonds does an institution have?" Historically such information would not have been considered especially important but it is now critical and requires rapid data consolidation and analysis from an institution's mainframe systems. This is an example of a tactical IT development requiring input from, and cooperation among, a firm's main IT department personnel and IT literate risk management staff.

An institution's main systems contain massive amounts of data which must be accessed directly but the panel felt that building full flexibility into the many systems of record would be an inefficient exercise. Nevertheless, the ability to extract most information in the main systems

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into a flexible tool such as a spreadsheet or desktop application is vital to the risk management undertaking in these markets. The questions that you focus on as a risk manager quite often change from week to week and month to month, making ad hoc reporting capabilities a must.

Perhaps the horizons of these risk management teams are too narrow, contends Marc Meyer, head of Adaptiv solutions at SunGard. The next credit crisis is likely to occur within another unexpected area so you need to have a fully flexible solution that is able to react to a crisis. It should provide you with an indication of your exposure without requiring weeks’ worth of tactical development to achieve it. We have customers that can access their information at a keystroke and this highlights the fact that it is possible, he explains.

With Adaptiv Credit Risk, institutions can implement within the system the models, measures and products that they are interested in. So if they have a new complex product and their own measure of exposure, it is possible to configure that within the system. We provide a solution that allows banks to cope with change because it is very easy to add new products and reconfigure the system

In the absence of liquidity across multiple markets, a centralised view of the full enterprise becomes especially important. Tactical data gathering and report generation may be essential, since it is never possible to anticipate every future contingency. Nevertheless, improved enterprise-wide information with effective drill-down and flexible reporting capabilities is emerging as a key initiative for the future. If you have all the information about exposures in one place it is then a very simple exercise to go into that system and understand your risk exposure to any particular sector.

#### MISSION CRITICAL INFORMATION

The requirements for information on credit exposures and credit risk are increasing at an exponential pace. Regulatory pressures, especially those related to Basel II, are also having an impact on this area. Information about risk exposure used to be ‘pushed up’ by the risk management team to senior management. Now senior managers are demanding the ability to pull such information to meet their own rapidly changing needs. A panellist used the analogy of a newspaper to illustrate the issue – the

risk management team must take the information from the market, decide what the lead stories are and then determine what they need to highlight to senior management. Even newspapers, however, are using their internet sites to provide access to further details and the full text of source documents for those with a special interest in a topic.

In order to manage organisations in the most efficient way, risk management teams need access to as much information as possible as fast as possible. As a result of this, understanding the plumbing of their organisations as well as some of the tactical solutions is increasingly critical to success. If risk managers are spending more time hunting down data than analysing and delivering the headline important data to senior management, then this is indicative of a system in need of replacement, says Meyer. The objective should be to have an IT infrastructure that consolidates and centralises crucial risk information and has the flexibility to analyse and mine those data. It should provide tools to risk managers to analyse the data and the ability to deliver the important information upwards to senior management to act upon.

As senior managers require more detailed insight into issues with which many are less than fully familiar, providing a proper perspective on the data is an increasingly important role for risk managers. It is much better if you are able to provide a snapshot with a historical perspective, the panel agreed, because historical information at least provides an informative benchmark for comparison.

#### SCENARIO ANALYSIS

It was generally felt that the industry is in fairly good shape in terms of planning for risk. There are many technical tools available, institutions have massive quantities of data and they have the capacity to do types of analysis that were once impossible. Part of the objective of planning for risk is to develop scenarios that are the most useful.

This involves creating a storyline with the analysis that captures people’s attention. It is useful to look into the future and see at what point certain parameters could become a problem – for example the size of credit spreads.

Developing stress testing models that engage senior managers in the potential problems is crucial. The risk management team needs to spend much more time getting senior managers to resonate with their story. Two years ago the industry organised a risk management exercise on planning for the bird flu pandemic and the panel agreed that this was a good example of getting the risk message across.

## RELIABILITY

Reliability has two main components – accuracy and timeliness. Institutions are now in an environment where they must include more specifications at the start of a project about their ability to produce reliable information in a timely fashion. For example, today's environment is very different from the one that prevailed when most credit systems were first created. The number and complexity of credit products wasn't as great then as it is today.

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Adaptiv Analytics is designed for an ever changing marketplace – institutions need to have tools to enable them to cope with the pace of change. The system is designed so that it is as easy as possible for users to extend its coverage – this includes providing them with all of the source code for our models so that they can change them as required. The concept of one risk engine is therefore not out of reach despite the fast paced nature of today's financial markets.

## KEEPING UP WITH THE PACE OF CHANGE

Having seen the issue from both the user and the vendor perspectives, David Rowe, EVP for Risk Management at SunGard, argues that it is necessary to move beyond the old buy-or-build dilemma. Even the largest institutions can no longer afford to keep their systems up-to-date in an exclusively in-house build mode.

SunGard's Adaptiv Analytics is an excellent example of a "Buy and Build" approach, he says. It is a widely applicable and highly scalable calculation engine that leverages the latest advances in grid computing technology, including 64-bit architecture that enables handling of massive amounts of data. By leveraging this application across many clients, SunGard is able to devote much more effort to its continued development than would be commercially feasible for an individual institution. While it comes with a broad array of pricing and risk management modules, clients can concentrate their own resources on implementing calculations within Adaptiv Analytics that are relevant to their unique business strategies and their own proprietary analytics. Only an effective continuing collaboration between clients and vendors, Rowe argues, will allow financial institutions to generate the risk management information required to react with confidence when future crises erupt.

It was clear from the lively and wide-ranging debate that risk management pervades financial organisations. It was equally clear that providing timely, comprehensive and accurate information to this function is essential for its success. This does not just involve risk data, but also well-defined requirements from users and senior managers to ensure that the outputs from risk systems support improved decision-making and thereby generate a valuable return on investment. SunGard regularly works with its clients to ensure that this holistic approach to risk systems is taken and, as recent market conditions have indicated, we expect to be very busy for a long time to come.

## About Adaptiv Analytics

SunGard's Adaptiv provides enterprise-wide credit and market risk management and operations solutions for financial services institutions. Adaptiv assists institutions of varying size and complexity to deploy technology to meet both internal and regulatory requirements for risk management and operational control. We help financial services institutions from the banking, hedge fund, asset management, insurance and corporate sectors with our deep understanding of risk management and operational processes.

For more information visit [www.sungard.com/adaptiv](http://www.sungard.com/adaptiv)