Catch Me If You Can: Tightening the Risk Reins

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By Craig Costigan

As regulation old and new continues to plague bank balance sheets, banks are under pressure to drive risk principles into every trading or lending decision before any transactions take place, loans are agreed or deals are done. Managing risk at inception in this way can help banks profit within regulatory constraints. But it also requires front-office, risk and treasury teams and systems to collaborate more effectively.

For example, new emphasis on pre-deal portfolio risk analytics is putting pressure not only on traders, but also on banks as a whole, with risk advisory managers and the front office typically sharing responsibility for determining, allocating and optimizing the costs of trade and collateralization.

Whether a bank is trading for a customer or on its own behalf, it must make a growing number of complex risk calculations before a trade can even take place. How will the trade affect the bank's liquidity, risk-weighted assets and available pool of collateral? Has credit been used and priced in the most appropriate way, through a credit value adjustment? How much initial margin will be required?

All of these considerations make it imperative for risk, finance and front-office functions to share information more readily and rapidly in order to meet regulatory requirements, support an intricate set of processes and improve investment decision-making as a whole. But with so much complex data now managed by the front office and required on counterparty portfolios, the risk infrastructure is also under pressure.

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Dedicated Attention

For the effective aggregation of data, banks need to streamline their number of front-office applications and ensure the rapid integration of pre-deal data with upstream systems. All too often, however, banks do not have the systems or control of data they need to make complex pre-deal analytics an integral part of front-office workflow or allow risk information to be passed back and forth at the point of trade or credit acceptance.

That said, in banks with highly sophisticated treasury and risk departments, there is an emerging trend to manage the collateralization of trades and the impact on liquidity through a separate, dedicated desk.

In this case, a trader will find the counterparty he or she wants to trade with and will then hand over the trade to the collateral/liquidity management desk to work through with which broker and clearing house the trade will be cleared.

Most notably, it's not the trader making the decision, but another entity in the bank. For the optimal management of both securities and liquidity, a funds transfer pricing system will usually be involved, incentivizing the pricing mechanism and improving stewardship of the investment book.

Risk Management at Every Step

Similar improvements are necessary when it comes to commercial lending practices - and once more they involve capturing risk from the point of inception. Rather than attracting the greatest number of clients at any cost, today's commercial banks must minimize credit losses by identifying businesses that will be "right" for the bank. This requires relationship managers to act less like loan officers and more like trusted advisers, while taking the opportunity to build better client knowledge.

With the technology tools to proactively monitor customer relationships from the word go, banks are better able to prevent defaults and losses - or retain more "profitable" customers by offering more attractive terms. Again, the key is for organizations to join up their processes and incorporate risk management into every step of commercial lending, from first contact and then throughout the lending process to the provision of other products and services.

The bottom line is that now more than ever, risk is the responsibility of the entire bank.

Organizations need sophisticated systems and tools to assess and manage risks of all classes from the start of every deal or customer relationship - and incorporate complex analytics, costs and regulatory constraints into all their decisions. Those that make the real-time analysis and exchange of risk data part of their everyday workflow across the front and middle office will be primed for both compliance and profitable growth.

Craig Costigan is president, risk and compliance, of the SunGard capital markets business. This article is a follow-on to the previously published Three Rs for 2015: Breaking Down Risk Roadblocks.