Three Rs for 2015: Breaking Down Risk Roadblocks

There is still work to be done on culture, agility and those stubborn organizational silos

By Craig Costigan

From a risk and regulation perspective, 2015 will be anything but dull. The Basel rules and Dodd-Frank will continue to keep banks busy, and purse strings will draw ever tighter as regulation consumes even more budget in the area of risk IT.

As risk managers continue to battle the regulatory burden, this situation has become an all-encompassing norm that defines the function of risk as we know it today. How will it further evolve?

The start of the new year provides an opportunity to explore the game-changing risk and regulatory trends that are set to impact the industry this year. There are three major roadblocks - three Rs - that that the industry needs to attack in full force to ensure not only regulatory compliance but robust performance and profitability: risk at inception, risk alignment and right-time risk.

1. Catch me if you can - risk at inception

Capturing risk before it hits will be front-of-mind for the banking risk community in 2015. Risk calculation in specific areas such as credit valuation adjustment (CVA) will increasingly migrate to the front office, driven by a greater need to understand precisely how a trade will affect the bank in terms of liquidity, risk weighted assets (RWAs) and available collateral pool. At the same time, margins are shrinking, and traders are subject to all kinds of costs (especially for funding), while instrument pricing has become portfolio dependent.

So, primarily driven by the dual need to maintain profitability and manage regulation, banks will continue to enhance their front-office capabilities. The number of complex risk calculations a bank has to make before a trade can even take place is only set to accelerate and will demand the migration of analytics to the front office.

We expect a parallel shift in both risk culture and technology strategies as risk, finance and front-office functions are forced to work more collaboratively and effectively. Exchanging information more readily and rapidly will lead to more proactive and effective regulatory compliance, support an intricate set of processes and, in turn, help improve investment decision-making. The evolution of culture and IT go hand-in-hand for achieving this.

2. Joining the dots - risk alignment

More than ever, firms will need to break down risk silos and achieve close alignment to perform effectively. A key factor in the 2008 economic downturn was risk silos. Banks' spaghetti-like infrastructures made it impossible to know what the impact would be if risk events moved from

one silo to another. It's hard to believe that more than six years on, the situation is still very much the same across banks of all sizes.

Craig Costigan is president, risk and compliance, in SunGard's capital markets business.

Why the hold-up? Firstly, it's not the will of the banks to achieve risk integration that is the issue. Budgetary constraints and technology challenges are delaying the pace of risk renovation. Awareness of the need to break down risk silos has grown considerably since 2008, but the more organizations need to spend on regulation, the less they have available for risk IT initiatives.

The situation is unique to every bank. However, inevitably, the bigger the bank, the more siloed it is likely to be, even in areas that make common sense to integrate. For most, a real-time understanding of capital usage remains an unrealized vision, and there is a continued reliance on batch and end-of-day processes.

Typically, risk infrastructures have grown incrementally. Thanks to cost, time and capability pressures, functionality has been added bit by bit to manage different regulatory requirements or enable particular front-office activities. Replacing these diversified environments with a whole new infrastructure represents a significant investment for banks.

And in an era of regulatory uncertainty, complex requirements changing all the time, and the final impact on infrastructure sometimes hard to define, there is an understandable hesitance to commit budgets to supporting an integrated risk approach. Risk, after all, is a cost center, not a profit center.

Budgets for risk and compliance initiatives are on the up, but we see few firms proactively implementing strategies to bridge disparate infrastructures to pursue innovation and drive value. In 2015, firms will need to seriously explore avenues for transformation and deliver innovation at multiple levels, guided by strategic IT principles and practices and not tick-the-box, reactive fixes.

3. Tick tock - right-time risk

For the front office to take a more active and effective role in risk management and, as a result, price credit more effectively, it needs to work more closely with the treasurer and traders. Together, they must gain as holistic and dynamic a view as possible of the balance sheet, basing decisions on consistent and accurate data. This will help banks to equip themselves with the ability to respond to market and risk-profile changes as they are happening.

We anticipate that banks will re-evaluate their credit risk strategies to mirror their overall positions as well as market and regulatory changes. Integrating credit risk systems across the business will not only deliver a holistic picture of credit risk, but, more importantly, enhance the ability to adapt strategies when necessary to support real-time decision-making that drives value to impact the bottom line.

As we move through 2015, we see these "three Rs" reaching the top of the C-level agenda as risk continues to permeate throughout the bank. Its impact across more business lines, more stakeholders and more situations will create new demand for agility in the banking risk infrastructure, one that firms cannot afford to ignore lest they put their future profitability in jeopardy.

Craig Costigan is president, risk and compliance, of the SunGard capital markets business.