Global Custodian

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Anita Bradshaw Explains Why The CSC Risk Constellation Enterprise-Wide Risk Management System Is A Business Tool, Not A Compliance System

The Computer Sciences Corporation (CSC) recently unveiled what it believes to be a breakthrough in enterprise-wide risk management for banks, fund managers and securities firms, because it builds on existing investments in compliance systems rather than looking to build an entirely new platform (see "CSC Claims Breakthrough In Enterprise-Wide Risk Management, As Tower Group Highlights Basel II Challenge To Banks"). In this article, Anita Bradshaw, a senior industry expert in risk management at the Computer Sciences Corporation (CSC) in London, explains what the Risk Constellation product - which was developed in conjunction with a consortium of twelve consultancies and software firms, including CD Financial Technology, idRisk, J.E.G. & Partners and Z/Yen - can do for the securities industry.

Risk management is, for many people in the investment business, a necessary evil. During the last few years, most financial institutions have been exposed to "new" risk disciplines, mostly in response to regulation or the fear of the introduction of regulation. Few financial institutions have imposed risk management as a way of meeting business objectives, and many people still claim never to have seen a "true" business case for any type of regulatory compliance. Outside a few specialised fields such as market risk analysis, and the credit models used in the derivatives markets, few institutions claim to profit from their use of risk management.

However, this approach is, of course, counter-intuitive. Regulations are not generally imposed to create burdens, but to prevent problems that seem worthy of intervention. History tells us, however, that even the most benign regulations can distort the market, and can cause more harm than they prevent. It is possibly true that more sophisticated markets are even more prone to this than less developed markets: creative minds being used to circumvent regulation are arguably sometimes even more devious than corrupt officials seeking to benefit from red tape in the developing world. The scale on which the former can occur can certainly dwarf the latter.

Our approach to doing business is to understand the client's commercial objectives, and develop the business case for change alongside the implementation plans. Risk management in the face of regulation presents a harder problem than many, but not an insoluble one. We have developed the idea of "supercompliance", building on existing investments in the area of compliance in order to gain competitive edge in the marketplace in which the client operates. We developed our Risk Constellation offering, which provides capability in a number of areas, to meet client needs in this area which we believe were often not being addressed by the numerous point solutions on the market. In addition, we are offering the services of leading edge consulting and software companies at minimal risk to the client, in addition to our reputation in mission-critical applications, large scale data management and complex integrations.

Large businesses are often managed in silos for ease of control and clarity of reporting lines. However, the competing priorities of different business and operations managers can lead to a lack of co-ordination across the entire company. The view from the Boardroom can be distorted by a lack of appreciation of correlations and relationships between different areas. The Risk Constellation offering was designed to allow a holistic view of the business, and to provide indicators for tracking key business parameters. It represents a true enterprise risk management solution set, and is designed to "future-proof" the client organisation, making further process or operational change less arduous and risky.

Central to this concept is the idea of the executive dashboard, allowing senior management to view possible outcomes of strategic decisions, and to track emergent risks in their business. Risk is balanced against the long-term returns of each business in order to provide decision support for investment or divestment strategies. This dashboard supplements other reporting at business segment and operational level, which allows business managers timely access to key business parameters. A data warehouse forms the base of this structure, with our e4 integration layer providing the different levels of data to feed the reporting applications. As business priorities change, the way in which risks are reported will also change, and the process layer is all-important in maintaining the integrity of the dashboard.

Risks are mapped across the business, with emphasis on providing an aggregated position in real-time, or as close to real-time as the client's existing business allows. The emphasis on real-time reflects the fast-moving nature of much investment business, and the diminishing value of information garnered after the event, so to speak. Competitive advantage is often produced simply by ensuring that the client can respond to external conditions faster than the competition, allowing a better service to the end customer, or facilitating rapid withdrawal from a deteriorating position before competitors become aware of it. Each risk is defined and quantified, including "soft" risks. If they can damage the business, they can de defined.

Studies in a number of financial institutions have shown that few organisations can manage all their business processes adequately at all times. Our estimate for the insurance industry which is probably better than many other sectors is that perhaps 60% of core processes are significantly exposed to risk at any one time. Risk should, of course, be managed in order to yield return, but it is the outlying significant risks that must be mitigated most actively in most cases, to prevent them undermining the entire business. Monitoring those risks, their development and their interrelationships with other risk areas is the first, and most important priority towards prevention: most severe problems in financial institutions can be traced to a series of "small" failures. Awareness of events that could be significant generally allows damage limitation at the least, and should allow business managers time to prevent most problems. In the case of custodians, the process tally is generally smaller, but the thin margins and high values involved, together with the complexity of risk positions in international organisations lead to a greater number of significant risks that could place the entire organisation at risk. Hedge funds are probably at the extreme of the investment management community, with possibly only a few processes at risk, but with the effects on investment performance from small failures more likely to be catastrophic.

Where do these potentially catastrophic risks arise? Generally, the individual risks themselves are well understood, but the potential of small failures to create dangerous concatenations is not. A surprising number of organisations rely on applications such as Excel and Access to carry out business critical calculations for which they were never designed, for example, laying the organisation open to a variety of different risk types. Manual processes may be more prone to errors of certain types, and possibly also fraud as they often allow a clear view of control processes - or the lack of them. Business processes are often not controlled as tightly in times of market turbulence as in calmer trading, leading to delays and backlogs. Hedging imperfections may not be monitored actively. Client IT failures may lead to "tidal waves" of transactions that can create ripples in a range of related areas: this is a familiar situation to those monitoring liquidity in cash markets, but is often less well understood where securities or derivatives are concerned. Trading surveillance may not be seen as a priority in some organisations, leading to delays in tracking suspicious or erroneous trades. Indeed, many organisations do not attempt to detect trading errors until after weeks have elapsed, despite the technology being available to look for aberrant trades due to a variety of causes within minutes of execution. Overseas operations may often be exposed to risks that might be offset if a consolidated view were available, or can be additive in some cases where reporting takes place over inappropriate time horizons. Senior management may be aware of risks, but do not cascade their understanding well down to operational levels. The list is lengthy indeed.

The key to managing risks is broadly three fold: timely monitoring, cascading of vital information and active mitigation. Vital information will include the feedback from experience, which can be used to price risk more accurately. We place emphasis not just on these traditional areas, but also on modeling risk to establish the business case, to check and verify priorities, and most importantly, the introduction of new ways of working in a way itself designed to maximise benefits. Chance should have no place in risk management.

The first stage is often to change the perception of risk management. If a business case for providing some risk management feature can be made, showing the generation of revenue or competitive advantage, the first change management hurdle may collapse of its own accord. Cost savings are a good start, but lack the business impact. Embedding risk management techniques in the business strategy allows the volatility of operations to be controlled more closely, and thus will lead to more stable performance, and better stakeholder returns. The most valuable shift, in our experience, is to emphasize the creation of business value, rather than regulatory compliance, underlining management will to use risk management for its converse side: opportunity enhancement.

We believe that the leading organizations of the future will be those that embrace the challenges of risk management, rather than engaging in sterile box-ticking exercises around compliance. These organisations will be able to respond rapidly to market and environmental change, and will take regulation in their stride. Certainly, they should be able to outstrip those taking a narrower and apparently more cautious view as they will understand more completely the risk profiles of their business. At CSC, we believe that we are and shall be supporting those companies in their drive towards a more holistic view of risk.

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