Capital Markets Chamber

This house believes greed - not fear - will drive Goliath's thirst for risk data

PJ Di Giammarino, CEO, JWG
James Babicz, Head of Risk, SAS
Scott Nygaard, Global Head of Short Term Markets and Financing, RBS Global Banking & Markets
Rosali Pretorius, Partner, SNR Denton

What the Club does

The Financial Services Club is a private networking club for financial professionals that focuses on the future of financial services through the delivery of high quality and in-depth research, analysis, commentary and debate.

Established in 2004 with regular meetings in London, Edinburgh, Dublin and Vienna, the Financial Services Club provides a platform for practitioners, regulators and industry leaders to meet, network and discuss the future of our industry.

Our white papers, research and meetings are published in full on our website www.fsclub.net for members, with summaries available through our official blog at www.thefinanser.com.

The Chatham House Rule

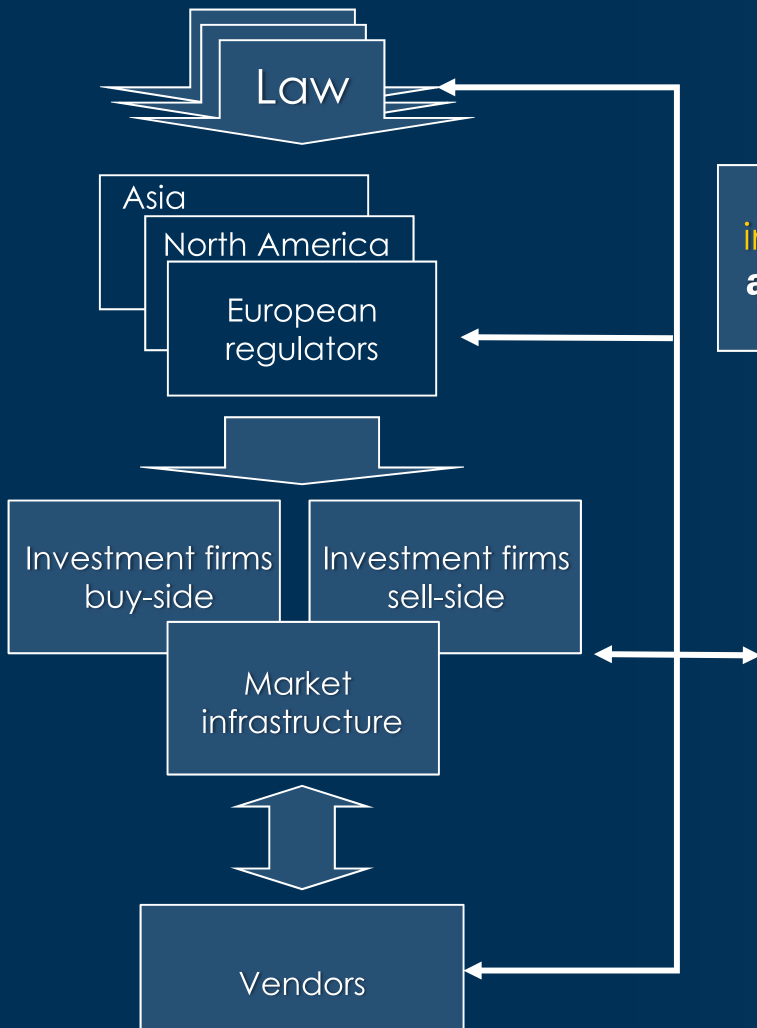
"When a meeting, or part thereof, is held under the Chatham House Rule, participants are free to use the information received, but neither the identity nor the affiliation of the speaker(s), nor that of any other participant, may be revealed."

The world-famous Chatham House Rule may be invoked at meetings with the aim of providing anonymity to speakers and to encourage openness and the sharing of information.

This house believes greed - not fear - will drive Goliath's thirst for risk data

A debate about firms' risk management priorities for 2011

JWG: an independent think-tank



We seek to be recognised by regulators, financial institutions and technology firms as **the independent analysts to help determine how the right regulations can be implemented in the right way**

- **Mapping the operational heat from 250,000 pages of FS regulations**
- **Mirroring, shaping, defining global standards**
- **Facilitating regulator, firm and supplier collaboration**

Limited company with unique IP. Revenues derived from membership fees and research projects

Making sense of financial service regulation since 2005

2010 research focus

Trading (2006)
Analysing global market infrastructure regulatory change

Reference data (2008)
ISO MPG, AFME, FOA

Risk (2008)
Global risk implementation priorities

Systemic risk (2009)
Plumbing research with FS KTN and TSB

The new business of risk management

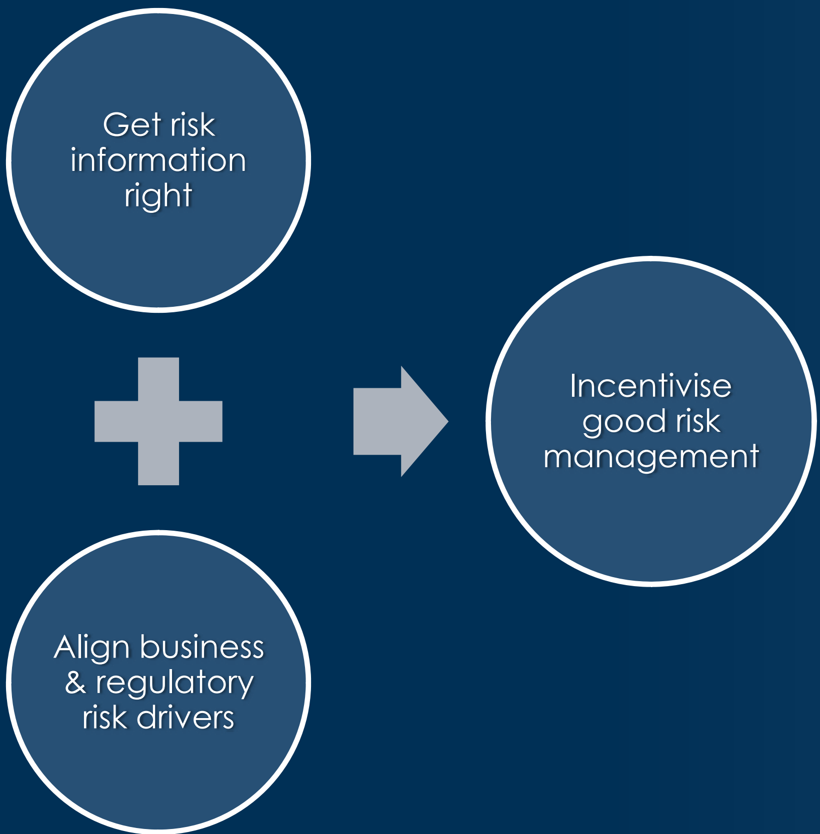
JWG research summary

9 November 2010

JWG
Making sense of financial services regulation

Executive summary

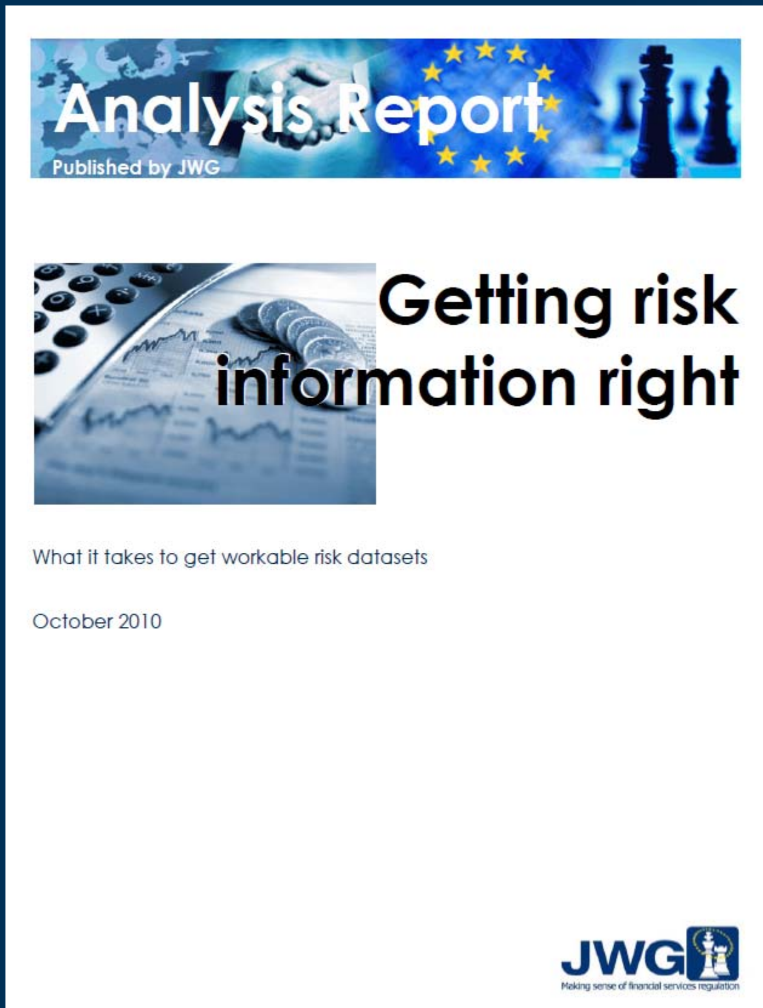
Strategic risk management targets



- 2010: business proposition for better risk management unclear
- Lots of box-ticking to produce new reports
- Approaches being revisited in 2011, but resources not yet secured
- The sprint for best capital ratios begins in earnest by 2H 2011
- Fears of greater penalties (buffers, fines) for inadequate risk infrastructures by 2013
- The leaders are starting to tackle the big issues now … Benchmarks looming?

The risk priorities for next year are currently uncertain

Our research has found some serious gaps


Analysis Report
Published by JWG
Getting risk information right
What it takes to get workable risk datasets
October 2010
JWG
Making sense of financial services regulation

- 39% indicated that data consistency, accuracy and their ability to aggregate were insufficient to meet the new risk management requirements
- 89% indicated that they struggle to set the right risk management strategy and allocate financial resources to exposure management
- It is unclear whether the average spend is sufficient (£3.4 million for a large bank, £117,000 for a small bank or branch)

There are many regulatory-driven fears

- Risk
  - Basel III will increase the cost of capital for many investment firms and may increase data requirements to calculate ratios
  - The Joint Forum recently criticised the effectiveness of risk aggregation models (RAM) across financial firms
  - There is a renewed focus on operational risk
  - What is the right form of governance to produce good risk data
  - . . .
- Market
  - Central clearing of OTC derivatives may well increase the cost of collateral
  - Increased transparency for OTC derivatives and non-equities will require firms to report more data about their transactions
  - MiFID review may increase the cost and complexity of trading
  - New HFT/algo rules are on the horizon
  - . . .

Could ‘greed’ trump ‘fear’?

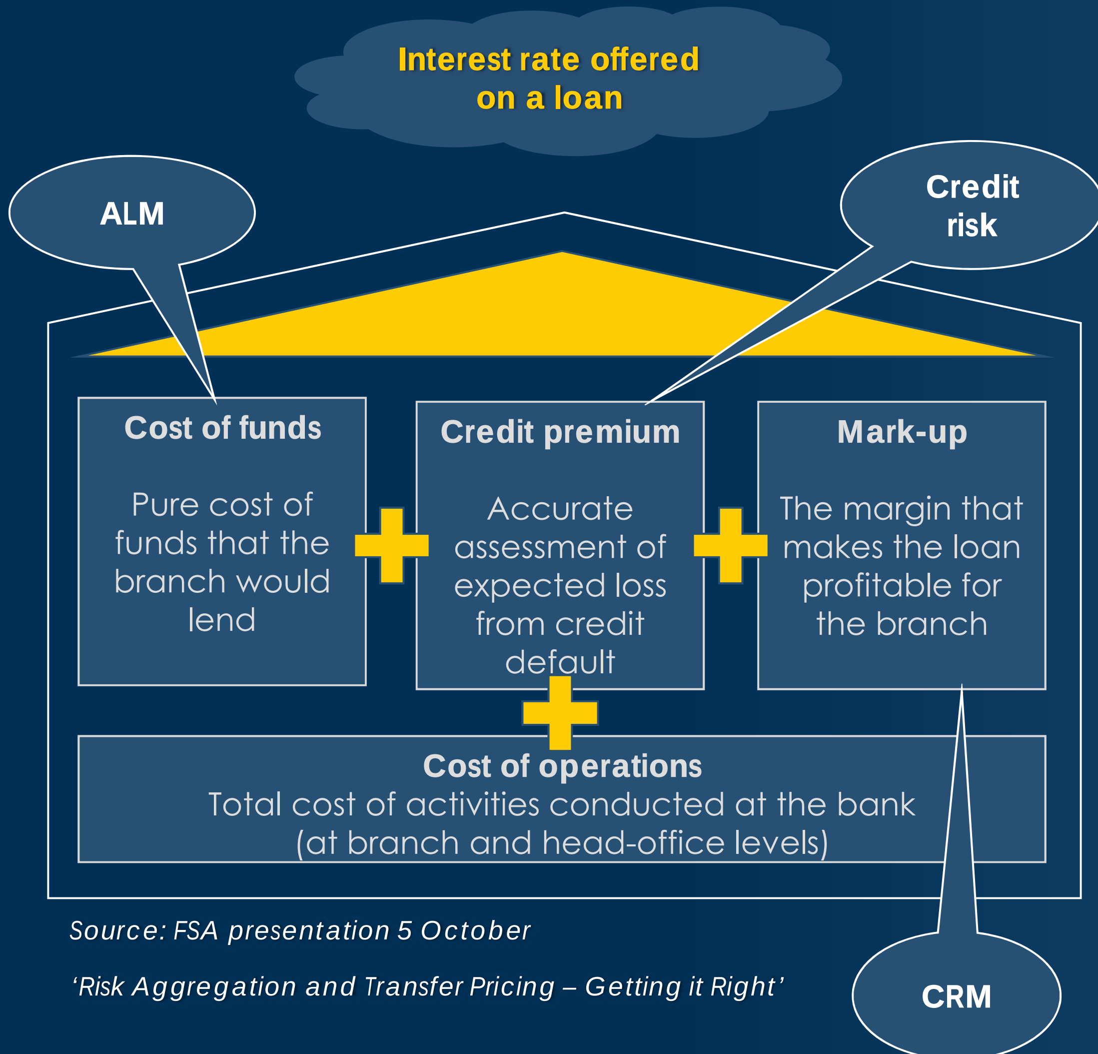
<u>**Greed**</u>

- CEOs want to conduct beauty contest to the CFAs to **improve reputation**
- Smarter allocation of capital through better FTP and CVA makes **more money**
- **Cut** operational **costs**
- **React faster** than competitors to changes in market conditions
- Look good to regulators winning **investor confidence**

<u>**Fear**</u>

- Risk of **reputational damage** from regulatory fines
- **Increased buffers** and capital levels are demanded by regulators
- **Cost/income** ratio increases
- **Quality of MI** is not sufficient to make the right business calls
- **Auditors** and lawyers start raising issues

Solution = ‘optimal granularity’ for risk data



Source: FSA presentation 5 October

‘Risk Aggregation and Transfer Pricing – Getting it Right’

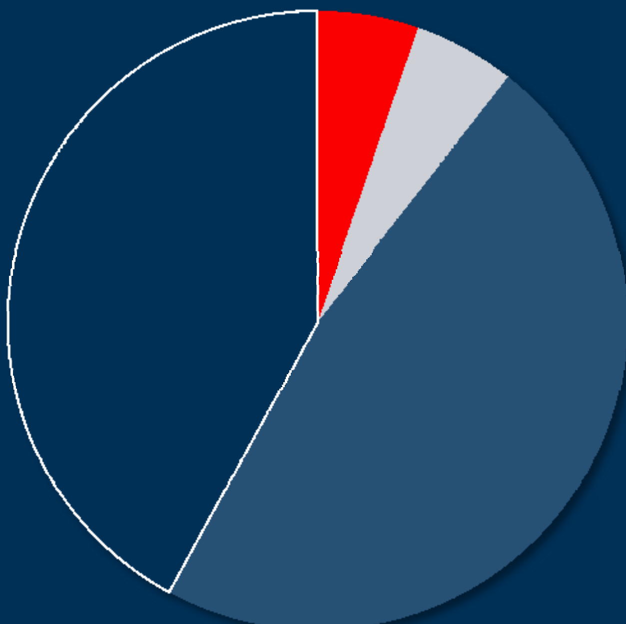
There are many components that play a part in the overall price offered to, and profit generated from, any particular customer.

Better information can increase the accuracy of the process, especially in aggregate, allowing firms to make better judgements and thus make more money, safer. But at some point the increased costs will outweigh the benefits.

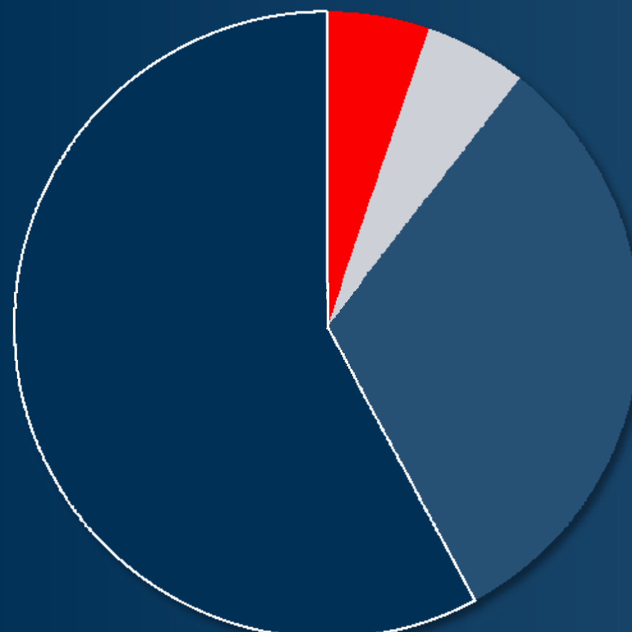
So what is the ‘optimal granularity’ for each part of the business? The answer depends on **what** the information is needed for, **who** needs it and **how** one gets it.

1. Most claim to know <u>what</u> they're doing

I feel my firm fully understands the business and regulatory imperatives for better risk information



Improving risk information is a high priority within my firm



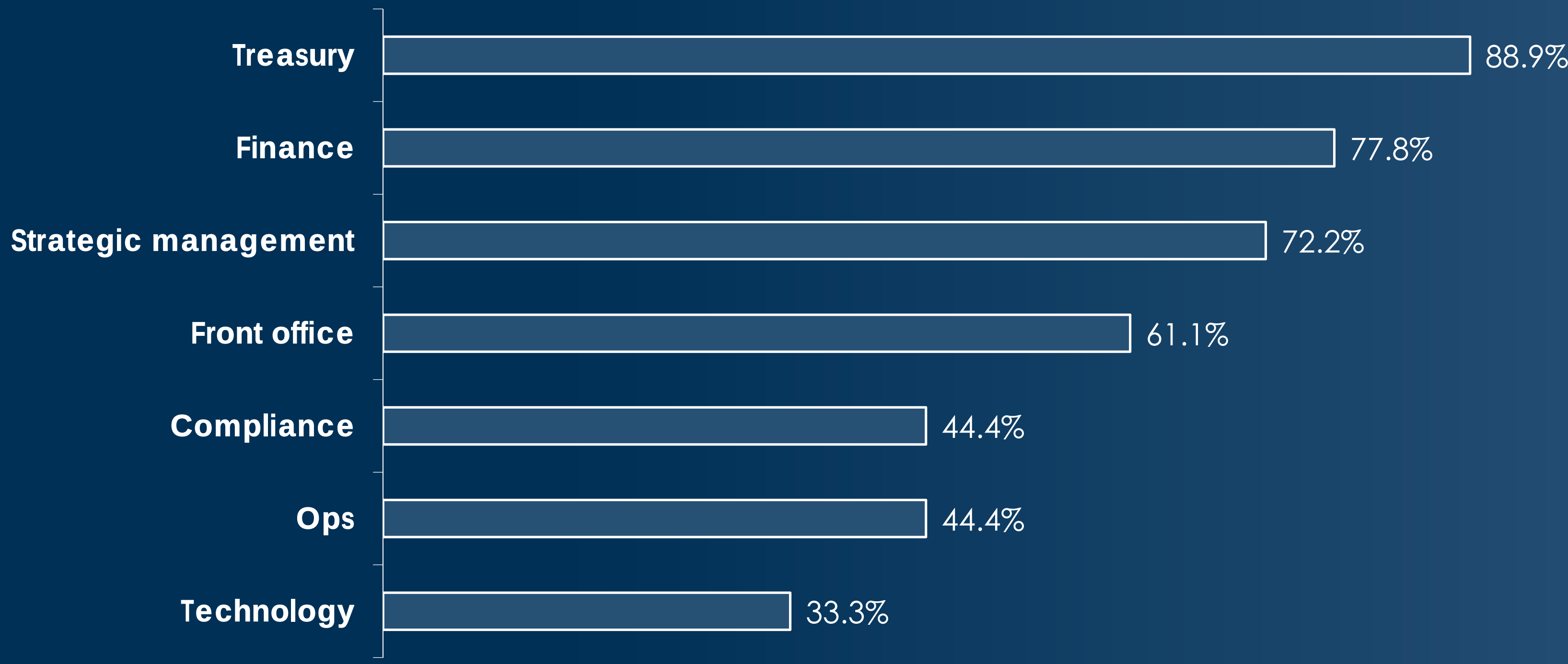
- Strongly agree
- Somewhat agree
- Neither agree nor disagree
- Somewhat disagree
- Strongly disagree

Source: October survey of 19 financial firms

90% agree that their firm understands the imperatives

2. Although <u>who</u> benefits is more uncertain

Which functions, other than risk, stand to benefit from better risk information?



Source: October survey of 19 financial firms

The majority (69%) do not agree that the drive is purely from compliance

And how to proceed raises many questions:

Firm and regulator

Defining objectives and ownership

- **Industry** solution led **versus regulatory** mandated?
- **Specialised** to business types **versus comprehensible** to managers?
- **Who owns** the change programme, rulebook, data and performance measurement?
- How can you **justify the cost** of going above and beyond BAU?
- What **service levels** and **tariff models**?

Technical approach

- **Top down versus bottom up** – is there a penalty for a reductionist approach?
- **What scale** is required?
- **Homogenous** definitions **versus smart** aggregators?
- Industry **standards** versus regulatory **requests**?
- How linear? How **forensically sound**?
- What timeliness, accuracy and **quality**?

Success criteria and consequences

- What **rights does the regulator have** to drill into the data?
- How '**whiter than white**' do we need to be?
- How do you define and assess **what is 'good enough'**?
- What does 'good' look like from a **regulatory viewpoint** across firms?

The Financial Services Club

Debate questions

JWG Making sense of financial services regulation

- **What are the business implications of Basel III and market restructuring?**
- **How will the combined impact of these changes shift priorities for risk managers?**
- **What does this mean to the way risk is managed across the firm?**
- **How can firms overcome the technical risk barriers that stand in their way?**
- **Will the 'fear factor' or the 'greed factor' kick in first?**

LIRAN A JWG Workgroup

Invest Northern Ireland

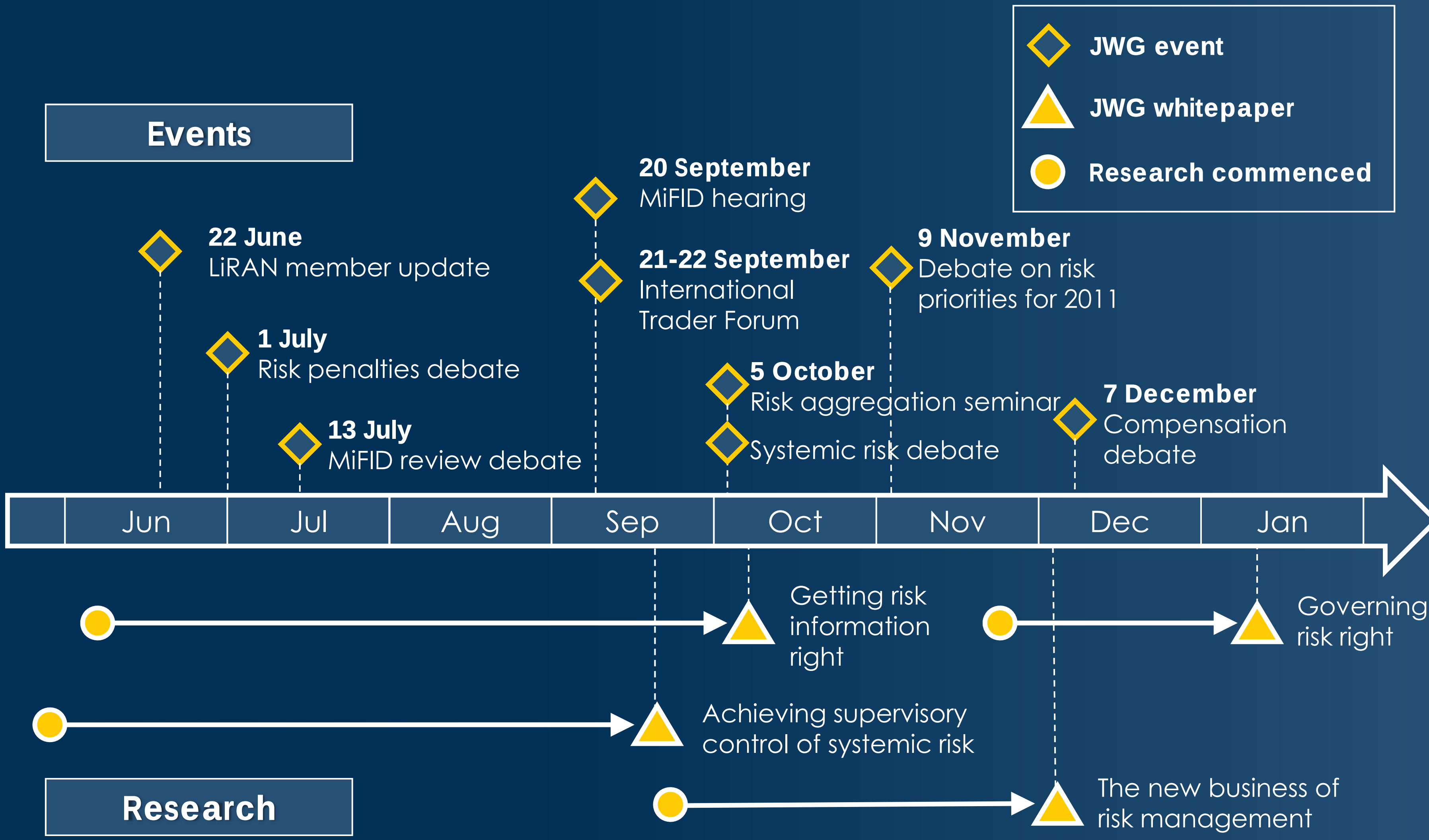
VOCALINK

A-TEAMGROUP

This house believes greed - not fear - will drive Goliath's thirst for risk data

What do YOU think?

The JWG risk research timeline



CMC
Agenda, 2010

Date	Debate
7 December	**This house believes the bonus Grinch will be outwitted.** A debate about compensation rules and practices in financial firms.

Thank you

JWG Group Ltd

admin@jwg-it.eu +44 (0)20 7870 8004 www.jwg-it.eu

Customer Data Management Group
www.The-CDMG.eu

Liquidity risk
www.liran.eu

Systemic risk
http://www.jwg-it.eu/syrig

Trading
http://www.jwg-it.eu/techsig

http://twitter.com/jwg_group http://twitter.com/JWGIT_LiRAN