

Need for Effective Exposure Management

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EXECUTIVE SUMMARY

Challenging market dynamics are forcing banks to assess their exposure and the impact on the P&L. To be able to realistically gauge the magnitude of exposure, an organization will have to move beyond siloed limits and collateral management that exists at an application level. Today, banks do not have an enterprise wide view of the exposure, centrally, owing to their diverse IT and Application landscape. Each system has its own set of workflows for maintaining and managing limits, while collateral management is done in a different system. The larger players have invested in warehouse for risk and finance along with departmental solutions. They have established an effective mechanism of rolling up the information from the silos but the control actions, from a risk management committee cannot be effectively used as there is no plumbing for inheriting the decisions into the transaction systems. Centralized limits and collateral management solution address such challenges by offering exposure information at one place.

INTRODUCTION

Banks being the financial backbone for all businesses are closely connected and equally impacted by events affecting these businesses. Slowdown in one sector, troubles in certain countries or difficult times for a customer means that the bank have to assess their exposure levels vis-à-vis the industry, geography or the customer and take appropriate measures. However, obtaining relevant information for gauging the actual exposure levels is a cumbersome task. Limits defined for each business line are managed by accounts or products, in different applications and collateral underlying these limits is handled by another system, making it difficult to get a unified view of exposure level. Considering the fact that businesses are run across geographies, the complexities increases.

Slowdown in one sector, troubles in certain countries or difficult times for a customer means the bank have to assess their exposure levels vis-à-vis the industry, geography or the customer and take appropriate measures. However, obtaining relevant for information for assessing the actual exposure levels is complex, time consuming and ineffective today.

To add to this, in market conditions where exposure changes every second, collateral revaluation is either not done real-time or the details are populated towards end of day. Further, the need for repeatable covenant management to ensure strong vigilance cannot be ignored. There is a challenge of converting risk and capital recommendations

from the business' existing analytics system into effective transaction controls, since transaction systems are disparate. These silos lead to problems like fragmented view of exposure, inability to track exposure by customer relationship, incorrect collateral revaluation.

Further, the exposure due to the underlying collateral from a particular sector is difficult to measure and report. In wake of these dynamics it is imperative for the banks to effectively manage and monitor exposure across customers, industries and geographies with a centralized repository of limits and collateral management with real-time exposure tracking capabilities.

THE CASE FOR A CENTRALIZED LIMITS AND COLLATERAL MANAGEMENT SYTEM

Centralization of exposure management provides significant advantages to banks:

Process Standardization

Centralized limits and collateral management repository and real-time exposure management ensures adoption of uniform exposure management practices across the enterprise. Adoption of uniform business practices help in streamlining operations, better response time to credit requests, easier identification of bottlenecks in processes and adherence to compliance standards

One of the biggest challenges faced by banks in exposure management is lack of standard business processes since data and processes are embedded within multiple applications across the enterprise. The non-availability of unified information for measuring exposure results in fragmented views, inefficiencies in setting up limits, managing collateral and managing customer relationship holistically keeping exposure in consideration. A centralized limits and collateral management repository and real-time exposure management ensures adoption of uniform exposure management practices across the enterprise. Adoption of uniform business practices help in streamlining operations, improving response time to credit requests, easier identification of bottlenecks in processes and adherence to compliance standards. However, if the processes are not adopted in the IT systems, the whole exercise is futile.

With SOA-based solutions banks can make effective use of their existing software and information assets and use them in new business processes. In an SOA environment, business tasks are accomplished by executing a series of "services," which sometimes participate in a business process. These services have a well-defined way of talking to other services and obtaining a response. The implementation of a service does not matter to a user as long as the service responds in the expected manner and offers the quality of service expected. SOA automates and optimizes complex business workflows, helping prevent silos across lines of business and multiple products.

Centralize for efficiency and real-time management

A centralized repository of limits and collateral management ensures centralized setup and management of limits which streamlines the whole process. It also facilitates centralized online tracking of limits for all transactions across the bank

Defining and managing limits structure is a complex process in the area of exposure management. Each line of business application defines the limits structure and manages it. Hence, to know the total exposure of a customer, data needs to be collated at one point. To achieve this, the bank either uses its legacy application where it has to spend a huge amount of money and effort on integration with other applications it has or bank's personnel do it manually on spreadsheets. This leads to long lead time to service the customer, higher probability of errors due to manual processes, high costs of serving requests etc. Once the limits are defined, there is a need to continuously monitor the exposure on the basis of the value of underlying collateral.

Exposure tracking should be accomplished in two ways, direct and indirect. Direct exposure tracking pertains to monitoring the credit exposure to the customer, the limits the customer utilizing on what products, in which geographies etc. Indirect exposure tracking is to track the value of collateral which is in bank's collateral repository and it belongs to an entity which not doing well in market.

Centralized limits and collateral management solves the problems faced by banks in the area of collateral management. A centralized repository of limits and collateral management ensures centralized setup and management of limits which streamlines the whole process. It also facilitates centralized online tracking of limits in real-time for all transactions across the bank. Limits can be managed at customer, entity and geography levels. The exposure tracking can be done real-time or periodically and can span different categories like industry or sector or any category as defined by the bank. Utilization of limits can be monitored to ensure that a customer's liability to the bank remains within a preset limit and establishment of a process wherein alerts are raised when these limits are breached.

Information delivery to all Stake holders

Centralized system ensures consistent information delivery for decision making and reports

Reporting is a critical need for banks both from business and compliance perspective. Banks need to monitor changes in exposure and corresponding limits. A centralized system ensures consistent delivery of information for decision making and reports. The information should be measurable on parameters such as entity, customer, industry, geography so that the bank has the capability to holistically track exposure at various levels. Further, the ability to drill down to the desired levels of granularity to isolate exposure tracking for entity or customer sub-sets is an important pre-requisite. Being able to extract reports at the desired frequency to make proactive, informed business decisions affecting

exposure is another important consideration for designing a report generation framework. This information can then be used by the risk analytics engine for further analysis which will help the bank take informed business decisions and complete the cycle of generating reports relevant to its business.

Centralization also offers the bank an option to automate and leverage technology for exception management and control. Alerts and application Dash Boards help product owners and business heads to accept or reject a request, if the limits are violated. This ensures direct and timely intervention to protect the bank's long term interests.

Integrate for better insight and control

One of the key requirements for a centralized limits and collateral management system is coexistence with the existing landscape. Delivering a centralized exposure management solution requires the system to play the role of aggregator of exposure data from the existing account or product processors in the bank and publish the appropriate alerts to them. Banks that do not wish to de-commission the existing best-of-breed product or account processors can leverage the facility to track enterprise wide exposure from such processors on a unified platform in real time. From an application design perspective, this translates into ability of the centralized exposure tracking system to interface with multiple application gateways on diverse technology platforms.

SOA-based solutions are ideal for use in situations where software and hardware from multiple vendors are deployed, or when the existing IT assets are mixed with newer applications, integration technologies, or data sources. This enables banks to leverage their existing enterprise assets and ensure better return on investment.

CONCLUSION

Banks face challenges in exposure management because of fragmented view of limits and collateral. Limits and collateral management data and processes are embedded across applications in the enterprise. It ensures adoption of uniform business practices leading to efficient limits and collateral utilization and streamlined limits and collateral management across the enterprise. Availability of limits and collateral data centrally also ensures consistent information for reporting and business decisions.

Ability of the exposure tracking system to co-exist with multiple applications on diverse technology platforms is the key to a successful deployment.

Centralized repository for limits and collateral management and real-time exposure tracking enables effective exposure management. It ensures adoption of uniform business practices leading to efficient limits and collateral management and effective utilization tracking



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