

# An **integrated** approach

**Ken Knowles** of OpenLink explains how a unified future may be the best thing for better credit and operational risk management

**R**isk managers have found themselves in a tailspin for much of the last 18 months. While not exactly forgotten, it's fair to say that risks beyond market risk are now much more clearly in focus than they were before the financial crisis began.

Banks' willingness to lend to borrowers with lower credit quality and buy into securitizations of this credit risk, alongside inadequate borrower documentation and data management are exemplars of the credit risk and operational risk management challenges that lay at the heart of the US subprime mortgage crisis.

We've also witnessed numerous examples of how one form of risk can quickly transform into another. For example, how:

- Heightened market risk can prompt poor operational risk to accentuate credit risk. Just think about the several headline-grabbing instances when financial and corporate treasury groups have found themselves nursing huge losses, as extreme market volatility that has exposed unauthorized derivatives trading activity.
- Concern about credit risk can lead to greater market risk, and vice-versa. Hedge funds, for instance, have suffered as heightened market risk prompts investment strategies to unravel, prime brokers to reel in credit and investors to scramble for the exits. Similarly, this de-leveraging has amplified market volatility and stressed liquidity further, and so the cycle continues.

Regulators and politicians are understandably focusing a lot of their attention on the key roles that regulation, executive compensation and government-induced moral hazard have played in creating and exacerbating the crisis. Perhaps equally significant is the role of risk management. It could be argued that the severity of the US subprime crisis – one of the initial catalysts of our current financial woes – might have been lessened if banks had better appreci-



ated that lax operational processes were exposing them to much more credit risk than might be apparent. It has therefore become abundantly clear that to be measured and managed effectively, market, credit and operational risks must be dealt with in a holistic manner.

But as some firms may have also discovered during the financial crisis, market stress can expose shortcomings in trading and risk management approaches and solutions that, although effective in some ways, are not truly integrated.

The value proposition of truly integrated and extensible risk management technology such as those created by leading New York-based vendor, OpenLink, has never been more compelling. OpenLink's Findur and Endur solutions are targeted at financial capital markets and energy markets participants, respectively. Both are built upon the same core architecture and functionality and allow users to manage the entire lifecycle of a trade: from deal entry right through to settlement and accounting.

There is a definite industry-wide desire to improve risk management. According to an American Banker/Greenwich Associates Executive Forum, 52 percent of participants said that their company had plans to improve their operational risk management effort, and 57 percent of these said they would do so by mid-

2009. From OpenLink's perspective, we've witnessed a definite upswing in end-user interest in making greater use of workflow functionality and our solution's collateral management capabilities – especially in light of the emergent dynamic policies and processes that have developed in the current market environment.

Using our easy-to-implement 'point-and-click' interface, exceptions-based management is straightforward – hopefully enabling users to prevent unauthorized trading activity from escalating into a major exposure, by triggering additional levels of review prior to automatic confirmation and settlement when user-defined triggers are hit.

We believe that this kind of functionality is liberating. It empowers clients to dynamically implement their own business controls and monitoring processes and not be constrained, as has often been the case, by a technology that assumes standard trade processing. Echoing our earlier discussion of the transformation and overlap of risks, user-defined workflows can also be a powerful tool to deploy at the intersection of operational and credit risk. Rules could, for example, be set up so that a particular workflow is invoked when the credit rating of a specific counterparty is changed or put under review.

The failure of major derivative counterparties and heightened systemic counterparty credit risk concerns are naturally leading to increased interest in measures that look at the sensitivity of credit exposures to market rates and the downstream impacts of credit and market events on liquidity. Recognition of the imperative to fold collateral management into an overall risk management framework is growing too.

These developments and recent market experience have demonstrated beyond a doubt that effective risk management can only be achieved when you have a truly integrated and adaptable system in place. ■

**Ken Knowles**, EVP, Risk Management and Analytics, has full responsibility of the risk and analytic elements of OpenLink's solution sets. These include the management and oversight of a multi-functional team of developers, consultants, and Ph.D's.