FINASTRA

Lending in the new normal series #4

In lending, it's time for risk management to break out of its silos

The opportunity to optimize

How can risk management work effectively today, with many extra challenges piled on top of the usual to-do list? With widespread remote working, for example, is it possible to ensure consistency in due diligence? There's an understandable acceleration in the desire to digitize, but managing the risks around this transformation is not straightforward. And on a macro level, how do lenders manage the U-turn from 2008's rapid increase in risk measures to 2020's pressure to loosen them and bring liquidity in to the market?

In our last post in this series we looked at one aspect of risk – credit management – and how banks find it challenging to address borrower risk quickly because current infrastructures are not fit for purpose. And we explored how an ideal solution could fix the problem.

On the other side of risk – market risk – the challenge is efficiently understanding how market events impact the internal risk ratings of customers. Right now, in loan origination, risk management happens late in the day. As with credit management, there isn't enough connectivity or interoperability for this to happen quickly or effectively enough.

"Relationship managers and sales teams need tools to understand how the deals they are servicing impact the bank's overall risk appetite in relation to sectors, countries and pricing thresholds."

Chris Papathanassi,
Global Solution Lead, Lending

Thorough risk management needs to look beyond a bank's data into other factors such as market trends and sentiment. One example illustrates this.

A bank had margin call options in its collateral agreement, meaning it had to call in funds or seize the collateral (in this case, a perishable commodity) if it got too low. Market fluctuations drove the collateral value down, so when the bank came to look at the value of the collateral compared to the loan, it was left having to offload tonnes of the perishable commodity.

In another example, having failed to record collateral, a bank had to employ people to go through individual agreements and find out what collateral they held on each one.

Ongoing risk management is challenging too, because there's a lack of data. In this "unintegrated" world, it's hard to know whether the business you're doing is good for business. It means that more controls are needed, which has knock-on effects to the cost of capital. Risk-free rates add uncertainty, as it becomes harder to project and manage cashflow, and therefore to assess borrowers' risks. This may make it necessary to use interest rate swaps, which could have a knock-on effect into market pricing.

Collateral has always been a highly manual part of the lending process, with many moving parts: even if agencies are employed to check and monitor it, the information can remain fragmented. The inability of some banks to capture collateral means that in some cases, they opt to overestimate risk weighting to ensure adequate capital coverage, which impacts the cost of lending. It's another opportunity to optimize.

And if collateral and risk are not being managed effectively, banks may not be in a position to adequately control and enforce borrower compliance, exposing themselves to the risk of breaches and the balance sheet impact (revenue leakage, for example) and reputational risk that can result. Here, again, there's an opportunity to optimize.

About the author

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As Global Solution Lead for Lending at Finastra, Christopher Papathanassi is responsible for the overall line of business within the field, and works cross functionally to provide support with; deal execution, validation and execution of go to market activity, product strategy and bringing thought leadership to the market . With over 14 years' in the industry, he is an experienced commercial lending specialist.

Prior to his current role he worked on the bank side where he held a variety of roles within lending, both on the business and change management side. He holds a Bachelor's Degree in Business Management from Bournemouth University.

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> *"Covenant monitoring is often siloed and monitored by a separate team, using data from the servicing system. However, because the tracking isn't integrated, it can often be months before a covenant breach is spotted, which exposes the bank to balance sheet risk."*

So in risk management, silos prevail. Integration and collaboration have been an aspiration but never a reality. Today, however, APIs and platforms could finally join up the different elements of risk management, so the process can "front run" rather than being continually reactive. Contemporary tech can provide both the visibility and the distribution to make sure the right pieces of data are seen by the right people, in the right places and at the right time.

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About Finastra

Finastra is building an open platform that accelerates collaboration and innovation in financial services, creating better experiences for people, businesses and communities. Supported by the broadest and deepest portfolio of financial services software, Finastra delivers this vitally important technology to financial institutions of all sizes across the globe, including 90 of the world's top100 banks. Our open architecture approach brings together a number of partners and innovators. Together we are leading the way in which applications are written, deployed and consumed in financial services to evolve with the changing needs of customers. Learn more at **finastra.com**

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