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ARTICLE
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Name of Topic

Beyond Regulations
The Value of Building an Effective Data Analytics Infrastructure

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Beyond Regulations: The Value of Building an Effective Data Analytics Infrastructure

Depending on your point of view, regulation can be viewed as a hindrance or a compliance cost. However, hidden in the pending regulations being mandated in the global financial service sector is an opportunity to leverage regulatory investment into business gains.

Progressive rollouts of increased regulatory scrutiny for most financial institutions and increased convergence among various regulatory agencies are seen as obvious reasons why institutions should invest in a centralized data repository and data analytics. An equally important and related reason is to protect their bottom lines, particularly in the case of a deteriorating financial or monetary environment, as was seen in the recent financial downturn.

An even more critical benefit than regulatory compliance or bottom line protection against specific events is, however, the ability to leverage the investment in data analytics to capture enhanced business value consistently over a longer term. A well-structured data analytics infrastructure could pay for itself in ways more than one.

The first milestone in risk data management is establishing a centralized datamart to facilitate all deal structuring and approvals of existing exposures and pending loan transactions. A centralized approach, which includes a central dashboard to review your total relationship with a specific entity and its affiliated group of entities, enables managers to quickly scan their entire deal pipeline in one click. Moreover, it delivers this information to their fingertips, updated in real time, creating huge payoffs in terms of faster and efficient business decisions and a more satisfied client base.

It is critical that the central datamart supports data feeds from multiple risk sources (both market and credit) to offer an integrated picture of enterprise risk. It is also important to note that although current and future forecasts are becoming increasingly important for designing a forward-looking risk management strategy, easy accessibility of centrally stored historical data remains critical to account for the behavior of key metrics in known past events.

Emphasizing Accuracy and Consistency

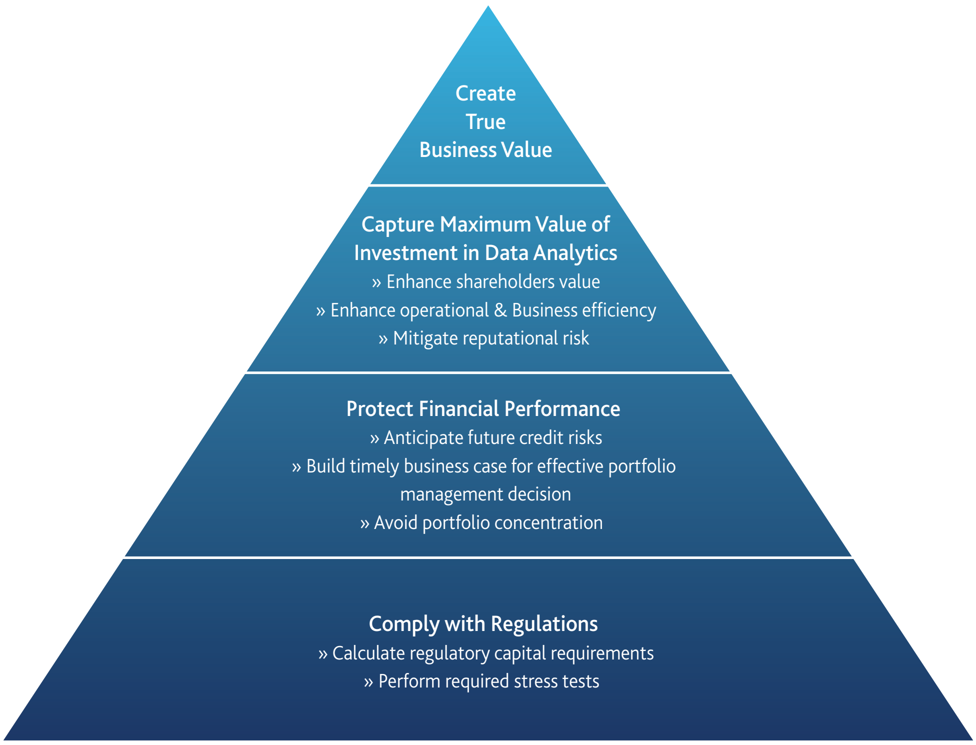
The second step in reducing the time to credit decisions is ensuring that the data entered into the datamart is accurate and consistent. Using out-of-the-box templates to spread historical entity financial data and qualitative data, and enabling automated updates, are proven tools for ensuring data accuracy.

Spreading information in rational categories closely linked to decision drivers - such as exposure, limits, performance, expected loss and policy exceptions - makes critical business metrics for loan approvals available in a user-friendly format that supports faster and more efficient decisions. The scalability of data storage resources, which contributes to the consistent accuracy of data by reducing calculation time and opportunities for human error in organizations seeking operational efficiency, is another factor to consider while planning a data analytics infrastructure. The more scalable your data storage resources, the better.

Pressed to allocate scarce capital most judiciously in the current environment, most business organizations are also seeking to capture every extra basis point of return, while minimizing the potential downside from their credit decisions. Working under this broad constraint, lending organizations need an ability to easily calculate their overall current and future exposures at a much higher level of granularity.

Companies need to view exposure profile segmented by region, industry and internal rating (probability of default and loss-given default) to make an objective assessment of the impact of their pipeline of contemplated transactions, both total and segmented, on their overall risk exposures. An array of "out of the box" templates, customized for specific loan type and backed by an efficient datamart, will help organizations realize this goal. Be mindful, however, that the available templates account for multiple hierarchies across different groups to reflect how some of these exposures could be linked to each other, which could result in undue concentration in the total portfolio.

Figure 1: Generating Economic Value through a Data Infrastructure



Parting Thoughts

As the regulatory requirements continue to evolve, bringing the spotlight on the importance of pro-active measures on the part of lenders, an ability to anticipate when future limit breaches or covenant breaches may occur empowers business managers to understand the impact of their exposures on their limits. What's more, it also offers a key tool to mitigate any potential breaches in reputational risk.

A transparent, complete and accurate presentation of required disclosures with the regulators will also result in shareholders keeping their confidence in the company's management.

Looking holistically, reliance only on covenant breaches does not allow risk managers to view all sources of potential risks or prepare the organization to recoup losses, particularly as collateral might lose value in the face of a credit risk event. Hence, an approach that includes limits and covenant breaches - along with any override decisions made across any credit deal within the entire organization - is a preferred one.

Understanding policy exceptions is also important for avoiding undue concentrations in exposures across the enterprise. Instances of pricing overrides and model overrides have to be timely, recorded in a format that allows risk managers to see their impact - not only on the current transaction but also at the portfolio level, accounting for multiple hierarchies.

Capturing accurate data at the time of origination, although necessary, is not enough. Data must be kept accurate throughout the life of an exposure by overlaying sophisticated access management and audit features. Automated data quality checks and advanced security features offer (potentially) substantial savings for an institution, because they ensure that any change in the risk profile of an exposure or a portfolio is noticed by business users without a significant delay.

Clearly, the investment in sophisticated data analytics goes much further than just meeting regulatory guidelines.

About Moody's Analytics

Moody's Analytics, a unit of Moody's Corporation, helps capital markets and credit risk management professionals worldwide respond to an evolving marketplace with confidence. The company offers unique tools and best practices for measuring and managing risk through expertise and experience in credit analysis, economic research and financial risk management. By offering leading-edge software and advisory services, as well as the proprietary credit research produced by Moody's Investors Service, Moody's Analytics integrates and customizes its offerings to address specific business challenges.

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