Risk Management in Financial Institutions
Formulating Value Propositions

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Are you able to formulate and communicate value added propositions to your stakeholders?

Life-cycle needs are continuously evolving, is your organization ready for tailored client needs?

The foundations of risk management in financial services have been in place for years. However, as concepts, tools, and approaches are changing is your organization benefitting from these developments?

Risk managers are scrambling to understand the intricacies of Basel II and Solvency II. In their desire to understand market, credit, and insurance risks have your risk managers relegated Operational Risk to an afterthought?

The most important job of senior risk managers today is to: identify, formulate, assess, deliver and communicate value added propositions to their stakeholders. How do you formulate yours?
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1. Introduction to risk management

Risk management has been in place in financial institutions for hundreds of years. Managing on the five major decision variables (Liquidity, Credit, Interest rate, Cost, Capital) have been considered in one degree or another for quite some time. However, our approach to managing these interactions has changed considerably. New approaches and techniques have been developed based on technological developments, greater access to data, and a deeper understanding of the relationships between the variables. These developments have come at a good time as stakeholders such as clients, employees, suppliers, and regulators are increasingly becoming more informed and more demanding in terms of transparency and accountability.

Risk managers are under pressure to compete in highly competitive markets while solidly honoring their obligations and navigating their businesses safely into the future. Paramount to their success is the ability to identify, assess, formulate, and communicate value added proposition to those same stakeholders. It is with this objective in mind, to assist senior risk managers compose value added propositions, why this book exists. There are many value drivers to the success of a financial institution, when reading through the chapters in this book we are confident you will find many insightful ideas, concepts, and methods to help shape or reshape your value added propositions. Some ideas you may find very unique others rather complimentary to your current approach in constructing value added propositions.

The primary objective of this book is to support senior risk managers in further developing and effectively communicating viable, coherent, and sound value added propositions to their stakeholders. We define a value added proposition as a clear, concise series of realistic statements based on an analysis and quantified review of the benefits, costs, risks and value that can be delivered to stakeholders.
2. Risks in client relationships

Financial Institutions (FI) have come into existence to service the evolving financial needs of clients. Mainly motivated by the credit crunch, market pressure, e-commerce and decentralization many financial institutions increasingly focus their efforts on their clients. As such, there is a strong need for further developing and strengthening client relations.

As financial institutions increasingly recognize the quality of client relations are important, they actively implement this focus in their daily business. Both the management of risks (such as: integrity, credit, operational and reputation) and optimal client advisory – with initiative and foresight – have to be taken into account when aiming at service across the client’s full life-cycle.

Nowadays, client relation management is characterized by risk management and preferably incorporated in the strategic policies and operating procedures. Good risk management is embedded in daily work processes of the institutions and can help formulate value propositions in anticipation of client needs, thereby further strengthening client relations.

In this chapter we will provide senior risk managers with insight in the risks regarding the development of client relationships, the government of client relationships and the monitoring of these client relationships. With these insights senior risk managers can formulate value added propositions for their stakeholders.
The foundations of good management in financial services have been in place for years. However, as concepts, tools, and approaches are changing is your organization benefiting from these developments?

M. Bozanic

3. Risks in the building blocks

Joop Rabou RA RE
Drs. Gerr Jan Sikking

The activities that financial institutions perform can be broadly divided into two distinct sets. One set of activities is associated with ‘building’ the institution. The other set of activities are associated with ‘running’ the institution. In this chapter we present several sections which focus on risks in the building blocks. These risks are associated with “building” an institution.

The current credit crunch has highlighted the importance of sound risk management within the financial institutions industry. The prudence in executing the risk policy determines to a large extend the risk profile of the financial institution as well as the capital ratios. Risk management within financial institutions requires clear risk management principles and policies for interest rate, market, liquidity and currency risk, as well as credit risk at a portfolio level. Risk management requires a rigorous framework of limits and controls to manage the risks and support the value proposition of the institution.

This chapter covers the basis of credit risk management and the ongoing developments in this area. Topics covered are acceptance policy for wholesale clients based on the know-your-customer principle as well as the use of credit risk models in credit risk management. Probability of Default (PD), Exposure at Default (EAD) and Loss Given Default (LGD) are important Basel II parameters that are extensively used as part of credit risk management frameworks within financial institutions. In addition you will find a section focusing on risk indicators, combining probability distributions, data scaling and the characteristics of diversified hedge fund portfolios.
Risk Management in Financial Institutions

Formulating Value Propositions

Risk managers are scrambling to understand the intricacies of Basel II and Solvency II. In their desire to understand market, credit, and insurance risks have your risk managers relegated Operational risk to an after-thought? How does your organization approach operational risk and formulate value propositions from this risk type?

M. Bozanic

4. Risks in running the business

Drs. Philip Gardiner
Drs. Gerr Jan Sikking

In chapter two we argued that the activities that financial institutions perform can be broadly divided into two distinct sets. One set of activities is associated with ‘building’ the institution. The other set of activities are associated with ‘running’ the institution which is the focus of this chapter. These activities are associated with governance, management and operations. In this chapter we present a series of sections associated with non-financial risk, the identification, measurement and control. These are the risks associated with ‘running’ an institution. Within a financial institution there are a number of departments whose activities focus directly on aspects of non-financial risk exposure through participation in the overall operational risk and control framework. These departments, Operational Risk, Compliance, Legal, Human Resources, and Information Security all perform specific risk control activities that add to the efficiency of ‘running’ the institutions business.

The following chapters discuss specific approaches to controlling non-financial risk. They examine ways of approaching the control process and how to establish an institution wide support system. Techniques for the identification and examination of risk are presented along with methods to use data gathered, provide predictive models and assess the institutions ability to respond in periods of stress. Taken as a whole these activities enhance the operational risk and control framework and reduce the likelihood and impact of unexpected direct and indirect loss as the result of events. The reduction of the likelihood and impact of non-financial risks on an institution has a positive effect on profitability and the resulting reduction of unexpected loss aids in the institutions solvency improvement process over time.
The most important job of senior risk managers today is to identify, formulate, assess, deliver and communicate value added propositions to their stakeholders.
J. van Grinsven

5. Formulating value propositions

Dr. ing. Jürgen van Grinsven

We observe that senior risk managers are under pressure. They must participate in a highly competitive environment while solidly honoring their professional obligations and navigating their business safely toward the future. Paramount to their success is the ability to identify, formulate, assess, deliver and communicate value added propositions to their stakeholders. In this chapter we reflect upon the previous chapters, present an outlook and provide guidance for senior risk managers to formulate value added propositions.