Navigating in a new environment:

HEIGHTENED RISK MANAGEMENT

In the Post-Crisis World

By Lawrence Komo
Asia Pacific Head of Investor Services, GTS, Citi
The global financial crisis has been a wake-up call for the global investment management industry. Irrespective of geographic location, the turbulent market environment has impacted the entire investment management industry and has drawn into sharp relief the cornerstone role played by risk.

Discussions with investment managers indicate the morphing of risk management strategies to the next level as a consequence of the financial crisis and events including the Lehman Brothers' collapse. A renewed focus on effective and robust risk management structure capable of withstanding external and internal shocks is sweeping the investment management industry in Asia Pacific.

For investment managers across the region, a robust risk management framework provides the base foundation to meet business objectives. However, a risk management framework that comprehensively covers the pre- and post-trade environment does come at a cost for investment managers. As capital deployment remains tight and the objective for investment managers remains skewed toward generating returns, custodians have seen their role in providing effective and scalable risk management solutions evolve significantly since the onset of the financial crisis.

The Risk Management Fallout

Significant capital investment and a high level of technological and operational support is often necessary to drive market expansion, product innovation or improved client service. Unfortunately, as a consequence, the premium placed on risk management by investment managers across the region proved to be inadequate to cope with the global financial turmoil. Risk management strategies across credit risk, operational risk and liquidity risk were woefully inadequate, prompting a sea change in both opinion and strategy execution.

As a result, for investment managers severely burned by the financial crisis, risk management is now front-and-center of concerns. In other words, the market conditions since late 2008 have drawn attention to capital preservation, which relies heavily on risk management techniques throughout the trade and settlement cycles.

According to a recent study by the IBM Institute of Business Value, which surveyed global investment industry participants, transparency has emerged as the largest concern in today’s financial architecture. Approximately 35% of respondents listed transparency as the major focus required to reconstruct the global financial infrastructure, while a further 15% earmarked enhanced security as the primary concern going forward.

The same selection of investment management participants also painted a bleak picture of current risk management platforms and devices. According to the IBM Institute of Business Value, the same respondents rated their ability to manage systemic risk and manage associated risks with new products and markets as key priorities, but also recognized weak proficiency in executing as inhibiting their plans.

This data does have defined implications for custodian banks. In this environment, the traditional boundaries between investment managers and their service providers—be they custodians, fund accountants, middle-office service providers—have blurred.
Clearly, to achieve effective and efficient risk management, the ability of the entire investment management industry as a whole, including internal and external service providers, to function together as a seamless unit is key. This is in stark contrast to the previous model, which functioned as a random summation of what may be perfectly functioning individual units. As the concept of engaging the best solutions provider grows in acceptance in Asia Pacific, the risk management focus clearly plays to the advantage of proactive and innovative custodians, with the resources and the experience of packing an effective solution to the client rather than individual product silos.

The New Risk Management Value Proposition

Although the future of the global investment management space remains unclear at this stage, it is widely accepted that market volatility will remain a fact of life for investment managers for some time to come. As the most recent financial crisis has shown the industry, market volatility can be extreme when it occurs and when risk management is concerned, traditional risk management techniques tend to fall short.

For investment managers, selecting an effective partner who can implement risk management solutions is key to their ability to function in the most effective and efficient manner. While mitigation solutions remain important to any outsourced risk management relationship between an investment manager and a custodian, there are clearly new variables required to enhance transparency and rebuild lost confidence in processes.

Clearly, the cost and effectiveness of providing robust risk management solutions correlates directly to a custodian’s technology platform and ongoing investments to this platform. To foster transparency and enhance security, technology must seamlessly serve investment managers and integrate both the pre- and post-trade space to provide optimal risk management.

In the new risk management paradigm, the true value of technology is discovered in consideration of the new premium being placed by custodians that provide these outsourced services. For example, backed by seamless technology platforms, innovative back- and middle-office outsourcing can enable investment managers to make more informed and actionable decisions.

From where we stand, the role to be played by integrated solutions in managing risks relies on closer interaction with investment managers. This is particularly true when unique concerns over transparency and security throughout the pre- and post-settlement cycle for each client are fully considered. Investment managers clearly require their custodians to have a complete view of their footprint, levels of automation, processes, investments and future ambitions to provide value-added risk management solutions.

Citi has proactively addressed this evolution in the market. As investment managers look to outsource more risk management processes and focus on core competencies in light of the new economic paradigm, personalized service provides greater peace of mind.

In other words, through a “client solutioning” approach, solutions provided by custodians like Citi are evolving and becoming less commoditized. Custodians like Citi use a partnership and adviser approach to work with investment managers to decide what processes they want simplified and eliminated, what technology platforms can be integrated and what risk management strategies can be added to enhance existing processes and support future expansion plans. This is truly where value is being added in the new environment, where clients are turning, allowing them to focus on core competencies.
The risk issues highlighted by the financial crises will not disappear, but the responses to and strategies to manage the same are continually evolving. The fallout of the crisis has prompted many investment managers to reevaluate their approach to risk management with a greater focus on transparency and security. Increasingly, to achieve these goals without sacrificing the primary objective of generating investment returns, investment managers see custodian-provided partner-based and integrated solutions as the answer to address risk management concerns.

Clearly, investment management firms across Asia Pacific, in their various business objectives, require innovative solutions straddling the investment life cycle from presettlement to post-settlement. However, a unique understanding and trusted adviser approach is required to cater to each individual investment manager and take into account their unique characteristics.

By working closely with investment managers and combining our comprehensive service platforms, we are able to help them achieve optimal risk management solutions. Partnering with Citi provides investment managers access to market-leading technology, the most adaptable service platforms and the comfort of the most personalized services to drive business growth while ensuring effective risk management.