Global Research & Analytics

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Target operating model for credit risk management (CRM)

Roundtable Summary

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Target operating model for CRM: challenges and best practices

Global banks have embarked on a journey to optimise their operating models for CRM amid rising regulatory scrutiny and compliance cost. While the optimum model needs of each bank differ, some best practices are emerging.

In this context, CRISIL Global Research & Analytics and Greenwich Associates hosted a roundtable on 'Target operating model for credit risk management' on September 16, 2020. Senior leaders from eight global banks participated and shared their views on aligning policy and governance set-up to meet regulatory asks, building a curated credit-risk data repository and digitalisation of credit-risk workflow.

Snapshots of insights from the roundtable:

Front-to-back review to build a sound business case when aligning policies and processes

- Banks are working backwards to create the best target operating model by establishing optimal infrastructure and framework. This involves conducting a front-to-back review of current processes, roles and responsibilities to identify gaps vis-a-vis the optimal state
- Banks have opted to engage with business leaders to accelerate the transformation. They are looking to reinforce their case on the premise that process efficiency can be improved by taking a closer look at the roles and responsibilities. This has afforded an easier buy-in for realigning credit-risk processes and policies. To begin with, banks are looking to adopt this approach for businesses with higher volumes where small efficiency gains can have a major impact on the bottom line

Benchmarking helps match the right processes and individuals

- As banks move towards an optimal target operating model, they are benchmarking processes by measuring the time spent and allocated through credit risk value chain including for underwriting, monitoring and limit-access management
- Benchmarking is relatively easier for underwriting, but difficult for complex areas such as structured products. Banks are facing difficulty in conducting an effort or time spent benchmarking across different regions. Therefore, it is important to look and analyse the location and skillsets to identify and subsequently rationalise the process on a regional basis

Clearly defined roles and responsibilities raise efficiencies and helps identify digitalisation opportunities

- Bifurcation of roles and responsibilities across the first and second lines of defence is a struggle and is often a point of contention across the industry. There seems to be a consensus about optimising the credit risk function by scoping out roles and responsibilities. Banks have started defining the 'what' and 'how' for roles and responsibilities. Once the exercise is complete, it will be easier to codify policies and procedures and look for avenues for digitalisation
- A peer-benchmarking exercise revealed that the roles and responsibilities between first and second lines is delineated to some extent in the lending portfolio, but not across capital market exposures. The desired level of demarcation is generally absent across counterparty teams. Consequently, the same group ends up looking at the origination, due diligence, limit approvals and also portfolio management
- Industry leaders feel the front office might just be an online portal in future. There would be little distinction between analysis and documentation in a robust automatic credit risk process. In such cases, the focus will shift to whether the automation works as intended. There is some uncertainty around whether regulators will be comfortable with fully automated processes. The automation of retail lending portfolios could be a useful guidepost for automating complex lending processes. Robust in-built checks and balances are required across the automated processes to achieve regulatory approvals and prevent operational mishaps. Some

firms are trying to define a common set of key performance indicators with leaders co-owning some of the initiatives around automation for effective risk management

Solving the data conundrum can help reap digitalisation benefits

- Curated credit-risk data continues to elude banks and they are still grappling with legacy systems, which makes it difficult to collate accurate data in a timely manner that can assist them in day-to-day monitoring as well as portfolio analytics
- As banks look to generate efficiencies through automation of low-value tasks (e.g., manual data entry and data sourcing), availability of high-quality curated credit data will be of paramount importance. In this context, third-party utilities could help pave the way (e.g., net asset value data for hedge funds or regulated funds). While banks are exploring these avenues, but they are not there yet. Third-party utilities can help generate attractive returns on investments if banks work together

Digitalisation making inroads into credit risk assessment workflow

- There is a strong push towards automation of credit risk workflow for lending portfolios spanning across retail, mid-market/small and medium-sized enterprise and wholesale clients. While the journey of automating the credit risk workflow for retail portfolio has been relatively easier, banks are having to adopt a more nuanced approach towards the digitalisation of credit risk workflow of non-retail portfolios
- While automating the lending process, the focus is on defining assessment parameters and risk appetite and ensuring that the reporting is not only appropriate but also automated to the extent possible, and available on demand. However, having said that, there is lot of complexity around the need to build engines to automate the data flow. It is hard to convince regulators on this front. It is important to walk them through the entire process and remain cautious while using the black box algorithms
- Some areas of credit risk assessment workflow being automated across banks are: (1) usage of historical balance sheet data to project the future debt capacity with a manual override facility; (2) forecast of cash flow statement with big data and advanced analytics; (3) processing news and translating them into action items using a scoring engine; and (4) automatic computation of relevant credit ratios

Compliance challenges due to multiple regulatory regimes, but global convergence underway

- Global banks need to comply with regulatory asks across multiple material booking centers. There are several regulators within the United States (US) itself, which presents a set of challenges. The quantum of reporting has been increasing exponentially with rising demands from local regulators. Teams spend a significant amount of time coordinating with colleagues across the globe
- When it comes to regulatory reforms, the US has led the way after the Global Financial Crisis by setting up benchmarks on regulatory requirements. Many jurisdictions have been following suit. And given rising convergence of regulations, firms are likely to benefit from lower compliance costs
- For now, banks find it prudent to follow a global approach and incorporate regional variations wherever required. Global firms are adopting a hub and spoke model wherein they have a global framework, as opposed to each region creating its own

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