

First Enterprise Risk Management Seminar



Institute of Actuaries of Australia

Beyond The Global Financial Crisis

How the Financial Services Industry Will Change

Tuesday, 29 September 2009

Risk Management Implications for Investment Banking

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Investment Banking – changed forever?

- # *Bulge Bracket Investment Banks: **NIL***
- *Still many specialist niche players*
- *Universal banks are now the big players*



My view: no major paradigm shifts

- *Still need M&A, intermediation, innovation...*
- *Opportunist sector: creative minds will create*
- *Different cultural mindsets will continue to challenge*



What will be Different?

1. *Capital (more, more, more...)*
2. *Compensation Arrangements (Bonuses)*
3. *Chinese Walls*
4. *Liquidity Management*
5. *Valuation Models*
6. *VaR Models*
7. *Securitisation*



Liquidity Management

- Cost of Liquidity: used to be “cheap” or “free”
 - ↪ *A natural mindset, if balance sheet available for sale*
 - ↪ *A world awash in cash chasing yield*
- GFC: a serious wake-up call
 - ↪ *Collateral Calls*
 - ↪ *Downgrade Triggers*
 - ↪ *Silent obligations for off-balance sheet vehicles*
- AUS Banks (and their Investment Banking units):
 - ↪ *Relatively well-positioned*
 - ↪ *Constructive dialogue between APRA/banks*



Valuation Models

- *Gaussian Copula Model: A “crash & burn” victim?*
 - ↳ *Useful as another anxiety index?*
- **Mark-to-Market**
 - ↳ *only works in a market, and*
 - ↳ *when positions can be moved via “normal size” parcels*
- **Mark-to-Model**
 - ↳ *Who’s model?*
 - ↳ *Can buyer & seller both report a profit?*
 - ↳ *Will we see a day when all valuations are done by independent utilities (e.g., exchanges/clearinghouses)?*

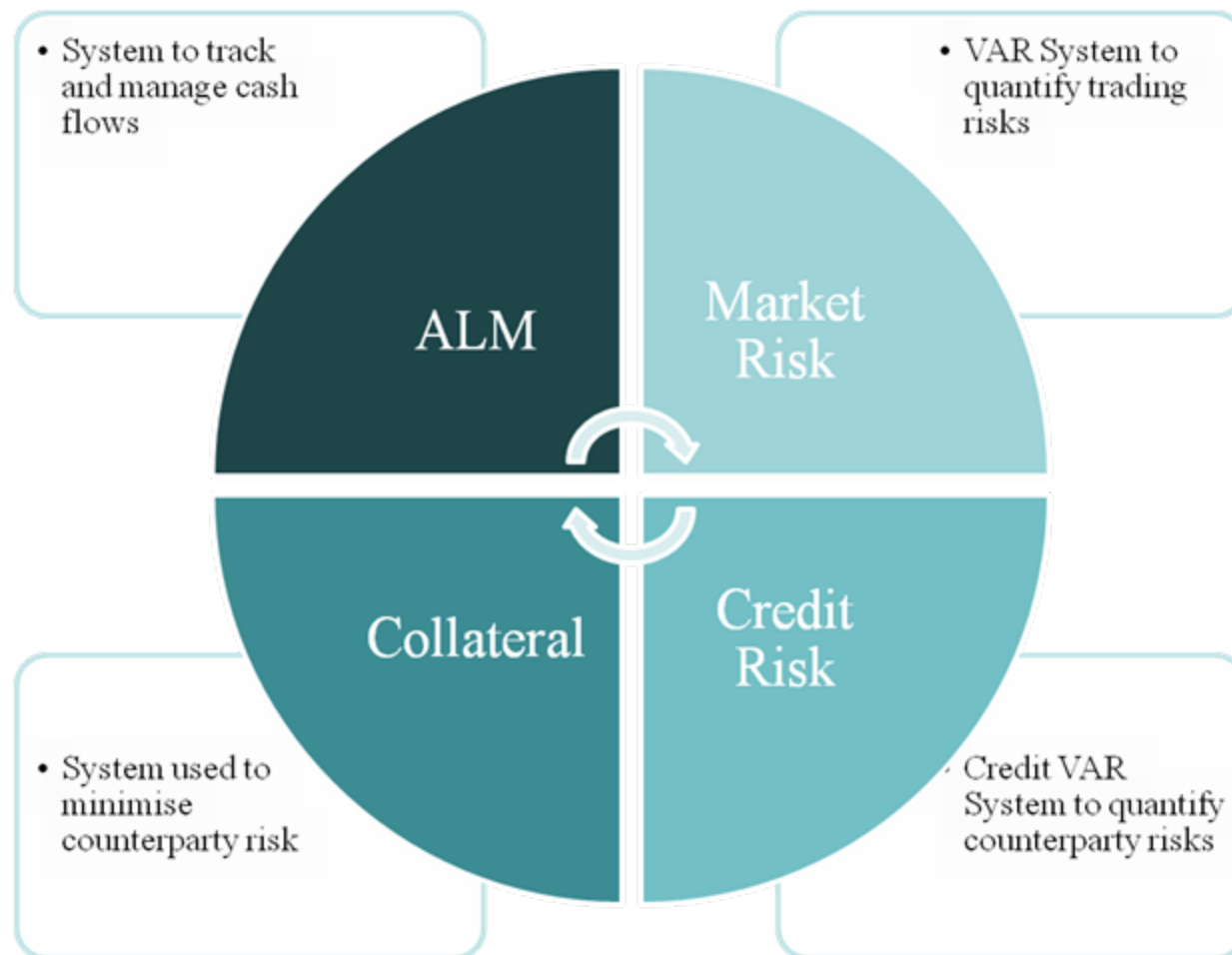


VAR Models

- *VAR Models: flawed, or just lousy implementation?*
 - ↪ *Lots of misinformation circulating*
 - ↪ *Too much academic focus versus workflow mgmt*
 - ↪ *Only a compliance process for many organisations*
 - ↪ *Increased use of multi-pass analysis to address pro-cyclicality*
- *Counterparty Risk: A new mantra (...again)?*
 - ↪ *More deals processed thru clearinghouses*
 - ↪ *Impetus for even more collateralisation*
- *Evolving integration of risk systems*



Example: Integrated Risk Systems





Securitisation

- **Originate-to-Distribute model**

- ↪ *No longer acceptable as a means to fund credit that an institution will not hold*
- ↪ *Market will require Originator to stand behind the risk and participate...*

- **Ratings and Rating Agencies**

- ↪ *Sector will become regulated*
- ↪ *Increased scrutiny of ratings by investors, banks, and regulators.*
- ↪ *“Investor Pays” rather than “Issuer Pays” model?*