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Technology commitment

Institutions prepare to comply with new regulatory directives

Asset managers with a long-term commitment to structured finance investments are coming under increased pressure to respond to recent regulatory directives relating to infrastructure. As internal credit analysis of issuer and loan data - alongside integration and monitoring of ratings - becomes the norm, technology is also having to step up.

"We are seeing a growing demand from financial institutions and investment managers looking to reduce the inefficiencies and risks associated with managing and integrating multiple databases and data sources for different structured finance deals," confirms Doug Long, evp business strategy at Principia Partners.

He adds: "Policymakers are making sure that organisations with long-term investment goals involving securitised assets have a robust operational framework in place to really understand their investments on an ongoing basis. That's not possible on spreadsheets and systems that aren't developed specifically to adapt to the dynamic requirements of structured finance."

Last month, the Financial Stability Board advisors to the G20 reiterated the importance of the Basel 2 Framework Enhancements to supervisors and regulators (SCI passim). Their address also highlighted IOSCO's recommendations on how to better inform and protect investors by 'including initial and ongoing information about underlying asset pool performance'.

The Basel 2 enhancements state that in order to qualify for the new risk weightings, institutions must be able to access performance information on the underlying pools on an ongoing basis, in a timely manner. Such information should include, as appropriate: exposure type; percentage of loans 30, 60 and 90 days past due; default rates; prepayment rates; and loans in foreclosure.

"Those investors that are committed to the ABS market have known since the onset of the crisis that regulation was going to come down hard and recent reports from Basel, IOSCO and the G20 have confirmed this," says Long. "Existing clients and participants we are currently speaking with see value in having a strong operational backbone to get a single view of their portfolios as they look to address the challenges highlighted by recent regulatory reports."

Long notes that while all aspects of data, such as loan-level data and performance metrics, have been available to investors in the past from various sources, the data is rarely consolidated into one engine that makes it consistent; from initial investment through to accounting. "Having a dedicated system that tracks and monitors all positions simultaneously gives investors the upper hand in spotting weaknesses in transactions and gives risk surveillance teams the ability to put controls and warnings in place as soon as possible," he adds.

Long continues: "Structured finance bonds feature a 'cliff risk' that doesn't necessarily feature in other fixed income assets. An ABS can move from triple-A to double-C very quickly. Although investors still value ratings - along with new metrics that the rating agencies offer - they now see the value in doing their own due diligence, stress testing and collateral tracking. In doing so, investors will be able to spot problems before rating downgrades occur."

Recent research on risk management practices published by the Senior Supervisors Group in the US highlights shortcomings in firms' management information system (MIS) infrastructure and in their ability to produce useful reports during the crisis. The document highlights the fact that better quality and more timely liquidity reporting is essential to effective management of liquidity and funding issues during a crisis.

In light of this, the research suggests that a number of firms are increasing their spending on infrastructure, improving their data and strengthening the quality and timeliness of their reporting. The importance of a resilient IT environment with sufficient processing capacity in periods of stress is also becoming increasingly evident, it says.

"Firms are constrained in their ability to effectively aggregate and monitor exposures across counterparties, businesses, risk strands and other dimensions because of ineffective information technology and supporting infrastructure," the report states.

Many firms, in their self-assessment submissions and in subsequent discussions with the Senior Supervisors Group, indicated that they are making considerable investments in risk management infrastructure. Many projects, however, are in the planning stages or in the infancy of execution, with significant work remaining.

One challenge to improving risk management systems has been poor integration resulting from multiple mergers and acquisitions, the report notes. One of the surveyed firms suggested that acquisitions over the years have produced an environment in which static data are largely disaggregated. Another firm echoed this view, reporting that certain products and lines of business have not been included in data aggregation and analysis processes.

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