

Client	The client is a leading financial institution with global footprint that boasts an extensive line-up of financial structured products in very specialised areas.
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Project Name	Economic Capital: Risk-based decision making and risk culture
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Project Start Date	January 2005	Project End Date	July 2005
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Industry	<input type="checkbox"/> Commercial banking	<input type="checkbox"/> Insurance
	<input checked="" type="checkbox"/> Investment banking	
	<input type="checkbox"/> Private banking	<input type="checkbox"/> Asset and wealth management
	<input type="checkbox"/> Retail banking	
		<input type="checkbox"/> Corporate

Category of Service	<input checked="" type="checkbox"/> Performance measurement and monitoring	<input type="checkbox"/> Regulatory compliance and reporting
	<input type="checkbox"/> Portfolio risk management	<input type="checkbox"/> Business process improvement
	<input type="checkbox"/> Specialised risks	<input type="checkbox"/> Training and people change
	<input type="checkbox"/> Data Quality	<input type="checkbox"/> System selection and implementation

The Challenge	<p>The Economic Capital (EC) project was initiated to embed a stronger risk culture throughout the institution reflected in a more robust risk-based decision-making process.</p> <p>The client sought to leverage the investment previously made in improving the reporting infrastructure to not only comply with the new Basel II requirements but also embed risk and Economic Capital consumption measures throughout the business. Formerly, the client had employed credit measures such as Risk Adjusted Return on Capital (RAROC) and Economic Value Added (EVA). However, to be aligned with the latest developments brought about by Basel II, the client required a more sophisticated and flexible portfolio credit risk application.</p> <p>The client investigated a number of solutions but found that none could deliver the requisite sophistication or specific calculation and enterprise-wide coverage. Senior management decided to build the application “in-house” with the assistance of advantage.</p>
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Approach and Solution	<p>avantage developed an approach to aid the design and development of the future platform. This approach ultimately included the preparation of detailed business and technical specifications. The objective of advantage’s proposed solution was to enable the provision of consistent and reliable information appropriate to each decision maker. Such information would allow the decision maker to take action within an overall risk appetite defined in terms of RAROC and EVA measures.</p> <p>The platform would be used to provide comparative figures with regulatory capital. The client would be able to calculate economic capital across all</p>
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	<p>portfolios and ensure that the amount of capital available is consistent with current and planned levels of activity. The platform would also define clear risk boundaries, enabling the effective management of risk profiles and aide business decisions. In commercial terms, the platform would facilitate an increase in the origination of more profitable business.</p> <p>Initial integration of the portfolio EC model, internal and external data sourcing and prototype build took just four months, allowing the first reports to be released to the senior management very quickly. Computation and data management processes were automated shortly after that, bringing the total implementation, validation and acceptance testing period to less than six months.</p> <p>The speed and success of the implementation contributed significantly to building credibility with the front office staff and senior management and boosted their confidence in Economic Capital as a management philosophy.</p>
<p>Results and Benefits</p>	<p>The clear, comprehensible and wide-reaching management reports produced by the platform illustrate the main benefit of the project. The reports are a key component of capital management and strategic portfolio planning. The client also uses the risk calculations provided by the application as a central part of its lending process. The model's results help decision making on loan issuance through risk pricing calculations by enabling the client to allocate Economic Capital to each transaction and use that information as part of the pricing model.</p>
<p>Software used</p>	<p>Not applicable.</p>