

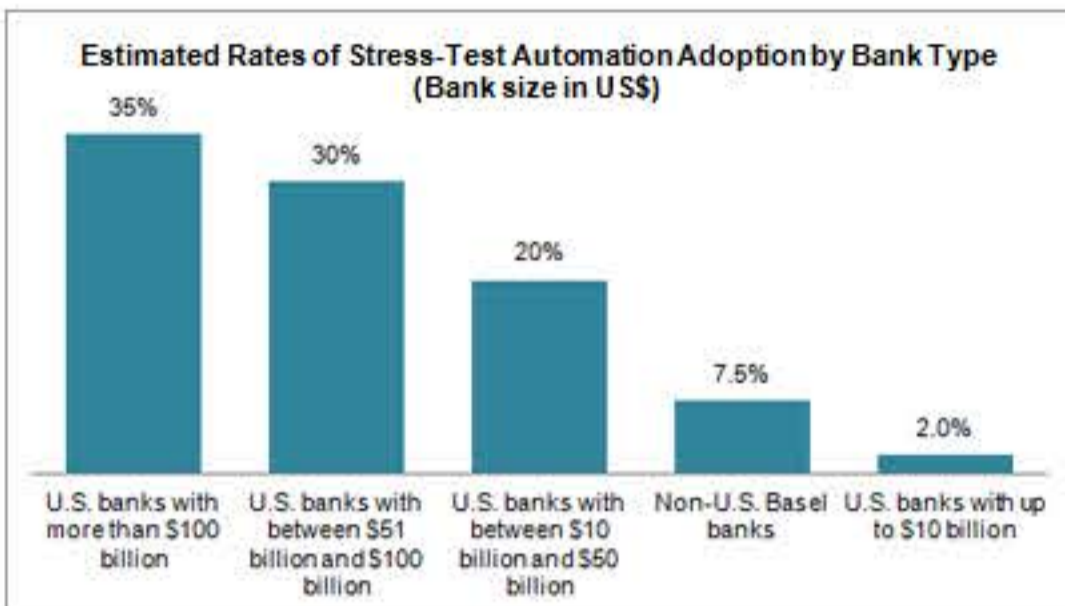
Stress Testing Solutions: The Supply and Demand

Significant numbers of banks are pursuing automation, Aite Group finds
Wednesday, October 02, 2013 , By Katherine Heires

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Growing numbers of banks – and not just the biggest ones – are seeking out automated systems, rather than depending on traditional, manual processes, in hopes of managing their stress testing requirements cost-effectively. As the regulatory burden spreads to institutions below the top tier (see “[Stress Testing and Technology Stress](#)”), so will demand for software products that a number of vendors are scrambling to deliver.

These are among the conclusions of “The Global Stress Test Automation Market: Stress, Uncertainty, and Moral Hazard,” a [report](#) released in September by Boston-based research and consulting firm Aite Group. The study by Aite senior analyst David O’Connell sets the current state of stress test automation as follows: 35% at banks with more than \$101 billion in assets; 30% at those between \$51 billion and \$100 billion; 20% at banks between \$10 billion and \$50 billion; and just 2% at those in the under-\$10 billion category.



Source: Aite Group

Stress test automation sales this year are estimated at \$32 million, rising to a peak of \$79 million in 2016. After that, with many of the requisite systems in place, the growth is expected to tail off.

To assess the market dynamics, Aite queried 10 global providers of stress test automation tools and held discussions with three major financial institutions in North America and Europe, all in the context of guidance provided by the U.S. Federal Reserve Board and the Basel Committee on Banking Supervision.

The stress test process involves pro forma analyses of financial institution performance under a variety of economic scenarios to determine the ability of an institution to survive financial catastrophes of varying severity. Although Basel III, the Dodd-Frank Act and other regulatory mandates are driving demand for systems and analytics, particularly at the biggest, systemically important banking companies, stress testing is also taking on strategic significance inside these institutions, serving as a vehicle for gaining deeper insights into business operations and risk profiles.

“Completing a stress test is no easy task,” writes O’Connell, who illustrated the 46-page report with comparison charts of vendors including Fiserv, IBM Corp., Oracle Corp. and SAS Institute. Done poorly and with insufficient automation, he says, a stress test effort can divert bank personnel away from revenue-generating lending functions to regulatory tasks.

But, if done effectively, with automated data extraction, scenario calculations and reporting, “a bank can cost-effectively comply with stress test regulations and even obtain risk-related analytical insights that can improve performance,” says O’Connell. He acknowledges, though, that smaller banks may seek merely to satisfy regulatory requirements and not need a high level of stress test automation.

Understand Goals First

O’Connell contends that banks, before embarking on the process, “need to ask, are they going to just comply, or go beyond compliance and achieve insights that will help them run the bank better?” The answer will determine their stress test roadmap and, in turn, their technology choices.

The roadmap will vary based on a bank’s size, complexity, growth expectations, areas of specialization, and how it aims to utilize the findings and outcomes of its stress testing.

In addition, says O’Connell, “they need to have very honest and difficult discussions with vendors about their data environment at the outset,” in view of the data-rich nature of the exercise. Will a product offering assist, or not, given a bank’s current data status? Is there compatibility between a vendor offering and tools currently in place – or not?

“Sometimes banks underestimate how enterprise-wide stress testing is, and how complex the data challenge may be,” O’Connell says.

Once a bank has charted its course, it needs to seek out vendors that can address their specific goals and needs. To a top-tier bank, for example, scenario automation, enterprise-wide tests, loan-level analysis, reverse stress tests, contingency planning and Monte Carlo analyses might all be considerations.

A comprehensive evaluation would include such questions as: To what degree does a new product leverage existing bank infrastructure? Can the vendor provide data to complement a bank’s existing data sets? Does the vendor provide consulting services related to scenario construction, the selection of scenarios to be presented to regulators, the construction of a bank’s capital plans, and the proper presentation of test results to regulators? What’s more, the computational speed of a given technology or platform should be considered.

Data Acquisition and Integration

The Aite report says vendors deliver value in two key ways: First, by automating labor-intensive tasks and reducing risks. Questions would therefore focus on data integration capabilities: automation of data acquisition, provision of external data sets and granularity of loan data.

Second, value is enhanced via analytical insight. Banks need to assess the degree to which a vendor can provide enterprise-wide analysis, contingency or strategic planning, so that if capital begins to erode, it can be addressed by such measures as asset sales and cancellation of capital distributions. Also, a bank’s actual risk profile can be compared to its intended one, along with an estimation of the impact of strategic changes such as acquisitions, divestitures and entry into new markets.

The good news, O’Connell says, is that “it’s a richly competitive environment out there, and banks can really obtain a lot for themselves by getting support and, frankly, cherry picking from the nine or ten very good vendors.” He suggests banks of all sizes are better off assessing at least five or six potential vendors, rather than just one or two.

O’Connell points out that a new and welcome offering in the stress test marketplace is a database of publicly held companies that can inform a bank’s assessments of privately held companies or assets.

He warns smaller and mid-tier banks, in particular, against dragging their feet. “Maybe they can wait a year, but not two years,” he says. If the Fed increases the scope of stress testing by just one factor, he adds, “The complexity of these tests will quickly scale up in a nonlinear way.”

Vendor Recognitions

The report concludes by conferring four vendor awards. A “Stop the Whales” award went to Numerix, which offers the ability to tap into a treasury desk’s book of records, identify risks and stress test them. “We have learned that a bank’s treasury department can operate sometimes as a de facto hedge fund, aka, the London Whale, and so ‘Stop the Whales’ reminds banks that they need to extend stress testing all the way to the treasury department,” O’Connell explains.

Oracle won the “One Stop Shopping” award for the breadth of its offering. “Oracle not only has every box checked in the Aite Group capability grid, it has the broadest offering of non-regulatory reporting assets such as interactive reports and dashboards, which enable improved analysis and management of risk,” O’Connell says.

IBM got the “Attention to Detail” award for including an application designed to provide a single view of a borrower based on data from such sources as loan accounting systems, core banking systems, financial statement-spreading systems and other data points. “IBM gets kudos for taking its scope of data acquisition and analysis all the way to the level of the lowly underwriter,” O’Connell asserts.

The fourth award, “Usability,” went to SAS for addressing stress test users’ need for speed. As O’Connell sees it, “although sometimes thought of as merely a shiny bright thing, speed plays an important role in stress tests. With speed comes more iterative and thoughtful analyses, and speed should therefore be on the list of vendor requirements for large banks seeking analytical outcomes from their stress test processes.”

Katherine Heires is a freelance business and technology journalist and founder of MediaKat llc. www.mediakat.com

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