UK Banks and their Loan Information Problems

Real Consulting Services Ltd & RT IT Consulting Ltd

Introduction

The pressure

UK Banks are under increasing pressure from a range of external stakeholders to clarify the real value and nature of their assets. This pressure is a response to economic events that thrust the banking sector under the spot light. There are many aspects of banking and its operations that complicate a Bank's reaction to this pressure. More often than not, this reaction is a tactical business intelligence initiative which is both manual and intensive.

The challenge

Responding to these new pressures, the Banks' objectives are to construct richer views of customer loans, assets and securities on their balance sheets as fast as realistically possible. These objectives will kick off new tactical initiatives.

In this document, we use two example pressures to bring this objective to life; Securitisation, and Asset Protection Scheme (APS).

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The Examples

The Securitisation Pressure

Drivers	• A UK bank wanted to reduce RWAs* associated with their property loans in order to be able to sell property loans to customers looking to gain (more) exposure in this asset class • To do some learning about Securitisation as a means of supporting a wider programme of securitisation across the bank.
Objectives	• Identify data & documentation requirements for securitising property assets • Consider changes to existing processes, systems & organisational structures • Reduce property loan related RWAs • Establish market confidence in the RWAs associated with these property loans.
External stakeholder(s)	• Credit rating agencies, investors.
Example information that stakeholder(s) wanted	• 1st drawdown date – this refers to the date fixed by the lender at which the loan was available for use • Balance details • Granular amortisation data at an individual loan level – the gradual reduction of the value of the asset or liability by some periodic amount.
Challenges	• Frequent changes to the scope and scale of the initiative meant that the amount and scope of data held was much more than was required to fulfil the scope at any given point in time. Eventually, the scope was limited to the range of loans for which there was a good level of data at Connection, Legal Entity, Facility, Security and Property levels • Cleansing and consolidating data (in a variety of formats) for the purpose of external and internal disclosures

	• Satisfying and responding to the increasing information requirements from credit rating agencies (in relation to data accuracy & completeness) • Accuracy & completeness of data sent to external/internal stakeholder(s).

*RWAs or Risk Weighted Assets represent the minimum capital that is required within banks and other institutions, based on a percentage of the assets, weighted by risk.

The Asset Protection Scheme (APS) Pressure

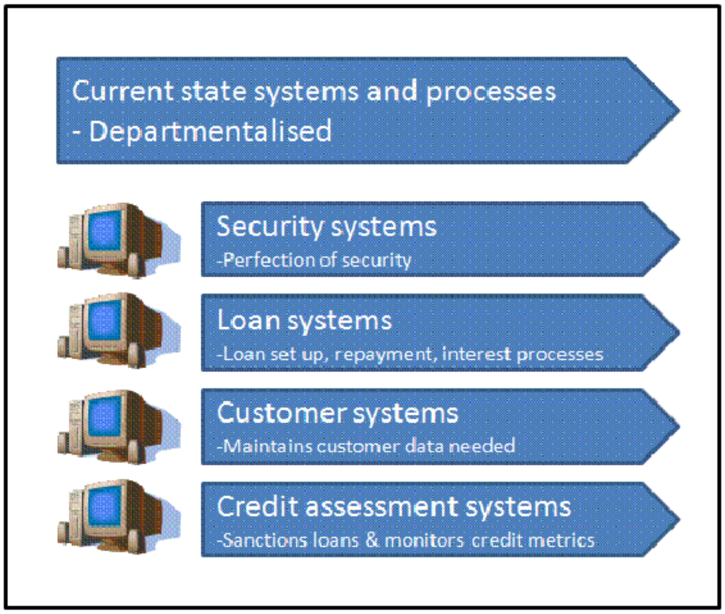
Drivers	• The need for the UK government to underwrite major UK banks in order to maintain a viable banking sector.
Objectives	• Allow UK banks to insure a range of assets with the government in order that people feel more secure about the banking sector • Attain protection against stressed losses through the economic cycle • Enhance the capacity to extend new lending in the UK.
External stakeholder(s)	• HM Treasury, European Commission, FSA, UKFI, Shareholders.
Example information that stakeholder(s) wanted	The list of assets covered in the scheme as well as details of: • 1st drawdown date – this refers to the date fixed by the lender at which the loan is available for use • The asset type • Ongoing losses (the difference between the amount covered in the scheme and the outstanding amount) • Recoveries (any amount paid back) • Risk parameters (such as the Probability to Default, and Loss Given Default).
Challenges	• Timescales and requirements were driven more publicly by external stakeholders • The involvement of the

	government/government bodies required much more transparency for the internal projects and communication about them • The rights and expectations of the external stakeholders were a lot more significant than comparable initiatives (such as the aforementioned securitisation initiative).

What are the Core Issues?

The disconnect between what Banks need to do and what they can do is the greatest hurdle to a satisfactory relationship with external stakeholders.

The production of views of customer information was never the focus of Banks as external stakeholders were virtually nonexistent. In the past, the systems and processes were more oriented around day to day operational banking. Secondly, the diagram below outlines that the internal banking operating model is heavily departmentalised. This does not lend to itself nicely to a single view of customers, loans, assets and securities information.



The data is poor because the data entered is currently only required to support the business process. For example, a loan backed by property would have data needed calculate the interest in a loan systems and the current balance outstanding. A security system would keep details of the address of the property, date of property valuation and the nominal value at the time in order to track the perfection of the security process. The Credit sanction system would maintain credit grades for the customer whilst the customer system would have more detail on things like Name, Address (held for customer communication processes).

However the data needed for external stakeholders is much richer than that needed for each of the bank internal processes. An external stakeholder may need information about the security (property in this case; such as the number of bedrooms, purpose built or conversion, post code or GPS reference, which is not recorded on any of the systems).

Conversely some data is common to all systems (such as customer address) but maybe different on each of the systems for different process reasons. For example, the customer is temporarily living abroad so for communications purposes the address in the customer communication database is an overseas address. These inconsistencies create real problems when trying to produce a clean view to external stakeholders.

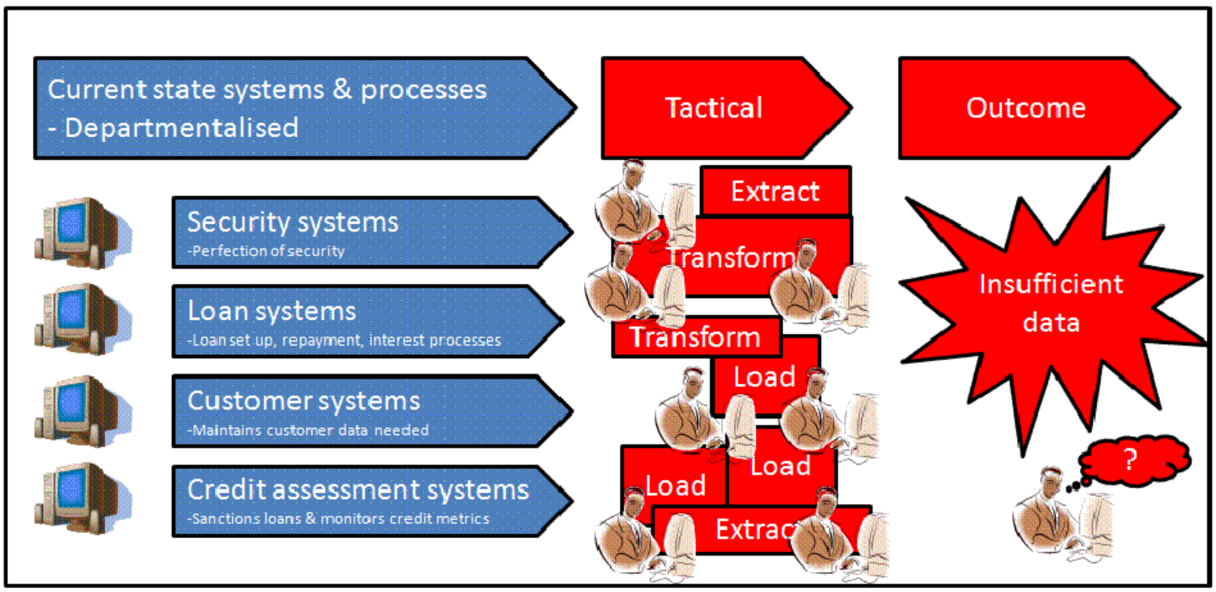
A single view of this information would require consolidation across a range of operational, finance & risk systems, paper records and other manual sources. This suggests the need for an information culture shift transitioning from a focus on operational banking to business intelligence.

How Have Banks Reacted So Far?

Trend

Good information about loans, assets and securities on bank balance sheets is naturally a pre-requisite to the transfer of distressed assets away from UK Banks in to the Asset Protection scheme (or for American Banks the equivalent is the TARP). This was also the case for Securitisation initiatives where the Banks wanted to sell off securitised assets and as a result they needed to provide accurate information towards the production of RWAs and LTV ratios. In both of the examples cited above, the initiatives started out as single projects which then became a program with multiple projects.

Thus, tactical approaches are developed in order fulfill this objective of more information. As the diagram below portrays, this tactical approach is reliant on a significant amount of manual data activities with data from a myriad of information sources, processes and paper trails.



Often these “mandatory business intelligence projects” are initiated as a means of fulfilling tight timescales. And, it is interesting that these initiatives have some commonalities (common similarities) such as the steps undertaken and the inherent extension of information requirements.

Commonalities

Firstly, it is possible to notice a pattern with every business intelligence initiative in so far as the current state always fails to satisfy information requirements. As a result, there is a need to improve the current state so that right answers are achieved. There are 5 key project phases to consider;

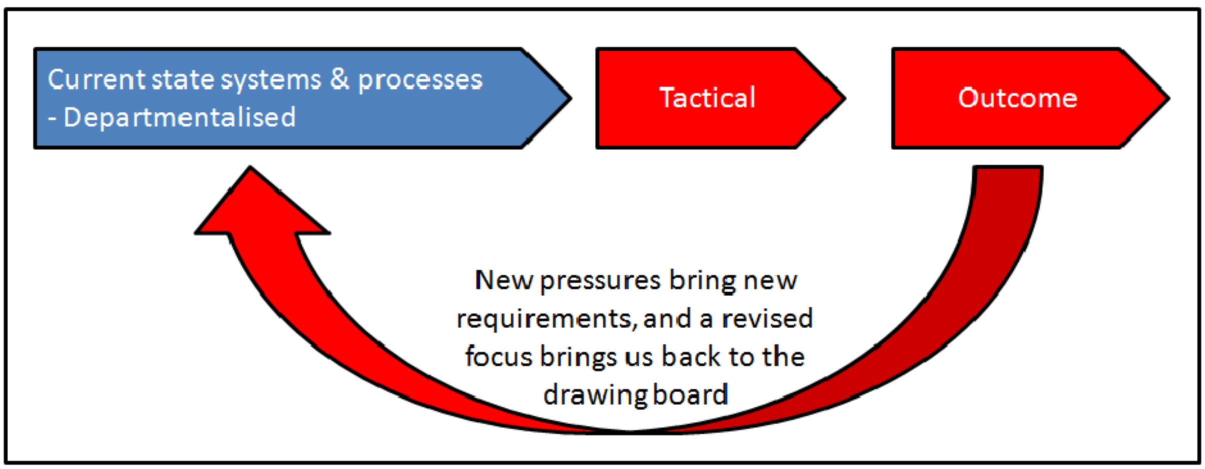
1. External stakeholder requirements

2. Current state gap analysis, data quality and availability assessments
3. Re-negotiation with the external stakeholder re 1. & 2.
4. Temporary remedial (& rarely long lasting) activities on data quality and availability
5. Final data collation and submission to external stakeholders.

However, another common aspect is the extension of requirements. By giving information to external stakeholders, they generally come up with further questions. In this sense, external stakeholders ask further questions in order to try to understand the information received or clarify the accuracy of the data.

Recurring Pattern

As depicted in the diagram below, it is inevitable that further data requirements arise from these initiatives. This means that the process of reviewing and improving the current state, in order to fulfill information requirements, is started again. This represents a recurring pattern.



Surely, Banks can find a better way of responding to these pressures from external stakeholders.

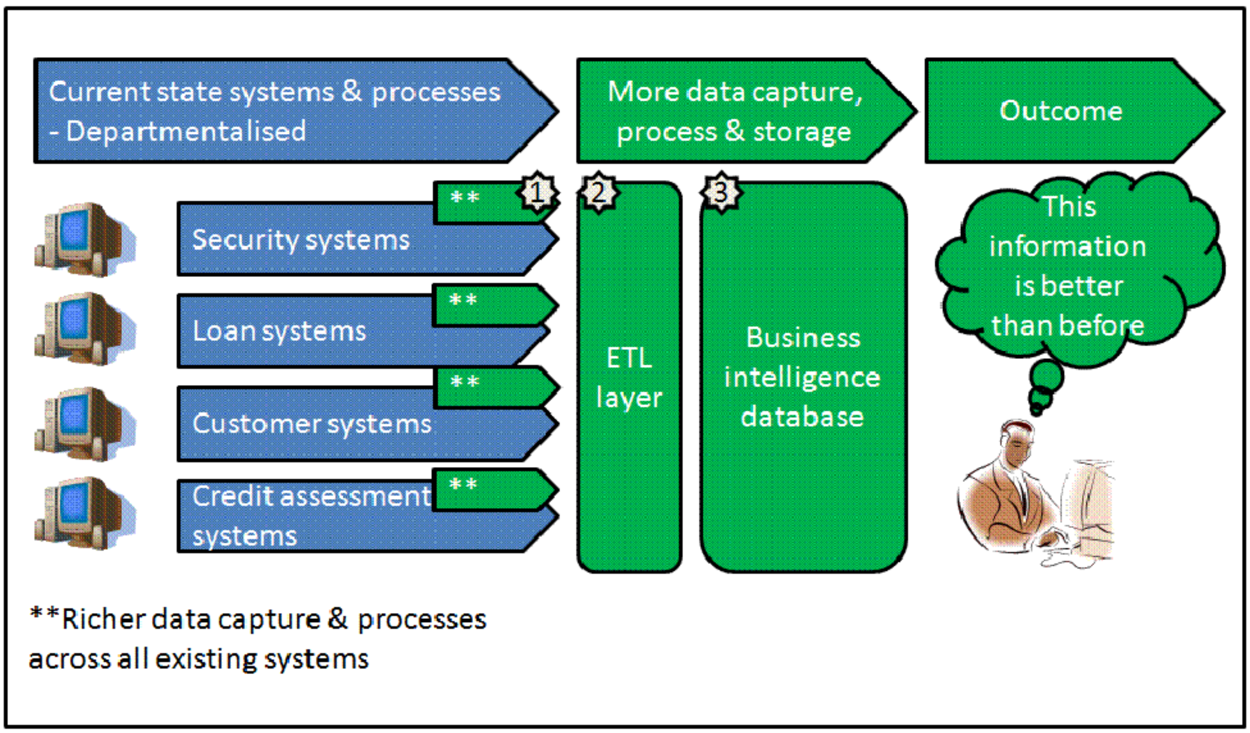
A Better Way?

If there is a better way, why haven't Banks put a more strategic approach in place? Equally, does management want to break this recurring pattern?

Of course, the banks internal processes will still have to work. As an example, interest will have to be collected as well as paid daily, and security will still need to be perfected, revalued and released and so on. But is there that much "conflict" between slick operational processes and rich data entry & maintenance?

However, it is also true that the management does need to commit to a strategic approach. This will serve to reduce the damage of this "recurring pattern" and escape the never ending gauntlet of tactical business intelligence initiatives.

The better way would rely on richer data capture, which is paralleled with the normal operational processes. As per the diagram below, this richer base of data would need to be processed and consolidated through an ETL layer for storage in a "business intelligence database".



In the diagram above, the three new elements of the better way are tagged with numbered stars;

1. New data capture and processes
2. ETL layer
3. Business intelligence database

By overlaying existing processes and systems with new data capture and process, the bank is empowered with a more sophisticated way of processing, storing and extracting business intelligence.

This would reap the benefits of meeting external information expectations whilst reducing the labour and manual intensive nature of tactical business intelligence initiatives.

In conclusion, this paper argues for management commitment to a strategic business intelligence approach because the needs and rights of stakeholders are only going to grow.