

Inside Reference Data

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Data Quality: The Forgotten Risk

While investment in efficient risk management systems is rocketing, the data feeding the systems is often overlooked. Firms simply forget that best-of-breed risk management systems rely on good quality data.

Carla Mangado examines the impact of faulty data on risk calculations

Risk management was voted the top priority of senior financial executives in an informal poll taken at the 2008 Sybase Executive Summit held in New York in May. Data quality, however, traditionally comes quite low on managers' tick sheets. And yet good quality data is essential for efficient risk management systems.

Reference data professionals have been trying to convey this message to senior management for several decades, but it seems they are finally starting to be heard. At the North American Financial Information Summit in New York, end-

much greater challenge than expected—and few want to take ownership of it.

Some professionals assume data is always something someone else should deal with—they assume other people ensure it is good quality. New York-based Neil Edelstein, vice-president, product solutions at enterprise data management software vendor GoldenSource says: "Historically, data has always been regarded as someone else's problem."

And even if data management professionals stress the need to focus on data and the negative impact poor data can have within organiza-

calculations and inaccurate risk reports. These facts must be highlighted to the industry. "People dealing with risk management systems are not thinking about the data...it is something that requires more prominence," says Sentance. And despite the link between data and risk management when it comes to data quality, the gap between the two seems immense.

But the industry is trying to move forward, and hopefully data will start moving to the fore. "Everybody is looking for the risk measure, for the output of the risk system, but I think there is a growing realization that the output is only going to be as good as the input," says GoldenSource's Edelstein.

"Since data has always been a step-child within the investment community, it stands to reason that now that risk is becoming such an important factor for both the asset management and the institutional side, there is a growing need to look at data quality," says Edelstein. "Data is the forgotten element, but more importantly, the realization that it is the essential element is growing," he says.

Lack of support from senior management, however, remains a persistent issue. Even if the data issue has now been brought out of the back office and into the front office, Allan Grody, president of Financial Intergroup Advisors, emeritus adjunct professor, risk management systems, Leonard N Stern Graduate School of business NYU, says



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Brian Sentance, Xenomorph

users said more people are starting to say 'hi' to them in the elevator in the morning. The industry is becoming increasingly aware of the negative impact of faulty data, and more firms are beginning to realize that poor data is the root cause of many of the issues highlighted by the recent market turmoil. But a 'hi' is not enough. The problem of poor data may result in a

tion, the quality of data is often taken for granted. London-based Brian Sentance, chief executive at data management system provider Xenomorph, says data management often comes second place in risk managers' minds. "Often data is regarded as a magical area where everything sorts itself out," he says.

Poor quality data will inevitably lead to poor decision-making, incorrect

some CEOs do not yet entirely appreciate the great impact data can have throughout institutions.

Still, there is not always awareness of the fact that faulty data feeding risk management systems is a problem. If risk management reports are being produced and the systems are on budget, data inaccuracies will not easily be noticed. "As far as senior management is concerned, they are getting their risk reports, so what is the problem?" says Sentance.

So data quality and transparency are still issues the risk world needs to overcome. "There is a differentiation between quality of data and completeness of data, and recently issues have had to do more with the completeness or disclosure and transparency through the risk systems," says Edelstein.

But even if the threat is genuine, the risk world is not thinking about data inaccuracies enough. And the assumption and expectation that the data being used is fit for purpose is not facilitating change. Edelstein says professionals often do not think about where their data came from but instead just focus on their part of the deal. "Asset managers, for example, expect to have high-quality data in front of them and the correct attributes concerning the securities that will be traded," he comments.

The data problem might therefore only be noticed once the scale of the issue represents a much bigger challenge to overcome. "Data is fundamentally the problem. It has been for a long time, and it has been so pervasive that people have not been able to deal with it, forgot about it and moved on and built houses on top of unsupportable foundations," says Grody.

Sentance says one of the scenarios in which the data issue becomes clear is when firms start to report losses. "When losses occur, especially in turbulent times in the market, it becomes apparent that some of the assumptions and some of the data that was used was inappropriate or not as high quality as it should have been," he says.

Grody says firms must realize that to solve risk management issues, the data problem must be dealt with. "Many will

treat the symptoms rather than the real cause," he says. Insurmountable circumstances must be avoided, but this will be complex if there is a need for a disastrous event to occur to take action.

Sentance does note though that some financial institutions are looking ahead and dealing with the data issue before regulators step in and losses occur. "Clients are taking a pro-active response to these challenges and some are in a good position to deal with the regulators... looking at better and automated ways of managing market data, more complex securities and managing all the terms and conditions data that go alongside," he says.

Inevitably, though, if other firms remain with their heads in the sand, regulators will have to step in, and the spotlight

will fall on the data. "Regulators may assess that risk management systems models are good but the data going into the systems is not fit for purpose, leading to bad decisions, and bad reporting, making the actual approval process and the whole reduction in capital requirements, which a lot of the banks and institutions are aspiring to, more difficult to achieve," says Sentance.

Grody says "there are very few people who both have the power and the prestige and the understanding of the detail of the internality of the problem". Yet, he thinks the debate is certainly starting to gain momentum, and those with the

ability to make changes are also raising their concerns. In fact, in March, US Secretary Henry Paulson remarked in his Blueprint for Regulatory Reform that the real problems in the financial industry must be solved at the root level, while the regulatory system seems to focus the efforts above the ground—what he referred to as tree level. The intertwined nature of financial institutions means it would be beneficial to solve some issues centrally, according to the report.

So with organizations looking forward, regulators pressing for change and increasing awareness of the data issue, reference data may soon start to share some of the spotlight with the risk division. The data debate is bound to develop. Edelstein says usually there is a need for a compelling event to draw people to make change. And recent credit events and other headline-grabbing incidents could certainly be described as compelling. It is now up to the reference data managers to get the conversations going.

