ENTERPRISE RISK ASSESSMENT, MEASUREMENT, & MANAGEMENT FOR INFORMATION PROFESSIONALS

CASE WORKSHEET FORMAT: CHASE MANHATTAN CASE

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| **STUDENT NAME: Rutwik Ghag** | **CASE NAME: Chase Manhattan** |

Fill this out BEFORE trying to complete the discussions. These cases present information throughout the chapter. If you try to answer questions as you read, you will miss many of the important facts presented later in the case and may have problems presenting your information in an insightful manner. The discussion forum may be helpful.

1. **As an industry, what are some of the unique terms or other aspects that were new to you?**

The Banking industry is a huge one, as we all know, the banks run the world’s economy. There were a handful of terms that were new to me. These were:

* Shareholder Value Added (SVA)
* Value Added Risk (VAR)
* Stress Tests
* Credit Risks
* Market Risks
* Operating Risks

By going through this reading, I have a good idea of what each of these terms means which is essential for a student like me with a STEM background trying to dwell into the Management sector.

1. **After reading the case, what do you feel are the *most important facts about* the company’s business, markets, and/or history that influenced the firm’s RISK culture? WHY are these important?**

Reading the case made me feel that the most important facts that influenced the firm’s Risk culture were as follows:

* Three major banking companies that merged in the 1990s to form the present-day Chase Manhattan
* The banking companies that merged were themselves the products of scores of smaller mergers over almost 200 years.
* Over the years, they pioneered many of the innovations in financial services like check endorsements, bank credit departments, check-clearing houses, ATMs, and home electronic banking.

Chase believes in the policy of diversification and control. Chase split its overall risk into three basic components: market risk, credit risk, and operating risk by diversifying their income portfolio to maximize their profit. Chase has assets worth more than 2 trillion USD today. This has been a distinguishing factor throughout the years, making Chase a pioneer in terms of investment banking.

1. **Why did Chase Manhattan feel they needed to engage in Enterprise Risk Management? How did they manage the transition, i.e. who championed the initiative? What other key tactics did they utilize? Do you feel that they would have been more or less successful if they had done it differently?**

Chase Manhattan felt the need to engage in Enterprise Risk management as according to what Marc Shapiro says “We see the fear of higher interest rates driving down stock prices across all financial companies. And yet the way we manage our company today, we’re indifferent to which way interest rates move. We can make money in a rising environment or in a falling environment. We think a balanced bank is the right answer because it provides a diversification you have to have, as long as you have leadership in each of your businesses. The key to reducing risk is to have diversification across your businesses and have leadership positions.” These initiatives were implied to be championed by Marc Shapiro. The key tactics utilized were diversification and control. I do think they would have been less successful had they done things differently as they implemented their tactics at the right time. Capitalization is done by not missing a single opportunity.

1. **Describe how the company structured their ERM governance? Why do you think Chase structures their ERM the way they did? For example, why not have a single** **Risk Management Department and a Chief Risk Office (CRO)? Did they radically change their approach or build on their past approaches? Is there anything unusual about their approach?**

Chase structured their ERM governance by splitting its overall risk into three basic components: market risk, credit risk, and operating risk. Market risk is the risk of losing money because the market price of an asset or a rate changes unfavorably and possibly unpredictable. Credit risk is the risk of loss because a counterparty to a contract does not perform, such as when a customer defaults on a loan. This is the type of risk most closely associated with the traditional banking function of loaning money and collecting principal and interest. Operating risk is the “risk of loss due to fraud by employees or outsiders, unauthorized transactions by employees, and errors relating to computer and telecommunications systems.” Chase structures their ERM the way they did and do not have a single Risk Management Department and a Chief Risk Office (CRO) as they believe in the policy of diversification and control. They built on their past approaches while making important changes along the way for example they introduced the concept of Shareholder Value Added (SVA) in their business model. Yes, there were some things that were unusual about their approach such as transferring much of the risk to other institutions via syndication, but this eventually worked out to them, as is evident from their success today.

1. **What were some of the company’s biggest challenges in making the transition from their old approach to dealing with risk to the new focus on an Enterprise view of Risk Management? Why were these challenges for their firm? Do you think every company would face these same challenges? Why or Why not?**

Some of the company’s biggest challenges in making the transition from their old approach to dealing with risks were caused by the introduction of Shareholder Value Added. These were challenges for their firm as [1] “there were some problems in the company because people didn’t trust the financial systems, so they were all making up their own standards by which they ought to be judged and adjusting the numbers”. Marc Shapiro was worried that assets were growing too fast, and people weren’t making trade-offs. Another challenge was the management of Operating Risks. This was problematic as [1] “A lot of operating risk is so random that it’s hard to develop models that are reasonable predictors.”

1. **Using the Risk/Measurement/Management table from the worksheet, identify five risks with their measurement and management approaches.**

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| **Risk (definition and example; Be specific)** | **Measurement Strategies** | **Management Strategies** |
| Credit risk is the risk of loss because a counterparty to a contract does not perform, such as when a customer defaults on a loan. This is the type of risk most closely associated with the traditional banking function of loaning money and collecting principal and interest. | Transferring capital  Shareholder value added | •Establishes policies for credit risk management, including limits for country, product, industry, and single obligor exposure |
| Market risk is the risk of losing money because the market price of an asset or a rate changes unfavorably. For example, suppose Chase holds a short position in French francs and the price of the franc increases.1 | Nonstatistical risk- Nonstatistical risk measures include net open positions, basis point values, option sensitivities, position concentrations and position turnover  Value at Risk- VAR is a measure of the dollar amount of potential loss from adverse market moves in an everyday market environment  Stress Test- Portfolio stress testing is integral to the market risk management process and is co-equal with, and complementary to, VAR as a risk measurement and control tool | Establishes policies for market risk management, including market risk limits for all trading, investment securities, and balance sheet activities |
| Operating risk is the “risk of loss due to fraud by employees or outsiders, unauthorized transactions by employees, and errors relating to computer and telecommunications systems.”11 To a large extent, it results from deficiencies in internal control systems. For example, Christopher Goggins, a trader in the foreign exchange and interest rate markets, reportedly overstated the value of his foreign exchange forwards positions by some $60 million over a period of about a year | Transactional Volumes  Error Impact | Authorized to review the design of the control function within Chase |
| Capital Risks- Risk when assets increase rapidly. Eg when assets increase associated risks increase | Volume | Establishes capital and liquidity policie |
| Fiduiciary Risks-Risk when funds are not used for intended purposes.  Eg-When money is not properly accounted for | Auditing | Responsible for approving Chase’s policies for fiduciary risk |

1. **What are two roles that Information and Communication Technologies (ICT’s) played in the ERM approach at Chase Manhattan? Are these transferrable approaches to other companies or unique to Chase?**

The two roles Information and Communication Technologies played in the ERM approach at Chase Manhattan are: - [1] Information systems produce reports, containing operational, financial, and compliance-related information that makes it possible to run and control the business. They deal not only with internally generated data, but also information about external events, activities, and conditions necessary to informed business decision-making and external reporting. [1] Effective communication also must occur in a broader sense, flowing down, across, and up the organization. All personnel must receive a clear message from senior management that control responsibilities must be taken seriously. They must understand their own role in the internal control system, as well as how individual activities relate to the work of others. They must have a means of communicating with external parties, such as customers, suppliers, regulators, and shareholders

1. **How does Chase explain** **the contingency planning or disaster recovery strategies as part of their overall ERM approach?**

Chase explains the contingency planning or disaster recovery strategies as part of their overall ERM approach by integrating a Corrective Action Plan (CAP) which states all the risk assessments taken by the department. The CAP includes: -

-Self-assessment reference

-Existing Deficiency

-Corrective Action

-Accountable Personnel

-High/Low Risk

-Targeted Deadline

This helps chase deal with unforeseen situation and minimize losses as much as possible.

1. **What does the company feel are the main benefits of ERM for their firm? Do you agree?**

The company feels the main benefits of ERM for their firm are: -

[1]

-achieve its performance and profitability targets, and prevent loss of resources.

- provide reasonable assurances as to reliable financial reporting;

-provide reasonable assurances as to compliance with laws and regulations;

-avoid damage to its reputation and other consequences

Yes, I agree with what the company feels are the main benefits of ERM for their firm.

1. **What do you think are the two *most important lesson*(s) to be learned from this firm’s experiences with Enterprise Risk Management? It may help to consider what surprised you most about this case and why. Be SPECIFIC.**

The two most important lessons to be learned from this firm’s experience is the policy of:-

1)Diversification and Control- Diversification of assets centered around securities, investments, and syndication. And the quality and institutionalization of the controls at the micro-level.

2) Quantifying Operating and the management of Operating Risks. This was problematic as [1] “A lot of operating risks is so random that it’s hard to develop models that are reasonable predictors”. This is important as [1] “Operating risk affects a manager’s SVA calculation just as market and credit risks do, but not surprisingly, the methodology is not nearly as advanced”.

What was surprising to me was how chase reduced credit risks by Transferring much of the risk to other institutions via syndication. This was done as to[1]” Retain less of the outstanding loan because it reduces the capital charge and ensures that loan pricing includes a sufficient premium for risk because riskier loans will be charged higher risk-adjusted capital.”

References:

### [1] Making Enterprise Risk Management Pay Off (Barton et all, 2002)