# WHO WILL ACT UPON THE RISK OF ANOTHER FINANCIAL MELTDOWN?

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In their testimony to the U.S. Financial Crisis Inquiry Commission, various executives from Citigroup described how flawed risk assessments involving over USD 40 billion in complex securities triggered a global crisis. ***How could such a large pool of complex financial assets bear virtually "no risk"?*** What would make sophisticated investors believe that a financial conglomerate could offer billion-dollar investments with attractive returns backed by purported "no risk" assets? Executives are quick to blame an unexpected and unprecedented combination of market factors that turned supposedly top-quality (super-senior) tranches of residential mortgage backed securities into almost worthless derivatives.

Going forward, discerning investors could use a bit of business intuition: Premium yields may have hidden risks attached. Of course, many parties along the risk management chain should do a better job at analyzing systemic interdependencies and evaluating possible albeit unprecedented scenarios. For example rating agencies and risk managers should ensure that their risk models encompass, and are sensitive to, all relevant internal and external information. ***Most importantly, Boards of Directors should have the wherewithal to question and challenge the credit worthiness of massive asset pools.***

Why should Boards and regulators bother? Will a similar subprime meltdown happen again? Should they focus on solving the apparent issues that led to the past crisis? Leaders must also understand the underlying and unresolved causes that still haunt the safety and soundness of the financial system.

As business dynamics and financial flows evolve dynamically and globally, new risks and opportunities will continue to unfold. Boards have a fundamental responsibility to all stakeholders to set strategic direction. Corporate directors, in concert with an independent and robust risk management function, must understand those trends that might affect their companies in new and unforeseen ways.

Improved capital adequacy and transparency will help in containing future excesses. To achieve systemic stability however, Boards should sponsor a comprehensive approach with sound risk management principles at all levels. Besides staying on top of the pace of innovation in businesses and financial markets globally, regulators and senior risk managers must instill a higher sense of awareness and responsibility throughout the system. Such systemic approach should link all the interconnected parties and business units vis-à-vis the various credit, liquidity, market, and operational risk types involved.

When it comes to strategic risk management, corporate directors should stop being blindfolded. Together with senior leadership teams and risk officers, Boards must find a way to grasp advanced scenario modeling and stress testing techniques. Modern information technologies have the ability to orchestrate a fuller picture of plausible risks and outcomes across products, geographies and business counterparts. ***Strategic analyses will spark good business judgment and help Boards to spot possible points of failure, risk sensitivities, and concentrated exposures.*** As the future of the entire financial system is at stake, companies must break out from the constraints of legacy systems and provide relevant risk management information to their leadership suite and regulators.

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