UBS loses hundreds of millions in a failed risk management project

After the "A-Risk" project failed, UBS risk control aggregates risks using an excel patchwork. Recently, the investment bank has been inadvertently running open risks stemming from unhedged trading positions with CHF 500m loss potential.

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UBS's top management is now being grilled by the British parliamentary commission for constantly failing to get risks under control, as demonstrated by several catastrophic and reputation-wrecking scandals: the gigantic $40 billion suprime loss, the tax-evasion scheme perpetrated in the USA, the Adoboli fraud and the Libor manipulation.

The line of defense of the UBS managers is always based on the same answer: "we did not know". In reality, UBS's top management has always been aware of the deficiencies in risk control.

For instance, Walter Stuerzinger and Philip Lofts, the former and the current Chief Risk Officer, were already warned in 2002 by two risk specialists ("The crisis at the heart of UBS", published in "The Sunday Telegraph" on 6 July 2008) of the Zurich head office with extensive experience at main trading centers that the bank was building-up an unacceptably large risk concentration in the US structured credit sector (including subprime) and that the risk management approach was flawed and incapable to capture and hence adequately measure the true loss potential of these exposures.

After the subprime losses UBS declared that it had changed its approach and had become particularly risk-averse. However the reality was different: as history shows, UBS did never turn the corner and has remained one of the most aggressive investment banks.

The recent failure of the "A Risk" project is further evidence for this statement and it also shows that the integrity and the solidity of the risk control infrastructure is still not a top priority of top management. The "A Risk" initiative was supposed to deliver a state-of-the art and innovative risk monitoring infrastructure and it should have allowed top management to have a global view of all the risks of the bank.

After 5 years development and the spending of several hundred million Swiss Francs, "A Risk" does not run as expected and, according to an insider source, is in a "catastrophic status" and has failed to deliver: the various trading desks of the bank still run on different IT infrastructures and the various risks have to be collected from "different databases" and aggregated using Excel spreadsheets with several manual interventions. These are clearly very prone to operational errors.

Not very surprisingly, given UBS track record in dealing with risk control failures, the people directly responsible for this failure are still employed by UBS and hold highly paid positions. Among these are teh above mentioned Walter Stuerzinger and Philip Lofts, the former and the current Chief Risk Officer. But also at the next hierarchical level no major consequences seem to have been taken:

Galo Guerra, who graduated at the Sloan School of Management of MIT and was leading the “A Risk” project is still on the payroll of UBS;

Pieter Klaassen, also graduated at the same school, according to the insider source has been removed from his position as “Head of firm-wide risk aggregation” apparently because of his lacking leadership skills. However, on LinkedIn he appears to still hold the same position;

Darryll Hendricks, who holds a PhD from Harvard, was in charge of the “Risk Methodology” function of the investment bank and was therefore at least partly responsible for the correct representation of the risks. He is still with the bank and has the position of “Head of Strategy” of the investment bank;

Tom Daula, who was till the crash of 2008 the Chief Risk Officer of the investment bank and had good prospects of becoming Chief Risk Officer of the bank, changed internally and is now apparently the head of global research and analytics.

While highly paid top shots have succeeded to stay on board, many employees in the back office function are being axed due to the fact that the bank has decided to reduce the investment banking activities.

However, good specialists in this area are urgently needed. According to the insider source, in late summer 2011 the Swiss investment banking unit in Opfikon executed a very large transaction in Korean Won. However, the Treasury department that is in charge of managing the balance sheet and hedging the positions forgot to execute the hedge.

As a result, the position bearing a 500 million loss potential remained open for several months. As this failure was discovered, UBS started an investigation in which also Finma (Swiss regulator) was involved. However, no consequences at personnel level have been taken.

A UBS press spokesman refused to comment this event.

Further remarks linked to this story on http://www.nakedcapitalism.com/2013/01/ubs-risk-management-fiasco-illustrates-hidden-big-bank-it-time-bombs.html