

Risk

The *Risk* 20 awards

When we conceived the idea of the *Risk* 20 awards, our aim was to recognise those institutions that have helped drive the development of the derivatives market over the past two decades – those responsible for the birth of the markets and at the forefront of innovation. We very quickly came up against a major problem: few of the banks that really helped get the market off the ground in those early years are still around. Bankers Trust, Chemical Bank, Salomon Brothers and Security Pacific are just four that immediately spring to mind. But there was something else: very few institutions had gone through the 20 years without some form of blow-up, loss or crisis. Bankers Trust, for instance, was an undisputed leader and innovator in the derivatives markets in the 1980s, but its reputation will always be sullied by the allegations of mis-selling by Procter & Gamble and Gibson Greetings.

Was there a way we could recognise the contributions of the early pioneers, those who had dreamed up so many of the products still traded today and done so much to get the infrastructure of the markets in place, but also recognise those firms that have taken the market on to the next level and have been consistently strong over the past decade?

We decided to split the awards into two: the pioneers and modern greats. The pioneers are those institutions that led the development of their respective derivatives markets. They were the early innovators, were instrumental in the development

of the first derivatives products, and helped set up the framework and infrastructure for their markets. In many cases, the early innovators no longer exist.

The modern greats are those firms that have taken the market to the next level by developing second- or third-generation products. These are the firms that may or may not have been in the early wave of innovators, but which have shown thought leadership, innovation, trading savvy, commitment and good client service over the past five to 10 years.

We also wanted to highlight some of the key industry developments over the past 20 years that have helped shape the risk management and derivatives industries. We've picked four – the G-30 report, the International Swaps and Derivatives Association master agreement, the use of internal models to calculate regulatory capital for market risk, and Basel II. There were many others to pick from, and narrowing it down to these few was extremely difficult.

These awards were decided by a *Risk* editorial committee. Unlike the end-of-year awards that *Risk* publishes in January, these were more an exercise in research based on past awards, polls, third-party research and *Risk* articles over 20 years. ■

By Nick Sawyer, Navroz Patel, Rachel Wolcott, Alexander Campbell, Gareth Gore, Jayne Jung, Mark Pengelly, Wietske Brees, Clive Davidson and David Rowe

The winners

Derivatives house 1987–2007

JP Morgan

Interest rate derivatives

Pioneer: Bankers Trust

Modern great: Deutsche Bank

Currency derivatives

Pioneer: Salomon Brothers

Modern great: UBS

Credit derivatives

Pioneer and modern great: JP Morgan

Equity derivatives

Pioneer: Bankers Trust

Modern great: Société Générale

Energy/commodity derivatives

Pioneer: Morgan Stanley

Modern great: Barclays Capital

Derivatives end-user

World Bank

Derivatives exchange

Chicago Mercantile Exchange

Interdealer broker

Icap

Risk management system vendor

Moody's KMV

Trading system vendor

Reuters

Industry trade processing platform

TriOptima

Industry trading platform

EBS

Landmark development

Isda master agreement (1993)

G-30 report (1993)

Basel Committee's decision to allow use

of internal models for calculation of

regulatory market risk capital (1995)

Basel II (1999–present)



Risk management system vendor



The past 20 years has seen the evolution of modern risk management. Many individuals and organisations have contributed to this discipline, including systems vendors. A number of these vendors have not only developed innovative technologies to support the measurement and monitoring of risks, but have also helped define the concepts and methodologies behind them.

Algorithmics springs to mind for enterprise risk management, while SunGard created a flexible

outperformed the rating agencies in distinguishing between defaulting and non-defaulting firms, providing a leading indicator of rating agency upgrades and downgrades.

In 1993, KMV introduced Portfolio Manager, a tool for managing credit portfolio risk that would eventually be used to calibrate the credit risk model in Basel II. Over the years, the company has upgraded EDF and Portfolio Manager, and introduced a number of other tools. In 2000, it launched RiskCalc for private firm credit risk evaluation, and introduced LossCalc in 2002, a loss given default predictor. That year, the company was also acquired by New York-based rating and research company Moody's Corporation for \$210 million, and changed its name to Moody's KMV. Moody's president and chief executive officer John Rutherford remarked at the time: "The people of KMV are pioneers and innovators in the field of quantitative analytics."

One of the lessons learnt in risk management over the past 20 years is the critical importance of high-quality data for any exposure analysis or forecasting. For credit risk, Moody's KMV has led the market in this regard. To back up its models, the company has assembled 30 years of information on more than 6,000 public and 170,000 private company default events for a total of 50,000 public and 2.2 million private companies, healthy and distressed, around the world – the largest database of its kind.

"Moody's KMV has been not only a thought leader in credit risk management, but combined it with strong growth of revenue, while its database is universal in banks," says Simon Turner, analyst with London-based Chartis Research Europe. Moody's KMV revenue in 2006 was \$142.8 million, an increase of 8.8% over 2005, with profits of \$16.6 million.

Nowadays, Moody's KMV products are used by more than 2,000 top-tier organisations in more than 80 countries, including nearly all of the 100 largest financial institutions. In a fast-moving and highly competitive field, Moody's KMV has maintained its position as head of the pack.

As Andrew Liegel, senior risk management research analyst at Massachusetts-based research organisation Financial Insights, says: "Moody's KMV is the 800-pound gorilla of credit risk management." ■

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Simon Turner, Chartis Research Europe

platform that could accommodate a variety of risks and methodologies. Moody's KMV, meanwhile, started out with the problem of credit risk and has never lost its focus since. Over the past 18 years, the company has created credit risk management tools and databases that are now found in almost every major financial services company. And in doing so, it has created an enormously successful and profitable business.

In 1989, three San Francisco-based quants, Stephen Kealhofer, John McQuown and Oldrich Vasicek, set up KMV to exploit Vasicek's recent work on valuing credit risk. Already famous for his earlier equilibrium model of the term structure of interest rates, Vasicek devised a new way of credit evaluation based on option pricing theory.

Together with his colleagues, he created an expected default frequency (EDF) model that measures the probability that a company will default over a specified period of time using the current market value of a firm, the level of the company's obligations and the vulnerability of the market value to large changes. The model changed the way organisations thought about credit risk, and since then EDF credit measures have consistently

The contenders

Algorithmics
Moody's KMV
RiskMetrics
SAS
SunGard