

RWE Trading improves efficiency and accuracy of credit risk department

When RWE Trading needed a sophisticated system to reflect its commitment to effective credit risk management, it turned to Financial Objects *energycredit*. Replacing a largely manual, spreadsheet-driven environment with a single system that handles credit scoring, collateral management and legal contract handling, RWE Trading has greatly increased the efficiency and accuracy of its credit risk management.



FINANCIAL
OBJECTS

Background

RWE Trading is the energy trading division of international RWE Group—a leading company in the global production and sale of power and gas. RWE Trading acts as a hub for all tradable commodities such as power, emission certificates, gas, coal and oil in physical form as well as trading in energy derivatives to hedge price risks.

The division takes a very conservative yet sophisticated approach to risk management, and manages credit risk more like a bank than many other energy companies. Since the division's inception it relied heavily on spreadsheets, both for internal rating processes, i.e. credit scoring, and credit approvals. But as its trading activities became more sophisticated and volumes grew, it wanted to find a way to centralise its data and automate its processes.

The Challenge

For internal ratings, RWE Trading found that it was maintaining a growing number of spreadsheet templates covering different industries and customer profiles. Changes to one often meant changes to the others too. Also, RWE Trading found that back-testing of its internal ratings was impossible.

Similarly, creating and modifying credit approvals was a manual process. There were no linkages to systems where the division captured its exposures. Manual re-entry of data was required, and this created a greater potential for error.

To help improve the situation, it wanted a system that it could use to centralise all its credit risk-related data. It wanted to be able to report from the database, aggregate limits and monitor and update counterparty agreements and guarantees.

It also realised that it would benefit from a system that provided it with collateral management and legal contract management

functionality. These areas are tightly-linked to credit scoring and make up what RWE Trading refers to as its 'extended credit risk management environment.'

Dr. Michael Jost, Credit Risk Manager, RWE Trading, says: "Integration was very important to us. We didn't want to install multiple systems that fail to work together as one."

RWE Trading conducted a public tender for the project, and received numerous offers of consulting and custom development work. But it really wanted a solution that was already built and that met most of its needs. From a shortlist it selected the *energycredit* solution from Raft International (now Financial Objects).

The Solution

energycredit offered the full collateral management functionality that RWE Trading required, and it also had a sound foundation for providing RWE with advanced credit scoring and legal contract management features.

The Financial Objects team worked closely with RWE Trading to further develop the solution in these areas. "They understood our business and our needs very well," says Jost. "They were very responsive. During the development project there was continual improvement, where we saw things that could be done better, and these were nicely implemented into the solution. It was a perfect relationship in that regard."

With *energycredit's* scoring module one can evaluate a counterparty on relevant criteria, specifically selected and weighted for its particular industry, based on individual proprietary Internal Rating approaches

All credit risk-related data is stored centrally, and there is tight integration with RWE Trading's exposure management system. This helps

Objectives

- Automate credit scoring and collateral management processes
- Improve integration in the extended credit risk management environment
- Reduce reliance on spreadsheets
- Centralise credit-related data in a single database

Solution

- *energycredit* Scoring
- *energycredit* Collateral
- *energycredit* Legal

Results

- Credit event, collateral and legal workflow
- Single database of centralised data

Benefits

- Work efficiency increase
- Greatly reduced risk of errors from manual re-entry of data
- Better quality counterparty analysis, internal ratings and credit approvals
- Ability to instantly generate projections and peer group analysis
- Automated reporting and margining processes

automate the processes for internal ratings and credit approvals.

energycredit also meets all RWE Trading's collateral management needs. Additionally, the legal contract management module provides a central repository of all legal documentation and provides for the safe storage and retrieval of legal contracts, netting clauses and comparison of contract differences.

"Financial Objects did far more than collect data in a central system," says Jost. "It added significant value based on its great experience in the energy industry. Features such as peer group analysis, credit score simulation, and the automated margining process attest to this. *energycredit* also integrates with the SAP accounting, fax and email systems, and Microsoft Outlook and Word."

The Benefits

The *energycredit* solution has added a new dimension to RWE's credit analysis, which was practically impossible with spreadsheets. An example is the ability to perform simulations by extrapolating annual results into next year's projected numbers – at the press of a button. Another feature is peer group analysis, which allows analysts to compare any part of a score sheet with a selected set of counterparties with the same line of business, for example.

energycredit is not prescriptive about the credit scoring logic that needs to be used. Jost found it straightforward to enter the credit scoring questionnaires and models that RWE Trading has developed over time, and these can be easily updated.

The credit risk managers can also easily get an aggregate view of e.g. all the internal ratings in real time. Additionally, they can use the system to monitor the performance of the team's credit analysts.

The previous spreadsheet-driven processes made back-testing of credit scoring models practically impossible. But RWE Trading can now use *energycredit* to validate the models it uses and refine them where necessary.

Workflow functionality makes the job of the credit analysts much easier and the automation means they can focus much more on their core responsibilities rather than compiling documents. Because all data is held centrally, credit analysts can pre-populate their credit

approval sheets with data at the press of a button. This gives them more time to focus on the actual analysis of counterparties.

energycredit's alert features also let them know when certain tasks need to be performed—for example, when a counterparty is due for a limit review.

Together these features mean that RWE Trading's credit department has benefited from an increased efficiency.

RWE has seen even greater improvements in the collateral department. Dirk Daveluy, head of the collateral team, says: "We would not have had a chance with the old manual procedures given the increasing margining activity we have experienced recently."

For the collateral team, *energycredit* provides automatic margin call and interest statement calculations. Users can also generate funding cost reports to allocate lending cost on internal units, and view statistics on margining disputes.

As well as the immediate benefits of using the solution, Jost says it is also helping RWE Trading anticipate compliance with future regulations. "Although the energy trading business is not regulated under the Basel II capital accord, which dictates the way banks must manage credit, market and operational risk, RWE Trading follows much the same principles as best practice," he says. "On the operational risk side, *energycredit* means we are much less exposed to system and human errors, and our analysis is much more accurate. For example, we no longer run the risk of aggregating exposures and limits incorrectly when making our credit approvals."

The Future

Credit policy for the RWE Trading division is set by high level-risk committee at the group level. This is evidence of how important effective risk management is to the entire group.

"*energycredit* is a critical solution for the RWE group that reflects our commitment to sound risk management principles and operational processes," says Jost. "RWE Trading started with a sound credit risk management philosophy at its foundation. And this approach has been adopted across the group. It's an aim of the group to eventually use *energycredit* as the group-wide credit risk management system."

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Dr. Michael Jost, Credit Risk Manager, RWE Trading

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