Risk manager of the year Richard Evans, Deutsche Bank

The head of group market risk's stress-testing approach has helped transform Deutsche Bank

RICHARD EVANS can time on his watch how long it takes for one of Deutsche Bank's trading chieftains – people such as Anshu Jain, Michele Faissola or Rajeev Misra – to return one of his calls. "It takes minutes," he says.

Such responsiveness, says Evans, is due to the culture of risk management that has taken root at Deutsche. It might also be due to the fact that Evans, as head of group market risk, reports directly to board member and chief financial officer Clemens Börsig, and has the power to order the trading business to cut or hedge positions once they hit their limits. "We've got the discipline and we've got the power to be tough if we need to be," Evans says.

And 2003 has been a challenging year for both traders and market risk managers. The plunge in US Treasuries in July had a contagious effect on trading books – an effect that was particularly apparent at JP Morgan Chase. Rocked by losses in proprietary trading and its Chase Home Finance mortgage arm, the US bank reported two trading days at the end of the month where losses exceeded firm-wide value-at-risk. As a result, JP Morgan Chase entered August with all its lines of business close to their VAR limits, sharply curtailing the firm's ability to trade. At Deutsche Bank, however, only the losses in the interest rate book came close to its VAR level during August (resulting in a curtailment of swap market-making activity). As Evans proudly points out, no VAR exceptions were reported at the firm-wide level.

Before joining Deutsche Bank in January 2000, Evans spent 18 years at JP Morgan, first as a trader and after 1993 as a risk manager. After a brief spell working at JP Morgan subsidiary Euroclear, Evans became the bank's head of market risk, managing a team that included well-known figures such as Charles Monet (now at Morgan Stanley) and Robert Leblanc (now head of market risk at Barclays). At JP Morgan, Evans witnessed the invention of VAR, and was responsible for compiling the firm's so-called 4:15 report, giving senior management a risk snapshot as soon as markets closed.

Upon joining Deutsche Bank, Evans noticed similarities to and differences from his old firm: "The old JP Morgan was a relatively small firm," he says. "Culturally, Deutsche was not that different in its trading business, but the overall scale of business was enormous." This scale made it difficult to track Deutsche Bank's overall risk, Evans recalls. When he asked for a 4:15 report, Evans found that it took up to 72 hours from the close of the day's business to assemble the information. That had to change, and now Evans says he knows the daily position information at 7:30am the following morning, and firm-wide VAR by lunchtime.

Deutsche Bank headquarters

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Equally important to tackle were what Evans calls the 'non-traded risks' in Deutsche's portfolio. These include the bank's historically important equity cross-holdings in German companies, private equity and real estate investments, seed capital invested in funds of hedge funds marketed to investors, and long-dated employee pension fund liabilities. Evans says he has worked hard to reduce the economic capital tied up in such areas, which at the end of 2002 stood at €8.3 billion, almost 10 times the size of its trading book's economic capital.

In his approach to the trading book, Evans has parted company with his previous employer's approach to incorporating risk factors in calculating economic capital. Thus, while at JP Morgan Chase risk contributions to economic capital are 50% VAR-based and 50% stress loss-based, at Deutsche Bank stress loss contributions account for 100% of economic capital. According to Evans and his colleagues, this has had a significant effect on how Deutsche charges its traders for taking exotic derivatives positions. The problem for VAR-based economic capital charges is that exotic derivatives prices often depend most on parameters such as correlation or vega that change infrequently and are therefore not properly captured by VAR. Deutsche's stress-tests incorporate shocks to these derivatives parameters, in addition to large underlying market moves. As a result, argues Evans, Deutsche is better than many rivals in accounting for the risk and return characteristics of its derivatives business.

Evans supplies several examples of where his approach to stress-testing has had an impact during 2003. One area where Deutsche has grown rapidly is in its commodities business (*Risk* October 2003, page 96). As this business grew, there were times in 2003 when risk management analysis of potential stress losses were used to justify the purchase of options to protect against such extreme risks.

Another area where Deutsche plans to increase activity is in guaranteed products linked to dynamically traded hedge fund baskets offered to investors. Evans says he worked closely with the business manager Wayne Felson, to put in place diversification criteria to be used in selecting hedge fund baskets. Meanwhile, in credit trading, Evans' team encouraged the growth of Deutsche's single tranche synthetic CDO business because the lower than fair value spreads received by many European clients made the trades highly attractive from a risk-return perspective. In other words, by selling such products to clients unaware of fair value, Deutsche sales people may have performed a valuable risk management service.