The future of risk management

A Ginkgo Management Consulting White Paper 2018

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Approximately 10 years after the 2007-2008 financial crisis, the financial services industry is back on track with solid growth figures and bold expansion plans.

In our 2017 Whitepaper on robotic process automation, the disruptive potential of technology for the financial sector was first explored. In this 2018 publication, we want to continue this explorative journey and study the drivers of change for risk management - a vital business unit within banking and financial services.

This Whitepaper aims to describe from a strategic perspective why and how risk management must evolve if it wants to continue to counsel its business partners during the next (financial) crisis.

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Introduction

Volatility, Uncertainty, Complexity and Ambiguity – better known by its acronym VUCA – are risk management's best friend. Contrarily, black swans – rare events with extreme impact and retrospective predictability – are its worst enemy.

Today, organizations and managers are regularly confronted with both notions. Consequently, successfully managing risk means carefully balancing between extremes; being applauded and being scapegoated, being involved in important decision making and then grotesquely ignored. Against this backdrop, only a steady, transparent and proactive risk management can deliver sustainable value for its business partners.

In this whitepaper, Ginkgo Management Consulting highlights five change drivers for decision makers in the field of risk management. Based on practical project experience and extensive industry know-how, Ginkgo is convinced that – despite undergoing profound changes - risk management has a decisive role to play in the years to come.

In the end, organizations will continue to place selective bets on the future and will need proper guidance and counseling throughout this process. For as long as the notion of VUCA remains, we see great relevance in what a leading figure from today's tech scene once said:

> "The biggest risk is not taking any risk... In a world that is changing really quickly, the only strategy that is guaranteed to fail is not taking risks."
>
> - Mark Zuckerberg

Five Drivers of Change

Risk managers need to consider several change drivers if they want to remain relevant in tomorrow's corporate world. Each of the five drivers listed below will have a profound impact on the organization and functioning of risk management in the years to come. As a whole, the points addressed in this whitepaper form the basis for a strategic agenda on the future of risk management (see figure 1).

1. Regulatory and policy changes

For most banking players, Basel III, PSDA-2, GDPR and open banking are "usual suspects" and are already driving a wide array of implementation initiatives. Ginkgo foresees both a convergence of existing regulatory frameworks as well as the appearance of new legislation in the coming years. Whether the triggers are macroeconomic shocks, company scandals or an overall economic downturn, policy makers will respond by using momentum to create new or adjusted policy frameworks. Risk managers should carefully assess the impact of these changes and use this opportunity to revise risk management structures and processes.

2. Technological advancements & cyber-security

Due to the increased availability of big data and analytics solutions, risk managers can tap into entirely new data pools and dramatically improve their insight generation capability. For instance, by combining the transactional data generated by core banking systems with unstructured data such as social media, entire new customer risk profiles can be defined, reducing fraud levels and increasing the potential for scoring automation.

Furthermore, by adopting and combining chatbot and artificial intelligence solutions, credit decisions can be optimized to reduce losses by up to 10 % for a given portfolio[1]. Maintaining default rates steady in a growing portfolio whilst reducing manual decision making truly is a "golden ticket". Recent advances in technology bring this vision one step closer to reality as demonstrated in Ginkgo's 2017 whitepaper on the potential of robotic process automation for CIOs. It is evident that managing cyber risk is one of risk management's top priorities.

"Data is the new oil" is a leading credo of the 21st century, and targeted attacks on valuable corporate data will both increase in frequency and vigor. Risk management must join forces with IT security to determine overall vulnerability and identify potential entry points. Nurturing a top-down culture that promotes prevention and employee awareness for these topics is of utmost importance. In parallel, drawing up worst-case scenarios along with incident response plans should be included in risk review meetings to prepare for unexpected security breaches.

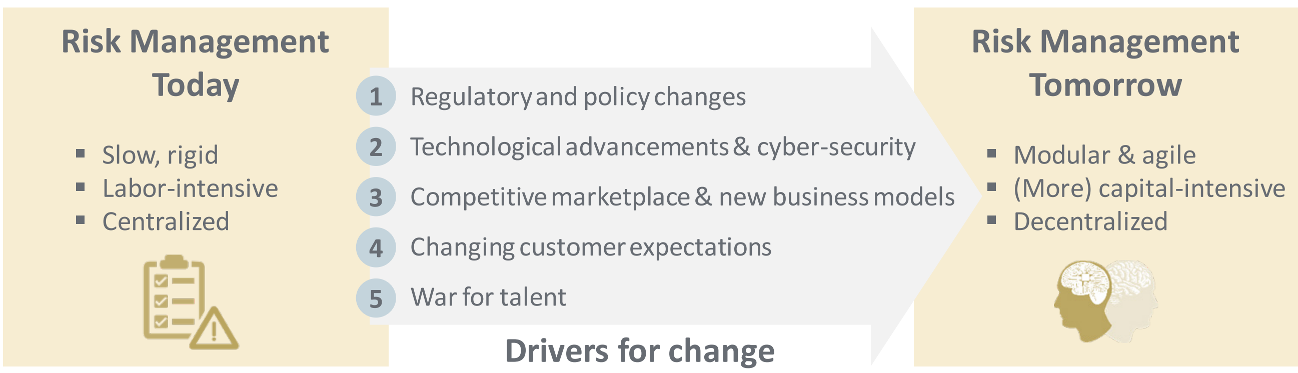

Figure 1: The transformation of risk management (Source: Ginkgo Research, 2018)

[1] Source: Ginkgo and industry experts

3. Competitive marketplace & new business models
New players with innovative business models will continue to challenge incumbents by offering new, user-friendly and scalable risk solutions.
These fintech players tailor their offering along the corporate value chain, whilst carefully considering the four classical risk dimensions: liquidity risk, operational & credit risk, market risk and systemic risk. Their assertive plug-and-play approach will force risk managers to (re)-evaluate which services are to be kept in-house and which services are eligible for outsourcing to fintechs (see figure 2).

Ginkgo estimates that in the next 5 years, over 50% of risk management activities will evolve into commodity services, resulting in a whole new architecture of the risk management function. Orchestration of the risk management service portfolio and vendor management will become more significant, whereas risk modeling and reporting will become less commonplace as they will increasingly be provided by the market.

4. Changing customer expectations
Nowadays, “customer centricity” is a key principle for executives across the board and across industries. For risk management’s customers and business partners, this principle translates into three concrete expectations.

First and foremost, customers expect increased speed of risk management services. Put differently, cycle times of core risk processes must be significantly reduced, for example credit reviews – often lasting over several weeks in large organizations – must be reduced to a matters of hours rather than days.

Secondly, customers expect increased pro-activity and transparency. Whether concerning policies, specific risk mitigations or complex deal decisions, risk management is expected to be capable of providing context, status and outlook on a wide array of matters, around the clock. Lastly, customers increasingly expect highly customized solutions. This includes but is not limited to individual credit conditions and financial products, specific governance and oversight and tailored communication channels with relevant risk managers. To survive in this era of customer centricity, risk management will need to simplify its operations regarding decision making along with its internal structures. Ginkgo predicts that risk management operating models will increasingly switch “glocal” variants with strong regional and local influences yet intensive centralized (HQ) orchestration. In this approach, by adopting and implementing customer self-service portals in local markets and digital policy platforms on the headquarters’ side, risk management teams can significantly reduce workload on standard risk inquiries whilst improving transparency towards its customers.

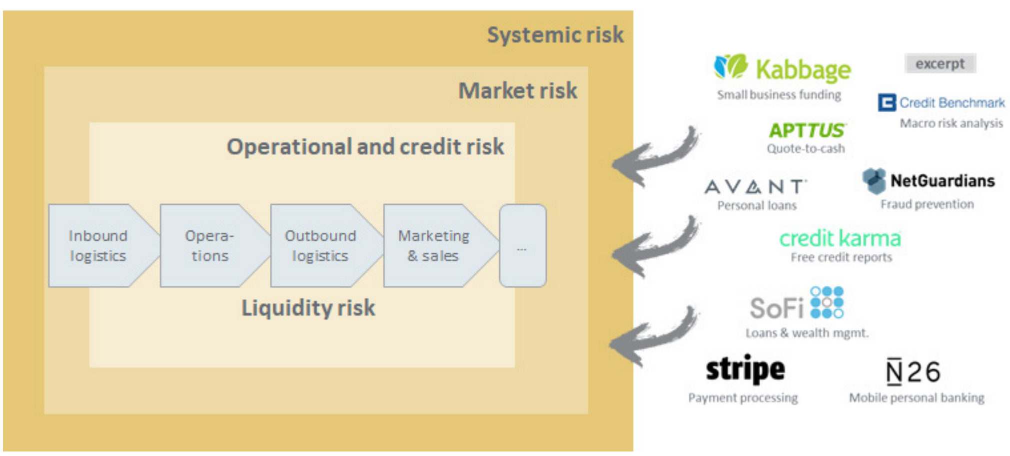

Figure 2: Fintechs’ impact on risk management (Source: Ginkgo Research, 2018)

5. War for talent

In the coming years, the gap between demand and supply for qualified employees will intensify. Risk management will need to compete with tech-leaders for attracting and retaining the brightest minds in the fields of data science, analytics and user experience, just to name a few.

Additionally, soft-skills such as strategic thinking, consensus building and intercultural mediation will become more important as globalization and international project assignments continue to accelerate. Risk management must prepare for these changes by adjusting its hiring strategy, improving its employer-branding and establishing partnerships with universities and specialized training institutions. Corporate HR will be a crucial business partner in this process as well as the broader top management. For even in the digital age, human capital will remain a business' most valuable resource.

Conclusion

In this whitepaper, Ginkgo presented five major shaping forces at play and highlighted their impact on the risk management function of tomorrow. Predicting the future is difficult, if not impossible. The future is not a linear extrapolation of the past. Risk management will undergo an intense process of change in the coming years. According to Ginkgo, the risk management function of tomorrow will be more responsive, data-driven and decentralized than ever before (see figure 1).

Chief risk officers (CRO) will need to make important decisions on the direction of their business if they want to stay credible conversation partners around strategic topics and drive crucial decisions.

By maintaining a holistic view on Ginkgo's five drivers of change, the CRO will remain in the driver's seat and hold the best cards to shape and realize the global risk management agenda. Key to success will be the close collaboration between chief digital officer(s) and chief risk officers.

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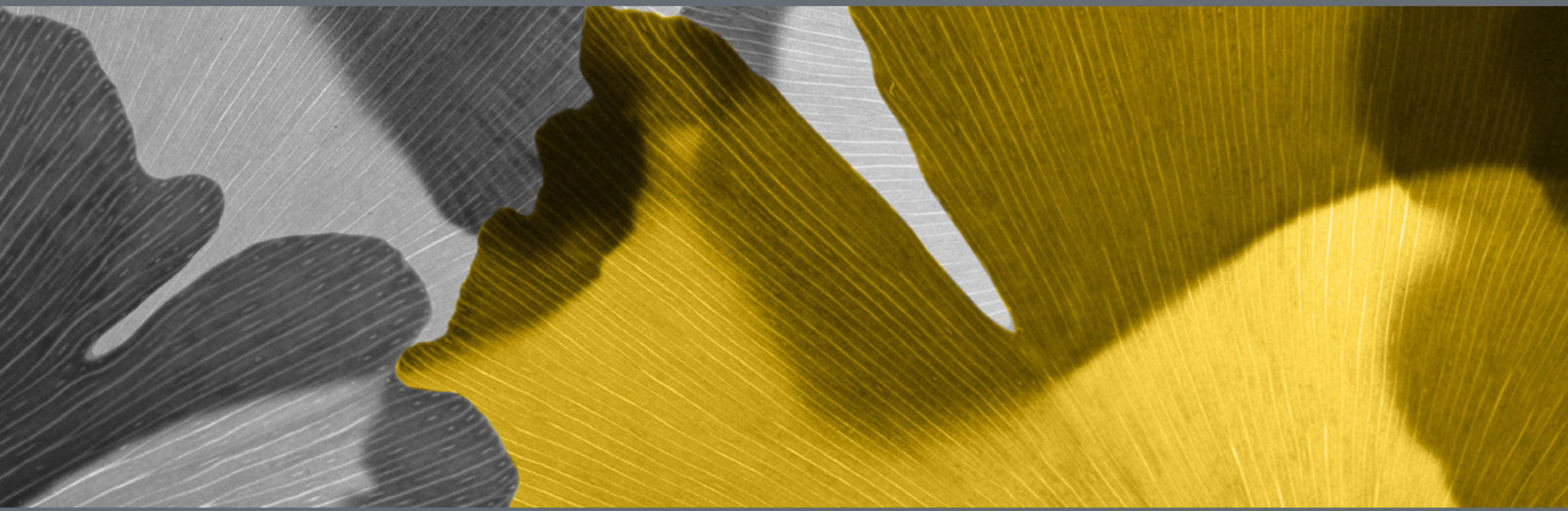

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