Risk management in the new era

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Agenda

1. **Digital, FinTech and Big Data eras – status quo**
2. **Challenges of the banking system**
3. **Regulatory approach on the new era**
4. **Banks' responses and the risk management future**

1. Digital, FinTech and Big Data eras – status quo

Digital is the new normal

- It has already transformed industries such as media, transportation, and retail and is now sweeping through financial institutions.
- Global Bank CEOs and CROs tend to be cautious when considering the very idea of a *digital risk transformation*, wondering just how far they can automate crucial processes and rely on automated decisions.
- Most banks have digital risk prominently on the radar, with different levels of management attention.
- An increasingly share of banks have invested part of their annual risk budget to digitize risk management.
- ***The banks have the chance to leverage their current expertise from scoring and statistical models used in risk management in order to faster move towards new era.***

1. Digital, FinTech and Big Data eras – status quo
What is Digital?

Data management
- data governance, data quality, consistency processes, and operating models
- structured (such as transactions) and unstructured (emails and text messages, social-media posts, photographs, and so on).

Process and workflow automation
- Computers streamline, standardize, and efficiently execute routine tasks

Advanced analytics and decision automation
- Advanced statistical techniques and algorithms, together with artificial intelligence

Cohesive, timely, and flexible infrastructure
- modernized data environment
- data lakes, virtualization, and the hybrid cloud

Smart visualization and interfaces
- Tools and applications
- self-service reports, interactive dashboards,

External ecosystem
- market-leading digital capabilities developed with established peers, utilities, start-ups, and others

Talent and culture
- People's experience with modern data, analytics, and digital expertise
- a knack for "failing fast"; and deep collaboration

2. Challenges of the banking system
Digitalization of risk management must overcome a set of challenges

- IT and data
  - legacy IT systems and a lack of easily accessible high-quality data

- Risk leaders are inherently and appropriately conservative
  - culture is the main challenge in digitizing.
  - how to attract and retain talent both proficient in risk and comfortable with digital technologies.

- Risk has bankwide interdependencies
  - requires considerable collaboration from others to deliver a digital risk solution
  - complex organizational structure is a main challenge in digitizing

- Regulation
  - regulatory requirements for transparency, auditability, and completeness observed that “black box” machine-learning techniques have had a slow rate of adoption in regulatory-reviewed models

3. Regulatory approach on the new era
New regulatory focus

European Supervisory Authorities (ESAs):

- European Banking Authority (EBA)
- European Securities and Markets Authority (ESMA)
- European Insurance and Occupational Pensions Authority (EIOPA

monitor any emerging risks for consumers and financial institutions that might arise from:

Digitization

FinTech

Usage of
Big Data

3. Regulatory approach on the new era

The regulatory approach to be based on the following principles

- appropriate balance between the close monitoring of the regulatory perimeter and the need for neutrality towards new technology applied by incumbent institutions and other FinTech firms
- to foster technological neutrality and innovation across the single market
- the assessment of money laundering/terrorist financing ('ML/TF') risks arising from FinTech
- the EBA's new '**FinTech Knowledge Hub**' which will provide an overarching forum bringing together competent authorities enabling knowledge sharing on FinTech
- monitoring of alternative dispute resolution ('ADR'), developments relating to the Regulation on electronic identification and trust services for electronic transactions in the internal market ('eIDAS Regulation'), the interaction of the second Payment Services Directive ('PSD2') and the General Data Protection Regulation ('GDPR'),7 and FinTech self-regulation

The European Commission (March 2018 FinTech Action Plan), mandated 'ESAs' to carry out specific tasks relating to FinTech (authorizations issues, regulatory sandboxes and innovation hubs and virtual currencies.

3. Regulatory approach on the new era
Regulatory priorities 2018/2019

- **monitoring the regulatory perimeter**, including assessing **current authorization and licensing approaches** to FinTech firms, analyzing **regulatory sandboxes and innovation hubs**;
- **monitoring emerging trends** and **analyzing the impact** on incumbent institutions' business models and the prudential risks and opportunities in order to enhance **knowledge sharing**;
- **promoting best supervisory practices** on assessing **cybersecurity** and promoting a common **cyber threat testing framework**;
- **addressing consumer issues arising from FinTech**, in particular in the areas of unclear regulatory status of FinTech firms and related disclosure to consumers, potential national barriers preventing FinTech firms from scaling up services to consumers across the single market, and assessing the appropriateness of the current regulatory framework for **VCs** (virtual currencies);
- **identifying and assessing ML/TF risks** associated with regulated FinTech firms, technology providers and FinTech solutions.

4. Banks' responses and the risk management future

A digital transformation for risk would mean a number of changes

- Risk would capture and manage information from a broader and richer set of data, looking into nontraditional sources like business-review ratings online.
- Automate processes it controls, and work with others to do the same for decision-heavy processes.
- Use advanced analytics to further improve the accuracy and consistency of its models, in part by greatly reducing the biases.
- Inside the bank, leaders would consult self-serve dashboards informed by risk analyses—and thus act on risk-driven strategic advice.
- It would alter its organizational setup, as well as its culture, talent, and ways of working.
- <u>Risk would review and reshape its mandate and role to capitalize on its ability to provide faster, more forward-looking, and deeper insights and advice.</u>

4. Banks' responses and the risk management future

The risk management digitization will be a game-change for the system

- ✓ **Risk executives** will focus on more strategic and high-value decisions as routine work is automated away and fewer exceptions require manual handling.
  - they will use *advanced-analytics capabilities* to generate insights that are hard to produce today to help the front line optimize its decisions and offerings.

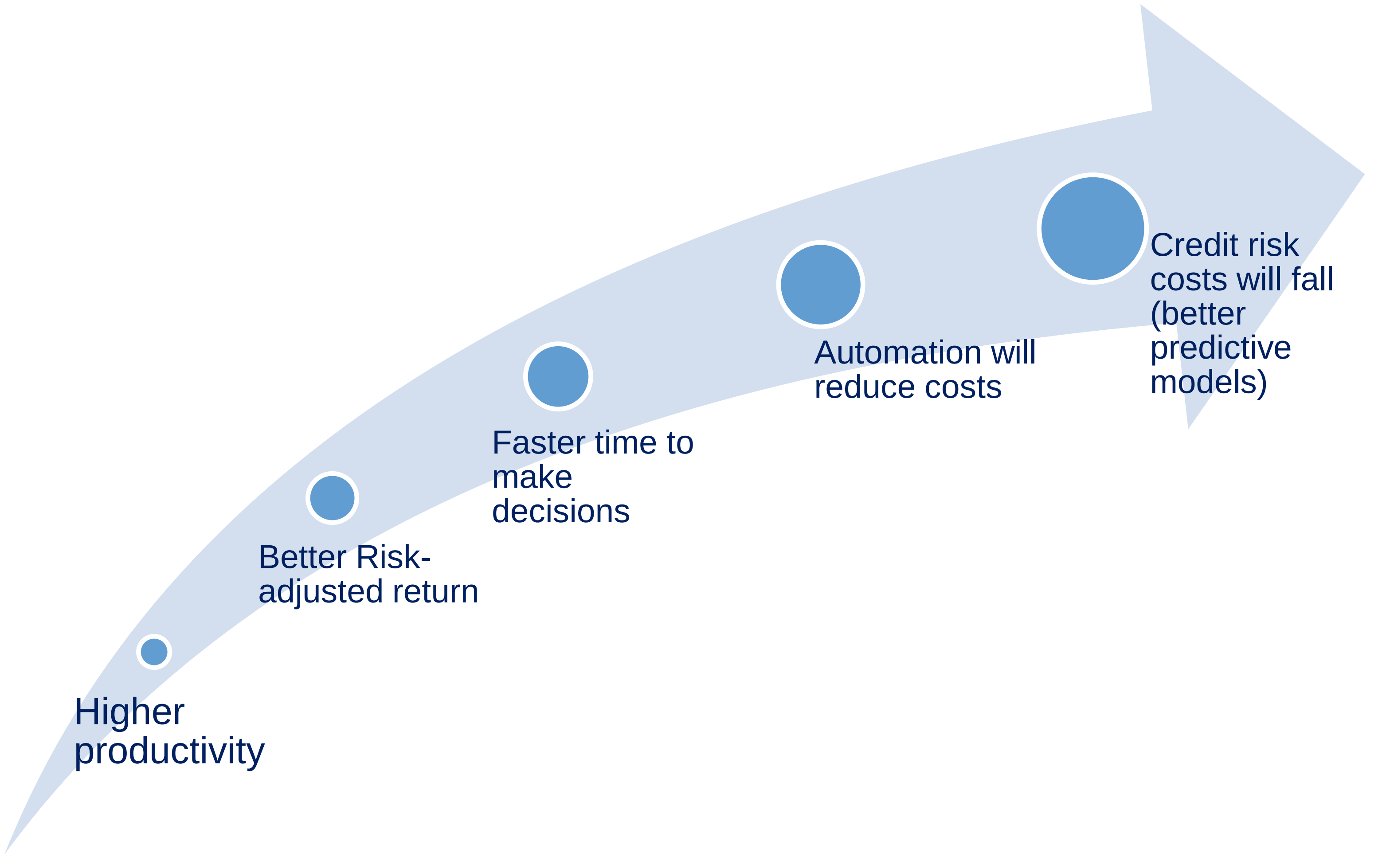
- ✓ **CEOs and heads of business** will receive automatically generated strategic advice on risk-oriented business decisions
  - rely on an intuitive *visual tool* to provide advice on demand at an appropriate level of detail

- ✓ **Retail and corporate customers** will have individualized banking experiences that meet their high expectations.
  - *Banks' advice*: from simple nudges to avoid overdrafts or late-payment fees to more sophisticated help managing account balances to optimize interest income.
  - The *advice* will come *in real time* and will be fully embedded in the *customer journey*.
  - For *corporate customers*, the bank will also be able to *integrate into the supply chain*, assessing risks and providing timely financing (advice and decisions would be fully embedded in the customer journey).

- ✓ **Regulators** will move from consuming reports to *receiving near-live data*.

4. Banks’ responses and the risk management future

Two to three years to bring value in digital state



4. Banks' responses and the risk management future
A recipe for success in Romania, as well?

Our TO DOs

Three prerequisites for making digital risk real:

1. Defining a vision for digital risk
   - A view on the key activities risk will perform in the future
   - Start growing and bringing talents in the organization
   - Bring the organization to believe in it

2. Determining the opportunities for digitization
   - Plan, budget and set up KPIs to measure the success
   - Identify top priority processes to be touched and their tools and data needed
   - Not running after perfection and do it in an agile way

3. Ensure safety
   - running old and new processes in parallel for a while
   - conducting more back-testing on new analytical approaches.

Digital risk transformation might be successful if includes all the tasks of digitization efforts elsewhere in the bank, such as getting *alignment among top executives*, assigning the *right priority* and changing the *culture*.

Q&A

Thank you!