

# BUILDING THE RISK FUNCTION OF THE FUTURE

Banks need a strategy for Digital Talent, not just Tech



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The financial services industry has undergone significant disruption in the last decade, with increasing regulatory pressure, rapid advances in technology, and the emergence of FinTech. All of these place pressure on incumbents to act quickly. The COVID-19 pandemic has added to the challenge: Margins are being squeezed by rising credit losses, and the low-interest-rate environment is putting further pressure on profitability.

All organizations are busy reminding themselves, as the saying goes, never to waste a good crisis. Risk functions are no different. While they have often lagged behind other parts of the financial services business in their ambition and agility, there is now a growing sense of urgency to re-evaluate the future of risk management and question how it can best serve organizations in the future. As the pace of change accelerates, it may no longer be enough to be a fast follower. Risk functions that use this crisis to learn and position themselves for the future will gain momentum in the recovery and help their firms to emerge from the crisis faster and in a stronger state.

To envision the future of risk management, Oliver Wyman engaged with 40 senior risk leaders across the Asia-Pacific region, compiling their visions and opinions on how risk functions in financial services need to evolve over the next decade. We identified two persistent themes at the front of risk leaders' minds, which are expected to dominate the risk functions of the future:

- **The Digital Opportunity:** Driving broad adoption of new digital tools to vastly expand the scope of data-driven decision-making, improve efficiency, and deliver superior customer experience.
- **The Talent Imperative:** Attracting and developing the right talent for a digital future, in light of the increasing digital content of financial services work and sharp competition with FinTech.

## THE DIGITAL OPPORTUNITY

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### **“FinTechs make SME credit decisions in minutes compared to months for some incumbents” — Bank CRO**

FinTech credit services such as Prospa, OnDeck, Alex, GetCapital and more are benefiting in every dimension of the mantra ‘faster, better, cheaper’. Decisions are made for customers in minutes rather than days or weeks; the customer experience has a lighter touch with greater choice of channel and time of day; and the cost-to-serve is down, with some providers operating at a cost-to-income ratio as low as 15 percent. Case studies reveal much broader success, as FinTech provides superior customer experience, transforms costs, and even facilitates smoother interactions with regulators.

It is vital that financial institutions’ risk functions adopt digital capabilities much more broadly to compete effectively with peers and FinTechs in the future. Here are some ways in which digital technology can help a financial services institution work better.

### **CAPABILITIES FOR CURRENT TASKS**

#### **Mass automation of routine tasks**

Routine production tasks such as reporting should be automated as soon as possible, so that resources can be reallocated to less-well-defined work where greater judgement and expert intervention are required. Regulatory reporting has in many instances already migrated to a ‘self-serve’ model, forcing improvements in data quality controls to reduce the manual processes involved.

#### **A truly integrated data access layer across the organisation**

Connecting banking and non-banking data seamlessly will enable credit decisions based on minimal client input and allow faster and more accurate data-driven decisions (for example, using a restaurant’s water bills to indicate its financial health). Further benefits include improved data consistency in the development and production of risk models, removed rework around data definitions and source of truth across portfolios, and greater data traceability.

### **INFRASTRUCTURE FOR THE RISK MODEL SUITE**

#### **Pivot to thinking about models as software**

Modern software development practices should be adopted to improve model development, validation and deployment. For instance, version-controlled code repositories can be used for collaborative development. And the model lifecycle can be managed using shared code libraries, simplified coding standards, and continuous integration and delivery (CI/CD) pipelines.

### **Simplification of model deployment, from development into use**

Parallel production and exploration environments should be implemented for model results. This would provide both a hardened pathway for regulatory and internal reporting and a less restrictive but still controlled 'sandbox' for rapid results diagnostics and sensitivity analysis.

### **Seamless integration across the model lifecycle**

End-to-end, systematized model management can connect the model register to the real-time, ongoing monitoring of models and portfolios. These will identify model drift or portfolio deterioration and thus trigger actions.

### **Adopt service-based tools and capabilities**

By pivoting to a service-based toolset, firms can take advantage of scalable computation on cloud-based infrastructure. They can also build models on platforms that structure the development pipeline, simplify diagnostics and reinforce best practice. Overall, these shifts will increase efficiency, consistency, and efficacy in their teams.

## **TOOLS AND RESOURCES TO BOOST COMPETITIVENESS**

### **Digital tools to match front-end customer experience**

FinTechs have been able to give themselves a competitive advantage by using recent digital developments, such as automated ID checking, data ecosystem linkages, real-time analytics, and open banking. This advantage places pressure on incumbents to rethink their own user experiences.

### **Capabilities to manage emerging risks**

The risk function must be quick to identify, and manage for, an acceleration in the emergence of new risk types. The common themes of cyber risk, conduct risk, and operational risk are now firmly established in risk's taxonomy, and more needs to be done to pivot towards what comes next, for instance climate risk, culture risk, and model risk associated with automation and deployment of more complex and opaque analytics.

### **Getting comfortable with a broader suite of risk-models**

Machine learning and advanced modelling techniques are seeing powerful application beyond traditional risk analysis in credit decisioning and transaction monitoring. While there is still work to be done to satisfy regulators that these techniques can safely be used to determine solvency parameters, machine learning and artificial intelligence are here to stay. Their application will only multiply as the breadth of risk taxonomies expands, especially in non-financial risk areas such as cybersecurity and anti-money laundering.

While the benefits of digital adoption are clear, the road there is complex: The industry is constrained by legacy systems, as well as inertia related to data and regulation. Executives responsible for risk management will need to show strong leadership and take a keen interest in evolving developments: If they fail to adapt, their firm will lose competitiveness relative to first movers and disruptors.

## THE TALENT IMPERATIVE

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**“We’ll need a mix of old school thinking, married with new age data thinking. There’s a fine balance, and you can’t replace one with the other” — Bank CRO**

As well as technology, risk teams will need the right people and skills to adopt digital technology. As leaders chart a course to radical evolution in the nature of risk management, they also need radical change in the risk teams doing the work. Risk leaders, however, are caught in a vice: They need digital talent fluent in emerging technologies and techniques — and they also need employees with the knowledge and expertise of how banking works that is typically only gained from a career in finance. As financial expertise has grown increasingly specialized, banks have generally dismantled formal training and career programs in favor of apprenticeship models. Meanwhile, challengers have entered the fray, combining a handful of industry veterans with an army of agile technologists.

No large universal bank can jump straight to the Ant Group model dominated by digital natives. But with the right investment, a bank can develop a digital-ready environment that offers new recruits attractive career paths and enticing possibilities. This evolution is essential. Over the past two decades, career paths in risk management have become like a series of apprenticeships, through which individuals become increasingly specialized until they can find their personal career options limited. But this old model will work for neither employers nor employees, because of the rise of the gig economy, the very different skills now required, and the seismic shift in value (and economic activity) from old to emerging business models.

As incumbent institutions plot their evolution to a digital future, the career offer to new joiners needs to incorporate and build for a number of skills:

### DIGITAL SKILLS

Core pillars of the risk function already include cloud-based platforms and tooling, tight integration with technology throughout the model lifecycle, and advanced analytics. Therefore, digital skills to manage these assets will be a necessity.

## **COMMERCIAL AND BUSINESS SKILLS**

Commercial skills will be at least as important as digital. Risk professionals will need to be more proactive and liaise effectively with other functions, which will require broad strategic and business skills. Algorithms will need to be complemented by human qualities, and communication skills will be at a premium. Complex issues and choices will need to be explained in ways that enable effective decision making.

Leaders are aware that risk functions currently lack depth and consistency in these critical skills. But retraining will not be enough, so they will have to acquire talent via recruitment. That is a major challenge: Risk management today lacks a compelling value proposition that can attract the talent needed. This is evident in five main areas:

### **The branding of risk management and its perceived value**

Though risk issues affect billions of dollars of business value, the function is too often seen or portrayed as less exciting than other areas of the financial services industry. As with previous waves of destination preferences (such as dotcoms and venture capital firms), talent will continue to flow to areas that are 'hot', offering dynamic working environments and with perceived greater upside potential.

### **Career development**

Risk management is seen as having the culture of a control function rather than of a strategic or innovative field, and career development is seen as slow. This is particularly salient in roles below senior leadership. The challenge for leaders will become more rather than less pronounced, as smaller, more-digitally enabled teams will still require broad experience in risk management leadership, and rising stars may be hard to retain if they do not see a path to gain that experience.

### **Focus of work**

Risk management places a high priority on the quality of data used in its analyses. That, coupled with massive challenges from legacy data, means risk professionals have to invest more of their time in data exploration and engineering than the high value insight derivation they are hired to provide. Incoming digital talent will be looking for high-impact, varied work, and they will expect data to be accessible so that they can readily deploy their skills. This means that success with talent will be inseparable from success with digital technology. Both imply a shift in the balance of work from data to insights.

### **Tools and techniques**

Risk functions are often perceived to be locked into legacy tools and techniques, sometimes several generations behind those used in other functions and FinTechs and those taught in universities. The best graduates or recruits will find these legacy practices a disincentive to take on a risk role.

## **Regulation**

Accountability regimes such as the Banking Executive Accountability Regime (BEAR, now the Financial Accountability Regime — or FAR) and the Senior Managers Regime (SMR) make executives personally liable for certain regulatory breaches. These regimes are non-considerations for some financial services competitors. While such a concern is perhaps not front of mind for new recruits, it is one important example of how more-lightly regulated sectors — such as private equity, technology, and FinTech — may be more attractive to talent at all levels of experience.

Risk functions are being forced to become more innovative and digitally savvy, but leadership and vision are needed to tell this story and attract the talent required to pull off the transformation. To set themselves up for future success, risk functions will need to think strategically and holistically about recruitment and career paths. The work of risk management is changing radically, and incremental adaptation of the workforce is unlikely to be an adequate strategy.

By taking a strategic approach to talent, the risk function will be able to redesign and rebrand itself, adjusting career propositions to compete with peers and disruptors and positioning the profession as a compelling landing space for future talent. Banks that do not do this may struggle to achieve their digital risk ambitions. However advanced risk-management technology becomes, the human element will continue to play a critical role.

## **PATHWAYS OF EVOLUTION**

The changes in the work of risk management imply that current operating models must evolve. Over time we expect traditional barriers to erode between analytics related to risk and that for more general topics such as pricing, customer preference, and the propensity to leave, acquire new products, or otherwise restructure financial arrangements. In some cases, particularly in smaller firms such as monolines and those with more focused commercial offerings, organizational boundaries may not exist between risk classes such as credit, market, and non-financial. Risk analytics itself will, in many cases, just be one part of the analysis conducted by a combined data science team.

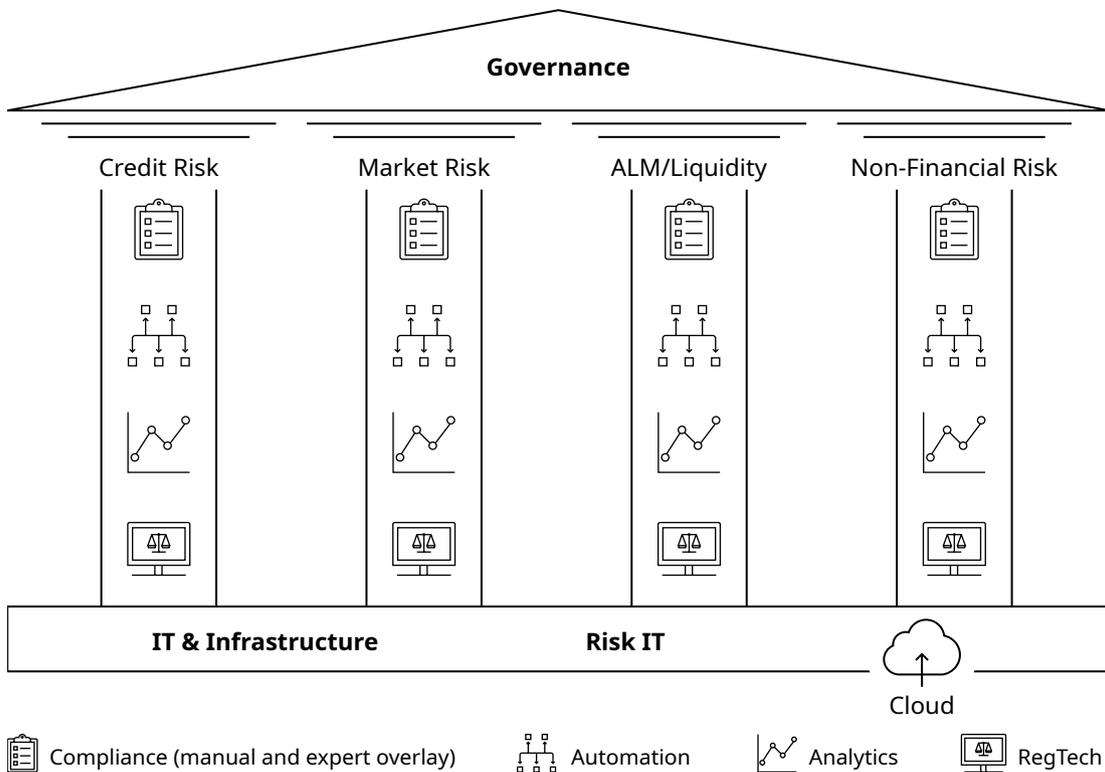
However, this is not the world where large incumbent universal banks will land immediately. For larger institutions, three models are likely to define the path of future evolution.

## SHORT TERM — EVOLVED TRADITIONAL MODEL

The risk function at many larger firms will retain its current structure in the short term, while adopting new technologies where suitable. In this model, the risk value chain remains cohesive and in-house, while the industrialization of simple and repetitive activities continues. Substantive productivity and efficiency gains at this stage will be achieved through incremental advances in technology and the application of analytics to data — all at lower risk than more-radical change.

This approach won't, however, yield a step change from banking with a cost-income ratio of 40 percent to banking with a ratio of between 20 and 30 percent. And it might not lend itself to facing up to the strategic challenges related to talent. But this model will require ongoing investment in digital assets and can be a sensible interim target as a financial institution plans more-radical change.

**Exhibit 1: Evolved traditional model**



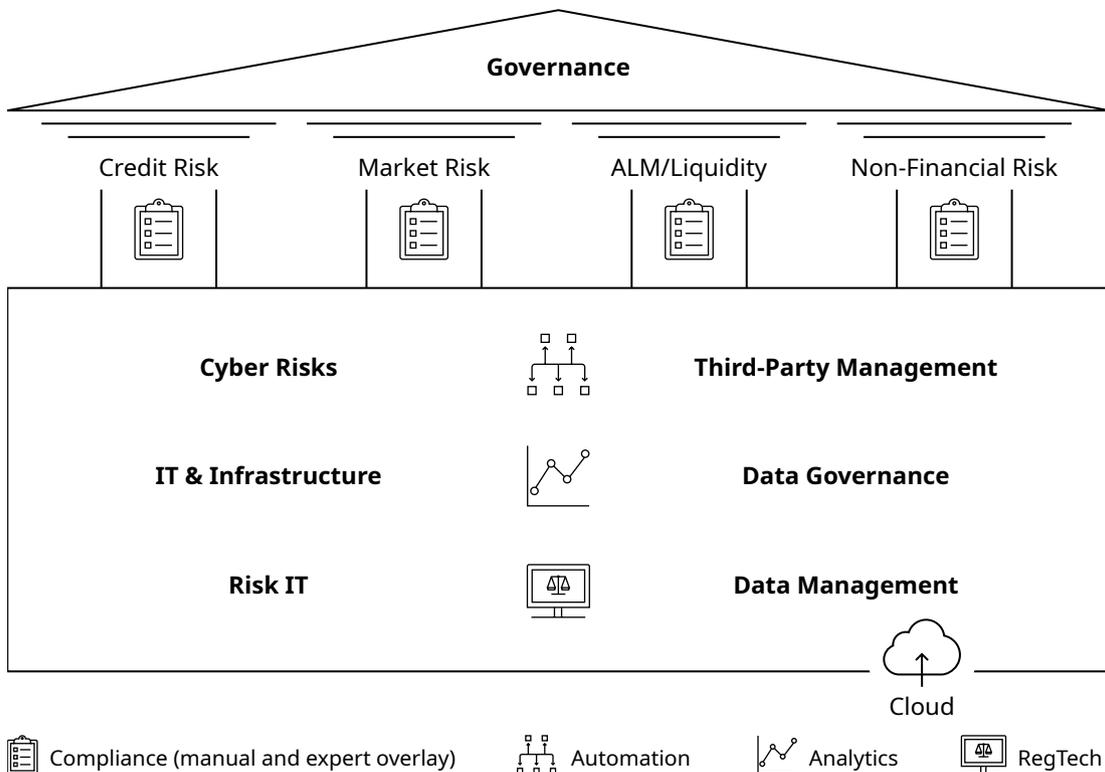
Source: Oliver Wyman Analysis

## MEDIUM TERM — TECH-ENABLED PROGRESSION

In the medium term, traditional risk silos are thinned down relative to overall organizational activity, as functions are commoditized and outsourced. Cross-risk utilities expand and are integrated further with other analytics. There is a greater move of known processes — especially those concerning regulatory scrutiny, such as capital adequacy and stress testing — out of the second-line risk organization and into other areas such as finance and operations.

The relative need for risk specialists will decline with the outsourcing of commoditized functions, for example financial risk, where credit decisions might increasingly be derived from bureau and external data. A greater proportion of risk function resources will be dedicated to cross-risk, lateral functions, in which core activities include policy setting, oversight, the design of stress and scenario testing, and the monitoring of emerging risks.

**Exhibit 2: Tech-enabled progression**



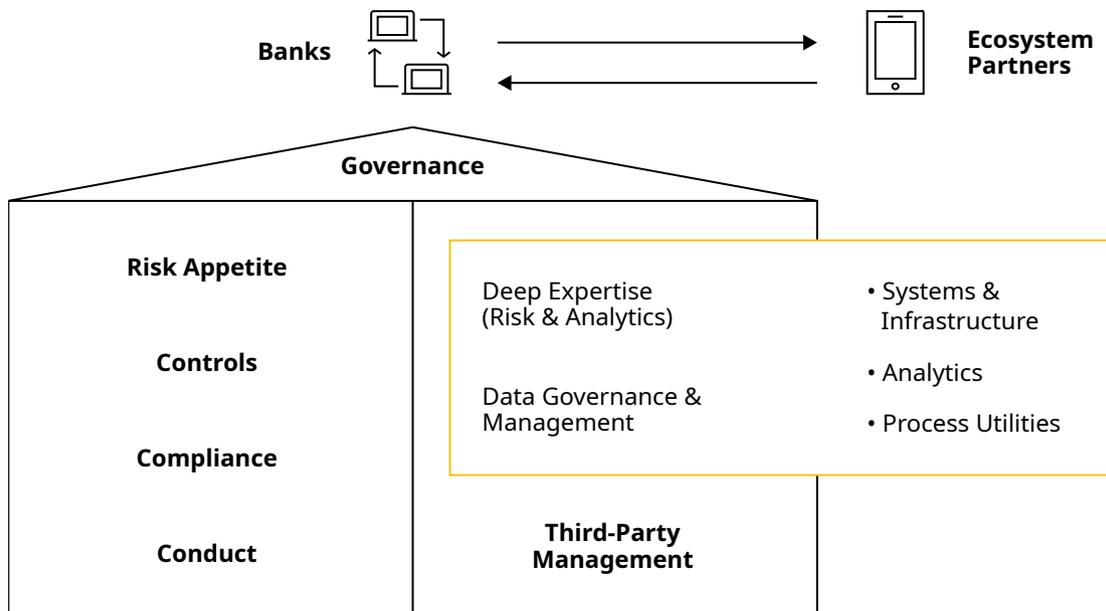
Source: Oliver Wyman Analysis

## LONG TERM — FUNDAMENTAL DISRUPTION

In the long term, many risk functions may be radically slimmed down, as a financial institution re-focuses on governance, control, and cooperation with third parties. This model is already present in technology firms and FinTechs and will certainly be easiest to adopt for non-regulated and monoline firms. Larger universal banks may achieve this model only in parts, for example in retail and SME banking, which may lead them to carry out strategic reviews of certain portfolios of activity.

In a modularized banking environment, large-scale tech players and industry-wide utilities will dominate parts of the risk value chain. In-house risk management will play an even more strategic role, with its greatest focus on their firm’s specific areas of competitive advantage.

**Exhibit 3: Fundamental disruption**

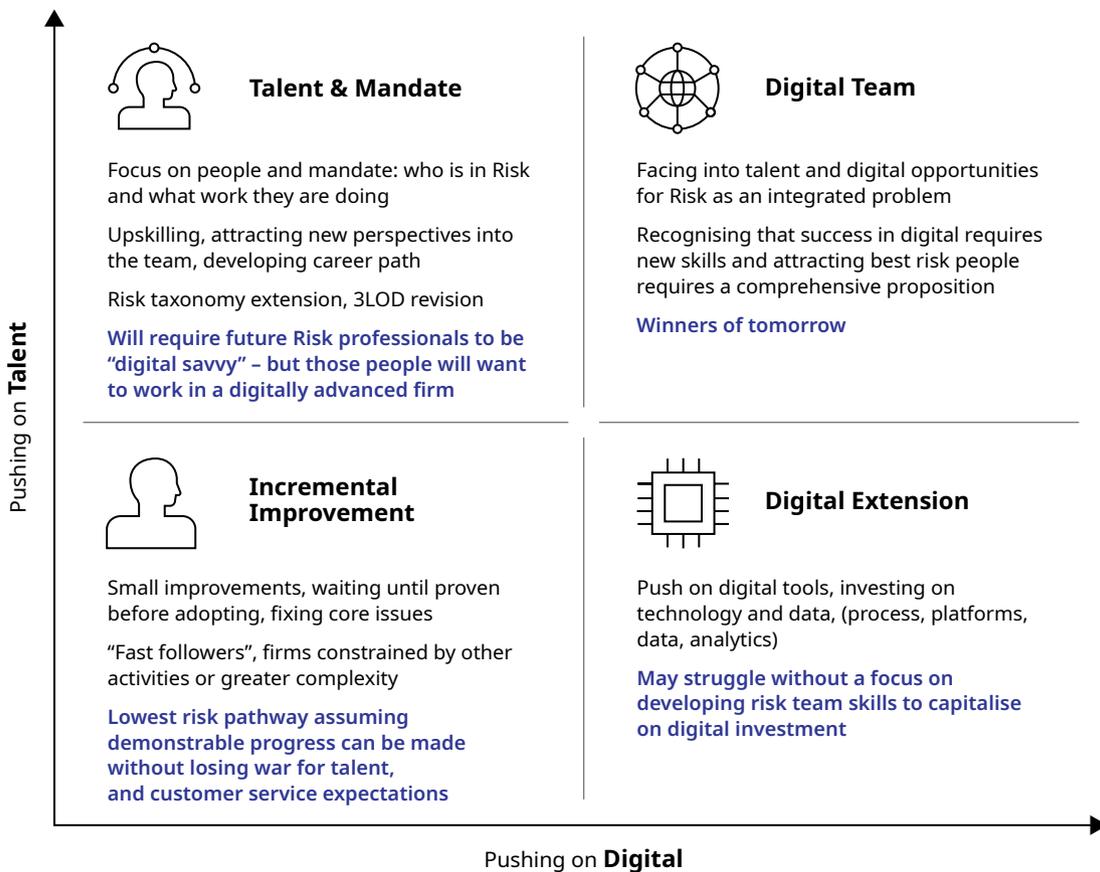


Source: Oliver Wyman Analysis

# CONCLUSION

From our discussions with risk leaders, it is evident that larger firms have focused more on talent and organization, pushing into the upper-left quadrant in Exhibit 4. Smaller firms have made greater digital advances. This finding is consistent with smaller firms' commensurately simpler ranges of product offerings making them more ready and able to implement widespread change to underlying technology.

**Exhibit 4: Measured against these themes, survey participants fall broadly into 4 archetypes**



Source: Oliver Wyman Analysis

But the future does not belong solely to the FinTechs. We believe the winners of tomorrow will be the firms who approach talent and digital opportunities as an integrated problem for risk. Aspiring leaders must recognise that success in digital requires new skills, and that attracting the best risk talent requires a comprehensive career proposition.

Oliver Wyman is a global leader in management consulting that combines deep industry knowledge with specialised expertise in strategy, operations, risk management, and organisation transformation.

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