De-Risking Financial Institutions In ‘The New Beginning’

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Background and key dimensions of pandemic impact

After the 2008 recession, financial institutions (FIs) & central banks have been continuously building resilience against market shocks to avoid resorting to public funded bail outs. Capital & liquidity buffers have been maintained at a healthy level through the past decade, that can now be used to mitigate the financial crisis triggered by the current pandemic.

Moreover, in responding to the pandemic, global regulators have come out with similar responses, by encouraging FIs to support customers in surviving this crisis and gradually land on their feet. To this purpose, many non-critical regulatory deadlines have been postponed in order to reduce the operational burden to some extent. In brief, the guidance has been:

- An increased focus on protecting consumers and market integrity in the short term, and remaining vigilant against financial crime
- Continuation of liquidity injection into the markets to avoid any ripple effect resulting into a systemic breakdown
The present crisis has an impact on various dimensions of business operations. These repercussions fall under four main buckets – Financial, Operational, Customer and Regulatory – that can ultimately lead to business disruption (see Figure 1).

CRO / CCO response to pandemic impact to date

The impact of COVID-19 has dealt a dual blow creating supply chain disruption and demand-side slowdown. The chief risk & compliance officer (CRO/CCO) division plays a key role in the mitigation of rapidly emerging risks and to lead recovery efforts into the new beginning. Two primary focus areas are driving these efforts: client centricity and operational resilience.
Moreover, the risk & compliance leadership is using pandemic impact (e.g. changed working practices), as a strong driver to accelerate their digital adoption roadmap. The upcoming two quarters will prove critical in determining the future course of the financial organization and industry.

Operational resilience and customer centricity will become the overarching theme for CROs to deliver confidence and continuity of services

Indicative regulatory focus

We are witnessing a two-way push across the regulatory spectrum, with the focus increasing in some areas and easing out in others. Broad categories across global regulators include:

**Client Centricity**

- Efflux of Remote operations & change in operating model to ensure client safety and continuity of services
- Focused analytics to sustain surge in call demand and agent supply, along with dedicated helplines and personalized services
- Creative customer engagement & communication mechanisms
- Minimize customer Complaints and drive positive conduct outcomes
- Deal with client challenges by delivering out of the box services & customer centric risk management
- EWI’s to effectively assess sectorial risks and drive mitigation

**Operational Resilience**

- Identifying critical processes, staff and infrastructure to prioritize mitigation and deliver remote services
- Re-calibration of financial risk models & streamlining model risk management frameworks
- Deliver Capital optimization
- Improvement in controls effectiveness across the enterprise with special focus on fin crime
- Execute BCP & DR plans
- Re-prioritize and right-size book of work
Outcomes map in the New Beginning

With the rapid evolution of financial ecosystems, the risk and compliance function is also constantly growing in coverage as the result of newer risk types into the governance, risk and compliance (GRC) spectrum. The pandemic has accelerated this change, and encouraged CROs to reassess & reimagine their core capabilities and the corresponding expansion possibilities in delivering incremental value, positioning CROs/CCOs as potent catalysts in optimizing risk-return profiles.

Furthermore, there is also an active focus on proactively developing transformational capabilities toward delivering a competitive advantage for the organization. The segregation of outcomes across core, adjacent and transformational themes can be seen in Figure 2.
Role of emerging AI and ML technologies to re-imagine use cases

In a recent survey report conducted by TCS and Chartis across 166 relevant risk business & technology leaders, covering retail and commercial banks, capital markets institutions, and insurance and wealth management firms, we discussed the maturity of AI in their institutions, and the potential for further uplifting these capabilities to deliver specific outcomes. The next few sections list some of our key findings.

In enterprise resource management (ERM) the use of artificial intelligence (AI) techniques is focused on non-regulated use cases, such as the generation of early warning signs, and the analysis of what-if scenarios instead of regulatory reporting projects. A representative of a large universal bank proposed leveraging AI capabilities to construct a varied and expansive stress and scenarios library. The bank could then scan tens of thousands of benchmark results, and millions of market data points, to pinpoint potential areas of concern.
In regulatory reporting, AI has been used in managing and validating data, validating results against predetermined criteria and monitoring overall compliance. Representatives from several large banks explained that they are now running elaborate data management and validation programs using strong machine learning (ML) and related analytical frameworks.

In financial crime risk management (FCRM), respondents see the greatest benefits in anti-fraud, anti-money laundering (AML) and cybersecurity applications, with KYC an area of growing interest. Client screening using external risk factors and alert prioritization frameworks for sanctions screening and transaction monitoring are providing greater resiliency in the management of financial crime signals.
In operational risk, quantifying has traditionally been extremely challenging. Standard statistical models have struggled with the relative paucity of data and lack of deep statistical processes. However, in our discussions with banks and other FIs, three key trends stood out:

- Widespread digitalization has effectively solved the data paucity problem.
- External and internal networks can now be monitored in much greater detail.
- There are broad uses for AI in non-financial and operational risk management contexts, although one quarter of respondents are not engaged.
CROs’ evolving influence in a client-centric ecosystem to deliver growth and transformation

CROs are gradually moving toward a user journey-driven operational model that’s focused upon client centricity. Initiatives like improvement of customer data view, including hardships and dispute analytics, enable insights for a more informed and empathetic decision making by the frontline. This model also requires reimagining of business services and processes to improve throughput and risk management efficiency.

Moreover, in the time of crisis, strengthening workforce availability and effectiveness in forbearance, and restructuring cases and guidance on alternate products is imperative to expand operational capacity and ensure business continuity. CROs are looking at strengthening risk & compliance capabilities to deliver insights and value-added services, like ratings and hedging advisory for SME clients, and defensive measures like improving customer data protection against cyber-attacks and financial crime, to create competitive advantage in the marketplace.

These factors, coupled with an expanding profile of a CRO, necessitate a larger ecosystem to mitigate the expanding risk profile of financial institutions. Figure 3 shows different enablers participating together in a conducive ecosystem:

Figure 3: Risk ecosystem view
Horizon for CRO initiatives (6 to 8 quarters)

We are witnessing a sudden surge in risk clusters and their interplay, which has never been observed before in recent history. While we have had pandemics in the past, the potential impact of a pandemic has increased exponentially, due to the sheer size of today's global banking system, and an ever increasing reliance on the infrastructure to conduct day-to-day transactions. In such an environment, prioritizing remediation initiatives is proving very challenging for CROs. Figure 4 visually represents this horizon of prioritized initiatives.

In summary, the pandemic presents unique challenges and opportunities for the FIs in adapting to a new normal of delivering business continuity in a remote operation’s dominant setup. Risk & compliance organizations have so far responded well, in delivering client centricity and operational resilience, wherein FIs are going above and beyond their traditional mandates, with value-added services for customers while continuously adopting newer design patterns. Capability uplifts in areas like conduct risk mitigation, reputational risk management & early warnings for shifting left, are emerging as priorities, with a customer centric use journey approach, to deliver client protection and enablement.

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