POINT OF VIEW

How banks can manage risk during and after the crisis

Due to COVID-19, banks are under increased pressure to provide financial assistance to consumer and commercial clients. But with the impact of this disruption still unknown, how can chief risk officers (CRO's) help their banks adapt in the short term and come out stronger in the future?

Gina Hertel, head of editorial for banking and capital markets, Genpact, interviewed Manish Chopra, global risk and analytics leader and Enrico Dallavecchia, head of risk practice, North America, Genpact, to shed light on this important topic.

Gina Hertel: This is a very unusual time for banks in terms of managing risk, isn't it?

Manish Chopra: This is not only an unusual time for banks, but also the beginning of a new era. How banks look at risk today is materially different from how they looked at it just a few months ago – they have been forced to accept more risk. The journey toward work from home solutions and digital transformation is one that banks thought would take years. But it has to happen now.

Gina Hertel: Enrico, you were the former chief risk officer for Fannie Mae and PNC Financial during the 2008 global financial crisis. As a former CRO, what would you say are the key areas that chief risk officers need to be thinking about today?

Enrico Dallavecchia: CROs need to pay attention to several areas, but today I'd like to focus on operational risk and credit risk.

We are now operating in a new environment where, worldwide, banks' staff, service providers, and clients are all, for the most part, working off-premises. But banks haven't based their risk controls, compliance practices, and business processes on remote ways of working. So there has been a significant increase in operational risk.

From a credit perspective, a recession that encompasses most industries and geographies will cause a spike in delinquencies and put a lot of pressure on portfolio monitoring and default management. Banks will have to accelerate their implementation of digital capabilities to effectively cope.

Gina Hertel: In today's environment, banks are becoming more of a lifeline to customers. What are the implications of this?

Manish Chopra: Banks are already seeing a significant rise in the number of customers asking for credit and credit management. As we move forward, these numbers will only go up.

Small and medium-sized companies are looking for credit lines because their revenues are slowing, and they're still trying to pay their employees, suppliers, rent, and more. In the US, the CARES Act, which the Senate passed just last week, materially increases the availability of credit to small businesses by relaxing eligibility requirements and providing grant funding. So banks will have a week, at most, to get ready for a twentyfold increase in credit applications. And consumers are also contacting their banks for financial help, requesting, for example, moratoriums on credit card payments – because they're facing layoffs and wondering how to pay the bills.

Meanwhile, banks are fueling additional customer contact by letting customers know they can help with payment holidays or forgiveness for delayed payments. To handle this surge in inbound and outbound contact, and to move fast to assist clients with their credit needs, banks need to scale intelligently and fully embrace an omni-channel approach.

Gina Hertel: It sounds like banks will have to continue helping millions more than they used to – and all at the same time. What will that look like in practice – and will it beoperationally difficult?

Enrico Dallavecchia: Yes, it will be difficult. Banks are set to operate in what we call a 'goldilocks' economy – one where the temperature is just right. This pandemic will require most financial institutions to alter their business models to handle the increased volume in customer contact.

Staff augmentation is one solution. But just throwing bodies at the problem will not solve it. Banks also need to plan for staff to operate remotely, safely, and ramp up their omni-channel approach to customer interaction. This should be backed up by analytics and digital capabilities that enable staff to work smarter.

For example, robotic process automation solutions like chatbots can help banks respond to customers' questions more quickly, cost-effectively, and consistently than they could with a traditional workforce alone. They also enhance productivity in call centers where agents are currently exhausted due to high call volumes. And machine learning and analytics models can help devise scripts that will be most pertinent to the current environment.

Gina Hertel: What operational risks are associated with banks suddenly upscaling their responses and switching to different solutions? And what can risk officers do to mitigate them?

Manish Chopra: Banks need to prepare for a material increase in fraud. They're responding to an increased volume of contact from customers through more impersonal and often remote channels, and they're trying to deliver credit quicker than usual.

This is creating a situation that a whole range of bad actors will look to take advantage of. But risk officers can prepare for this. Digital and analytics make it possible for banks to have a more sophisticated understanding of their clients' circumstances, which they will need to spot fraud in this environment.

For example, there's going to be a dramatic rise in unusual banking behavior (like spikes in cash withdrawals and the use of online and digital financial services). Fraud models are based on patterns in historical and transactional data, which enable us to pinpoint anomalies and identify risks. But customer behavior is changing dramatically right now. So banks need to be nimble in the implementation of new models to determine whether these behaviors are actually criminal.

Gina Hertel: With changes to credit policies, and an increase in customer demand and delinquencies, how can CROs manage their banks' credit risk during this time?

Enrico Dallavecchia: It's important to remember that this is an economic crisis, not a banking crisis. It will be harder for banks to manage credit risk. First, because the need for credit is higher. And, second, because banks will have to be more lenient in their definition of financial hardship. For example, if a customer hasn't lost her job, but her partner has, the bank may allow her the option of a payment holiday. This will put pressure on banks' credit-loss reserves.

So, even though banks are far better capitalized than they were during the 2008 financial crisis, they need to be even more confident about their liquidity. Risk officers should be stress testing their position regularly, especially given the current level of volatility and dynamic changes to government policy. This is an area that can really benefit from artificial intelligence to help banks model complex, developing scenarios with a lot of variables.

CROs should also be looking to invest very quickly in digital and analytics capabilities that help them to understand which of their commercial clients is in the most trouble, who has the most exposed supply chain, whose business is too concentrated, and so on. I'm talking about things like sophisticated end-to-end portfolio monitoring for early warning signals, collateral monitoring (which becomes a lot more important as more loans go into default), and machine learning to prioritize when, how, and from whom to collect to mitigate loss.

Gina Hertel: Manish, what are your thoughts on how banks can manage their credit risk?

Manish Chopra: I agree with Enrico. In addition, CROs also need to stop and think about how long this crisis will last. The duration will impact the assumptions in their risk models and the activities they decide to undertake. At this point, I feel it's better to be safe than sorry, and to plan for an extended duration. This will lead banks to implement more agile policies, set clear priorities for their staff, and turbo charge their digital capabilities, which will only put them in a better position to serve their clients in the future.

Gina Hertel: Bank CROs are going to be stressed-out at the moment. Do you have any final advice for them?

Enrico Dallavecchia: Yes. This is the perfect storm. It's impacting almost every country, every industry, and every business, at pretty much the same time. The complexity of this situation is unprecedented. No business continuity or disaster recovery plan could possibly address this exact situation. But that's the nature of the beast. There will necessarily be some degree of inventing as we go along.

With that in mind, I would say to management: It's going to be very difficult for you to prioritize what to address first. But data and analytics can help. And you need to find a way to make yourself some headroom. Your job is to think about the problems that will exist in six or twelve months' time. The way to do that is to delegate, either to your own team or to partners, or both.

Gina Hertel: Manish, what parting words of wisdom do you have for bank CROs?

Manish Chopra: In times of crisis, it is not uncommon for businesses to look inwards. But it is imperative right now that banks connect with other banks in the industry, other companies across sectors, and service providers to converse widely and figure out how to address problems. There are huge collaboration opportunities ahead of us.

Don't try to solve everything yourself. Speaking to other banks will help you understand their respective risk appetites. Is it higher or lower than yours with respect to, say, collections agents working from home? And what safeguards are they putting in place? Communicate with regulators too: banks will be implementing a whole new set of capabilities - for example, machine learning models to analyze customer data. Banks need to be able to explain these models to auditors and regulators - both to keep them in the loop and to benefit from the collective wisdom they will acquire as they see best practices rolled out across the sector.

Banks are critical to our economy and our society. Right now, management teams need to strike a balance between prudently extending credit to serve their clients and maintaining the right liquidity and capital ratios to stay solvent. Then, and only then, will we conquer this crisis and emerge stronger on the other side of it.

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