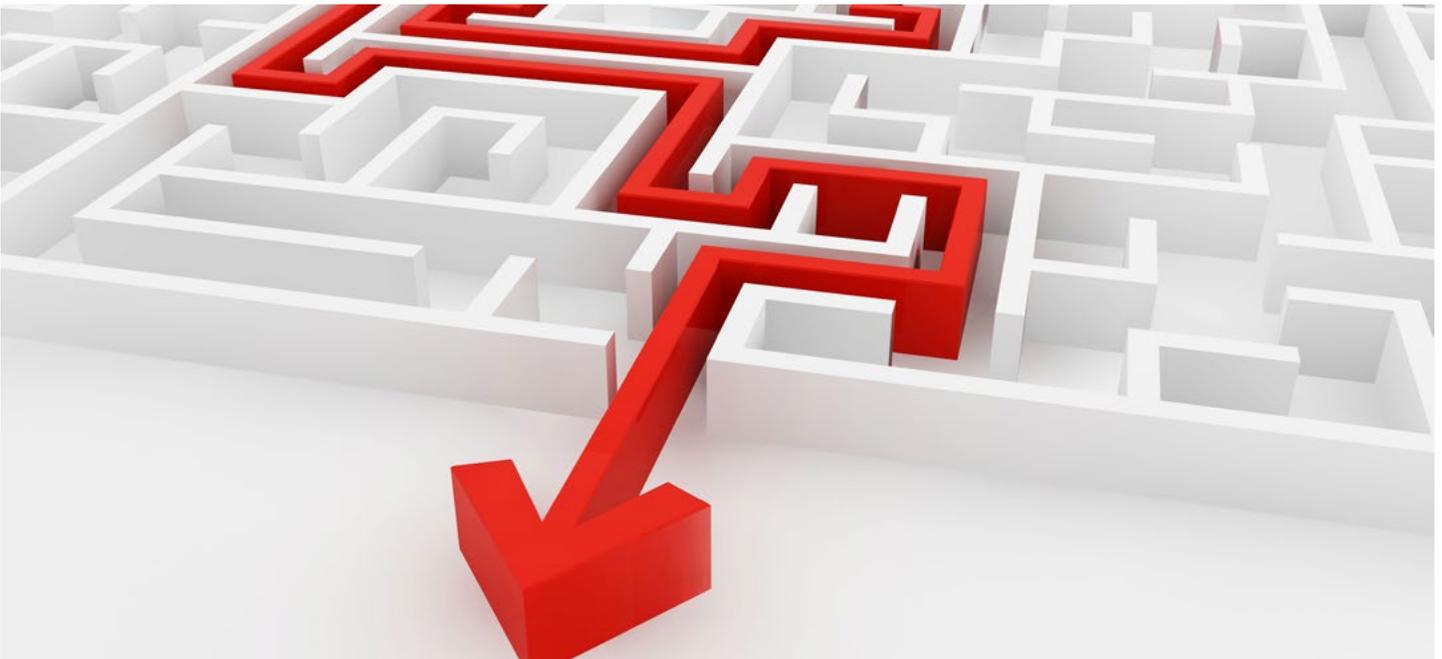




Toward a Lean risk function



Under mounting regulatory and margin pressure, banks need to start making material structural changes in order to stay profitable. In particular, operating models must be fundamentally transformed to create and protect value for the organization and enhance the management of governance, regulatory, and compliance risks on a sustained basis. Currently, business as usual (BAU) risk activities such as stress testing and risk analytics account for approximately half of the risk function's workforce costs, leaving very little budget to actually change the bank. Banks must reduce costs in order to free up time and money for transformative risk projects that will add value to the organization. A **Lean-based approach for risk management**, utilizing a combination of process-centric digital technology, principles derived from Lean management methods, and design thinking is the most effective way forward.

Banks are currently looking to reduce their cost-to-income ratios in order to carry on the deleveraging process and build capital buffers as required by regulators. With that goal in mind, various cost-reduction initiatives have been launched across the entire industry. Low profitability, driven by both cyclical and structural factors, is undermining current risk operating models and processes. Relying on BAU processes will not work. Banks are therefore considering operational excellence projects that leverage advanced analytics by **embedding digital solutions** into core risk and regulatory processes.

Externally, stakeholders and regulators are demanding more transparent and reliable information in less time. Internally, boards of directors and management teams require fast and accurate information to support informed risk and capital decisions. The challenge for banks is to increase efficiency within the risk function while cutting costs to restore profitability. However, if banks reduce the resources dedicated to regulatory activities in order to cut costs, there could be consequences elsewhere—risk functions might not have adequate resources for strategic issues and innovation, for instance. That would hamper the process of capital optimization and the technological adaptation that is vital for long-term viability.

Most risk processes are similar to the processes carried out by other functions in the bank, and could benefit from **alternative operating models** such as centers of excellence, risk managed partnerships or shared services centers which could be run at a fraction of current costs and enable firms to put a greater focus on strategic risk initiatives.

Current landscape and challenges

Regulatory matters—from addressing areas of non-compliance to implementing tactical and structural changes to meet new rules—are consuming disproportionate amounts of board time. The need to address the proliferation of new rules often means that risk change management is in fact institutionalized as a BAU function in many banks. This also means that once new requirements are implemented and related processes moved to BAU, the level of efficiency is **sub-optimal**.

Figure 1 illustrates the typical lifecycle related to the implementation of a new requirement. The more mature and embedded the process is, the better opportunities there are to standardize, industrialize it, and make it more efficient.

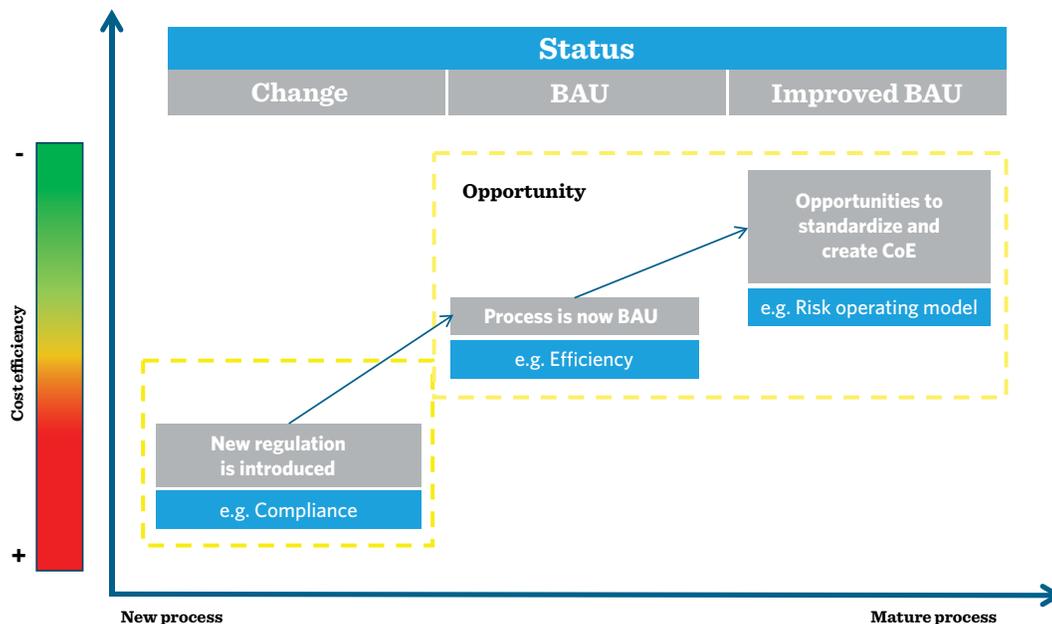


Figure 1: Example of lifecycle when new regulation is introduced and application of Lean to processes

When new processes are introduced, there is often a limited focus on efficiency, as the main objective is to achieve compliance. Once the change activity is completed and new processes and resources become BAU, these are absorbed within the day-to-day management of the function. At this point, there is an opportunity to improve efficiency; banks should take stock and evaluate efficiency gains that can be obtained by integrating and industrializing BAU processes (new and established), in addition to considering different operating models such as outsourced centers of excellence or co-managed risk managed partnerships.

Time to make risk lean

Process efficiency, cost reductions, forward-looking analysis—these are just some of the things that have not been top of agenda (at least not concurrently) for chief risk officers (CRO's) over the past few years.

Risk management is lagging behind other functions, not only due to regulatory priorities, but also because of technology and change management issues. Rooted in Lean principles to minimize waste and create efficiencies that drive value, a **Lean risk management**

solution assesses an enterprise's end-to-end risk management function. CRO's considering a lean risk management approach need to consider strategic-level initiatives, capital planning, and core processes, such as monitoring and controls.

The **first step** is to create a structured process that helps answer a number of fundamental questions:

- Is the function doing the right thing? For example, who is the end customer for the particular stress testing process? How are the results used?
- How should risk be organized for most effective delivery?
- Can improvements be made to the organization's processes, tools, and approaches?

Lean methodologies, when applied to mature risk processes, release resources which can be utilized for strategic risk management. Lean implementations contribute directly to the bottom line by reducing costs and give executives broader perspective on process, making it easier to identify additional opportunities for improvement.

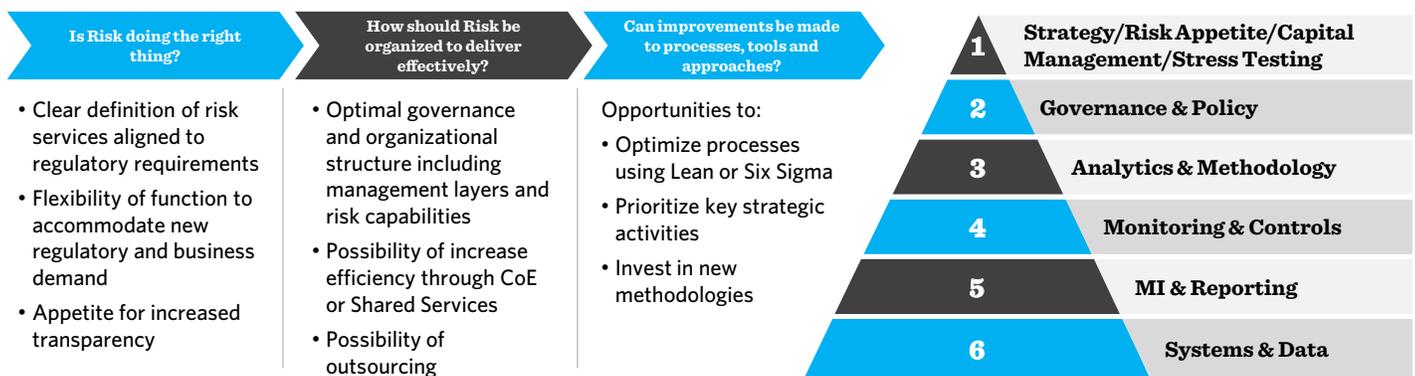


Figure 2: Fundamental questions that should be addressed by banks

Achieving a lean risk and regulatory function

Most regulatory-driven and risk-related processes, such as stress testing, have some level of inefficiency. A Lean-based approach in combination with digital technologies and risk and regulatory domain knowledge can be used as an enabler to identify areas of improvement, such as mapping of regulations against current risks and controls, and assessments of the cost-impact of new regulations.

Figure 3 shows how breaking down a risk sub-function into its component parts, grouping by areas of influence, and determining candidates for operational improvement provides a roadmap.

A Lean-based approach in combination with digital technologies and risk and regulatory domain knowledge can be used as an enabler to identify areas of improvement

	Key activities & requirements				
Governance & policy	Operational Risk Framework	Operational Risk governance structure	Operational risk policies & procedures	Business Continuity Policy	Outsourcing Policy
Strategy/risk appetite/capital management/stress testing	Risk appetite structure	Strategy and vision			
	Capital modeling	ICAAP framework	Validation methodology	Stress testing	
Analytics & methodology	Operational risk event database	KRI monitoring framework	Scenario analysis	Model development	Model governance & validation
Monitoring & controls	Risk and control assessment framework	Business "use" of the framework	Business education on op risk methodology		
MI & reporting	Operational risk reporting	Escalation processes	Regulatory reporting requirements	Management reporting	
Systems and data	Data infrastructure	External data (ORX, ORIC)	Data quality		
	Operational risk management system				

Opportunities for industrialization

Potential for industrialization

Strategic, not for industrialization

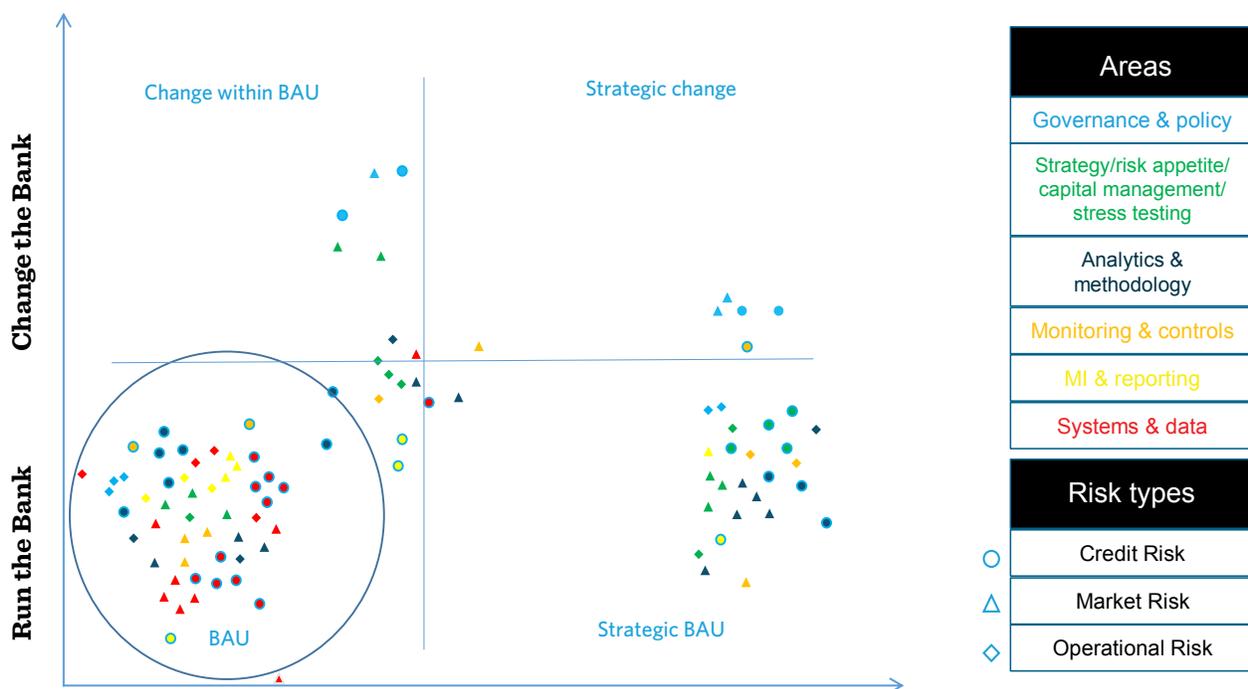
Figure 3: Example of key activities assessment for operational risk

Once the key activities of all risk sub-functions are assessed, they can be mapped on a matrix as seen in **figure 4**.

The example provided below illustrates how a number of activities carried out within the market, credit, and operational risk spaces could be standardized and transitioned to advanced operating models, thereby releasing valuable capacity for strategic risk management activities.

The steps towards lean risk management include:

- **Qualification** and interpretation of data using cognitive computing, machine learning, and robotic automation
- **Quantification** of comprehensive risk assessments using digital technologies such as natural language processing and advanced analytics
- **Execution** of targeted actions
- **Realization** of process efficiency and value added which can release capacity and resources for “change-the-bank” activities



Opportunities to apply lean risk and industrialize activities

Risk executives should find synergies across sub-functions to:

- Understand if the risk function is effective
- Identify an optimal operating model
- Identify process, tools, and approaches which can generate the required impact

Figure 4: Opportunities to apply a Lean risk operating model to the risk management function

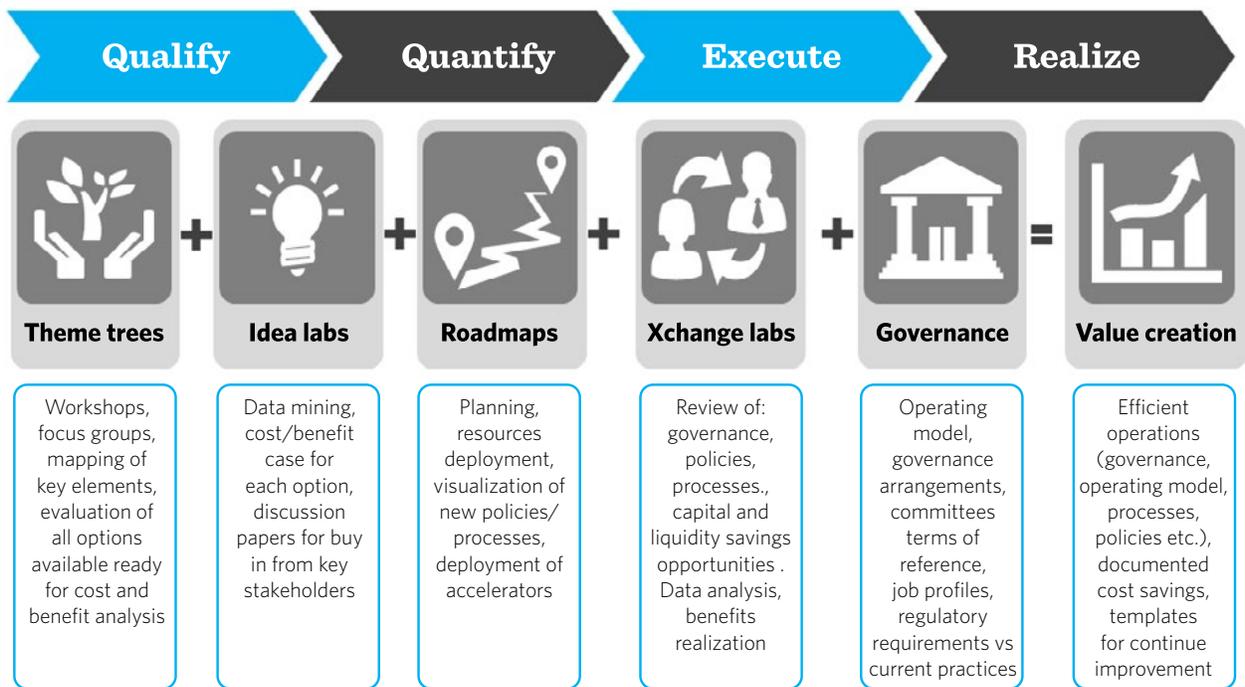


Figure 5: Typical steps to identify opportunities to apply a lean risk operating model

Figure 5 shows the full list of steps that a bank will typically take in order to industrialize its risk management function. Through the application of a structured approach, a bank can achieve an estimated impact of 25%-45% (based on results Genpact has obtained industrializing processes and delivering Lean methodologies).

Supporting lean risk management with digital accelerators

Lean thinking often gives a broader perspective on a process, making it easier to see the possibilities for improvement. Lean risk management, in

combination with **digital support**, can help banks ensure that both the risk management function and return on associated strategic initiatives reach maximum potential.

Digital accelerators such as automated model validation, automated model documentation, and financial spreading have been developed utilizing advanced machine learning capabilities, which give them an edge over other "static," or traditional, accelerators. Leveraging digital accelerators expedites and automates a large number of activities, enabling firms to achieve a lean risk management function faster and more efficiently.

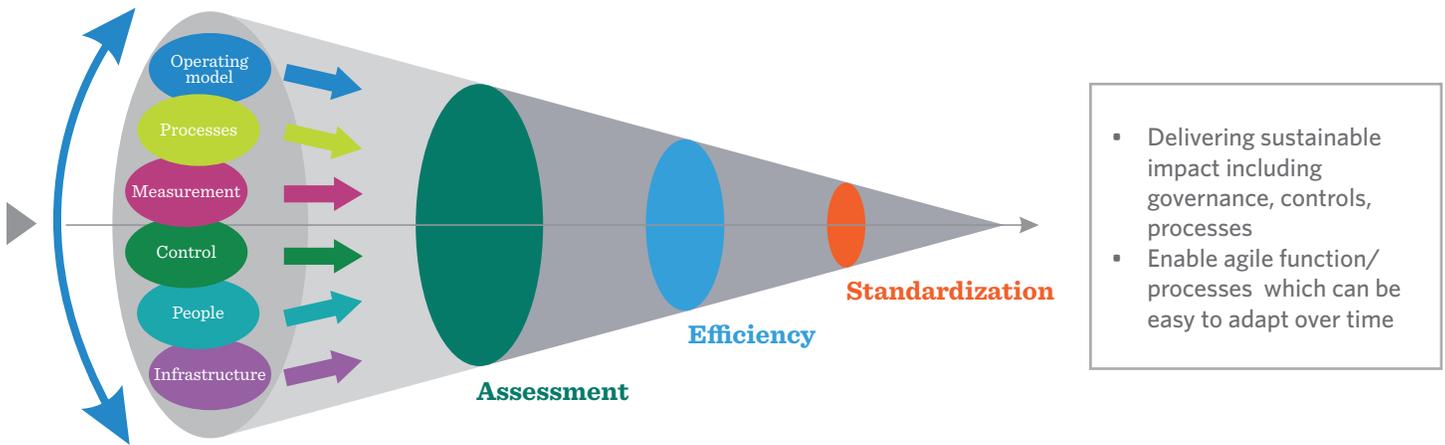


Figure 6: Digital accelerators can increase the accuracy and efficiency of the assessment and help standardize identified processes

Conclusion

Lean risk management is a logical and collaborative approach to addressing common challenges within the risk-function. It enables the risk function to become more accountable and agile streamlining processes

and aligning it with stakeholder values. With rising costs of regulatory compliance concomitant with shrinking margins, the prospects of boosting efficiency, cutting outlays, and freeing up capacity through Lean based thinking is more compelling than ever.

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About Genpact

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For additional information, contact, banking.solutions@genpact.com and visit, www.genpact.com/what-we-do/industries/banking-financial-services

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