“CHANGING SUITS FOR CHALLENGES AHEAD WITH SMART RISK CULTURE”

Indraka Liyanage
Head of Risk, ICICI Bank

1. Introduction

Challenges are identified in many ways. In recent years financial entities faced various such challenges, which were not seen during an era of a decade earlier. Each of these challenges will consist of a particular aspect of risk management at the expense of a business strategy invented by these financial organizations. Information technology risk, compliance risks, liquidity risks and consolidation or enterprise risk management are some of the terms now commonly used to identify such risks. If these risks were addressed in isolation without integration, it would be to an activity similar to that of some blind men trying to define an elephant. Though it is difficult to ascertain the delimitations of risk management aspects versus the controls used by financial organizations, nevertheless it is also difficult to explain the functions of these firms without a proper integrated risk management system. It may be also due to the fact that process of an integrated risk management system is a complex process within the organization. With the increasing tense of changing phase it becomes more sophisticated for organizations for adaptation to new regulations and in the meantime they will neither make it easier for financial firms to move into such modern utilities.

As concerns of risk management become more intense with rapidly changing environment, one may ask whether the contributions made so far are adequate to address these changes. Ideally these new developments and methodologies should be helpful to achieve the goals of financial organizations while ensuring the safety of such entities. The systematic approach of identification, analysis and response used in risk management according to the activity or the unit should be properly used for improved functions of financial institutions. Hence the transformation of solo risk management processes to new concepts such as Integrated risk management or enterprise risk management will define a better culture in financials entities, which could minimize the impact during a time of crisis. Increasing investments in risk management, especially after the crisis in 2008 shown its imperativeness towards business functions and at the same time the contribution of such activities have made in preventing their repetitions thereafter. However with emanating risk in unknown territories it is always prudent to prepare for changes if necessary to prevent failure of organizations in future.

2. The changed Landscape

The playing field has changed for many financial organizations. Mainly the regulatory bodies have imposed many new controls as the conditions change in the environment. The rules have risen and then fallen in strength as the time pass according to the market conditions. Fall of many international banks and some local finance companies have led the authorities to impose such regulations on existing firms. It is an on going process and an evolving one too. Some of the changes include the balance at the top, which has resulted in transformations to the 'tone from the top' of these organizations. However, the cost of regulation does not favour the business environment as it leads firms sometime to compromise on level of implementation.

These changes sometime have a ripple effect on financial organization's external environment. While the impact by the main regulator relates to doing business the other ancillary regulations impact the earnings of the firm. Hence cumulatively the firms are beaten on many sides. This is inevitable considering the public backlash on the regulators when things go wrong. While many evolving instruments are available in the market regulators also will have to take necessary measures based on growing public opinion about the world of financial services. We saw that the main aspects of business that are done these days such as remunerations, risk management, transparency and detailed reporting are mostly governed by external control factors. This may due to the complexity of the structuring of investments and client aspirations.

Another effective aspect would be that legislation born during crisis situations are continued event during good times restricting expansion. In the meantime it is noteworthy to mention that the existing regulations had little or zero impact on preventing the crisis, which would take place during a downturn of conditions in the environments. While legislation ensures proper control for on going scenarios, new entrances and innovations to the markets are not immediately reviewed until a major impact is foreseen. Hence they may be politically motivated and real protection of the sector is yet to be observed in many environments.

Some game changing legislation was introduced to protect public from unscrupulous practices within the financial services sector and they have been made law from time to time. Some of them are the money laundering regulations and anti-money laundering sanctions regulations, which have an impact on the processes of doing business. Due diligence activities under such regulations would need some sort of stringent measures for client on boarding and processing of transactions.

Looking forward on fintech and cyber related products would be a major part of financial services in time to come. With every financial institution opting for such new technology the emanating risks of such activities could not be avoided. Such new developments will need infrastructure change over while the organizations would similarly need measures to control, monitor and ascertain the level of operations in such sectors. Independence of such processes is also required to ensure better risk management controls. With financial innovations happening in highly regarded roundtables,equal action should be taken for the hype in cyber sales. The movement of funds one end to another would take place at such high speed the financial organizations need to adopt methodologies for monitoring purposes. Though these activities take away many human interventions the cost involved should also considered. Similar cost for a risk management arm would not be explained on such occasions to ensure proper monitoring which have a hindering effect on adopting proper systems for monitoring purposes.

We cannot put aside the global economic growth, productivity and the job creation in new sectors, which would challenge the financial operation. The new emerging business operations in technology would need vast movement of assets as well as skills. The knowledge becoming obsolete will happen in a rapid pace than in the current context. The required level of trainee and trainer requirements also will challenge the industries. In the world of low interest rates clients would look out for guaranteed steady yields in investments. Even the infrastructure investments like roads, railways, airports and ports will face challenges based on the investments they would generate on the short run.

Increasing economic crime should be debated for prevention and action. The significance of intelligence and controls becomes an important factor in such situations where public interest would be a major component for perusal. However with boundaries of knowledge in these new methodologies adopted, increased research would assist those who are involved in prevention. However uncertainty will prevail in all sectors if the predictions are not done on a more accurate manner. With continuing professional development and self-assessment techniques it would help many industries for early detection and prevention. Therefore the latest studies should focus on issues concerning uncertainty as highlighted in many forms by expertise in the risk fraternity

3. The risk element

Risk behaves in accordance with the normal patterns in environment and does not attach any special phenomena. It can neither be created nor destroyed where it exists and would be true for even financial surroundings. The proportions in which it emanates would differ from each product; time the markets operate and depends on many other components. However, one should understand how it will relate between the perceptions of such scenarios and the reality and the level it may hit each incident.

It is a known fact that individuals are exposed to all kinds of risk in everyday life. Such activities as crossing a road will create a risk until the pavement of the other side of the road. As such in the financial markets the risk is acquired by investing in an asset. There will be an uncertain future for that asset until the value is realized. This may happen by selling that asset at an accepted price. Though it is assumed that cash has no risk but some historical incidents depict that in an economy where inflation is present, the said statement will not stand for long. However there are many other elements we could envisage in case of investments in assets in the financial world but will be not discussed here. However, we should be aware of such exposure that would be available when dealing in financial assets by the industry. The risk could be taken or removed on the action taken by purchasing and sale of assets in such an incident.

The uncertainty that prevail in the asset while is kept in the custody will attract a price. Some assets will have a predetermined value at a future point guaranteed and will carry lesser risk for its value as cash. These features are identified as the return element of risk taken and will vary from product to product.

The use of word risk is rather imprecise in many occasions. Some of such elements could be identified in the following chart.

The above breakdown of total risk in an asset illustrate some of the main components. It will be not a comprehensive explanation of the risks, which would be seen in an incident. It should be noted that transmutation of risk between different elements comes into play during a real time scenarios of financial market behaviour. The ways in which each risk is captured would not be explained here but the reader would understand that these risks could be identified in each incident we may come across. The list of risks which are not identified would be included in other risks and also would include future risks too. In real life incidents some of the risks could be measured correctly while others are unmeasurable. These measured risks could be neglected or potentially swept. The alchemy of risks could be identified by looking at each financial institution's book and out come of the risks could be figured based on impact of such products.

4. The reasons for embracing change

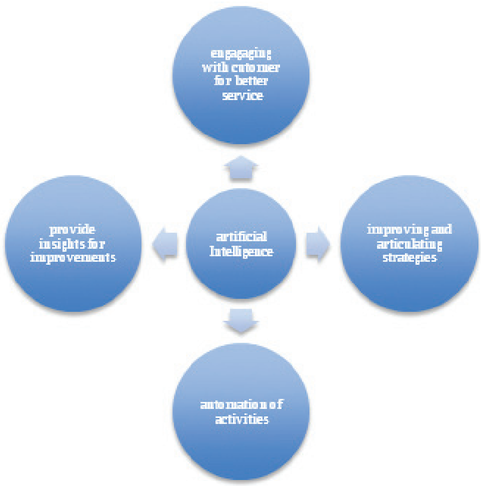
Changes take place in all fronts. How these are adopted in the organization will depend on the strategies used by each institution. The socio-economic behaviour also plays as a major contributor for these changes to be effective. If a simple example of the multi- channels used by banks in present context could be listed as

Traditional – Branch network, call center, ATMs (Automated Teller Machines)

Digital – Mobile banking, Internet, Point of sale, BC Channel (Banking Correspondent), Phone Banking, Apps

In time to come these may be developed in to many virtual banking concepts facilitated with QR code adaptation. It is inevitable that one bank will require to move to the latest invention in banking tech development to keep abreast with the other competitive firms for survival.

Many partnerships are built with fin-tech companies and banking institutions to ensure survival. Some of the advantages in such partnerships would include scalability, Product life cycle, trust, buy vs build decision and vision. With these advantages the banks benefit by getting along with the fin-tech companies. The other latest innovations in the industry would include use of artificial intelligence and cognitive technologies for smart banking industry. This activity could be broadly described in following sectors



the latest but not least addition to the financial sector is the robotic automation process where most financial transaction activities would take place with minimum or zero human intervention. Global banks are investing in big time in such methods to ensure an efficient and accurate service delivery within those financial organizations. This will improve the way in which financial transactions are carried out in future and the risks would be minimized in such processes. Since other industries are also shifting to robotics it would be an easier task for the financial industry to integrate with such sectors.

5. Changing suits

The global recession in 2008 witnessed many large companies not making it through the tough times, which resulted in failure. The governments had to interfere and rescue many financial firms ultimately having an impact on taxpayer's funds. Businesses opting to unknown areas of operations would require the risk management function also to move into more stringent and controllable functions. The adaptation of IT risk management function within risk management could address the development in technological developments. In addition the invention of various derivatives would need strengthening the market risk function for monitoring of movement and volatility in the portfolios of banks.

Some of the big threats in IT (Information Technology) related areas would include phishing fraud, sniffing attacks, intrusions and cyber attacks. Moving further vulnerabilities in fake KYCs (Know Your Customer) manipulation of files and misconduct by employees are some other areas, which are identified in risk management functions. Since most banks are on plastics the PIN (Personal Identification Number) attacks are also emanating at present such as skimming activities. The prevention controls in some of these threats would prevail at the front line of operational areas of financial firms. Hence the controls should be imposed in such intensities to ensure safety of the organizations.

Therefore the adaptation of suits to counter attack the threats in the industry would be challenges faced by the banking sector. Sometimes the operations officer would have to get into the risk manager's suit to ensure stringent operations of the bank. The risk manager would need the skills and functions of the business manger to understand the business so that correct decisions are made especially with regard to credit and market risk activities. The business activities are so complicated that decisions taken based on paper may not carry through in many occasions. In the meantime periodic reviews by both sectors are necessary for continuity and ERM processes.

6. Conclusion

The contextual imperatives of risk management concepts should not be missed. The context detects the risk management process and the relative emphasis on changing suits for challenges in new market trends. The more relevant and stable context basic risk management functions need to be improved to suit the modern products and operations. With complicated markets and operations and business competition it is inevitable that complex products are innovated to attract customers for their convenience. However the protection of investor rights are also important socio economic obligation.

The importance of having a proper risk management culture and process, which create a framework for organizational operations, should be introduced. This does not and should not limit the business activities of the bank. Within this culture the banking firm may evolve over time for better-managed bank. These adaptations will assist them to achieve the desired objectives of the banks with minimum interruptions for the business results of the bank. Adaptability to suit the changes in markets and creativity will also take the organization forward with correct risk management function. We should remember the comforts we had in the old school do not assist us to take the organization to the next level with the changes but at the same time having controls and monitoring tools to suits the present day complex world of business.