White Paper

Reformatting Risk Management for Financial Institutions in the Age of Digital and Tech 3.0

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Introduction

Current risk management structures, protocols and practices are under pressure like never before. To unlock the solution needed to address today's risk challenges, an exploration of 'Tech 3.0' may well uncover the elusive key that bank directors and risk managers are searching for. It provides real potential for top risk managers to rethink their approach to risk and redesign the basis upon which risk culture and risk frameworks are built.

What is 'Tech 3.0'? Web 2.0 loosely defined the Internet's evolution into a network, group and collaboration platform. The continuing evolution of technology and its application is now well beyond Web 2.0. 'Tech 3.0' has been coined here to represent everything broadly associated with or enabled by 'social', 'digital', or 'mobile'. It is a loose collective of new technologies, applications, capabilities and behaviours that are converging to produce a proliferation of previously unimagined outcomes. As a result, this convergence, referred to here as 'Tech 3.0', is creating opportunities for fundamental change.

Tech 3.0 and the management of risk. Tech 3.0 is opening up a significant new horizon for risk management strategy, by recasting the role of the individual in organisations. It is changing the way we inherently act, think and work.

However, the significant task of embracing Tech 3.0 to deliver significant gains in risk management should not be underestimated. While, it presents the opportunity to audaciously reset risk frameworks and culture, it is also fraught with real danger as new thinking and new skills are required. Absolute commitment to the transformation must be made before embarking on this journey.

The purpose of this paper is to provide a small window into the potential for achieving major advances in risk management objectives through substantive reform of methodology, frameworks and culture – now possible with Tech 3.0.

Financial institutions and the increasing risk challenge

In recent years, a parade of banking scandals has hit the headlines: trading irregularities, the LIBOR scandal, wrongful selling of derivative products to unsophisticated clients, just to name a few. Public confidence is continually being shaken. Many now simply ask the question: "What will be the next piece of bad news?" These events bring sharply to light the daunting challenge involved in achieving and maintaining the failsafe risk systems, strong risk culture and robust operational disciplines board of directors of financial institutions demand.

The perfect storm? The current climate may be the 'perfect storm' for bank risk. No growth globally, sovereign debt issues, regional economic challenges, Tech 3.0 revolution disrupting whole industries. These forces are putting

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unprecedented strain on financial institutions and their ability to meet shareholder performance expectations, remunerate staff at historical levels and even provide job security. For employees (even good ones) working under enormous performance pressure and financial stress, the temptation to 'blur' risk boundaries is stronger than ever. Add to this the fluid, dynamic and volatile nature of financial markets risk, and there should be no surprise that scandals continue to surface!

A traditional response

Many risk managers have attempted to meet the challenge by adding increasing layers of policy & compliance: more rules, stricter rules, more levels of supervision, more audits and higher hurdles. All these measures are adding greater complexity to daily operations and decision making. This traditional approach blunts innovation, dulls creativity, hinders decisiveness and undermines strategic risk taking. In so doing, it diminishes the much needed competitive advantage banks are desperately seeking, in order to succeed in today's tough market.

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The irony is this: the greater the bureaucracy imposed on managing risk, the less effective it will likely be. Our hypothesis is: greater bureaucracy will only serve to further reduce scope to achieve performance objectives, and so heighten performance stress. This simply puts people put in the position of having to make bigger trade-offs (concerning risk) in order to get the business done, meet performance requirements and achieve their remuneration goals. The temptation is to accept bureaucracy as a proxy for transparency.

Many risk failures evidenced today find their root in systemic failure at both the organisational and cultural level.

There appears a clear and present need for fundamental change in corporate cultures and risk management approaches for financial institutions. At the same time, technology is significantly changing the way we behave, live and work. This presents new opportunity for forward thinking institutions to radically change their approach to risk management and rise to meet today's significant challenges.

A fresh approach – introducing 'Tech 3.0' to the enterprise

The catalyst for seismic change: Major institutions the world over are only just beginning to come to grips with Tech 3.0 and how it can be utilised for the enterprise. Tech 3.0 is changing behaviours and revolutionising how work can be done in many industries and markets. It is opening up new ways to manage work practices, empower staff, power productivity, build collaboration, increase transparency, drive accountability, facilitate cultural transformation and deliver innovation.

The enabling impact of Tech 3.0 provides the catalyst to rethink the fundamental building blocks supporting risk management frameworks.

Tech 3.0 can:

- Increase transparency
- Enable collaboration, remove barriers and empower employees at all levels
- Democratise and maximise speed, flow and reach of information
- Strengthen cross company communication
- Drive desired behaviours, values and work practices
- Deliver dynamic risk identification, analysis, assessment and decisions
- Enable real-time activity tracking, escalation of issues and faster problem solving
- Drive real-time accountability and performance management
- Expedite best practice deployment
- ... and more!

Let's consider one aspect ... the social enterprise

'Social democracy' rather than bureaucracy is a more effective way to increase transparency – key to strong risk culture.

Cognitive bias: Research shows individuals are predisposed to refrain from openly discussing or thinking about risk until it is too late! People tend to overestimate their ability to influence an outcome to avoid the risk scenario. This confidence anchors a cognitive bias favouring supportive and dismissing contradictory evidence.

This is often further exacerbated by 'groupthink'. A strong enterprise 'social eco-system' can help counter this. It empowers employees to question existing assumptions, collaborate across silos and contribute to decisions.

Democracy, not bureaucracy: An enterprise 'social ecosystem' has the effect of democratising information and liberating decision making. It achieves this by empowering employees to take responsibility for managing their own broad based communication networks and protocols across silos and functional areas. It is built on the same premise as social network 'wiring' that many employees exercise in their personal space.

Example 1 – Incubating risk: A key challenge for any risk framework is overcoming the dangers of risk 'compartmentalisation' – the inability to pick up on the interaction of seemingly disparate risks in an overall picture. It allows minor failures to be tolerated, early warning signs treated as false alarms and deviance to normalise over time. In these circumstances, risk is incubating.

How 'social' helps: Properly managed, an enterprise 'social eco-system' empowers employees at all levels, breaking down functional and divisional silos. This allows relevant information to be quickly sought, exchanged and disseminated, delivering vital information and transparency across an organisation. At a big picture level, this increases an organisations ability to become aware of more risks, more quickly, with scope to analyse broader interaction between risks more comprehensively. Thus, helping to reduce systemic incubation of risk.

"…an effective risk framework … should … enable businesses to engage in greater … risk taking."

At the coalface, it also facilitates faster more comprehensively informed decision making.

Example 2 - Early warning radar: 'Separation of duties' protocols ensure all transactions must have multiple team members involved. Generally, these protocols involve formal communication both inside and outside the team. Within a 'social eco-system', tools can be utilised to filter, track and trend communications and other 'chatter', forming a bespoke early warning system. Risk officers can also follow specific deals, transactions or projects.

Example 3 – 'Whistle-blowers': A 'social eco-system' can afford greater more sophisticated protection to 'whistle-blowers' by creating multiple avenues of contact, which are simple and more discreet. This opens the gate for more people willing to 'point' Risk Officers in the right direction, potentially well before it is technically 'whistle blowing'.

'Social Enterprise' so far: To date, the focus of such initiatives has been on collaboration, information flow and speed to customer. It has transformed corporate cultures (delivering authenticity and integrity) and improved collaboration, productivity and transparency.

Early adopters are finding the nature and speed of information flow is powering agility and innovation, and building competitive advantage in a dynamic market environment. It is also reaping gains in employee engagement and satisfaction.

Some gains in risk management effectiveness have been achieved, but only as an indirect consequence rather than a conscious strategy. The opportunity is to establish risk management effectiveness as the key objective of such a Tech 3.0 initiative to powerfully reform risk management methodology across the organisation.

Beyond social

While 'social' on its own can deliver significant benefits to risk management, it is only one pillar of Tech 3.0. The Tech 3.0 suite includes: social[1], digital, mobile, mobile applications, cloud services, big data, high performance analytics, visualisation, virtualisation, gamification, crowd sourcing, context-based services… the list goes on and is growing. Tech 3.0 is ubiquitous, intelligent, social and disruptive.

Furthermore, technology is continuing its advance, devices are converging, data flow and capture is exploding and intelligent big data analytics is entering a new phase of sophistication and performance. Tech 3.0 is providing the pivot point for 'changing the game'.

[1] While 'social' was also a key platform of Web 2.0, it has significantly evolved to become a critical pillar of Tech 3.0.

The opportunity

Tech 3.0 is intersecting with and often powering what were traditionally non-technology based areas such as: culture transformation, change management, behavioural science and organisational psychology. The challenge is to piece together Tech 3.0 and these non-technology levers to work in concert, integrated with business processes to achieve a desired risk result.

Irrespective of an organisation's current risk model, a creative and wide reaching utilisation of Tech 3.0 functionality is critical in crafting the ideal risk culture and framework. If the approach is comprehensive and properly integrated, it has the potential to transform the way employees work, create product, sell, trade, problem solve and achieve their objectives. It will also reset how risk is considered and managed.

"... ensure all the right dots are joined in the right sequence and with the right interconnections."

Strategy & implementation

A Tech 3.0 enabled risk strategy must be holistic in its conception, pervasive in its planning and tactically staged in its execution. A piecemeal approach will create disparity of focus, an inability to build momentum for change and dysfunction in the existing risk framework, generating system risk of its own.

New mindset and unique skills: The challenge is to bring together diverse and complex areas of expertise and constructively combine it with company, industry and market knowledge. Only then will ensure all the right dots are identified and joined in the right sequence and with the right interconnections to achieve the audacious objective of reforming risk management.

Success requires a new portfolio of skills, namely a critical mix of:

- Leading business & market insight
- Risk management expertise
- Deep technical skills (business operations & technology)
- Understanding human behaviour
- Significant business analytics
- Strong design skills
- Experienced cultural change capability.

These experts must be brought together in a collaborative environment to constructively challenge current thinking and create a new and transformative Tech 3.0 approach to risk management and culture.

***Renovate, not detonate*:** Many existing management control and risk systems may need to be preserved, though perhaps rewired and redeployed. Existing IT systems will also play an important continuing role. A critical success factor is Tech 3.0's ability to generate content and derive power by integrating with an enterprise's existing systems (CRM, ERP, Risk etc), for effective and timely results.

***Not simply another IT or 'cultural change' project*:** The goal is to revolutionise the technological and behavioural context within which risk philosophy, framework and culture are augmented and all risk initiatives are integrated, implemented and managed.

***Months, not years*:** Organisations harnessing the power of Tech 3.0 are progressing at a rapid rate. Projects are being measured in months not years!

The leadership imperative

The leadership challenge: Risk management runs counter to most leadership team 'can do' cultures. This is understandable as they strive for growth and search out new opportunities. Consideration of risk is often perceived as negative (threats and failure) in comparison to strategising about growth (opportunities and success). Leaders must overcome this bias and exemplify the belief that strategy is as much about 'risk' as it is 'opportunity and execution'. It is as much about managing risk as it is driving efficiency.

A compelling irony: Far from inhibiting risk taking, an effective risk framework – able to manage inherent downside – should actually enable businesses to engage in <u>greater</u> strategic and innovative risk taking.

***Absolute leadership commitment*:** Going down the Tech 3.0 path requires clear, unified & unwavering *commitment* from the top. The initiative is about systemic cultural revolution. Appropriate resources and authority to get the job done must back this commitment. Given the magnitude and critical priority of the exercise in the current climate, if risk reform strategy is not leadership enabled, driven and resourced, it will fail to deliver on its promise.

Conclusion

Enterprise risk remains a clear and present danger for banks. This paper has endeavoured to open a small window into the new potential to achieve rigorous risk management objectives. By looking through the lens of Tech 3.0, the ability to reinvent and reformat risk frameworks and the foundational risk culture upon which they are built, is now real.

"... a new mindset and a unique skill set are required to bring together diverse and complex areas of expertise..."

To transform risk management framework and culture is an audacious objective, requiring unwavering commitment from a united leadership. Designed and executed well, enabling Tech 3.0 in your business will reinvent risk management and provide: agility, engagement, collaboration, innovation, decision making and drive growth. The challenge is to identify all the right dots, joining them in the right sequence and with the right interconnections.

Leadership Resources
.... helping to 'join the dots'

We consult to organisations on the journey towards a 'Tech 3.0 enabled enterprise'. We work with leadership teams to design a comprehensive strategy to achieve the vision for audacious change. We help plan, support and resource implementation.

We bring a unique mindset, critical thinking, lateral thinking, creative and design skills and a well-honed 'generalist' skill set to the task. We facilitate the synthesis of the critical disciplines and moving parts. We also work with specialist partners in all mission critical areas to ensure best practice expertise is applied to deliver market leading outcomes.

Our resources and those of our partners cover: strategy, risk advisory, technology expertise, competency and capability enablement, data analytics, culture transformation, behavioural science, organisational psychology, organisational development, people development & training, leadership coaching, performance management, corporate communications and project management.

If you would like to discuss this topic further or require more information, please contact:

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About the author

Michael is a management consultant to corporations transforming performance and culture utilising Tech 3.0 strategies. He is also an investor and director in a number of leading edge technology ventures. He is formerly Chief Operating Officer of Macquarie Private Bank and Division Director of the Macquarie Group, working in Australia and Asia. Risk management and achieving commercial imperatives were core responsibilities. He also consults to Aon Risk Services and OAMPS Insurance Brokers (a Wesfarmers business), advising corporate brokers on understanding client risk and developing risk advisory capability. His risk management philosophies and approach were first developed when working as an executive with the highly regarded Lend Lease Group (property and financial services) in the late 80s to mid 90s. He graduated in economics, accounting and law from the University of Sydney.