White paper

Risk assessment in financial services

New research shows that risk assessments can provide value for more than just regulatory compliance. It can also improve business performance, with automation being key to this more strategic role.

pwc

Financial services: The evolving role of risk assessment

The assessment of risk has been a core capability in the financial services industry, but in recent years, it has become more important and more complicated. As a result, many financial institutions are taking a deeper look at their processes and trying to find ways to get more out of their risk management capabilities, according to recent research.

Today, many financial institutions operate in an expanding, dynamic risk environment. Risk can now arise from a growing array of sources, including competition, economic uncertainty, cybersecurity threats, operational problems, and environmental concerns—among other things. This reality is making it increasingly necessary to be able to identify, quantify, and decrease the damage of risk, quickly and accurately.

To better understand how financial institutions are conducting risk assessment in a changing world, marketing research firm KS&R and PwC recently conducted a study including more than 200 executives and managers involved in risk assessment at a range of financial institutions, including banks, insurance carriers, asset and wealth management firms, investment banks and securities firms. Among the key findings of this research: Financial institutions are taking a broader, more holistic view of risk management, and their expectations and goals for the process are evolving.

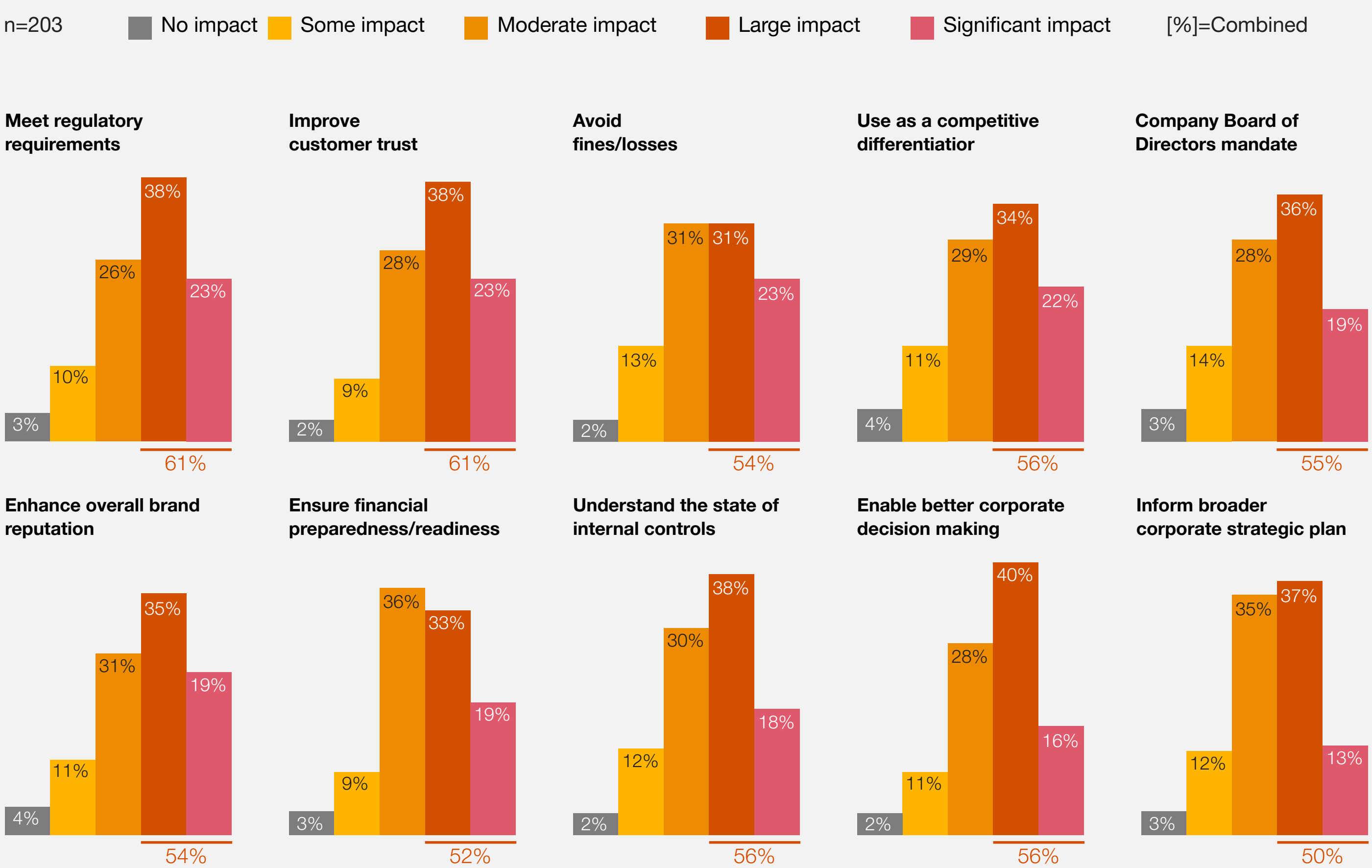
Traditionally, risk assessment efforts have been driven by the demands of regulatory compliance and the attempt to avoid the high fines and reputational damage that can result from not being adequately prepared for risk. But now, as they continue to invest in risk assessment capabilities, many institutions say that their investments are driven by other, more business strategy-related factors, such as competitive differentiation and the ability to enter new markets. In short, often institutions are looking for more from their growing investments in risk assessment. They are considering the combination of better business performance (e.g., the ‘carrot’) along with avoiding compliance issues (e.g., the ‘stick’)—this view can represent a significant shift from the past.

To achieve those types of benefits, institutions should overcome a range of obstacles. The research points to steps they can take to improve risk assessment that can help achieve a broader range of benefits from their investments. In particular, it can clearly show the positive impact that technology can have on risk assessment—and highlights the growing role of automation in making risk assessment more effective and, ultimately, helping institutions compete more effectively.

Greater expectations

As financial institutions invest in risk assessment capabilities, they are responding to a growing range of factors. Certainly, regulatory compliance is still important, with 61% of respondents saying it has a large or significant impact on their decision to invest in risk assessment. However, the same percentage said that improving customer trust was a top aspect—and many other factors related to the business, rather than compliance, were not far behind. These included competitive differentiation, enhancing overall brand reputation and informing corporate strategic plans. Many also cited internal factors, such as facilitating financial readiness, understanding the state of internal controls and following the mandate of the board of directors.

Impact of factors driving business investment in risk assessment



As one might expect, those drivers can help map closely to the desired outcomes that financial institutions want from their investments in risk assessment capabilities.

Here, respondents most often pointed to creating a competitive advantage (52%) and improving their ability to operate and grow in a high-risk environment (51%). Avoiding regulatory punishment was ranked fourth, cited by 48%.

Many respondents also pointed to strategic outcomes such as increased growth, the ability to offer new products and services, and the ability to enter new markets.

Desired outcomes from company's risk assessment investments

Overall, these findings indicate that there is a growing recognition that effective risk assessment is not just a regulatory requirement or a burden. Rather, it can be a powerful tool helping drive the business through outcomes such as building trust, differentiating the brand and exploiting growth opportunities. Indeed, being better at risk assessment helps make an organization better at risk management in general. That opens the door to being able to pursue markets that others cannot reach—including riskier markets that tend to be less competitive and therefore more profitable. In an era of ever-growing risk, that ability can be a powerful competitive advantage.

While often many financial services companies foresee a growing range of business benefits from their investments in risk assessment, they are also aware that they can overcome key challenges to reap those benefits. When asked to identify the key barriers to applying a risk assessment process, respondents most often cited the challenge of having to stay aware of ever-changing risks and cost concerns.

Interestingly, many respondents said that a lack of industry-specific tools and difficulty finding the right solution were key barriers—the latter being more frequently cited by respondents from banks and insurance carriers.

Certainly, there is no shortage of tools and solutions on the market. These responses may stem from the growing range of strategic business-related expectations that institutions have for risk management, which require more sophisticated, tailored, real-time approaches, compared to those used in traditional regulatory-focused risk management.

Somewhat surprisingly, relatively few respondents said that siloed data was a problem.

Key barriers to a successful risk assessment process

Risk assessment today

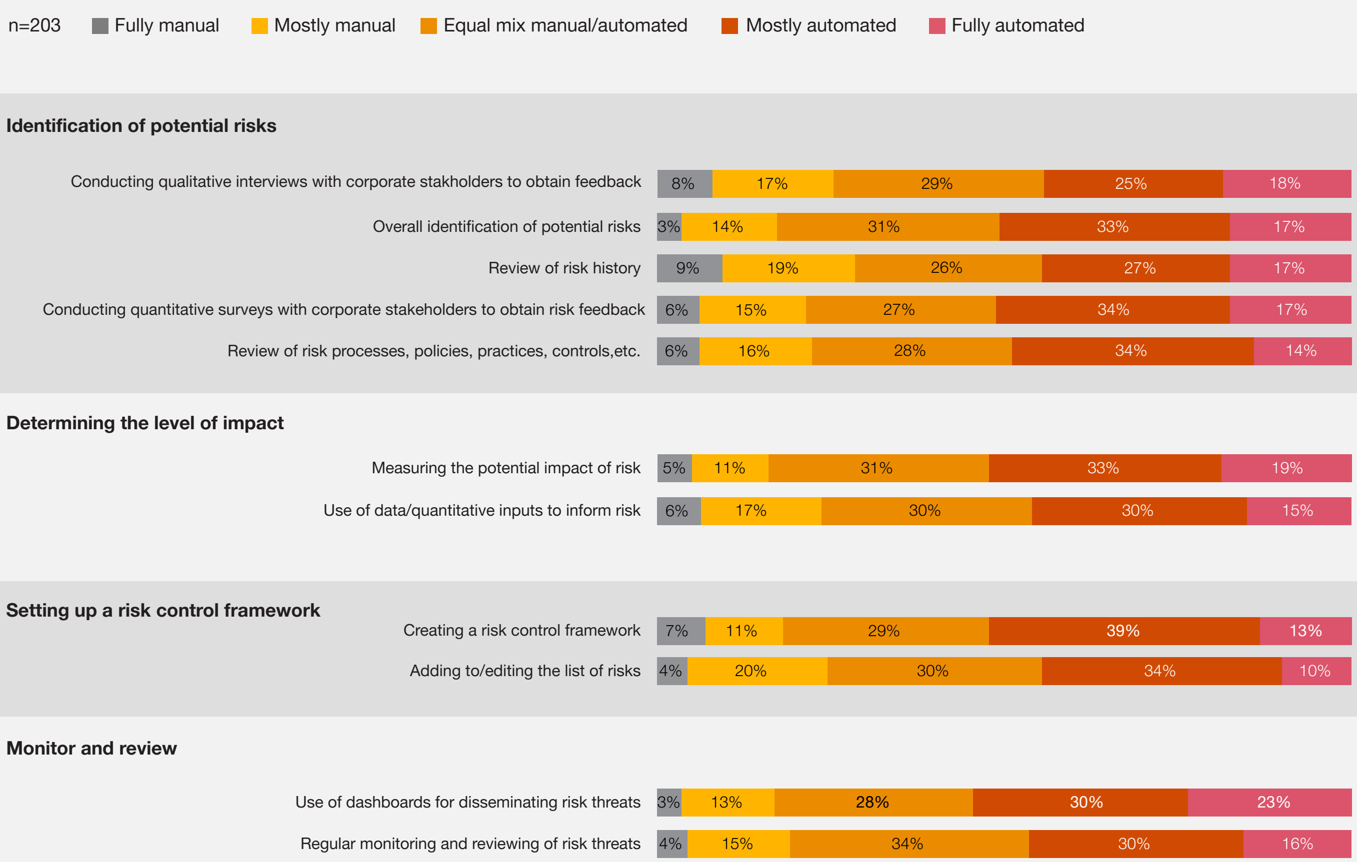
The study also gauged the current state of risk assessment at financial institutions, and, in particular, how widely and effectively they are using technology to support and enable risk assessment processes. Most have moved many parts of the process away from manual/paper-based work, but the levels of automation vary.

Across four risk assessment workflows—identification of potential risks, determining the level of impact, setting up a risk control framework, and monitoring and reviewing—the penetration of automation is similar. In various parts of those workflows, only a small percentage (10% to 23%) of financial institutions are fully automated.

Roughly one-third are mostly automated, and the remaining one-half or so have some mix of automation and manual/paper-based activities.

For example, the activity likely to be fully automated can be the use of dashboards for disseminating risk threats (23%). Sixteen percent do this through an entirely or mostly manual approach.

Degree of manual or automated support across risk assessment workflow activities



Meanwhile, researchers asked respondents how confident they were in their institution's current approach to risk assessment.

Only 18% said they were extremely confident, while 48% said they were mostly confident. Thirty-four percent essentially said that they had relatively little or no confidence.

When asked why they answered as they did, about 5 out of 10 in the more confident group said that they thought their current risk-related processes were strong. Fairly low percentages cited specific factors such as their use of technology (11%), the ability to gather risk-related feedback from stakeholders (9%) and strong data analysis capabilities (5%). It is possible that the higher levels of confidence among some respondents may decline as more institutions look beyond the traditional demands of compliance to focus on business-oriented outcomes from risk assessment, which requires more sophisticated capabilities.

In the less-confident group, 21% said that they needed to improve the risk-assessment process. Specifically, they cited the need to make room for growth and the need for improvements in technology/automation. Some noted that the threat landscape is always changing or that it is impossible to avoid 100% of the risks out there—a recognition of the growing range of risks facing the industry.

Overall, for a majority of financial institutions, there appears to be room for improvement in the risk management processes, particularly in the use of automation—even among those who were mostly confident in their current processes. Many respondents seem to agree. About 6 out of 10 indicated that their organizations plan to invest more in risk assessment automation in the next 12 to 18 months. Respondents from Tier 1 financial institutions were most likely to say they had such plans, with 66% expecting to increase their investments in the near future. Overall, institutions report that an average of 60% of their risk management investments are spent in-house, compared to 40% being spent on external resources. Respondents who said they had difficulty finding industry-specific tools were more likely to be focusing on in-house efforts, suggesting that many institutions are opting to build their own tools.

Operating the process

The research explored the details of how financial institutions can perform the risk assessment process. Typically, they involve a variety of roles in the risk assessment: Most often, this includes risk assessment leads, cited by 71%, followed by the chief risk officer (60%), cybersecurity professionals (57%), the chief information security officer (44%), the chief technology officer (38%) and the CEO (20%). The chief risk officer is most likely to be the head or champion of the process (cited by 34% of respondents), followed by the risk assessment leads (20%).

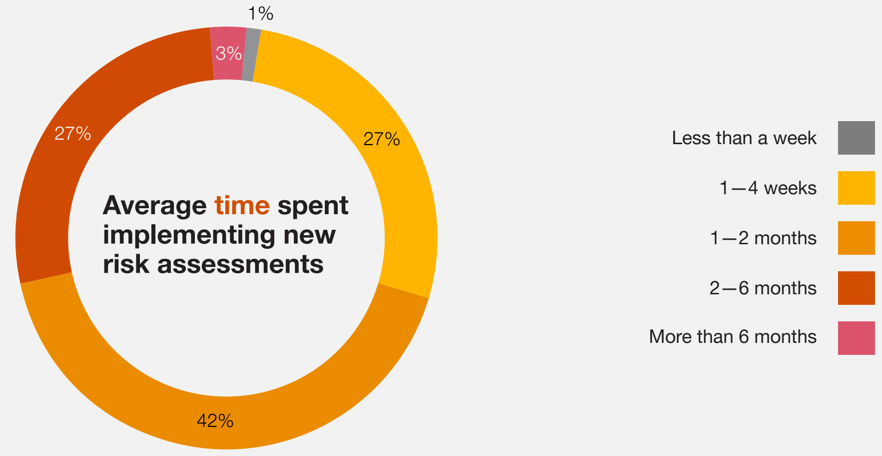
In terms of frequency, 45% of financial institutions are conducting risk assessments on a quarterly basis that help provide regular updates, and 16% do so on an annual basis to develop a snapshot of risk. A sizable number (39%) are now conducting assessments on an ongoing, dynamic basis using near real-time data—an approach that is typically suited to meeting strategic business goals with risk assessments, and that generally requires higher levels of automation. Indeed, many institutions conducting ongoing assessments also place a relatively high importance on drivers beyond regulatory compliance, such as the ability to operate and grow in high-risk environments, to sell new products and services, and to enter new markets. Not surprisingly, Tier 1 financial institutions are significantly more likely to conduct ongoing risk assessments, while Tier 3 institutions are slightly more likely to conduct annual assessments.

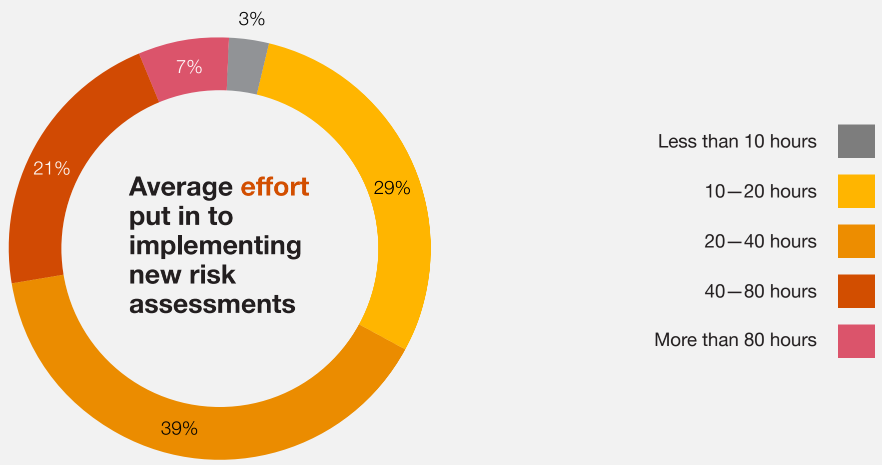
The ability to develop and deploy new risk assessments is important to being able to adapt to a complex and changing risk environment. Forty-two percent of respondents said that it takes one to two months, on average, to execute new assessments; 27% said they spend just one to four weeks; and another 27% said it takes two to six months. In terms of hours spent establishing new risk assessments, 29% said 10 to 20 hours, 39% said 20 to 40 hours, and 21% said 40 to 80 hours. Seven percent said that it typically takes more than 80 hours. Respondents were most likely to report that the cost of implementation was moderate.

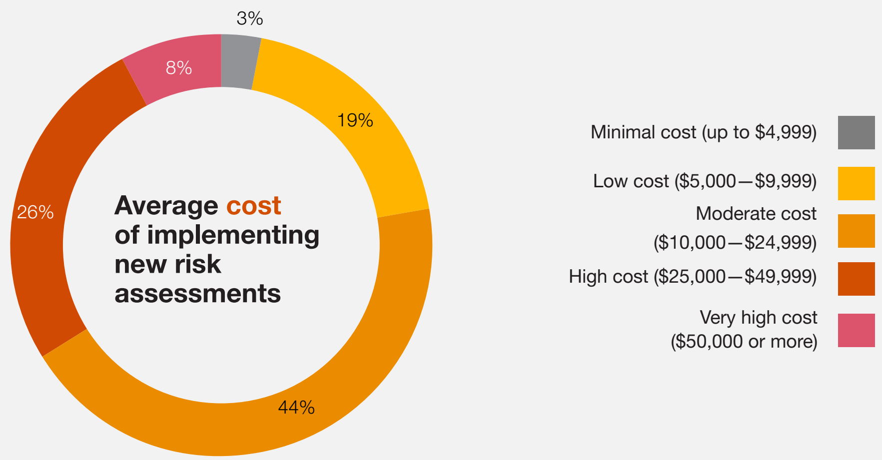
The vast majority of financial services companies are using a tool for risk assessments, or a combination of a tool and paper-based processes. Among those, some (19%) are using internally developed risk models and methodologies and some (18%) are using external models and methodologies, but most (63%) are using a combination of the two. Seventy percent said the tool they use allows them to source data automatically—the rest rely on manual methods. In terms of the data itself, an overwhelming majority (70%) are using quantitative data in the risk assessment process. Of those, 72% are using real-time data, and 55% of these institutions are automatically gathering data from different sources. However, experience would suggest that these findings might be highly optimistic. For example, institutions that have a tool for gathering data will often end up needing to manually load that data into their assessments, limiting the impact of automation on the process.

Average time/effort/cost of implementing new risk assessments

(n=203)





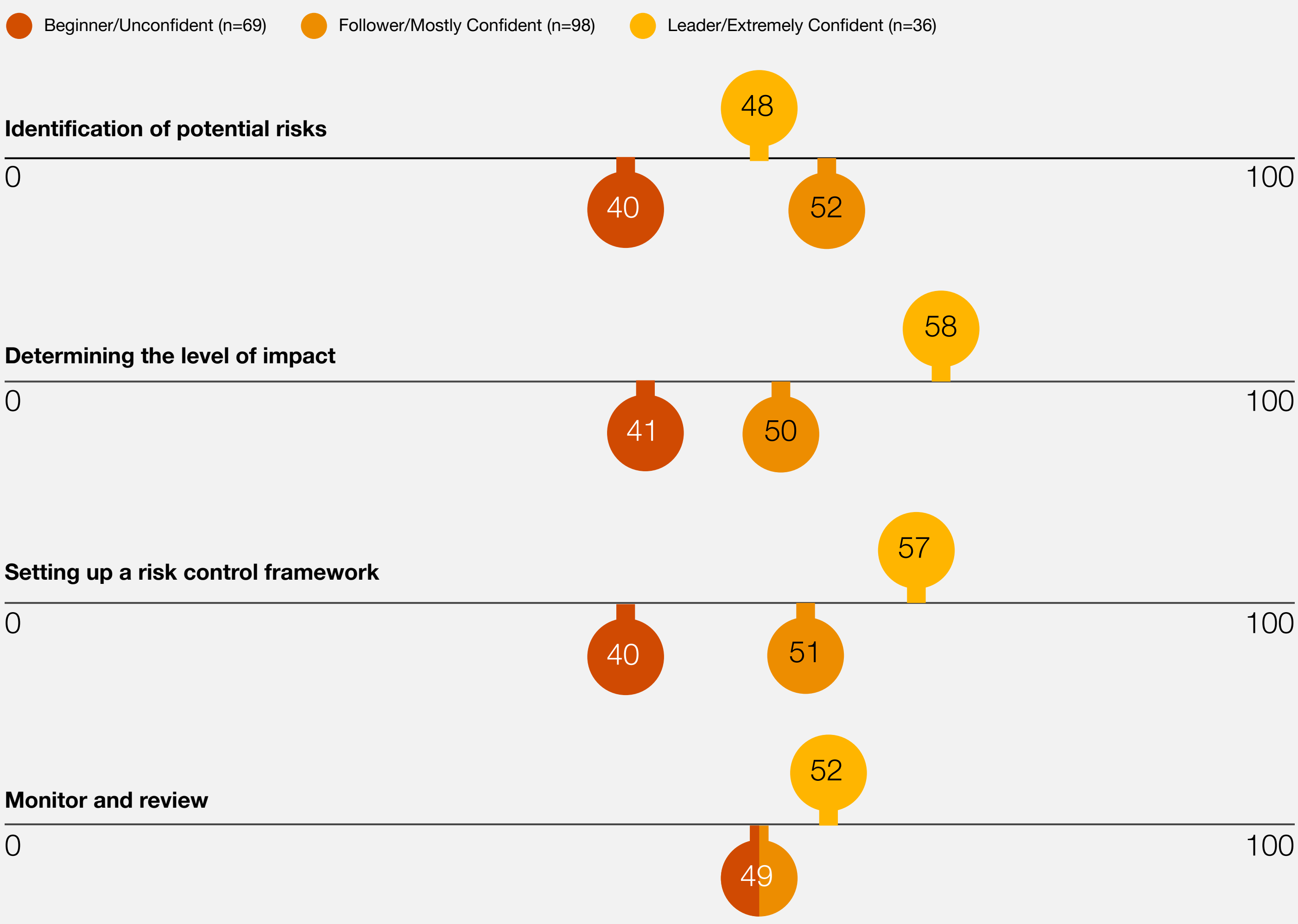


The automation edge

With many financial services companies focusing on improving risk assessment, researchers sought to better understand the impact of such efforts—and especially, the value of applying technology to the process.

As discussed above, respondents had varying levels of confidence in their risk assessment processes. However, a closer look shows that the institutions that were extremely or mostly confident also tended to have higher levels of automation across many risk assessment activities compared to their less-confident peers. For example, 72% of the extremely confident respondents had applied automation to measuring the potential impact of risk compared to 55% of the mostly confident group and just 36% of the unconfident group. For conducting regular reviews of their risk processes, policies, practices, controls and so forth, those automation levels were 56%, 52% and 38%, respectively. To help examine the relationship between automation and results, researchers grouped institutions into three categories based on their confidence and automation levels—Automation Leaders, Automation Followers and Automation Beginners.

Mostly/fully automated support across risk assessment workflow activities



In general, risk assessment improvements have been paying off for many financial services companies.

Looking across the four basic risk assessment workflows, more than half of respondents (55% to 62%) said that their risk assessment process was mostly or extremely effective. The rest said that their process is only somewhat or not at all effective. But Leaders were 29% more likely than Beginners, on average, to say that their process was mostly or extremely effective.

Effectiveness of overall risk assessment process

Effectiveness of overall risk assessment process: Ratings across identification, impact, control, and monitoring

Mostly/extremely effective risk assessment process and automation levels in current risk assessment

		Automation Beginners (n=69)	Automation Followers (n=98)	Automation Leaders (n=36)
Identification of potential risks	Conducting quantitative surveys with corporate stakeholders to obtain risk feedback	35%	76%	64%
	Regular review of risk processes, policies, practices, controls, etc.	45%	63%	72%
	Review of risk history	41%	65%	72%
	Conducting qualitative interviews with corporate stakeholders to obtain risk feedback	41%	64%	67%
	Overall identification of potential risks	41%	64%	58%
Determining the level of impact	Measuring the potential impact of risk	42%	68%	72%
	Use of data/quantitative inputs to inform risk	39%	65%	67%
Setting up a risk control framework	Creating a risk control framework	39%	70%	83%
	Adding to/editing the list of risk controls	38%	60%	75%
Monitor and review	Regular monitoring and reviewing of risk threats	42%	70%	67%
	Use of dashboards for disseminating risk	39%	61%	67%

A look at some process details sheds light on those figures. For example, 33% of Beginners said that it takes more than two months to execute a new risk assessment compared to just 11% of Leaders. And 31% of Beginners spend an average of more than 40 hours doing so, compared to 14% of Leaders. In addition, institutions that have higher levels of automation across the risk assessment process are more likely to have the more sophisticated ongoing risk assessment processes in place. Interestingly, Leaders reported significantly higher implementation costs than Beginners. Presumably, this reflects the fact that manual and paper-based assessments are cheaper to set up initially but more expensive to perform and maintain over time. With their increased use of automation, Leaders are paying more up front but are reaping the benefits of lower long-run costs, along with the increased adaptability and speed that automation provides.

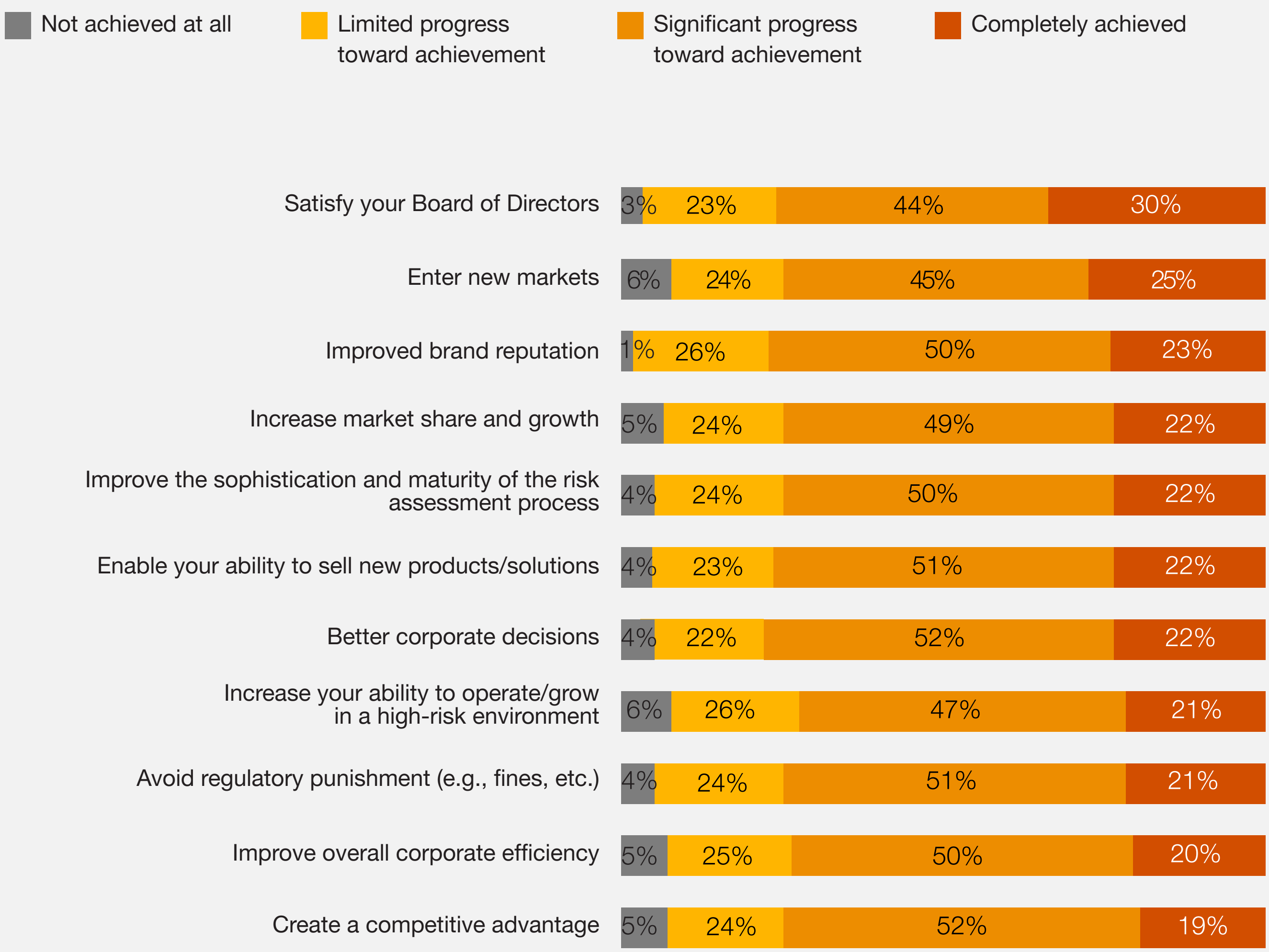
Average time/effort/cost of implementing new risk assessments

		(n=203)	Automation Beginners (n=69)	Automation Followers (n=98)	Automation Leaders (n=36)
Average time for implementing new risk assessments	Less than a week	1%	1%	1%	3%
	1—4 weeks	27%	30%	18%	42%
	1—2 months	42%	35%	46%	44%
	2—6 months	27%	33%	30%	8%
	More than 6 months	3%	0%	5%	3%
Average effort invested in establishing new risk assessments	Less than 10 hours	3%	1%	6%	0%
	10—20 hours	29%	30%	20%	47%
	20—40 hours	39%	36%	42%	39%
	40—80 hours	21%	22%	23%	11%
	More than 80 hours	7%	9%	8%	3%
Average cost of implementing new risk assessments	Minimal cost (up to $4,999)	3%	7%	2%	0%
	Low cost ($5,000—$9,999)	19%	26%	13%	19%
	Moderate cost ($10,000—$24,999)	44%	39%	45%	50%
	High cost ($25,000—$49,999)	26%	16%	33%	25%
	Very high cost ($50,000 or more)	8%	10%	7%	6%

Many financial institutions also said that they have been making significant progress toward reaching the outcomes they wanted from their investments in risk assessment. About 20% to 30% said that they have completely achieved their expected outcomes in various areas. These include many strategic, business-oriented outcomes, such as being able to enter new markets, improved brand reputation, increasing market share and growth, and enabling the sale of new products and services. Another 50%, roughly, said that they have made significant progress toward meeting many goals.

Degree of achievement of outcomes in an organization's risk assessment process

n=203



Those results are impressive enough, but they are even more so when one compares the responses of Automation Leaders and Beginners. For example, 92% of Leaders said that their efforts have helped them completely achieve or make significant progress toward increasing market share and growth compared to 52% of Beginners. In terms of creating a competitive advantage, those figures were 81% versus 59%. And for improving the risk assessment process itself, they were 92% versus 54%.

Overall, Leaders were 22% more likely than Beginners to say that they were achieving their expected outcomes.

Degree of achievement of outcomes in organization's risk assessment process

Significant progress toward achievement/completely achieved expected outcomes and automation levels in current risk assessment

	Automation Beginners (n=69)	Automation Followers (n=98)	Automation Leaders (n=36)
Satisfy your Board of Directors	62%	81%	78%
Better corporate decisions	61%	78%	89%
Improved brand reputation	58%	81%	81%
Enable your ability to sell new products/solutions	68%	77%	69%
Improve the sophistication and maturity of the risk assessment process	54%	78%	92%
Avoid regulatory punishment (e.g., fines, etc.)	58%	77%	83%
Increase market share and growth	52%	77%	92%
Create a competitive advantage	59%	76%	81%
Enter new markets	59%	76%	78%
Improve overall corporate efficiency	59%	77%	75%
Increase your ability to operate/grow in a high-risk environment	57%	72%	75%

Learning from experience

The research shows that there can be significant opportunities for financial institutions to help increase the effectiveness of risk assessment across different stages of the process—and respondents provided some guidance on how that might happen. When asked what would most help improve the state of risk management, they ranked the creation of stronger risk management frameworks and techniques as the top priority, followed by technological improvements. Other areas of potential focus included better data analysis, being able to stay up to date on industry trends and risks, and the increased use of qualitative and quantitative data. And the identification of automation leaders opens the door to further development of industry leading practices for risk assessment.

The research also shows that increased automation in risk management is already paying off for many institutions. Those with higher levels of automation tend to perform assessments more frequently and deploy new assessments more quickly and say that their assessment processes are effective. They are more likely to feel confident in their risk-assessment capabilities. And they are more likely to report that they are achieving the key outcomes they expect from their risk assessments.

Overall, automation is helping institutions transform risk management to not only support compliance efforts, but also helping them deliver more strategic benefits to the business. In the coming years, the focus on automation is likely to increase, as more institutions target strategic, business-related outcomes with their investments in risk assessment—and come to regard it as a competitive weapon.