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The risk management function of the future

How regulatory mandates and expectations are shaping risk management at U.S. banks

2017 SURVEY EXECUTIVE SUMMARY

Advisory

Financial Services

Risk

Executive summary

In this report, *The Risk Management Function of the Future: How Regulatory Mandates and Expectations Are Shaping Risk Management at U.S. Banks*, we convey the results of a survey of bank and regulatory professionals taken at a time when the financial regulatory framework is being revisited.

The risk management function (RMF) at banks has progressed substantially in recent years. Regulatory frameworks developed in response to the Basel Accords, Dodd-Frank and other mandates have driven a more disciplined, consistent and systematic approach to risk management. In that context, we present the following key findings of this survey.

Key findings

Regulatory compliance remains a driving force in risk management.

- A majority of respondents indicate that their institutions' RMFs are focused largely on regulatory compliance.
- The perceived cost of compliance varies among regulations and, to some extent, between bankers and regulators. Both bankers and regulatory experts perceive requirements for stress testing and the Consumer Financial Protection Bureau (CFPB) as having significant costs. Bankers also view capital requirements as entailing significant costs, whereas regulators rate them as much less costly. Conversely, bankers do not view living wills as significantly costly, whereas regulators do. Both groups were relatively unconcerned about the costs of the Volker Rule and the supplementary leverage ratio.
- As to the effectiveness of specific regulations, respondents from larger banks and regulatory experts concurred that stress testing is effective. Both groups rated capital requirements as either moderately effective (bankers) or very effective (experts). For most regulations, regulatory experts rated effectiveness more highly than bankers, with the largest differences pertaining to living wills and the supplementary leverage ratio. Both groups gave the CFPB low marks for effectiveness.
- Many institutions are either planning or implementing initiatives to consolidate and simplify compliance units.

Banks' RMFs are also increasingly utilized for revenue-generating purposes.

- Heightened risk management practices, such as stress testing, are improving many banks' business decision-making processes, such as facilitating capital planning and management, managing credit risk, calibrating risk appetite, and linking risk-related decisions with strategic intent.
- Some institutions, particularly larger ones, aspire to monetize RMF activities and deliver revenue-generating external risk-related services (e.g., supplementing FinTech capabilities).
- While large institutions perceive value from the information obtained through the RMF, smaller institutions regard their RMFs as primarily aimed at achieving regulatory compliance.
- Practices for allocating risk costs and internal transfer pricing have not been consistently adopted in the industry, which may impede recognition of RMF value beyond regulatory compliance.

The RMF is evolving to exploit emerging technologies and cover a broader range of risks.

- Advancing RMF efficiency is a common objective among a majority of institutions, pursued through continued right-sourcing, automating, simplifying, digitizing and standardizing. However, efficiency measurement and tracking are not consistent across the industry.
- Many institutions are investing in advanced analytics and data modeling techniques aimed at deploying digital business tools and improving risk management practices.
- Banks are seeking to adapt new technologies, such as blockchain, to potentially reduce operational risks.
- The RMF is incorporating and assimilating new risks related to nonfinancial/operational matters such as cybersecurity, digital, model and vendor risks.
- The majority of respondents are highly concerned about cyber risk but do not yet consider their cyber risk management approach robust.

Risk management is becoming more prominent in bank culture.

- Banks expect the future role of the chief risk officer (CRO) to include increased strategic involvement and greater influence.
- There is a general trend toward upstreaming risk activities to a first line of defense to improve performance and strengthen risk culture.

This report organizes the survey results into four areas expected to have significant impact on the future of the RMF at U.S. banks and provides context to assist in interpreting the findings. Those areas include: i) managing regulatory compliance costs; ii) institutionalizing the RMF; iii) utilizing risk data, analytics and infrastructure; and iv) sustaining an effective risk culture.

The invitation to participate in the survey was sent to over 1,000 senior bank officers in institutions with total assets greater than $5 billion.[1] Invitations also went to 117 regulatory experts. While the responses provide valuable insights into the participants' views of risk management, limited sample size precludes drawing statistically significant inferences.

Appendices to the report explain the survey methodology and provide additional information about the data, including response rates to each survey question highlighted in this report.

[1] Two institutions with assets less than $5 billion were included in this survey.

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