



Financial Services

GEG CONSULTING

A Division of Global Economics Group, LLC.

THE GLOBAL RISK AGENDA

LISTENING TOUR RESULTS

FALL, 2023



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INTRODUCTION

Banks are facing challenging **macroeconomic** and **regulatory** environments as the shift away from a zero-interest rate policy has made managing core risks more difficult, profitability harder to sustain, and has drawn the focus of regulators. In addition, global market conditions continue to challenge banks' abilities to operate as geopolitical unrest increases and climate risks escalate. These issues are central to the Chief Risk Officer's (CRO) agenda and extend across the executive suite, including legal, operations, technology, and the business.

All of this is exacerbated by the need to control and reduce operational costs. Banks have invested heavily in their risk and control capabilities in response to the global financial crisis. Now the focus must shift to **efficiency and effectiveness** by leveraging advancements in technology including **automation, data & analytics, and artificial intelligence**.

The following material highlights our perspectives on these risks and suggests some strategies to manage and mitigate them.

OUR APPROACH

As part of the launch of the GEG Financial Services consulting practices, we embarked on a listening tour to understand the key issues and challenges that financial institutions are focused on for 2023 and beyond. During this tour we conducted over 50 meetings with Chief Risk Officers, Chief Compliance Officers, General Counsels, Chief Operating Officers, Chief Technology Officers, and P&L Owners.

Who We Talked To

- 35 Financial Institutions
 - G-SIBS
 - Regionals
 - Global
- 50 Individuals (C-Level Executives)

Questions We Asked

- What risk areas are you most focused on?
- How are you balancing emerging risks with evergreen issues?
- What new capabilities are you investing in to optimize your risk position?

Key Emergent Themes

- Capital and Liquidity
- Client Profitability
- Data Analytics and AI
- Culture and Conduct



RESULTS FROM OUR CONVERSATIONS

LET'S DIVE IN

CAPITAL AND LIQUIDITY MANAGEMENT

Capital and liquidity management were near the top of most banks' concerns (along with CRE and interest rate risk), driven by changing macroeconomics and the nature and timing of new regulatory requirements

Context

- How, when and to what degree will US regulators adopt the Basel 3 endgame (minimum capital floors, Ops Risk RWA and FRTB among other issues)?
- What changes to the Tailoring rules might be adopted (annual stress tests, AOCI, thresholds, etc)?
- What changes are coming for banks that are currently below the G-SIB threshold but above \$100B in assets?

Takeaways

- Under any of these scenarios, many banks will confront more detailed and time-sensitive requests for information and reporting from regulators, as well as deeper scrutiny of underlying methodologies and data.
- Need to ensure capital and liquidity models are robust, updated and validated and that governance over data and regulatory reporting remains effective.
- Factors used for client profitability models also should be reviewed and updated for these changes

CLIENT PROFITABILITY

The likelihood of increased capital requirements combined with a higher cost of funds will require fine tuning client profitability and ROE models

Context

- Measuring profitability at the client level requires understanding costs at a granular level, including RWA and the cost to serve
- Balance sheet usage needs to be compensated
- Digitization is reducing revenue for non-credit and fee-based products

Takeaways

- Banks need to be more selective in choosing who they do business with
- Bespoke client service approaches may be too costly for all but the most lucrative clients and segments
- Data, analytics and automation are key to providing products and services that meet your client's needs while also earning an appropriate return

DATA ANALYTICS AND AI (ML, NLP, GENERATIVE AI, ETC.)

Virtually every bank is either testing, piloting or implementing AI-related models or tools in Cybersecurity, Third Party Risk Management, Surveillance, Client Service, and Financial Crimes.

Context

- The capability of AI to analyze vast amounts of data and customer/employee behavior across networks, transaction systems, call logs, etc. has enabled many banks to significantly enhance identification, assessment (e.g. risk scoring), monitoring and reporting of high-risk areas
- Data quality and availability remain key hindrances to progress.

Takeaways

- Generative AI has garnered the interest of many executives to deliver a differentiated experience, but the risks associated with this technology are not well understood
- Regulators are still playing catch-up in understanding how AI can impact risk, compliance, and client service

CULTURE AND CONDUCT RISK MANAGEMENT

Increasingly boards and regulators seek information to assess, measure and monitor conduct risk to understand if the bank's culture aligns with its mission, vision and regulatory requirements. .

Context

- Banks have developed metrics, dashboards and the like focused on conduct risk.
- But things are changing...Boards are asking about better, more relevant metrics.
- The Basel Committee has also recently proposed revisions to core principles for banking supervision which put Culture and Values squarely at the center of effective management and supervision.

Takeaways

- Culture is challenging to measure. We have experience in identifying the right data to collect from appropriate areas across the enterprise, and in developing insightful ways to evaluate the data to to measure alignment with the organization's cultural standards.
- The key components of culture are leadership tone and commitment, incentive structures, and ownership and accountability



WHAT'S NEXT

RISK MANAGEMENT STRATEGIES

SUCCESSFULLY NAVIGATING THESE UNCERTAIN TIMES



Focus on Data

- All strategies devised to better manage and mitigate the emerging risks on the horizon are going to require more and better data
- Effective data management, governance, and self-service capabilities provide the foundation



Leverage Automation

- The selective implementation of automation technologies can improve the accuracy and reduce the cost of core risk management and compliance functions
- Next generation capabilities, like NLP and Generative AI, can create value from stranded data assets

SUCCESSFULLY NAVIGATING THESE UNCERTAIN TIMES



Culture Eats Strategy

- The best plans in the world can't succeed if your organization doesn't share in the proper culture
- Strategy and culture must be aligned, and it starts from the top



Simplification Drives Efficiency

- The 3LOD model has been in place for a decade but some areas, like financial risk, are more mature than others, like Non-financial risk
- Clear lines of responsibility and accountability allow the organization to drive out redundancy



ABOUT GEG FINANCIAL SERVICES

OUR MISSION

We are industry veterans with decades of experience who have helped banks successfully navigate historic regulatory and economic upheavals. We see new and unprecedented **Regulatory Challenges** wrought by technological changes in a volatile economy. We want to help our People and our Clients succeed by Collaborating on solutions which address risk, compliance and operational challenges.

We provide **high-value consulting** services leveraging a uniquely experienced and efficient network of experts and partners to financial services companies—banks, broker-dealers, asset managers, insurance companies and credit unions—across the 1st, 2nd and 3rd lines of defense. Our services address the regulatory, people, process, technology and data factors which ultimately affect the ability of our clients to successfully address their key challenges. Our delivery resources consist of GEG professionals and key alliance partners who are experienced in helping banks meet regulators' expectations.

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