Risk in the Value Chain

Simplify Consulting

Introduction

We pride ourselves on having clients in all parts of the value chain. We think that provides us with real insight into the opportunities and challenges for all parties involved in the Wealth Management industry; and it is one of the reasons that sets us apart from the rest.

One of our specialisms is Risk Management. We have noted down some thoughts on the challenges with embedding risk management in the value chain and what threats and opportunities the industry faces at a macro level.

Risk Management should be simple – it is often over complicated unnecessarily. It is common sense and needs to be considered at all levels of the organisation. It should not be seen as a tick box exercise but more that risk management genuinely helps organisations better manage their businesses and protects their customers.

For help with defining, embedding or simplifying your risk management framework and processes, get in touch with us today:

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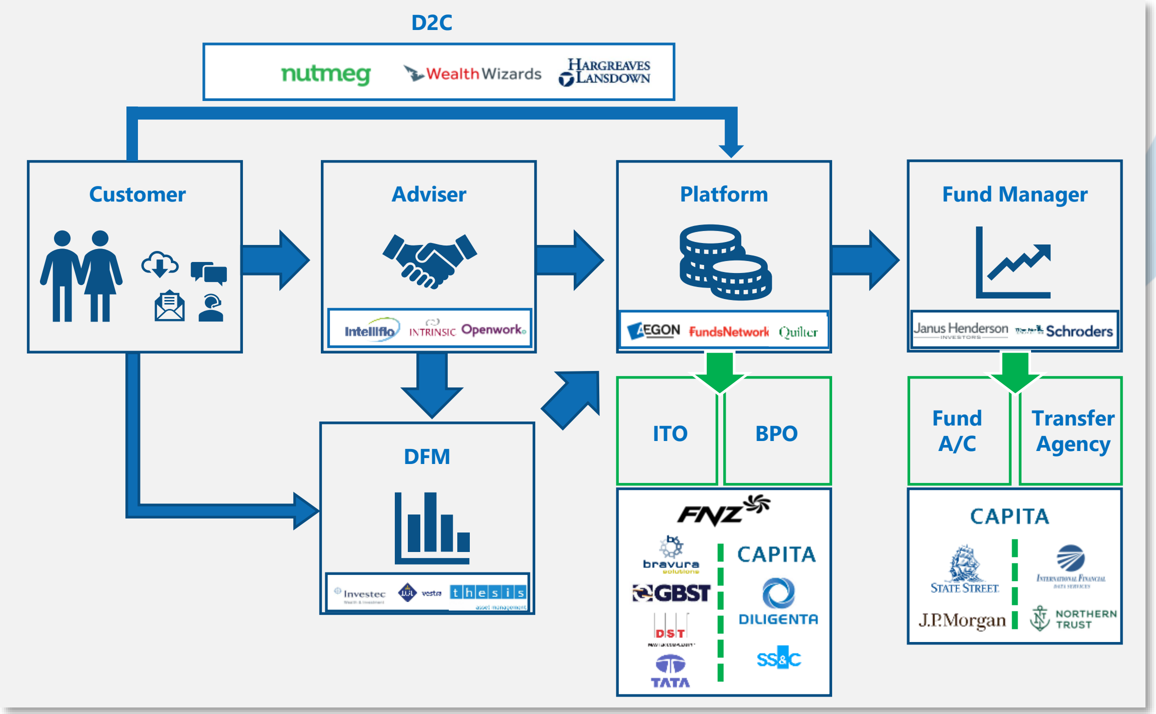
Simplify Consulting. **It's what we do.**



Top of the Charts…

According to analysis of the financial services sector*, the number one Operational Risk facing firms today is IT Disruption – this risk has two dimensions. Firstly the risk of a cyber attack, given the new digital age and sophistication we are in. Secondly, the risk of upgrading legacy technology which may result in outages. Both feed into Operational Resilience risk, which is top of the agenda for the FCA this year – where firms need to be able to demonstrate their processes can withstand disruption. The top 10 Operational Risks are listed …all of these will be high on the agenda for any part of the value chain.

1. IT Disruption
2. Data Compromise
3. Theft & Fraud
4. Outsourcing/3rd Party
5. Operational Resilience
6. Organisational Change
7. Conduct
8. Regulatory
9. Talent
10. Geopolitical

**Source: risk.net "Top 10 Operational Risks for 2020"*

The different challenges of embedding risk

Advisers

There are Adviser networks which can provide risk management frameworks and systems and this is often managed centrally. For the smaller firms, it is often a struggle to find something proportionate and affordable. With significant liabilities in relation to customer detriment & complaints (even after many years) and the accountability on the Adviser to understand and implement new regulations, it is a challenging environment and good risk management is paramount.

Platforms

With the introduction of Solvency II, many firms were forced to focus on risk management. However we have seen many examples of where risk frameworks have been well defined and established by the 2nd line, but these have not been adopted and embedded by the 1st line. Whilst risk may be technically mature in terms of the tools & techniques used, these are not relatable to those in the business – they are over complicated and often defined by people who have no experience in actually working in the 1st line.

Fund Managers

There is a huge focus on regulation and regulatory change – the amount and the level of detail expected, in particular around transparency of information and charging, is a huge burden and cost for Fund Managers. A good example of this is MIFID II, which at a high level has good intentions in improving transparency and but it is the details and practicalities which Fund Managers are left trying to implement. Regulation is too often open to interpretation and will depend on the risk appetite of the Fund Manager on how to implement and meet those requirements.

Outsourcers

Often the challenge is ensuring appropriate governance – a provider will want to outsource to transfer operational risk to an outsourcer. Their risk profile then changes to 3rd party risk. The outsourcer is the “slave” to the provider – there is always a continual challenge between cost and risk management. Processes such as client money must be compliant. The only way an outsourcer can compete is on price – however they need to ensure they have the appropriate risk & compliance framework in place, that is also affordable.

Technology Providers

Similar to outsourcers, technology providers need to be able to demonstrate to their clients they have the appropriate risk mitigation in place – in particular relating to system performance and sustainability. How do providers demonstrate they can cope with increased volume? How can providers demonstrate they can get the IT platform back in service. Much of this risk management is about providing reassurance to the product providers and customers.

What are the key risks the Wealth Management industry faces today?

Advisers	In addition to the typical regulatory challenges which can introduce bureaucracy and cost to an Adviser business, there is also a much more burning issue – is the Adviser industry sustainable? It is well understood that the average Adviser is male and over the age of 50. There are no specific financial advice courses at University. Whilst there was talk about robo advice replacing Advisers, the fact is some Wealth products don't suit digitisation – the complexity means clients need to sit with someone to talk through scenarios. Will there be enough people wanting to go into a Financial Advice career?
Platforms	There still seems to be a huge challenge in providing online / digital customer journeys. Customer expectations are higher than ever in terms of service and immediacy of information – however that is not easy due to the complexity of products within Wealth. There is rarely the risk appetite to challenge the boundaries of regulation when it comes to removing paper from the process; there seems to be much more opportunity in the banking sector where AI, voice recognition and online journeys are now the norm. Platforms with legacy books of business have even more of a challenge to remove the complexity from the process – this typically involves a customer consent process to change terms & conditions – the more complex a process, the higher the cost to administer.
Fund Managers	Obviously one of the key risks facing fund managers is market volatility – this results in a significant amount of transactional activity and outflows and lowers the attractiveness of that fund. Part of the point of MiFID II is monitoring fund performance and communicating that to investors & investor representatives (e.g. Advisors) – however this can create a negative spiral of disinvestments which may threaten the long term viability of the fund. The reputational risk is huge and there are questions over whether poor performing funds can ever recover, as who would want to invest in them.
Outsourcers	There are still opportunities for outsourcers to thrive in Wealth, in particular those that offer both business process and IT outsourcing solutions. With increased margin pressures on the provider and to transfer the operational risk to the outsourcer, the platform can focus on the services that differentiate them in the market. Back office processing is a commodity. For outsourcers with scale, there is always the challenge of whether to consolidate and replatform, especially those who acquire legacy systems – as that is really when economies of scale can be achieved. However is there ever time to do that, when focus is always on the next deal?
Technology Providers	The appetite to replatform seems to be reducing, where large scale transformation projects are challenging to deliver on time and without excessive costs. There seems to be an opportunity for the smaller technology providers or "micro service" providers, where incremental improvements and changes are much more palatable. There is a shift from aiming to have one system which can do everything to partnering with specialist providers and the focus is on integration.

How a risk can pass through the value chain?

Risks that can pass through the value chain from a **customer** perspective are behaviour and demand. Expectations, in particular, from a digital perspective are driving a lot of change in Wealth Management, but these changes are not necessarily being implemented in the way a customer would expect.

Risks that can pass through the value chain from an **Adviser** perspective are mis-selling. Suitability and risk profiling are key ways to ensuring the customer gets the most appropriate product for their needs. If mis-sold, this can lead to complaints and lengthy rectification programmes

Risks that pass through the value chain from a **Platform** or provider perspective relate to product and then servicing. Does the product have issues in its design which may cause customer detriment. From a servicing perspective, there are likely to be people, IT or process failures causing an adverse impact.

Risks that can pass through the value chain from a **BPO** perspective are the treatment and protection of client records – too often Platforms are faced with data issues, from breaches to quality to missing information

Risks that pass through the value chain from a **Technology Provider** relates to performance and availability – if the underlying technology has issues it impacts all parts of the chain.

Case Study: Risk Consultancy

Overview

We were approached by a Life and Pensions provider to help increase the maturity of their first line risk team. We quickly mapped their existing operating model and assessed the capability of their people, processes and supporting technology to understand where the focus of a transition towards a target operating model should be. We worked closely with the head of operational risk to document the target operating model including a new organisational structure, new risk processes (e.g RCSA, Risk Event Management) and MI and reporting requirements and helped deliver training to the wider team to help embed the new concepts.

Approach

As a new client, we brought our operating model methodology to firstly map out the current environment and to understand the level of maturity within the function. We used that model to help drive definition of a target and identified the key deliverables that would help transition the business towards the target state.

We worked closely with 2nd line Risk and with the 1st line team to workshop new risk processes and we delivered training to help embed some of the learning. We supported the team in running the new processes and created an action plan with a clearly defined roadmap to continue the journey.

Results

In under six months we transformed the function, redesigned its key processes, increased the capability of the team and addressed a number of audit and regulator concerns.

We also provided visibility of the control framework and overall risk environment, creating a baseline to build out a roadmap for continued evolution of the function

Process

Measure & Assess → Define & Document → Create Target & Transition → Train & Embed

Services Provided Included:

Business Architecture

Project Management & PMO

Risk Consultancy

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The Future of Risk in the Value Chain

There is no “one size fits all” when it comes to risk in Wealth Management. Each part of the value chain faces different risks and opportunities and they need to be dealt with in different ways. Whilst at the highest level, the risk framework can apply to anything, it almost becomes meaningless if it’s not practically applied.

Other disciplines such as change, IT development, process and business analysis have evolved and changed with the introduction of Agile, Dev Ops, Systems Thinking and Lean, to name a few. I’d question whether risk has really evolved. It is still document and process heavy; even with the introduction of Solvency II and Enterprise Risk Management, the approach to risk management was often disproportionate to most parts of the value chain.

It would be great to see a more efficient, optimal and value add way of managing risk, rather than just a list of risks sitting in a standalone tool – it would be great to see risk integrated better with the business and something that tracks the risks through the value chain; a true end to end view. If more is done to understand the risks end to end, decisions on how those risks can be managed are more informed.

As the world becomes more interconnected, the Wealth Management industry is also changing; the component parts are becoming more intertwined. There needs to be a better, more practical way of managing risk in all parts of the value chain.

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Simplify Consulting. It’s what we do.

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