

# Trends and Innovation in Risk Management

CLAR 2023 – Felaban

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# Risk Management is critical to sustain profitability and growth in financial institutions

Level of relevance to...

▲  
... appear in  
the top 40 list

▼  
... get off the  
top 40 list

Description



**Industry  
momentum**



Top 40 change driver; banks with greater geographical diversification are less exposed to economic imbalances



**Business mix  
momentum**



Universal banks have higher revenue pools and are more able to mitigate their exposures to specific businesses



**M&A activity**



M&As are key to entry in the top 40, and even more important to stay among them



**Risk  
Management**



Poor Risk Management or systemic risks were responsible for ~50% of the cases where banks went off the list, usually with almost total value destruction



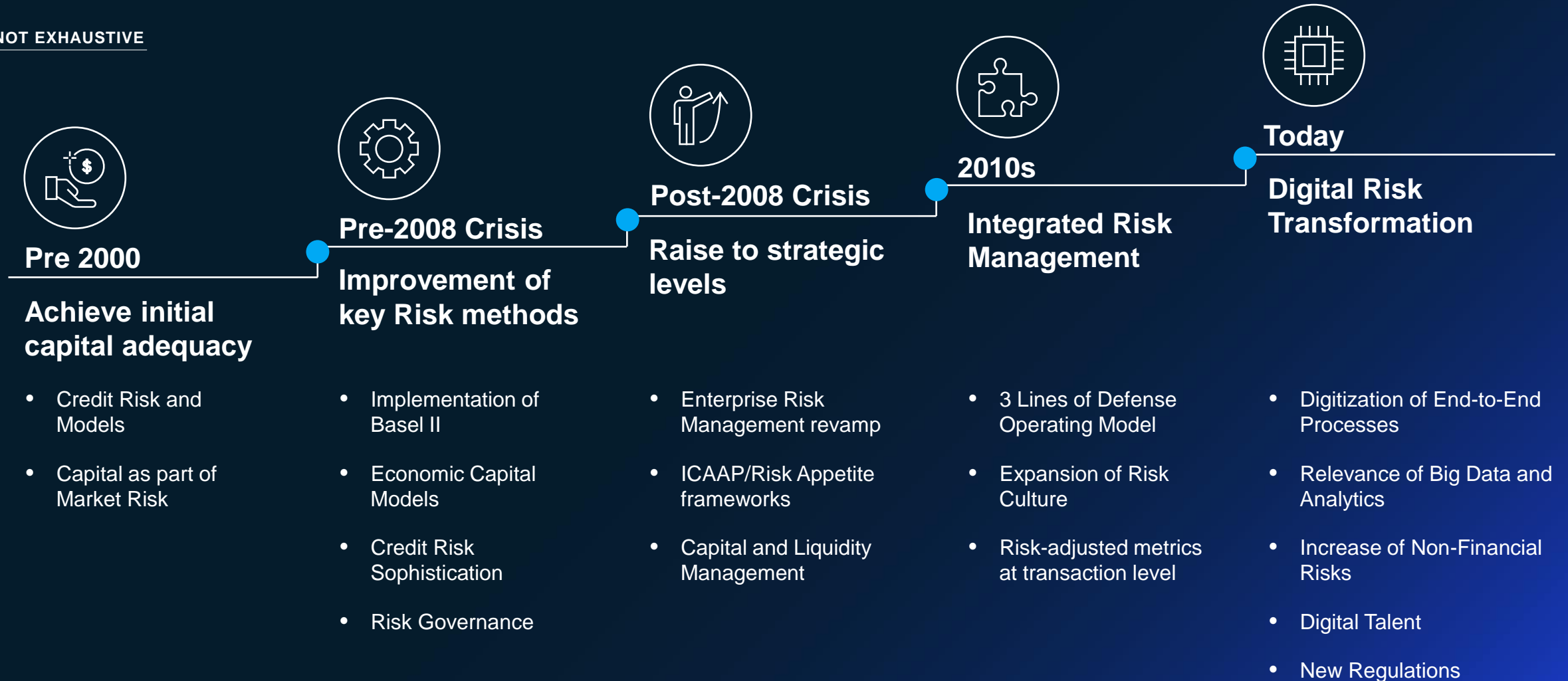
**Operational  
performance**



It is important to maintain a healthy level of operational performance to stay among top banks

# Risk Management has evolved over the years, with complexity increasing over time

NOT EXHAUSTIVE



# Currently, we are observing 5 priorities on top of the agenda of CROs

NOT EXHAUSTIVE



## Ensure financial resilience

- **Slowdown of credit** and increase in **delinquency** levels
- Volatile macroeconomic conditions; pressure in **capital and liquidity management**



## Address the rising nonfinancial risks

- **Increased digitization** of interaction with customers
- Higher levels of **sophistication on cyber attacks**



## Embrace emerging risks

- **ESG and climate** change as major risk (and opportunity)
- **Increasing geopolitical and political** changes
- Rising use of **new technologies** such as generative AI



## Renew the operating model

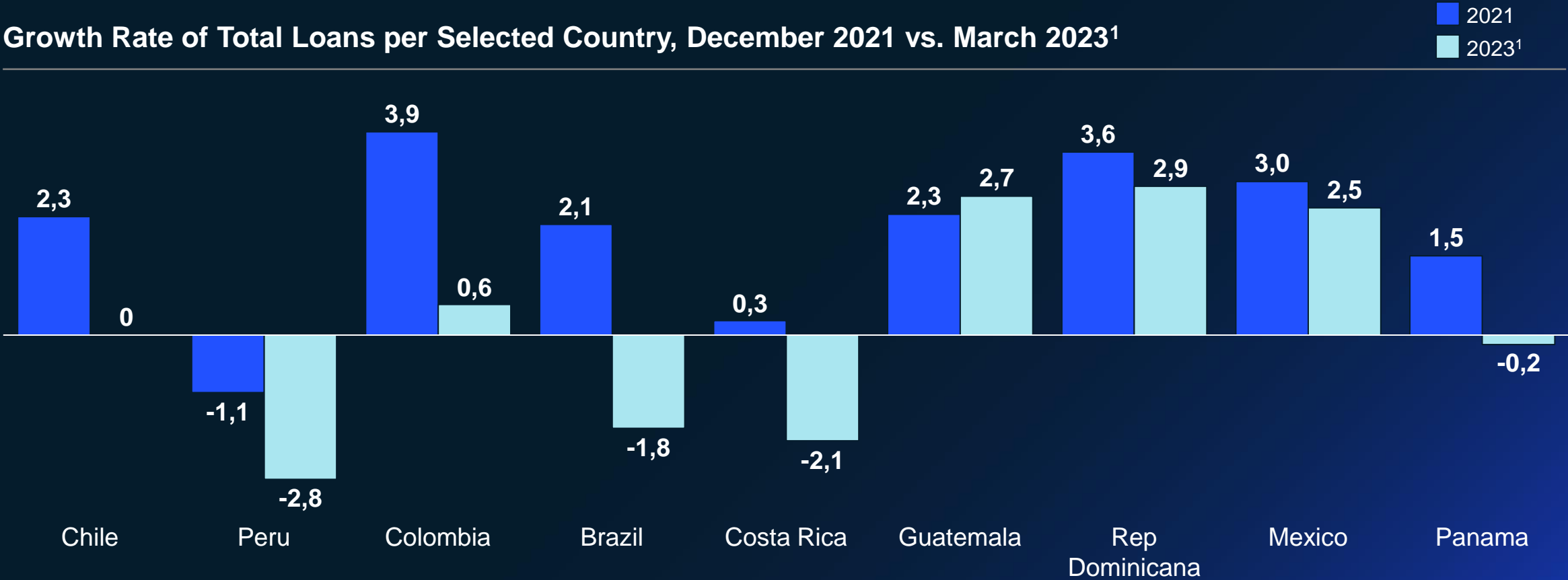
- Pressure to deliver **more effectiveness with more efficiency**
- Leverage technology to adopt **new ways of working**




## Prepare for the new regulation wave

- Increase in **regulatory expectations and scrutiny**
- Latam **moving forward on key regulations** (e.g., Basel III, GDPR, etc.)

# A. LatAm banks are dealing with a high-uncertainty economic scenario, adding pressure to an already stressed market (1/3)

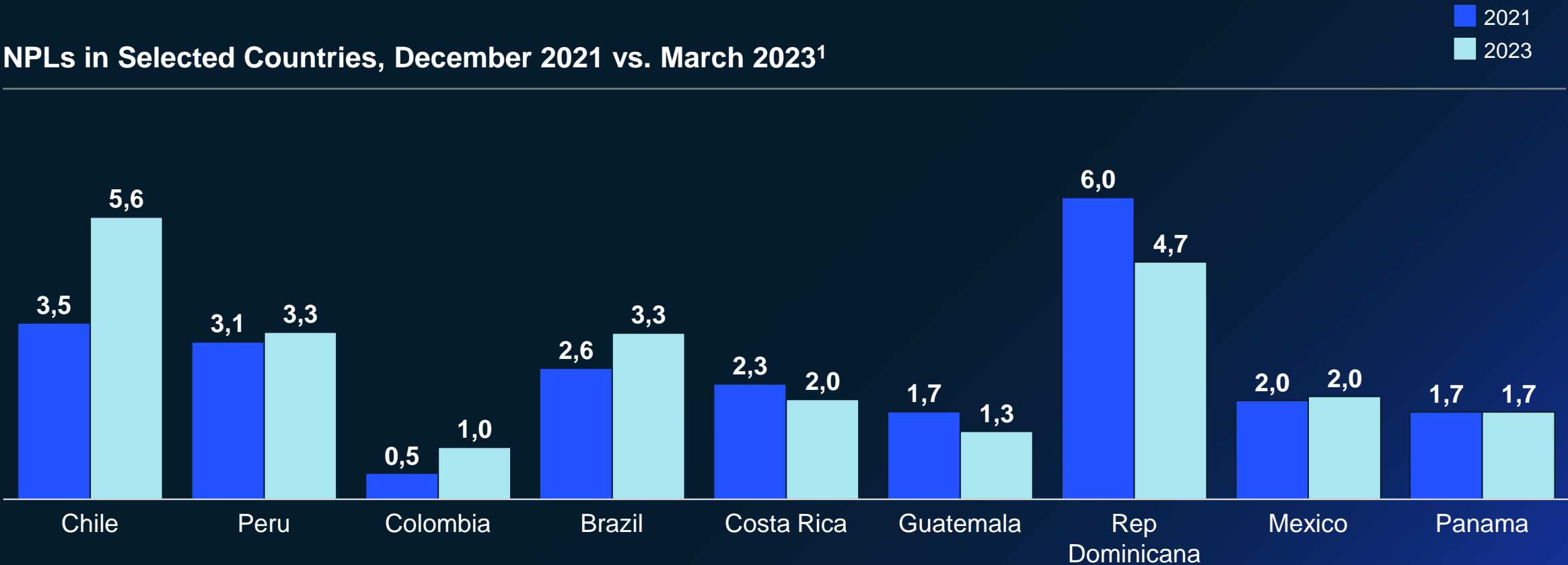


 In most Latam countries, we are observing a slower credit origination in 2023 than it was in 2022

1. 1Q 2023

# A. LatAm banks are dealing with a high-uncertainty economic scenario, adding pressure to an already stressed market (2/3)

NPLs in Selected Countries, December 2021 vs. March 2023<sup>1</sup>



Additionally, most countries are facing an increase in NPLs

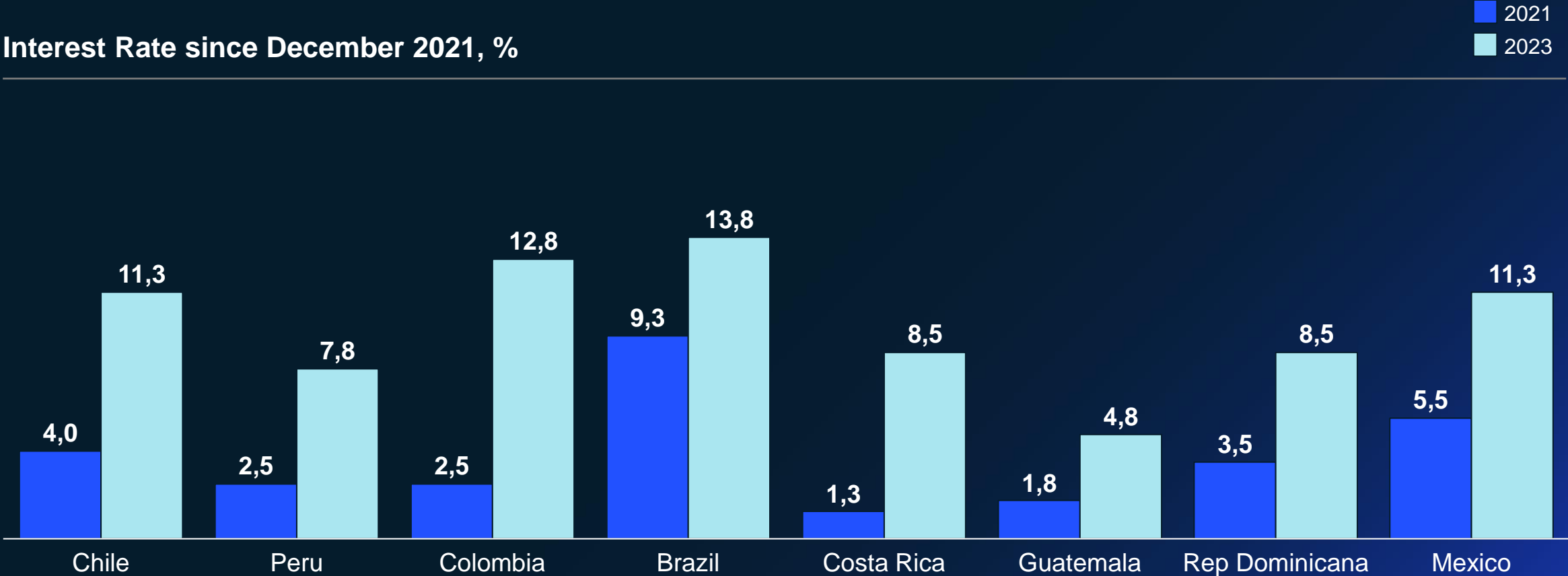
1. 1Q 2023

Source: Financial market regulators of each country



# A. LatAm banks are dealing with a high-uncertainty economic scenario, adding pressure to an already stressed market (3/3)


Interest Rate since December 2021, %

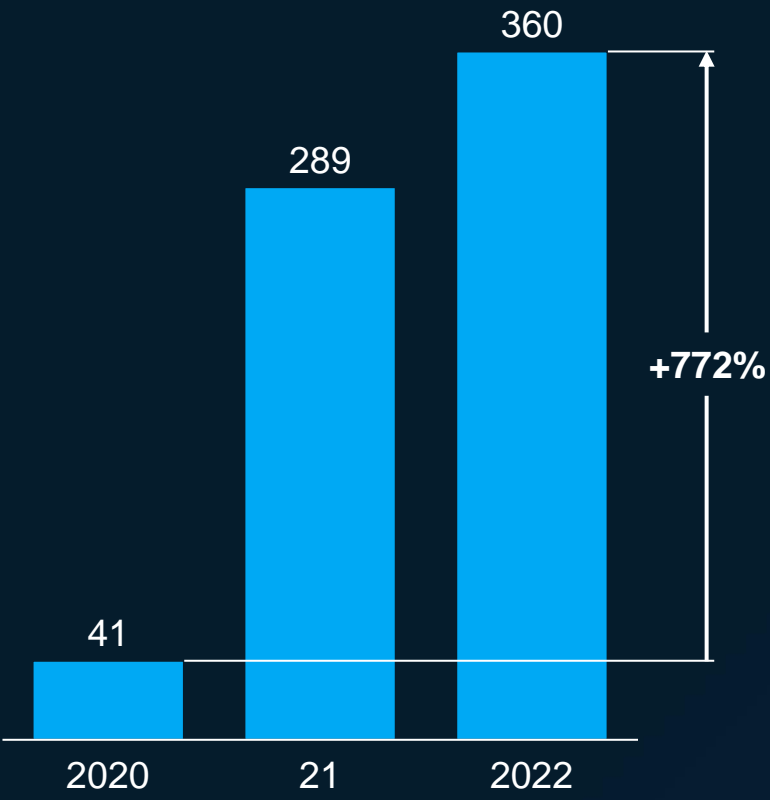



Lastly, we see an increase in interest rates in all selected countries, increasing the cost of funding


Source: Central banks of each country

# B. On the other hand, non-financial risks are increasing in relevance, in particular digital-related risks


 **Number of cyber attacks in Latin America, # billion**

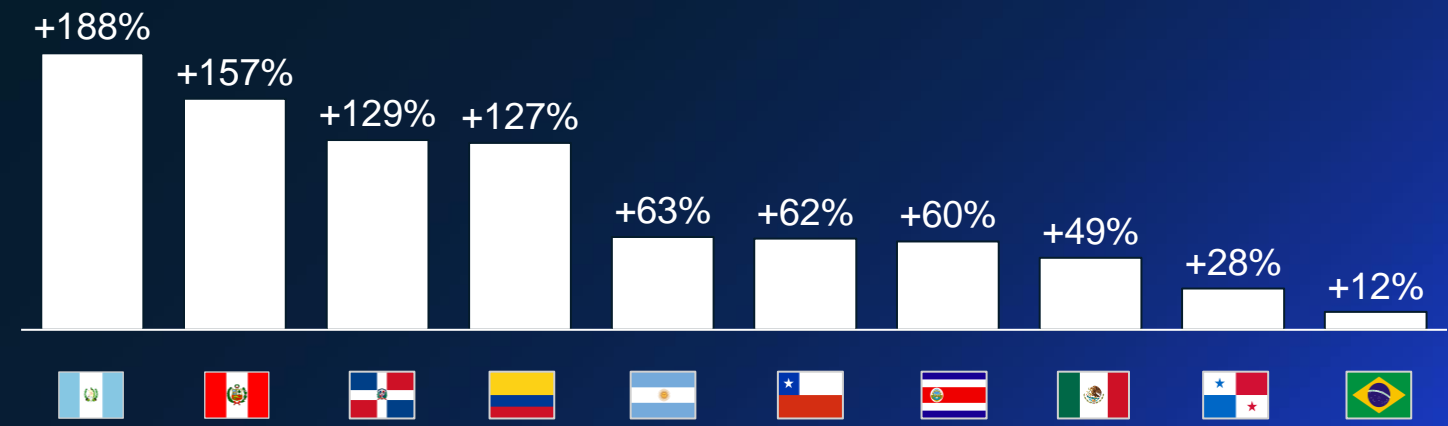


 **~USD 6 M**  
Estimated average cost per data breach for a financial institution

 **25%**  
% of declined e-commerce transactions that were false positives in 2021

 **~10 -25%**  
YoY growth in card fraud losses

 **Phishing attack variation, 2021 - 2022**





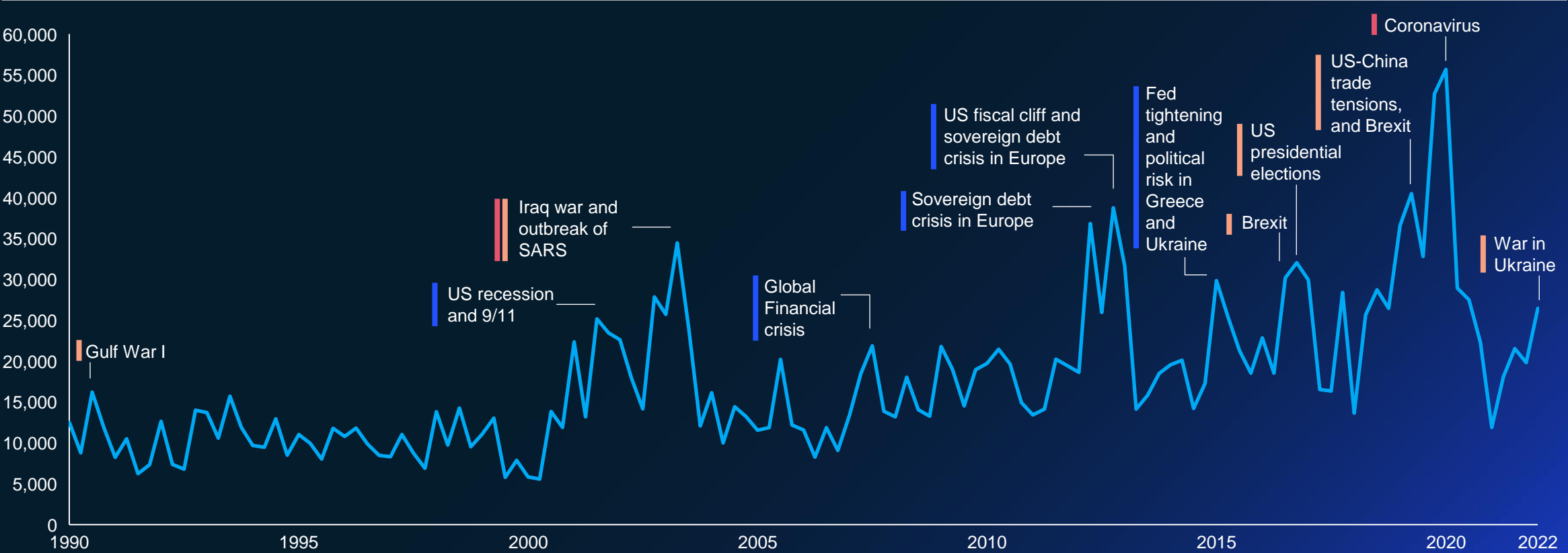
# C. The world has become structurally more uncertain...

Today's level of uncertainty is 3-5x higher than 30 years ago

Economic Political Technological Societal

3-5x higher global uncertainty level in 2020 compared to 1990s

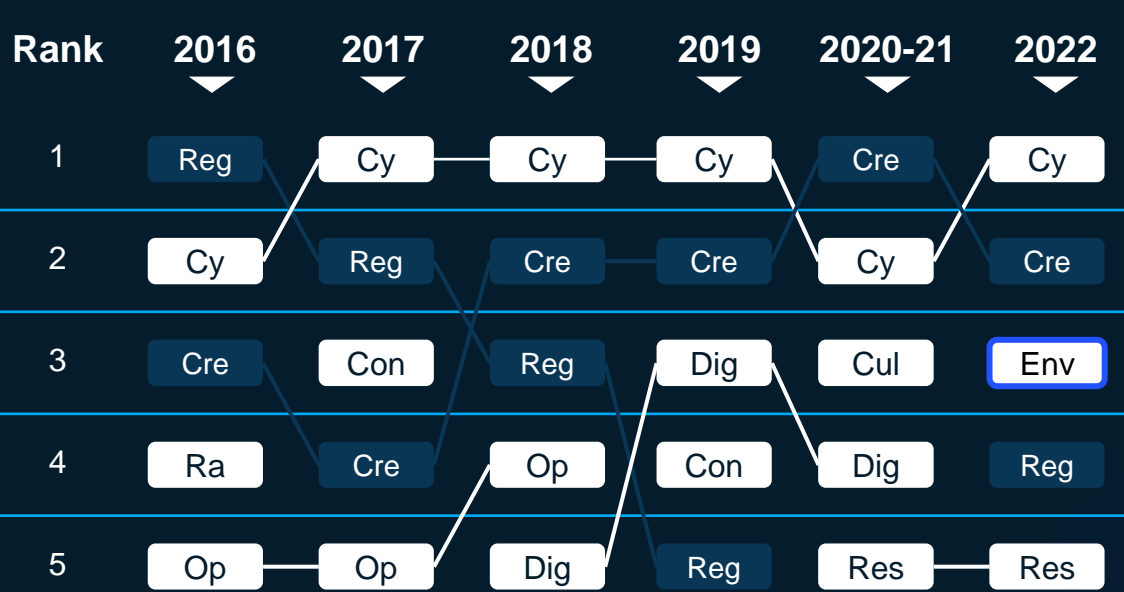
World Uncertainty Index (WUI)<sup>1</sup>



1. Based on percent of word "uncertain" (or its variant) in the Economist Intelligence Unit country reports (source: <https://worlduncertaintyindex.com>). The WUI is then rescaled by multiplying by 1,000,000. A higher number means higher uncertainty and vice versa. For example, an index of 200 corresponds to the word uncertainty accounting for 0.02 percent of all words, which – Given the EIU reports are on average about 10,000 words long – Means about 2 words per report.

# C. ...which is bringing in new risks for Banks to manage

Top 5 | CRO priorities 2016 - 2022<sup>1</sup>



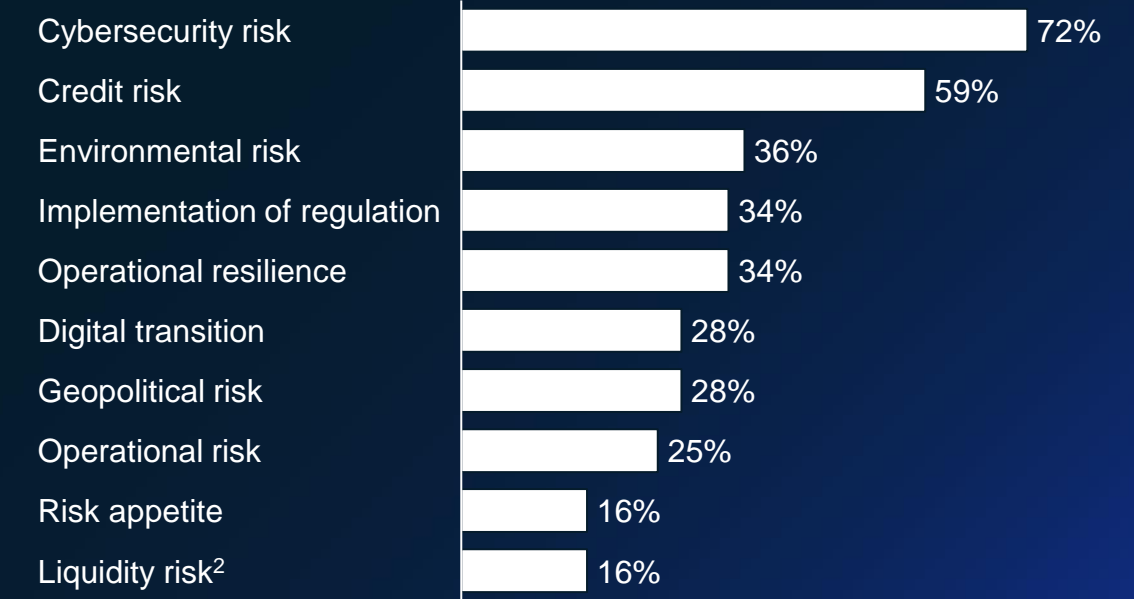
## Non - Financial

Cy	Cybersecurity	Con	Conduct
Ra	Risk Appetite	Dig	Transition to digital
Op	Operational	Cul	Cultural
Res	Resilience	Env	Environment

## Financial

Reg	Regulatory Implementation
Cre	Credit
Emerging	

Top 10 | CRO priorities for 2022



Top 5 | emerging risks according to CROs

Q: What five emerging risks do you believe will be most important for your organization over the next five years



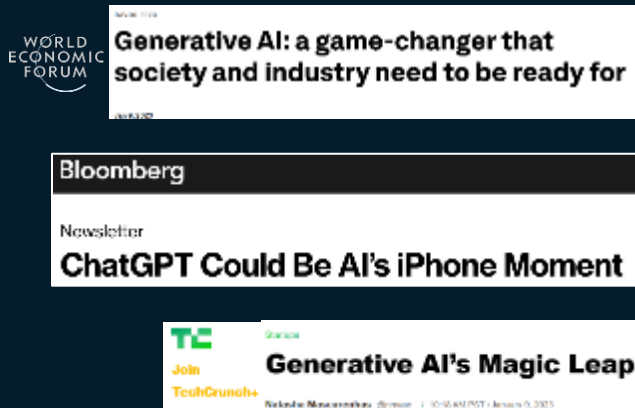
1. From IIF (2022), 12th annual global bank risk management survey  
 2. Expected to have gone up through 2023 due to the current market

# C. For example, there is global excitement around Generative AI, with traditional corporates already engaging in pilots leveraging automation, acceleration and augmentation processes

**>\$10B** investment in one of the top players<sup>1</sup>

**425%<sup>2</sup>** increase in VC investment in Generative AI since 2020

**8X** growth in search for “Generative AI”<sup>1</sup> in 2022<sup>3</sup>



Stability AI has reached 30k+ stars on GitHub **8 times faster** than any previous package

**~80%** of current AI research is focused on GenerativeAI today<sup>4</sup>

Morgan Stanley

OpenAI

andreesen.  
horowitz

slack

otpbank

stripe

McKinsey  
& Company

co:here

How should the Risk function respond to rising usage of Gen AI from consumers and companies?

1. Microsoft investing in OpenAI
2. <https://www.ft.com/content/9c5f7154-5222-4be3-a6a9-f23879fd0d6a>
3. Between Jan & peak Dec 2022 (pre holiday) based on Google Trends results
4. <https://www.economist.com/interactive/briefing/2022/06/11/huge-foundation-models-are-turbo-charging-ai-progress>

# D. Agility and tech-enabled ways of working that are closer to the business are increasing in relevance for top Banks

Motivations for adopting Agility in Risk

Clients' examples



**~15-20%**

**Generation of org.  
efficiencies**

Generate organizational efficiencies by fastening decision-making processes, empowering teams, and automating business-as-usual functions



**~50-60%**

**Decrease in time-to-market**

Reduce TTM in key Risk processes pilots (e.g., policy changes, new scoring models) by giving more authority to squads and focusing on key projects



**~2x**

**Improvement in  
customer exp.**

Increase number of customers approved with a credit offer by improving credit scoring models, adjusting KO filters and enhancing monitoring function



**-**

**Increase alignment  
with Business**

Optimize balance between business support and risk management by defining clear roles and responsibilities (LoD model)

# E. Banking regulation varies widely across the region but there are trends across the board: ESG and non-financial risk management

Selected Countries – as of Q4 2022

● Early stage

● Developing

● Advanced

● Requirement

Country / Aspect	Basel III implementation date	GDPR	Open Banking	IFRS 9	ESG	Trends
<div>Brasil</div> <div></div>	2023	●	●	●	●	Tightening of regulatory <b>capital requirement</b> with the implementation of Basel III New regulations to combat money laundering and other <b>non-financial risks</b>
<div>Colombia</div> <div></div>	2025	●	●	●	●	Implementing regulations of <b>Data Protection</b> Law to ensure compliance with personal data protection standards and other consumer protection standards Focus on promoting <b>financial inclusion</b> , with the expansion of banking services in rural areas
<div>Mexico</div> <div></div>	2023	●	●	●	●	New law of the National Banking and Security Commission requires the installation of bio-metric machines across all banking institutions to control <b>non-financial risks</b>
<div>Chile</div> <div></div>	2025	●	●	●	●	Tightening of AML and KYC regulations to combat money laundering, terrorist financing and other <b>non-financial risks</b> Strengthening of regulatory oversight for financial institutions to prevent <b>misconduct and fraud</b>
<div>Argentina</div> <div></div>	2023	●	●	●	●	Focus on promoting <b>financial inclusion</b> , with the expansion of banking services in rural areas Increased oversight of cryptocurrency trading and other <b>alternative financial products</b>
<div>Peru</div> <div></div>	2023	●	●	●	●	Initiatives to increase <b>competition and innovation</b> in the banking industry Implementation of measures to control shadow banking and limit <b>systemic risks</b>

## E. Additionally, a new wave of regulation is expected based on the recent failure of SVB and other Banks



"I'm going to ask Congress and the banking regulators to strengthen the rules for banks to make it less likely this kind of bank failure will happen again"

**Joe Biden**  
President of the USA

"SVB's failure demonstrates that there are weaknesses in regulation and supervision that must be addressed"

**Michael Barr**  
Fed Vice Chair for Supervision



# To approach these challenges, we are seeing an increased deployment of Integrated Risk Transformations in the region

## Principles

## Description



**Everything on the table**

Review all risk-related levers with a focus on increasing the **effectiveness and efficiency** of the function, including 1<sup>st</sup> and 2<sup>nd</sup> lines of defense



**Focus on performance + capability building**

Prioritize **impact levers** (e.g., credit, renegotiations) to bring bottom-line improvement, but also ensure **long-term sustainability by addressing enablers and new capability building** (e.g., Risk ID, RAS, Culture)



**Self-funded**

**Gain buy-in from the organization** and be able to re-invest on long-term initiatives and talent

# 10%+



**Increase in operating margin<sup>1</sup>**  
observed as a result of integrated risk transformations in Latam

1. When applying credit, collections, capital, liquidity, pricing, portfolio management and fraud/AML initiatives

# Closing remarks

- 1** The Risk function is **key to maintain performance and long-term solvency for Banks**
- 2** The Risk function is **constantly evolving, increasing in complexity and exposure**. Managing these changes and new regulations require **consistent improvement over time**
- 3** To consistently improve, risk functions have to **continue working in understanding, sizing and controlling “known” and emerging risks**. More technology, intelligence, data and talent, among others, are required
- 4** Banks can approach these challenges with a **holistic and integrated approach**, balancing performance and long-term solvency while capturing synergies and increasing collaboration, creating a muscle, to evolve and adapt through time

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