

# Possible Challenges and Recommendations for Risk Managers in Financial Institutions

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**Abstract:** The article analyses the importance and potential challenges of risk management in financial institutions, highlights the difficulties financial institutions face in identifying, assessing and mitigating the various risks within their organisations, and makes a number of recommendations to address these issues. This paper explores these challenges, which include spillover effects, cybersecurity issues, efficiency trade-offs between costs and processes, regulatory compliance, and the impact of globalisation. Recommendations are made to address these challenges, such as adopting standardised procedures, embracing technological innovation, identifying emerging risks, and increasing automation of risk management processes. Effective risk management practices are essential to address the complexity of the financial industry and ensure organisational resilience.

**Keywords:** Risk Management, Financial Organizations, Spill-Over effects, Globalization, Standardized procedures.

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## 1. Introduction

Risk management in organisations includes all relevant steps and activities that are associated with identification, evaluation and mitigation of different types of risks within the organisation (Fadun, 2013). Effective management of risks within an organisation includes not only adoption of effective practices and strategies that can be used for mitigation of risks, but also requires development and adoption of effective risk management frameworks, policies and also an infrastructure that can be used for their management (Fadun, 2013). While there are several tools and frameworks that have been developed for assisting people in managing organisational risks effectively, people involved in it still face a plethora of challenges. The essay thus focuses on evaluating the challenges that people in general face while improving the way risk and uncertainty are dealt with in companies and also then makes recommendations that can be beneficial for overcoming these challenges. The focus of the essay remains on financial organisations and the recommendations that have been made further also relate to such firms.

## 2. Challenges faced by People Improving Management of Risks in Financial Organisations

The global financial crisis that occurred in 2008 has highlighted the regulatory and underlying management issues of these financial organisations, thus making risk management a key priority for them (Cheng et al 2015). While these organisations are focusing on adoption of new and efficient ways of managing risks, people who are responsible for integration of these practices seem to face massive challenges.

One of the major issues as identified by Adams et al (2014) and Wang et al (2017) is the issue caused due to spill-over effects. Financial institutions usually offer a range of products and service based solutions to their customers and clients and adopt a consolidated enterprise risk management system and

solution. While the consolidated risk management helps in accomplishing higher coordination across departments and also effective establishment of different methods for managing different risks, it does not help in managing spill-over effects (Berry-Stölzle and Xu, 2018). Berry-Stölzle and Xu (2018) explain that when a financial institution offers a range of products in its portfolio and hence losses and risks associated with one of them can also have spill-over negative effects on other products in the portfolio. Thus, while the consolidated approach towards risk management helps the people in standardising the process, they often face the issue of these spill-over effects and are not able to effectively identify and manage all the risks.

The people also face challenges in the process of risk management because of the increase in cyber-security issues and concerns. On one hand, use of technologies and digital innovation has considerably increased in banks and other financial institutions to improve and enhance performance, but on the other hand, these technologies come along with a large number of cyber-security and digital issues and challenges (Singh and Singh, 2016). Especially, as technological advancements are taking place, the ability of criminals and hackers to overcome the security measures adopted by firms and hack into the system has increased considerably (Kopp et al 2017). The growth of Fintech firms has further added to the issue because these firms require execution of a large number of transactions and financial activities online, thus increasing the risks of cyber-security. People managing risks in these organisations thus often face the problem and issue of not being able to manage these technologies for effectively managing and mitigating risks (Kopp et al 2017).

Trading off between costs incurred in management of risks and the efficiency of processes that are adopted is yet another challenge that is commonly faced by people managing risks in case of financial organisations (Waemustafa and Sukri, 2016). Increasing competition in the financial sector and their need to manage and follow all the regulatory requirements has resulted into a high need for them to be able to minimise and

reduce costs. Thus, a major issue that the people in financial institutions face is that while they try to accomplish higher efficiency in the processes that they adopt, they also need to make sure that the underlying costs go down (Waemustafa and Sukri, 2016).

The regulators and people responsible for managing risks in financial institutions also face challenges because of the regulators and associated compliance issues. Global financial crisis has resulted into enactment of a large number of regulations and laws that are focused towards protection of the financial firms and interests of the stakeholders (Lucey et al 2018). People thus responsible for managing risks in these organisations face the challenge and issue of making sure that they adhere and comply with all regulatory needs and requirements. This can be explained with the example of the Dodd-Frank Act, which has been established to define the regulatory enforcement associated with compensation of executives, corporate governance and people involved in security-based major swap activities (Mohanty et al 2018). The Act has a provision called “say no pay”, which has resulted into a large number of suits against different financial institutions (Mohanty et al 2018). Thus, management of these regulatory requirements remains a major issue faced by people responsible for management of risks in case of financial institutions and organisations.

While the existence of different laws and regulations remains a massive issue in banking risk management, Lu (2018) argues that financial institutions are becoming more and more international, which is adding to the legal and regulatory issues faced by them. There are several banks around the world such as Bank of Credit and Commerce International (BCCI), Deutsche Bank and Standard Chartered Bank that have been accused in money laundering cases (Giudici, 2018). The occurrence of these cases and events has resulted into additional pressure for the financial firms wherein they need to make sure that their global transactions are being carried out adequately. This thus adds to the problems for people responsible for management of risks in these firms. The execution of global transactions and making sure that the practices comply with international regulations and laws make it difficult for the people to carry out and complete their transactions effectively.

These discussions thus establish and confirm that there are indeed a plethora of different challenges that people in financial institutions face while trying to manage and carry out their relevant activities with respect to management of risks in their organisations. Some recommendations that can be made for them to be able to deal with these challenges and issues in a better manner are being presented further.

### **3. Recommendations for Improving Dealing with Risk and Uncertainty**

It can be recommended for the people managing risks in financial organisations to focus upon the standardised procedures and practices as defined in standards such as Basel IV (Stankovska et al 2018). The new improved framework for managing risks has resulted into several changes as compared to the older standards and standardised procedures, which have strong and positive implications for different parts and aspects of the business such as mortgages and also high-quality loans (Stankovska et al 2018). It can be thus recommended that people managing risks in financial organisations can adopt and focus upon these standardised

procedures for risk management. These standardised risk management framework can be further amalgamated with specific department wise policies and practices. It has been discussed earlier that consolidated risk management practices in financial organisations can result into several challenges and issues (Zhang et al 2018). Thus, people managing these risks can integrate and combine the standard procedures as defined under frameworks such as Basel IV with specific policies for different departments. This will ensure that the spill-over effects are minimised and the overall practices improve.

The people in these financial organisations can also be further recommended to focus upon technological innovation for improving the adopted practices. Adoption of new technologies such as artificial intelligence (AI), allows the financial organisations to be able to carry out simulations and detailed data analysis, which in turn helps in making sure that overall analysis and management of risks tend to improve (Scott et al 2019). Barclays Group for example has integrated a new technological approach called agent based modelling, wherein the focus of the technology remains on evaluating the overall behaviour of the given system by modelling and analysing the behaviour of each individual agent within the system (Berndt et al 2019). Barclays has even partnered with a third party called Simudyne for being able to carry out better analysis of the underlying risks and to integrate technologies for improving the overall practices of risk management (Berndt et al 2019). Earlier discussions have revealed that changing technologies are resulting into risks of cyber-security for the financial organisations and it can be hence recommended that if people who are responsible for management of risks, need to also focus on these technologies. Third party collaborations can further help them in improving their technological capabilities that would result into better and more effective management of risks.

Another recommendation that can be made is that the people responsible for management of risks need to focus upon identifying and managing new risks that emerge with respect to the financial sector. The analysis by McKinsey (2016) establishes that financial organisations are facing new risks such as the business model risk, cyber security risks and contagion risks. Asia-Pacific Bank for example applied incorrect assumptions while making use of the interest-rate models, which resulted into a total loss of around \$4 billion (McKinsey, 2016). It is thus necessary for the financial organisations to focus upon constantly identifying new risks that can emerge in the business. Earlier discussions have revealed that the sector is changing wherein there has been a growth of fintech firms and also international transactions are increasing (Karol and Poltorak, 2018). Thus, as these changes take place, it is essential for the firms to be able to identify and manage all the risks. The people responsible for risk management thus need to make sure that they constantly carry out research to identify potential new risks to be able to effectively adopt risk management practices (Karol and Poltorak, 2018).

One of the challenges identified above is the increasing costs associated with the process of risk management. While organisations in the financial sector are trying to minimise their operational costs for higher cost cutting that would reflect on cost cutting activities related to the risk management practices as well, they can be recommended to focus on increasing automated control of the adopted practices (Kou et al 2019). Automated control in the process

of risk management is also said to be advantageous because it helps in reducing human intervention, which reduces and minimises overall errors that can emerge and occur in the process. According to the analyses by WNS (2019), banks and financial institutions almost lose around \$15 billion on an annual basis due to fraud and hence these organisations can integrate almost over 500 controls to be able to manage the risks efficiently. Royal Bank of Scotland in addition to these automated controls, has also focused on developing an internal culture of managing risks. The culture focuses on implementation of controls along with well defined, standard processes for managing risks. Teams within the bank are given responsibilities and a framework to follow to make sure that all the involved people are able to adopt suitable practices. Thus, people managing risks in financial organisations can focus on adopting these controls along with creating a suitable culture for better outcomes.

#### 4. Conclusion

The essay has thus established that people who are responsible for managing risks in financial organisations do face a large number of challenges. The challenges that are seen in these organisations are in fact increasing because of growth and adoption of new technologies, increasing regulations and also international transactions. It has been thus recommended that people responsible for managing risks in financial organisations need to integrate new technologies, automated controls and standardised practices for making sure that risks are managed efficiently.

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