Grant Thornton
An instinct for growth™

Financial services: Poised and prepared for the next great leap?

Governance, Risk and Compliance Survey 2016

Powerful trends are exerting great pressure on financial services organizations as regulatory pressure intensifies, disruptive competitors multiply and technology advancements escalate. Complex and interrelated networks that include customers, suppliers and even competitors are increasing, and leaders everywhere are grappling with complicated, multidimensional risks. Whether regulatory, compliance, security, financial or operational, quickly fluctuating risks are forcing financial services executives to face challenges never before imagined.

In response, some organizations have built sophisticated enterprise risk management (ERM) systems and put in place processes and procedures for risk culture, reputational risk and more, but considerable opportunities exist in many financial services businesses to move beyond activities focused strictly on compliance and mitigation to broader, deeper risk management and assessment that drives strategic growth.

Specifically, the list of challenges facing the banking industry, such as Dodd-Frank Wall Street Reform and Consumer Protection Act regulations (including the Volcker Rule, Consumer Financial Protection Bureau mandates, stress tests and capital requirements), consume leadership focus at the expense of product and service innovation. Now the aggregate cost of compliance (operational, risk management and compliance, as well as internal audit) represents a material, and often growing, share of noninterest expense.

There is an urgency facing banks and financial services firms in today's volatile environment. Prioritizing product and service innovation alongside compliance and leveraging risk management tools to gain competitive advantage are but two of the great opportunities in front of financial services leaders today.

To help industry executives identify opportunities and plan for 2017 and beyond, Grant Thornton LLP deployed its annual *GRC Survey*, which highlights trends, activities and challenges facing today's leaders. The *GRC Survey* defines GRC as collaboration of many roles and functions versus a specific organizational department. Those functions include legal, internal audit, audit committee, finance and compliance. The goal of the *GRC Survey* is to assess the management of GRC activities and processes across these roles and functions. To do so required input from industry professionals with a range of titles. The *GRC Survey* builds upon research conducted on internal audit and general counsel roles in recent years.

This segment of the overall *GRC Survey* focuses on the financial services industry, where there is a growing desire among executives to see GRC assume more significant roles in helping organizations achieve their strategic business goals. The good news for the financial services industry, compared to other industries surveyed in the full study, is that it is poised to seize this moment in ways others are not.

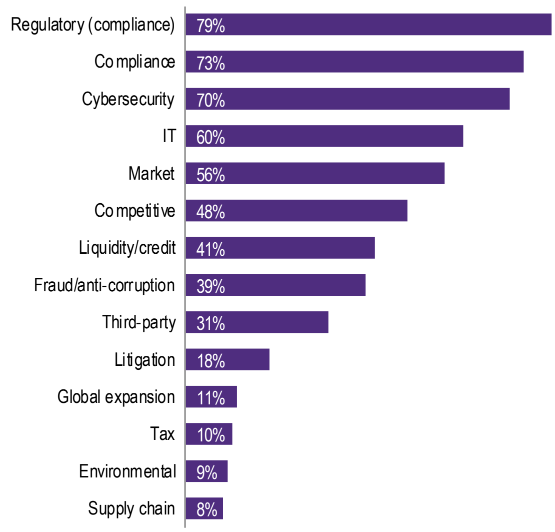
Top findings include:

- According to financial services leaders who participated in this survey, the GRC function is integral to the industry and critical to its health. At the most basic level, firms are satisfied by the performance of their GRC functions, rating their organizations as effective or highly effective.
- Areas of greatest concern to financial services leaders are not surprising. In general, regulatory, compliance and cybersecurity risks topped the list. And when asked about the risks specifically affecting business growth, respondents cited regulatory, cybersecurity and IT as the three most significant, with market threats a close fourth.
- Despite the fact that respondents reported increased levels of investment for GRC functions, they also identified great unmet opportunities for GRC teams to expand from strict monitoring, measuring and mitigating activities into activities designed to increase strategic value by positively affecting business results for their organizations through greater focus on driving efficiency, identifying opportunities for improvement, and helping to inform decisions related to business growth and strategy.
- So while satisfaction is high, there is also a palpable sense that it is time for GRC leaders to leap into becoming consultative advisers to their organizations, and for good reason. GRC professionals are uniquely positioned to provide comprehensive views of risk, and the window is now; the potential is great, and the investment is growing. The question is who will lead the way?

Most significant GRC risks and the cybersecurity confidence gap

Not surprisingly, financial services executives identified regulatory, compliance and cybersecurity risks as the most significant risks facing their organizations today and, interestingly, they named these three risk categories almost twice as often as their peers in other industries did.

Figure 1: Business-specific risks by significance



That said, a large majority of financial services leaders felt that their organizations were effective or highly effective at measuring and monitoring two of the three most worrisome risks: regulatory (compliance) (76%) and compliance (68%).

Unfortunately, their confidence is significantly lower for cybersecurity efforts, with just more than half (53%) reporting that their organizations were effective or highly effective at measuring and monitoring cyberrisk.

Given the expressed concern of leadership and the significance of technology to organizational health and vitality, the confidence gap related to cybersecurity risk management begs for attention, and argues for a deliberate focus and additional investment.

Spending more and leveraging technology

Overall, financial services institutions are investing more heavily in GRC functions than their peers in other industries. Case in point, 70% of financial services leaders reported a somewhat or significant increase in their GRC investments as compared to only 57% of respondents from other industries.

Figure 2: Effectiveness of measuring and monitoring key risk indicators

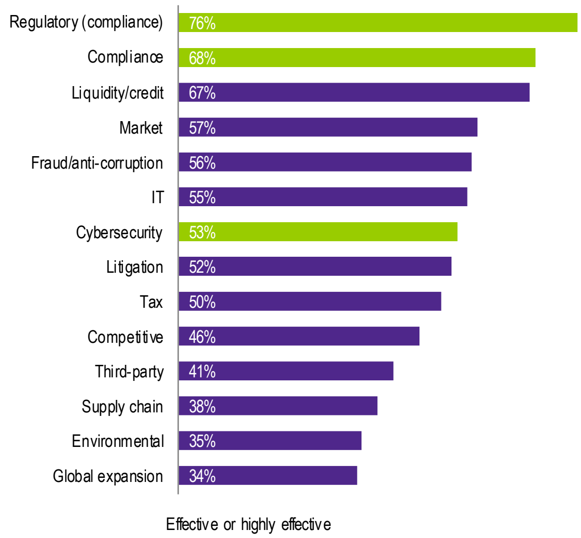
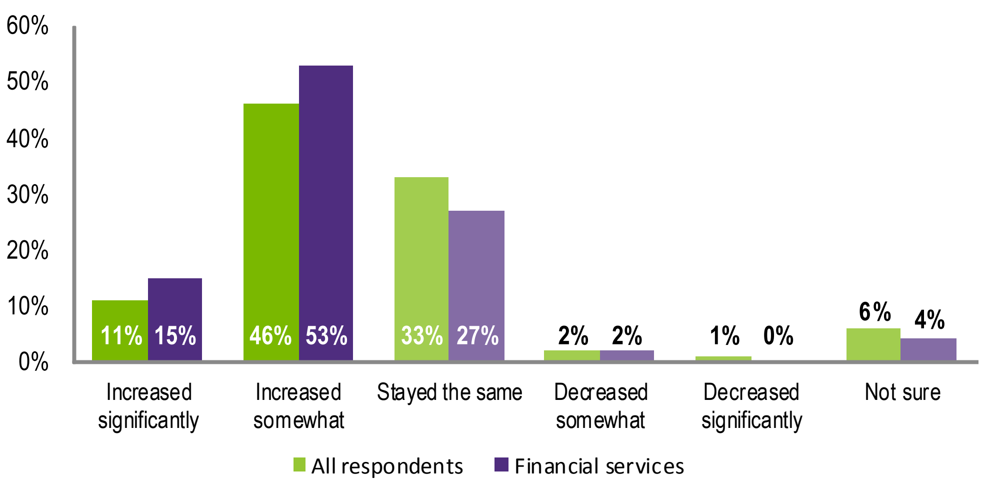


Figure 3: GRC Investment 2014 to 2015



For 2016, financial services firms put their cost of GRC activities at about 10% of revenue, essentially on par with other industries.

The increased investment is touching a number of key areas and ultimately translating into more focus for technology systems and solutions. For example, almost half of all respondents reported enhancements related to refining/improving existing ERM programs. Another four in 10 noted increased focus on data analytics and risk modeling, and more than one-third reported additional enhancements to GRC technology solutions.

But technology-related activities are not the only ones reaping the benefits of more attention and dollars. Over one-third of respondents noted an increased emphasis on integrating GRC into operations and business strategy, and additional consideration of third-party monitoring and audits were also high on the list (see Figure 4).

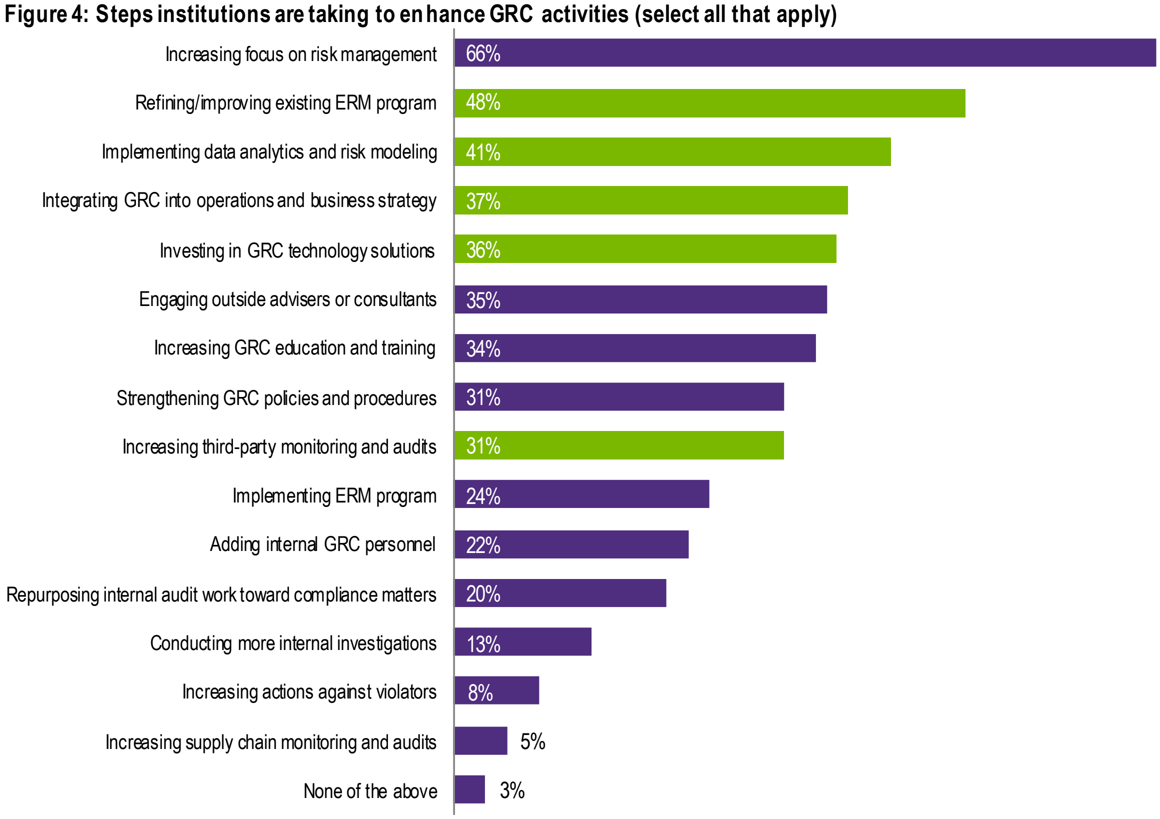
The use of data analytics and risk modeling by financial services firms is far outpacing other industries, with half of all financial services leaders confirming that they make extensive or moderate use of data analytics and risk modeling as compared with only 35% of all survey respondents. There is reason to believe this difference may exist because the highly regulated financial services industry often relies on a centralized risk management function and strong analysis as a natural output of that role.

With benefits that include cost reductions, faster decision-making and more sophisticated market insight, data analytics and risk modeling activities are helping financial services companies streamline audit processes, reduce fieldwork, sort massive amounts of data and predict multiple outcomes.

Not surprisingly, respondents named data analytics and risk modeling as most useful for mitigating financial and operational risks (50%), mitigating compliance/regulatory risks (43%), and providing business/operational insights (33%).

To date, only 2% of financial services respondents use data analytics to monitor supply chain compliance, while just 10% use it to monitor third-party compliance. Clearly, great opportunity exists for financial services organizations to use these tools to augment and improve these critical business functions.

Figure 4: Steps institutions are taking to enhance GRC activities (select all that apply)



Falling short?

Despite an increase in GRC budgets — which would seem to translate into an increased and broader investment for all GRC activities — respondents report that GRC functions are mostly focused on monitoring compliance at the expense of activities that can help improve performance by driving strategic growth.

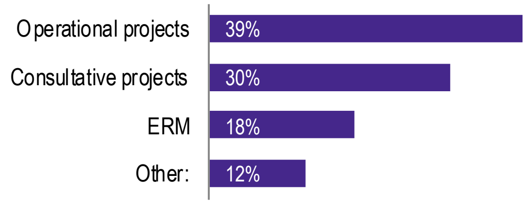
For example, only one in 10 respondents ranked its own GRC activities at the highest maturity level, as a function that adds substantial value to the organization. Further, only 40% said that their GRC functions offered value-added activities (Levels 4 and 5 in Figure 5).

Equally disappointing is that only 41% of the firms responding report that their GRC organizations go beyond monitoring compliance, although a majority of financial services firms do report that their GRC organizations incorporate GRC controls in their daily practice.

Potential barriers preventing the chief audit executive (CAE) and the audit staff from providing optimum value were also identified by respondents. In some cases, a negative perception of internal audit limits ability to provide optimum value.

The fact is that more than 70% of respondents indicate that the compliance focus of their internal audit function increased in 2016. The increase seems to be to the detriment of other operational projects and consultative projects (see Figure 6).

Figure 6: Internal audit reductions in light of increased compliance



Given the levels of investment, this type of value-driven disconnect is concerning.

To be sure, regulations are not going away, but firms of all sizes have opportunities to comply with them more efficiently and effectively by reducing costs for activities that do not add value, and refocusing compliance teams on providing competitive advantage.

Leveraging massive amounts of data collected by internal audit to improve performance is one of the possible steps. Three-quarters of respondents confirmed that stronger compliance efforts in other functional areas will empower internal audit to add the most value to the organization and its strategic goals.

Figure 5: GRC maturity continuum

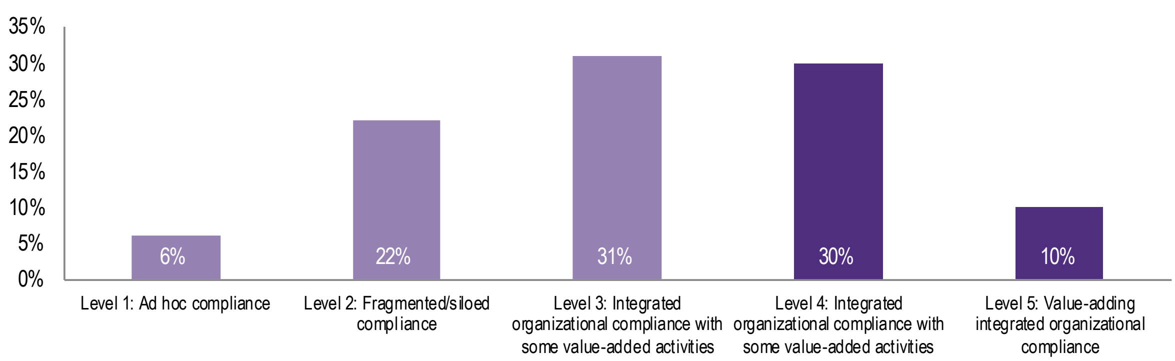
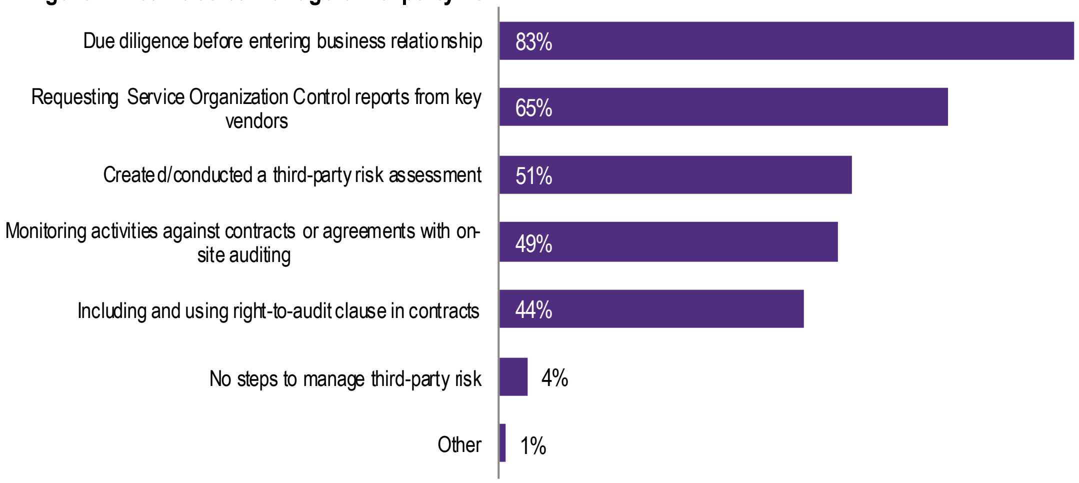


Figure 7: Activities to manage third-party risk



Opportunities for improvement

Overall, many financial services companies question whether current personnel are up to the challenge, especially in the areas of audit and operations leadership/management. Almost half report that audit skills are in short supply, and 44% identify skills deficits in operational leadership. Accordingly, almost one-third expect staffing increases in the next 12 months, while just 5% anticipate a decrease in personnel.

But the lack of skills is only part of the issue. A large majority of respondents (68%) also believe that a shift in focus or lessening of existing constraints (such as the strict focus on monitoring and compliance) would enable the internal audit function to add more value to GRC activities.

Additional opportunities exist for most GRC teams as evidenced by the low responses to the question, "What steps is your organization taking to enhance GRC activities?" Only four in 10 said they are implementing data analytics and risk modeling; 37% reported integrating GRC into daily operations and business strategy; 36% reported investing in GRC technology solutions; and 35% said that they engage outside advisers and consultants (see Figure 4).

The good news is that efforts to enhance the functions of GRC are alive and well in about one-third of financial services companies, but there are still many with GRC organizations that function primarily as monitors, and opportunities abound for them to provide greater value to their institutions.

There also appears to be room for improvement in efficiency within several specific areas of GRC activities including GRC compliance efficiency, in that only 40% of respondents indicated that their organization derived value from that effort, and just a third of all respondents felt their organizations were receiving value from the greater use of technology and third-party resources too.

Although technology is acknowledged as an important way to enhance GRC activities by more than a third of the financial services respondents (36%), fewer than 10% felt that there was enough use of technology for either compliance or regulatory risk.

For firms looking to enhance the consultative capabilities of its GRC functions, third-party expertise also presents a major opportunity for efficiently adding knowledge and wisdom to the GRC team. To date though, just over half of financial services respondents actually rate third parties by the level of risk they pose. Given the high level of regulatory, compliance and cyberrisk, this area of third-party risk management is ripe for expansion.

Although 83% of respondents reported completing some level of due diligence before entering a business relationship, only 49% have set up functions to monitor activities against contracts or agreements with contract auditing. There is great opportunity to expand and enhance contracts with third-party vendors.

Embracing the possibility and opportunities of new and enhanced technology systems and solutions to improve corporate performance is an enormous opportunity across the board for GRC functions and their leaders.

Explore industry utilities

On the innovation front, a number of leading banks are reaching outside their institutions, establishing cross-industry "utilities" to address core functions that are not a source of competitive advantage. Banks are looking at all their nonstrategic processes as the industry aims to operate in a fundamentally simpler way. Initial utility forays in banking include vital yet time-consuming administrative functions, such as client screening, tax documentation and third-party risk assessment and monitoring activities.

The benefits are undeniable. For banks, the high volumes and innovative systems of these independent utilities lower costs, increase efficiency and improve performance. In some cases, the ability to look at risk and potential fraud across the industry may also enhance the collective ability to respond to threats.

Benefits accrue to third parties as well. For example, industry suppliers need to respond to just one monitoring organization for most (if not all) of their banking clients. The burden of multiple responses and different reporting criteria is reduced, allowing suppliers to work more efficiently and pass savings to their banking customers.

"The banking sector is ahead of many industries in its exploration of the benefits of collaborative utilities," explained Dennis Frio, a managing director in Grant Thornton's Financial Services Advisory practice. "We see the model extending to relieve additional areas of regulatory burden."

Call to action: It's time for the next great leap

What can be done? First, the GRC function can and should look more extensively to technology and external service providers to elevate its role in the organization from being effective monitors to being consultative advisers.

Second, the GRC function can and should more completely embrace data analytics and risk modeling to tease out key market insights and strategic analysis from the considerable information currently collected and laying fallow. The convergence of finance, risk and treasury cannot be overlooked here. What used to be very separate functions — treasury worried about cash flows, risk worried about interest rate shifts and impact on client portfolio, and the CFO oversaw both along with finance — are today managed together. Now all three areas need access to the same underlying data and a way to overcome the crushing data complexity.

Third, the GRC function can and should seek more efficiency in their operations to free up time and resources for higher-value activities that improve performance, especially including a more comprehensive view of risk across the organization (including cybersecurity and third-party risk). In short, the GRC team should use its expertise to help guide the organization forward.

About the survey

The Grant Thornton *GRC Survey* was administered in 2016, and received 535 valid submissions from a mix of executive titles and roles familiar with GRC activities. Participants in the *GRC Survey* represented a range of organization types, sizes and industries in the United States.

This subreport focuses strictly on the financial services industry sector and the 171 responses collected as part of the larger *GRC Survey*.

Grant Thornton LLP is committed to helping executives and their organizations identify, prioritize, manage and monitor risks. Leaders can leverage this survey to optimize GRC activities and investments and prepare for events commensurate with their organizations' appetites for risk.

Financial services sector breakdown

- 51.2% are banking/financial institutions
- 18.5% are asset management
- 21.4% are financial services (other)
- 8.9% are insurance (non-health care)
- >1% private equity

Revenue

- Less than $100 million — 38%
- Between $100 million and $500 million — 21%
- Between $500 million and $1 billion — 14%
- Between $1 billion and $5 billion — 18%
- More than $5 billion — 9%

Assets managed

- Less than $1 billion — 33%
- Between $1 billion and $10 billion — 37%
- Between $10 billion and $50 billion — 16%
- Between $50 billion and $100 billion — 1%
- More than $100 billion — 13%

Respondent titles (top 3)

- CFO — 19%
- Internal audit — 17%
- CAE/lead internal auditor — 13%