Reimagining risk management for financial institutions in the post-COVID-19 world

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Over the course of last four months, the COVID-19 pandemic has pushed the global economy towards a great depression. Central banks have slashed rates off-cycle and injected liquidity in emergency measures to keep economies moving for now.

While it seems that the wheel is coming off, those who survive need to seek the opportunities that emerge amid the chaos. We need to change the way we are running our financial institutions; we need to adapt fast to this new normal. For financial risk management specialists, the burning question is how risk management needs to realign itself to the new realities of the post-COVID-19 world. What are the key themes that would enable the financial institutions to become robust and resilient in the post-COVID-19 era?

Financial institutions, first and foremost, need to be agile to ensure alignment with the new realities of the operating environment. In the post COVID-19 world, given the increase in non–performing loans (NPLs), financial institutions are expected to recalibrate their risk appetite opting for low-risk assets. While there was a pre-COVID-19 push towards digitisation, COVID-19 is going to materially accelerate its adoption. Further, an increase in acceptance and usage of advanced analytics are expected across the entire banking value chain. These changes, coupled with the focus on increasing efficiencies and cost reduction are expected to bring structural changes in the operating model of financial institutions (FIs), pushing them to become leaner and more agile.

From a Chief Revenue Officer’s (CRO’s) perspective, the role of risk management is expected to increasingly become that of a business advisor focusing on the preservation of business value, rather than merely a control function. Some of the key areas that require proactiveness are –

- **Credit risk** – Credit rating models need to be completely recalibrated to incorporate revised risk profiles of impacted industries and loan products. Disruption in highly impacted industries calls for a greater focus on the increased review and real-time portfolio monitoring to identify incipient stress and take proactive corrective actions. Entities may conduct scenario assessment on an on-going basis and ensure that sufficient provisions are maintained even in case of stress scenarios.

- **Liquidity risk** – Implementing a robust liquidity management framework needs to be one of the first measures taken during these uncertain times. Institutions need to revise liquidity assessments and stress-testing models and conduct more frequent assessments. Also, a robust and tested contingency funding plan should be in place which can be relied upon in case of unforeseen shortfalls.

- **Operational risks** – Changes in working modalities necessitate a complete revamp of capabilities in managing cyber risks, technology risks, human capital risks as well as organisational reputational risk. Besides, business continuity management becomes key, given uncertainties in the operating environment.

- **Capital management** – A robust stress testing framework should be developed and an impact on key profitability measures, earnings and capital adequacy should be assessed continuously. Business plan and associated risk appetite will need to be dynamically reviewed and updated to ensure relevancy. Funding and capital plans also need to be consistently aligned with business plans.

- **Recovery and resolution planning** – Entities need to ensure readiness in case of crisis management with continuous development and updating of recovery options linked with liquidity position to ensure solvency.

COVID-19 as a 'black swan' event has provided CROs with an unmatched opportunity to lead the function's evolution as an organisation's strategic partner. Every facet of risk management needs to be realigned to enable businesses to be more agile and nimble – this presents a powerful tool in the risk department's armour. As the financing business shifts away from traditional concepts, data and real-time information driven analytics are set to be the backbone of the new operating model.