Cost transformation in risk

How to cut risk management costs without compromising quality.

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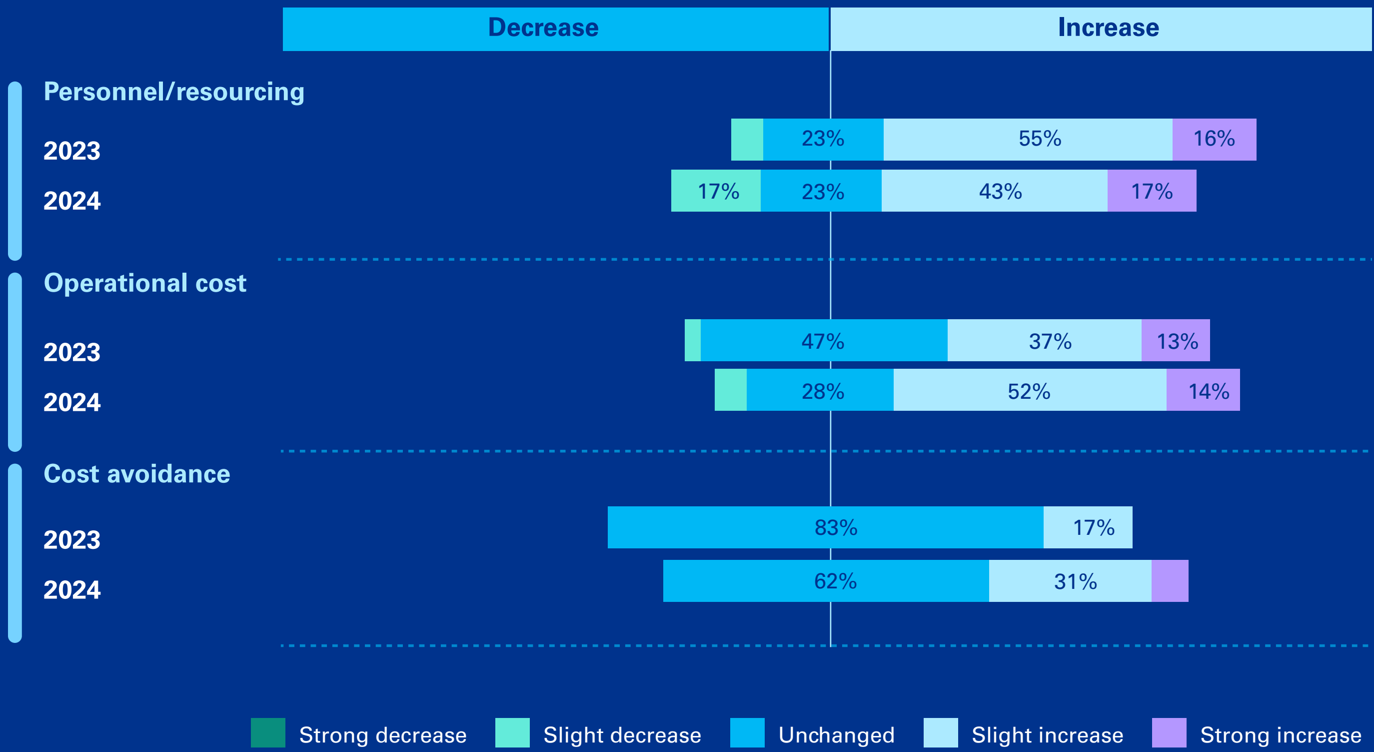
Risk management is at a tipping point

The cost to maintain effective, regulatory-compliant programs is at an all-time high, with ever-evolving expectations that will only add to operational costs. In today's uncertain economic environment, minimizing cost and improving an organization's efficiency ratio are at the top of nearly every C-suite's agenda.

No department is exempt from this scrutiny and risk leadership should be prepared to contribute to overall organizational cost-cutting targets. Results on planned change to investments from the KPMG Global Risk and Compliance Benchmark show this trend (Figure 1). Banks see the need to better prepare their risk and compliance functions for future challenges. Sixty percent of the participating banks plan to invest more in personnel and resourcing in 2024, while an additional 66 percent intend to increase their operational costs in the same year. However, at the same time, 38 percent of banks plan to slightly or strongly increase their efforts to lower costs in 2024, which is 21 percent more than in 2023.

Most efforts to reduce costs associated with risk management oversight and execution have failed to yield maximum and sustainable savings. This paper explores practical approaches to help reduce risk management spend without sacrificing quality.

Figure 1: Planned change to investments in the risk and compliance function by cost type



Source: KPMG Global Risk and Compliance Benchmark

The drivers

Balancing risk transformation priorities

It's important to recognize that cost takeout is not the only transformation driver for the risk organization (Figure 2). Most organizations also have initiatives underway to support the following areas:

- Growth or strategic change (via products, services or delivery channels).
- Effectiveness and efficiency improvements (i.e., quality, consistency, extensibility and confidence).
- Regulatory compliance with new or emerging expectations from oversight bodies.
- Efforts to "de-risk" or reduce risk exposure.

These transformation efforts are not mutually exclusive, often intersect, and should be effectively balanced to not significantly impact one another with unintended outcomes.

Figure 2: Risk transformation drivers

Going beyond incremental cost-cutting

Before launching cost-cutting efforts, it's imperative to analyze what's driving the incremental cost in risk management at any organization (Figure 3). This can be further divided between direct costs and cost avoidance categories, which can also be an unintended outcome of an ineffective risk infrastructure.

While institutions vary, personnel and labor are typically the largest contributors overall. This includes both the second-line risk function's headcount to design, maintain, and oversee the risk framework, along with the first-line personnel who execute risk requirements.

To begin, organizations should first understand their cost landscape across all lines of defense and then prioritize cost takeout efforts on the largest (controllable) contributors, balanced with the upfront investment and speed to realize the potential.

Figure 3: Cost drivers in risk

	Risk management: spend categories		Spend*
Direct costs	Personnel	Direct/second line of defense: Risk oversight	$$$
Direct costs	Personnel	Indirect/first line of defense: Execution of risk programs	$$$$
Direct costs	Third parties/vendors		$$
Direct costs	Tools/software		$$
Direct costs	Training/licenses		$
Cost avoidance	Discretionary spend		$
Cost avoidance	Fees/penalties		$ – $$$$
Cost avoidance	Unplanned/unexpected regulatory remediation		$ – $$$$
Cost avoidance	Loss events		$ – $$$$

*Illustrative representative spend

Ten levers for cost takeout in risk

A modern approach to risk management lowers costs while maintaining or improving quality. For risk executives, there are ten primary cost-reduction levers to engage that can help individually reduce costs but collectively yield significant cost-saving opportunities:

01 Functional, organizational and legal entity rationalization
Rationalization of legal entity, functional and organizational risk accountabilities to eliminate redundancies while aligning appropriate experience and skillsets in execution and oversight of risk-taking.

02 Product and channel simplification
Rationalization of product offerings and channel delivery strategies to help reduce the variability in associated risk and oversight burdens, a decision that is typically led by the business.

03 Location, geographic or global sourcing
Acquiring risk headcount from cost-advantageous locations.

04 Delivery model improvements
Enhanced or streamlined operating models to execute risk requirements in a cost-advantageous manner, including the use of centers of excellence, utility functions or other consolidated delivery approaches; in many cases, these changes can be paired with low-cost or global sourcing strategies.

05 Outsourcing risk as a service
Use of third-party vendors to execute select risk management oversight or execution activities on behalf of the first and second lines of defense.

06 Integrating risk technology
Common technology strategy to collect, maintain and facilitate risk-related data (i.e., single platform or linked systems, data repositories).

07 Digitization of risk (i.e., cloud, automation, advanced analytics)
Digitized risk processes, documentation and control environment, including the use of automation and advanced analytics to gain efficiencies.

08 Rationalizing foundational risk data and architecture
Creating a single, rationalized and clean source of truth of organization risk taxonomies, inventories and data in an optimized architecture strategy.

09 Risk simplification
Alignment and rationalization of risk processes, assessments and methodologies to streamline the annual burden of risk execution and oversight while still maintaining quality.

10 Other expense optimization
Rationalization of other risk oversight and execution-related costs not related to headcount, such as training programs and license fees.

Pulling the levers

Not all levers are equal and impact the balance sheet differently. Some levers offer immediate savings with little to no investment, while others require substantial up-front investment (Figure 4).

Figure 4: Measuring the impact on the balance sheet

Levers for cost transformation		Recognizing cost transformation			Balance sheet impact				
Macro cost lens	**Cost reduction lever**	**Upfront investment**	**Speed for ROI**	**Potential cost savings**	**Personnel**	**Third parties/ vendors**	**Tools/ software**	**Training /licenses**	**Discretionary /other**
Governance model and strategy	1. Functional, organizational and legal entity rationalization	$$$	Immediate	Medium	✓				
	2. Product and channel simplification	$$$	Near-term	Medium	✓				
Delivery model	3. Location, geographic or global sourcing	$$$	Long-term	High	✓	✓		✓	✓
	4. Delivery model improvements	$$$	Long-term	High	✓	✓	✓	✓	
	5. Outsourcing risk as a service	$$$	Immediate	High	✓	✓		✓	
Tech modernization (platforms, digital)	6. Integrating risk technology	$$$	Immediate	Medium			✓	✓	
Data as an asset	7. Digitization of risk (e.g. cloud, automation, advanced analytics)	$$$	Long-term	High		✓	✓	✓	
	8. Rationalizing foundational risk data and architecture	$$$	Long-term	Medium		✓	✓		
Risk execution	9. Risk simplification	$$$	Immediate	High	✓		✓		
	10. Other expense optimization	$$$	Near-term	Low		✓		✓	✓

Correct sequencing is key

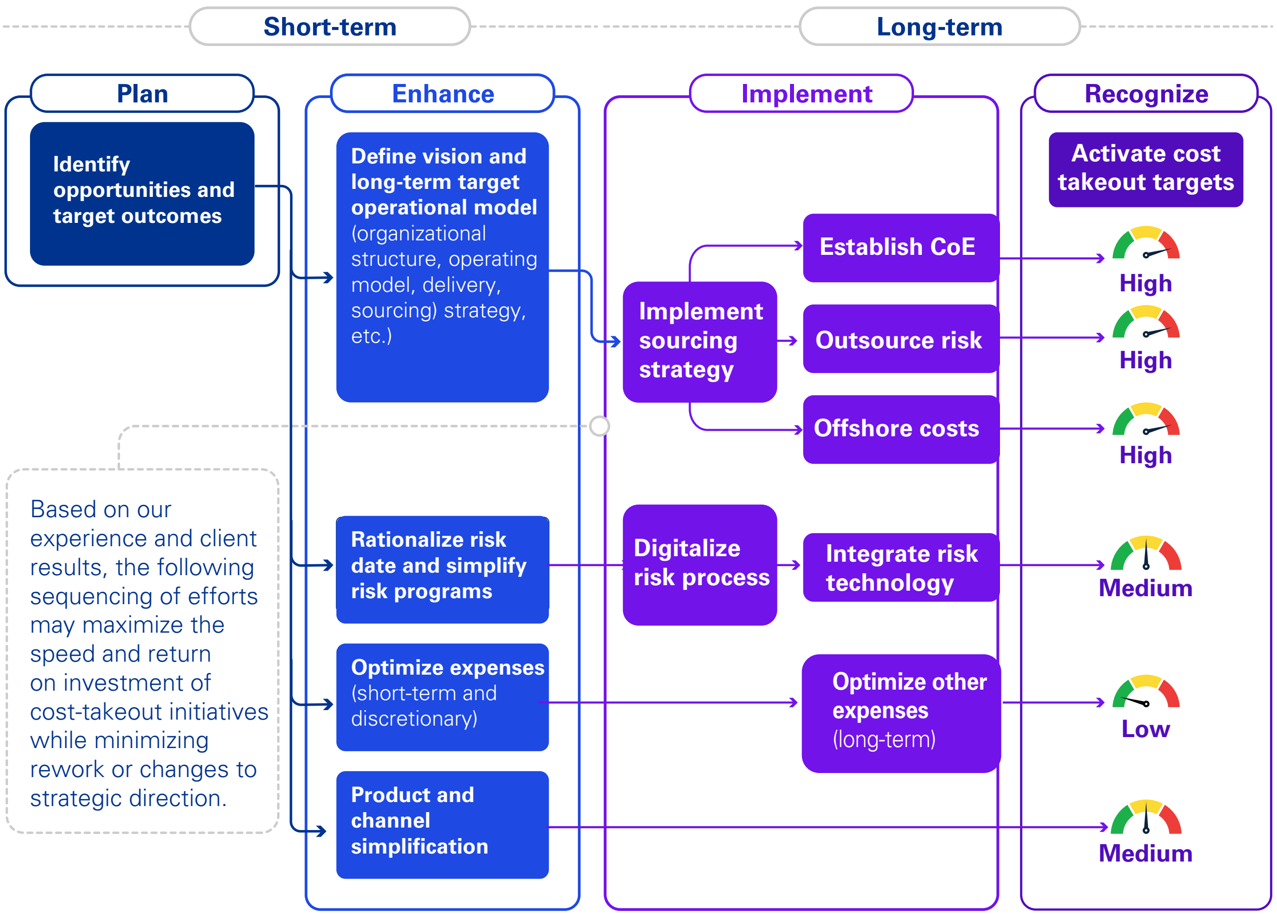
The sequencing of cost takeout efforts can be critically important to get maximum benefit in the shortest timeframe (Figure 5). To date, traditional efforts to alleviate costs in risk management have yielded marginal results. These conventional efforts typically lead with technology or rush to automation without addressing the root causes that drive duplication and inefficiencies.

These inefficiencies are then compounded as organizations establish centers of excellence to process high volumes of risk activities while still leveraging complex methodologies or including a push to offshore functions that still rely on heavy onshore oversight. Some of these efforts are being scrapped altogether, given the marginal yields and quality control issues to explore alternative delivery models, such as outsourcing to a third party, which often results in a loss of the upfront investment made.

Unplanned and potentially short-sighted cost-cutting efforts are ultimately frustrating given the volume of rework, time to market and multiyear investment required to yield marginal results or non-scalable solutions. Moreover, such efforts may fail to keep pace with changes in the marketplace, evolving strategy or modifications to regulatory expectations. The difference between strategic and thoughtful cost takeout transformation versus near-term cost-cutting can be dramatic.

Sequencing cost takeout efforts through the lens of short-term and long-term savings can position an organization to methodically and purposefully build with the end result in mind. As illustrated, an organization should focus initial efforts on planning and ideation to clearly define intended outcomes and a long-term target operating model. These are essential to enhancing cost savings with limited investment. Subsequently, organizations should then focus on enhancing root causes or foundational issues that result in higher costs before fully implementing the long-term vision.

Figure 5: Sequencing cost takeout efforts to maximize impact



Building the case for change

Outsourcing risk as a service, sourcing from cost-advantageous locations, and standardizing and automating risk procedures are key elements in a cost-efficient transformation. Taking a deep dive into the results of the KPMG Global Risk and Compliance Benchmark and the KPMG Global Model Risk Management Benchmark, these three levers unfold their impact.

Lever 3

Location, geographic or global sourcing

Sourcing headcount from cost-advantageous locations can have several advantages, including:

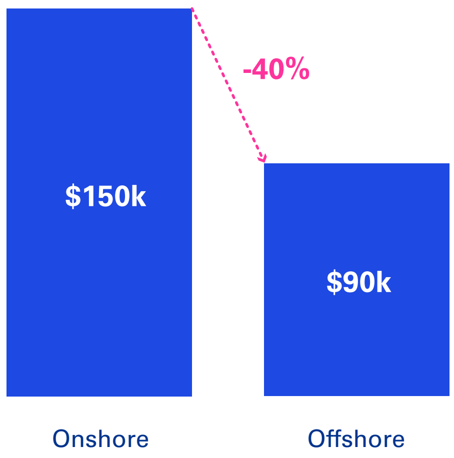
- Cost savings: Banks can save on labor costs, which can be a significant expense.
- Access to talent: Locations may have a large pool of skilled professionals willing to work for lower salaries, providing banks with access to a broader talent pool.
- Diversification: Different locations can help banks diversify their workforce and reduce reliance on one location.
- Time zone coverage: Having employees in different time zones can provide banks with 24/7 coverage, which can be particularly important for risk management functions.

However, it's important to note that some challenges may be associated with sourcing headcount from cost-advantageous locations, such as language barriers, cultural differences and the need for effective communication and collaboration across different locations.

The KPMG Global Risk and Compliance Benchmark showed that banks leverage (on average) more than 20 percent of offshore locations if they already utilize offshore locations. In particular, large global banks do leverage offshoring opportunities to a larger extent, but some smaller banks have also achieved a good cost differential.

In the same benchmark, we also saw an average savings of 40 percent per FTE between onshore and offshore activities in the risk function (Figure 6). These numbers show why sourcing from cost-advantageous locations continue to be one of the main drivers in cost reduction.

Figure 6: Average cost per FTE for onshore and offshore activities in the risk function



Source: KPMG Global Risk and Compliance Benchmark

Lever 5

Outsourcing risk as a service

Using third-party vendors to execute select risk management oversight or execution activities on behalf of the first and second lines of defense can help banks reduce costs in several ways:

- Outsourcing certain risk management activities to third-party vendors can be more cost-effective than building and maintaining an in-house team. These vendors can leverage economies of scale and specialized expertise to provide services at a lower cost.
- Outsourcing can help banks to avoid the costs associated with hiring and training new employees. By outsourcing certain risk management activities, banks can avoid the costs of recruiting, hiring and training new employees, which can be significant.
- Outsourcing can help banks to reduce the costs associated with maintaining and upgrading technology and infrastructure. Third-party vendors often have the latest technology and infrastructure, which can be more cost-effective than investing in new technology and infrastructure in-house.

However, banks need to carefully select and manage their third-party vendors to help ensure that they provide high-quality services and comply with applicable laws and regulations. Banks should also have appropriate oversight and monitoring mechanisms in place to help ensure that third-party vendors effectively manage risks on their behalf.

A popular field for outsourcing risk as a service is model risk management. The KPMG Global Model Risk Management Benchmark results showed that a significant percentage of banks outsource some activities in model risk management (Figure 7).

Figure 7: Outsourcing in model risk management

41% of banks outsource some model development activities

32% of banks outsource some model validation activities

27% of banks outsource some model internal audit activities

Source: KPMG Global Model Risk Management Benchmark

Lever 9

Risk simplification

Aligning and rationalizing risk processes, assessments and methodologies can help streamline the annual burden of risk execution and oversight while still maintaining quality in risk management. This can lead to cost savings in several ways:

- Reduced duplication of effort: Banks can reduce duplication of effort and avoid unnecessary work, which can save time and money.
- Improved efficiency: Banks can become more efficient, reducing the time and resources required to execute risk management activities.
- Better resource allocation: Banks can better allocate resources to areas of highest risk, reducing the need for unnecessary spending in lower-risk areas.
- Improved risk management: Banks can identify and address gaps in their risk management framework, leading to better risk management outcomes and potentially reducing the likelihood of costly risk events.

Overall, risk simplification can help banks reduce costs while still maintaining quality. However, it's important to ensure that any changes made do not compromise the effectiveness of the risk function or increase risk to the organization.

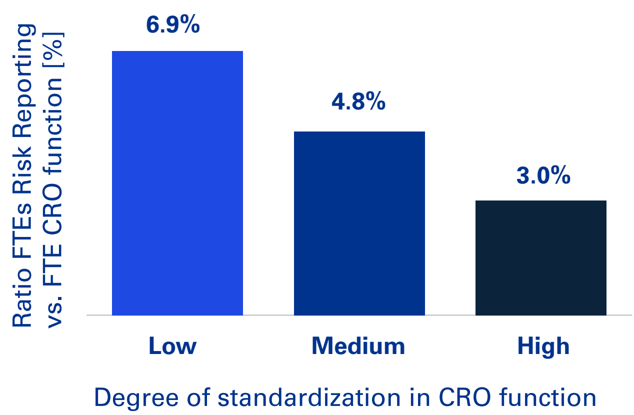
One example of risk simplification is setting up a central reporting hub. A central reporting hub provides an opportunity to increase the efficiency of the risk and compliance function and improve the quality of reports. The two success factors in setting up a central reporting hub are:

- Separation of responsibilities for risk analysis and monitoring while including specialized knowledge from risk analysis in risk reporting to ensure the content is of high-quality.
- Consolidation of risk reporting across different risk types results in improvements in the quality of the reporting.

In particular, larger banks have a significant potential for improvement. The KPMG Global Risk and Compliance Benchmark results reveal that the size of the reporting function relative to the size of the risk and compliance function decreases as its level of standardization increases (Figure 8). A high degree of standardization in the risk and compliance function can reduce the relative size of FTEs in risk reporting by more than 50 percent.

While the three presented levers offer huge potential for improvements, it's important not to see them isolated but in a holistic approach and the right sequence towards cost transformation.

Figure 8: Relative size of the reporting function and the degree of standardization in the risk and compliance function



Source: KPMG Global Risk and Compliance Benchmark

Can your organization benefit from cost takeout?

By analyzing and prioritizing responses to the following questions, risk leaders can determine the cost takeout levers deemed most impactful.

Important questions to ask

What is the ratio of time spent **assessing risk versus managing** it?

Are there **redundant** risk oversight functions that can be **consolidated**?

What is my average **cost per risk FTE**?

Are my risk outputs **consistent across businesses**?

Have the first and second lines established **duplicative capabilities** (e.g. testing)?

What risk **functions** must **stay in house**?

How many **manual risk processes** do we operate today?

How many **risk platforms** do I utilize? Are they **integrated**?

Does the organization have the right **skill sets** in the right **marketplace**, at the right **cost**, supporting our risk programs?

Is the risk infrastructure **ready to scale** if needed?

Is there a **single source of truth** for risk data that is a high-quality data source, reliable and provides consistent granularity?

Is the organizational and functional **structure lean enough**?

How many **first-line FTEs** are involved in risk programs today?

Does the organization have the **right people** focused on the **right responsibilities**?

Who is testing what for **what purpose**?

Are the risk **programs** and **methodologies aligned**?

What are **repeatable risk activities**, and can they be **moved offshore**?

Is the organization's data, processes and control environment **ready for a digital change**?

Where do you start?

Cost takeout efforts should be thoughtful, strategic and coordinated. While the long-term cost takeout opportunity is significant, it's equally important to demonstrate incremental savings and quick wins to internal and external stakeholders.

Some organizations are pursuing a dual track of cost takeout initiatives that include utilizing short-term tactical solutions such as headcount or expense rationalization to help reduce costs in quarterly increments while also executing strategic initiatives to unlock maximum and sustainable savings. This approach has been successful in demonstrating immediate savings to investors, contributing to the strategic cost takeout vision and garnering internal support for further cost takeout investments.

Before launching any specific initiatives, organizations should:

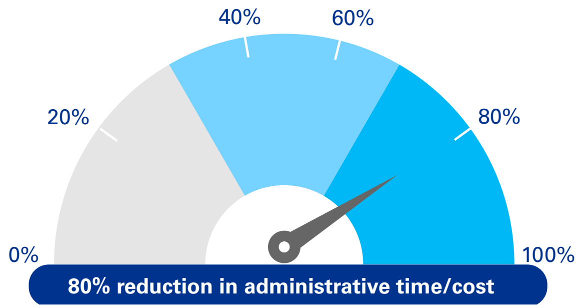
- Identify and inventory existing direct and indirect costs associated with the delivery, oversight, maintenance and execution of risk-related activities (across all lines of defense).
- Clearly define the organization's intended outcomes or cost-saving targets (both short-term and long-term).
- Develop an organizational value proposition, including expected return on investment.
- Define the "must haves" for go-forward risk programs and execution.
- Examine existing capabilities to identify redundancies, inefficiencies and other pain points.
- Define and prioritize cost takeout initiatives with critical path sequencing.
- Understand other competing or complementary transformation initiatives that may consume organizational effort.
- Establish a multigenerational and multiyear cost takeout roadmap integrated with other organizational initiatives.
- Establish quantifiable success measures to track and report progress.
- Socialize the roadmap internally (and externally) to gain organizational buy-in.
- Start small and demonstrate savings fast (quick wins).
- Continuously evaluate, challenge and modify your roadmap as the organization and marketplace evolves.

How this connects to what we do

KPMG firms help clients along every step of the risk transformation journey, including cost takeout, from identifying strategic enhancement opportunities to executing against them. A holistic assessment of risk processes in light of regulatory requirements, evolution of technology and cost efficiency is crucial for a successful risk transformation journey. In addition, examinations of topics including accelerating digital migration, evolution of risk resources and modernizing technology architecture helps to ensure the right focus on recent developments.

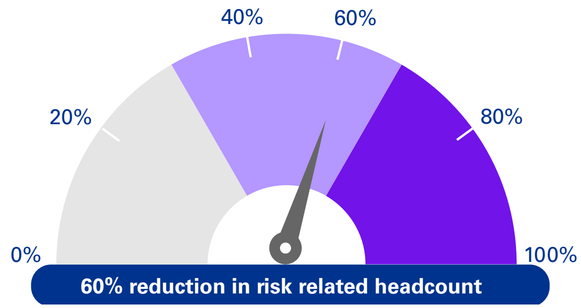
The two examples in Figure 10, explore how KPMG firms helped two organizations' multiyear efforts to reduce cost while increasing efficiency.

Figure 10: Cost reduction use cases



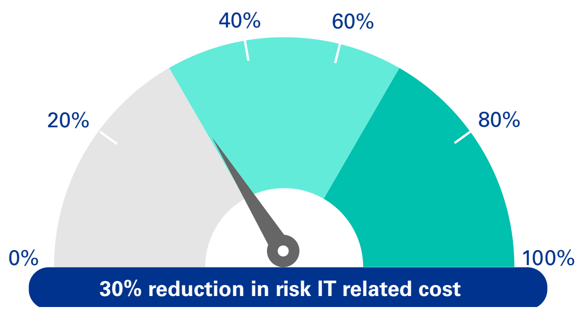
Supervisory simplification

With the support of KPMG in the US, a large global investment bank was able to rationalize and automate key supervisory tasks resulting in a 50 percent reduction in volume and 80 percent reduction in administrative oversight.



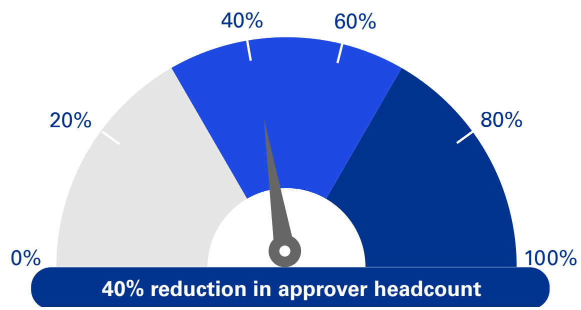
Assessment convergence

KPMG in the US helped facilitate the consolidation of four regulatory assessments for a financial services firm into a single assessment. These efforts resulted in the number of participants and hours spend per unit falling by more than 60 percent, the number of risks and controls by more than 90 percent, signoffs from 130 to just 11.



Risk technology modernization

KPMG in Germany advised a public savings bank to modernize its risk IT architecture toward an integrated vendor solution. This resulted in a 30 percent reduction in operation, maintenance, and oversight costs.

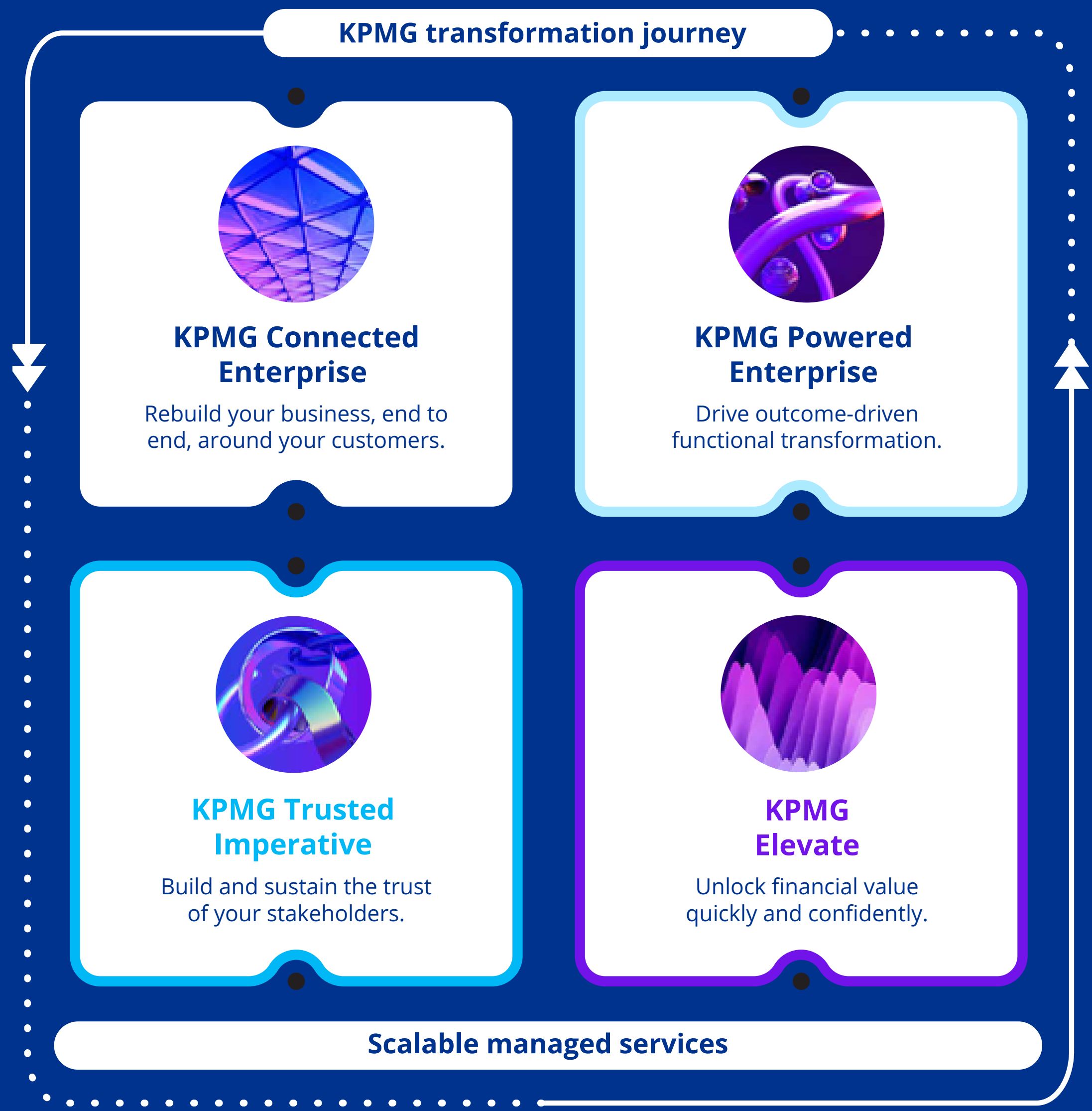


Credit approval optimization

KPMG China advised a global bank in Hong Kong SAR, (China) with significant lending operations on a new target operating model and assessed the bank's ability to handle higher volumes and more complex credit applications. The team provided options for reducing approver headcount by 40 percent or doubling approval rates over five years.

Transforming for a future of value

KPMG firms' suite of business transformation technology solutions can help you engineer a different future — where new opportunities are designed to help create and protect value.



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