Xcina Consulting White Paper
Xcinaconsulting.com

Evolving risks in digital financial services

xcina Consulting

xcina Consulting

Digital banking risks – new and evolving

The financial services sector continues to evolve rapidly, driven by improving technologies, actions to accommodate requirements from regulations and regulators, wider access to markets and the increasing general acceptance of internet services.

The emergence of technology-based open banking solutions and the so-called challenger banks has shaken up traditional banking business models. These changes bring "new" risks with them.

Keeping pace with changing risks from an internal controls' perspective is vital for every service provider. During this unprecedented period of technological transformation and a related shift in customer attitudes, retaining strong customer loyalty is also vital so that these innovative financial services continue to meet the changing customer needs.

Challenges faced by firms in a digital financial environment

It is important for firms to have detailed policies, robust processes and regular risk assessments as well as accurate and complete operational procedures within an integrated governance framework that supports effective strategic direction, operational strength, decision-making, analysis and reporting for key business processes.

The emergence of technology as an effective customer engagement and product distribution tool has not eradicated the requirements for face-to-face customer service. Some interactions remain best served by traditional bricks-and-mortar banks. The migration to the digital model has highlighted the heightened risks of maintaining operational resilience.

Banks must reassess their core capabilities and move from managing broad technology networks to a more direct marketing relationship with their clients, particularly as open application programming interfaces (APIs) emerge in the mainstream markets and create new competitive opportunities for technologies that challenge earlier approaches.

The traditional high-street banks have been joined by many new entrants, broadly consisting of four groups with different models, aspirations and challenges:

- mid-sized full-service banks;
- specialist banks;
- digital-only banks (including new digital brands of already-established banks); and
- non-bank brands.

Risks created by changes to effective delivery of financial services

A big challenge facing traditional banks - and the source of many related risks - is their ability to modernise their technology to improve efficiencies and maintain competitiveness.

The new bank approaches rely not only on new technology; they also involve new people, new approaches and a new corporate culture. The newest banks are using cutting-edge technology to deliver innovative services to today's demanding and technology-aware customers.

Such emerging technology offers speed, flexibility, adaptability, cost savings and an overall better experience for individual customers.

For traditional banks, the maintenance of legacy systems is increasingly difficult and expensive, adding operational complexities and risks. As one major UK bank explained in its 2017 Annual Report:

"The vulnerabilities of the Group's IT systems are in part due to their complexity, which is attributable to overlapping multiple dated systems that result from the Group's historical acquisitions and insufficient investment prior to 2013 to keep the IT applications and infrastructure up-to-date. Within a complex IT estate, the risk of disruption due to end-of-life hardware and software may create challenges in recovering from system breakdowns."

Business disruption due to technology failures

British banks had over 300 major IT shutdowns in the last nine months of 2018 that left their online customers unable to make payments. At the top of this list was Barclays, which reported 41 incidents, followed by Lloyds, with 37, and Halifax, with 31.

Although Barclays reported the most problems, it described many of those as being minor incidents. Data reported recently to the FCA show that major banks suffer over one outage every month on average.

Although the major outages are as a result of technology failures, significant disruption to services has many possible causes, not only IT-related but also due to changes in existing business models, evolving customer requirements and the continued emergence of new services and challenger banks.

Regulatory compliance risks

The changing business models and increasing regulatory requirements have increased the risk of non-compliance for organisations. Every firm needs to consider how to most effectively balance its increasing costs of regulatory compliance against innovations that can reduce transactional costs without adding to overall risks.

All firms need to show that they operate and enforce internal policies to achieve full compliance with legislation, rules and guidance from their regulators.

Examples of recent continuing regulatory challenges include these:

- Second Payment Services Directive (PSD2) – in place since January 2018, PSD2 is intended to level the playing-field for payment service providers by opening up customer accounts, with consent from customers, to third parties providing information and payment services.
- General Data Protection Regulation (GDPR) and UK Data Protection Act 2018 (DPA)- since May 2018, all firms face post-GDPR updated regulatory requirements and many frequent updates to operational compliance processes. The huge amounts of data that customers provide to banks increase their data protection risks.
- Senior Managers and Certification Regime (SM&CR)- Introduced in March 2016 for some financial firms- and significantly expanded since then across the whole UK financial sector- SM&CR aims to make it easier for UK regulators to hold senior executives accountable for failings and breaches.

xcina Consulting

For further information, please get in touch with our team.

Email: consulting@xcina.co.uk
Phone: +44 (0)20 3985 8467

Xcina Consulting
1 King William Street
London
EC4N 7AF

xcinaconsulting.com