

3rd IRM (UAE) Meeting

**Abu Dhabi
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Rethinking Risk
Management in
Financial
Services

**A World
Economic
Forum Report**

1/21

3rd IRM (UAE) Group Meeting

Discussion Forum on the World
Economic Forum Report conducted
with the cooperation of the Boston
Consulting Group

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Introducing WEF

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- The World Economic Forum is an independent, international organization, incorporated as a Swiss not-for-profit foundation, striving towards a world-class corporate governance system where **values are as important a basis as rules.**
- WEF motto is '**entrepreneurship in the global public interest**', believing that economic progress without social development is not sustainable, while social development without economic progress is not feasible.
- The vision for the WEF is threefold. It aims to be: the foremost organization which **builds and energizes leading global communities**; the **creative force** shaping global, regional and industry **strategies**; the catalyst of choice for its communities when undertaking **global initiatives to improve the state of the world.**

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Rationale behind this document

- The report was part of an industry partnership project by the Financial Services Governors' Community.
- The objective was to identify lessons from the financial crisis that would enable the financial services industry to become more resilient to future 'shocks'.
- It is different from other studies in that it takes an '**from the outside in**' view of to learn lessons from other industries that can be learnt by the financial services sector.
- The document is intended to stimulate "*discussions aimed at improving long-term stability of the global financial system.*"

A note on the Financial Stability Board

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- The FSB was established to coordinate at an international level the work of national financial authorities and international standard setting bodies and to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies.
- It brings together national authorities responsible for financial stability in significant international financial centres, international financial institutions, sector-specific international groupings of regulators and supervisors, and committees of central bank experts.

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Starting premise of this project ..

“Risk taking is an integral part of
many financial institutions’
business models.”

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9 lessons from the 6 industries examined:

- Aviation
- Fisheries
- Wildfire fighting
- Immunology / epidemiology
- Telecommunications
- Pharmaceuticals

A summary of lessons learnt

System-wide Perspective

- *Diversity*: Homogeneous systems are less resilient than diversified ones.
- *Simulation*: Realistic and concrete simulations improve planning and prepare for crisis.
- *Controlled failure*: Systemically important institutions may be required to produce recovery and resolution plans ('living wills') which set out how operations would be resolved in an orderly fashion. Some companies should be 'allowed to fail'.

A summary of lessons learnt

Transparency and Information Flow

- *Aggregation of Industry Information:* Aggregation of the correct data can provide an 'early warning' mechanism;
- *Analysing Complexity:* The industry needs to go beyond direct causes and consequences into the iatrogenic and 'unintended causes' ..;
- *Transparency in Innovation:* Breaking down complex products into simpler components to standardise risk assessment and control.

A summary of lessons learnt

Governance and Culture

- *Seek trouble*: Foster a culture that continuously seeks out emerging threats to the company / industry.
- *Value Experience*: Improve the retention of more experienced staff and document accidents and incidents and the learning points from them.
- *Frontline Empowerment*: Reward proactive risk flagging, empower frontline management to take tactical decisions and encourage whistle-blowing without fear of retribution.

System-wide Perspective



System-wide Perspective

Chilean salmon

1. A viral disease kills millions of fish causing thousands to lose their jobs (2007);
2. High density, close proximity and drug resistance resulted in rapid disease spread and catastrophic losses.
3. Robustness is achieved through HETEROGENIALITY, REDUNDANCY & MODULARITY.

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System-wide Perspective



*Simulate system
disasters*

*Examples from WHO
and the aviation and
telecom industries*

- 1. Pilots train for multi-emergency scenarios. Pilots are re-trained and re-evaluated frequently;*
- 2. WHO builds tools to support member states in developing action plans to manage epidemics.*
- 3. Plans are also periodically tested.*

System-wide Perspective



Managed 'fires'

Wildlife fire-fighting

- 1. Complete suppression of fires has resulted in adverse environmental conditions as natural fires stemmed the spread of disease and controlled natural redundancy;*
- 2. Government intervention and bailouts may contribute to a protraction (rather than solving) some of the industry's problems. 'Too big to fail' may come at significant economic cost.*

Transparency & Information Flow



**Aggregating and
analyzing complexity**

Air-traffic control

1. *An industry-wide information analysis and sharing programme ensures that as much information is collected, segmented and analysed;*
2. *From a financial services perspective, this level of aggregation of information and analysis would help to mitigate the possibility of mutation of products which contributed to the financial crisis.*

Transparency & Information Flow

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Scrutinize complexity

*Pharmaceuticals and
Fishing Management*

- 1. Medicine is effective / beneficial only if one takes a holistic view to medication;*
- 2. Iatrogenic factors, contra-indications and unhealthy practices contribute to adverse results;*
- 3. Fishing management takes a 'holistic' view to balance the predator-prey relationship.*

Transparency & Information Flow



*Innovate transparently
– ‘keeping it simple’*

*Telecommunications,
aviation industry and
pharmaceuticals*

- 1. Success in the development of telecommunications from analogue to digital and VOIP is attributable to the ‘keep it simple’ modular approach to development;*
- 2. Aircraft engineers (like computer programmes) design in modules;*
- 3. The pharmaceutical industry undertakes testing in gradually increasing sample sizes.*

Governance and Culture

'Installing Risk Sensitivity in Governance and Culture

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Look for trouble

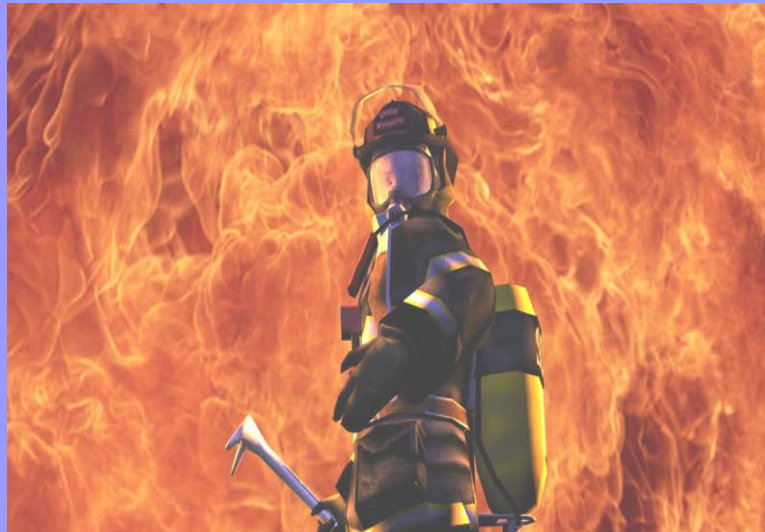
Fisheries, aviation industry and medicine

1. *Global Public Health Intelligence System constantly monitors events that can indicate any potential outbreak;*
2. *ASIAS programmes aggregate system-wide data to identify 'near miss' trends;*
3. *'Tragedy of the Commons' is controlled through privatization. Ownership instils accountability.*

Governance and Culture

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Value experience

*Aviation and fire
fighting*

1. *Retaining experienced fire fighters and documenting experience pays;*
2. *Post-accident analysis in aviation helps in reducing accidents.*

Governance and Culture

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Empower the frontline

*Aviation, fire fighting
and medicine*

- 1. Simulation training empowers pilots to take decisions in difficult situations;*
- 2. Subject to management protocols physicians are also empowered to act in emergency situations. The same applies to civil defence/fire fighting.*

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Conclusion

International and cross-industry
cooperation and trust are crucial in
achieving system-wide resilience