Breaking the Fail-Fix Cycle of Process Compliance in Banks with a Process Mining Off-Ramp

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Introduction

Since 2008, US banks have been fined $243bn for compliance-related events, and the global cost of compliance for financial services firms is equivalent to an 8% tax.[1] The last five years have been particularly challenging in an Australian context, with Australian regulators highlighting multiple compliance issues, particularly among the four major domestic banks. This has led to i) a Royal Commission; ii) regulators issuing penalties exceeding A$2 billion; iii) tightening executive accountability; iv) more than A$8 billion in remediation costs and a significant investment in compliance resources; and v) the resignation of three CEOs and two Chairmen of these banks.

Understanding the Issues

To understand why banks find business process compliance so challenging, a research team from the University of Melbourne interviewed 22 Senior Managers from the four major Australian banks. The interviewees had backgrounds in Operations, Risk & Compliance, Process Excellence and Technology. The findings were remarkably consistent, and, for anyone that has worked in a large bank over the last twenty years, the results may not be particularly surprising. In summary, there were three broad issues: there are many, many requirements that must be satisfied, and they are complex and dynamic; the processes designed to meet these requirements resemble impenetrable spaghetti; and, the business case to address the issues sustainably remains elusive (Figure 1).

Complex & Dynamic Requirements Load

Bank processes must accommodate hundreds, if not thousands, of requirements. This is driven by complex business models, increasing regulatory scrutiny, the threat of disruptive competition and frequent changes to business direction such as restructures, hiring freezes and budget cuts. Not only are there lots of requirements, but there are also many different types of them, from regulatory obligations and codes of industry practice to customer requirements and business policy. They are often duplicated and written in ambiguous language and, with bank processes touching many parts of an organization, they frequently bump up against conflicting business objectives.

Impenetrable Spaghetti Processes

Meeting this complex and dynamic requirement load is dependent on disjointed and disparate process foundations, fragmented across the bank, with inflexible, legacy technologies and data that, if it exists, just doesn't seem to connect. Processes are

1 Ascent Reg Tech, The Not So Hidden Costs of Compliance - June 30, 2020 rife with exceptions, riddled with patches and workarounds, and have wholly inadequate support tools. To make matters worse, many processes are only partially automated, yet they are expected to cope with significant volume and are "protected" by controls that are largely detective and manual, i.e., they are flawed. It is not surprising that these resource-intensive processes are prone to failure, made worse by the fact that knowledge and experience is also in short supply.

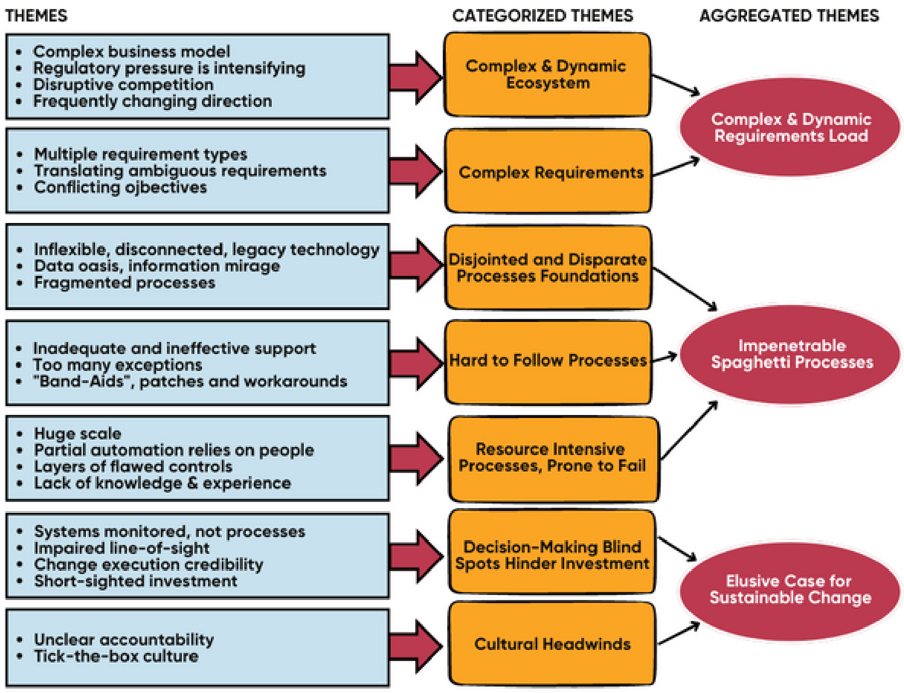

Figure 1: Research Findings

Elusive Case for Sustainable Change

Interviewees acknowledged that addressing these issues is not straightforward – there are decision-making blind spots and cultural headwinds to manage. There is limited process monitoring and line-of-sight is impaired by a lack of strategically aligned metrics. Furthermore, change execution can frequently lack credibility, and investment tends to focus on remediation and short-term fixes. Add to this unclear accountability and a culture that sees business process compliance as more "Tick-the-Box" than a strategic endeavour, and it is hardly surprising that senior executives are reluctant to place a big bet on resolving the issues sustainably.

It's Complicated

One obvious solution would be to appoint a team of process professionals and let them loose on the process-related issues. However, the major banks have already had several attempts at this, and the results suggest it's not quite as easy as that. As one interviewee pointed out: "Every three to five years the banks get rid of all their process improvement people."

This points to something more fundamental at work. The overarching theme from the interviewees' perspective was that end-to-end processes are so complex that people don't understand them - this is perfectly understandable when interviewees referenced mortgage processes with more than 56,000 pathways or 950 ways to open an account.

This lack of visibility and transparency reduces the chance of successfully improving processes. In some cases, the project team underestimates the complexities, and the costs and timelines blow out, so the project is shut down. In others, the project team acknowledges the complexities, costs are incurred, but results are not delivered in a timely manner, so the project is shut down. A third scenario is where part of a process variant is improved successfully, but it is just one of many variants and is so immaterial no one notices.

In this context, signing-off on the business case to implement a sustainable solution is not for the faint-hearted. The certainties are that it will be expensive, it will take a long time, and the benefits, if any, will be tacked on to the end of the most "strategic" of time horizons. In short, it's a proposition where a significant portion of the risk is borne during the tenure of the average CEO, while the benefits are realised well after.

This combination of factors locks banks into a fail-fix cycle with no obvious off-ramp (Figure 2).

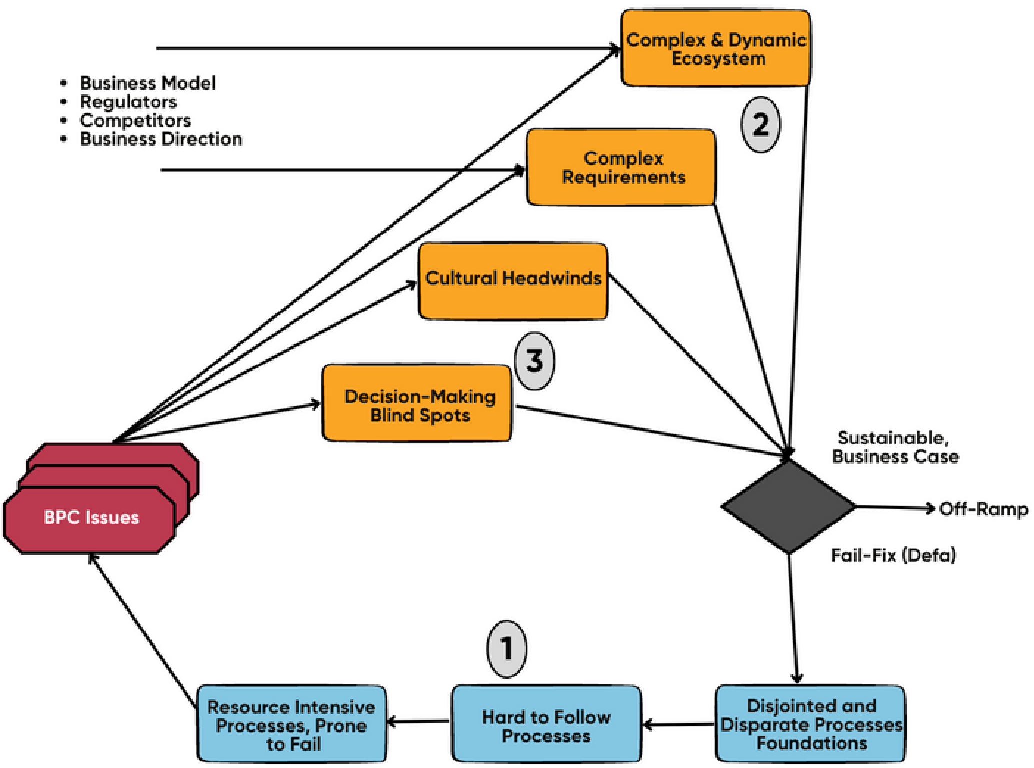

Figure 2: Fail-Fix Cycle

Accessing the Off-Ramp

The research identified three circuit-breakers that must be addressed to avoid being locked into the fail-fix cycle.

1. End-to-End Visibility

At the heart of the issue is the inability to "see" the cost of complexity. Traditional process mapping and modelling techniques do not work – in processes with so much variation, it is impossible to capture all possible pathways manually, no matter how motivated the working group is. The only way to do this is by applying automated process discovery, a core process mining capability. Seeing all the exceptions, all the pathways, and all the performance data associated with those pathways is essential to improve transparency, enable visibility and enable analysts to view the system holistically.

2. Simplify Requirements

The second circuit breaker is to simplify requirements. At present, requirements are considered in silos, (e.g., regulatory requirements, codes of practice requirements, business policy and customer requirements). However, there is a significant amount of overlap. The controls necessary to ensure requirements are met have much in common, irrespective of the silo they came from. There are relatively few control patterns such as time-based controls, e.g., SLAs, resource-based controls, e.g., segregation of duties, data-based controls, e.g., transactions over a certain amount require a four-eye check, and control-flow controls, e.g., a reconciliation activity following the execution of a transaction. Today, bank processes are cluttered with controls. Every incident seems to lead to the addition of a new control — and with so much impenetrable process spaghetti there are many incidents — but a portfolio of controls is rarely reviewed to identify duplication and inconsistencies, which makes it hard to see the core process. As one interviewee put it: "I think the more controls you put in place, the higher the risk of any process, because you can add complexity". Consolidating, standardizing, and simplifying controls only enhances visibility.

3. Developing a Viable, Sustainable Business Case

End-to-end process visibility also enables the third circuit breaker – developing a viable business case for sustainable change. The fail-fix cycle is perpetuated not because of a lack of funding and resources, but because the business case to address the issues sustainably does not appear to be viable. Leveraging the enhanced end-to-end visibility and the rationalization of controls, the task is to demonstrate the value of a strategic approach to business process compliance:

the impact of exceptions on the level of operating cost and operational risk capital held, the cost of re-hiring and training people on broken processes, the opportunity cost of not being able to absorb more change, the "tech debt" associated with hollowing out legacy systems and keeping them on life support, the impact on product pricing of actually knowing your costs. It is hard to answer these questions accurately in the major banks today.

Getting Buy-In

As with any initiative, finding support, funding and resources for a new program of work when the investment agenda is more than likely already over-subscribed, can be a major impediment to progress. As part of the research, interviewees were asked where they would start if they were accountable for addressing the issues. The majority focused on piggybacking off existing programs of work. They would select a process that was material to the bank's results, one that is a significant pain point for executives, one that is fully funded and with a senior executive sponsor already in place. They were adamant it should not be a stand-alone program. The objective should be to enable an existing program to deliver better outcomes faster by addressing the issues discussed.

The link to the original paper can be found at https://arxiv.org/abs/2203.14904.

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