



Dancing with disruption

Have you mastered the steps?

A forward look at Internal Audit in
Banking and Securities

In the past several years, Internal Audit groups in large banking and securities (B&S) organizations have embarked on a remarkable journey in response to skyrocketing regulatory demands. Recently, they have been increasingly focused on helping their organizations respond to changes in internal behaviors such as conduct and culture, information and communication technologies, and other disruptors.

Internal Audit departments in other B&S institutions are still developing, or are in the process of transforming, their strategies to address multiple facets of the current environment. The notion of dancing with disruption—and mastering the steps of this dance—recognizes that disruption will likely continue to characterize the B&S industry. Internal Audit groups should not resist disruption, but do what they can to stay a few beats ahead of it.





Disruptive Forces

Deloitte Risk and Financial Advisory sees four forces driving disruption in B&S organizations and their Internal Audit groups.

- **Disruptive digitalization:** Digitalization and related technologies continue to revolutionize the financial behavior of businesses, consumers, and investors, as well as expectations around financial communications, transactions, and reporting.
- **Disruptive business models:** Enabled by financial technology (FinTech), new competitors and business models are encroaching in areas such as deposits, payments, lending, investing, trading, and other lines of business. New technologies and the ongoing cyber risks associated with these new business models will likely continue to challenge existing operating models.
- **Disruptive data:** The amount of data generated by technology and organizations continues its exponential explosion. B&S organizations need methods, processes, tools, and skills to harness that data to enhance end-to-end processing of automated controls, operational efficiency, risk management, and financial returns, as well as customer experiences.
- **Disruptive regulatory compliance strategies:** Under the new administration, regulatory demands will need to be monitored and will vary depending on complexity, global reach, and size. Irrespective of the changing regulatory landscape, Internal Audit departments (the third line of defense) should collaborate with the second line to understand compliance and risk management modernization activities and implications to the internal audit approach.

As a result of these continuous changes and emerging technologies, new forms of risk are rising in areas such as financial institution conduct and culture, governance, brand, and reputation, as well as increased potential for terrorism, cybercrime, and other events that could extensively impact the industry.

Depending on the institutional size, complexity and resources, many Internal Audit groups have continued to make advancements in addressing these forces in recent years, but for some, those gains only amount to a good start. For most, the journey remains in its early phases as they move beyond responding to regulatory requirements and search for approaches to dealing with disruption. This document presents steps to learn, and to master, in this disruptive environment.



Digitalization

Disruptive digitalization...

Although B&S customers' core needs remain the same, the digitalization of currency, information, transactions, and customer experiences continues. Distribution of traditional bank offerings will be significantly transformed as mobile banking ramps up and an increased use of cognitive technologies emerges. As mobile banking continues to become the dominant mode of interaction with consumers, integration with wearables devices and Internet of Things sensors will likely become a key differentiator in distribution. New payment mechanisms are changing customer behavior. Robo-advisors are forcing investment managers to evolve. New lending platforms are transforming credit decisions and loan origination. Crowdfunding has made capital more accessible to more parties. FinTech presents potentially transformative opportunities, along with new risks¹.

As B&S organizations respond, Internal Audit can, in its advisory roles, provide objectivity and "sanity checks". However, this will call upon Internal Audit to raise its technological awareness and expertise.

...drives disruptive risks:

- Are the emerging technologies designed to meet current and projected regulatory requirements and support strategic organizational decisions?
- Are appropriate mechanisms included to detect, respond, and recover from cyber events?
- Are proper controls in place to safeguard assets when new financial disintermediation strategies are implemented through marketplace lending, social brokering, and crowdfunding?

Steps to learn or master:

Digitalization will require Internal Audit to:

- Have a seat at the table when strategic decisions are made on disruptive technology. Help management evaluate the impact on the organization, process, resources, geography, regulatory landscape, cyber and third-party oversight.
- Adopt a cyber assurance framework and provide assurance to the board and senior management regarding cyber risks.
- Help the business monitor risk culture and conduct risk related to financial, banking, payment, trading, settlement, and investing activities. The audit team's focus needs to shift from not only known risks and tangible controls but to potential outliers that may pose significant risk.
- Advise on opportunities to apply technologies such as cognitive intelligence, blockchain², robotics, digitally-enabled sharing, and crowdsourcing in the business. (See "Breaking down disruption")

¹ *Disaggregating fintech: Brighter shades of disruption*, Deloitte, 2016
<https://www2.deloitte.com/content/dam/Deloitte/us/Documents/financial-services/us-fsi-disaggregating-fintech-brighter-shades-of-disruption.pdf>

² Break through with blockchain: How can financial institutions leverage a powerful technology? <https://www2.deloitte.com/us/en/pages/financial-services/articles/blockchain-series-deloitte-center-for-financial-services.html>

Business models

Breaking down disruption

Viewed in general terms, disruption can seem overwhelming. To defuse that feeling, review disruptive technologies and developments on a case by case basis.

Two cases of disruptive technologies include the following:

- Robotic process automation and cognitive intelligence can improve simple, repetitive, process-heavy organizational tasks and evolve to play a role in activities requiring judgment.
 - Potential applications: customer service, fraud monitoring, analytics automation
- Blockchain can enable not only digital currencies (like bitcoin) but also distributed ledger technologies to boost efficiencies.
 - Potential applications: trading, clearing, and settlement; loyalty and rewards program management³

Two cases of disruptive developments:

- The sharing economy may impact financial services revenue and potentially shift bargaining power and the competitive landscape.
 - Potential outcomes: asset utilization patterns will continue to evolve; concentrated ownership will provide greater leverage and market access
- The wisdom of consensus underlies many new constructs, such as distributed ledgers, idea crowdsourcing, and social sentiment analysis.
 - Potential outcomes: network verification, crowdsourced earnings estimates, social media intelligence

Disruptive business models...

Technological and social developments, such as the platforms and the trust that enable the sharing economy, generate new business models. Consider the continued emergence of FinTech, an industry composed of companies that use new technology to deliver financial services and compete with traditional financial institutions. Banks will likely remain dominant, but teaming with the extended ecosystem will become a key source of competitive advantage. While new entrants—particularly startups—often possess built-in advantages, they typically lack legacy systems, and robust processes.

Banking markets are expected to expand swiftly, even as the core product feature set remains unchanged. Automated underwriting, servicing, and digital distribution enable penetration of segments that—until now—were uneconomical. Customers will continue to gain unprecedented control over transaction experiences, using end-to-end digital engagement, from origination to servicing.

...drive disruptive risks:

- Do new methods for customer interaction and experience align with the organization's strategy and reputation?
- Is the core business value being protected?
- Are extended enterprise relationships and third party vendors compliant with the organization's overall risk tolerances?

Steps to learn or master:

Arguably, every business mode—from the credit card and the ATM to securitization and derivatives—was at one time disruptive. However, given today's proliferation of business models, Internal Audit can execute these useful tasks:

- Help management to balance risk appetite and engage with them as they explore new business models for development or adoption by the organization
- Understand the design of robotic technology which automates processes and controls to mitigate the risks and enhance the results of new business models
- Advise the organization on the extended enterprise risk framework to drive mechanisms for monitoring vendor relationships

³ Making blockchain real for customer loyalty rewards programs, Deloitte, 2016
<https://www2.deloitte.com/content/dam/Deloitte/us/Documents/financial-services/us-fsi-making-blockchain-real-for-loyalty-rewards-programs.pdf>

Data

Disruptive data...

Between internally generated and externally available data, B&S organizations have either a valuable resource or a mountain of misery. Data may be the rawest of raw materials. Without the skills and infrastructure to access, aggregate, and analyze data to produce relevant reports and insights, its value is negligible.

Business user complaints indicate the need for structures to address data governance and data quality challenges. In addition, industry regulatory mandates, such as those specifying levels of data management transparency, mean that organizations need structures to address requirements and strategic opportunities. Better access to quality data also fuels awareness of its potentially broader benefits as an enabler of business insights, strategies, and innovation.

Many of the data challenges for organizations stem from legacy systems, competition for resources, and unclear business cases. To ensure that the data utilized is complete, accurate, and appropriate, Internal Audit should develop a proactive strategy around data and data analytics. This strategy might focus on applying analytics to available data throughout the internal audit lifecycle, conducting pilot projects with stakeholders to build business cases, and assisting in development of data governance and data quality guidelines⁴.

...drives disruptive risk:

- How are integrity and quality problems being addressed when dealing with legacy system complexity and shortcomings?
- Does the data governance framework include establishing meaningful metrics by which data effectiveness and value is (or could be) delivered?
- Is the organization leveraging emerging technologies such as data mining, blockchain, robotic process automation, risk sensing, and cognitive analytics to derive business benefit from data?

Steps to learn or master:

Many B&S organizations have much work to do to further enhance capabilities and move further along the maturity spectrum with respect to data. To assist in this effort, Internal Audit should:

- Advise the organization on data governance structures to drive data quality, data management, and data ownership and stewardship – while balancing regulatory requirements and innovation.
- Understand data utilized by management to make strategic decisions, particularly those involving new markets, processes, products, or vendors, and promote application of risk sensing technologies to inform decision makers.
- Lead by example by using data analytics to risk assess, scope, execute, and report audit results through data visualization tools and dashboards.

⁴ See Internal audit analytics: The journey to 2020 – Insights-driven auditing, Deloitte, 2016
<https://www2.deloitte.com/content/dam/Deloitte/us/Documents/risk/us-risk-internal-audit-analytics-pov.pdf>

Regulatory compliance strategies

Disruptive regulatory compliance strategies...

Demands from regulatory agencies often lag disruption and innovation, yet the trend has been clear—increased expectations and deeper regulatory involvement in risk management and governance. Coupled with a push for cost reductions, elimination of redundancies, value creation, and a need to accomplish more with less, many companies find themselves moving to compliance modernization.

A modernized compliance program takes the foundational activities and enhances them, using technology to rationalize oversight and execution functions and drive better coverage and reliance. This is not about building more but rather taking a critical review of what exists and rightsizing administrative practices in favor of a more strategic approach. Modern companies need strategies and compliance models, fueled by data that keep the three lines of defense on the same page.

...drive disruptive risks:

- Has the organization developed a clear compliance vision and strategy to ensure the first and second lines of defense are coordinated in eliminating redundancies and gaps in regulatory compliance? Does the vision and strategy allow internal audit to perform their third line role efficiently and effectively?
- Has the Internal Audit department considered an operating model that is more proactive versus reactive?
- Have disruptive technologies been considered to allow regulatory compliance practices to be transformed to drive not only efficiency but also improved risk management quality?

Steps to learn or master:

As the third line of defense in risk management, Internal Audit should:

- ❑ Advise management on developing flexible risk management and governance infrastructures to use analytics to create actionable insights to enable strategic, operational, and tactical decision-making.
- ❑ Work to clarify roles, responsibilities, and coordination for the three lines of defense and reduce redundancies.
- ❑ Define a proactive talent management strategy for capacity planning and scalable resource deployment.

Choreographing your disruption management plan

While Internal Audit groups in the largest, most forward-looking institutions have been working on addressing these disrupters, the landscape will continue to evolve for them. For those departments not yet addressing these disrupters, time is of the essence. All B&S Internal Audit groups need tools that help anticipate developments before they impact the organization, and ways of responding as events unfold.

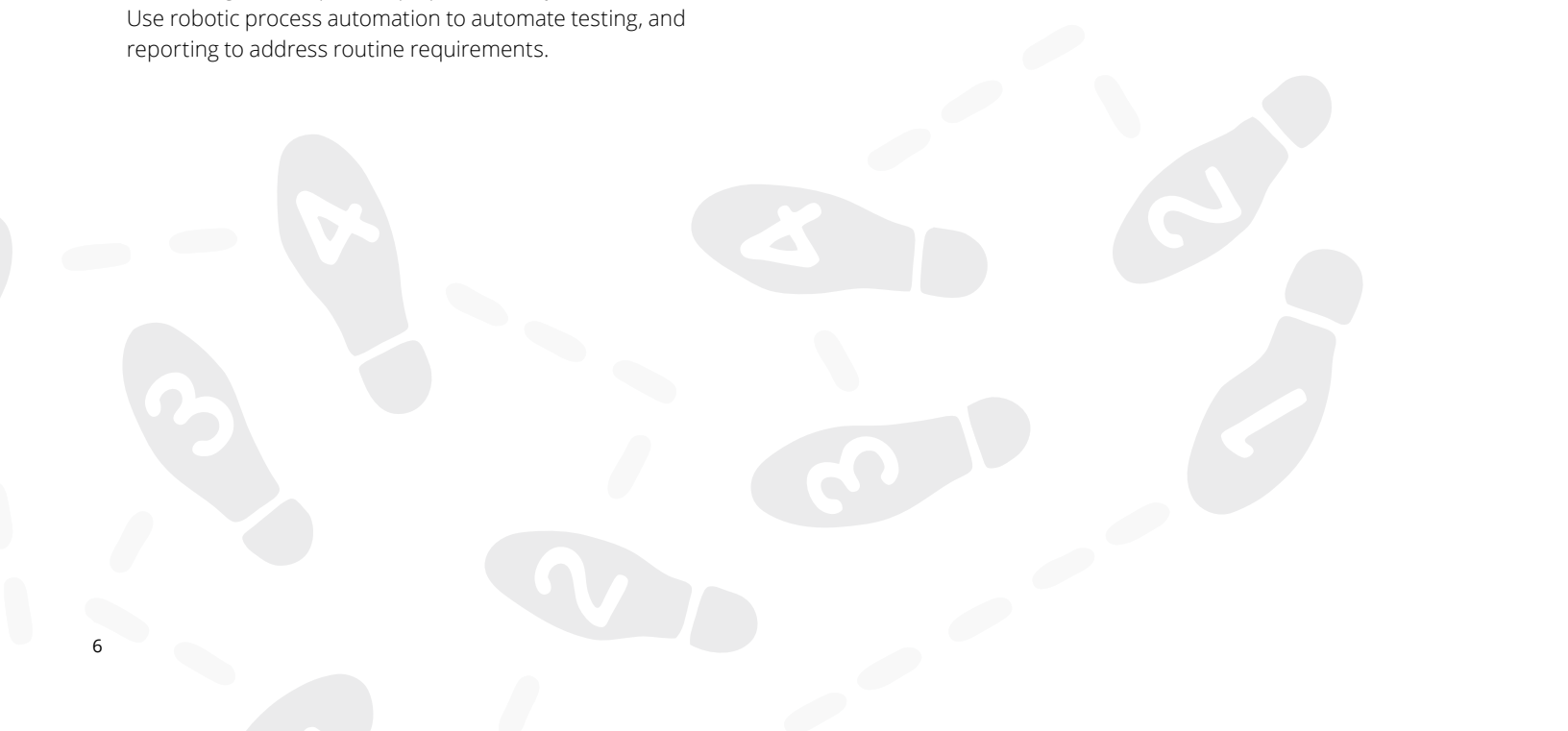
At this point, the goal is not prediction but preparedness. For Internal Audit, preparedness means flexibility, agility, resourcefulness, expertise, vigilance, credibility, objectivity, and stature. It means executing assurance efficiently, providing advisory services expertly, and anticipating risks effectively.

Here are final steps to consider adding to your routine:

- ▶ **Become agile and dynamic:** Flexibility must be designed into the function because the future remains highly uncertain. The task is to be predictive and proactive against the next disruptions, whether it's a liquidity crisis, capital shortage, power outage, or cyber attack; and be ready to operate amid such disruptions in a proactive versus reactive manner. Establishing centers of excellence to focus on key issues and specialized teams to deploy can enhance both expertise and flexibility.
- ▶ **Face forward:** Pivot to a more forward-looking view of organizational activities, strategic decisions, and risks. Use data analytics and cognitive technologies to provide insights (advice) and foresight (anticipate) to pinpoint the key risk considerations. Use robotic process automation to automate testing, and reporting to address routine requirements.

- ▶ **Adjust the talent model:** Make the most of the fact that this is a great time to be in Internal Audit. Seize this moment to not only further upgrade capabilities but also to transform the function into a talent magnet and career springboard. Anyone seeing this as farfetched may be viewing the function in outmoded "policing" terms. Anyone who understands the crucial role that Internal Audit now plays in B&S organizations should use this opportunity to attract the expertise needed in areas such as specialized technology, data analytics, and innovation.
- ▶ **Align the lines of defense:** Assist the first and second lines of defense in enhancing synergies to improve efficiencies and rationalize oversight and execution processes. This means helping to translate the compliance modernization strategy—risk appetite, risk tolerances, desired risk profile, and desired conduct—into operational reality and to calibrate those roles.

As with the specific impacts of disruption, the specific needs of each B&S organization—and therefore of each Internal Audit function—will vary. However, the overall challenge is the same on all fronts: get comfortable with discomfort and learn to dance with disruption. Deloitte Risk and Financial Advisory's globally recognized practice can help you proactively manage and prepare for disruption. Our people, tools, and processes offer strategic solutions to assist you in emerging areas including cognitive intelligence and robotic process automation, as well as predictive data analytics. Disruption is here to stay—leverage our experience to help you master the steps.



Contacts

Get in touch with any member of our Banking & Securities Internal Audit leadership team to discuss disruption within your organization and how Deloitte Risk and Financial Advisory may be able to assist you.

Monica O'Reilly

Principal | Deloitte Risk and Financial Advisory
Banking & Securities Leader
Deloitte & Touche LLP
+1.415.783.5780
monoreilly@deloitte.com

Sandy Pundmann

US Managing Partner, Internal Audit
Deloitte & Touche LLP
+1.312.486.3790
spundmann@deloitte.com

Paul Lindow

Lead Partner,
Financial Services Internal Audit
Deloitte & Touche LLP
Tel: +1 313 394 5219
plindow@deloitte.com

Robert Antoine

Partner, Internal Audit
Deloitte & Touche LLP
+1.904.382.9316
rantoine@deloitte.com

Bruce Goldberg

Managing Director, Internal Audit
Deloitte & Touche LLP
+1.212.436.4567
bkgoldberg@deloitte.com

Adam Regelbrugge

Partner, Internal Audit
Deloitte & Touche LLP
+1.312.486.2165
aregelbrugge@deloitte.com

Michael Schor

Partner, Internal Audit
Deloitte & Touche LLP
+1.212.436.6208
mschor@deloitte.com





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