Improved Risk Management in Financial Services Through Collaboration?

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– Independent federal agency, investigate transportation mishaps, all modes

– Determine probable cause(s) and make recommendations to prevent recurrences

– Primary product: Safety recommendations
  • Favorable response > 80%

– SINGLE FOCUS IS SAFETY

– Independence
  • Political: Findings and recommendations based upon evidence rather than politics
  • Functional: No “dog in the fight”
Regulatory Challenges

– US Commercial Aviation
  • Fatal accident rate stuck on a plateau
  • Solution: More regulations?

– Financial System
  • . . . crossed a threshold of complexity where the system is evolving faster than regulators and regulations can keep pace
The Context: Increasing Complexity

- More system interdependencies
  - Large, complex, interactive system
  - Often tightly coupled
  - Hi-tech components
  - Continuous innovation
  - Ongoing evolution

- Safety issues are more likely to involve interactions between parts of the system
The Solution: System Think

Understanding how a change in one subsystem of a complex system may affect other subsystems within that system.
“System Think” via Collaboration

Bringing all parts of a complex system together to collaboratively

- Identify potential issues
- **PRIORITIZE** the issues
- Develop solutions for the prioritized issues
- Evaluate whether the solutions are
  - Accomplishing the desired result, and
  - Not creating unintended consequences
Collaboration Success Story

83% Decrease in Fatal Accident Rate, 1998 - 2007

largely because of System Think

fueled by Proactive Safety Information Programs

P.S. Aviation was already considered VERY SAFE in 1997!!
Moral of the Story

Anyone who is involved in the problem should be involved in the solution
Benefits of Collaboration

– Old: The regulator identifies a problem, proposes solutions
  - Industry skeptical of regulator’s understanding of the problem
  - Industry fights regulator’s solutions and/or implements them begrudgingly

– New: Collaborative “System Think”
  - Industry is involved in identifying the problem
  - Industry “buy-in” re solutions because everyone had input, everyone’s interests considered
  - Process is completely voluntary
  - Prompt and willing implementation . . . and tweaking
  - Solutions probably more effective and efficient
  - Unintended consequences much less likely

– Note: The process generated no new regulations!
Challenges of Collaboration

– Human nature: “I’m doing great . . . the problem is everyone else”

– Participants may have competing interests, e.g.,
  • Labor/management issues
  • May be potential co-defendants

– Regulator probably not welcome

– Not a democracy
  • Regulator must regulate

– Process is voluntary, but all must be willing, *in their enlightened self-interest*, to leave their “comfort zone” and think of the System
Characteristics Enabling Collaboration

- Nobody wants an airplane to crash (true in financial systems?)
- Objective is minimizing residual risk (vs. optimizing risk in financial systems?)
- Anyone’s accident is everyone’s accident
- No competition re safety
- Only one regulator
- Largely domestic, US as world leader
Conclusions

– When the reduction in the fatal aviation accident rate stopped, the industry chose a collaborative process instead of more regulations

– The collaborative process has been very successful, but it presented major challenges

– As financial systems are evolving faster than regulators and regulations can keep pace, query whether a collaborative process can improve risk management as effectively as it has in aviation
Thank You

Questions?