THE EMERGING THREAT OF SUPPLY CHAIN RISK IN FINANCIAL SERVICES

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INTRODUCTION

Historically, large financial services companies have led the market in adopting supplier administration programs as a means to controlling costs and to streamline the effort of engaging multiple vendors.

Oddly enough, this leadership still has not translated into much of a talent supply chain strategy. Culturally, a vast majority of these firms prefer the proprietary control of human capital engagements, thus have cast a broader supply chain management strategy aside.

Moreover, this fact is even more profoundly true for the institutional end of the financial services business spectrum, otherwise known as capital markets. In the pre-global financial crisis (GFC) era, brokerage firms, dealers, and investment houses built cultures intent on keeping their operations entirely proprietary; a clear bias for build vs. buy. Of course, they could afford to behave this way. New trading and hedging product innovations were fat with market-making, commission and distribution profits during the early decades of the modern capital markets era.

However, the post-GFC era has changed all that. An array of new regulatory mandates and guidelines has washed over the global financial services ecosystem since 2008-2009. As the industry's most pervasive and impactful mega-driver of the past five to six years, this regulatory juggernaut has caused unprecedented and long term transformation of financial services operating models. Within this, is a trend towards increased use of contingent workers, managed services and other flexible engagements that lead to both right-sized costs and "operational agility". However, because of the increased movement of critical capabilities to outsourced engagements, regulators have also become more focused on developing guidelines for financial firms to manage the emerging threat of supply chain risks.

Within the growing spectrum of new rules and mandates however, there remains relatively low awareness of guidelines that can dramatically improve financial firms' ability to manage the complexities related to "know your vendor" (KYV) and talent supply chain management (TSCM). This paper provides some insight on this topic and details new guidelines designed to manage the growing risks of third party engagements, where most firms' capabilities are today relative to these guidelines, and finally, the solution profiles that are currently available to manage the growth of supply chain risks.

GROWTH OF SUPPLY CHAIN RISK AWARENESS

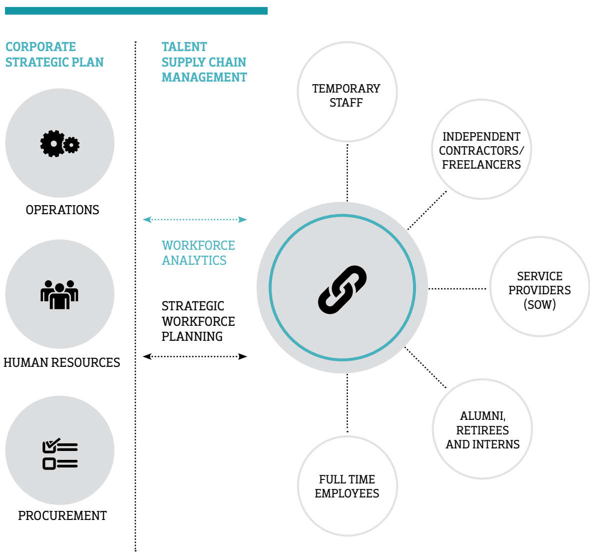
Supply chain risk – which is directly or indirectly introduced to an organization via 3rd party engagements - is set to rise in the pantheon of new risk management requirements for large financial services firms.

Much in the same vein as new operationally-oriented risk management mandates like "know your customer" (KYC), increasingly detailed "know your vendor" (KYV) guidelines that give rise to much more rigorous talent supply chain management (TSCM) initiatives are quickly becoming equally important. In parallel with new regulatory mandates, large financial intermediaries are also becoming more responsive to increasing supply chain risks through formal internal audits, legal actions, or deeper interpretations of existing rules and guidelines.

Operating models from the pre-GFC era need to be "right-sized" to fit with a new market reality. (Those who believe in the perpetuity of this environment have demonstrated greater urgency in this difficult right-sizing exercise. Those who believe the market environment will return to a prior reality have adopted a more "wait and see" approach to right-sizing.) Re-designing operating models that deliver enhanced performance and agility at lower costs – *"more-for-less"* - has become a mantra from this wound. And, among many other types of initiatives, the use of contingent workers has consistently grown among banks, brokerages, insurance, and asset managers.

With consensus expectations – and ample evidence, the utilization of an indirect (contingent) workforce will continue its upward trajectory for the foreseeable future in the financial services sector – and become increasingly anchored to critical operations.

According to the 2015 HBR Analytics Services Report "Holistic Talent Supply Chain Management", Nasdaq is one such company providing evidence of increased utilization of an indirect workforce.



Talent Supply Chain Management is a proactive management approach to securing and optimizing supply and services through all input channels to meet the human capital needs of companies, enabling them to better produce, distribute, and deliver their good and services and meet their strategic objectives.

Rebecca Arnold, vice president and global head of talent management, says that external workers compose about 20 percent of Nasdaq's workforce. But Arnold and her colleague Doug Kortfelt, vice president and global head of strategic sourcing and procurement, say they expect to deploy an even higher percentage of external workers in the future.

INCREASINGLY COMPLEX GUIDELINES

This new artery of the overall global regulatory juggernaut was initiated by the US Office of the Comptroller of the Currency (OCC).

In a bulletin published by the OCC on October 30, 2013 ("OCC Bulletin 2013-29"), entitled "Third-Party Relationships: Risk Management Guidance", new guidelines were directed to CEOs and Chief Risk Officers (CROs) of all US national banks and federal savings associations (collectively, banks), and also included technology service providers. Expectations were set for banks to "practice effective risk management" whether it performs the activity internally or through a third-party, although the use of a third-party does not absolve a board of directors or senior management from ensuring the effectiveness and compliance (with applicable laws) of these risk management duties.

Highlights of the guidance on banks' new supply chain risk management processes are that they should:

1) be commensurate with the complexity of its third-party relationships;
2) ensure comprehensive risk management oversight of critical activities; and
3) be performed throughout the life cycle of the relationship (including details for impact on bank strategy, inherent risks of the third-party activity, third-party selection and due diligence process, written contracts, monitoring, contingency planning, oversight, independent reviews, documentation and other details).

Yet, if this were not already a dramatic departure from the lack of supply chain risk awareness from the pre-GFC era, the KYV landscape continues to evolve: On February 6, 2015, *more* detail was added to this initial guidance in the form of OCC Bulletin 2015-9. Because of a growing dependence on third-party providers to support critical (banking) operations that many large financial institutions face, the Federal Financial Institutions Examination Council (FFIEC) incorporated the principles from OCC Bulletin 2013-29, along with those from other regulatory guidance, to update the "Business Continuity Planning" (BCP) booklet. This update resulted in the release of a new appendix to this booklet, "Strengthening the Resilience of Outsourced Technology Services" (otherwise known as Appendix J). The new appendix intends to ensure that the BCP booklet aligns with regulatory guidance on third-party relationship risk management and incorporates emerging risks by strengthening guidelines in four specific areas: 1) third-party management, 2) third-party capacity, 3) testing with third-party technology service providers, and 4) cyber resilience. In short, the updated guidelines attempt to more effectively address the growing interdependencies of third-party services in a financial institution's overall business resilience strategy.

FRAGMENTATION AND THE TALENT SUPPLY CHAIN CHALLENGE

Most banking, insurance and capital markets executives are aware of these guidelines already.

Many (primarily among the largest and most complex – "Tier 1" - players) have implemented internally-developed, outsourced, or hybrid programs to measure talent supply chain risks and improve decision support for when to build, when to buy, and when to do nothing. But, given the stark contrast of these guidelines relative to where most financial institutions' TSCM capabilities were just a few short years ago, we believe that it is safe to say that most Tier 1 banks are still struggling to comply with them – and most other large financial institutions are well behind.

And, here's the chain of logic for why supply chain risk and TSCM are now so critical: First, the human resources (HR) function has primarily been focused on the internal talent (FTE) planning with the non-employee population managed directly through operations and/or procurement. As a result there is little or no expertise inherently employed by financial institutions that is dedicated to contingent workforce laws, co-employment engagement alternatives, and other facets of contingent workforce management. Along these lines it is becoming increasingly difficult to identify qualified candidates for what is certain to be increasingly advanced statements of work (SOWs).

Secondly – and to make matters much worse- it is common for the engagement of contingent workers to be handled by individual business units – where each business unit may have relationships with different vendors. Case in point: Once an SOW contract is signed, the procurement function typically goes away, and then the business units are on their own to manage the execution of the project, including all of the approvals and payments according to different contractual milestones. This is the essence and challenge of the lack of an integrated TSCM strategy. There are typically different business units utilizing different vendors with contractors who may be engaged via several successive layers of subcontracting to those vendors; a very complex web of interactions.

> *"I think our senior management doesn't realize how dependent we are on certain vendors for certain types of work.*
>
> **SO THERE'S NOT ONLY AN OPPORTUNITY HERE FOR COST SAVINGS BY INTRODUCING MORE COMPETITION, THERE'S ALSO A HUGE RISK."**
>
> **Koenraad Lecot,**
> **Head of Contingent Workforce Management**
> **Leading US Insurance firm**

If it's not obvious by now, the problem with this portrayal is that at an enterprise level many organizations lack an overall governance structure, and therefore, there is extremely limited capability to measure and monitor the spending and supply chain risks to which the aforementioned guidelines apply – and frankly, to which senior management teams absolutely need to have greater clarity.

In this scenario, even the most basic information – like indirect headcount, worker location, and general scope of work – is extremely challenging to quantify, period. Assembling this information in a timely manner is often out of the question. Furthermore, in this context, responding to one-off, ad hoc requests – a scenario which happens often – is nearly impossible. Forget the hard questions. And, definitely forget forecasting. In this scenario, even the simple questions are very challenging to answer. If you are thinking that costs are an increasing concern, you'd be correct. But, the bigger near-term challenge is around compliance – and having the capability to answer the most basic questions on contingent workforce usage.

REAL TALENT SUPPLY CHAIN MANAGEMENT STRATEGIES

The mission to address the talent related supply chain risks outlined above is clear based on where the guidelines are headed – and the readiness level at which many large financial firms' TSCM capabilities currently reside.

Information about your contingent workforce needs to be standardized and centralized in order to be able to create the visibility to answer even the simplest questions faster. Truth be told, TSCM capabilities ultimately need to go beyond visibility, as we will demonstrate shortly.

There are three primary pathways for managing talent supply chain risk. Simply stated, these include 1) develop an internally-managed program, 2) outsource to a managed service provider (MSP), and 3) do nothing / wait and see. Based on the current landscape, we can dispense with the "do nothing" approach right away. Those employing the "wait and see" strategy might as well embed "laggard" into their corporate messaging. Doing nothing is simply unacceptable - with the possible exception being those firms whose outsourced talent supply chain is minimal and/or contractually simple - or whose responsibilities do not go beyond proprietary capital. At the very minimum, all financial firms of any consequence need to be engaged in an exploratory mission to determine how much of their contingent workforce risk can be properly managed with internal resources or if an MSP partner is needed to support some or all of their TSCM function. **The exploratory mission should include engaging with an experienced talent supply chain advisory services firm who can objectively consult to assist with aligning talent strategy to business priorities, recommending program structure and governance for internal or outsourced programs, as well as help in building the business case.**

A simple test of this decision point is whether basic questions can be answered about your contingent workforce *in a timely manner*. We define timely manner at less than 24 hours. If you can't answer questions like contingent headcount, worker locations, or general scope of work, then you need to identify a supply chain risk partner (if you don't already have one) or fire the supply chain risk team you currently have in place and identify a new one.

Internal development vs. MSP: While many financial firms have relied on internal development to manage what has only recently been labeled supply chain risk, the growth of outsourced talent utilization, (and therefore, the growing complexity of those programs), and the increasingly analytical demands of regulators, senior management teams and other stakeholders alike, the DIY strategy still brings its own risks. This is particularly true of Tier 2 players whose internal capabilities are likely insufficient to properly manage the growing complexity of contingent workforce programs.

Today's outsourced talent programs require more centralized and enterprise-wide monitoring and management solutions. Their role *should be* to address the entire scope of indirect workers. This piece typically comes together with the use of a vendor management system (VMS), which serves as a workflow management tool for procurement of part-time and in some case permanent staffing (including all documentation). On top of this, best practices – increasingly demonstrate that specialist managers (MSPs) are put in place not only to manage the VMS but to bring specific operational and strategic expertise to the enterprise TSCM program.

Benefits of MSPs start with organizing what can often be a vast tapestry of talent suppliers which constitute the firm's indirect workforce. With such organization comes much greater visibility into what each supplier – (often) down to each individual contractor – is working on, and details of specific engagements. These programs should also be able to aggregate information across engagements, vendors and SOW focal areas. Ultimately, this level of visibility under specialized management gives financial firms the decision support they need to determine where and when contingent workforce support is warranted.

Here are the nuts and bolts of the problem (and solution): There are typically multiple layers – and sometimes, silos too - of subcontracting that occur in large and complex financial institutions. If left entirely unmanaged, this scenario creates excess complexity in terms of disjointed documentation and inconsistent project specifications – and renders accurate measurement, monitoring and forecasting of activities and exposures nearly impossible. For instance, in this scenario, it would often take days or weeks to answer simple questions about resource allocations, concentrated and "single-threaded" dependencies with a single vendor, or the linkage among layers of subcontracts. But, in the end, financial firms have much bigger responsibilities today than managing an indirect workforce environment.

A base case solution to this scenario is to drive the linkage of all subcontracting through a single "master" intermediary who provides administration services, but often little else in terms of cost or risk mitigation strategies. Talent procurement, background checks, work visas, ID management, and payroll services are specific tasks that are commonly included with such an administration outsourcing program. There are a number of global firms that provide this kind of service. Some of the largest banks employ this strategy (supplemented with internal development and management) – and further believe that it insulates the bank from certain supply chain risks. This is only partially true since, according to recent and evolving OCC guidelines, the use of third parties does not absolve an entity from responsibility for their actions. Lines of separation don't hold water in this more highly regulated environment. Firms need to know where their workers come from, particularly in multi-layered subcontracting arrangements.

A more sophisticated workforce strategy takes a holistic approach to TSCM that addresses the full spectrum talent engagement including, internal hires, traditional contingent labor, Independent contractors, Statement of work project-based talent, as well as retiree, alumni and intern talent pools. This holistic program is then infused with domain expertise, in this case the increasingly complex regulatory environment and the evolving skillset needs within financial services firms.

> *"Everything was ad hoc. We were managing our payments through emails and paper invoices. It was a very manual process, with zero certainty on whether our output was accurate or not. There was no clear chain of responsibility and accountability.*
>
> **WE HAD LIMITED PROCESS GOVERNANCE AND VERY LIMITED INSIGHT INTO OUR SPENDING (ON ANY STATEMENT OF WORK)."**
>
> **Koenraad Lecot,**
> **Head of Contingent Workforce Management**
> **Leading US Insurance firm**

With this enhanced approach, the primary goals of the MSP are simply stated as: 1) operational management and 2) strategy development support. Operational management starts with implementing standardized process efficiencies, enhancing visibility into statements of work (SOWs) and the contingent workforce vendor roster. This visibility is achieved by centralizing the relevant documentation, data and MSP-coordinated process rules and policies into one system, such as the aforementioned VMS., What formerly took months, now can take as little as 20 minutes to assemble a detailed spend and analytics report.

With this dramatically enhanced visibility into the mechanics and analytics of SOWs and the contingent workforce as a launch pad, the goal then becomes continually working towards supply chain optimization. In order to achieve this level of proficiency, the MSP will provide supply chain analytics and performance metrics that help to guide better decisions on the most effective talent supply chain composition.

Specific management by the MSP includes governance of standard contracting, compliance to a defined process, analytics on usage patterns and resource allocation (via VMS technology), and, perhaps most importantly, risk mitigation via capacity, concentration and resilience testing. At the most detailed level, each SOW can be broken down into specific milestones, deliverables, and milestone payments.

In the end, the benefits of this comprehensive and holistic approach - an advanced TSCM approach – are many. For specific financial services firms, any or all of the following benefits may accrue:

- minimize fragmented capacity and build synergies across the supply chain;
- reduce risks introduced through single-threaded and critical competency exposures;
- achieve greater efficiency and savings through leveraged buys;
- diversify the supply chain optimally, not maximally;
- integrate alternative workforce engagement models in support of the above;
- establish audit trails for which managers approve specific milestones and milestone payments;
- provide comprehensive spend analysis and reporting; and,
- forecast estimates of usage patterns, spending, supplier concentrations and other analytics (limited only by the creativity of the partnership and the available data).

In other words, the MSP seeks to understand – and promote understanding for the client on – how to organize the talent supply chain in a way that is more than just a mosaic of temporary help vendors, service providers, and independent contractors. Ultimately, it seeks to assist in the alignment of talent to business strategy and identify the optimal manner by which the work needs to be done given pre-defined risk tolerance.

CONCLUSION

For companies in the financial services and insurance sector, exploration into how best to manage ongoing supply chain risk is not particularly new, even if the labeling of a talent supply chain is new.

Most Tier 1 banks have implemented – or are in an ongoing process of implementing – centralized MSP programs (and VMS technology) to manage their external workforce. This is mainly due to their SIFI designations and the fact that they have been embroiled in satisfying so many regulatory mandates over at least the past five years. The most successful programs result when there is a formalized governance role that bridges the business operations to the outsourced partner or vendor.

On the provider side, the major MSPs continue to evolve to second and third generation contingent and integrated labor management solutions. Given a highly fluid environment, the tactics and strategies for managing the ever-shifting landscape upon which a contingent workforce is deployed remains highly variable. There are three critical factors that need to be considered to promote the level of operational agility necessary to match the dynamic financial services ecosystem: ongoing regulatory and guideline evolution, in-house vs. outsourced capabilities, and non-SIFI applicability.

Your firm's supply chain risk mitigation strategy for talent needs to reflect this reality. Ideally, such a plan – whether internally managed, outsourced to an MSP, or some hybrid variation – brings clear visibility to external talent spend, mitigates compliance risk and provides business leaders whether HR, procurement or operations insights to improve decision-making and enable talent strategy alignment that drives optimal business results.

"I SEE MYSELF AS BEING A LIAISON BETWEEN THE *different functions who would benefit from other models of contingent workforce deployment"*

Koenraad Lecot,
Head of Contingent Workforce Management
Leading US Insurance firm

There's no magic bullet, and this work is much easier said than done. Impactful change will not show up overnight. This is a process of moving to a structured process with the right tools, processes and provider partners to first achieve visibility and ultimately, vision. There's a huge difference between the two. Awareness of the significance of supply chain risk is the first step.

CASE STUDY EXAMPLE

LEADING US-BASED INSURANCE FIRM

A leading insurance firm in the U.S. with a dynamic, highly visible footprint in the marketplace, engages a large number of contingent workers such as those assigned to statements of work (SOWs), along with outsourced workers. Individuals at their various business units and sites managed their contingent workforce for many years. As a result of this de-centralized approach for managing contingent workers, they lacked consistent processes for the engagement and oversight of this unique part of their workforce. This hampered the company's ability to drive visibility and consistent compliance of their contingent workforce, exposing them to risk and excess cost.

KellyOCG created and implemented a unique, partnership-driven MSP using VMS technology, enabling this client to manage their contingent workforce in a much more efficient, cost-effective manner, and at the same time improve compliance and visibility.

As the MSP managing their SOW life cycle, KellyOCG has:

- Ensured a timely implementation
- Driven a consistent SOW format to ensure scope, deliverables, and milestone payments are clearly stated up from at the time the product starts
- Administered milestone approvals improving timeliness of approvals
- Documented changes to SOW, providing clearer visibility to budget and delivery changes
- Improved the audit process, creating definitive audit trails for supplier compliance
- Given internal stakeholders more insight into their spend

RESULTS

The client now enjoys a greatly improved understanding and management of its contingent employees, its spend, and project status, as well as how to best allocate resources among its many offices and stakeholders.

ABOUT THE AUTHOR

BEN DECKER serves as Director & Global Workforce Solutions Consultant - Financial Services & Insurance for Kelly Services.. As a strategic consultant, he is focused on identifying the workforce trends and labor supply/demand dynamics impacting these complex industries. Ben's tenure with Kelly began in 2003 and has spanned the areas of service, implementation, sales, and consulting. These experiences have helped him navigate solutions and services to meet unique client needs. Ben holds a Bachelor of Arts degree in business administration with minors in human resource management and economics from the Haworth College of Business at Western Michigan University.

ABOUT KELLYOCG

KellyOCG®, the Outsourcing and Consulting Group of workforce solutions provider, Kelly® Services, is the leading global advisor of talent supply chain strategies that enable companies to achieve their business goals by aligning talent strategy to business strategy. We recognize each client's goals are unique to their business drivers and priorities whether speed, quality, compliance or cost. We apply supply chain management principles to help companies leverage talent across all internal and external worker categories: full-time employees, temporary employees, freelancers, independent contractors, and service providers, as well as alternate sources of workers like retirees, alumni, and online talent communities.

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KellyOCG was named in the International Association of Outsourcing Professionals® 2015 Global Outsourcing 100® list, an annual ranking of the world's best outsourcing service providers and advisors.

Further information about KellyOCG may be found at **kellyocg.com**.

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