

Too Good to Fail? New Challenges for Risk Management in Financial Services

A summary of a report produced by the Economist Intelligence Unit and sponsored by SAS

Findings at a Glance

- Financial institutions are increasing their exposure to risk.
- Managing complexity is becoming one of the biggest challenges for firms.
- The risk management function is finding it hard to increase its authority.
- There is plenty of room for improvement in the relationship between the risk function and other parts of the business.
- Progress on revamping and strengthening risk management has slowed.
- Management boards are now paying a lot more attention to risk.

Overview

Much has changed in the banking and insurance industries since the darkest days of the financial crisis. Today, it is almost unthinkable that any CEO would completely ignore warnings from a chief risk officer, as was the case at Lehman Brothers just before it collapsed in 2008. With regulators, management boards and investors scrutinizing risk practices more closely than ever, the risk function now has more teeth.

Financial services firms everywhere have initiated at least some measures to address the most glaring deficiencies in risk management exposed by the crisis. But have they done enough? The organizational and structural changes in the crisis' aftermath send a clear signal about the value placed on risk management. The changes are one piece of the puzzle. Instilling and embedding a stronger enterprisewide risk culture remains an ongoing challenge.

Perhaps the biggest challenge in risk management, as perceived by respondents in this year's Economist Intelligence Unit survey, is institutional complacency, but a nascent economic recovery and the relatively strong recent performance of the financial sector are emboldening many firms. Risk appetites are growing and there is increasing pressure on organizations to expand and boost earnings, which is reflected in the key findings of the research.

This report presents pertinent findings from the 2011 survey along with related insights drawn from interviews with industry experts, senior executives and commentators.

Report Highlights

Financial institutions are increasing their exposure to risk.

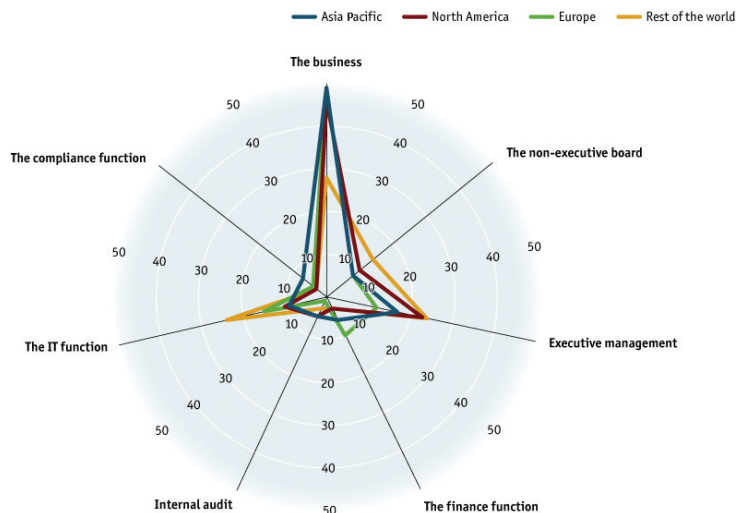
After three years of retrenchment, the competition for returns and profitability is intensifying. Slightly less than 40 percent of the respondents say the risk appetite at their firms has increased in the past year. Investment banks and respondents in the Asia Pacific region are more willing than their counterparts in other parts of the world to take on greater risk. Although a higher risk appetite is justified in most cases, it will be important for institutions to ensure that they have the right risk management structures and processes in place to flourish in a more competitive, returns-driven environment.

Managing complexity is becoming one of the biggest challenges for firms.

Turbulence has been the dominant theme of 2011, and it has been compounded by political unrest in the Middle East, the tsunami in Japan and continuing distress in sovereign debt markets. When it comes to threat perception, more than 60 percent of respondents

The full report is available at
www.sas.com/ermresearch.

With which of the following parts of your organization does the risk function most need to improve its relationship?
(% respondents)



Risk management needs closer alignment with the business function.

think external risks pose a greater challenge than internal ones. More than 60 percent also say that complexity is increasing the risk exposure for their organizations. But this increase in complexity is not always matched by a greater focus on risk management. Only 52 percent report that their employer's risk management processes are well placed to deal with volatility (although a much higher proportion of investment banks say that they have strong measures in place). In addition, only 34 percent say that they now have a better understanding of tail risks – an important insight, given the number and magnitude of unexpected events so far this year.

The risk management function is finding it hard to increase its authority.

While 50 percent of respondents say that the risk management function at their firm has gained in authority over the past year, this still leaves a sizeable proportion

of risk managers who think their authority has stayed the same or, in some cases, has decreased. A surprisingly high proportion of respondents – nearly 25 percent – report that the views of the risk managers are more often than not over-ridden or ignored.

There is plenty of room for improvement in the relationship between the risk function and other parts of the business.

Some progress has been made in the past couple of years in elevating the role of the risk management function, but risk managers at many organizations continue to find it hard to build strong and open relationships with colleagues from other lines of the business. Respondents cite poor communication between departments as one of the main barriers to effective risk management, while the relationship between the risk management function and business units is cited as the one that most needs improvement.

Progress on revamping and strengthening risk management has slowed.

Previous surveys in this series have found firms steadily increasing their efforts to strengthen risk management. This year, there are signs that the momentum of those efforts may have peaked. The percentage of respondents who are confident their organizations have a clearly defined risk management strategy is broadly the same as a year ago. Year over year, the proportion of respondents who are increasing investment in the risk function has fallen slightly across IT, data, training and recruitment.

Management boards are now paying a lot more attention to risk.

More than 40 percent of risk managers who participated in this survey indicate their management boards have beefed up their risk expertise, and more than 50 percent report that their boards are demanding more rigorous risk reporting. Retail banks are particularly likely to be facing increased risk scrutiny from their boards. Among those respondents that are experiencing greater demands from the board, there is significant change in risk reporting, particularly in the level of detail and comprehensiveness that they are now expected to provide. Overall, however, only a minority of firms are taking steps to upgrade aspects of their risk reporting such as timeliness and consistency.