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Industry research report
Executive highlights

New risk management insights for financial institutions



Over the course of the last 24 months or so, there has been extensive analysis of how the risks associated with financial institutions have changed. As each new revelation has entered the public domain, industry experts and media observers have commented in strong terms – telling us why things have gone wrong, who is to blame and how bleak the future looks. In turn, the general public has become much more financially literate, understands much better the cause-and-effect linkages of the global financial and economic crisis and has also become increasingly vocal in its criticism.

Government intervention and the international regulatory response will determine the future look and feel of this industry – everything from the business model to executive remuneration, from increased capital requirements to the payment of dividends. However, what is the industry's own response – how can it repair a battered reputation and restore stakeholder confidence? In the face of such fundamental change, it appears that Board level re-evaluation of risk and a renewed commitment to strengthen risk management practices are among the chosen ways forward.

Yet we know that many risk managers complain that they lack the tools or authority to do their jobs. The danger is that less investment (instead of more) will be made available in an economic downturn and there will be continued pressure to reduce costs whilst maintaining and improving the risk control environment.

In view of the above and in an attempt to move away from the anecdotal, Marsh commissioned Ipsos, an independent research agency, to conduct a survey of risks facing companies in Europe. The survey examined attitudes to risk management in the current economic downturn, including risk priorities, strategy, management and solutions. Ipsos interviewed senior executives responsible for risk management in over 700 organisations, spanning 12 countries and 7 industry sectors. Of these organisations, 121 were financial institutions.

The result is one of the most comprehensive risk management studies to have been undertaken among European financial institutions this year. This research report highlights the key risk management issues of most concern to the industry, the level of confidence shown in managing these issues and the direction that risk management utilisation appears to be taking.

The industry is responding dramatically and immediately

The financial crisis and the economic downturn have hit financial institutions hard and have highlighted failings of corporate governance and risk culture. Our survey provides dramatic evidence that the industry has recognised its problems and is making solving them a top priority.

Figure 1 compares the results from all seven industries, with exceptionally high or low results highlighted. Barring one indicator, the results from financial institutions stand out, often by a clear margin. For example, the industry believes it has been impacted most by the downturn. It has, by some way, the highest proportion having reviewed their approach to risk. It also has the highest proportion of respondents saying risk management is now seen as being more important at senior levels.

It is the industry with the least confidence in its risk management practices, and this has understandably resulted in its decreased appetite for risk. And finally, it has the highest proportion of respondents expecting risk management budgets to rise.

Figure 1: Results at a glance
(Percent of respondents in respective industries)*

	FI	CMT	LS	PE	P&U	RCB	T
Impact of downturn perceived to be greatest	64	51	14	35	21	30	54
Reviewed approach to risk	84	71	60	54	66	67	73
RM at senior levels is now more important	87	85	65	56	74	66	77
Risk aversity among Board	52	36	33	25	43	36	40
Retaining more risk	13	18	13	22	13	23	22
Very confident in RM processes	20	25	26	22	36	34	32
Increased budget for RM	47	36	38	25	36	29	30
Group causing most concern	Customers 68	Customers 69	Customers 43	Citizens 54	Customers 49	Customers 55	Customers 62
Most significant risk	Business continuity 58	Credit 69	Cash flow 78	Environmental 73	Power price 66	Cash flow 76	Cash retention 75

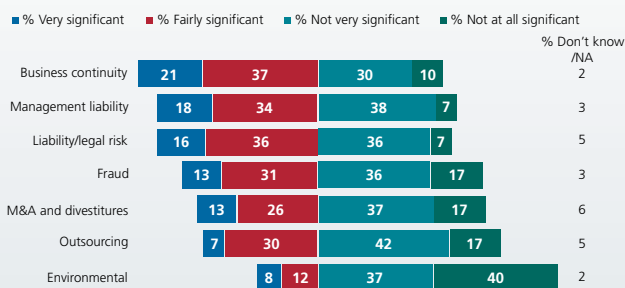
*Key: ■ indicates highest percent of respondents, ■ indicates lowest percent of respondents. CMT: Communications, Media and Technology, FI: Financial Institutions, LS: Life Science, PE: Public Entities, P&U: Power and Utilities, RCB: Retail and Consumer Brands, T: Transport

The most significant operational risks will be business continuity, liability and fraud

Survey participants say that, over the next 18 months, business continuity will be the most significant risk – 58% believe it will be very or fairly significant (figure 2). “Business continuity” is interpreted in its broadest sense here, referring to the longer-term viability of the industry and/or individual organisations, as opposed to “business continuity management” or “disaster recovery planning”.

The next most significant risks are liability and legal risk (52%) and fraud (44%). Unlike the threat of terrorism or the physical perils that featured prominently in historical risk agendas, these risks arise from reduced liquidity and credit and counterparty risks and manifest themselves differently across specific industry segments.

Figure 2: How significant will each of the risks mentioned below be for your organisation in the next 18 months?



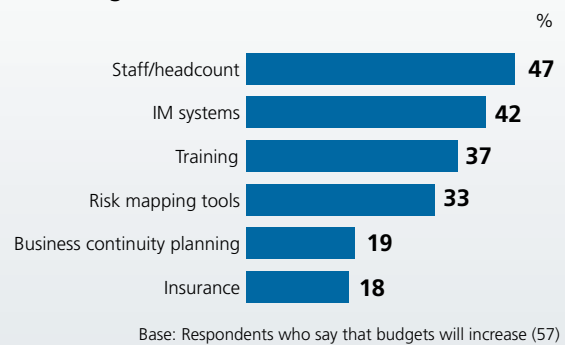
For banks and mortgage lenders, these risks stem from interbank lending, business failures and defaults on mortgages, loans and credit cards. Investment managers are facing the consequences of poor investment performance, increasing redemptions and the shrinking value of assets under management. Insurers are worried about their investment portfolios, particularly the complex asset classes and the resultant impact on their solvency ratios. The liquidity crunch and the conservative investment environment have also led to a stagnating private equity sector.

Overall, every segment of the industry is concerned about its financial performance, reputational damage and ability to continue business operations. Increased merger, acquisition and divestiture activities, combined with the spate of part- or full-nationalisations, have impacted industry, market and company stability. Amplifying these challenges, financial institutions are facing a dramatic increase in litigation and criminal activity, particularly as investors seek to recoup their losses and investigations into poor lending practices reveal increased internal and external fraud.

Budgets are increasing as risk management is overhauled

Budgets for risk management are growing in close to half (47%) of the financial institutions in our survey, with the most commonly mentioned area of increase being recruitment (47%). This is followed by information management systems (42%), training (37%) and risk mapping tools (33%).

Figure 3: In what areas do you expect the budget for risk management to increase in the next 18 months?



The consensus view is that the global financial crisis has revealed a breakdown of certain risk management controls in financial institutions. Recognising this, and in an effort to pre-empt government intervention and mitigate the impact of new regulations, these organisations are set to invest more in improving their overall risk management frameworks in order to avoid similar problems in the future and restore stakeholder confidence.

Recommendations and action

Building upon these executive highlights, the full Marsh industry research report titled “*New risk management insights for financial institutions*” studies the impact of the downturn, the changing risk profile of financial institutions and how the industry is responding. The contents also outline Marsh’s recommendations on risk priorities, risk strategies, risk management and risk solutions.

For further information or to obtain a full copy of the report, please contact Carrick Lambert, Financial Institutions Industry Practice Leader for Europe, the Middle East and Africa, or your local Marsh representative (see overleaf).

About Marsh's Financial Institutions Industry Practice

Our Europe, Middle East and Africa Financial Institutions Industry Practice is part of a global network providing risk management solutions to the financial institutions industry. Our clients include 11 of the global top 20 banks, 20 of the European top 50 banks, 14 of the global top 20 private equity firms and 18 of the 54 financial institutions listed in the FTSE 250.

The Financial Institutions Industry Practice leverages the expertise of colleagues across a wide range of product and process solutions. We offer extensive experience and expertise in all major industry segments, with particular focus on banks, insurance companies, mortgage lenders, asset management companies, private equity firms and exchanges, and clearing and settlement agencies. We also work in partnership with commodity dealers, foreign exchange traders, stockbrokers, venture capital firms, treasury teams and custodian and trustee companies.

The Practice includes retail and wholesale business segments; the latter involves doing business with 60 countries globally. We also offer specialised operational risk consulting services.

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