

Uncertainty tamed?

The evolution of risk management in the financial services industry*

Contents

- ▶ Executive summary
- ▶ The return of MoneySpinner
- ▶ Being aware is forewarned
- ▶ Invisible and lethal
- ▶ Conclusion
- ▶ Appendix: Survey results
- ▶ Contacts
- ▶ PricewaterhouseCoopers Global
Financial Services Briefing Programme

Uncertainty tamed?

The evolution of risk management in the financial services industry

Executive summary

- ▶ Contents
- ▶ Executive summary
- ▶ The return of MoneySpinner
- ▶ Being aware is forewarned
- ▶ Invisible and lethal
- ▶ Conclusion
- ▶ Appendix: Survey results
- ▶ Contacts
- ▶ PricewaterhouseCoopers Global Financial Services Briefing Programme

PricewaterhouseCoopers Global Financial Services Briefing Programme

Welcome to the ninth report in our global financial services briefing programme, entitled **Uncertainty tamed? The evolution of risk management in the financial services industry**.

This briefing, written in association with the Economist Intelligence Unit, addresses the key issues that financial institutions are facing with regard to risk management and is a follow-up to our earlier briefing, **Taming uncertainty: Risk management for the entire enterprise**, which we launched in July 2002.


The research effort for this briefing comprised two global initiatives:

- The Economist Intelligence Unit held over 20 one-on-one interviews with senior executives at financial institutions in Asia, Europe and North America.
- The Economist Intelligence Unit and PricewaterhouseCoopers conducted a special online survey of senior executives in financial institutions on the subject of risk management. Executives from 134 institutions in Asia, Europe and North America participated in the survey, which was conducted during June and July 2004.

The interviews and survey findings were further supplemented by significant desk research.

I am confident that you will find this briefing thought-provoking and insightful. Soft copies of this, along with our previous briefings on **Wealth Management, Economic Capital, Risk Management, The Trust Challenge, IFRS, Compliance, Restructuring and Governance**, are available from our web site www.pwc.com/financialservices

If you would like to discuss any of the issues addressed in this briefing in more detail in relation to your organisation please speak to your usual contact at PricewaterhouseCoopers. We would also appreciate your feedback on this briefing as it helps us to ensure that we are addressing the issues that you are focusing on.



Jeremy Scott
Chairman, Global Financial Services Leadership Team

Uncertainty tamed?

The evolution of risk management in the financial services industry

Executive summary continued

- ▶ Contents
- ▶ Executive summary
- ▶ The return of MoneySpinner
- ▶ Being aware is forewarned
- ▶ Invisible and lethal
- ▶ Conclusion
- ▶ Appendix: Survey results
- ▶ Contacts
- ▶ PricewaterhouseCoopers Global Financial Services Briefing Programme

For financial institutions, risk lies around every corner. With little or no warning businesses can stumble and even collapse because of unexpected events. Growing risk management departments and sophisticated technology have helped companies in financial services to combat many of the more quantifiable dangers, from credit and market risk to such things as regulatory and IT risks. But what about those areas, like reputational risk, that are both harder to measure and more sudden and severe in their impact?

As Sir John Bond, Chairman of HSBC, told a conference recently: 'It used to take years of dedicated bad management to destroy a company. Now it can be done almost overnight.'

Two years ago, PricewaterhouseCoopers carried out a survey of financial services institutions worldwide (see our previous briefing, **Taming uncertainty: Risk management for the entire enterprise**). The results showed that, while senior executives were keenly aware of the credit and market risks they faced and were doing more to address them, they tended to pay comparatively little attention to less visible, equally menacing dangers. Two years on, a fresh survey of more than 130 senior executives in financial services institutions, carried out by the Economist Intelligence Unit on behalf of PricewaterhouseCoopers for this briefing, indicates that risk management in general has climbed higher up the corporate agenda and that an awareness of unquantifiable

risks in particular has grown markedly: reputational risk is now regarded as the greatest threat to an organisation's market value.

Yet significant concerns remain. Many financial services institutions are still failing to think proactively about unseen and emerging risks. There is evidence that much of the impetus for change in risk management priorities is coming not from self-assessment but rather from pressure from regulators, rating agencies and the like. Some 72% of those questioned in the survey said that regulatory pressures were either an extremely significant or a major driver for changes in the priority of their organisation's risk management over the past two years. The evidence of the survey and our interviews suggests four main reasons why risk management remains primarily focused on meeting regulatory requirements and only secondarily on protecting and enhancing the value of the franchise:

A culture of risk awareness has yet to emerge. Risk management has climbed the boardroom agenda since the previous survey: expenditure on risk management as a percentage of its overall expenses is on an upward trajectory, and more organisations have a senior risk management executive and committee at the group level. But spending more on risk management on its own is no guarantee that a company will become better at it. In only 31% of respondent companies do all major decisions require interaction with, or some form of approval from, the group risk management committee (that number rises to a still low 47% for larger institutions with total gross income of \$1bn or more). There is a big difference, according to Juan Pujadas, US Advisory Services Leader of PricewaterhouseCoopers, between talking about steps to integrate risk management and actually taking them. 'Too often', he says, 'a company's head of risk is not at the same table as the chief executive officer

Uncertainty tamed?

The evolution of risk management in the financial services industry

Executive summary continued

- ▶ Contents
- ▶ Executive summary
- ▶ The return of MoneySpinner
- ▶ Being aware is forewarned
- ▶ Invisible and lethal
- ▶ Conclusion
- ▶ Appendix: Survey results
- ▶ Contacts
- ▶ PricewaterhouseCoopers Global Financial Services Briefing Programme

or other executive directors when important decisions are being made.’ A company needs to inculcate an appreciation of risk that goes beyond the risk management department and permeates the whole organisation.

Compliance is not being turned to competitive advantage. Too little emphasis on compliance can, of course, expose an organisation to regulatory sanction, litigation and damage to its reputation. But too much emphasis on box-ticking can also distract a company from using risk management to create value – by reassessing its investment strategies, making better operational decisions in areas such as pricing and capital allocation, and by gauging its own appetite for risk. True, almost 70% of survey respondents assess their performance on some measure of risk-adjusted capital. Yet many are failing to turn this fully to their advantage, by setting more appropriate product pricing, for example.

The importance of governance is underestimated. Robust risk management and sound corporate governance invariably make good bedfellows. Indeed, some argue that it is

impossible to get one without the other. But few survey respondents seem to have acted on the logic of this argument. When asked in which business processes their organisation had a structured approach to assessing risk, only 43% ticked M&A activity and just 17% pointed to the setting of compensation policies for directors and recruitment policies as a whole. It is accepted that paying executives too generously for failing to do their jobs competently or ethically raises questions about governance but it ought to be a major focus of risk management too.

Quantifiable risks are still absorbing too much attention. Asked to rate the effectiveness of their organisation’s risk management capabilities, survey respondents had most confidence in their ability to manage data-rich areas such as credit risk, liquidity risk and market risk. No one disputes the importance of managing these types of risk effectively – respondents still rate these the principal threats to earnings, but they are not necessarily the main threat to the health of the franchise upon which sustainable earnings depend. Says Phil Rivett, Global Leader of PricewaterhouseCoopers banking and capital markets practice:

‘Too many organisations are still concentrating on calculating market and credit risk to a further order of accuracy and too few on understanding the totality of the risks they face in order to give themselves a competitive advantage.’

The tendency for financial institutions to focus on areas of risk that are most familiar and where data and techniques are most developed is natural, of course. But in an environment where new and potentially lethal risks can suddenly emerge, the leading institutions consciously and continually look at the bigger picture. They seek to anticipate and avoid the submerged risks that can abruptly sink an enterprise. And they have both the crisis management processes and the underlying standards of behaviour that are likely to soften the impact of such risks when they do come to pass. Such institutions accept that uncertainty cannot be tamed, only mitigated.

Uncertainty tamed?

The evolution of risk management in the financial services industry

Executive summary continued

- ▶ Contents
- ▶ Executive summary
- ▶ The return of MoneySpinner
- ▶ Being aware is forewarned
- ▶ Invisible and lethal
- ▶ Conclusion
- ▶ Appendix: Survey results
- ▶ Contacts
- ▶ PricewaterhouseCoopers Global Financial Services Briefing Programme

In our original briefing on this topic, we listed ten attributes that would help companies create a world-class culture of risk management. Two years on, we believe they are as valid now as they were then:

1. **Pay equal attention to quantifiable and unquantifiable risks.** Institutions are increasingly attuned to the dangers posed by less quantifiable risks, particularly with regard to their market value. That awareness stretches right to the top of the organisation: in a recent PricewaterhouseCoopers survey of global CEOs¹, 28% of financial services bosses felt that reputational risk was a significant threat and 13% felt that it was one of the biggest threats they face.
2. **Identify, report and quantify all possible risks.** Despite a growing awareness of unquantifiable risks, there remains a danger that some organisations will take no action if they cannot find the numbers with which to measure a risk or set of risks. As one respondent to our survey tellingly replied: 'For some risks, the data is insufficient to construct a strategy.'
3. **Let an awareness of risk pervade the enterprise.** Everything from performance to pricing and pay should be adjusted for risk. Too few institutions currently obey that imperative: of the 69% of survey respondents to assess their performance on a measure of risk-adjusted capital, fewer than one in five use this information to pay bonuses or set remuneration for senior executives.
4. **Make risk management everybody's responsibility.** In the past, financial institutions have tended to look outside their own walls when assessing risks. But issues of governance, culture and integrity are arguably more critical in protecting firms from unseen dangers – and should be made the explicit responsibility of all members of staff. 'All 20,000 employees have the potential to do something to enhance or destroy our reputation,' says Tim Robison, Chief Risk and Compliance Officer at Mellon Financial Corp, a global financial services provider.
5. **Risk managers should have teeth.** Everybody involved in monitoring risk of all kinds should have a genuine influence over decision-making. Independent risk assessments of a new product or transaction should be made before the CEO and senior management have approved it in principle. Is it realistic to go back to the drawing board afterwards?
6. **Avoid products and businesses the enterprise does not understand.** If you don't understand the business, you cannot understand the risks facing it. Encouragingly, 77% of respondents now include a structured assessment of risk in their product development processes. Less happily, only 43% said they did so when it came to mergers and acquisitions.
7. **Accept that uncertainty exists.** More than two in five respondents to our survey believe that the greatest risks to the organisation's market value are 'unknown' sources of risk. Workshops, scenario planning and cross-industry reviews are

Continued overleaf

¹ Managing risk: An Assessment of CEO Preparedness, PricewaterhouseCoopers, January 2004

Uncertainty tamed?

The evolution of risk management in the financial services industry

Executive summary continued

- ▶ Contents
- ▶ Executive summary
- ▶ The return of MoneySpinner
- ▶ Being aware is forewarned
- ▶ Invisible and lethal
- ▶ Conclusion
- ▶ Appendix: Survey results
- ▶ Contacts
- ▶ PricewaterhouseCoopers Global Financial Services Briefing Programme

continued

among the techniques that leading institutions are using to assess the potential impact of, and response to, these future sources of danger.

- 8. Monitor your risk managers.** The amount of attention being paid to risk at board-level still leaves much to be desired. In fewer than a third of surveyed institutions are risks and risk management discussed in detail at all main board meetings. And although awareness of risk has grown in over 80% of institutions, in fewer than half is responsibility for enterprise-wide risk management higher up the organisation than it was two years ago.

- 9. Good risk management delivers value.** Loss avoidance remains the staple means of demonstrating the value of risk

management, but 50% of survey respondents also look to risk management to contribute to improved shareholder value.

- 10. Define and enshrine your company's risk culture.** The enterprise's appetite for risk should be clearly and widely understood. 'We have a very clear risk appetite for certain events,' says Elbert Pattijn, Managing Director, Credit Risk Management at ING Group. The institution's senior leadership should set a tone at the top that creates a behavioural and ethical benchmark for the entire organisation. Given the inherent vagaries of human behaviour, however, process controls also need to be put in place to reinforce cultural norms and compensate for any lapses.

Uncertainty tamed?

The evolution of risk management in the financial services industry

The return of MoneySpinner

- ▶ Contents
- ▶ Executive summary
- ▶ The return of MoneySpinner
- ▶ Being aware is forewarned
- ▶ Invisible and lethal
- ▶ Conclusion
- ▶ Appendix: Survey results
- ▶ Contacts
- ▶ PricewaterhouseCoopers Global Financial Services Briefing Programme

When we published our original briefing on risk management in financial services, *Taming uncertainty*, we related the story of an imaginary company, called MoneySpinner Group, which had made life much harder for itself (and for its shareholders) by failing to avoid the pitfalls that lay in its path. How has the organisation fared in the two years since then?

MoneySpinner Group, you may recall, is the product of a series of amalgamations between banks, investment houses and insurers. It serves customers across an array of businesses spanning disparate geographies. Like most such conglomerates, its employees come from many different professions, countries and backgrounds.

After suffering a series of public reverses, MoneySpinner has now introduced the latest measures of economic capital, made its capital allocation more efficient and has improved the profitability of its new products. It has already used these new techniques to improve its business development processes. Its first venture into the Chinese market is proceeding well and the group is now carrying out a structured evaluation of a series of products based on Islamic banking principles.

But not everything is plain sailing. Keen to cut costs as it knitted together the various companies that gave birth to the group, MoneySpinner cut corners on its information

technology systems and on its internal controls. The result was that the systems designed to collect data and manage risk were neither compatible nor up to date. Instead of amalgamating the records of thousands of clients from different subsidiaries as intended, the group sent many customers into limbo by losing their records altogether. Others were wrongly sent requests for extra payments on their credit cards when the company's computer systems defaulted to positions that bore no relation to the amounts on customers' accounts.

In investment banking, MoneySpinner decided to stop linking the pay of its analysts to performance after the bank was accused of, and fined for, touting the securities of unsound businesses in order to gain other types of business from these companies.

One of the group's fund management subsidiaries was accused, along with others, of 'late trading' – the practice of allowing professional investors such as hedge funds the chance to trade in their mutual funds after the

market has closed and thus profit at the expense of smaller investors. In return, MoneySpinner's mutual fund subsidiary got lucrative new business from the family of the owner of one particular hedge fund.

As a result of the scandal MoneySpinner found itself on the receiving end of yet another fine. But this paled into insignificance compared with the loss of business that resulted from the bad publicity and the subsequent slide in the share price and the impact on shareholder value. Not only were the pension funds of several public bodies forced to withdraw their business from MoneySpinner because of the fine but, stung by the revelation that the group had put its own interests ahead of theirs, thousands of small investors also voted with their feet.

The group's tarnished image was further tainted by candid remarks made the same week by the group's chairman. When asked by the media whether he was worried by the rising level of consumer debt, he replied (honestly) that, if he needed money, he would do what he could to

Uncertainty tamed?

The evolution of risk management in the financial services industry

The return of MoneySpinner continued

- ▶ Contents
- ▶ Executive summary
- ▶ The return of MoneySpinner
- ▶ Being aware is forewarned
- ▶ Invisible and lethal
- ▶ Conclusion
- ▶ Appendix: Survey results
- ▶ Contacts
- ▶ PricewaterhouseCoopers Global Financial Services Briefing Programme

avoid taking out a loan at high interest rates from one of the group's subsidiaries specialising in sub-prime business.

His robust defence in the same interview of the group's decision to switch 5,000 call-centre jobs to India poured fuel on the fire. Commentators and legislators in the US roundly criticised the firm for exporting jobs.

Over the past two years, the MoneySpinner Group has been forced to set aside more than US\$1bn in reserves against settlements or litigation that is still pending. Throughout all this, the group's earnings, buoyed by strong performances in the group's traditional banking businesses, have rebounded. But the group's share price has been falling for the best part of two years and its standing with customers, shareholders and regulators is at rock bottom.

Determined to reverse the slide in its fortunes, MoneySpinner's top brass decided to revamp the group's corporate governance structures,

by splitting the office of chairman and CEO. They also decided to embrace a slew of worthy causes such as sustainable agriculture and more sponsorship of the arts and education in the developing world. Will it make a difference? Most of the group's directors are content to see some favourable press coverage for a change, but it could take months or even years to filter through in the form of new business. By that time, the group that built itself up through a series of mergers could itself become a target for takeover or have to sell off bits in order to survive.

White-labelling: whose product is it anyway?

When financial institutions talk about focusing on their core competencies, they don't just mean spending less of their own time on call-centres and the back office. Often, they're referring to the products themselves. Take fund management. In Europe, more and more banks and providers of financial services are buying in from others the products they lack. While this is good business for the providers, it means that the intermediaries are putting their reputation on the line on the basis of somebody else's product.

According to Professional Wealth Management (PWM), a UK publication which tracks such things, banks and insurers in Europe are becoming increasingly open to the idea of white-labelling, under which investment management companies choose to distribute third party funds to their own clients. Traditionally, they used only to supply their own funds. Swiss and Italian institutions have been buying such products for some time, and the markets in France, Germany and Spain are now opening up to the same concept. Deutsche Bank and Commerzbank have both recently signed deals with a number

of providers of investment products, according to PWM, while ING and Fortis are talking to possible providers.

This may be fine while the investment funds that they are offering continue to perform well and their customers remain satisfied. But what happens if the provider fails to adhere to agreed investment objectives and loses money as a result? What happens, too, if there is a failure in the provider's back office, causing, say, unit holders' money to be paid late and in the wrong amount? Whose reputation is then on the line?

Uncertainty tamed?

The evolution of risk management in the financial services industry

The return of MoneySpinner continued

- ▶ Contents
- ▶ Executive summary
- ▶ The return of MoneySpinner
- ▶ Being aware is forewarned
- ▶ Invisible and lethal
- ▶ Conclusion
- ▶ Appendix: Survey results
- ▶ Contacts
- ▶ PricewaterhouseCoopers Global Financial Services Briefing Programme

Slippery concepts

MoneySpinner knows to its cost just how damaging reputational risk can be. But can it define the danger? It is significant that, in **Banana Skins 2003**, an annual survey of risks facing banks produced by the Centre for the Study of Financial Innovation and sponsored by PricewaterhouseCoopers, respondents referred to reputational risk repeatedly but were often at a loss to

know what to call it or how to categorise it. As a result, the CSFI found it difficult to 'rank' reputational risk, like credit risk, as a banana skin on which banks were prone to trip up.

At its most straightforward, it is the risk that a company's reputation might be eroded by adverse publicity, whether true or not, which could lead to a reduction in income because customers take their business elsewhere. In litigious places like America, this could result

in costly legal challenges which, in turn, undermine an organisation's reputation still further.

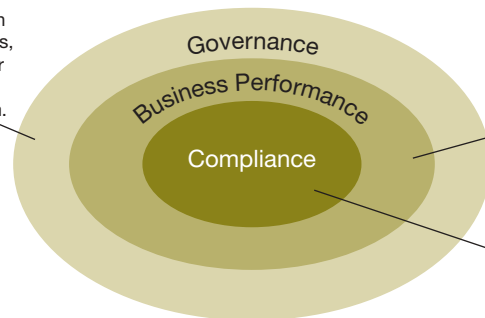
Some argue that reputational risk is not a separate class by itself but a by-product of others, such as fraudulent or incompetent behaviour. Others reckon that its definition can be cast wider still, to include business decisions which may make sense in the short term but which over time run the risk of undermining an organisation's franchise and so the sustainability of its business.

Dealing with reputational risk calls for good corporate governance, successful performance and risk management, and effective compliance, says Juan Pujadas of PricewaterhouseCoopers. Mr Pujadas visualises these three areas as a series of concentric circles. The outer layer is represented by governance – the environment and structure, in other words, in which a company and its employees operate. The middle layer represents the way in which a business performs – how it generates sales and how it controls the risks it takes in order

The sources of reputational risk

Reputational risk arises from failures of process, failures of strategy and failures of corporate governance. Companies must manage and monitor all these risks to protect their reputations.

The structure in which the company operates, who is responsible for what roles and accountable to whom.



How the business generates sales and how it controls the risks it takes in order to make profits on that turnover.

The formal checks, balances and policies with which the employees must comply, which ensure that the company is neither falling foul of regulators nor breaching the law.

Source: PricewaterhouseCoopers

Continued overleaf

Uncertainty tamed?

The evolution of risk management in the financial services industry

The return of MoneySpinner continued

- ▶ Contents
- ▶ Executive summary
- ▶ The return of MoneySpinner
- ▶ Being aware is forewarned
- ▶ Invisible and lethal
- ▶ Conclusion
- ▶ Appendix: Survey results
- ▶ Contacts
- ▶ PricewaterhouseCoopers Global Financial Services Briefing Programme

Slippery concepts continued

to make profits on that turnover. The third and innermost circle is compliance – the formal checks and balances which ensure that the company is neither falling foul of regulators nor breaching the law.

Each of these areas has to function properly for reputational risk to be successfully addressed. Without the accountability established through good governance it is quite possible that well-intentioned processes and controls can still result in questionable conclusions or decisions.

Similarly, without a rigorous structure of processes and controls, standards of governance are unlikely to be met.

Uncertainty tamed?

The evolution of risk management in the financial services industry

Being aware is forewarned

- ▶ Contents
- ▶ Executive summary
- ▶ The return of MoneySpinner
- ▶ Being aware is forewarned
- ▶ Invisible and lethal
- ▶ Conclusion
- ▶ Appendix: Survey results
- ▶ Contacts
- ▶ PricewaterhouseCoopers Global Financial Services Briefing Programme

With luck few companies in financial services are likely to be as accident prone as MoneySpinner, not least because there is clear evidence from our latest survey that companies have pushed risk management further up the corporate agenda.

Some 82% of respondents agreed that an awareness of risk is now more pervasive in their organisations than it was two years ago. Some 73% agreed that their organisations define their appetite for risk more clearly than a couple of years ago. Similar proportions agreed that the risk and finance functions as well as the risk and compliance divisions within their company have also become better integrated; 72% also said that senior managers now have greater access to risk data than they did.

But these encouraging numbers mask two serious and related concerns: first, are companies' good intentions matched by action and outcomes and second, are the right risks absorbing the attention of managers?

In many companies, the control of risk is still seen as a chore best carried out by a central risk group. The result is that an appraisal of the risks of a proposal to, say, launch a new product or, more especially, to pursue a major acquisition is not carried out when an initial decision to proceed is made but only comes later. By then, the company's risk officer may face an uphill task in trying to persuade his or

her colleagues of the potential pitfalls and the risk element of the risk/reward analysis.

When risk appraisals do take place, moreover, their quality and rigour can leave much to be desired. When asked in which business processes does their company have a structured approach to assessing risk, only 43% of respondents pointed to mergers and acquisitions and only slightly more (44%) to forming alliances and partnerships. Of course, these numbers disguise some large variations

between types of respondent – still fewer Asian institutions assess M&A risk in a structured manner, for example, while North American respondents performed better. But these low overall ratios remain surprising, not to say alarming.

Bruno Porro, Chief Risk Officer of Swiss Re Group, a big international re-insurer, believes that such an approach exposes organisations to dangers at the point where business decisions are made. He cites the example of an energy

In which of the following business processes does your organisation include a structured assessment of risk? (% of respondents)

New product development/approval	77%
Compliance	62%
Budgeting and financial reporting	54%
Strategy development	50%
Forming alliances and partnerships	44%
Merger and acquisition activity	43%
Entering new geographical markets	37%
Setting compensation policies	17%
Recruitment policies	17%
Other	7%

Source: PricewaterhouseCoopers/Economist Intelligence Unit survey, June-July 2004

Uncertainty tamed?

The evolution of risk management in the financial services industry

Being aware is forewarned continued

- ▶ Contents
- ▶ Executive summary
- ▶ The return of MoneySpinner
- ▶ Being aware is forewarned
- ▶ Invisible and lethal
- ▶ Conclusion
- ▶ Appendix: Survey results
- ▶ Contacts
- ▶ PricewaterhouseCoopers Global Financial Services Briefing Programme

group that transferred the ownership of part of an oil refinery to another owner. The assets were separated, as was the insurance cover. But the separated parts of the facility were left with a junction between pipes that went undiscovered by the box-tickers and was the eventual origin of a large uninsured loss.

Mr Porro goes further in suggesting that there is a dichotomy between the formal requirements of compliance and the effective management of risks. He maintains that, where possible, companies should incorporate the formal requirements of compliance into the day-to-day work flow of a business. This way those responsible for identifying and controlling risk are free to think through the consequences of their actions. 'You have to let people use their brains,' he says.

Bridging the compliance gap

The mounting burden of regulation in the wake of the corporate excesses of the past few years is forcing companies to expend significant effort complying with the rule book. Some firms look to risk management primarily to meet regulatory expectations and only secondarily to protecting franchise value.

It is significant that, when asked how their organisations demonstrate the value of their risk

How does your organisation demonstrate the value of its risk management systems and structures? (% of respondents)

Loss avoidance	73%
Contribution to improved shareholder value	50%
Favourable comments from analysts or regulators	47%
Lower volatility of earnings	46%
Other	5%

Source: PricewaterhouseCoopers/Economist Intelligence Unit survey, June-July 2004

management systems, almost half of the respondents to our survey cited 'favourable comments from analysts and regulators'. They might also have added ratings agencies, whose influence is growing fast. This was marginally more than said 'a contribution to shareholder value' and third only to a predictable catch-all of 'avoiding losses'.

When asked if their company measures its performance by using a measure of risk capital and, if so, for what purpose, a surprisingly high proportion (47%) of those questioned also cited 'satisfying regulatory requirements'. Indeed, some argue that upcoming changes in the international regulatory capital regime may create unnecessarily burdensome costs as financial institutions maintain an array of separate, complex models for regulatory, economic and perhaps even market reporting purposes.

We asked respondents to our survey what they regarded as the major causes of change during the past two years in their organisation's priorities over risk management. Regulatory pressure was chosen as an extremely significant driver of change by more respondents than any other driver. This result is borne out in other research: international regulation rose strongly (to number six from ten in 2002) in the **Banana Skins 2003** report.

Regulators are certainly demanding a lot more time and effort from companies than ever before. As well as the improved capital adequacy requirements under Basel II and the changes to be introduced under the new International Financial Reporting Standards (IFRS) – both of which will require even a small-to-medium-sized bank to pay an estimated US\$10m or so extra a year and involve thousands of hours of extra work –

Uncertainty tamed?

The evolution of risk management in the financial services industry

Being aware is forewarned continued

- ▶ Contents
- ▶ Executive summary
- ▶ The return of MoneySpinner
- ▶ Being aware is forewarned
- ▶ Invisible and lethal
- ▶ Conclusion
- ▶ Appendix: Survey results
- ▶ Contacts
- ▶ PricewaterhouseCoopers Global Financial Services Briefing Programme

there are the internal controls requirements of Section 404 of the Sarbanes-Oxley Act which requires controls over items in the financial statements (including the footnotes) to be documented and tested by management.

Regulation is not simply to be dismissed as pernicious, of course. Much of the governance-related legislation of the past two years addresses genuine failures on the part of financial and non-financial institutions. Similarly, aspects of Basel II will in effect require the use of some form of economic capital or other measures which link the levels of risk being run by an organisation with the amount of capital required to support it. For many smaller institutions, Basel II will mean a dramatic improvement in their risk management policies and procedures.

But according to Chris Matten, Executive Director with PricewaterhouseCoopers in Singapore, there is a danger that the cost of introducing Basel II will divert money that might have gone into other (possibly more effective) ways of managing risk. If Basel II becomes the de facto benchmark used by investment analysts, rating agencies and the like, it may be viewed as 'best practice'.

Mr Matten worries that this could effectively discourage further investment in other forms of risk measurement, such as the superior systems already being used by many large, international banks and investment houses.

Similarly, the evidence of a previous PricewaterhouseCoopers/EIU briefing is that good governance is equated by many institutions with meeting the demands placed on institutions by regulators and legislators, not with taking proactive steps to determine what it is that customers want over and above the minimum standards laid down by regulators (**Governance: From compliance to strategic advantage**).

Uncertainty tamed?

The evolution of risk management in the financial services industry

Invisible and lethal

- ▶ Contents
- ▶ Executive summary
- ▶ The return of MoneySpinner
- ▶ Being aware is forewarned
- ▶ Invisible and lethal
- ▶ Conclusion
- ▶ Appendix: Survey results
- ▶ Contacts
- ▶ PricewaterhouseCoopers Global Financial Services Briefing Programme

A majority of financial institutions have made good progress in addressing traditional forms of risk (such as credit and market risk) that are more easily quantified. Asked to rate the effectiveness of their organisation's risk management capabilities, survey respondents had most confidence in their ability to manage credit risk, liquidity risk, market risk and regulatory risk.

No one disputes that addressing and quantifying these risks fully is critical to the well-being of financial institutions. When asked which areas of risk represent the top area of potential threat to their organisation's earnings, survey respondents identified credit risk (37%) and market risk (31%) as their key areas of focus. Only 22% of respondents to our survey regarded reputational risk as one of their top areas of focus when considering the principal dangers to institutions' earnings.

But ensuring strong, steady earnings is not the only, or necessarily the most important, measure of successful risk management. The first step in recognising and guarding against any form of management risk, says Miles Everson, Advisory Partner for Financial Services with PricewaterhouseCoopers in New York, is to ask the question: risk to what? How much risk, in other words, is the organisation taking in relation to its business objectives and to the strategic aims understood by its various stakeholders (employees, shareholders, customers and the like)?

As MoneySpinner's tale of woe demonstrates, the less quantifiable forms of risk can do as much, if not more, damage to companies' reputations, shareholder value and the long-term sustainability of their business as the more straightforward types of risk. When asked which types of risk represent the greatest potential threat to their company's overall market value,

as opposed to earnings, more respondents (34%) cited reputational risk than any other, well ahead of the number who cited regulatory, market or credit risk.

Senior executives of financial institutions may appreciate the dangers of reputational risk to market value. But many are fuzzy about how to manage this and other less visible forms

Which areas of risk represent the greatest potential threat to your organisation's market value and earnings? (% of respondents rating as top area of focus; rank in brackets)

	Market value	Earnings
Reputational risk	34% (1)	22% (6)
Credit risk	25% (2)	37% (1)
Market risk	25% (3)	31% (2)
Regulatory risk	18% (4)	25% (3)
Business/strategic risk	16% (5)	23% (4=)
Operational risk	14% (6)	23% (4=)
Business continuity risk	13% (7=)	13% (8=)
IT/technology risk	13% (7=)	8% (10=)
Treasury/liquidity planning	10% (9)	19% (6)
Governance risk	7% (10=)	13% (8=)
Sovereign/political risk	7% (10=)	8% (10=)

Source: PricewaterhouseCoopers/Economist Intelligence Unit survey, June-July 2004

Uncertainty tamed?

The evolution of risk management in the financial services industry

Invisible and lethal continued

- ▶ Contents
- ▶ Executive summary
- ▶ The return of MoneySpinner
- ▶ Being aware is forewarned
- ▶ Invisible and lethal
- ▶ Conclusion
- ▶ Appendix: Survey results
- ▶ Contacts
- ▶ PricewaterhouseCoopers Global Financial Services Briefing Programme

of risk. Respondents' confidence in their organisations' risk management capabilities dipped markedly in less traditional areas of risk. Some 24% felt their institution was ineffective in dealing with reputational risk; even more took the same view of sovereign and political risks such as geopolitical events and changes of government (see case study).

The difficulties of quantifying these less visible forms of risk may help to explain why many organisations feel they are less than effective in dealing with them. When we asked respondents what technologies or methodologies their companies used to gauge levels of risk, for example, only 16% actually admitted to quantifying intangible risks. This compares with the substantial majority who reported having implemented risk-calculation programmes and reporting and disclosure technologies.

This finding is borne out by the results of a recent survey on enterprise risk management (ERM) among insurers carried out by PricewaterhouseCoopers², which found that, while many insurers have implemented advanced methods of tackling financial risk, many lagged woefully behind in understanding, let alone doing something about, the dangers posed by the more intangible forms of risk.

Case Study: Coming to grips with political risk

Political risk can be classed in two broad categories, which can occur together or separately. One, usually termed country, cross-border or emerging markets risk, is focused on the risk related to such things as the ability to transfer capital between countries and to convert currencies freely. The other, which might be called pure political risk, includes abrupt changes to the way a bank can operate in a country because of such things as government or regulatory interference, including expropriation, loss of licences and policy changes. Tackling these different types of risk takes different types of skills.

According to Elbert Pattijn, Managing Director, Credit Risk Management at ING Group, the Dutch institution uses quantifiable methods such as modelling, stress testing and scenario planning to assess credit and country risk. For country risk, Pattijn's team models currency transfer and convertibility restraints by looking at bond spreads, internal models, historical default and market pricing. 'We attach great value to being able to quantify these risks in order to paint scenarios if something goes

wrong,' he says. ING also has a special emerging markets committee for country risk comprised of risk and line managers who help set country strategy.

For other types of political risk, more qualitative measures are needed. Take the risk of expropriation. Mr Pattijn says it can't be quantified since it is based on a country's willingness rather than on its ability to pay. He also notes that with such events, history is not necessarily a good predictor of future behaviour since governments change. 'The fact that a country has a history of doing this doesn't tell you that the new government will do the same,' he says.

First, in-depth research helps identify the risks. Then, the country risk research team rates the risk high or low and uses this judgement to accept or decline proposals for new business. If ING sees new risk beyond its comfort levels in existing positions, it can change the risk parameters in its models to reflect the new insight, do less new business, restructure loans, or structure deals to avoid political risk. 'For every country, we have very specific lending advice of the type of business we

Continued overleaf

² Enterprise-wide Risk Management for the Insurance Industry, Global Study, PricewaterhouseCoopers, 2004

Uncertainty tamed?

The evolution of risk management in the financial services industry

Invisible and lethal continued

- ▶ Contents
- ▶ Executive summary
- ▶ The return of MoneySpinner
- ▶ Being aware is forewarned
- ▶ Invisible and lethal
- ▶ Conclusion
- ▶ Appendix: Survey results
- ▶ Contacts
- ▶ PricewaterhouseCoopers Global Financial Services Briefing Programme

Case Study: Coming to grips with political risk continued

want to do there which is completely geared to its individual risk profile,' says Mr Pattijn.

'We don't run with any models or machinery that can use methodology to predict or manage pure political risk,' agrees the Chief Risk Officer of another large European bank. 'We really have to manage it by being closely involved on the scene, working with local government where we can, and advisors where we need to, and trying to find as many avenues of influence as are available.'

As for taking corrective action for this type of political risk, this CRO sees limited options. Besides pleading with the government or regulators to reverse course, he says a bank can pay high premiums to insurers or banks to buy political risk insurance. And while it cannot directly hedge against a government action, it can protect itself indirectly by investing in instruments that might benefit from policy change.

Techniques to quantify such risks are evolving, however. Tina Trickett, who specialises in corporate governance and social responsibility for PricewaterhouseCoopers in London, points out that there are now sophisticated tests that can be applied to an organisation's structure. By using a mixture of forecasting techniques and case studies of what has happened to similar organisations, it is possible to find out where a company's particular 'hot spots' lie. Scenarios are then played out in order to see how the subject company would react if placed in a similar predicament.

Such tests can be useful in determining a company's vulnerability to reputational risk. Scores in the form of performance indicators are given to an organisation's preparedness. If the

result is negative, the company knows it has a lot of work to do. The process is made more complicated, of course, by the fact that many international financial institutions operate in hundreds of different territories, each one with a different regulatory regime.

Thanks to the requirements of operating financial reviews in annual reports, some banks and other financial institutions are also beginning to put hard numbers on the value of reputation and therefore on the risk of it being impugned. In an organisation driven by profit and loss, translating a reputation into an asset helps to concentrate the mind and makes it easier for managers to judge whether an organisation is making progress or going backwards.

Which risk management-related technologies and methodologies have your organisation implemented? (% of respondents)

Risk calculation programmes (VAR, credit exposure, etc.)	68%
Reporting and disclosure technologies	62%
Data-mining, storage and integration technologies	49%
Limits management technologies	47%
Risk-return analytics technology	46%
Corporate performance management technologies	32%
On-demand computing (to accelerate compute-intensive calculations)	20%
Quantification of intangible risks	16%
Reputational risk assessment tools	11%

Source: PricewaterhouseCoopers/Economist Intelligence Unit survey, June-July 2004

Uncertainty tamed?

The evolution of risk management in the financial services industry

Invisible and lethal continued

- ▶ Contents
- ▶ Executive summary
- ▶ The return of MoneySpinner
- ▶ Being aware is forewarned
- ▶ Invisible and lethal
- ▶ Conclusion
- ▶ Appendix: Survey results
- ▶ Contacts
- ▶ PricewaterhouseCoopers Global Financial Services Briefing Programme

Case study: What's in a brand?

'For us, reputational risk is a big part of the end game of risk management,' says Tim Robison, Chief Risk and Compliance Officer at Mellon Financial Corp, a Pennsylvania-based global financial services provider. Mellon either has or is instituting a number of procedures that help keep reputational risk front of mind.

These include:

- Board-level support through a separate risk management committee for which a big focus is the reputational impact of business decisions;
- The CEO's support of risk management, which sends a message that protecting Mellon's reputation is a key goal;
- Frequent reinforcement to the business lines of the message that tackling their major risks keeps reputational harm at bay;
- A measuring system for firm-wide errors to make sure that mistakes that alienate clients are kept to a minimum;
- Training that stresses the importance of pursuing actions that enhance the company's standing; and

- The implementation across Mellon's operations worldwide of web-based software that will highlight operational errors and send emails to line and risk managers when acceptable thresholds are surpassed.

To Mr Robison, the support of the CEO and the board is crucial to prevent risks from tainting Mellon's reputation partly because it encourages co-operation between the line and risk managers. 'Top-level support is the most important thing because, without it, nothing else will really function consistently, smoothly, effectively or for very long without being marginalised,' he says.

With policies set, the line managers and the risk team within the six business sectors work together to identify and define each area's top eight to ten risks, many of which explicitly cite reputational damage as one consequence of missteps. These managers then set reasonable thresholds for error. 'We want to make sure that we are all in agreement from a top-down perspective on what the major risks are – the things that can potentially hurt our reputation the most,' says Mr Robison.

Risk managers, assigned to Mellon's businesses but reporting to Mr Robison, must approve new or modified products, new business generally and changes to business processes. 'We have a template for people to follow which prompts them to get at all the areas of risk that should be considered when introducing a new product. Reputation is right there,' he says.

Mellon also actively trains its employees to follow the risk policies and processes that will help guard its name. 'All 20,000 employees have the potential to do something to enhance or destroy our reputation. By instilling risk management fundamentals, they will recognise why they need this attention to risk,' says Mr Robison.

Part of the training involves inculcating employees with the idea that any time a customer is approached with any kind of error, Mellon's reputation is at risk. This reflects the continuing evolution of risk management in the industry, which in the past focused primarily on financial cost, not on possible damage to the company's reputation.

Continued overleaf

Uncertainty tamed?

The evolution of risk management in the financial services industry

Invisible and lethal continued

- ▶ Contents
- ▶ Executive summary
- ▶ The return of MoneySpinner
- ▶ Being aware is forewarned
- ▶ Invisible and lethal
- ▶ Conclusion
- ▶ Appendix: Survey results
- ▶ Contacts
- ▶ PricewaterhouseCoopers Global Financial Services Briefing Programme

Case study: What's in a brand? continued

Further, over the next nine months, Mellon is installing new web-based software on desktops across all of its businesses around the world to help line managers detect operational risk early and to enable the company's risk managers to track errors so that they can be communicated upwards in the organisation and remedied quickly. Unacceptable risks will move from green to amber and to red on-screen as they pass pre-determined thresholds for key risk indicators, losses and errors. At that point, the line manager and the risk group will be emailed a warning.

The case for moral capital

The ever wider choice open to individual and wholesale customers alike has made brands in financial services important as never before. Financial institutions know, too, that it is becoming harder to stand out simply on the basis of the products and services they offer. What you stand for and how you go about what you do – what Bernard Allorent, Head of Risk Management at BNP Paribas, has dubbed an organisation's 'moral capital' – is increasingly as important as the product or service you provide.

Toby Hoare, a Global Client Leader with WPP, an advertising and marketing group that recently won the estimated US\$600m global advertising account for HSBC, concedes that building a brand, particularly one that crosses borders, is a difficult thing to do. That, however, is only part of the challenge. 'Many companies then struggle to convince people that the difference is relevant to the customer,' he says. And until he or she is convinced, a customer is likely to remain fickle.

Peter Simpson, Commercial Director of First Direct, an online bank owned by HSBC, believes that if you have the right philosophy and approach to your business, the rest tends to fall into line. 'You have to have all the usual things, like compliance and legal safeguards,

but in the end it comes down to the simple question: do we believe that we are doing a good job for our customers?'

Often this is as much about changing the culture of an organisation so that the instinct to treat customers and other key stakeholders well is embedded throughout the institution. Yet the evidence of our survey suggests that many senior executives still fail to grasp the importance of behaviour, ethics and governance in building a brand. Respondents to our survey pointed to such things as poor product design and performance (30%) or the poor financial performance of their organisation as a whole (57%) as major sources of reputational risk. Tellingly, poor ethics, poor treatment of employees and the conduct of senior executives received little attention from respondents.

What to do when a reputation is under threat? Most companies have (or should have) a manual which sets out how managers will deal with a public relations disaster: which director or directors speak on behalf of the firm; who decides what the agreed messages should be; who coordinates the drafting of statements and any responses on the record; what input is required from advisers; and when and if to alert lawyers should they be needed.

Uncertainty tamed?

The evolution of risk management in the financial services industry

Invisible and lethal continued

- ▶ Contents
- ▶ Executive summary
- ▶ The return of MoneySpinner
- ▶ Being aware is forewarned
- ▶ Invisible and lethal
- ▶ Conclusion
- ▶ Appendix: Survey results
- ▶ Contacts
- ▶ PricewaterhouseCoopers Global Financial Services Briefing Programme

Such processes are clearly critical but Mr Simpson believes that, in a retail organisation, a lot depends on culture and training. How a company reacts to problems of its own or others' making will determine whether its customers vote with their feet or not. Mr Hoare believes that humility goes a long way in binding people to a brand in the first place and in preventing them from deserting it should something go wrong.

Tim Robison, Chief Risk and Compliance Officer at Mellon Financial Corp, believes that speed is vital in rectifying mistakes that could ruin a reputation. 'We want to make sure that all employees know that if they think they have uncovered a problem, they should elevate it quickly and not worry if they don't have all the facts. Elevation gets enough eyes on it so that if there is a problem, we can jump on it as quickly as possible and have the best shot at minimising any damage, whether financial, customer-related or reputational,' he says.

Taking a holistic view of risk is also critical. Respondents to the recent PricewaterhouseCoopers survey of insurers agreed that ERM, which integrates the way

a firm looks at risk across the enterprise, is one of the best ways of guarding against operational risks that might endanger either a company's relations with regulators or the business's reputation. The new ERM framework being developed by the Committee of Sponsoring Organisations of the Treadway Commission (COSO) is likely to establish a benchmark in this area.

Just as important is the need to recognise that reputational risk management extends well beyond the boundaries of one's own enterprise. One of the lessons of recent scandals is that financial services institutions can be damaged by wrongful actions on the part of their customers, suppliers and partners – particularly if they consciously facilitate wrongdoing but also because they can be tarnished by association with a crooked third party. Some firms have implemented measures to monitor and analyse transactions with third parties, especially at quarter-end and year-end; others are reassessing their agreements with distributors and suppliers as they seek to protect themselves from potential liabilities and reputational harm stemming from their external relationships.

Uncertainty tamed?

The evolution of risk management in the financial services industry

Conclusion

- ▶ Contents
- ▶ Executive summary
- ▶ The return of MoneySpinner
- ▶ Being aware is forewarned
- ▶ Invisible and lethal
- ▶ Conclusion
- ▶ Appendix: Survey results
- ▶ Contacts
- ▶ PricewaterhouseCoopers Global Financial Services Briefing Programme

Some risks don't come in easily distinguishable wrappers. More than two in five respondents to our survey believe that the greatest risks to an organisation's market value are 'unknown' – the unexpected sources of danger that materialise suddenly and at a stroke, cause a company to reorder its priorities for risk management. As we have seen from the raft of scandals to have hit the industry of late, all of which have a conflict of interest at their heart, financial services has too often found itself playing catch-up instead of anticipating and managing the risks it faces.

The survey suggests that leading institutions are now consciously making efforts to tease out the shape of these unseen risks. According to one survey respondent: 'We moved from a passive approach to an active one, anticipating requirements of the regulatory bodies and trying to identify through internal risk audits the areas which are not presently covered.' Other approaches that are gaining ground include conducting workshops to discuss potential blind spots, scenario planning and cross-industry reviews to ascertain potential sources of danger and best practices.

Such exercises are undoubtedly valuable. But an even more critical imperative is for financial institutions to learn the lesson that breaching the trust of customers and other stakeholders can never be justified, whatever the potential for short-term gain. 'It would be folly to take action which may not be in your customers' best interests and expect the brand to remain intact,' says Mr Simpson at First Direct.

Benoît Catherine, Partner, Financial Risk Management with PricewaterhouseCoopers in Paris agrees: 'The benefits of building a sustainable business – one that deals honestly with its various stakeholders in as open a manner as possible – will invariably outweigh any snags in the short term.'

Uncertainty tamed?

The evolution of risk management in the financial services industry

Appendix: Survey results

- ▶ Contents
- ▶ Executive summary
- ▶ The return of MoneySpinner
- ▶ Being aware is forewarned
- ▶ Invisible and lethal
- ▶ Conclusion
- ▶ Appendix: Survey results
- ▶ Contacts
- ▶ PricewaterhouseCoopers Global Financial Services Briefing Programme

The Economist Intelligence Unit and PricewaterhouseCoopers conducted a special online survey of senior executives in financial institutions on the subject of risk management. Executives from 134 institutions in Asia, Europe and North America participated in the survey, which was conducted during June and July 2004. Our thanks are due to all those who participated for sharing their insights with us.

Answers are shown as percentages of the total respondent base, except for questions 11 and 12, where answers are shown as percentages of those respondents answering 'yes' to question 10.

Please note that totals do not always add up to 100 because of rounding, or because respondents could choose more than one answer.

Demographics

1. In which region are you based?

Europe	38%
North America	23%
Asia	20%
Middle East/Africa	12%
Latin America	7%

2. In which region is your institution headquartered?

Europe	36%
North America	23%
Asia	19%
Middle East/Africa	12%
Latin America	7%
N/a	3%

3. What is your title and area of responsibility? Please check all that apply.

Senior management	39%
Risk management	34%
Board member	21%
Finance	18%
Line manager	14%
Strategy/planning	14%
Internal audit	9%
Marketing and communications	8%
Operations	8%
Investor relations	7%
Legal	4%
Human resources	3%

Uncertainty tamed?

The evolution of risk management in the financial services industry

Appendix: Survey results continued

- ▶ Contents
- ▶ Executive summary
- ▶ The return of MoneySpinner
- ▶ Being aware is forewarned
- ▶ Invisible and lethal
- ▶ Conclusion
- ▶ Appendix: Survey results
- ▶ Contacts
- ▶ PricewaterhouseCoopers Global Financial Services Briefing Programme

4. What area of financial services do you work in? Please check all that apply.

Corporate banking	28%
Investment banking	26%
Retail banking	25%
Private banking	11%
Capital markets	29%
Investment management	27%
Non-life insurance	15%
Life insurance	13%
Reinsurance	8%
Private equity	12%
Outsourcing services provision	4%

5. What was your organisation's total global income, in US dollars, in 2003?

Less than \$500m	38%
\$500m-\$1bn	16%
\$1bn-\$3bn	12%
\$3bn-\$8bn	6%
Over \$8bn	19%
N/a	9%

Organising risk management

6. What level of attention do the main board and board-level committees at your organisation pay to risk-related issues? Please check all that apply.

The main board discusses risk issues on an ad hoc basis	49%
An executive with specific responsibility for risk management sits on the main board	40%
Risks and risk management are routinely discussed by the audit committee	38%
Risks and risk management are discussed in detail at all main board meetings	31%
All major decisions require interaction with and approval from the group risk management committee	31%
The main board conducts a cursory review of risks and risk management at all meetings	30%
There is a sub-committee of non-executives which reviews risk issues in detail	28%

7. Which of the following board-level risk-related committees does your organisation have? Please check all that apply.

Asset and liabilities committee	48%
Group risk management committee	42%
Credit risk committee	40%
Market risk committee	37%
Operational risk committee	35%
Governance committee	26%
Commitment committee	3%
Other	13%

Uncertainty tamed?

The evolution of risk management in the financial services industry

Appendix: Survey results continued

- ▶ Contents
- ▶ Executive summary
- ▶ The return of MoneySpinner
- ▶ Being aware is forewarned
- ▶ Invisible and lethal
- ▶ Conclusion
- ▶ Appendix: Survey results
- ▶ Contacts
- ▶ PricewaterhouseCoopers Global Financial Services Briefing Programme

8. What do you estimate your organisation's risk-related expenditure to be as a percentage of its overall expenses two years ago, currently and two years hence?

	1 Under 1%	2 1-5%	3 6-10%	4 Over 10%	5 Not sure/na
1. Two years ago	34%	32%	7%	7%	19%
2. Currently	19%	39%	13%	13%	16%
3. Two years from now	11%	38%	16%	13%	21%

9. What investment in risk management-related resources is your institution planning to make over the coming 12 months?

	1 Decrease in investment	2 No change in investment	3 0-5% increase	4 5-10% increase	5 10-15% increase	6 15-25% increase	7 More than 25% increase	8 N/a
1. People	3%	39%	28%	14%	7%	3%	3%	2%
2. Data	0%	22%	26%	26%	13%	5%	4%	4%
3. Technology	0%	16%	26%	28%	13%	7%	6%	4%

Uncertainty tamed?

The evolution of risk management in the financial services industry

Appendix: Survey results continued

- ▶ Contents
- ▶ Executive summary
- ▶ The return of MoneySpinner
- ▶ Being aware is forewarned
- ▶ Invisible and lethal
- ▶ Conclusion
- ▶ Appendix: Survey results
- ▶ Contacts
- ▶ PricewaterhouseCoopers Global Financial Services Briefing Programme

10. In which of the following business processes does your organisation include a structured assessment of risk? Please check as many as apply.

New product development/approval	77%
Compliance	62%
Budgeting and financial reporting	54%
Strategy development	50%
Forming alliances and partnerships	44%
Merger and acquisition activity	43%
Entering new geographical markets	37%
Setting compensation policies	17%
Recruitment policies	17%
Other	7%

11. Which risk management-related technologies and methodologies have your organisation implemented? Please check all that apply.

Risk calculation programmes (VAR, credit exposure, etc.)	68%
Reporting and disclosure technologies	62%
Data-mining, storage and integration technologies	49%
Limits management technologies	47%
Risk-return analytics technology	46%
Corporate performance management technologies	32%
On-demand computing (to accelerate compute-intensive calculations)	20%
Quantification of intangible risks	16%
Reputational risk assessment tools	11%
XBRL	1%

12. What has been the impact of changes to risk management processes and practices implemented by your institution over the past two years? Please state whether you agree or disagree with the following statements.

	1 Agree	2 Disagree	3 N/a
An awareness of risk is now far more pervasive in our organisation than it was two years ago	82%	13%	5%
The risk and compliance functions have become more tightly integrated over the past two years	75%	22%	3%
We define our organisation's risk appetite more clearly than we did two years ago	73%	20%	7%
Risk management is more central to our interaction with regulators and ratings agencies than it was two years ago	72%	21%	7%
Senior managers have access to more timely risk data and information about the business than they did two years ago	72%	22%	6%
The risk and finance functions have become more tightly integrated over the past two years	68%	24%	8%
The organisation takes the long-term sustainability and reputation of its business into greater account when launching new products or entering new businesses than it did two years ago	66%	19%	15%
Responsibility for enterprise-wide risk management sits higher up the organisation than it did two years ago	49%	34%	17%

Uncertainty tamed?

The evolution of risk management in the financial services industry

Appendix: Survey results continued

- ▶ Contents
- ▶ Executive summary
- ▶ The return of MoneySpinner
- ▶ Being aware is forewarned
- ▶ Invisible and lethal
- ▶ Conclusion
- ▶ Appendix: Survey results
- ▶ Contacts
- ▶ PricewaterhouseCoopers Global Financial Services Briefing Programme

13. How does your organisation demonstrate the value of its risk management systems and structures? Please check all that apply.

Loss avoidance	73%
Contribution to improved shareholder value	50%
Favourable comments from analysts or regulators	47%
Lower volatility of earnings	46%
Other	5%

14. How effective are your organisation's risk management capabilities in addressing each of the following areas? Please rate each area between 1 and 4, where 1 = Extremely effective and 4 = Extremely ineffective.

	1 Extremely effective	2 Effective	3 Ineffective	4 Extremely ineffective	5 N/a
Credit risk	31%	57%	11%	0%	1%
Treasury/liquidity planning	25%	60%	11%	1%	3%
Market risk	25%	63%	11%	0%	1%
Regulatory risk	22%	66%	10%	1%	1%
Governance risk	18%	60%	20%	1%	1%
Business continuity risk	18%	59%	20%	0%	3%
Sovereign/political risk	16%	51%	28%	3%	2%
Reputational risk	13%	62%	24%	1%	0%
Business/strategic risk	13%	66%	19%	0%	2%
Operational risk	11%	75%	14%	0%	0%
IT/technology risk	8%	68%	23%	0%	1%

Uncertainty tamed?

The evolution of risk management in the financial services industry

Appendix: Survey results continued

- ▶ Contents
- ▶ Executive summary
- ▶ The return of MoneySpinner
- ▶ Being aware is forewarned
- ▶ Invisible and lethal
- ▶ Conclusion
- ▶ Appendix: Survey results
- ▶ Contacts
- ▶ PricewaterhouseCoopers Global Financial Services Briefing Programme

15. Does your organisation assess its performance on some measure of risk-adjusted capital?

Yes	69%
No	31%

16. If your organisation assesses its performance on a measure of risk-adjusted capital, for what purposes does it do so? Please check all that apply.

Improving understanding of risk throughout the business	65%
Improving capital adequacy	63%
Making investment decisions on particular lines of business or acquisitions	60%
Setting product pricing	47%
Satisfying regulatory requirements	47%
Improving transparency of disclosure to shareholders	32%
Paying bonuses	22%
Setting remuneration for senior executives	20%
Other	2%

17. If your organisation assesses its performance on a measure of risk-adjusted capital, please rate how effective it has been at meeting the following objectives on a scale between 1 and 4, where 1 = Very effective and 4 = Very ineffective.

	1 Very effective	2 Effective	3 Ineffective	4 Very ineffective	5 N/a
Greater understanding of risk on part of business units	24%	64%	7%	1%	4%
More efficient allocation of capital to lines of business	22%	62%	12%	0%	4%
Enhanced capital adequacy	18%	61%	17%	0%	4%
More appropriate pricing levels	17%	63%	15%	0%	5%
Satisfying regulatory requirements	17%	64%	14%	0%	5%
Clearer reporting and disclosure to shareholders	12%	58%	17%	4%	9%
Greater profitability for individual lines of business	9%	71%	15%	0%	5%
Better alignment between bonuses and performance	5%	48%	34%	4%	9%
More appropriate remuneration packages for senior executives	3%	39%	45%	5%	8%

Uncertainty tamed?

The evolution of risk management in the financial services industry

Appendix: Survey results continued

- ▶ Contents
- ▶ Executive summary
- ▶ The return of MoneySpinner
- ▶ Being aware is forewarned
- ▶ Invisible and lethal
- ▶ Conclusion
- ▶ Appendix: Survey results
- ▶ Contacts
- ▶ PricewaterhouseCoopers Global Financial Services Briefing Programme

The risk management agenda

18. Which areas of risk represent the greatest potential threat to your organisation's earnings?

Please rate each risk between 1 and 4, where 1 = Among the top areas of focus and 4 = Not an area of focus.

	1 Top area of focus	2 Major area of focus	3 Minor area of focus	4 Not an area of focus	5 N/a
Credit risk	37%	34%	24%	5%	0%
Market risk	31%	54%	13%	1%	1%
Regulatory risk	25%	40%	27%	7%	1%
Business/strategic risk	23%	54%	19%	1%	3%
Operational risk	23%	51%	25%	1%	0%
Reputational risk	22%	40%	35%	1%	2%
Treasury/liquidity planning	19%	46%	31%	2%	2%
Governance risk	13%	41%	40%	4%	2%
Business continuity risk	13%	37%	47%	2%	1%
Sovereign/political risk	8%	31%	46%	14%	1%
IT/technology risk	8%	55%	34%	2%	1%

Uncertainty tamed?

The evolution of risk management in the financial services industry

Appendix: Survey results continued

- ▶ Contents
- ▶ Executive summary
- ▶ The return of MoneySpinner
- ▶ Being aware is forewarned
- ▶ Invisible and lethal
- ▶ Conclusion
- ▶ Appendix: Survey results
- ▶ Contacts
- ▶ PricewaterhouseCoopers Global Financial Services Briefing Programme

19. Which of the following types of risk represent the greatest potential threat to your organisation's overall market value? Please rate each risk between 1 and 4, where 1 = Among the greatest threats and 4 = Not a threat.

	1 Greatest threat	2 Major threat	3 Minor threat	4 Not a threat	5 N/a
Reputational risk	34%	41%	20%	2%	3%
Market risk	25%	51%	19%	2%	3%
Credit risk	25%	31%	37%	5%	2%
Regulatory risk	18%	40%	33%	7%	2%
Business/strategic risk	16%	54%	25%	1%	4%
Operational risk	14%	57%	24%	2%	3%
IT/technology risk	13%	40%	37%	7%	3%
Business continuity risk	13%	37%	43%	4%	3%
Treasury/liquidity planning	10%	40%	43%	5%	2%
Governance risk	7%	40%	46%	4%	3%
Sovereign/political risk	7%	23%	51%	16%	3%

20. The greatest risks to organisations' market value are often unexpected. In your experience, are the biggest threats to your organisation's market value known sources of risk or unknown sources of risk?

Known	57%
Unknown	43%
N/a	3%

Uncertainty tamed?

The evolution of risk management in the financial services industry

Appendix: Survey results continued

- ▶ Contents
- ▶ Executive summary
- ▶ The return of MoneySpinner
- ▶ Being aware is forewarned
- ▶ Invisible and lethal
- ▶ Conclusion
- ▶ Appendix: Survey results
- ▶ Contacts
- ▶ PricewaterhouseCoopers Global Financial Services Briefing Programme

21. What have been the major drivers of change in your organisation's risk management priorities over the past two years? Please rate each driver between 1 and 4, where 1 = An extremely significant driver and 4 = Not a driver.

	1 Extremely significant driver	2 Major driver	3 Minor driver	4 Not a driver	5 N/a
Regulatory pressures	31%	41%	23%	4%	1%
Financial market volatility	22%	52%	21%	3%	2%
Evidence that risk management can confer strategic advantage	17%	38%	37%	7%	1%
Governance scandals affecting other financial institutions or major corporates	16%	32%	40%	12%	0%
Demands for corporate transparency and accountability	16%	40%	31%	11%	2%
Increased levels of IT security risk	13%	43%	35%	6%	3%
Increased shareholder focus on risk management practices	9%	39%	38%	13%	1%
Macroeconomic volatility	8%	50%	36%	6%	0%
Threat of terrorist activity	4%	14%	45%	37%	0%
Increased offshoring activities leading to greater emphasis on business continuity, etc.	2%	17%	43%	37%	1%
Increased levels of geopolitical risk	2%	21%	52%	24%	1%

Uncertainty tamed?

The evolution of risk management in the financial services industry

Appendix: Survey results continued

- ▶ Contents
- ▶ Executive summary
- ▶ The return of MoneySpinner
- ▶ Being aware is forewarned
- ▶ Invisible and lethal
- ▶ Conclusion
- ▶ Appendix: Survey results
- ▶ Contacts
- ▶ PricewaterhouseCoopers Global Financial Services Briefing Programme

22. What are the main sources of reputational risk for your organisation? Please check the top three sources of risk it faces.

Financial underperformance of institution as a whole	57%
Poor customer service	50%
Compliance failures	39%
Poor product design and performance	30%
Failures of corporate governance/poor management and leadership	28%
Negative publicity around major issues of conduct (i.e. outsourcing)	26%
Perceived or actual failures in corporate transparency and business ethics	25%
Association with partners, suppliers or customers with poor reputation	23%
Generally poor image of the industry as a whole	19%
Conduct of senior executives	18%
Poor treatment of employees	11%
Perceived or actual inequities associated with remuneration of senior management	8%
Other	2%

23. What are the main sources of political risk for your organisation? Please check the top three sources of risk it faces.

Impact of geopolitical events on economic climate	58%
Changes of government and government policy in emerging markets	45%
Risk of rising red tape and bureaucracy	44%
Government interference in product pricing	36%
Changes of government and government policy in developed markets	34%
Corruption among governing classes	22%
Direct terrorist threats to staff and property	15%
Impact of terrorist threats on customers	14%
Cultural, religious and ethnic schisms that impede our organisation from operating successfully in other markets because of our nationality	12%
Other	4%

24. What are the principal sources of strategic/business risk for your organisation? Please check the top three sources of risk it faces.

Increased competition	75%
Underperforming products and services	57%
Failure to attract and retain key staff	46%
Mismanagement	36%
Inappropriate pricing strategies	36%
Slow time to market for new products	25%
Other	4%

Uncertainty tamed?

The evolution of risk management in the financial services industry

Contacts

- ▶ Contents
- ▶ Executive summary
- ▶ The return of MoneySpinner
- ▶ Being aware is forewarned
- ▶ Invisible and lethal
- ▶ Conclusion
- ▶ Appendix: Survey results
- ▶ Contacts
- ▶ PricewaterhouseCoopers Global Financial Services Briefing Programme

If you would like to discuss any of the issues raised in this survey in more detail please speak to your usual contact at PricewaterhouseCoopers or call one of the following:

Uncertainty tamed? The evolution of risk management in the financial services industry

Editorial board

Barry Benjamin
1 410 783 7623
barry.p.benjamin@us.pwc.com

Diane A. Kazarian
1 416 365 8228
diane.a.kazarian@ca.pwc.com

Leen Paape
31 65 3644 623
leen.paape@nl.pwc.com

Mark Train
44 20 7804 6279
mark.train@uk.pwc.com

Benoît Catherine
33 1 56 57 12 38
benoit.catherine@fr.pwc.com

Miles Kennedy
61 2 8266 5193
miles.kennedy@au.pwc.com

Juan Pujadas
1 646 471 7782
juan.pujadas@us.pwc.com

Tina Trickett
44 20 7804 2569
tina.trickett@uk.pwc.com

Rahoul Chowdry*
61 2 8266 2741
rahoul.chowdry@au.pwc.com

William J. Lewis
1 202 414 4339
bill.lewis@us.pwc.com

Phil Rivett*
44 20 7212 4686
phil.g.rivett@uk.pwc.com

Shyam Venkat
1 646 471 8296
shyam.venkat@us.pwc.com

Ian Dilks*
44 20 7212 4658
ian.e.dilks@uk.pwc.com

Peter Li
852 2289 2982
peter.pt.li@hk.pwc.com

Jose Luis Lopez Rodriguez
34 91 568 4445
jose.luis.lopez.rodriguez@es.pwc.com

Jerry Whelan
1 416 365 8209
jerry.whelan@ca.pwc.com

Miles E. A. Everson
1 646 471 8620
miles.everson@us.pwc.com

Chris Matten
65 6236 3878
chris.matten@sg.pwc.com

Richard Smith
44 20 7213 4705
richard.r.smith@uk.pwc.com

Hajime Yasui
81 3 5532 3041
hajime.yasui@jp.pwc.com

Paul L. Horgan
1 646 471 8880
paul.l.horgan@us.pwc.com

Fernando de la Mora
1 646 471 5257
fernando.de.la.mora@us.pwc.com

Felix Sutter
41 1 630 2820
felix.sutter@ch.pwc.com

* Member of the Global Financial Services Leadership Team

Uncertainty tamed?

The evolution of risk management in the financial services industry

Contacts *continued*

- ▶ Contents
- ▶ Executive summary
- ▶ The return of MoneySpinner
- ▶ Being aware is forewarned
- ▶ Invisible and lethal
- ▶ Conclusion
- ▶ Appendix: Survey results
- ▶ Contacts
- ▶ PricewaterhouseCoopers Global Financial Services Briefing Programme

Global Financial Services Leadership Team**Jeremy Scott**

Chairman, Global Financial
Services Leadership Team
44 20 7804 2304
jeremy.scott@uk.pwc.com

Thomas F. Barrett

1 617 530 7363
thomas.f.barrett@us.pwc.com

Etienne Boris

33 1 56 57 1029
etienne.boris@fr.pwc.com

Javier Casas Rúa

54 11 4891 4550
javier.casas.rua@ar.pwc.com

Rahoul Chowdry

61 2 8266 2741
rahoul.chowdry@au.pwc.com

Richard Stuart Collier

44 20 7212 3395
richard.stuart.collier@uk.pwc.com

Ian Dilks

44 20 7212 4658
ian.e.dilks@uk.pwc.com

Simon Jeffreys

44 20 7212 4786
simon.jeffreys@uk.pwc.com

John Masters

61 2 8266 7265
john.masters@au.pwc.com

Bob Moritz

1 646 471 8486
robert.moritz@us.pwc.com

Barry J. Myers

1 416 869 2441
barry.j.myers@ca.pwc.com

David Newton

44 20 7804 2039
david.newton@uk.pwc.com

Arno Pouw

31 20 568 7146
arno.pouw@nl.pwc.com

Phil Rivett

44 20 7212 4686
phil.g.rivett@uk.pwc.com

John S. Scheid

1 646 471 5350
john.scheid@us.pwc.com

Nigel Vooght

44 20 7213 3960
nigel.j.vooght@uk.pwc.com

Brett Yacker

1 646 394 9983
brett.yacker@us.pwc.com

Akira Yamate

81 3 5532 2518
akira.yamate@jp.pwc.com

Uncertainty tamed?

The evolution of risk management in the financial services industry

Contacts continued

- ▶ Contents
- ▶ Executive summary
- ▶ The return of MoneySpinner
- ▶ Being aware is forewarned
- ▶ Invisible and lethal
- ▶ Conclusion
- ▶ Appendix: Survey results
- ▶ Contacts
- ▶ PricewaterhouseCoopers Global Financial Services Briefing Programme

Economist Intelligence Unit (EIU)

111 West 57th Street, New York, NY 10019

Andrew Palmer

44 20 7830 1149

andrewpalmer@eiu.com

Nigel Gibson

44 1825 791474

nigel.gibson@btinternet.com

Uncertainty tamed?

The evolution of risk management in the financial services industry

PricewaterhouseCoopers Global Financial Services Briefing Programme

- ▶ Contents
- ▶ Executive summary
- ▶ The return of MoneySpinner
- ▶ Being aware is forewarned
- ▶ Invisible and lethal
- ▶ Conclusion
- ▶ Appendix: Survey results
- ▶ Contacts
- ▶ PricewaterhouseCoopers Global Financial Services Briefing Programme

Wealth management at a crossroads: Serving today's consumer – November 2001

Economic Capital: At the heart of managing risk and value – March 2002

Taming uncertainty: Risk management for the entire enterprise – July 2002

Risk Management Survey – A follow up to Taming uncertainty: Risk management for the entire enterprise – November 2002

The trust challenge: How the management of financial institutions can lead the rebuilding of public confidence – December 2002

Illuminating value: The business impact of IFRS – April 2003

Compliance: A gap at the heart of risk management – July 2003

Focus on restructuring: The drivers shaping the financial services sector – December 2003

Governance: From compliance to strategic advantage – April 2004

Uncertainty tamed? The evolution of risk management in the financial services industry – August 2004

PricewaterhouseCoopers (www.pwc.com) provides industry-focused assurance, tax and advisory services for public and private clients. More than 120,000 people in 139 countries connect their thinking, experience and solutions to build public trust and enhance value for clients and their stakeholders.

The Financial Services Briefing Programme is produced by experts in their particular field at PricewaterhouseCoopers, to address important issues affecting the financial services industry. It is not intended to provide specific advice on any matter, nor is it intended to be comprehensive. If specific advice is required, or if you wish to receive further information on any matters referred to in this briefing, please speak to your usual contact at PricewaterhouseCoopers or those listed in this publication.

For information on the PricewaterhouseCoopers Global Financial Services Briefing Programme please contact Áine O'Connor, Director, Head of Global Financial Services Marketing, on 44 20 7212 8839 or e-mail at aine.r.oconnor@uk.pwc.com

For additional copies please contact Alpa Patel at PricewaterhouseCoopers on 44 20 7212 5207 or e-mail at alpa.patel@uk.pwc.com

© 2004 PricewaterhouseCoopers LLP. All rights reserved. 'PricewaterhouseCoopers' refers to PricewaterhouseCoopers LLP (a limited liability partnership in the United Kingdom) or, as the context requires, other member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity. *connectedthinking is a trademark of PricewaterhouseCoopers LLP. Designed by studio ec4 16611 (08/04)