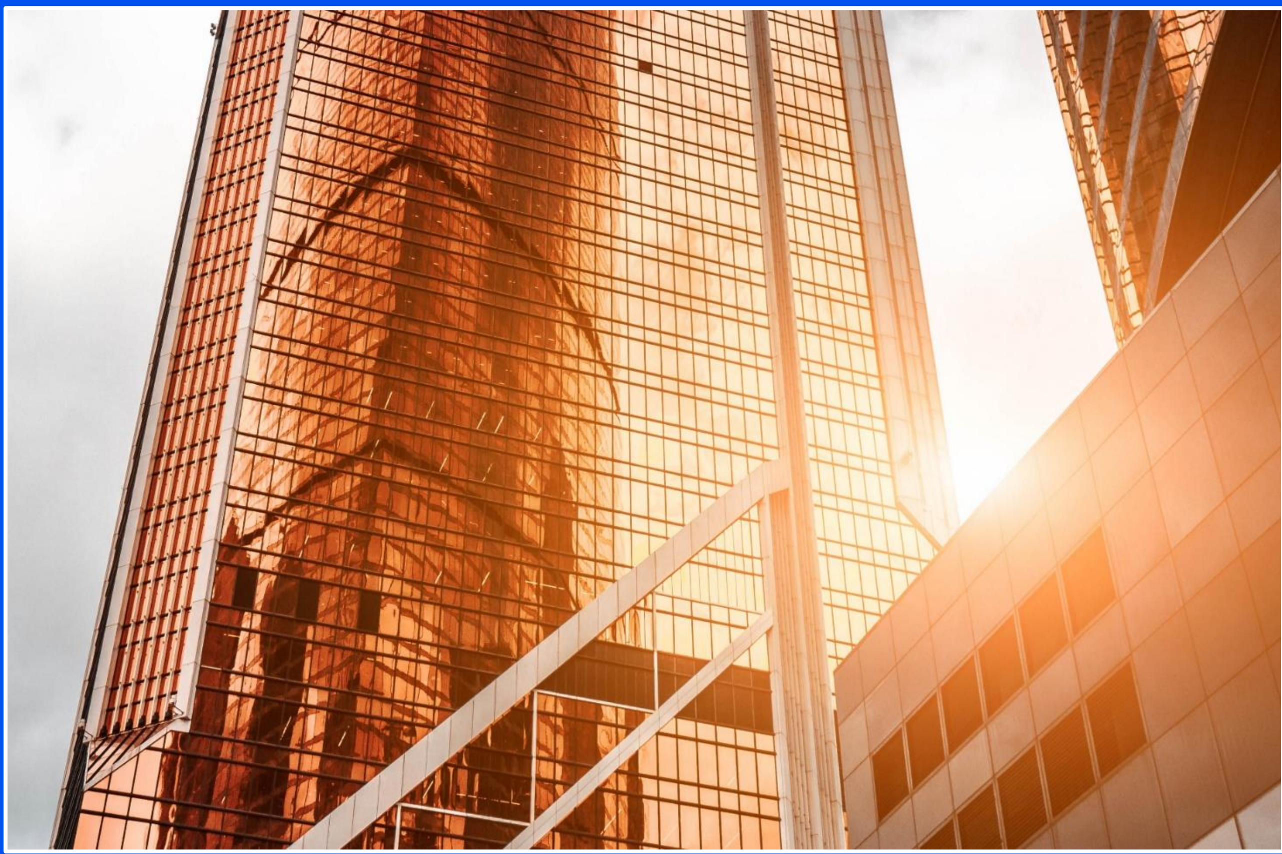
European Risk Management Council

Risk Landscape Review

December 2019



- Climate-related financial disclosures
- Risk, data and decision making
- Updates on UK and APAC Risk Sentiment Indices

DEAR READER,

I am delighted to present Q4 2019 edition of the Risk Landscape Review which includes four articles.

Our last quarterly Risk Council's meeting in London was dedicated to climate change risk. To follow up this important conversation, we include an article "**TCFD: Global Progress Report for the Banking Sector**" prepared by BCS Consulting. The article presents key findings of the report recently published by BCS Consulting.

The second article that we include in the current issue is "**In corporate risk, data is not the answer - insights are**" prepared by Dataminr. The article highlights an importance of extracting information that really matters for efficient decision making from the vast volumes of available data. It also tells about critical importance of the bridge between business strategy and data strategy and a use of public data for creating early warning signals.

We also continue our publications of **Risk Sentiment Index (RSI) updates**, an expert driven forward-looking index that reflects expectations of experts about the risk landscape of the financial sector in the next 12 months. Using results of our recent surveys that we conducted in London, Singapore and Hong Kong, we have updated UK RSI and APAC RSI and present you the detailed results.

My huge thanks to all contributors.

Enjoy the reading.

Yours sincerely,

Dr Evgueni Ivantsov

Chairman of European Risk Management Council

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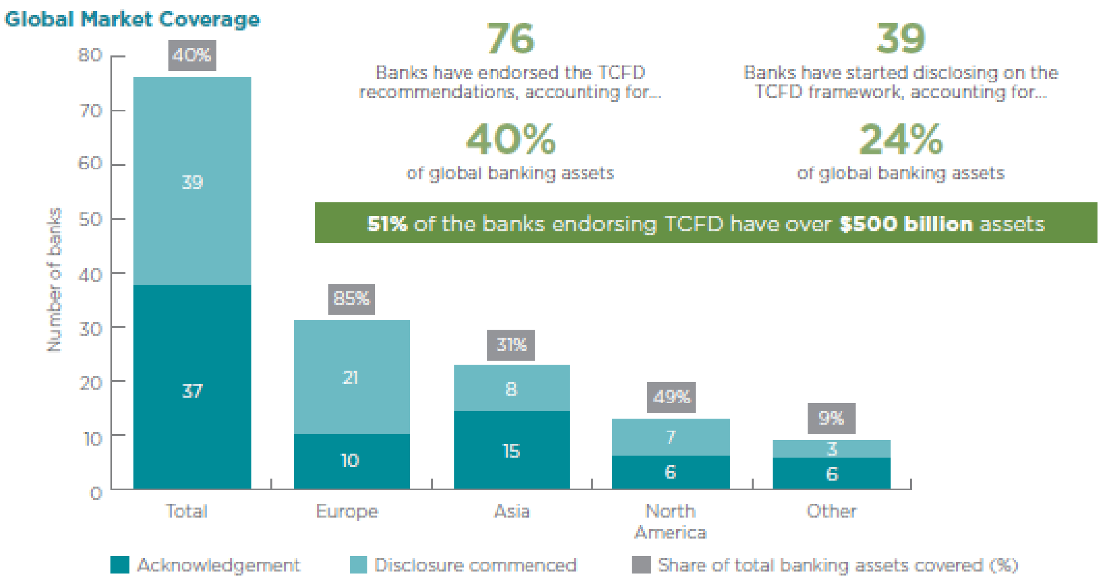
The Task Force on Climate-related Financial Disclosures: Global Progress Report for the Banking Sector – Key Findings

By BCS Consulting

In October 2019, BCS Consulting published the first comprehensive report on the progress the banking sector has made in implementing the Task Force on Climate-related Financial Disclosures (TCFD) framework[1]. The report highlights several key findings regarding current market coverage and the maturity of disclosures and provides insights into emerging best practices in sustainable finance across the banking industry. This brief document details the key findings of this study.

Global Market Coverage

Since publication of the TCFD recommendations in June 2017, 76 banks have endorsed the framework accounting for ~40% of global banking assets ($59 trillion). The results highlight that a significant share of global banking assets is covered by the banks endorsing. TCFD support is mainly driven by the largest banks (larger than $500bn in assets). Current endorsers account for 40% of global banking assets and about half of the banks have commenced disclosing. Europe is the leading region, with the highest market penetration and the largest number of banks endorsing the framework.

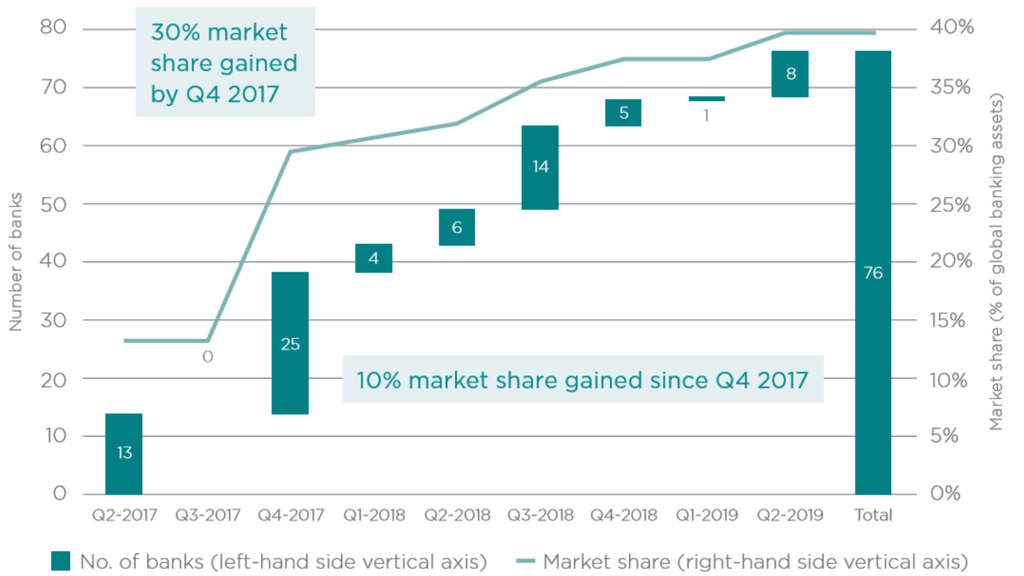


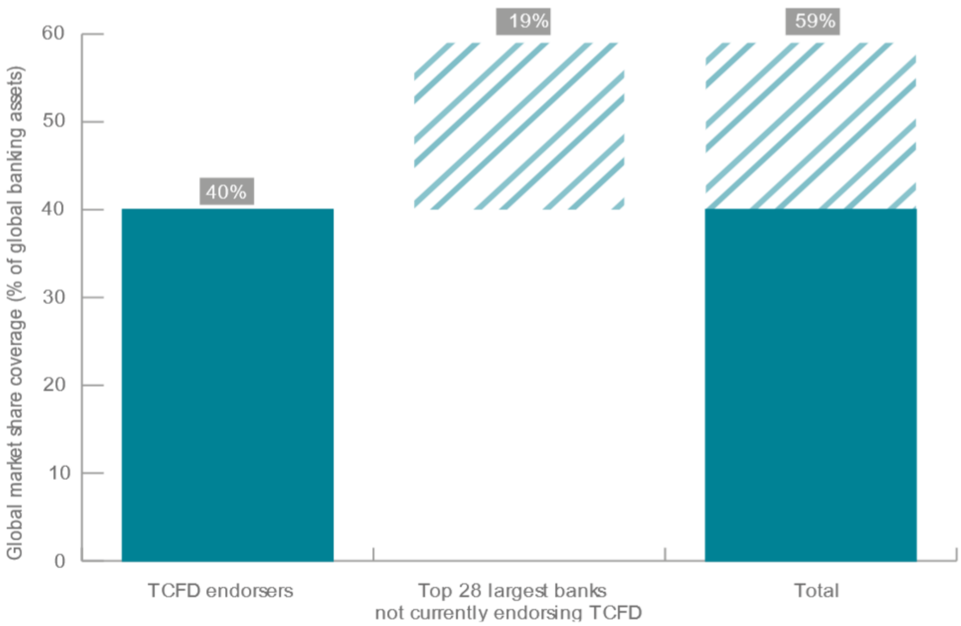
Engagement Trends

While the number of banks endorsing the TCFD framework has, in general, kept climbing, global market penetration trend has plateaued. By Q4-2017, the global market share of assets held by banks endorsing TCFD accounted for 30%. The market share gained since then has only been ~10%. The strongest year of TCFD endorsement was 2017 (38 banks), with a slight slowdown in 2018 (29

[1] http://www.bcsconsulting.com/wp-content/uploads/2015/07/TCFD-Recommendations-Global-Progress-Report-for-the-Banking-Sector-1.pdf

banks). So far in 2019 (as at 1 July), only 9 banks have added their endorsement to the TCFD recommendations. Currently, 28 of the world's top 75 banks have not yet endorsed TCFD. If this group supported the framework, global market share would reach ~59%. There is still significant potential for market penetration in TCFD endorsement by focusing on the larger banks.

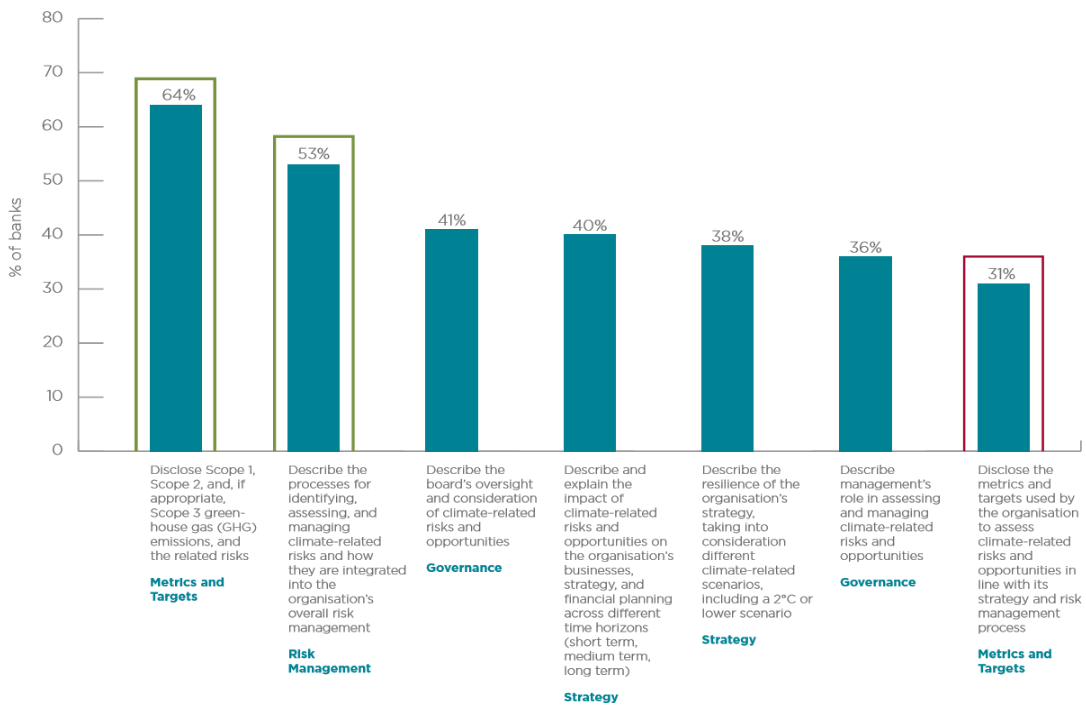




Maturity of Disclosures

BCS Consulting developed a maturity methodology based on 11 themes, with each theme linked to the relevant recommendations of the TCFD framework. All 39 disclosing banks have been graded based on 4 possible stages (not started, beginner, intermediate, advanced) for each theme based on public TCFD disclosures. Results have been consolidated to provide an industry view per TCFD recommendation.

- Metrics and targets for GHG emissions and related risks (operational footprint) is the most mature area with over 64% of the reporting banks in the advanced-intermediate maturity stage (highlighted in green).
- Processes for identification, assessment and management of climate risks is the second most mature area with over 50% of the banks disclosing in the advanced-intermediate maturity stage (highlighted in green).
- Metrics & targets for the assessment of climate-related risk and opportunities is the least mature area with only about a third of banks in the advanced-intermediate stage (highlighted in red).



Information concerning greenhouse gas emissions (GHG) operational footprint management is irrefutably high on the agenda across most banks and reporting is quite advanced. This is not surprising as there are already well-established methodologies and services able to conduct footprint tracking reviews.

Many banks are identifying the key drivers of GHG impact on their operations, there is evidence of targets tracking and increasing maturity in the granularity of GHG disclosures. Aside from GHG metrics and related risks, there has also been important progress in evidencing risk management processes and frameworks for climate risk; many banks are describing how ESG considerations have been factored in deal screening processes and defining approaches to consider transitional and physical risks, taking into consideration regional focus, sector and potential changes in the regulatory landscape.

There is however still plenty of work to be done to develop metrics to assess climate risks (carbon impact of lending and other banking services). Most banks acknowledge they are still developing measurement tools for carbon footprint lending impact. Only a few banks report metrics such as credit risk-weighted assets across fossil fuel sectors and measures of balance sheet exposure to carbon-intensive sectors. When these metrics are reported they are, in general, not granular and not tracked year-on-year.

Equally more evidence of management's role in assessing and managing climate-related risk should be disclosed. There is limited description of specific reviews and decisions carried out by climate-related executive committees and by executive roles appointed for climate risk management.

From a regional perspective, Europe is the most mature area with France, the UK and Switzerland evidencing the highest percentage of disclosures in the intermediate-advanced stage. Outside of Europe, Turkey, the US and Australia hold the highest percentage of disclosures in the intermediate-advanced stage.

Key Areas of Focus and Best Practices

TCFD Area	Area of Focus	Industry Best Practise (Selected Examples)
Governance	Board engagement	**EBRD** Board provides approval of the Bank's Environmental and Social Policy (ESP) which covers both lending and internal operations. In addition, the EBRD's Board is routinely appraised of climate-related risks and opportunities at the project level through the inclusion of relevant information (for example, GHG emissions and climate resilience considerations).
Strategy	Impact of scenarios	**Deutsche Bank** has completed oil and gas, and electricity sector tests using the International Energy Agency new policy scenario and sustainable development scenario. This information has been used to assess vulnerabilities in these carbon-intensive sectors and to evaluate diversification requirements in the portfolio.
Risk Management	Processes for risk identification and assessment	**Nordea** has integrated ESG risks in the credit risk framework and enhanced credit risk policies and guidelines. ESG screening is integrated in the credit risk assessment of all transactions.
Metrics and Targets	Metrics for assessment of risks and opportunities	**Credit Suisse** measures balance sheet and credit risk-weighted assets across fossil fuel sectors. **Mizuho** includes a description of loan exposures to oil and gas, utilities and coal mining.

Conclusion

As evidenced by this report, financial institutions are increasingly evolving from more traditional approaches centred on Corporate Social Responsibility and reputational risk to more focused initiatives that attempt to address the financial impacts of climate change. By carrying out detailed reviews of their current business processes, defining measurable and reliable metrics and targets, as well as enforcing a culture of responsibility, banks can play an important role in driving the transition to a lower-carbon economy. The last two years evidence a good start in climate financial reporting for the industry, but more work is urgently required to drive the response necessary to fight against the imminent threat of climate change.

In corporate risk, data is not the answer - insights are

By Dataminr

A myth is being perpetuated in financial services. It's delivered along the lines of 'the more data you have, the less risk you face.'

The truth is that many data strategies are not supporting more innovative approaches to risk management. Where businesses should be getting early warnings about at-risk assets or the security of global headquarters, no such signals are provided. A profound part of the problem is that organisations still struggle to extract the information that really matters from the billions of bytes that are out there. In turn they're failing to deliver consistent, meaningful outcomes from the investment being made in data strategy and digital transformation.

Leadership teams will increasingly find themselves asking how they can mitigate against the increasingly complex and multifaceted nature of risk. It turns out that more data isn't the answer. Rather, that one-in-a-million piece of insight is.

> Gartner has identified: "*many companies continue to struggle under the weight of traditional business models and analog business process that discount the potential of data and analytics. Others recognize their potential but cannot make the cultural shift or commit to the information management and advanced analytics skills and technology investments necessary to realize that potential*."

The burden is on leaders to improve decision making

The buck will always stop with the senior leadership team. So in a data-centric world, there must be a connection between decision making and data.

Yet under the strain of the vast volumes of data being amassed, the bridge between business strategy and data strategy are not being built. As Gartner has shown, "while 82% of CEOs have confirmed their organisation has a digital transformation program underway, in many cases this is accompanied by a lack of business model change penetration." In other words, the strategy looks good in a planning deck but isn't consistently reaping meaningful benefits.

Data may be a relatively new currency for senior leadership to speculate upon, and often data literacy is not high. However, this position can be an advantage. While significant expertise goes into storing, managing and manipulating data, the ultimate goal is for data to enhance decision making.

This is where leaders add value: by interrogating what insights they're gaining, how data is providing a common operating picture, and ultimately which outcomes have been improved.

In steering data strategy towards corporate risk, boardrooms will also have to address the importance of public data. Over the last decade, critical insights about economic, regulatory and reputational issues have been breaking in public forums rather than just through closed or proprietary channels. Senior leaders who don't gain these insights from public data early enough will be on the back foot when it comes to corporate risk management.

"*Many businesses are struggling to cope with the exponential increases in the data they now gather along with the ever increasing burden of regulations and compliance. Simply storing, managing, accessing and safely maintaining data as the law requires is a major challenge. This means that the cost of turning data into intelligence is becoming a hindrance to business agility for many, as is the need for high quality data analytics to prove compliance in a more complex and tightly regulated market.*" PWC

Public data enables direct decision making

Public data - the billions of bytes of data created by ships, cars, lorries, aircraft and trains, by weather sensors and IoT sensors in smart cities, and by social media blogs and other digital sources - is now critical to minimising risk. Key market, operational and security signals are often buried within it, and there is a clear relationship between the identification of insights and improved decision making.

Today, most organisations don't have the systems to surface signals - but artificial intelligence is changing this. AI-based systems that analyse public data are now able to provide pattern recognition at scale and speed. And by spanning languages, cultures and borders, they deliver market insights that can greatly aid decision making. Whether it's a trade embargo flagged by a journalist tweeting from a personal profile, or an early alert on assets at risk from a weather event, public data can deliver early signals on incidents that have the potential to affect operations and move markets.

Armed with these kinds of insights, businesses have access to critical information before the market moves, or the protest arrives. Public data is helping drive more effective decision making, and therefore it has significant scope to redefine the way financial services organisations approach corporate risk.

UK Risk Sentiment Index: Q4 2019 Update

The European Risk Management Council has updated its UK Risk Sentiment Index (RSI). Fresh data was collected for Q4 2019. Chief Risk Officers and other senior risk executives provided their views on the future trends of seven types of risk. Using the survey results, the Council aggregated the data into a forward-looking index that reflects expectations about the risk landscape of the UK financial services sector in the next 12 months. Numerically, the RSI reflects the adjusted percentage of experts who consider that risk will increase in the next 12 months.

Summary

- The aggregated RSI of seven risk types stands at 0.42. The index remains practically unchanged since the previous survey in June 2019.
- Only 16% of respondents expect that risks will increase substantially in the next 12 months – the lowest level since the launch of the index (the highest was 38% in March 2019).
- Majority of respondents (52%) anticipates a slight increase of risks in the next 12 months.
- Compared to the previous survey in June 2019, experts' perceptions about the future changes of financial risks (credit, market and liquidity risks) have become more positive, while perceptions regarding future trends of non-financial risks have turned to more negative.
- In the past 12 months, the UK RSI trend was largely driven by Brexit expectations. Fear of no-deal Brexit dominated in Q4 2018 - Q1 2019 when RSI reached its peak of 0.56. After the extensions of the original Brexit deadline until 12 April, then until 31 October and then again until 31 January 2020, the UK business started developing a fatigue from the endless Brexit saga and has become less concerned about the potential no-deal shock (see Figure 1).

Figure 1. Aggregated RSI trend: Q4 2018 – Q4 2019

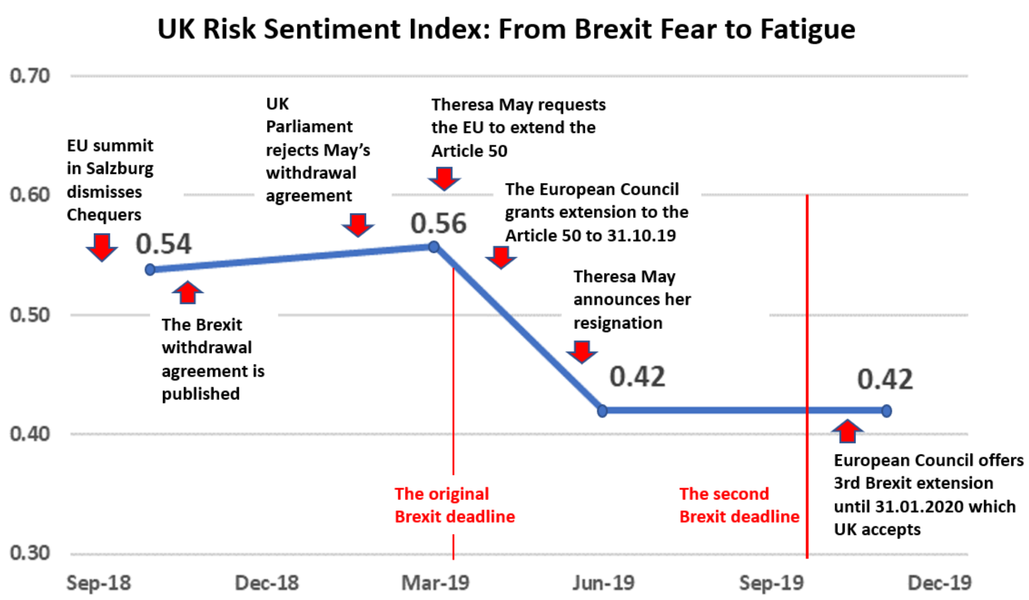


Figure 2. RSI trend for individual risks: Q1 2019 – Q4 2019

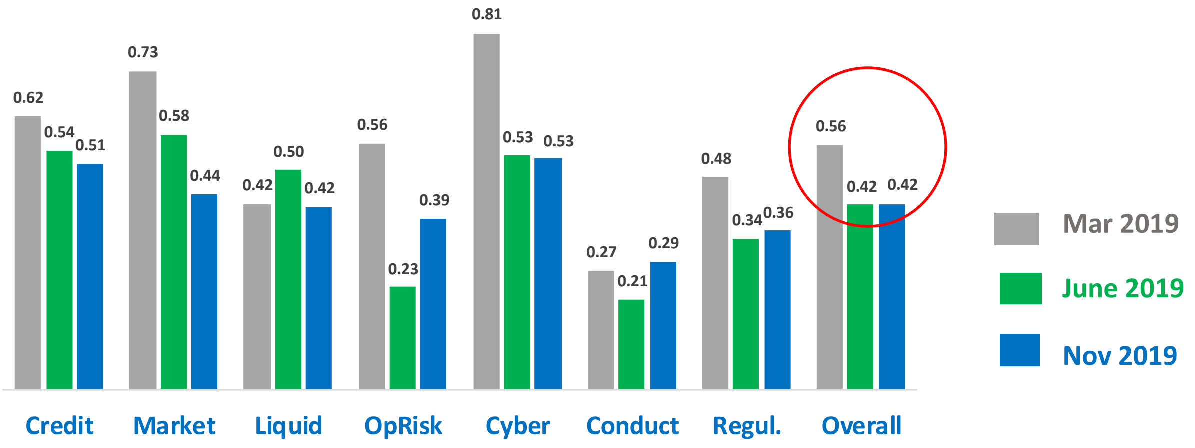
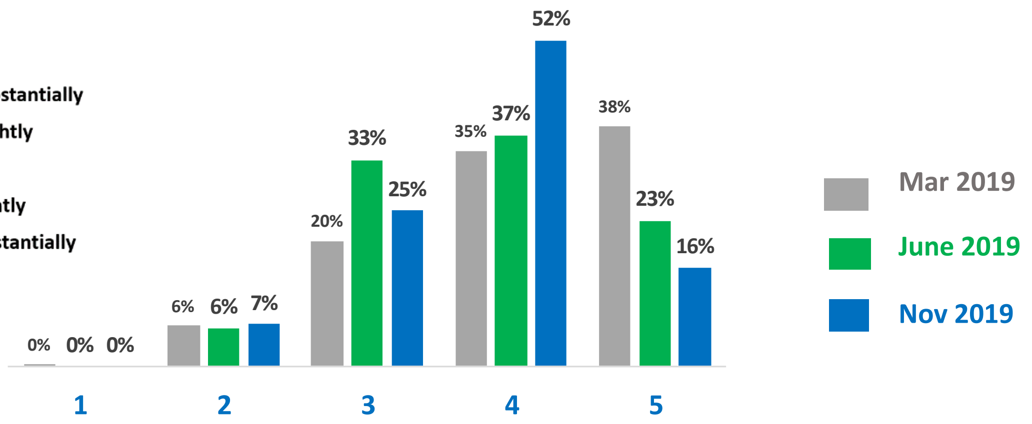


Figure 3. Aggregated results for all risks: % of votes for each option

1. **Decrease substantially**
2. **Decrease slightly**
3. **No change**
4. **Increase slightly**
5. **Increase substantially**

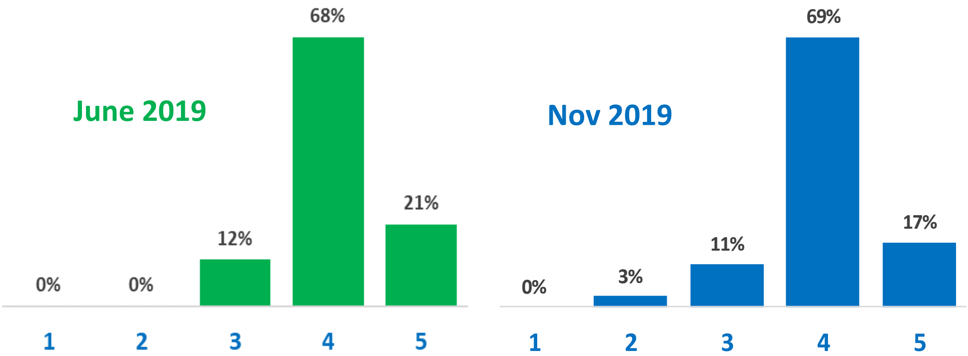


In your opinion, how will the following risks for UK financial industry change in the next 12 months?

Votes distribution (in % of total votes provided)

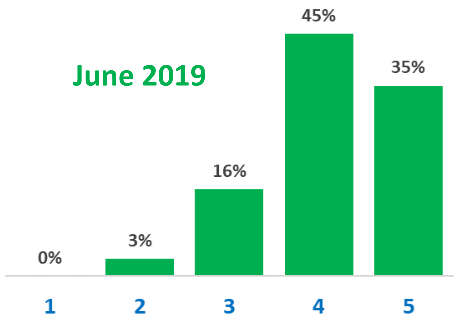
1. **Credit Risk** *(Risk that borrowers or counterparties will fail to meet its obligations in accordance with agreed terms)*

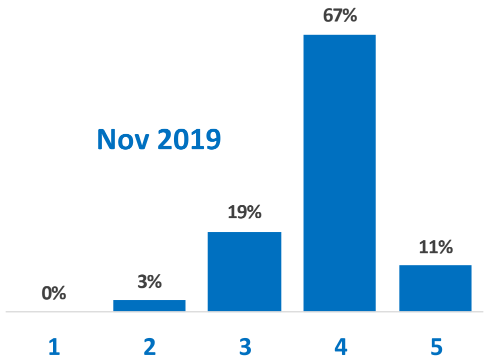
   1. **Decrease substantially**
   2. **Decrease slightly**
   3. **No change**
   4. **Increase slightly**
   5. **Increase substantially**



2. **Market Risk** *(Risk of losses in on and off-balance sheet positions arising from adverse movements in market prices)*

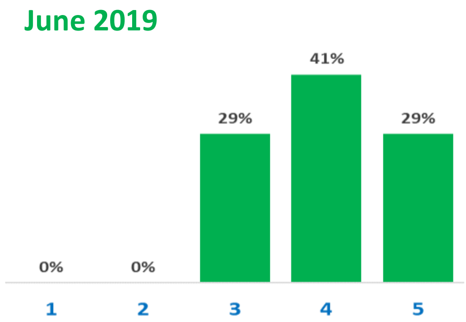
1. **Decrease substantially**
2. **Decrease slightly**
3. **No change**
4. **Increase slightly**
5. **Increase substantially**

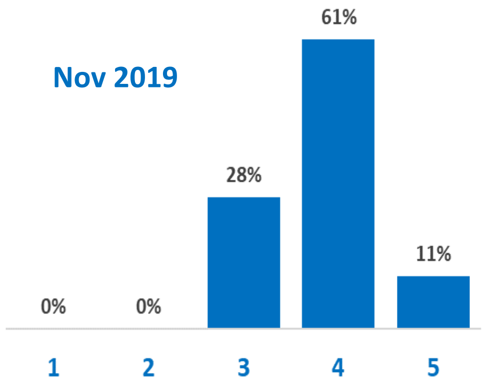




3. **Liquidity Risk** *(Risk for solvent institutions to lose their ability to make agreed upon payments in a timely fashion as well to raise funding in short notice)*

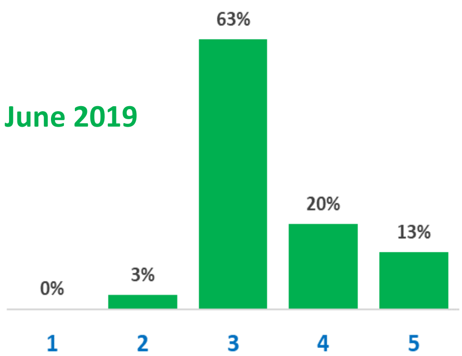
1. **Decrease substantially**
2. **Decrease slightly**
3. **No change**
4. **Increase slightly**
5. **Increase substantially**

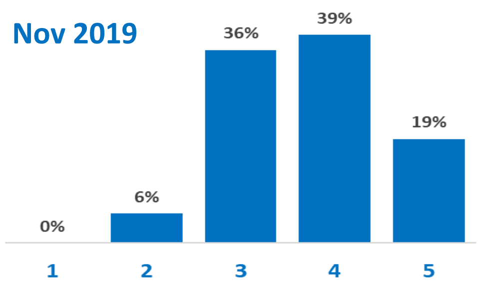




4. **Operational Risk excluding cyber and IT** *(Risk of human errors, control failures, failure of internal processes, model risk, risk of frauds, third party risk, physical safety risk)*

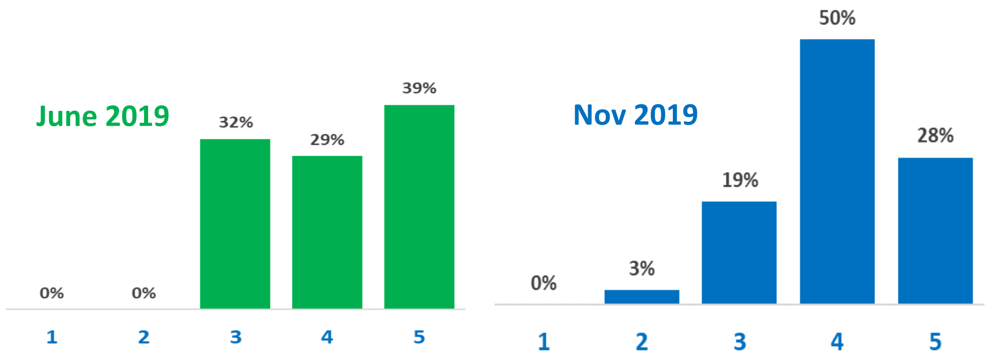
1. **Decrease substantially**
2. **Decrease slightly**
3. **No change**
4. **Increase slightly**
5. **Increase substantially**





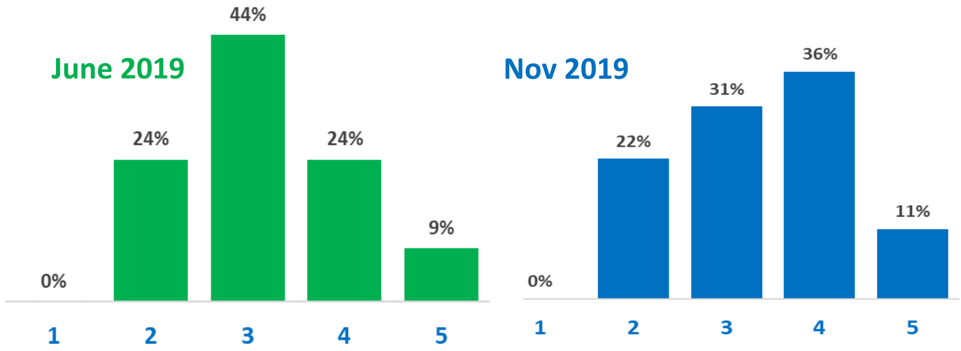
5. **Cyber Risk** *(Risk of events that can lead to data breaches, financial loss, reputational damage, and disruption of operations caused by a failure of IT systems and procedures)*

1. Decrease substantially
2. Decrease slightly
3. No change
4. Increase slightly
5. Increase substantially



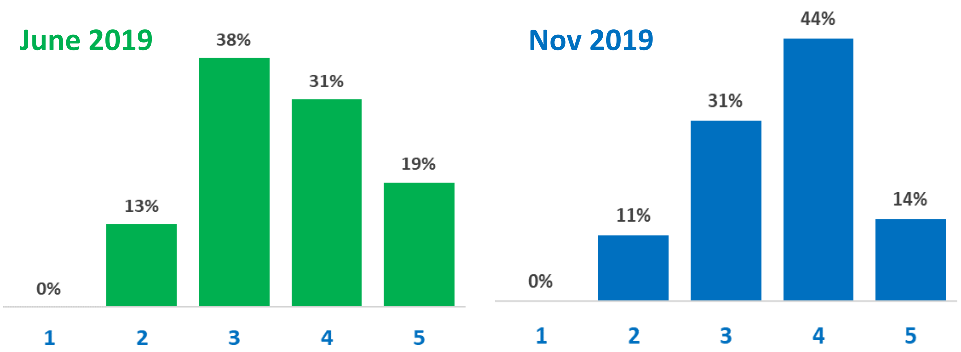
6. **Conduct Risk** *(Risk of actions that lead to customer detriment or has an adverse effect on market stability and effective competition as well as a failure to comply with a regulatory defined code of conduct)*

1. Decrease substantially
2. Decrease slightly
3. No change
4. Increase slightly
5. Increase substantially



7. **Regulatory Risk** *(Risk that a change in laws and regulations or unintended consequences of that change will materially impact a security, business, or market)*

1. Decrease substantially
2. Decrease slightly
3. No change
4. Increase slightly
5. Increase substantially

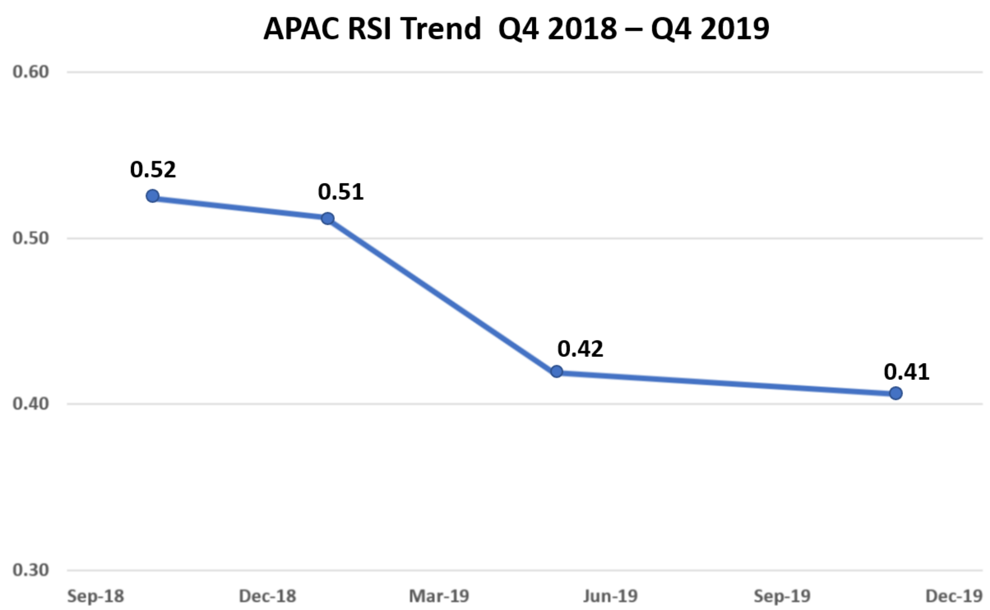


APAC Risk Sentiment Index: Q4 2019 Update

Summary

- The aggregated RSI of seven risk types stands at 0.41. It has been a marginal improvement since the previous survey in May 2019.
- Percentage of votes for the option "risk will not increase" reaches 29% - the highest number since the launch of RSI survey.
- Cyber & IT risk remains by far the main concern of the experts for the next 12 months with its RSI of 0.67 with a very slight increase since the last survey.
- Compared to the previous survey in May 2019, experts' perceptions about the future changes of market risk have become more optimistic, yet their perceptions regarding the future credit risk trend have changed to much more negative.
- An evolution of the aggregated RSI in the past 4 quarters has a clear downward trend. Respondents are much more positive about the future risk landscape than they were in Q4 2018. This is despite a technical recession and ongoing protests in Hong Kong and continued US-China trade tensions.

Figure 1. Aggregated RSI trend: Q4 2018 – Q4 2019



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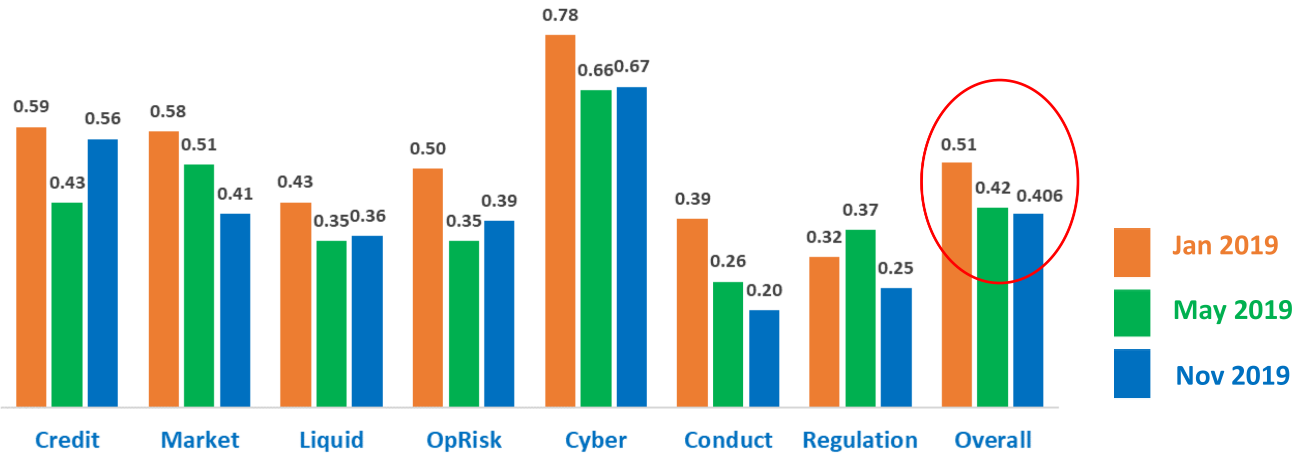
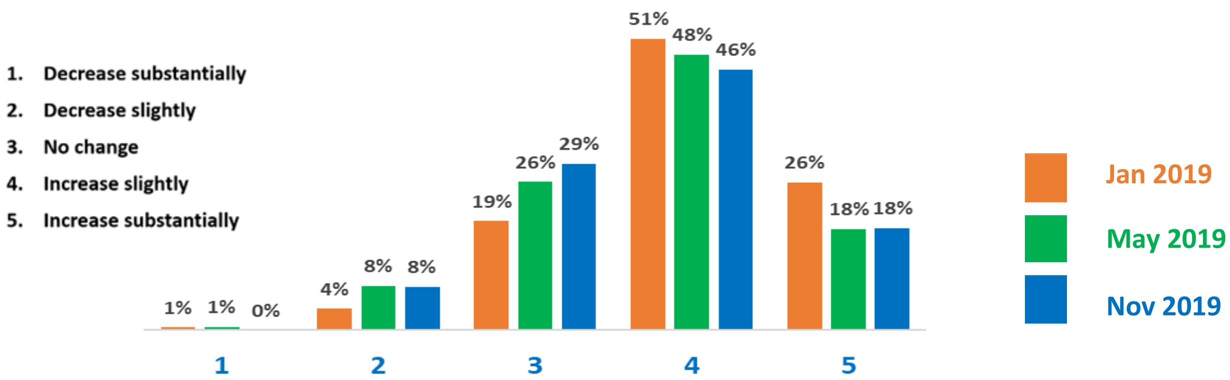


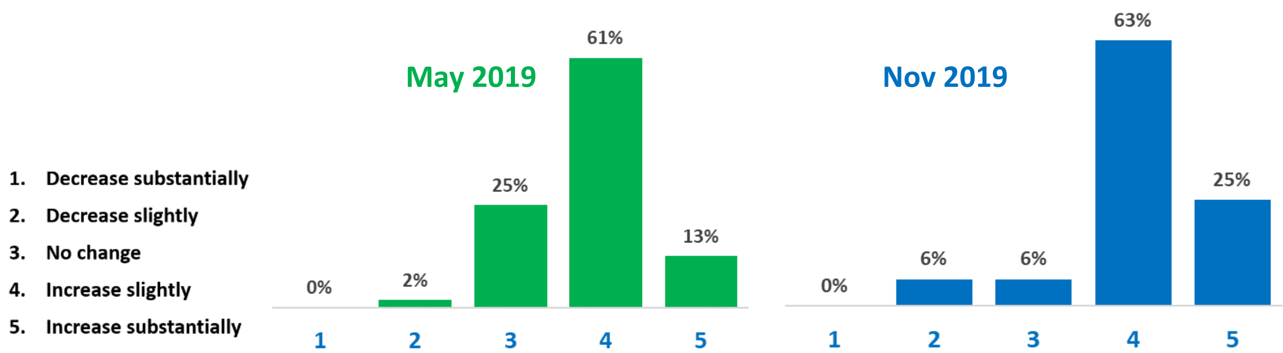
Figure 3. Aggregated results for all risks: % of votes for each option



In your opinion, how will the following risks for APAC financial industry change in the next 12 months?

Votes distribution (in % of total votes provided)

1. **Credit Risk** *(Risk that borrowers or counterparties will fail to meet its obligations in accordance with agreed terms)*



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1. Decrease substantially
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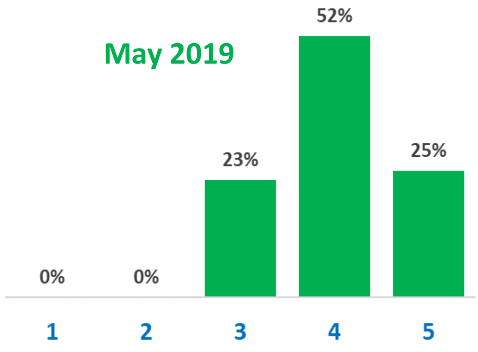
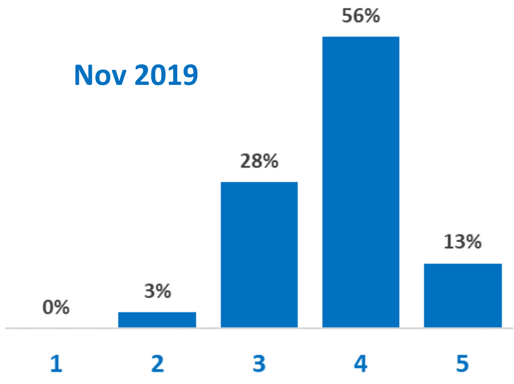
5. Increase substantially





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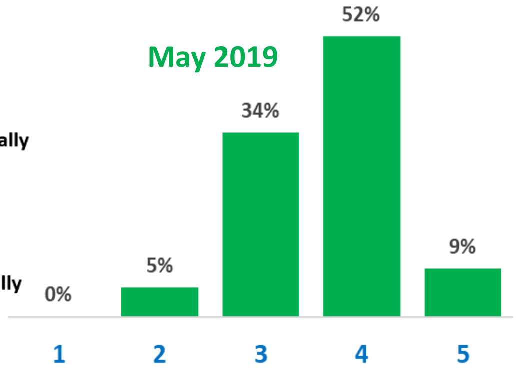
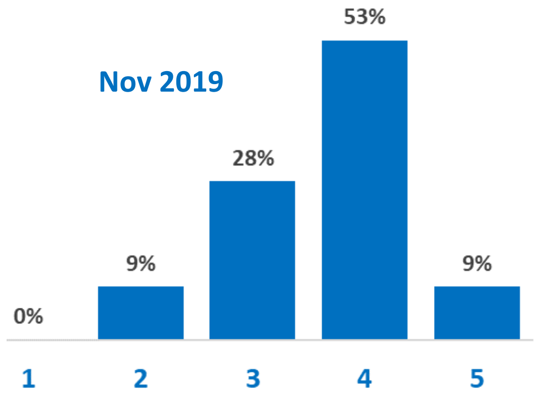
1. Decrease substantially
2. Decrease slightly
3. No change
4. Increase slightly
5. Increase substantially





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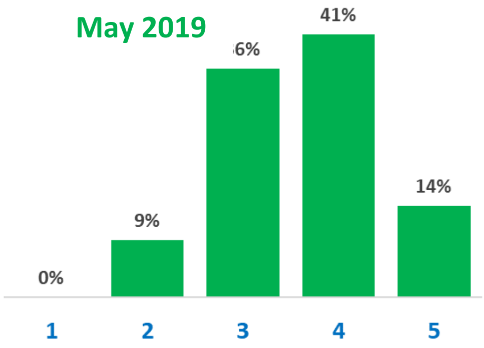

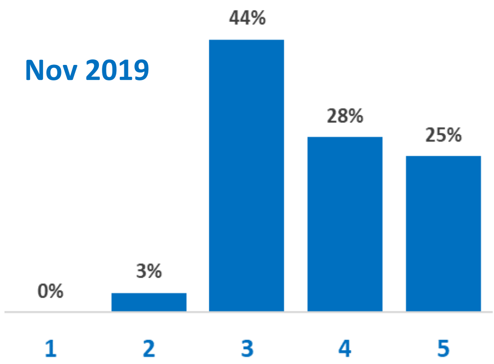

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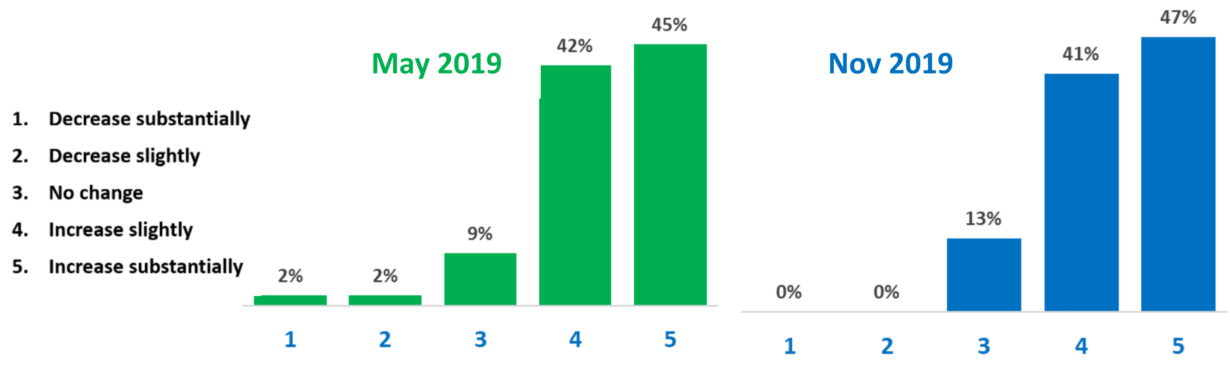

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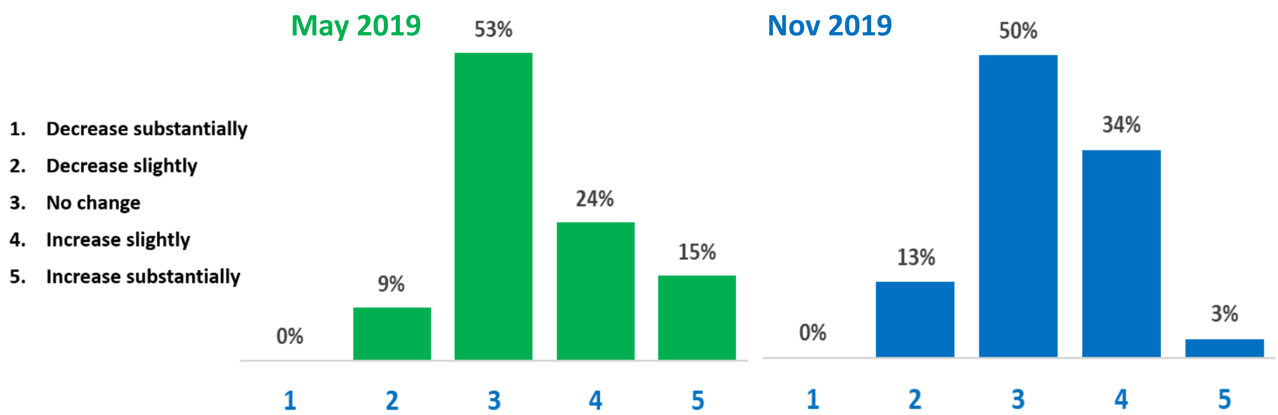

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