European Risk Management Council

Risk Landscape Review

June 2023

- UK Risk Sentiment Index
- APAC Risk Sentiment Index

DEAR READER,

I am delighted to present the latest edition of the Risk Landscape Review, featuring two articles focused on the Risk Sentiment Index (RSI). The European Risk Management Council has been publishing the RSI for the UK and APAC financial services sectors since 2018. As an expert-driven forward-looking index, the RSI provides valuable insights into the expectations of industry experts regarding the risk landscape within the financial sector over the next 12 months.

The recently conducted surveys in the UK and APAC have yielded intriguing findings, which are summarized in the articles included in this issue. While major risk drivers such as geopolitical tensions, high inflation, and market volatility possess a global nature, our experts in the UK and APAC hold notably distinct expectations regarding the future dynamics of the risk landscape for financial services.

My huge thanks to all survey respondents.
Enjoy the reading.

Yours sincerely,

Dr Evgueni Ivantsov

Chairman of European Risk Management Council

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Heightened Concerns for UK Risk Landscape

The European Risk Management Council has recently unveiled an updated version of its UK Risk Sentiment Index (RSI) based on fresh data collected for the second quarter of 2023. Esteemed senior risk executives, including Chief Risk Officers from banks and other financial institutions, have contributed their valuable perspectives on future trends across seven major risk categories: credit, market, liquidity, operational, cyber & IT, conduct, and regulatory risks. By consolidating the survey results, the Council has generated a forward-looking index that captures expectations regarding the evolving risk landscape within the UK financial services sector for the forthcoming 12 months. The RSI serves as a numerical representation of the adjusted percentage of respondents foreseeing an increase in risk within the next year.

UK Risk Sentiment Index: Key findings

The aggregated RSI for the seven risk types has risen from 0.41 in Q1 2023 to 0.49 in Q2 2023, signalling a shift towards a more pessimistic sentiment among the surveyed respondents (Figure 1). This marks a reversal of the positive trend witnessed over the past year, following the peak in Q2 2022, which was driven by Putin's invasion of Ukraine and a turbulence in the energy market.

The shift towards a more pessimistic outlook is reflected in the distribution of votes among the five voting options (Figure 2). The proportion of respondents expecting a significant increase in risk over the next 12 months has climbed from 17% in Q1 2023 to 30% in Q2 2023. Conversely, only 3% of respondents anticipate a decrease in risks, compared to 9% in Q1 2023. Overall, these changes suggest that respondents foresee heightened volatility in the UK financial services sector throughout the upcoming year.

Analysing the quarter-to-quarter changes in the RSIs for individual risk types reveals an increase in five out of the seven risks (Figure 3). Only RSIs for operational and cyber risks experienced some reduction compared to the previous quarter. Notably, financial risks recorded the most significant increase, with the RSI for liquidity risk more than doubling, and substantial increments in the RSIs for credit and market risks. This trend primarily reflects respondents' concerns regarding the banking sector's ability to withstand market volatility in light of recent events such as the collapse of SVB and several other regional banks in the US, as well as the demise of Credit Suisse in Europe. Additionally, respondents have expressed apprehension regarding regulatory risk, resulting in the RSI for this risk type reaching a two-year high. This mirrors the escalating regulatory expectations and heightened regulatory activity by UK regulators throughout 2023.

Despite notable fluctuations quarter-to-quarter, credit risk and cyber risk remain the focal points of concern, with respondents anticipating significant challenges in managing these risks over the next 12 months. The RSI for credit risk currently stands at 0.77, the highest among all seven risk types, followed by the RSI for cyber risk at 0.59 (Figure 4). Respondents harbour particular worries about the potential escalation of credit risk driven by the challenging macroeconomic conditions in the UK, including the persistent inflation. the possibility of a recession and a mortgage market crash. The RSI for credit risk in the current quarter remains well above the long-term average (Figure 5).

Overall, the updated UK Risk Sentiment Index highlights a shift towards a more pessimistic sentiment among senior risk executives. Concerns regarding the banking sector's ability to withstand market volatility, coupled with rising regulatory expectations, have contributed to the elevated risk sentiment. It is crucial for risk managers to proactively address the anticipated challenges posed by credit risk, market risk, and cyber & IT risk to ensure the stability and resilience of the UK financial services sector in the face of a fast-evolving risk landscape.

Figure 1. UK RSI trend: Q4 2018 – Q2 2023

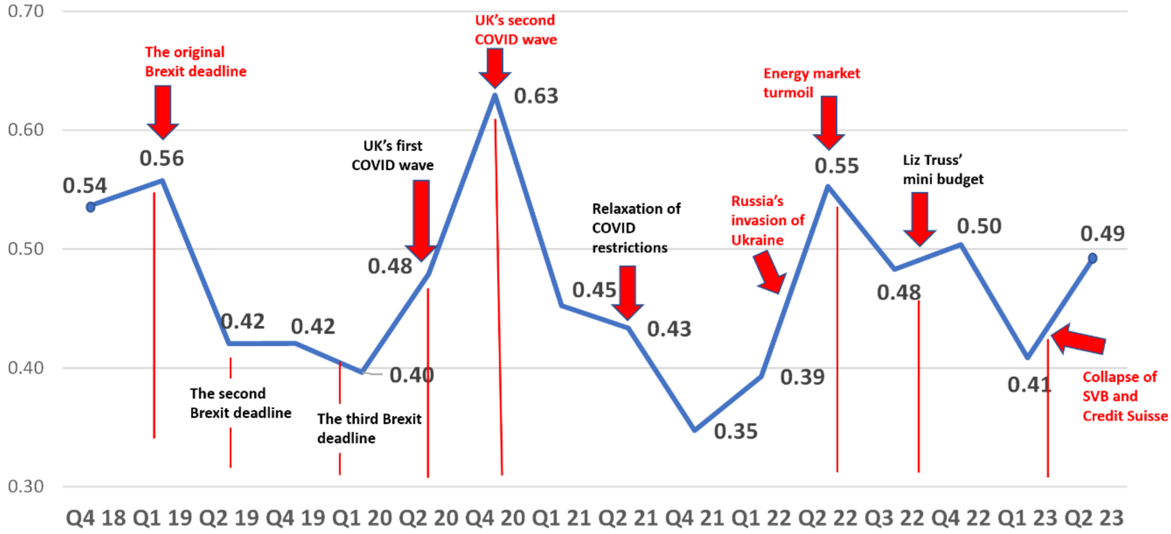


Figure 2. Distribution of respondents' votes

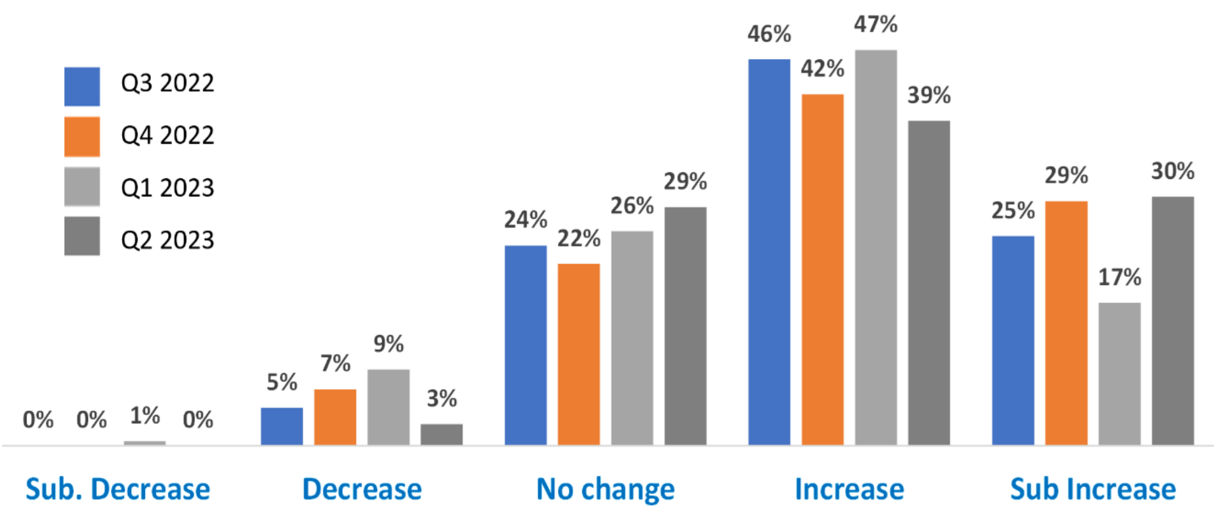


Figure 3. Recent RSI trends for individual risk types

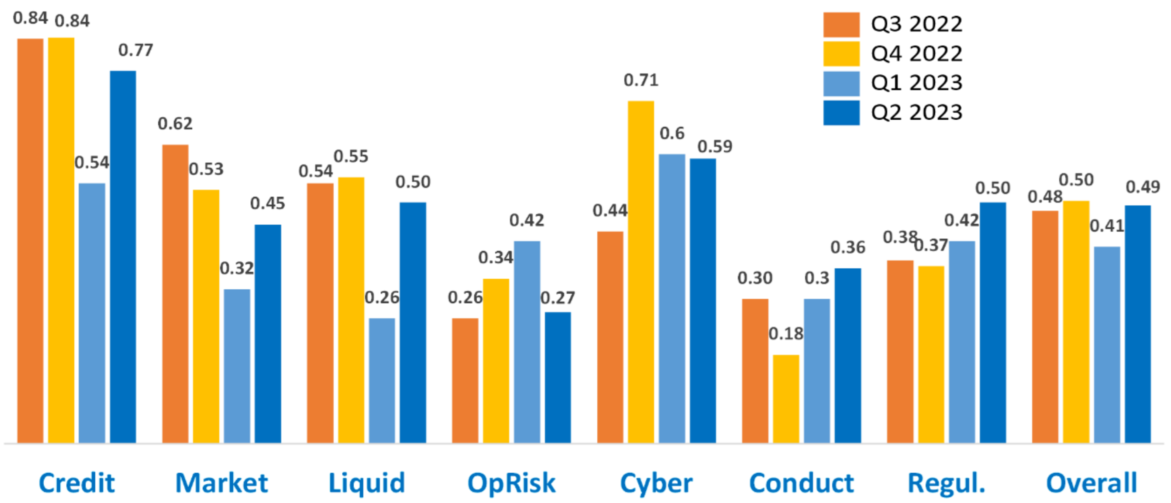


Figure 4. Comparison of RSIs for different risk types in Q2 2023

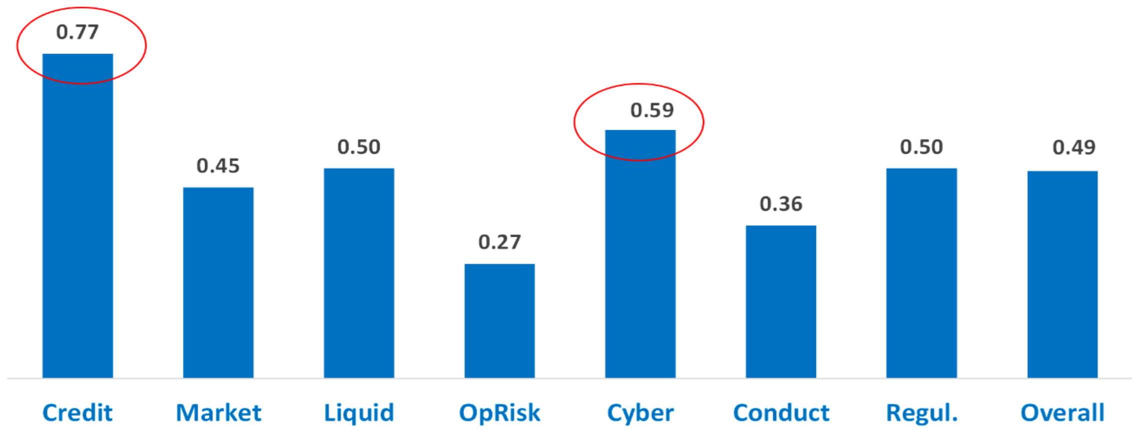
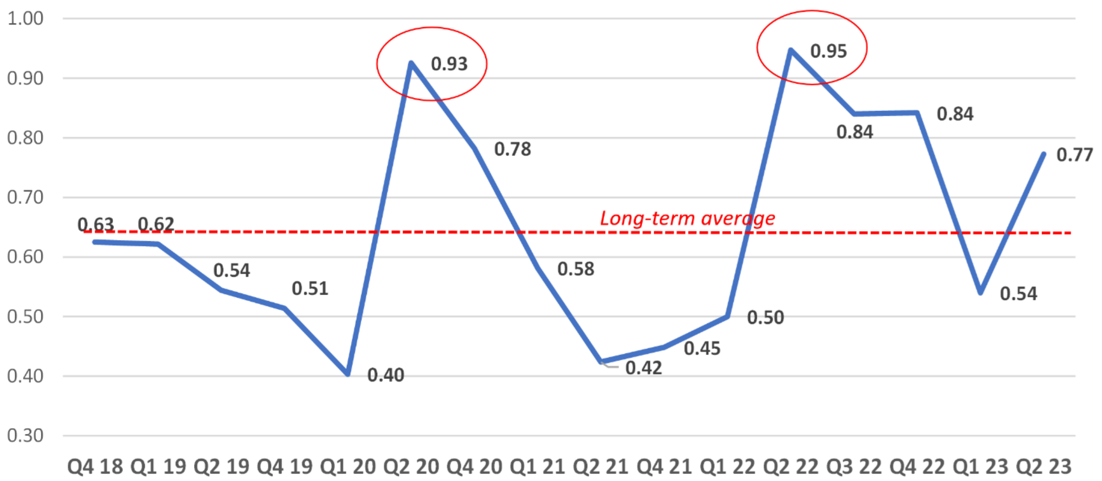


Figure 5. UK RSI: Credit Risk Trend Q4 2018 – Q2 2023



APAC Risk Sentiment Index: Q2 2023 Update

Moving towards stability

The European Risk Management Council has recently unveiled an updated version of its APAC Risk Sentiment Index (RSI) based on fresh data collected for Q2 2023. Esteemed senior risk executives from APAC region, including Chief Risk Officers from banks and other financial institutions, have contributed their valuable perspectives on future trends across seven major risk categories.

APAC Risk Sentiment Index: Key findings

Based on the survey findings, we have observed a continued improvement in risk sentiment across the APAC region, as evidenced by a decreasing aggregate RSI across the seven risk types. In Q2 2023, the RSI witnessed a further reduction to 0.47, down from 0.52 in Q1 2023 (Figure 6). This decline below the long-term average indicates the positive impact of the global market's normalisation from the initial shock caused by Putin's invasion of Ukraine, as well as the removal of all COVID-related restrictions within the APAC region.

The positive trend is substantiated by the distribution of votes among the five available vote options (Figure 7). Notably, the proportion of respondents anticipating a substantial increase in risk over the next 12 months accounts for just 19%, the lowest level recorded in the two and a half years since the onset of the global pandemic. Meanwhile, almost a quarter of respondents expect risks to remain unchanged during the same period. This exceeds the long-term average share of respondents who predict a stable APAC risk landscape.

Furthermore, the positive outlook is reflected in the movement of RSIs for individual risk types, with five out of the seven registering a decrease in Q2 2023 compared to the previous quarter (Figure 8). Only market risk and cyber risk exhibited negative dynamics in this regard.

According to survey respondents, the key areas of concern for the next 12 months are credit risk, market risk, and cyber & IT risk, with corresponding RSIs of 0.54, 0.56, and 0.71, respectively (Figure 9). Cyber risk remains the primary focus, while conduct risk stands at a significantly lower RSI of 0.27, well below the long-term average.

Overall, the latest data from the APAC Risk Sentiment Index indicates a positive trajectory in risk sentiment, driven by expected improvements of the market conditions and the diminished impact of certain risk drivers. However, risk managers must maintain vigilance as credit risk, market risk, and cyber & IT risk persist as areas of concern within the APAC financial services sector over the upcoming 12 months.

Figure 6. APAC RSI trend: Q4 2018 – Q2 2023

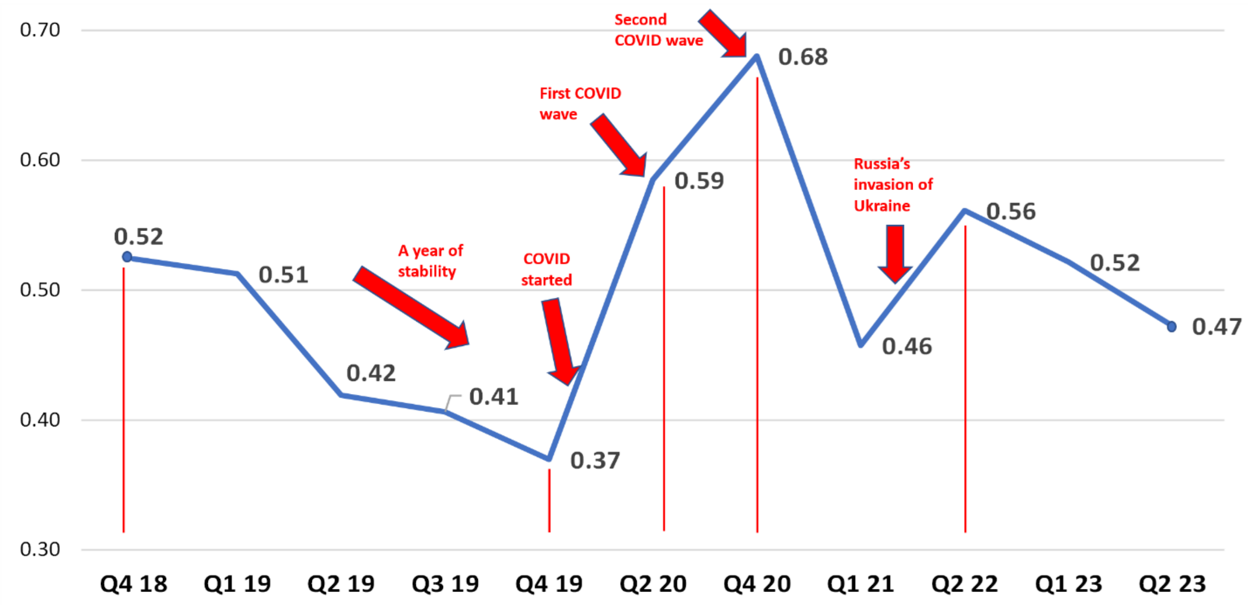


Figure 7. Distribution of respondents' votes

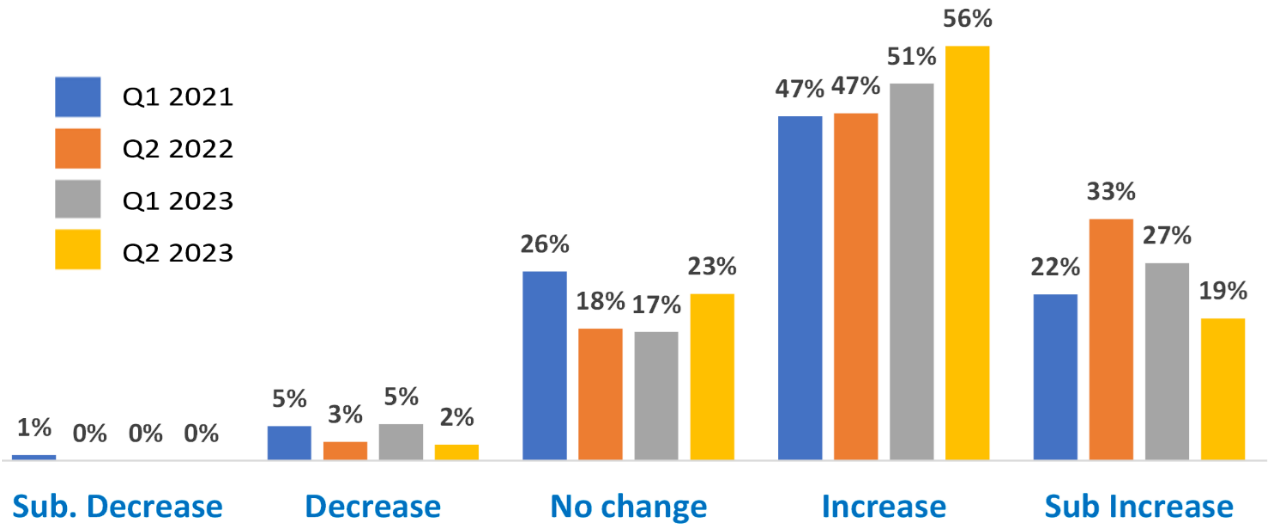


Figure 8. APAC RSI trends for individual risk types

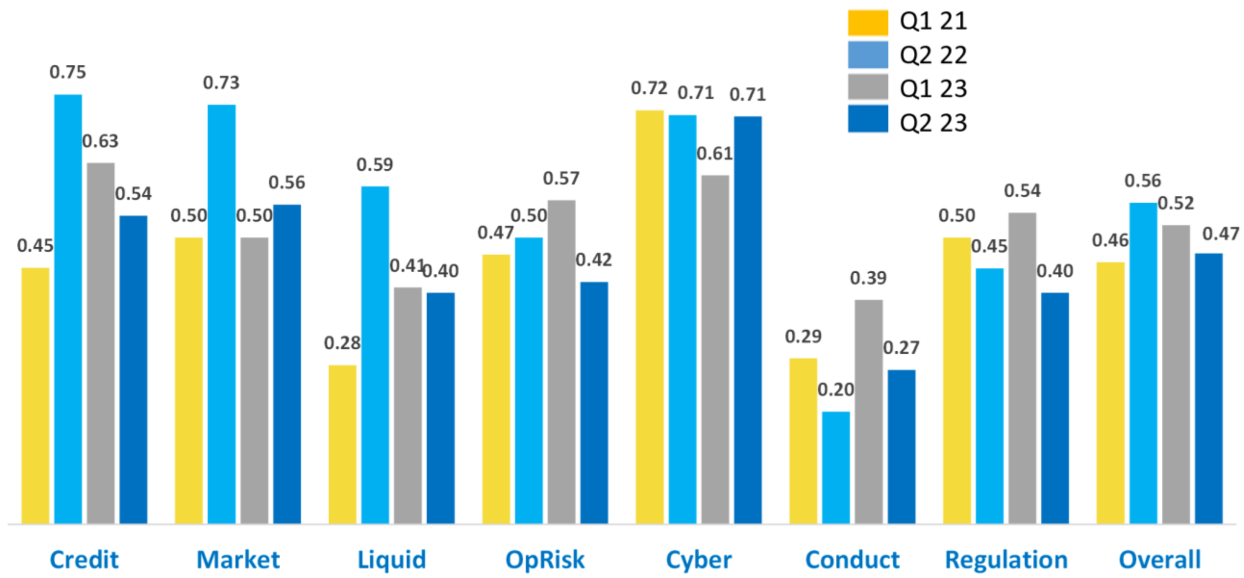


Figure 9. Comparison of APAC RSIs for different risk types in Q2 2023