European Risk Management Council

Risk Landscape Review

June 2024

- **Risk Sentiment Index: Update for the UK and the US**

DEAR READER,

I am delighted to present the Q2 2024 edition of the Risk Landscape Review.

The issue is dedicated to Q2 2024 update of the Risk Sentiment Index (RSI), an expert-driven, forward-looking index that reflects the expectations of experts about the risk landscape of the financial sector in the next 12 months. European Risk Management Council ran RSI surveys of Chief Risk Officers simultaneously in the UK and the US. This allows us to make a comprehensive comparison of respondents' risk perception in two countries, their views on top risks and potential future risk trends.

The aggregated RSI results unveiled a global trend in risk perception shared by two countries, albeit with some intriguing differences described in the article included to this issue.

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

Yours sincerely,

Dr Evgueni Ivantsov

Chairman of European Risk Management Council

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Risk Sentiment Index: Q2 2024 Update

Consensus on the mild risk volatility in the short run but more threats beyond 2024

In Q2 2024, the European Risk Management Council conducted surveys and produced Risk Sentiment Index (RSI) for the US and the UK. The aggregated results unveiled a global trend in risk perception shared by all three regions, albeit with some intriguing regional differences.
While RSIs are not intended to predict future risks, they provide valuable insights into the perceptions of banking executives responsible for risk management functions regarding dynamic trends within the risk landscape. RSIs evaluate seven major risk categories that have a first-order impact on financial institutions: credit, market, liquidity, operational, cyber and IT, conduct, and regulatory risks.

The RSI is derived from surveys of CROs and other risk executives in the financial services sector, serving as a numerical representation of the adjusted percentage of respondents anticipating an increase in risk over the next 12 months. Consequently, a higher RSI indicates that more respondents expect an upswing in risk.

Consensus on the mild volatility of the future risk landscape

Since the previous RSI surveys, economic data for both the US and the UK have shown improvements in most key economic health indicators. Inflation has finally reduced to target levels, signalling upcoming interest rate cuts, the labour markets have remained strong, and stock markets are booming in both countries. Despite positive economic dynamics, recent RSI measures suggest that CROs on both sides of the pond are becoming less optimistic than they were at the beginning of the year. The UK RSI has grown from 0.35 to 0.38 between Q1 and Q2 (Figure 1), while the US RSI has marginally increased in the same period from 0.40 to 0.41 (Figure 2).

Figure 1. UK RSI trend: Q4 2018 – Q2 2024

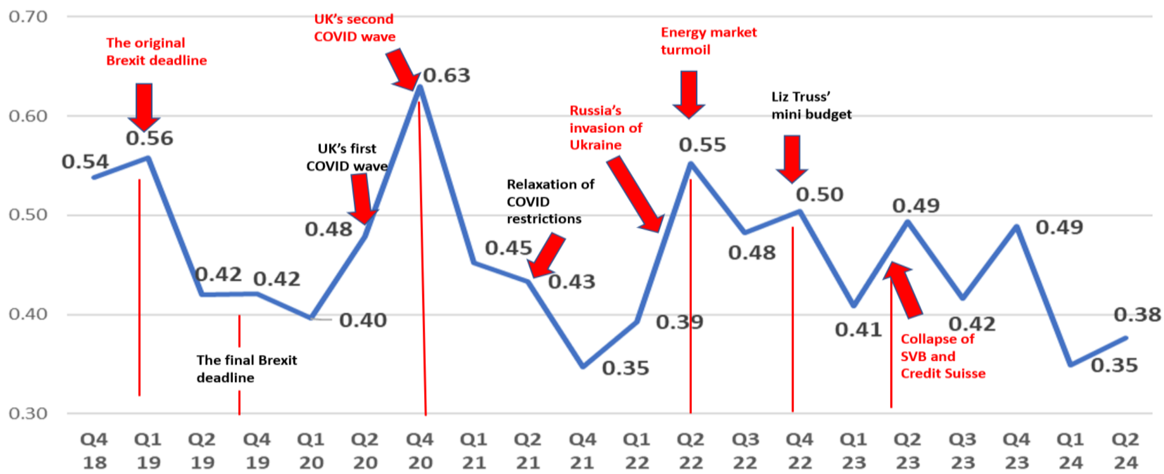
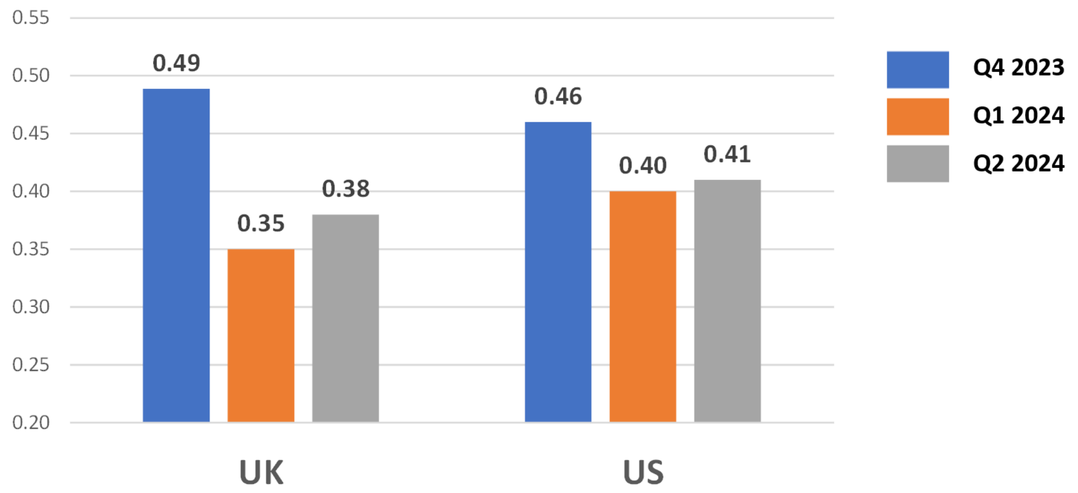


Figure 2. UK vs US: RSI trend Q4 2023 – Q2 2024



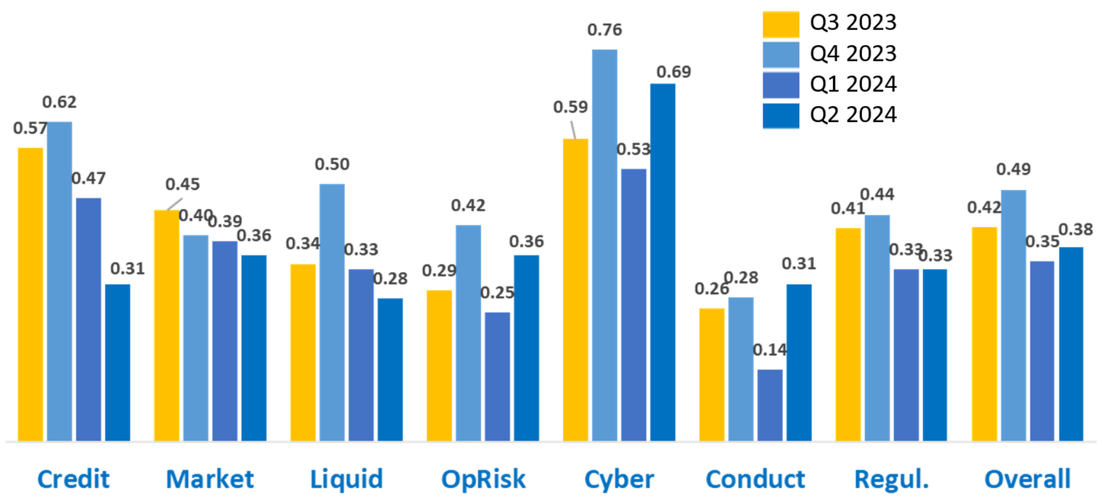
Therefore, after the more positive move in Q1 when the RSIs of both countries showed a substantial reduction compared to the previous quarter, this represents a new negative shift, albeit a minor one.

However, overall RSIs in both countries remain at relatively low historic levels, indicating that CROs expect moderate volatility in the future risk landscape and do not anticipate a significant increase in risks for the financial services sector in the next 12 months. The analysis of RSI by individual risk types reveals a more complex picture and some country-specific differences.

Beyond aggregated results: UK future risk landscape - a shift from financial to non-financial risks

A quarter-to-quarter change of the UK RSI for individual risk types suggests that financial risks are considered well-controlled by CROs for the near future. The RSI for credit, market, and liquidity risks all reduced compared to the previous quarter (Figure 3).

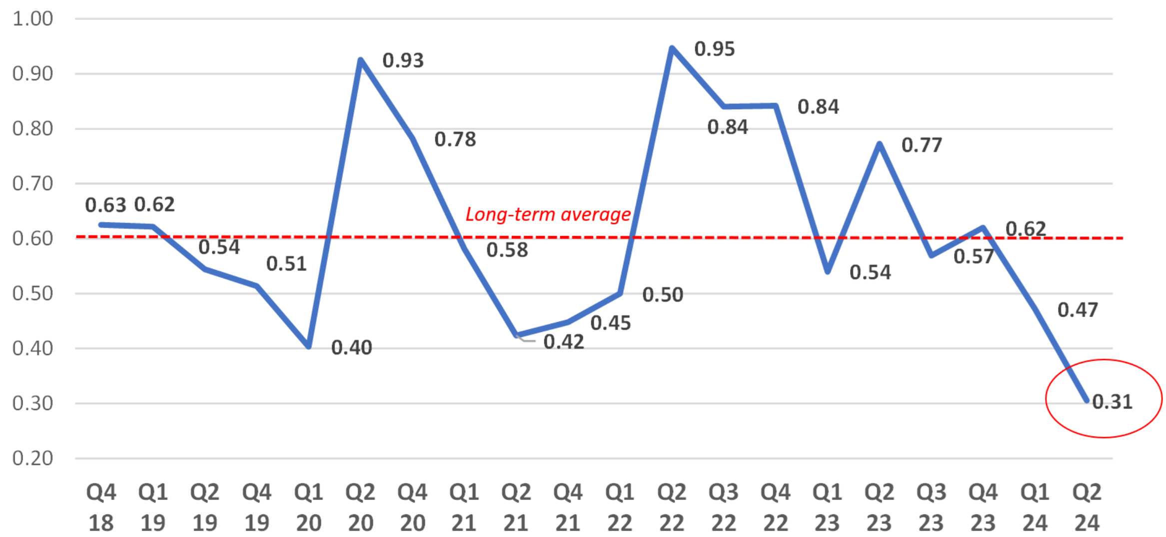
Figure 3. UK RSI trends for individual risk types



Remarkably, the RSI for credit risk dropped this quarter to 0.31, well below the long-term average, representing the lowest level since the RSI's launch in 2018. Moreover, for the first time, credit risk—traditionally considered one of the top three most serious risks—is not rated high enough to be in the top five risks. The main driver of this unusual positive sentiment about credit risk among CROs is the expectation of upcoming interest rate cuts by the Bank of England.

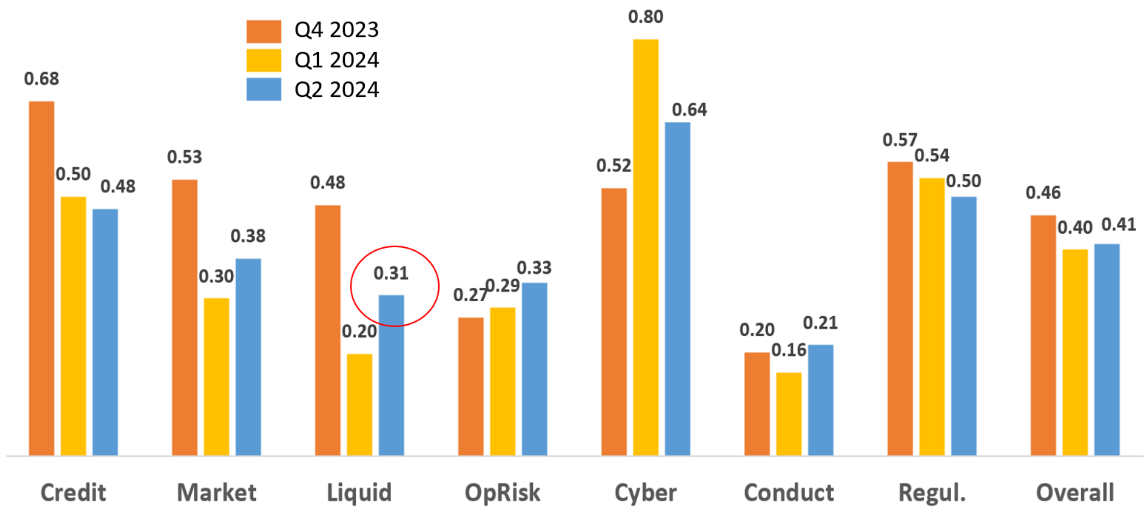
At the same time, UK respondents are less optimistic about future trends in non-financial risks. The UK RSI for operational risk, cyber risk, and conduct risk increased in Q2 2024.

Figure 4. UK RSI for credit risk Q4 2018 – Q2 2024



In contrast, the US RSI for individual risk types looks rather different. US CROs expect an acceleration of some financial risks in the future, especially liquidity risk, whose RSI has substantially jumped from 0.20 to 0.31 compared to Q1. The market risk RSI is also on the rise, gaining 0.08 (Figure 5).

Figure 5. US RSI: Comparison of RSIs for individual risk types

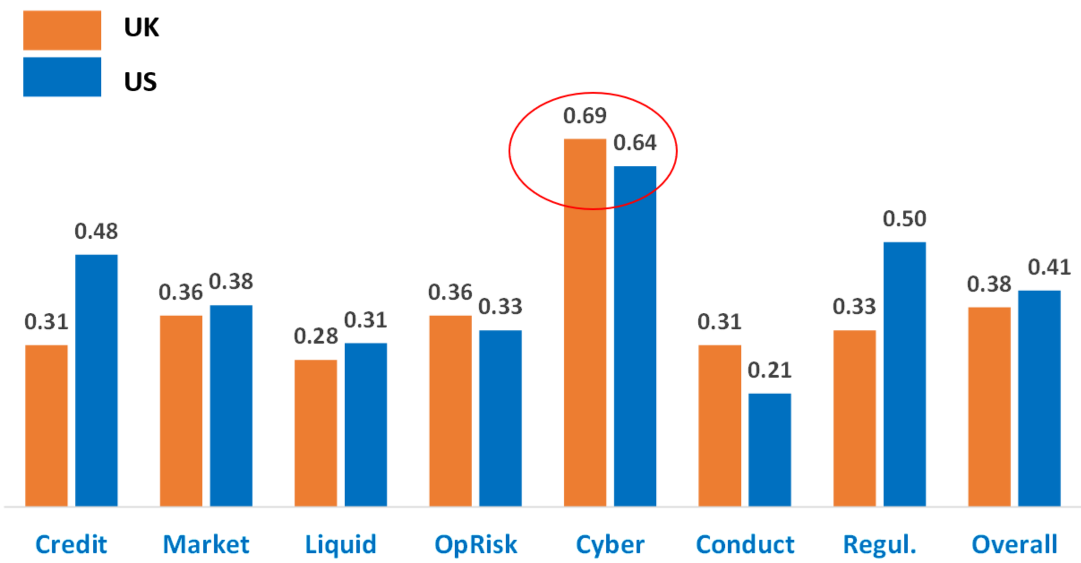


Top risks to watch out for

Survey results identified prime risk areas of concern for each country. The main consensus among US and UK CROs is that cyber and IT risk is the number one risk. By far, the RSI for cyber risk is the highest in both countries, indicating that CROs expect this risk to grow significantly in the next 12 months. While cyber risk has always been one of the prime concerns, these RSIs are now above the long-term average.

The main driver of this elevated level of cyber risk is the extremely volatile geopolitical situation. Instabilities such as the war in Ukraine, the Israel-Hamas conflict, and the political polarization surrounding the worldwide 2024 elections disrupt the risk landscape and undermine global cybersecurity, amplifying the risk of massive and well-planned cyber-attacks. Another important driver of cyber risk is the rapid adoption of AI, which penetrates all areas of financial business and, if not well governed and regulated, can compromise future cybersecurity.

Figure 6. Comparison of Q2 2024 RSIs for different risk types



Unlike their peers in the UK, US CROs express significant concern about the rise of regulatory risk in the next 12 months. Similar to the previous quarter, US RSI for regulatory risk ranks second highest after cyber risk reflecting the concern stems from the tightening of regulations by the Fed and FDIC and growing uncertainty of banking regulation’s change after the US Presidential election.

While a minor negative shift in RSI in Q2 in both countries should not be treated as a strong warning signal, yet it might represent a new longer-term trend to the high volatility risk landscape in 2025. This requires banks operating in the UK and US to activate a thorough risk monitoring and proactively consider risk mitigation strategies.