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5 Key risks for firms 2022

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Five key risks for firms in 2022

EXPERT TALK

In 2022, financial institutions need to consider the changes they might need to make permanent after their largely successful response to the COVID-19 pandemic. A combination of flexibility, deployment of technology and, in the case of banks, balance sheets which had been substantially bolstered following the financial crisis, all helped meet the unprecedented challenges in early 2020.

Work should be underway during 2022 to reassess the strategic approach, together with associated policies, procedures and control infrastructure.

The pandemic has not been only driver of change. Shifting geopolitics, the emergence of climate risk as a significant concern for financial services firms, the speed of innovation in cryptos and the need to deliver consistently good customer outcomes are all boardroom considerations. Those deliberations need to be informed by a highly skilled, well-resourced in-house risk and compliance function.

Skilled in-house resources will give firms the best chance of navigating future uncertainty, allowing firms and their senior managers to be, and be seen to be, compliant with all rules, requirements and expectations.

The risks financial services firms run are institution-specific but there are some high-level risks applicable to all firms, irrespective of geography or sector.

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1

Data governance

An effective approach to data governance is critical. The scale of the issue is significant; it is estimated that every person online produced 1.7 MB of data every second in 2020. That is 1.145 billion gigabytes of daily data. The world produced twice as much data in 2021 as in 2019, with predictions for the next five and 10 years increasing exponentially.

Many challenges can be turned into opportunities, and technological challenges are no exception. Digital solutions will continue to deliver benefits, but only if they are implemented appropriately. There is much that firms and their compliance officers can do to help themselves.

As a first step, firms need to embrace the fact that data is a strategic asset and from there build a business-wide approach to data aggregation, management, storage, security, retrieval and destruction — in other words, build a business-specific approach to data governance. This will have multiple benefits including greater line of sight to risks being run in a hybrid working environment, the ability to comply with the recently agreed climate risk reporting requirements and enhanced recordkeeping.

As with other elements of risk management, to deliver on data governance firms will need to invest in both skills and infrastructure.

2

Operational resilience

The pandemic was a test of firms' operational resilience. Operational resilience can be defined as the ability to deliver critical operations throughout disruption. This ability enables firms to identify and protect themselves from threats and potential failures, and to respond and adapt to, as well as recover and learn from, disruptive events, to minimise their impact on the delivery of critical operations.

In considering their operational resilience, firms should assume that disruptions will occur, and take into account their overall risk appetite and tolerance for disruption — the tolerance for disruption being the level of disruption from any type of operational risk a firm is willing to accept given a range of severe but plausible scenarios.

Firms need to consider governance, operational risk management (such that the management of operational risk should identify external and internal threats and potential failures in people, processes and systems on a continuing basis, promptly assess the vulnerabilities of critical operations and manage the resulting risks in accordance with the operational resilience approach), mapping interconnections and interdependencies, third-party dependencies, incident management and IT, including cyber issues.

3

The "G" in ESG

Environmental, social and (corporate) governance (ESG) covers the wide sweep of evolving risks and required future actions for firms as part of the international approach to climate risk mitigation. It has become clear that climate risk is unlike other financial risks. Its uniqueness and complexity, and the long-term nature of the risks, make quantifying the threat one of the biggest hurdles that regulators must overcome in developing new rules and regulations.

Financial services firms and their compliance officers need to ensure that "good" regulations are developed; poorly designed requirements will not achieve the required aims and are unduly expensive as they will need to be changed.

The environmental and social elements of ESG are important, but without appropriate corporate governance financial services firms (among others) will simply not be able to deliver on the challenges.

A particular deliverable is the sustainability-related disclosure standards which were agreed, at least in draft, at COP26. For firms, meeting the proposed reporting requirements will involve the collection, collation and reproducible reporting of millions of data points — even before jurisdictions overlay their own specific requirements.

There is an international shortage of ESG skills and experience, and firms should not underestimate the complexity of the governance which will be needed to meet the developing criteria and expectations.

The Regulatory Intelligence special report on the fast-moving challenges for firms arising from ESG can be downloaded here.

4 Remuneration

It is a measure of how crucial compensation, remuneration and good bonus design is seen to be that the very first thing the Financial Stability Board (FSB) did in the wake of the 2008 financial crisis was to implement supranational compensation standards seeking to drive better risk-aware behaviour. That was in September 2009, and last year the FSB reviewed once again the implementation and practical impact of these reforms.

The seventh progress report covered the practices of the largest financial institutions in the banking, insurance and asset management sectors, and highlighted uneven progress toward implementing the principles and standards, with banks seen to be relatively more advanced than insurance and asset management firms.

The report also covered regulatory and supervisory developments, the governance mechanisms for compensation which firms deploy, the effective use of metrics/criteria and compensation tools, and legal and regulatory challenges to the effective use of compensation tools.

Firms would be well-advised to benchmark their approach to compensation with this latest FSB progress report, which set out detail on emerging good and better practice, together with an insight into how firms are navigating certain legal challenges and the use of compensation to promote a sound culture and positive behaviour

5

Enabling technology

The pandemic is estimated to have accelerated digital transformation by as much as three years. Digital transformation is made possible by enabling technology, which includes application programming interfaces, big data analytics and artificial intelligence, biometrics, cloud computing (specifically outsourcing to the cloud) and distributed ledger technology.

Firms and their boards need to be able to ensure the safe adoption of any new technology so that the benefits can be reaped, and the risks arising from the adoption of innovative activities managed.

The consideration of the adoption, or indeed a choice not to use enabling technology, needs to be based on the surest possible decision-making.

Firms need to consider the governance structure in which the new technology will operate, together with the business strategy, risk and compliance policies, the ownership of the activity, any sourcing or procurement needs, project management and implementation, any outsourcing (with a particular focus on any increase in concentration risk), the required monitoring and reporting, and lastly how to decommission the new technology at the end of its useful life.

A lack of strong corporate governance may mean firms fail to reap the potential benefits and may lead to regulatory issues which affect both firms and their senior managers. Gone are the days when the IT function, capable or not, was trusted with driving technological change.

It is now a prerequisite for board members and senior managers to have sufficient technological knowledge (or ready access to that knowledge) to be able to challenge and oversee firms' technological strategic direction and the associated change management.

A fundamental part of that strategic direction is building the capacity and capability to trust the output of any new technological solution, so the solution itself can become part of firms' management information and an input into governance and decision-making.

ABOUT THE AUTHOR

Susannah Hammond is senior regulatory intelligence expert for Thomson Reuters with more than 25 years of wide-ranging compliance, regulatory and risk experience in international and UK financial services. She is co-author of "Conduct and Accountability in Financial Services: A Practical Guide" published by Bloomsbury Professional.
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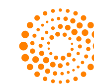

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