

Resilient banking: capturing opportunities and managing risks over the long term

11th annual EY/IIF global bank risk management survey



Executive summary

For well over a decade, EY and the Institute of International Finance (IIF) have had the privilege of analyzing and commenting on the transformation in how banks manage traditional and, more recently, emerging risks. In aggregate, progress has been significant, but incremental and evolutionary.

Then along came COVID-19. It proved to be the most unprecedented and unexpected test of banks' risk management - and of decade-long regulatory reforms. A global health crisis brought economies across the globe to a virtual standstill in a matter of weeks and quickly evolved from a health crisis into an economic crisis.

Financial and operational resilience were tested to the core. Thankfully, for the most part, the banking sector found that a decade-long effort to build greater and

higher-quality capital and liquidity paid off and allowed banks to contribute materially to supporting communities, economies and financial markets, while remaining financially safe and sound. IT systems, albeit in many cases legacy systems, held up and allowed employees to move swiftly to remote working at a scale never seen before. For the most part, virtual working and digital channels to access products and services worked.

But, COVID-19 also opened our eyes to broader dimensions of resilience. To start,

workforce resilience became more prominent. Not only did employers realize employee well-being has to be considered during COVID-19 times, but it needs to be in the forefront of their thinking on an ongoing basis. This is especially the case now that we all realize a hybrid working model - working at home and in the office - will be an enduring feature of the workplace. At the same time, events related to racial equity and subsequent social unrest greatly elevated our focus on diversity, equity and inclusiveness in society at large, as well as in the workplace.

Technology resilience came to the fore, a result of greatly accelerated moves to transform digitally. Change that many assumed would take years suddenly happened in a matter of weeks or months. The art of the possible became the art of the actual. With it has come energizing opportunities to deliver more value to customers and transform operating models and ways of working. But new risks abound, including how to build in resilience by design; carefully manage the transition to the public cloud; and govern and manage risks associated with large scale use of machine learning (ML) and artificial intelligence (AI). Cybersecurity concerns remain top of mind, especially within a sustained remote working environment with

an increased attack vector, and so many more customers accessing financial services remotely than ever before.

Societal resilience became that much more important. During 2020, as people worked and schooled from home, it was very evident the negative impact people have been having on the planet at large. Who wasn't shocked by satellite images over metropolitan areas showing how the smog of industry and commuting lifted as we stayed at home? We all knew the effect was real, but perhaps it was difficult to grasp: seeing glaciers melt in Greenland felt too distant for so many of us. Thus, climate change has become the existential threat to the planet, with significant consequences for the financial services sector.

Resilience, then, becomes the defining characteristic of long-term success for banks globally. Bank boards and senior management, advised by the chief risk officer (CRO) and risk team, have to capture the potential offered by change, manage the associated risks and remain resilient across many complex dimensions.



Priorities shifted significantly over the past 18 months

Since the last EY/IIF risk management survey,¹ a lot has happened. Going into 2020, the main topic for many was climate change. It was the center of attention at the World Economic Forum in Davos. What had felt like an emerging issue had hit a crescendo on the world's political and business scenes.

For sure, there were growing concerns about the global economy. In the 10th annual survey, credit risk had been working its way

up board and CRO agendas. Geopolitical concerns also rumbled in the background.

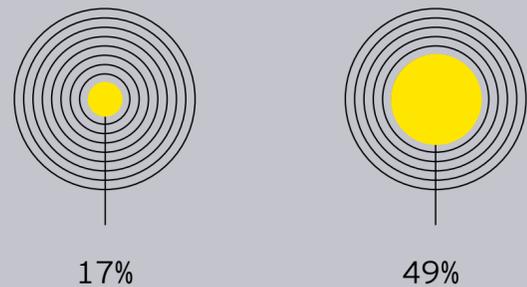
Then came COVID-19. An unprecedented public health crisis hit globally, with severe economic implications. The widespread impact on the economy triggered turbulence in financial markets and the real economy. Even today, we are still reeling from the effects and likely will be for years to come.

A view from the top

Climate change shoots up everyone's agenda

As a result of the last 12 to 18 months, CROs identify a range of changing priorities for their teams and for boards of directors, as shown in Figure 1.

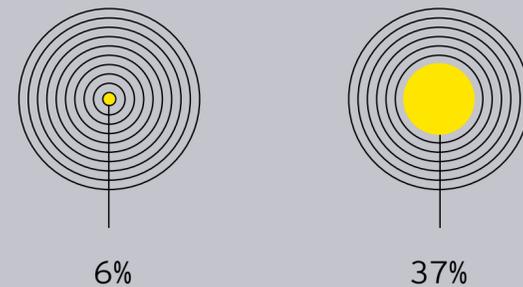
Environmental concerns among CROs



18 months ago

Next 12 months

Environmental concerns among boards



18 months ago

Next 12 months

Not surprisingly, credit risk has become the number one risk over the next 12 months. Banks came into the crisis in far better financial health than they did going into the last global financial crisis (GFC), with capital and liquidity positions strengthened substantially. But the sheer scale, depth and prolonged nature of the COVID-19-induced economic shock means banks are heavily focused on credit concerns, albeit government support measures have gone a long way in supporting businesses so far through the pandemic.

Cybersecurity remains high on the agenda, of course, especially with so many employees working remotely, and with

the prospect of remote working being a permanent feature of many workplaces. High-profile cyber attacks also explain why cybersecurity remains high on board and executive agendas (ranked second for both). The risk that has shot up the agenda most, however, is climate change and environmental concerns more generally.

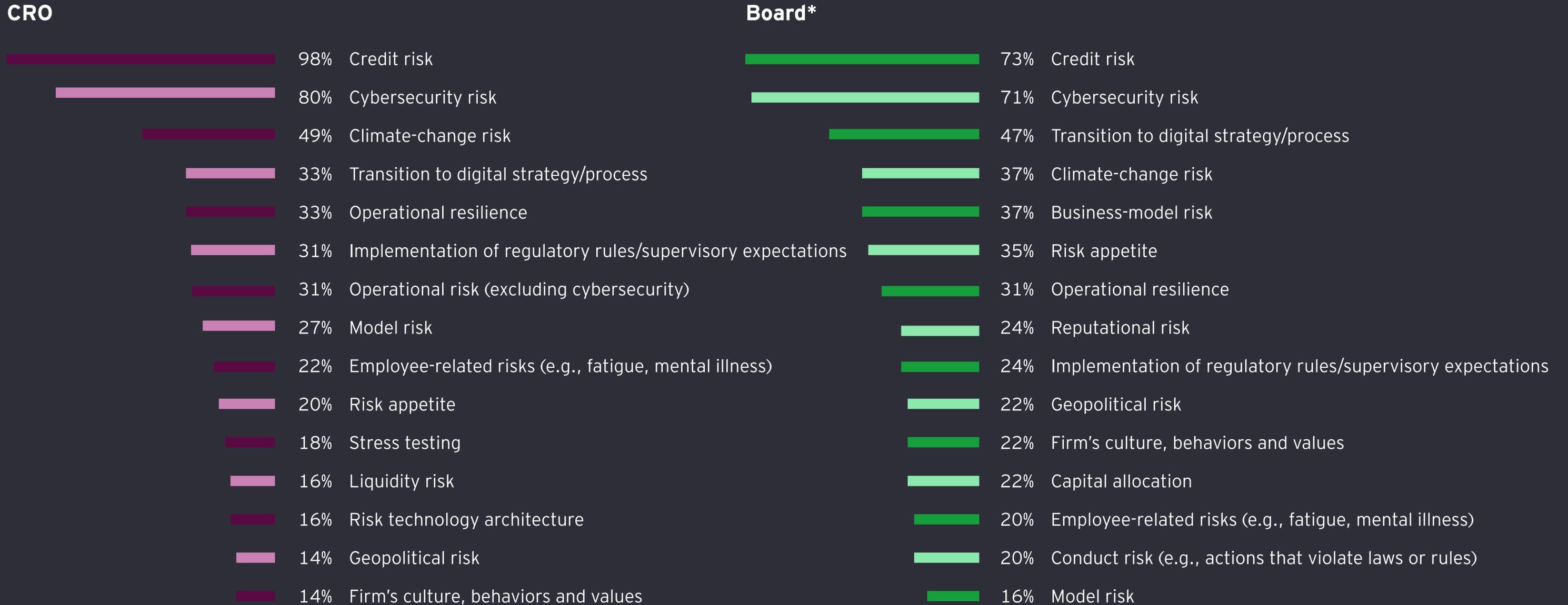
Almost half (49%) of CROs now view it as a top risk requiring their upmost attention over the next 12 months. Eighteen months ago, only 17% took that view. CROs highlight this risk is also higher on the short-term risk agenda for boards - over a third (37%) of CROs believe their boards see climate risk as a top risk priority, up from just 6% in 2019.



COVID-19 demonstrated how suddenly risks and priorities can change – and therefore, how crucial flexible and dynamic risk management frameworks are.

- Tim Adams, President and Chief Executive Officer, IIF

Figure 1: Risk issues garnering CRO and board attention over the next 12 months



* In the CRO's view

The focus on climate change is even more striking when viewed over the next five years, as shown in Figure 2. Over nine in 10 CROs (91%) and boards (96%) view climate change as the top emerging risk. Only about half (52%) of CROs stated that in 2019.

Second most important is the length and depth of the global economic recovery. The near-term risk priority may be credit, but banks remain worried that prolonged adverse economic conditions will continue, especially as countries may face new waves or variants of COVID-19 and support measures are expiring. The longer we have depressed economies or uneven recoveries, the worse credit issues are likely to become.

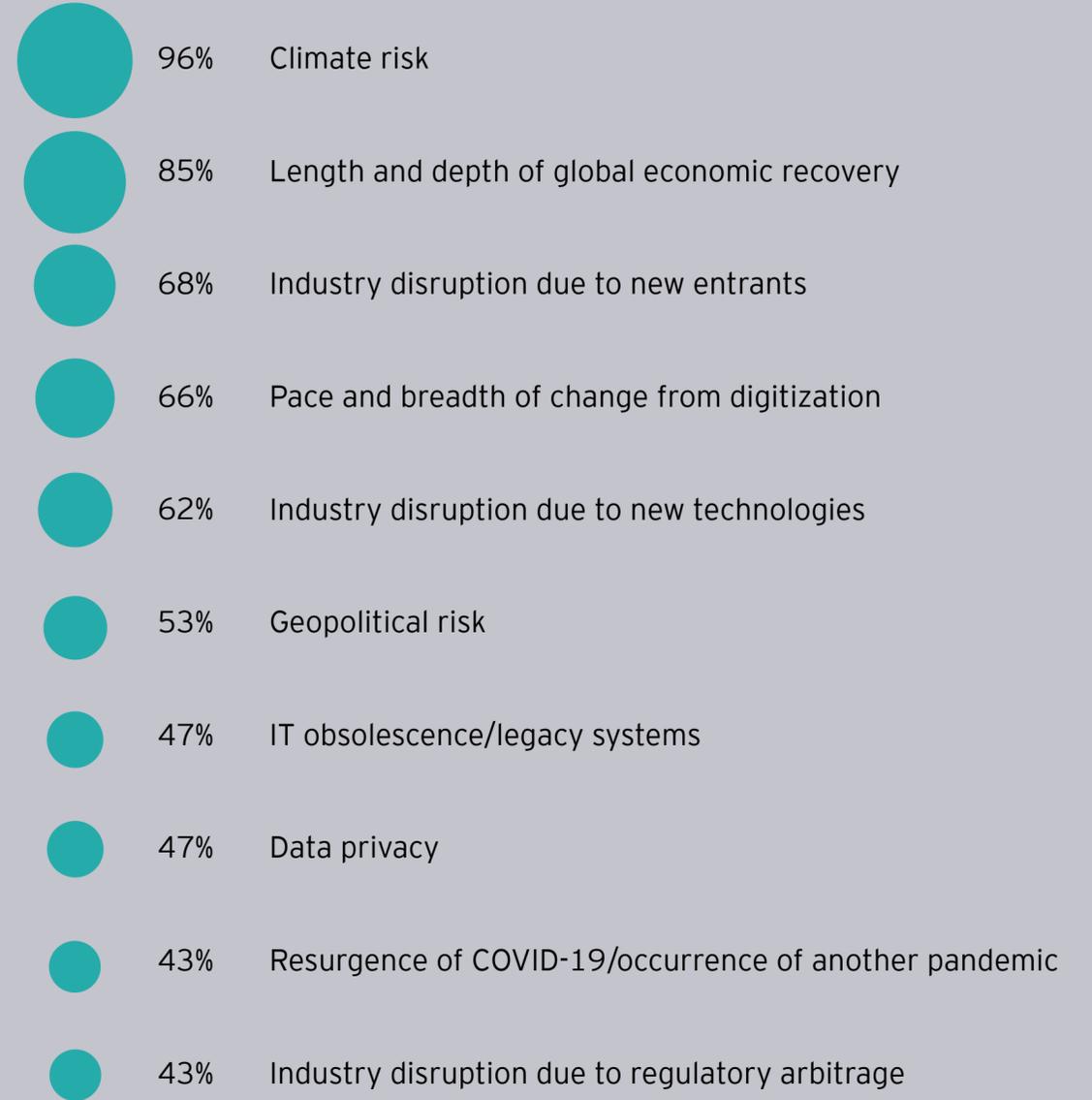
From a CRO perspective, seven of the other top 10 emerging risks over the next five years relate to technology and data: the pace and scale of digitization and industry disruption from new technology; legacy systems and IT obsolescence; the pace and scale of digitization and industry disruption from new technology; IT obsolescence and legacy systems; data integrity; data privacy and the use of ML and AI. CROs believe boards have similar concerns, although they indicate boards are more focused than they are on industry disruption from new entrants and geopolitical matters (see “Managing geopolitical risks”).

Figure 2: Most important emerging risks over the next five years

Concern to CRO

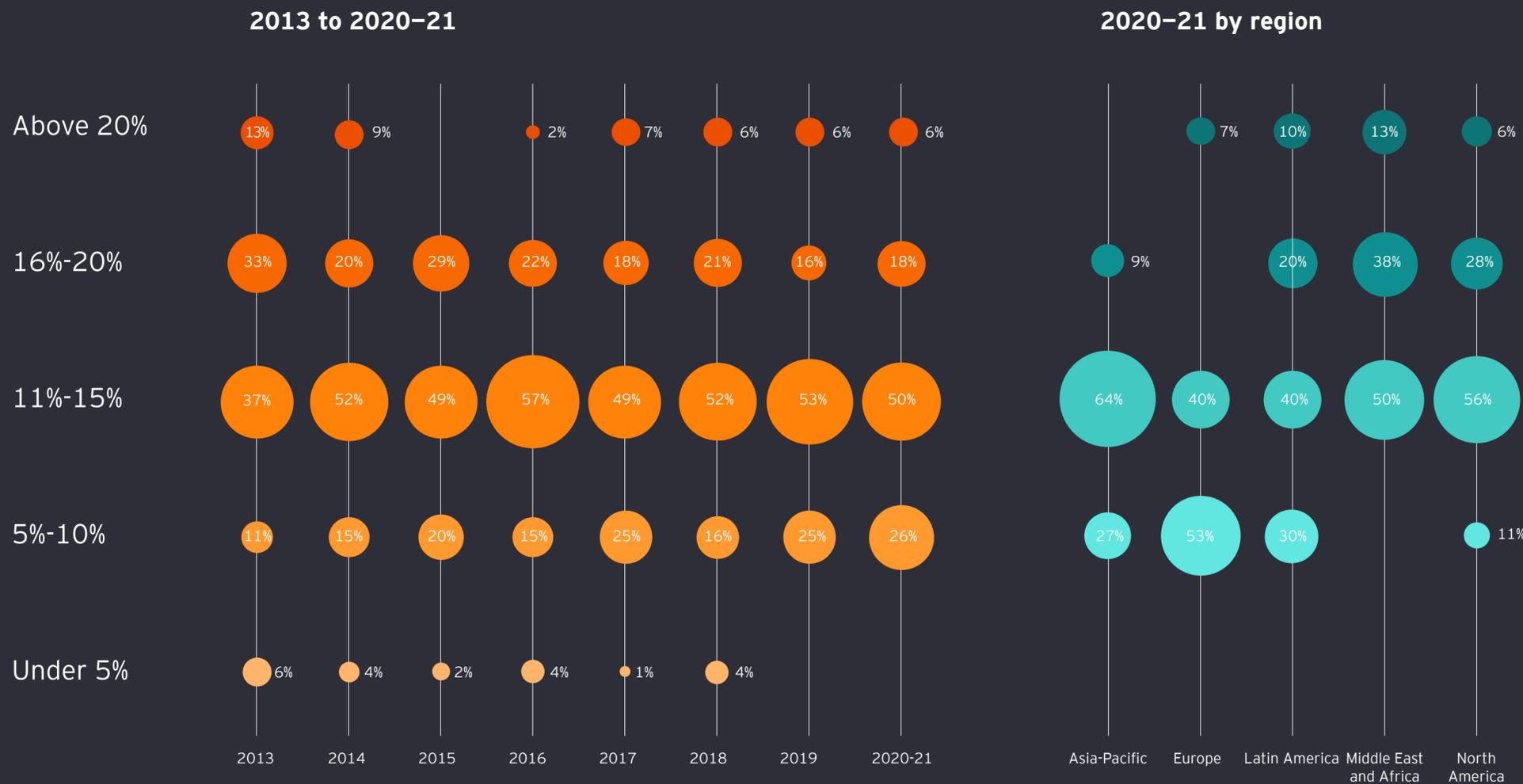


Concern to board*



* In the CRO's view

Figure 3: Global industry convergence, regional divergence
Forward predictions of return on equity over the next three years



Still expect strong returns, albeit depressed by COVID-19

Over the course of the EY/IIF survey, the economic picture for banks has been generally improving, in line with the broader global economy. Average expected returns on equity over a three-year horizon converged on 11% to 15% five or six years after the 2008 to 2009 GFC. While it has become harder to deliver the pre-GFC 20%+ returns, given higher operating costs and cost of capital, none of the banks in the survey since 2018 have expected their returns to be below 5%. This is quite an achievement, especially most recently given COVID-19-induced, severely distressed economic conditions.

However, regional differences still persist. European banks continue to be the most challenged, with by far the largest proportion expecting returns over the next three years to be in a range of 5% to 10%. By contrast, North American banks remain much healthier, with over a third (34%) expecting returns to be above 16%. Other regions are somewhere in between, although Latin America shows the greatest divergence of expectations for returns compared with other regions. However, regional differences still persist, as shown in Figure 3.

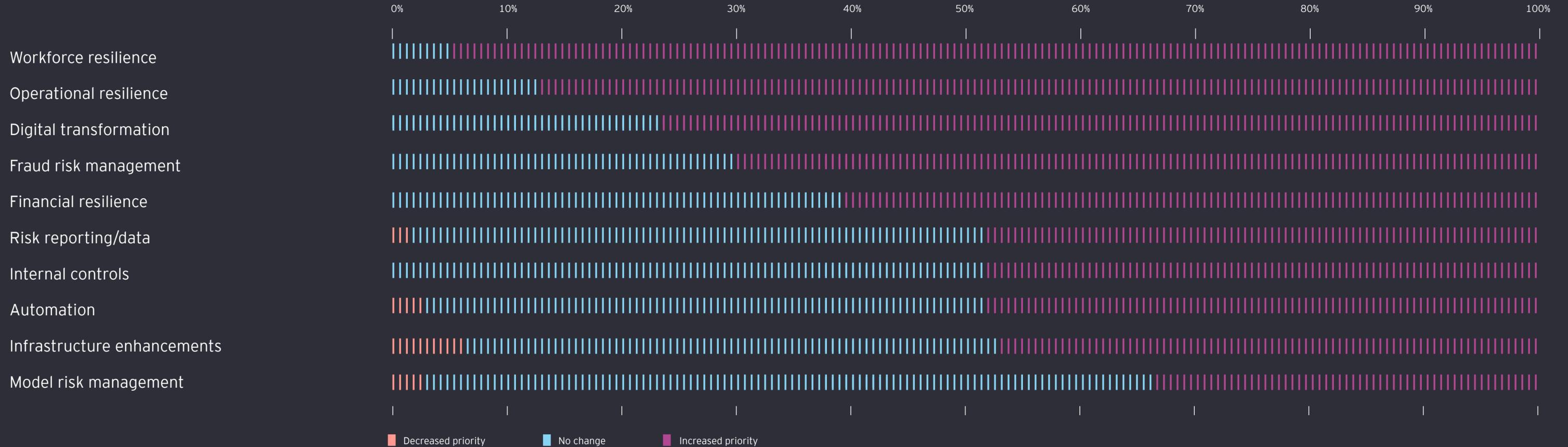
Effect of COVID-19 on priorities

A need to become more resilient



Banks were already investing more in operational or enterprise resilience, building on a decade of enhancing financial resilience. COVID-19 strengthened these priorities and added others, as shown in Figure 4. Workforce resilience (95%) also became a higher priority, as did digital transformation (77%) and fraud risk management (70%).

Figure 4: COVID-19 impact on priorities



Indeed, COVID-19 - and before that, the growing focus on climate change - highlighted that, if the last 10 to 12 years has been about financial and operational resilience, the next decade will emphasize other broader aspects of resilience. These include the resilience of technological transformation, which has been accelerated through COVID-19; the enduring need to focus on workforce resilience and employee well-being; and societal resilience and the role

financial services can play as a catalyst to customers and clients doing more to slow climate change - and better manage the associated risks.

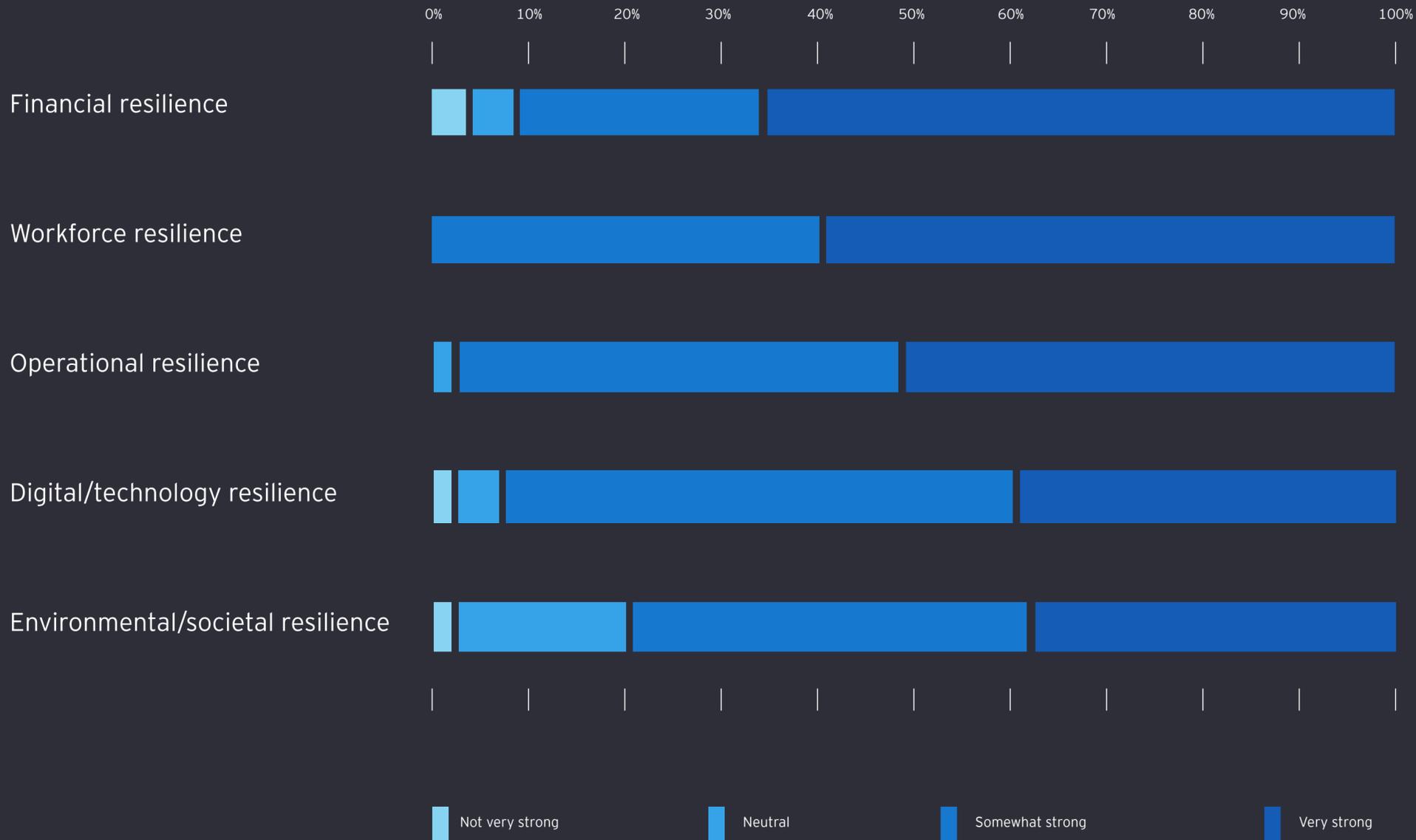
Bank CROs have a clear view on which aspects of resilience are most important. They view continuously delivering services and maintaining safety and soundness as extremely important (82% and 63%, respectively). But they also recognize the

broader aspects of resilience, with 57%, 53% and 47%, respectively, viewing the ability to recover financially, the need to support the community and environment, and the need to contribute to financial stability as important.

They are also open about the fact that their organizations have real work ahead to enhance their firms' resilience, as shown in Figure 5. They are fairly confident about

financial resilience, as you would expect after decade-long capital and liquidity enhancements. The somewhat unexpected success of work from home during COVID-19 also makes CROs fairly confident about workforce resilience, although there are real concerns about retaining a strong culture and controls and managing workforce fatigue. They are less confident about their banks' technology and societal resilience.

Figure 5: Confidence in banks' resilience



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Over the last 18 months, resilience across both existing and new risk dimensions has become a defining characteristic of long-term success for banks globally. The good news is that the majority of banks have coped well during the crisis and have a great opportunity to innovate for better resilience and future growth.

- Jan Bellens, EY Global Banking & Capital Markets Sector Leader

Managing geopolitical risks

Banks' boards and CROs view geopolitical risks as significant. Indeed, roughly half place such risks in their list of top emerging risks over the next decade. About the same number (53%) expect political risks to have more of an impact on their organizations over the next year.

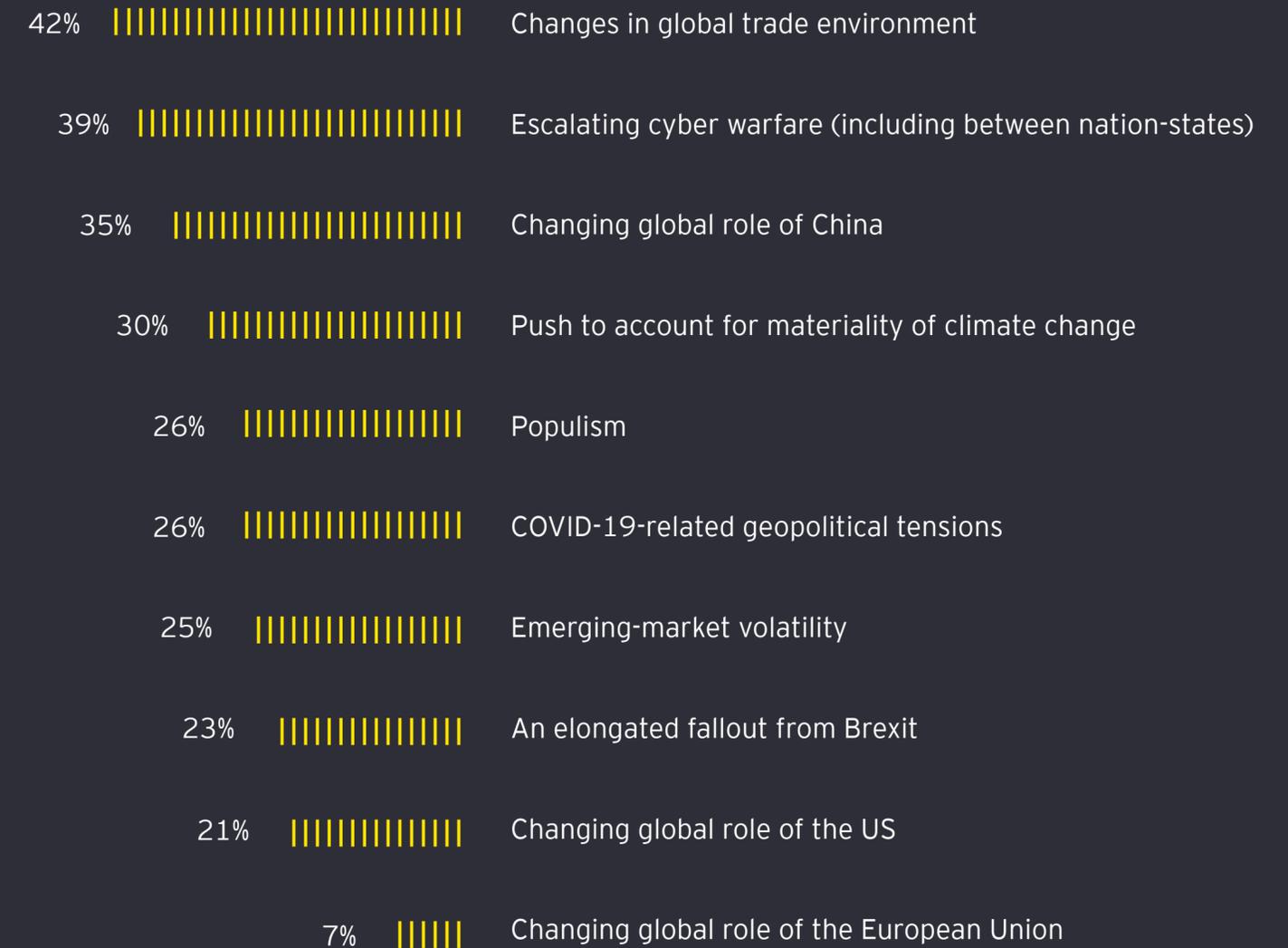
CROs indicate their concern is driven by a number of risk issues, as shown in Figure 6. Many of the issues should come as no surprise, given the focus on each in a period that featured trade conflicts, major state-led geopolitical attacks and a swath of climate initiatives leading up to the UN Climate Change Conference (COP26) in November 2021. Executives overwhelmingly indicate that a negative impact on demand (72%) or unexpected market volatility (67%) are most likely to affect their business.

Banks are focusing on better managing geopolitical risk. Over half of respondents indicate they plan to increase investment

in engaging with executive leadership and the board to inform decision-making (57%). Nearly three in 10 said that they plan to connect better with industry groups to coordinate actions on political risk. This seems to already be starting - over a third of respondents are coordinating via industry groups to address growing societal risks (36%).

As human-capital-driven companies, banks are rightfully focusing on their employees and proactively communicating with them on social issues (66%). In a period that has seen high levels of social protests and tensions in many major economies, banks recognize the associated reputational risks. Some are connecting employee communications to a broader enterprise risk approach to social risk (36%) or setting up cross-functional offices to chart strategies on these issues (20%).

Figure 6: Top geopolitical risks affecting banks in the next year





Risk management reaches a fork in the road

Over the course of our past 10 risk surveys, there has been a clear trend toward investing more in risk management. Certainly, the skills required to manage ever-more complex risks have continued to evolve and this year is no different. Nine of 10 banks expect to broaden the skills within their group, with most (85%) making some targeted additional hires and a small number (5%) expecting to add additional skill sets across a number of areas (see “Risk skills of the future”).

Better use of technology creates an option to control costs

Figure 7: Expected trajectory of the cost of controls over the next three years



When previously asked about future budgets, the common response was that the cost of risk management was going up. Few, if any, banks had found a way to maintain or enhance risk management, while simultaneously reducing costs.

This year's survey suggests banks are starting to diverge in their strategies. About two-third of banks (69%) are still expecting the cost of risk management to go up, with over a quarter (27%) expecting that increase to be over 15%, as shown in Figure 7. But a significant minority (21%) see a pathway to decreasing the cost of risk management.

The fact that we are seeing some banks chart a pathway to cost control points directly to the ever more present use of

technology and data. Over three-quarters (76%) of banks are automating manual processes, considering ways to enhance risk data (56%) or harmonizing control frameworks (36%). However, there are countervailing needs that could push up the cost of controls, notably managing risks associated with accelerated technology transformation (67%), enhanced cybersecurity to support remote working (56%) and enhanced or new regulations or supervisory expectations (26%).

Time will tell whether an increasing number of banks are able to balance the need to invest in new controls and leverage technology and data analytics to do more for less. Those banks that get the balance right will likely excel.

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Risk leaders are realizing they can do more and do better if they use data and technology and embrace innovation in how they operate.

- Federico Guerreri, EY Global Financial Services Risk Leader

Risk skills of the future

If COVID-19 has taught us anything, it is that flexibility and agility are essential. Most CROs (70%) believe the ability to adapt to a changing risk environment is the most important skill to be prioritized in the coming years. Risk professionals need to be able to focus on value-added, growth-oriented roles for risk management (cited by 49% of CROs) and know-how to leverage data (48%). They increasingly need to know more about agile ways to innovate and have a broader understanding of risk domains.

Agility fits within broader moves to agile ways of working, in which governance and organizational structures have to be adapted to speed up decision-making. Making it work, however, is complex because it not only

requires employees being predisposed to faster, more incremental change, but they and their leaders have to embrace a test-and-learn and deal-with-failure culture. Performance and reward systems have to be able to recognize more complex individual and group contributions. Thus far, risk management teams have been slow to actively adopt agile decision-making.

The specific skills in demand by those banks adding new professionals over the next few years align with new risks, such as climate change, and new technologies used in risk management and across the banks, such as data analytics science and AI, as shown in Figure 8.



COVID-19 has further underscored that agility remains one of the most important skills for risk managers, who have to manage emerging and fast-evolving risks, including those around cyber and climate change. - Andrés Portilla, Managing Director, Regulatory Affairs, IIF

Figure 8: Most important risk management skills over the next three years





Staying financially resilient to support economies and markets

The fact banks came into the COVID-19 crisis with such strong capital and liquidity positions – and for the most part, those cushions still remain – put them in a strong position to play a critical role in supporting economies, communities, customers and clients.

Credit, credit, credit

Even with strong financial positions, banks are naturally concerned about the potential for prolonged adverse economic conditions and, as a result, possible credit challenges. The state of these concerns changes as signs of economic improvements can be seen or as new waves of COVID-19 are identified.

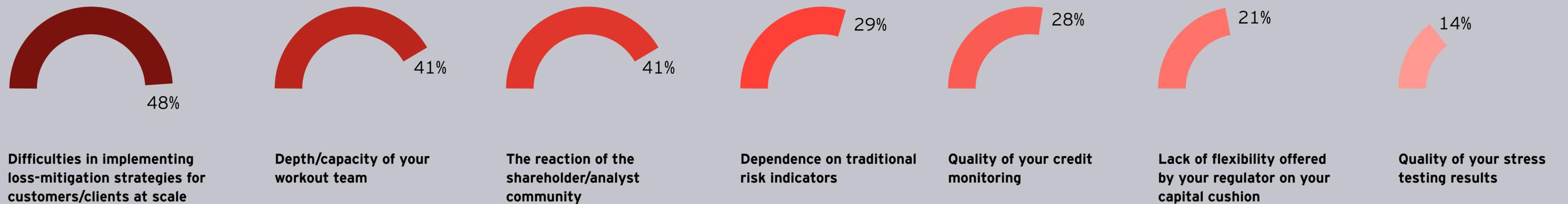
At the time the survey was conducted, just over a half of CROs (53%) indicated that they were not that concerned, believing they had ample capital, even for sustained, extremely negative, economic conditions. But over a third (36%) acknowledged that, if conditions deteriorate significantly, they would be

challenged. Just over one in 10 (11%) had even higher levels of concern.

To the extent banks start to experience significant credit losses over the next 12 to 18 months, CROs' main concerns center on banks' ability to deploy loss-mitigation

strategies for customers at large scale and the depth of their workout teams managing commercial clients (see Figure 9). They also worry about the reaction of shareholders and analysts to credit challenges.

Figure 9: Key concerns if the bank experiences significant credit losses



Together with extensive government support programs, banks showed enormous initiative in helping their customers and communities throughout the crisis. But there is prevailing uncertainty about the strength and breadth of the economic recovery. - Richard Gray, Director, Regulatory Affairs, IIF

Models stressed to the limits

A real challenge for banks during COVID-19 was their ability to conduct credible scenario analysis and stress tests. While banks have built up strong capabilities in this area, to meet regulatory obligations to assess capital and liquidity positions under stressed environments, few banks had built models to accommodate a global health crisis that brought global economies to a virtual standstill in a matter of weeks. Thankfully, some regulators suspended or delayed regulatory-run stress tests, which relieved some of the operational pressure on banks during the pandemic.

In many cases, historical correlations underlying many models used for risk management purposes made their application during COVID-19 challenging. As a result, many banks had to leverage new or alternative sources of data for risk management purposes (e.g., mobility data). Only about a quarter (26%) of banks did not

do so. Almost half of banks (48%) used new data sets and will continue to do so post-COVID-19, with over a fifth (22%) finding such data sets so informative that they are actively expanding what data sets they will use, going forward. "New data set analyses enabled the bank to create models for 2021 to assess the path to recovery of certain clients," said a risk executive.

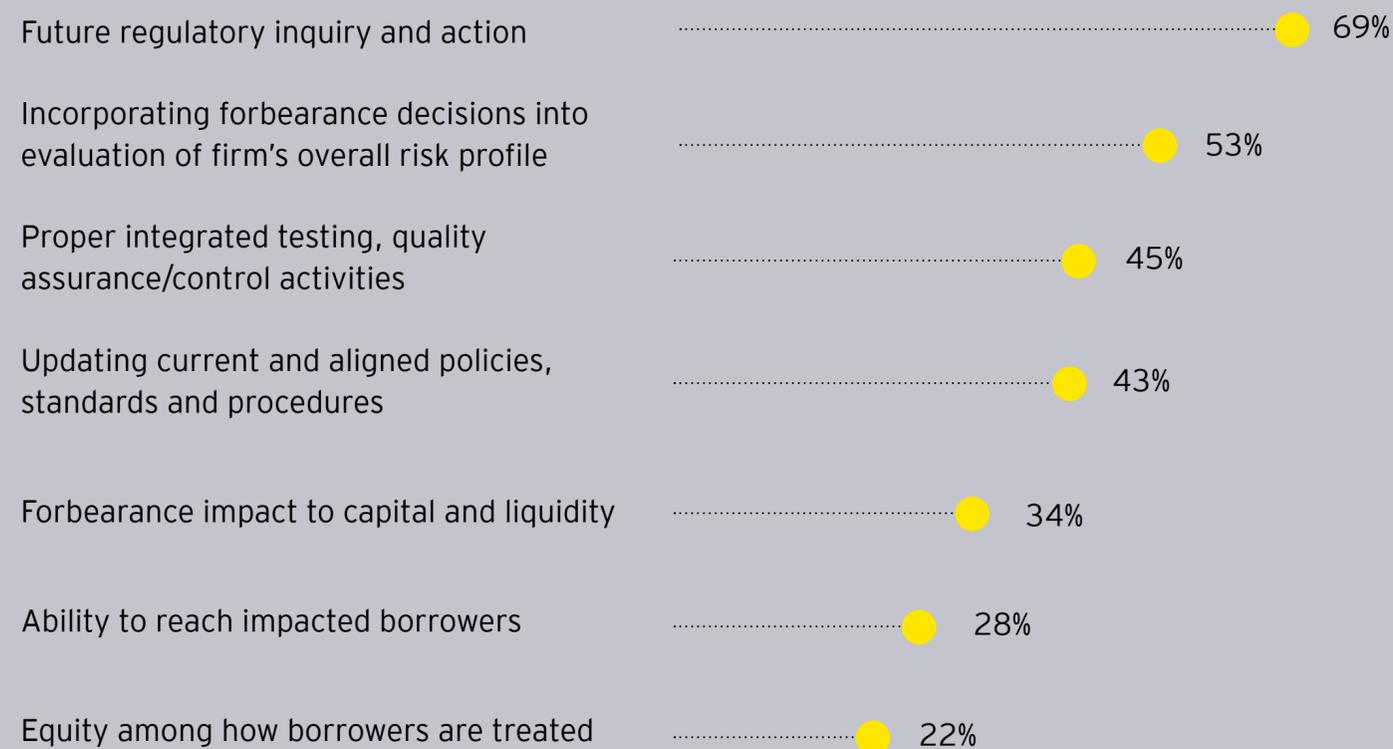
In conducting scenario analyses, banks point to a range of factors as being critical to develop a future outlook, as shown in Figure 10. Not surprisingly, the availability and distribution of COVID-19 vaccines globally remain the central factor driving bank outlooks.

Figure 10: Critical factors in developing a future outlook to conduct scenario analyses



Enabling customers and clients to get back to 'normal' will be challenging

Figure 11: Top concerns about loss mitigation/forbearance decisioning over the next 24 months



During COVID-19, banks enabled government support programs and proactively initiated measures and programs to support households and businesses experiencing financial hardship. Such relief included direct payments, offering loan-payment forbearance, fee reductions or waivers, and suspension of home foreclosure and evictions or repossession. Banks know the initiatives were necessary and part of their ongoing commitment to their local communities.

However, banks have concerns about how they will work with millions of customers and clients in getting them back on track financially. Forbearance doesn't equal forgiveness.

In terms of loss mitigation and forbearance decisions that will need to be made over the

coming 12 to 24 months, a large majority (69%) of bank CROs are most concerned about future regulatory inquiry and action about how government stimulus programs were administered by banks. The fact governments emphasized the need for a swift distribution of funds meant banks had to scale up processes significantly and quickly to meet customer needs and government expectations.

Other concerns, shown in Figure 11, relate to the practicalities of implementing loss-mitigation for vast numbers of customers in a way that aligns with the bank's risk appetite and its policies and procedures, and provides for equitable outcomes across all types of borrowers.

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Banks showed financial strength during the crisis. Helping customers getting back on course financially is the next big challenge. - Sonja Koerner, EY Risk

Transformation Leader, Banking & Capital Markets

Expect further tightening of financial resilience



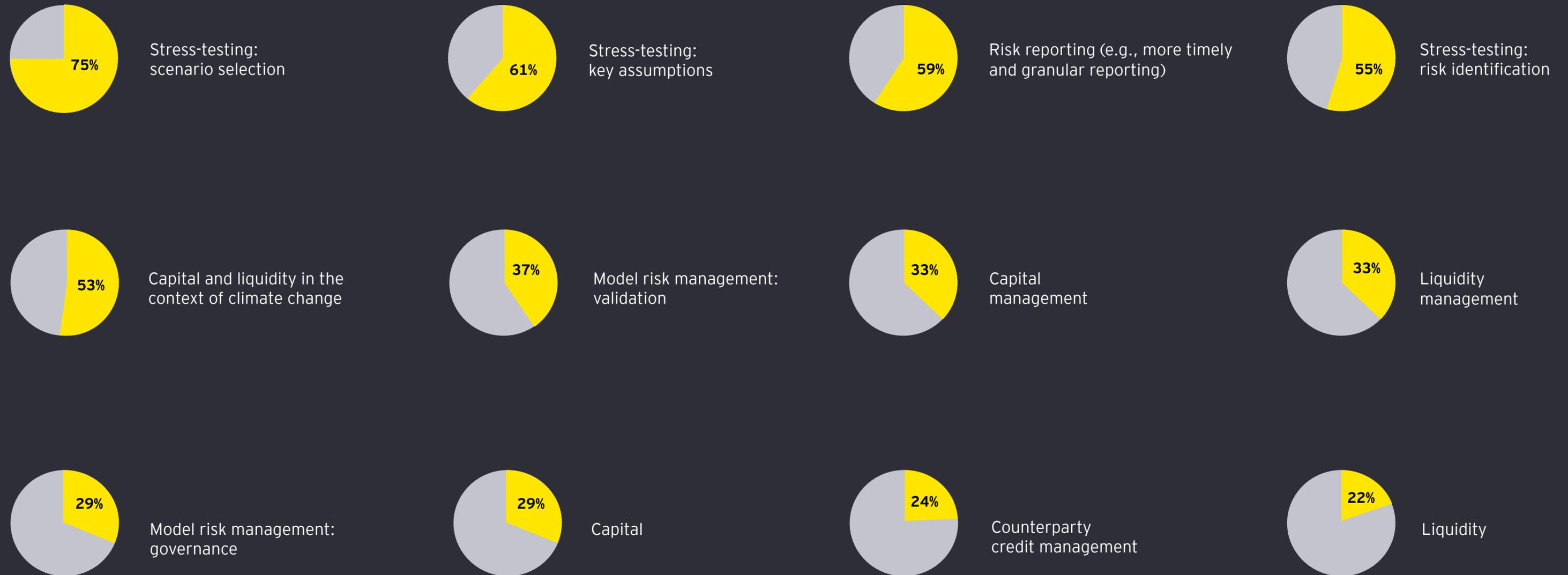
Banks have varied views about what can be concluded from COVID-19 as to the effectiveness of financial regulations implemented since the global financial crisis.

About one in 10 (12%) believe there will be no change - in effect, regulations have been found to be effective, overall. Almost twice that number (22%) believe the COVID-19 experience will generate more energy to reviewing financial regulations, with a view to identifying areas where regulations can be eased permanently. Here, banks have in mind regulations linked to leverage, margining and procyclical measures, which may have constrained banks' abilities to support economies and financial markets or necessitated more central bank intervention than may have been needed otherwise. However, two-thirds of bank CROs expect new or additional regulatory requirements, once we get past COVID-19. Such changes are expected most in the areas of stress

testing and risk reporting, as shown in Figure 12. Interestingly, over half (53%) of banks expect tougher requirements for capital and liquidity in the context of climate change. This reflects the growing focus of prudential regulators on potential financial consequences - for bank safety and soundness, as well as financial stability - from climate change.

An interesting question for regulators to consider as they reflect on lessons learned during COVID-19 will be banks' reticence to avail themselves of voluntary capital or liquidity buffers (above regulatory minima). The vast majority (88%) of banks in this survey did not draw down on their buffers.

Figure 12: Expected new or additional financial resilience requirements over the next three years





Staying resilient to continuously deliver services

In the past two to three years, regulators have greatly stepped up their focus on enterprise resilience.

The initial focus was on cybersecurity - the intensity of attacks on banks, and growing threats of a destructive nature, put cyber risks at the top of the agenda and they remain central concerns for regulators, boards and CROs.

However, in recent years, the focus shifted to broader operational resilience challenges associated with an ever more complex financial ecosystem and increasing

dependence on third (and fourth) parties - especially vendors who are critical to institutions or the industry at large.

Most recently, enterprise resilience centered on end-to-end continuous delivery of critical services. This can be seen clearly in guidance or requirements issued by international groups, such as the Basel Committee on Banking Supervision, or domestic regulators in the UK, US, European Union and elsewhere.

COVID-19 tested banks' operational resilience

In some ways, the pandemic can be viewed as an extreme live test for operational resilience.

Every aspect has been tested for a sustained period. Prior to COVID-19, banks were typically running simulations to see how long they could sustain services during a disruption lasting days or weeks. COVID-19 has tested capabilities for over a year.

For the most part, banks have performed very well. In reality, we have all been encouraged by just how well banks - and other organizations - transitioned to a fully remote model without major, sustained problems. The technology worked generally, business got done and customers and clients have been able to access services remotely and securely.

But there are lessons to be learned from an operational resilience perspective. Banks highlight a large number of high-priority tasks over the next three years, as shown in Figure 13. Cybersecurity and matters related

to third parties have clearly been further prioritized, as has technology capacity related to staying resilient (see "Focus on critical vendors"). Inevitably, this means banks will need to invest more in resilience over the next few years. After all, very little is viewed as a low priority.

To some degree, changing priorities reflect the learnings banks accrued in seeing how well various risk frameworks were integrated into operational resilience. As shown in Figure 14, a large majority of banks acknowledge data management and privacy were not that well integrated, and neither

was IT change management and third-party risk management. Indeed, few areas can be viewed as fully integrated.

This highlights the fact that operational resilience has to be woven deep into the fabric of operations and risk management, leveraging across existing approaches, and not viewed as a distinct discipline operating in isolation. Many employees have a role to play in helping banks maintain services for their customers and clients, whether working remotely or onsite.

Figure 13: Resilience priorities over the next three years

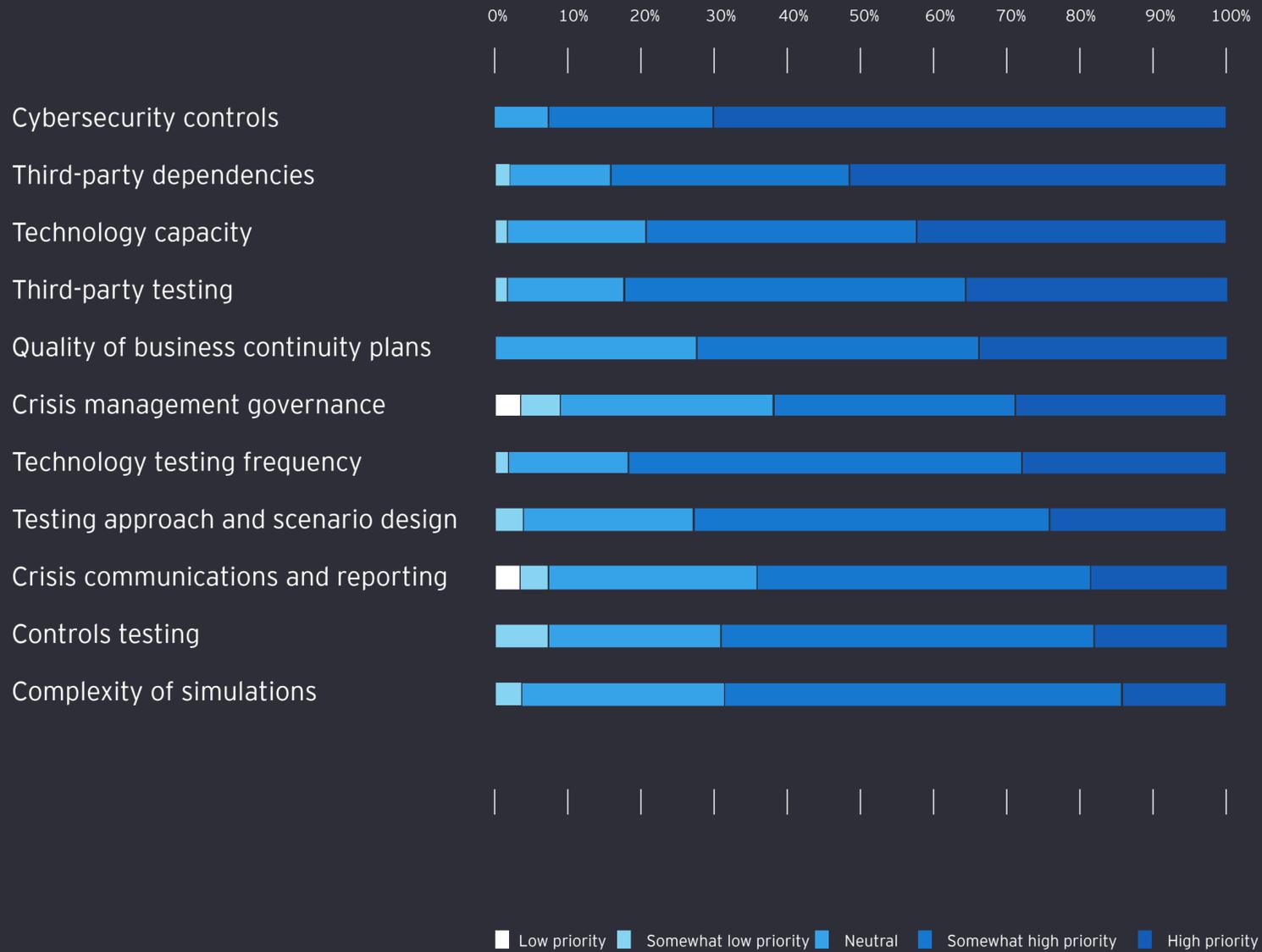


Figure 14: Observations on integration between risk frameworks and operational resilience



Expect enhancements ahead

In light of lessons learned during COVID-19, banks expect to enhance a number of areas, including:

- Cybersecurity controls, including identity access management (70%)
- Business continuity plans (58%)
- Crisis plans (56%)
- Fraud risk management (51%)

Being proactive is a major theme when talking to CROs about what they learned

about operational resilience during COVID-19. “We are using business resilience to identify preventive steps and looking to rigorously test our plans, for example, by using reverse stress tests to find breaking points,” explained one CRO.

Most banks (93%) expect regulators to impose additional or new operational resilience requirements over the next few years. Expected areas to change include data protection, third parties and end-to-end testing, as shown in Figure 15.

Inevitably, banks will need to review their approach to privacy, post-COVID-19, as well. COVID-19 may have rapidly increased reliance on digital services and platforms,

but it also reshaped consumers’ attitudes toward personal data privacy and altered their behavior. As shown in EY’s Global Consumer Privacy Survey,² for example, 54% of consumers said that COVID-19 had made them more aware of the personal data they share than they were before the pandemic.

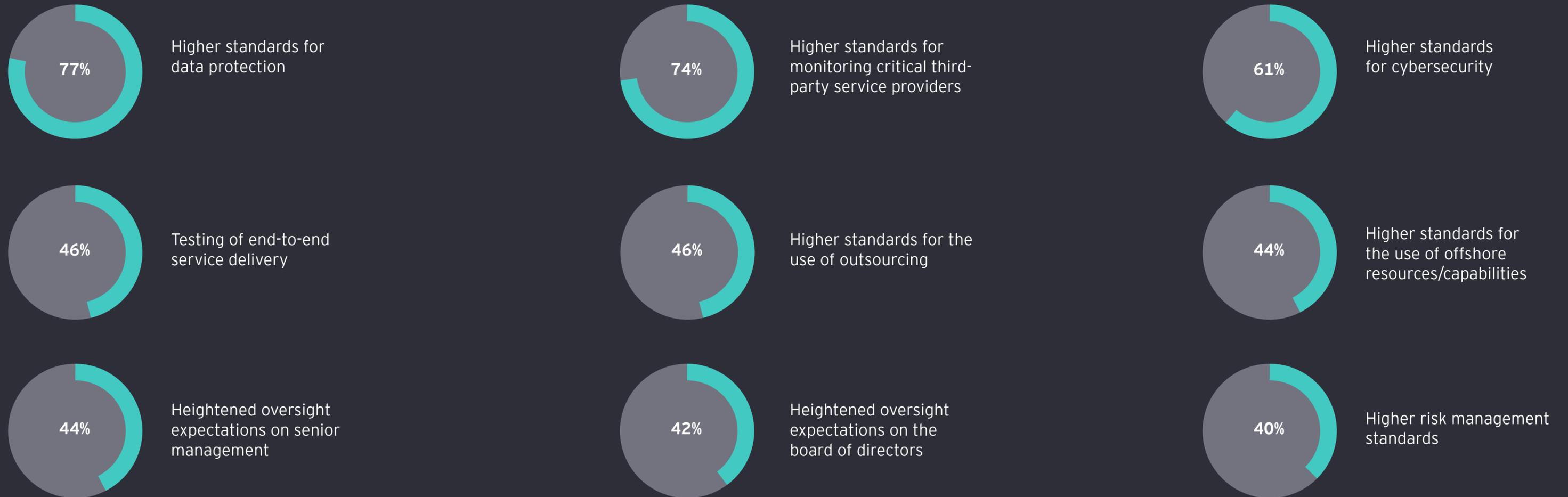
In that context, when asked what is most important to them when they choose to share their personal data with an organization, the majority point to secure collection and storage (63%), control over what data is being shared (57%) and trust in the company collecting their data (51%). Thus, the link between maintaining trust and protecting personal data has become even more entwined.

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Banks continued to invest in and improve their operational resilience during the crisis despite major organizational transformations that the pandemic made necessary.

- Martin Boer, Director, Regulatory Affairs, IIF

Figure 15: Additional regulatory requirements over the next 12 to 24 months



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Banks have identified a number of important lessons learned through COVID-19 to better deliver services end to end. - Ali Kazmi, EY EMEIA Resilience Leader

Figure 16: Expected actions to improve resilience of critical third parties



Focus on critical vendors

As banks have been pushed by regulators to focus on end-to-end delivery of services, they have had to review which third parties are critical. If the service is critical, so too is the third party that supports it (and even more so, third parties that support multiple critical services). This includes services provided to

customers, as well as internal or enterprise-wide functions critical to operations. These will be foundational to any external-facing services and can be critical in their own right.

In considering their COVID-19 experience, most banks (60%) believe they had already identified their critical third parties and had effective plans in place to manage them.

However, while another three in 10 banks had pre-identified their critical third parties, they found their plans less effective than expected. A tenth of banks realized they had more critical third parties than they thought.

Notwithstanding their level of preparedness, banks have identified a broad set of actions they plan to take in the next two years to

improve resilience of their critical third-party service providers and the broader supply chain that supports the banking sector, as shown in Figure 16. As one CRO put it, "We need more real-time engagement with our supply chain – and not just annual assessments. We need to engage key suppliers in different ways."



Making accelerated technology transformation resilient

The industry has been anticipating and preparing for technology transformation – or digitization – for the past several years.

There has been a sense of inevitability that it will move from being the actions of a few to an industry-wide transformation. It seemed to be a question of when, not if.

What no one knew was what was going to be the catalyst for widespread or accelerated change. Notwithstanding evidence that digital

channels were preferred by millennials and Generation Z, customers continued to go into branches and high-net-worth investors still liked visiting private banks. The entrance of large technology players into financial services and the ascendancy of FinTechs were expected to push the industry to transform.

COVID-19 kick-started transformation

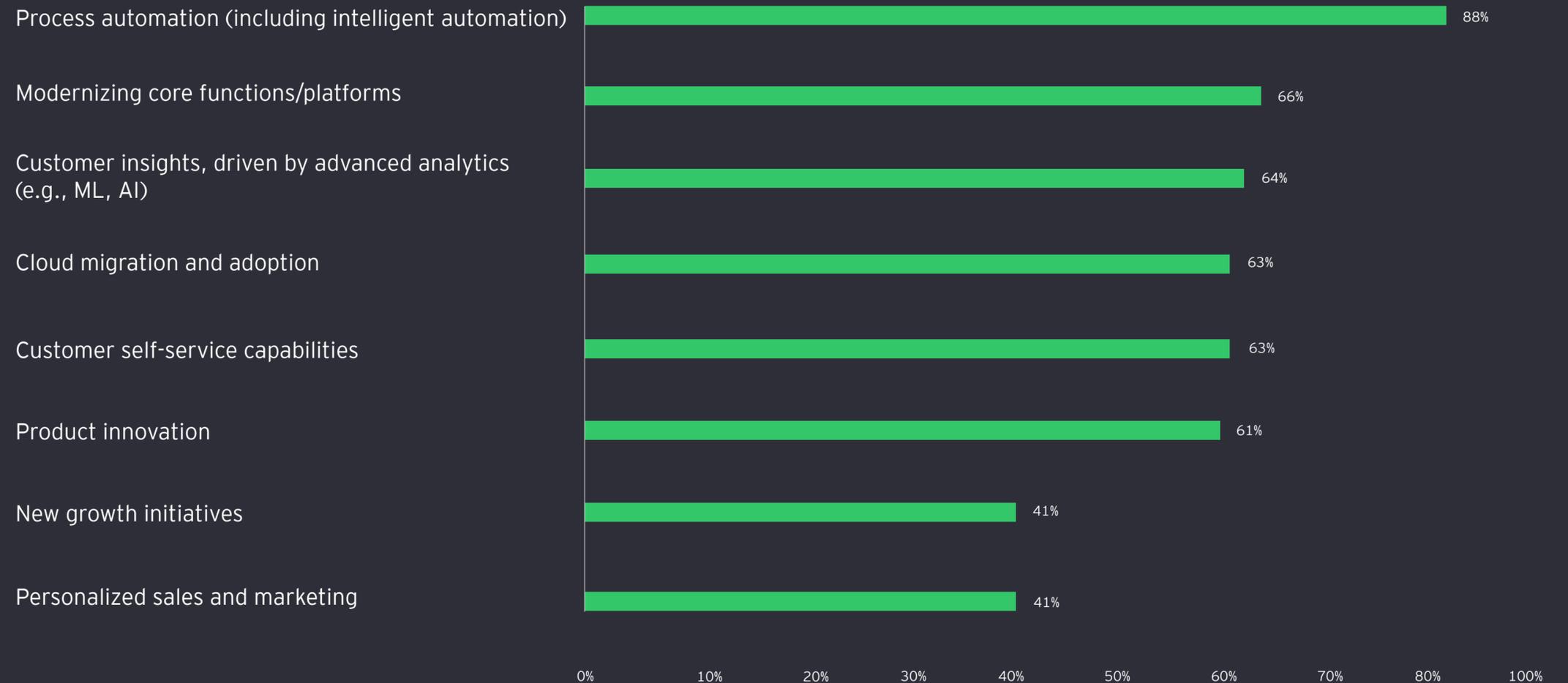


As it happened, COVID-19 was the catalyst to widespread change. All of a sudden, technology transformation became a necessity. Changes that were said to take years took place in weeks or months. Banks had to establish or greatly enhance digital channels, adopt technologies and implement new controls to enable remote work and collaboration.

Weaknesses in core systems may have been known prior to COVID-19, but those deficiencies became critical roadblocks as banks weathered through. The business case for change became much more compelling, especially as banks realized customers and clients quickly got much more accustomed to digital channels to access services and the economic benefits of transformation were shown to be convincing.

CROs expect their senior management team to accelerate transformation in a broad set of areas, as shown in Figure 17. At the top of the list is process automation, which brings with it gains in efficiency and effectiveness. Core IT platforms will also be transformed in an accelerated manner, as will the move to public cloud (see “Managing risks of cloud migration”). Accelerated transformation enables growth and broader change in value delivered to customers, including customer self-service capabilities, product innovations, personalized products and sales and marketing (what some call hyper-personalization). All in all, “technology modernization has become critical,” according to one risk leader.

Figure 17: Areas where senior management will accelerate digital transformation

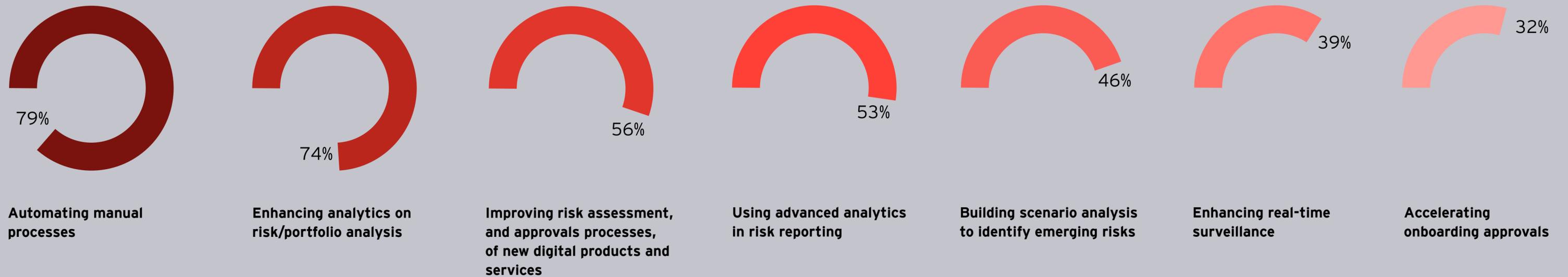


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Technological modernization and transformation accelerated significantly during the pandemic, so risk management needs to catch up to the pace of change.

– Yang Shim, EY Global Financial Services Technology Consulting Leader

Figure 18: Areas to accelerate digital transformation of risk management



Bank CROs point to myriad reasons why digital transformation is being accelerated, but chief among them (for 60%) is support for a more efficient operating model. Meeting customer expectations, enhancing their experience and addressing their differing preferences are also drivers of change. Indeed, one CRO noted, "Customers are very positive about automation. For them, the end-to-end customer journey and experience has improved."

CROs are not simply spectators to technology transformation. They highlight a number of areas where they expect to accelerate digital transformation of risk management, as shown in Figure 18.

As elsewhere, the top area of focus is automation. But portfolio analysis, risk assessments, risk reporting and scenario analysis are expected to be transformed, among other areas. Certainly, early movers in transforming the practice of risk

management stand a better chance of driving down costs, while improving and extending their performance and value-added activities.

Risk in some ways is still playing catch-up with the rest of the organization. COVID-19 changed many banks' strategic initiatives and capital investments to accelerate digital transformation. As one CRO put it, "Risk management has to respond accordingly to ensure we are staying on top of rapid deployment."

Of course, just because the case for digital transformation has been strengthened, doesn't mean change has become easier. While CROs cite a range of constraints, such as a lack of relevant technology expertise, integrated risk platforms or relevant change-management expertise, the two primary constraints are budgetary and the scale of change required (both 67%).

Managing risks of cloud migration

It has become increasingly apparent that digital transformation and the move to public cloud go hand in hand. Legacy systems cannot deliver the flexibility and functionality required, and certainly not for the same cost.

However, concerns linger as to how banks properly and safely migrate to public cloud. Publicized security failures or service outages associated with major cloud providers only exacerbate such concerns.

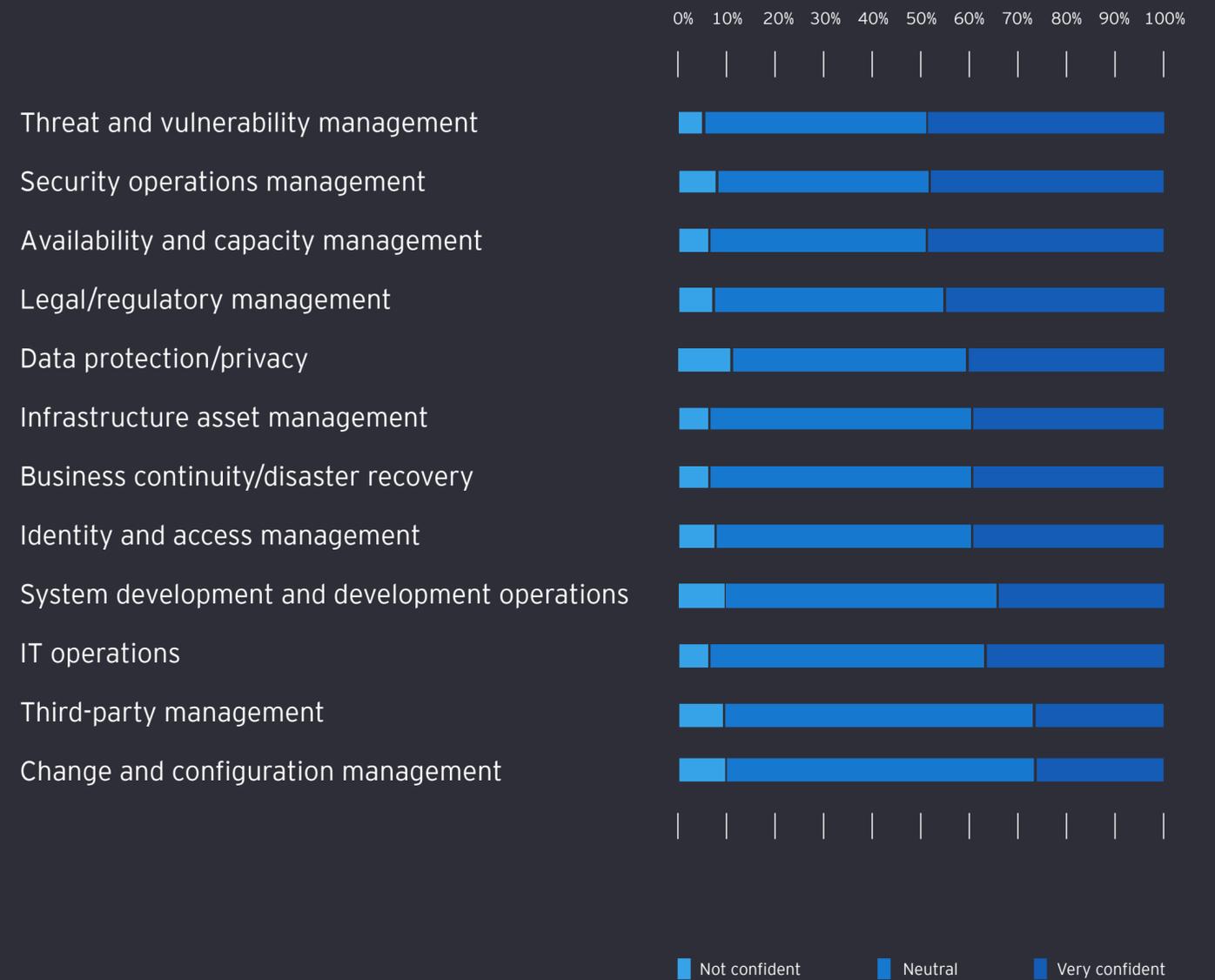
CROs point to a number of concerns, including:

- ▶ Security risk capabilities across both on-premise and cloud environments (59%)
- ▶ Adapting current risk capabilities to address cloud risks (46%)

- ▶ Applying the risk appetite and tolerance framework to cloud programs and implementations (34%)
- ▶ Adapting the culture of the risk and compliance functions to rapid innovation and business-driven transformations through cloud technology (34%)

Back in the 2019 EY/IIF survey, CROs expressed real concerns that banks' move to cloud was not being well integrated with existing processes. Two years on, those concerns remain. As shown in Figure 19, CROs have a fairly low level of confidence that a broad range of management processes are well integrated within their organization's cloud strategy.

Figure 19: Level of confidence management processes are properly integrated in cloud strategy



Managing risks associated with advanced analytics



A common theme in digital transformation is the widespread use of ML and AI.

Advanced analytics support operational efficiency and effectiveness and deliver insights and higher-quality services to customers.

As with technology at large, adoption of advanced analytics has been patchy across the industry. As shown in Figure 20, some banks already use ML and AI in a broad set of applications, while a decent portion do not.

However, between 47% and 63% of banks expect to use these technologies more over the next five years in a broad range of areas.

Broadscale deployment of these technologies needs to be managed carefully. Regulators are increasingly asking questions about how banks manage risks associated with ML and AI, including guarding against the use of biased data and not focusing on compliance risks.

Banks acknowledge that they are, in some ways, playing catch-up with accelerated use of these data technologies. Less than a third believe their existing governance processes properly account for key risks, as shown in Figure 21.³

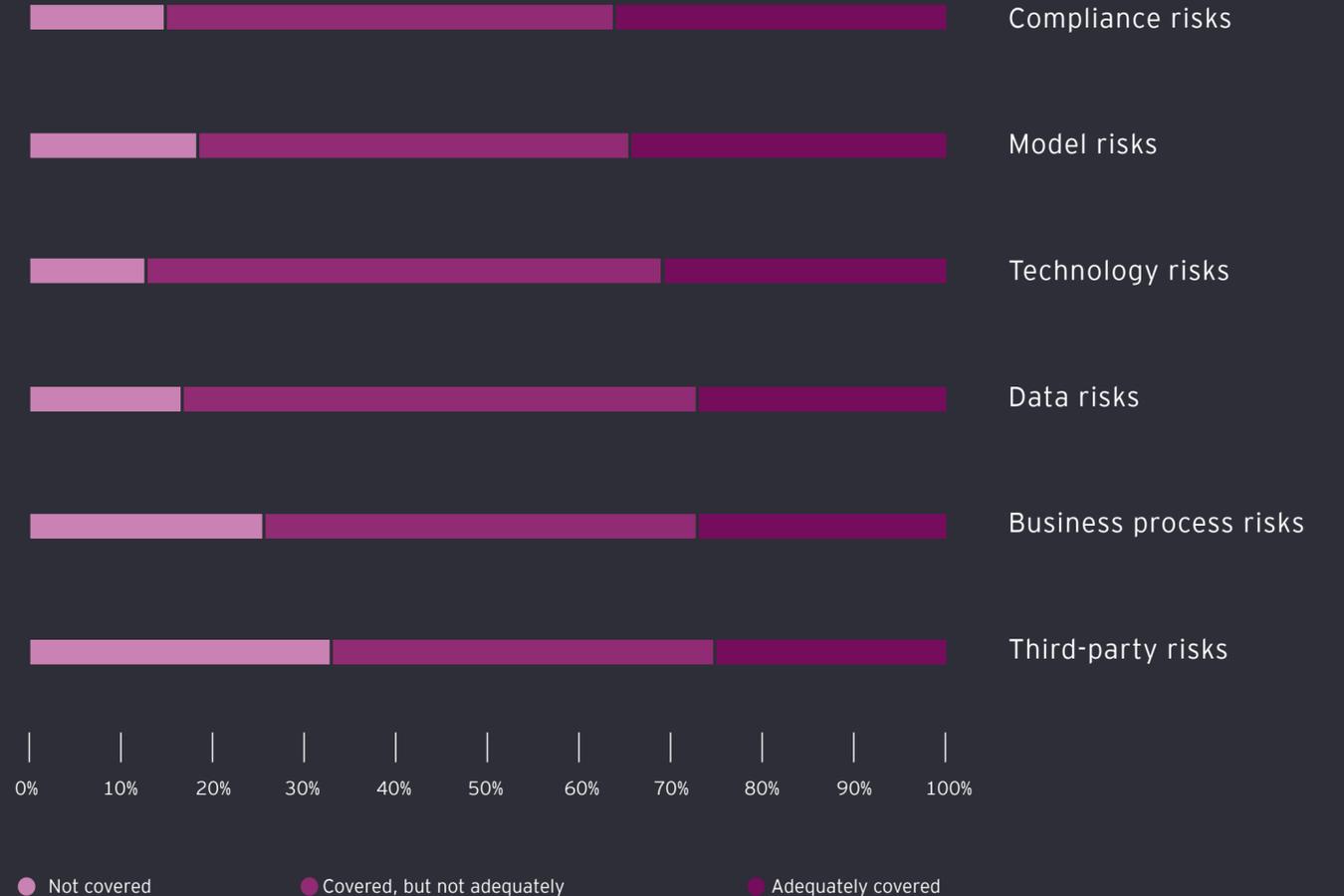


Cloud has been at the center of the sector’s accelerating transformation through the pandemic, and the biggest risk with cloud now is the business and strategic risk of not adopting it. - Brad Carr, Managing Director, Digital Finance, IIF

Figure 20: Current and future use of ML and AI



Figure 21: Coverage of risks by existing governance processes





Promoting workforce resilience and well-being

In the context of operational resiliency, employee safety has always been paramount.

Whether the disruption was severe weather, power outages or local unrest, firms have typically been well placed to reach out to employees and support them in adverse situations.

But COVID-19 elevated employee well-being to a whole new level. Suddenly, work, home and family collided, as most of us transitioned

to a prolonged period of working from home. Employees with care or parental obligations had to prioritize those with work and, as a result, employers had to be supportive. Prolonged periods of isolation or lack of social interaction, coupled with more intense virtual workplaces and oftentimes longer hours, as well as the disease itself, brought forward real concerns about physical and mental health.⁴

4 - For example, in the US, 44% of employees reported their mental health had declined as a result of COVID-19 (see [How do you ensure wellbeing is at the core of workforce resilience? | EY - US](#)).

Challenges in moving to a sustained hybrid working model

Figure 22: Top concerns in protecting employee well-being and health and safety on an ongoing basis



It has become increasingly apparent that employees will not return to work in the manner prior to COVID-19. During the pandemic, work transitioned from a place to an activity, which can be performed outside the walls of a traditional workplace. Although challenges remain, employees have generally enjoyed some of the changes brought by working from home, including more time with family, increased flexibility and the ability to work from virtually anywhere. While there is pent-up demand to get back to the physical workplace sometime, few employees want to return to the office five days a week. We all expect a hybrid work model to become standard, with some days at the office and others at home.

CROs raise a number of concerns related to sustaining a hybrid workplace, notably maintaining the firm's culture, behaviors and values (55%), employee engagement (47%), employee productivity (33%), information security (31%) and a robust control environment (29%). (See "Maintaining

controls with sustained work from home"). Beyond issues related to a hybrid working approach, CROs are focused on a broader set of challenges with protecting employee well-being and health and safety on an ongoing basis, as shown in Figure 22.

Notwithstanding the implementation of a range of virtual collaborative tools at work, CROs worry that connectivity and collaboration has been permanently degraded by the virtual work environment. Not only could this slow innovation, but it could reduce opportunities to collaborate outside of silos and across teams and for real-time control oversight and monitoring.

CROs are also increasingly concerned about employee burnout. Working from home may reduce the need to commute, but for many it has made work more demanding, especially as boundaries between work and home life have been eroded. The "always on the clock" working style is taxing.

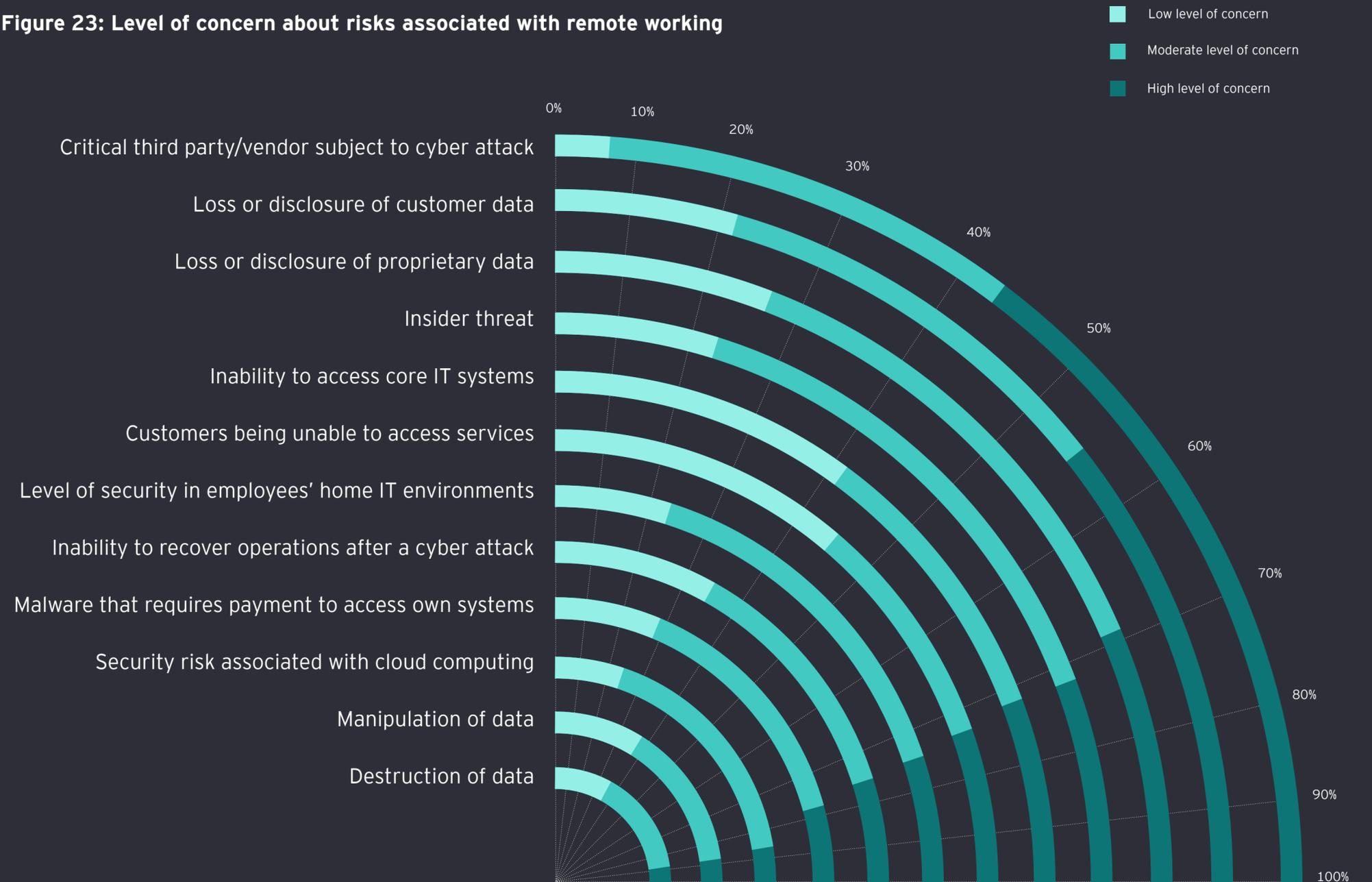
Maintaining controls with sustained work from home

About a quarter (27%) of CROs do not have concerns about material risks associated with sustained work from home. But the remainder are concerned about:

- ▶ Complacency related to complying with controls that help protect personal or customer data (55%)
- ▶ Latency or limitations in bandwidth that slows productivity (30%)
- ▶ Employee use of personal devices for work purposes, potentially exposing customer data (29%)

CRO concerns associated with remote working are varied, as shown in Figure 23.

Figure 23: Level of concern about risks associated with remote working



Maintaining a common cultural foundation

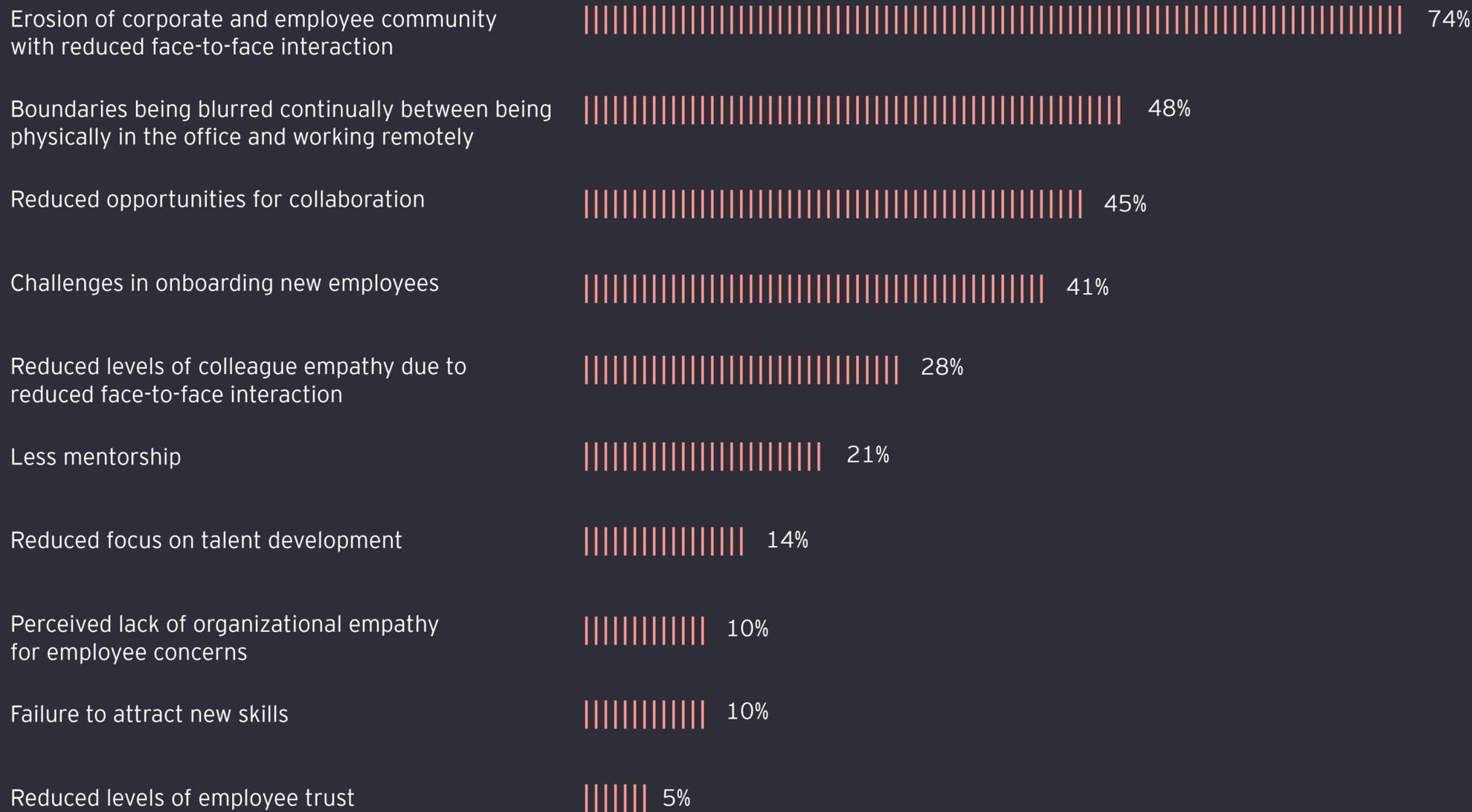


Executives are well aware that culture binds companies. Financial services firms are perhaps more aware of this than many other industries, given high-profile cultural failures that were visibly vivid in the years following the GFC. Conduct risk became an increasingly big concern.

A sustained hybrid working model presents real cultural challenges. We have all experienced how hard it is to properly integrate new employees who we have never met in person, to build rapport with new customers and clients, and to foster a common ethos and culture of work, collegiality and inclusiveness.

For senior leaders who grew up in financial services, the new model is particularly challenging. They have deep concerns that the apprenticeship model in which they grew and prospered is hard to replicate in a hybrid environment.

Figure 24: Top risks in maintaining a common culture in the 'new normal'



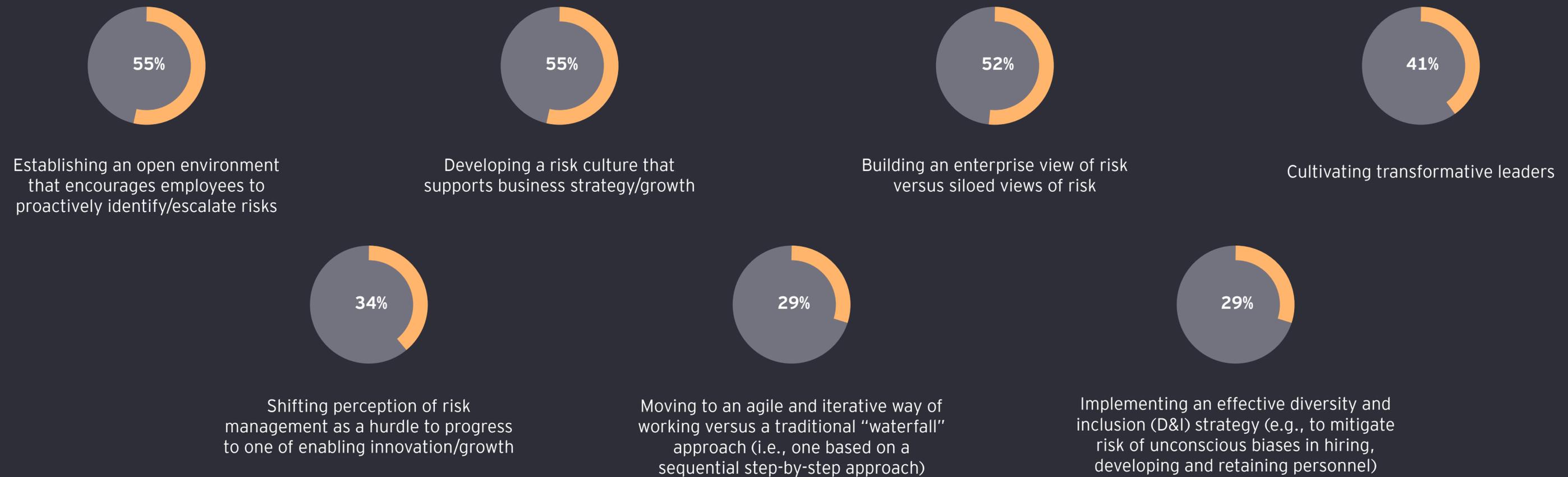
In the context of transitioning to a new model for work, CROs cite a list of risks in maintaining a common culture. About three-quarters are worried about the erosion of the corporate and employee community with reduced face-to-face interaction (see Figure 24).

Not surprisingly, banks are considering a number of ways to build a more positive culture and ways of working, as shown in Figure 25. Some firms are moving away from management by observation to managing performance based on outcomes. This calls for organizations to define clear success criteria so that individual performance assessments are fair and equitable. Also, the voice of the employee has to be systematically solicited, understood, monitored and measured as a key metric for company culture.

Banks are considering the most effective ways to monitor culture in the future, including:

- ▶ More routine employee surveys, e.g., "pulse" surveys (69%)
- ▶ Monitoring control and risk metrics, e.g., broken risk limits and compliance issues (38%)
- ▶ More routine use of focus groups or interview-based inquiries (36%)

Figure 25: Steps to building a positive culture and behaviors



“

Taking a disciplined approach to defining, implementing and reinforcing corporate culture will be a defining factor of success as we all work in a hybrid working model. - Heidi Boyle, EY Americas Banking & Capital Markets People Advisory Services Lead

“

The pandemic dramatically changed how we work, manage risk and protect employees' well-being. Both employers and employees have had to adapt to once-unthinkable circumstances. The future is still uncertain, but it's encouraging to see this culture of resilience and flexibility. - Clay Lowery, Executive Vice President, Research and Policy, IIF

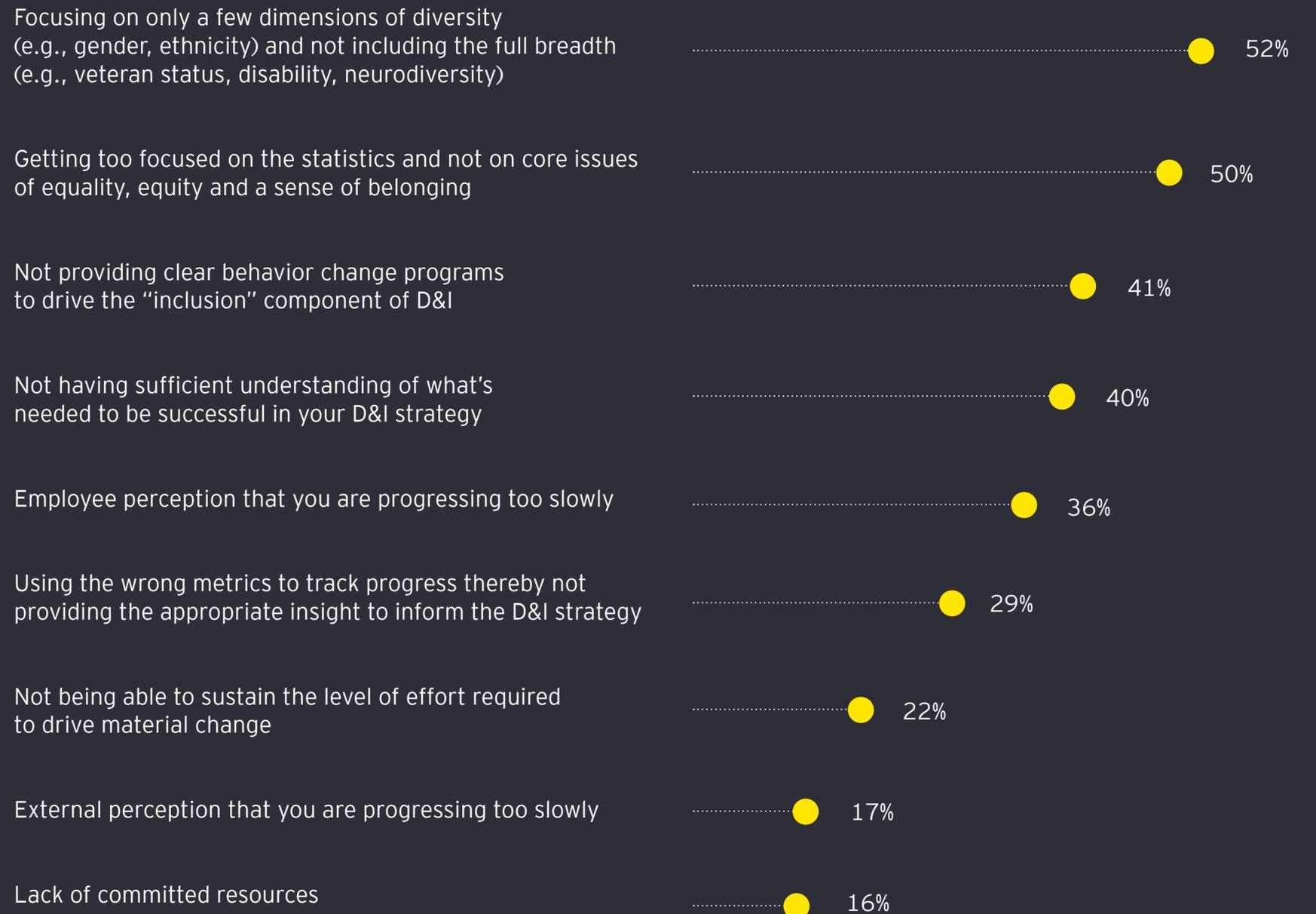
Implementing a successful diversity, equity and inclusion strategy

The events of the last 12 months in the US and globally related to racial inequity have shocked the world into action. Prior to COVID-19, banks, like other companies, had implemented diversity and inclusiveness strategies, with a major focus on gender parity - and were beginning to make some headway. But the heightened focus on racial, as well as gender, equity illustrated that such programs were not as broad as they should be, nor, frankly, achieving many of the desired outcomes. The fact that COVID-19 had a disproportionately negative effect on women and minorities escalated the need for firms to drive urgently for better outcomes.

COVID-19 also broadened the concept of inclusiveness and belonging. Being and feeling included is a fundamental need of every employee, but delivering on that promise on an ongoing basis in a complex work environment is highly challenging - even more so in a virtual environment. Yet, employee engagement has a direct link to employee satisfaction and performance, and talent retention.

Like their executive peers, CROs are highly supportive of efforts to enhance diversity, equity and inclusion, both within risk management and across the organization. But they are open to acknowledging getting this right will be difficult and they identify a number of risks their organizations will face in being successful in their efforts, as shown in Figure 26.

Figure 26: Top risks in implementing the banks' diversity, equity and inclusion strategy





Supporting and driving societal resilience

As noted earlier, climate change has quickly become a top priority for financial services, as well as for regulators, governments and society at large.

Not a week goes by without another global initiative being launched, a major investor calling for change or a regulator announcing a new effort or area of focus. It's hard to keep up. Increasingly more bank executives are concluding, as one CRO put it, "Climate change is one of the major risks banks will have to deal with in the future. The pandemic accelerated the general public's acknowledgment of this particular risk."

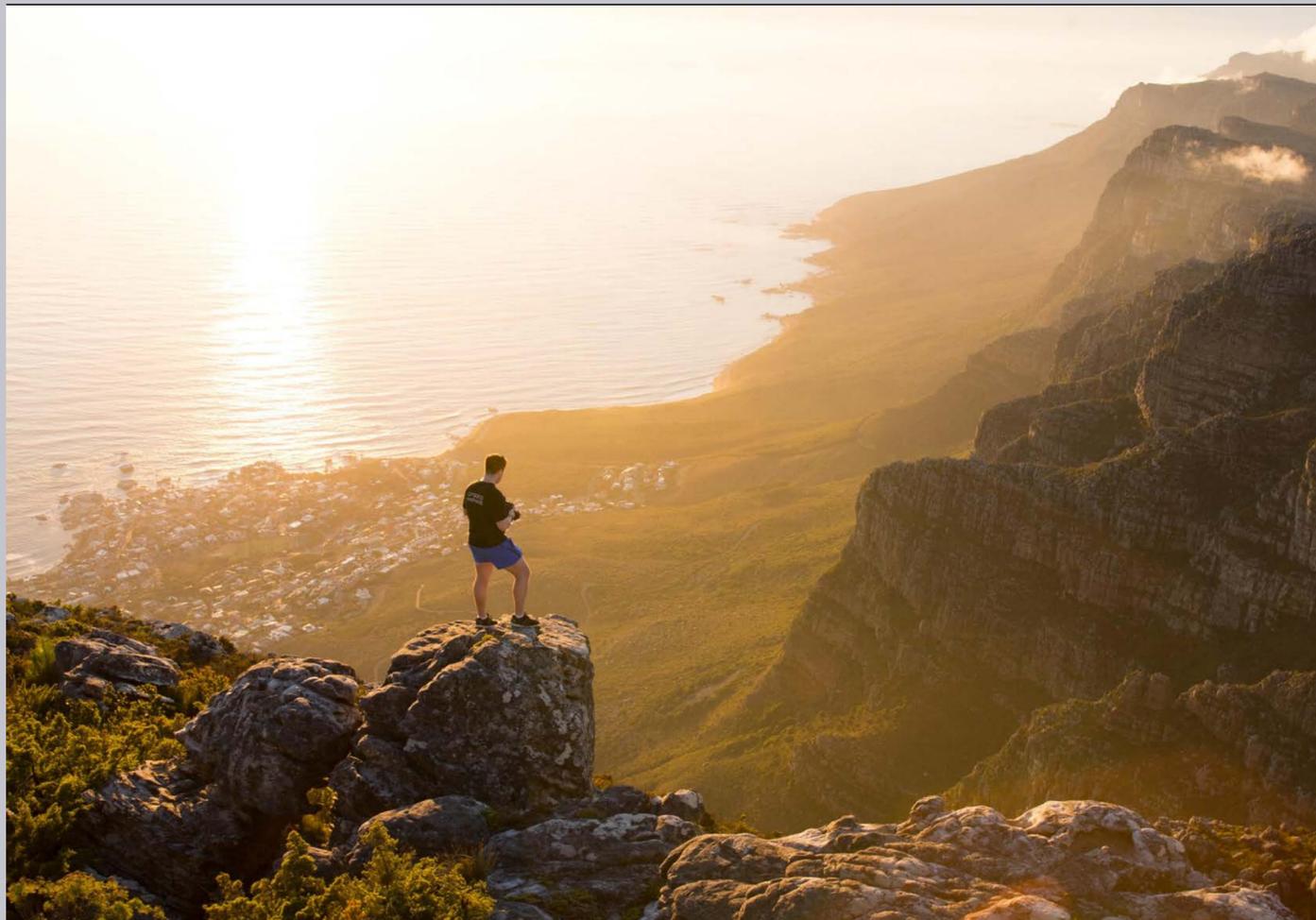
The heightened focus on climate has greatly elevated the discussion on environmental, social and governance (ESG) matters.

Yet, for all the recent activity and necessary urgency around ESG risks, they are not new issues. At least since the 1990s, boards have invested time and attention considering the day's issues, from environmental disasters, to human rights and labor practices, to board independence and leadership.

What has changed is the breadth of issues and their centrality to corporate purpose and strategy, and the need to adapt quickly and meaningfully to shifting societal issues and priorities.

Sustainable finance

An opportunity of a generation



Before getting into the detail of climate change and ESG, it is important to discuss sustainable finance.

The EY organization defines this as any form of financial service that incentivizes the integration of long-term ESG criteria into business decisions, with the goal of providing more equitable, sustainable and inclusive benefits to companies, communities and society. It is increasingly clear that there can be no effective transition to a greener or fairer economy without the active engagement and leadership of the entire financial services sector. ⁵

Embedding ESG concepts into investing is perhaps the highest-profile manifestation of sustainable finance. This has expanded to include ESG factors in stock selection, as well as using ESG to inform which companies investors should push for enhancements to their ESG approach. But sustainable finance extends well beyond ESG funds. A diverse range of ESG products and services are now available, including bonds (of many types), green retail products (e.g., green mortgages, credit cards) and insurance products.

Figure 27: Growth opportunity across various products



The growth potential is enormous. On the investment side, as of two years ago, investments influenced by ESG factors totaled US\$32t in key markets; albeit this is a large pool of assets in those markets, it is only about a third of the total.⁶

Since then, ESG-related assets have grown especially during COVID-19, and the scope

for expansion remains significant. On the bond side, the room for growth is even starker; the universe of ESG-labeled bonds has grown to US\$1.3t in 2020, up from just US\$15b a decade earlier, according to the IIF. That figure represents only about 1% of the global bond market.⁷ So far, financial services firms have only greened the fringes of global finance.

CROs are increasingly aware of the commercial opportunities, in part because of their work in analyzing the impact of climate risk on their bank's investment portfolios and assets.

However, as shown in Figure 27, banks have a long way to go in properly analyzing market potential. CROs may instinctively know green bonds, infrastructure financing, ESG

funds and sustainability-linked loans have significant growth potential, but they freely admit there are many opportunities that they have only partially analyzed, if at all.

6 - 2018 Global Sustainable Investment Review, Global Sustainable Investment Alliance

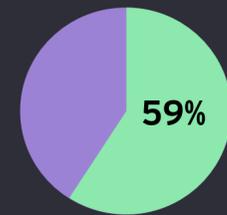
7 - Green Weekly Insight: ESG in Bonds Markets, March 25, 2021, Institute of International Finance

A fifth of CROs note their banks have not systematically evaluated ESG opportunities, so they do not have an informed view of the obstacles to capitalizing on those opportunities. Of the banks that have done some analysis, they identify a number of factors limiting growth, such as lack of data, industry standards and agreed-upon methodologies, as shown in Figure 28.⁸

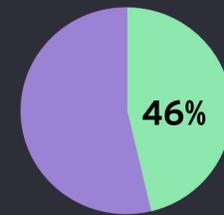
Banks that have done their homework have made bold commitments to sustainable finance, often expressed in terms of aggregate financing commitments to be achieved by 2030 (in line with the timeline in the Paris Agreement) or commitments about the firm's own sustainability practices and those of their vendors. Half of the banks that participated in this survey have made their commitments a strategic imperative for their organization and just over two-fifths (44%) have built them into business-line strategies.

Reporting progress on those commitments inside and outside the organization is driving stronger accountability. Almost half (48%) of the banks periodically report progress to their boards of directors, a few less than that (43%) report on progress publicly, and about a third (35%) actively track progress using detailed internal reporting. However, more than a quarter of banks (28%) have not made their commitments or goals public.

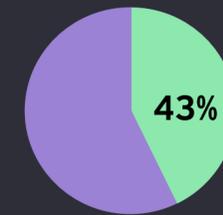
Figure 28: Factors limiting growth of ESG-related opportunities



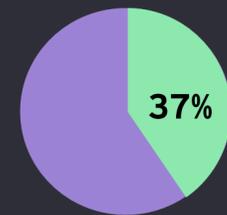
Lack of necessary data



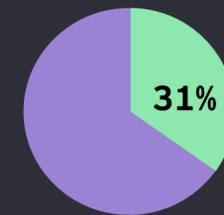
Lack of clarity of regulatory/supervisory expectations



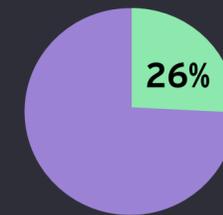
Lack of agreed industry methodologies



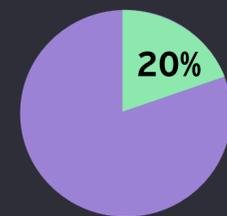
Lack of standardized industry framework(s)



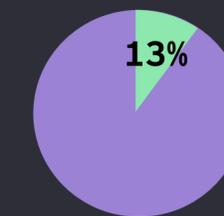
Lack of customer/client demand



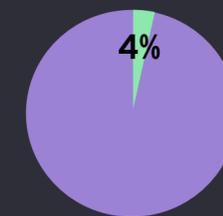
Lack of necessary skills in sustainable finance



Inconsistent regulatory requirements



Lack of senior management commitment to pursue opportunities



Self-imposed prohibitions on working with certain sectors or categories of firms

ESG governance and disclosures

The governance of ESG - or more broadly, sustainable finance - is evolving quickly, as befits the increased importance of these issues.

At the full board level, the discussion has expanded to consider how sustainable finance is at the heart of the bank's long-term strategy and aligned with purpose and community engagement. The commercial strategy behind sustainable finance has increasingly become a more routine topic. At the board committee level, some firms have broadened the scope of their governance committee or established new committees focused on ESG or corporate social responsibility. However, the breadth of issues means ESG governance spans other committees - the audit committee has to consider disclosures about ESG, especially those linked to financial statements; the risk committee has to consider associated

risks (e.g., the impact of climate change on the firm's risk profile and its assets and liabilities); the compensation committee needs to oversee talent and diversity, equity and inclusion efforts; and the governance committee has to embed ESG matters into director selection.

Management, too, is evolving its approach to sustainable finance. It has shifted from being a niche commercial area or one led by a siloed corporate social responsibility executive and reporting team to an enterprise-wide strategic initiative, overseen by a cross-functional, high-level steering committee and a senior executive (often with the title of chief sustainability officer or head of ESG) who has the ear of the CEO.

This diversity in governance approach can be seen in the survey. CROs identify a broad

set of governance mechanisms in place in their organization, as shown in Figure 29, including the discipline created by board and management committee oversight, internal management reporting and embedding ESG into the enterprise risk management approach.

External disclosure is viewed as important in terms of driving broader accountability. Increasingly, banks are making disclosures related to their:

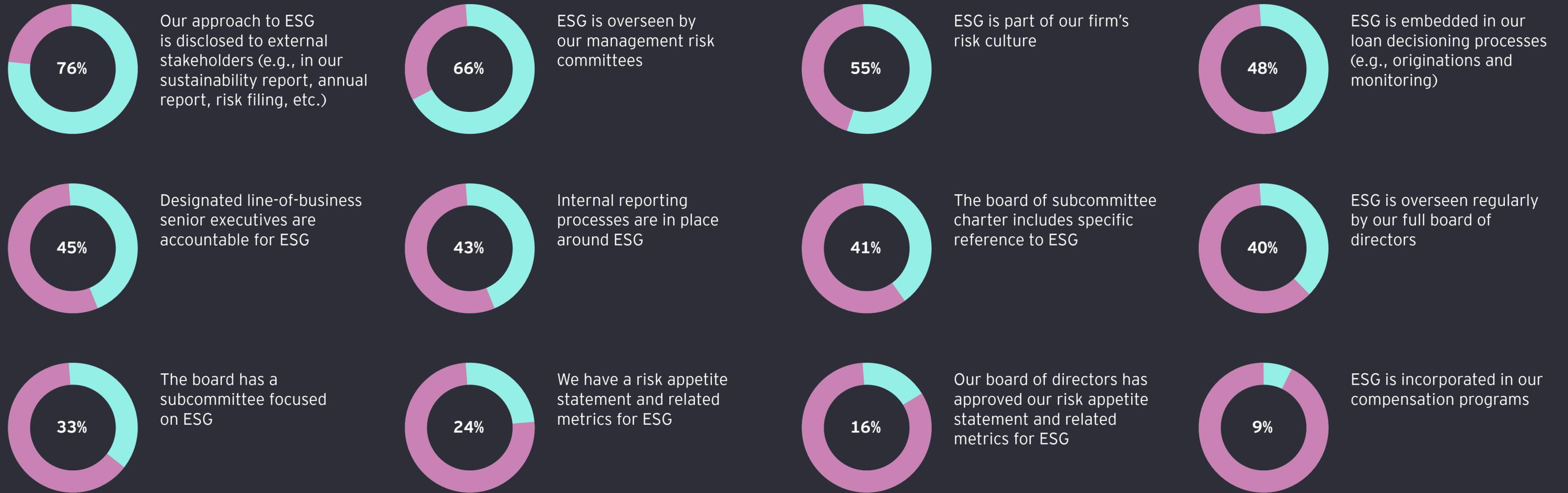
- ▶ Overall sustainability strategy, governance and approach, and progress in achieving disclosed goals and objectives
- ▶ Financial or outcome-based commitments to sustainable finance and progress in achieving those goals (sometimes linked to the 17 United Nations (UN) Sustainable Development Goals)

- ▶ Activities undertaken with regard to commitments to initiatives such as the UN's Principles for Responsible Banking or its Net-Zero Banking Alliance
- ▶ Governance, strategy, risk management and metrics associated with climate risk, notably through the use of the standards promulgated by the Taskforce on Climate-Related Financial Disclosures (TCFD)⁹

Bank CROs acknowledge there is scope to improve their bank's ESG disclosures, with over half (53%) saying that, while the disclosures are well developed, they are in need of enhancement. Over a third believe their disclosures are not yet fully developed and need even more enhancement.

9 - See the TCFD Playbook by EY, IIF and the United Nations Environment Programme Finance Initiative: [Task force on Climate-related Financial Disclosures report playbook](#) | EY - Global

Figure 29: Governance approaches to ESG



Managing and analyzing climate risk



Increasing awareness about the risks, as well as regulatory pressure on banks to analyze effects of climate change on their strategies, operations and customers, is pushing banks to enhance the risk management coverage of climate. Large global banks have started to establish standalone climate risk teams under their CROs. Most others are not quite that advanced, as yet.

Given there's no industry model for how to embed climate risk into risk management, banks have taken an array of approaches to doing so, as shown in Figure 30. The more common is including climate in their scanning of emerging risks - this was the case at the time of our last survey. But, increasingly, banks are analyzing the impact of climate change on material credit exposures, embedding it into the enterprise risk taxonomy and developing policies for the most impacted businesses.

Progress on conducting scenario and financial analysis on the impact of climate

change varies across the industry. Banks have or are developing approaches to:

- ▶ Identify material climate-change risks on an ongoing basis (58%)
- ▶ Assess the impact of climate change on expected credit losses (49%)
- ▶ Quantify the potential capital impact of climate-change risks (40%)

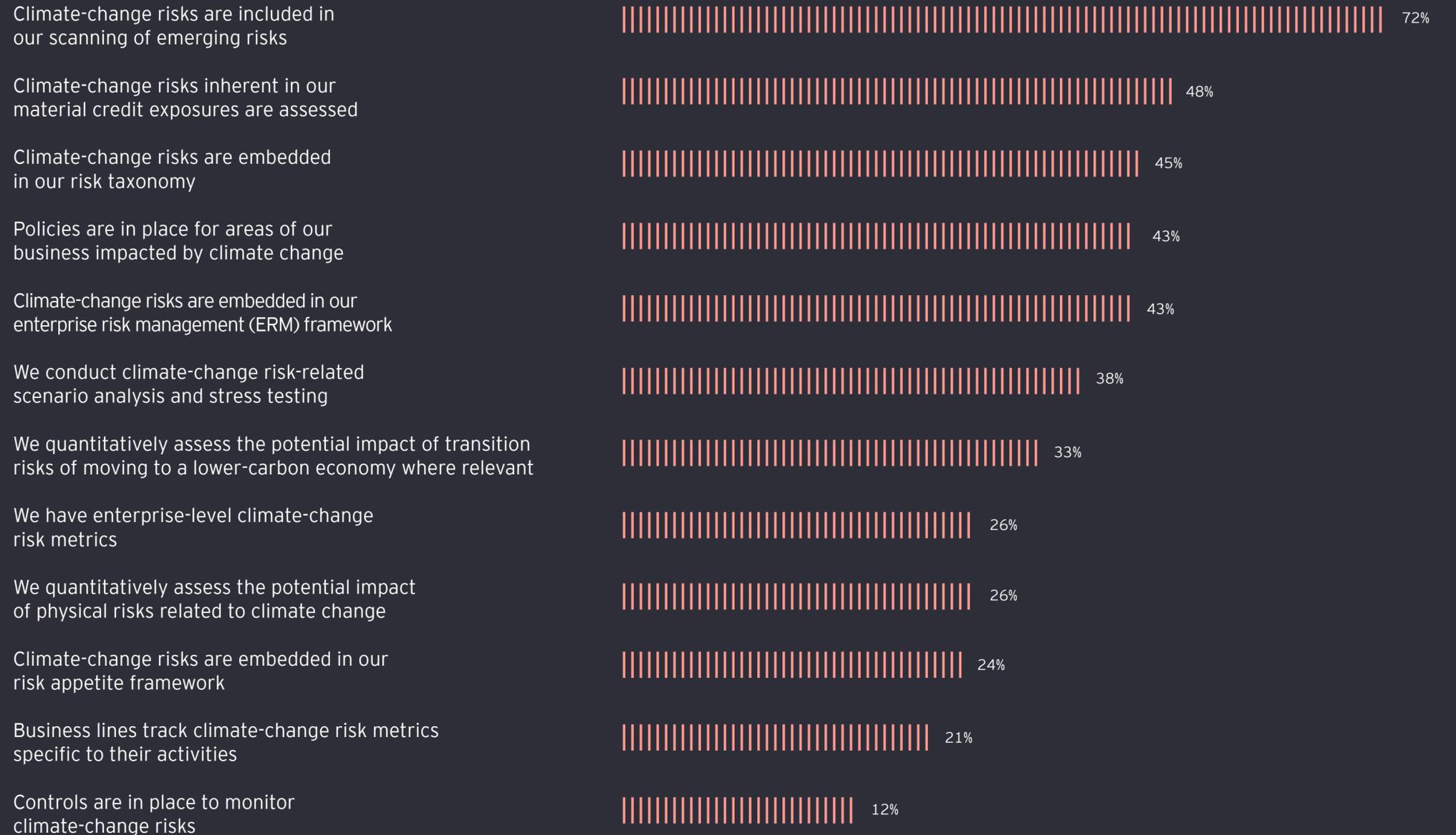
CROs emphasize the importance of some of these new analytical approaches. As one said, "Close monitoring of how portfolios are built, especially on the credit side, will be critical as clients might suffer from transition risk (albeit more difficult to assess). This will lead to more stringent client selection processes." Another CRO highlighted the need to be practical at these early stages of development, "For our initial climate change stress testing, the approach was rather pragmatic, e.g., sector average, because customer-specific data is hard to get."

Indeed, this later perspective highlights that, in practice, banks still have a long way to go to mature their ability to assess physical and transition risk exposures: just over half (54%) have a preliminary understanding of their climate-change risk exposure and about a quarter (28%) have a somewhat complete understanding. Most of the remaining banks lack an understanding of the risks, but intend to assess them in the future (19%).

“
Climate change is now top of banks’ agendas. Stakeholders expect banks to support clients’ transition to a zero-carbon economy. - Gill Lofts, EY Global Sustainable Finance Leader

“
New risk drivers like climate change require banks to reconsider and reconceive traditional risk management parameters - but also pose challenges due to their long time horizons and uncertain nature. - Sonja Gibbs, Managing Director and Head of Sustainable Finance, Global Policy Initiatives, IIF

Figure 30: Ways to incorporate climate risks into banks’ risk management activities



Resilience will be the defining characteristic of success

COVID-19 has made it hard to look beyond immediate priorities and issues. Adapting to a virtual working environment and managing conflicting personal and work commitments has called on everyone to be more flexible and resilient.

Risk priorities have shifted significantly. Financial and operational resilience dominated the agenda during the pandemic. While banks came into the crisis well buttressed by large amounts of capital and liquidity, the scale of economic impact globally has been unprecedented and concerns remain about the patchy state of economic recovery. New waves of COVID-19 continue to stall countries' effort to open up

their economies. Meantime, banks' systems have had to sustain a year or more of virtual working and digital access for customers to services and products.

Climate change has caught the attention of everyone and the financial services sector is being called upon to catalyze and incentivize their customers and clients to transition to a zero- or low-carbon economy

and to better manage the risks associated with climate change for the institution and the financial system at large. Technological transformation has accelerated, bringing with it a host of new and complex risks.

In our 10th annual survey in 2019, we highlighted that managing through longer-term risks would be the true test of survival for banks globally. If anything, COVID-19 has amplified this viewpoint.

But, COVID-19 added two new dimensions. First, it reminded us of the opportunities. For example, sustainable finance offers significant – perhaps once in a generation – commercial opportunities for banks and other financial institutions. Technological transformation creates opportunities to deliver added and more tailored value to customers, to operate more efficiently

and effectively, and to enable new ways of working that provide employees with much-cherished flexibility.

Second, COVID-19 expanded the vocabulary of resilience. Financial resilience was well known, as was increasingly operational resilience. But we quickly got accustomed to asking how resilient our new transformational technologies can and should be, how resilient our workforce is and how financial services supports and enables long-term societal resilience.

So, it is not simply whether banks have the steel to survive challenging new risks, but whether they have the ongoing resilience to do so, while capturing the opportunities offered by change. Resilience, then, will be a defining characteristic of success over the next decade or more.



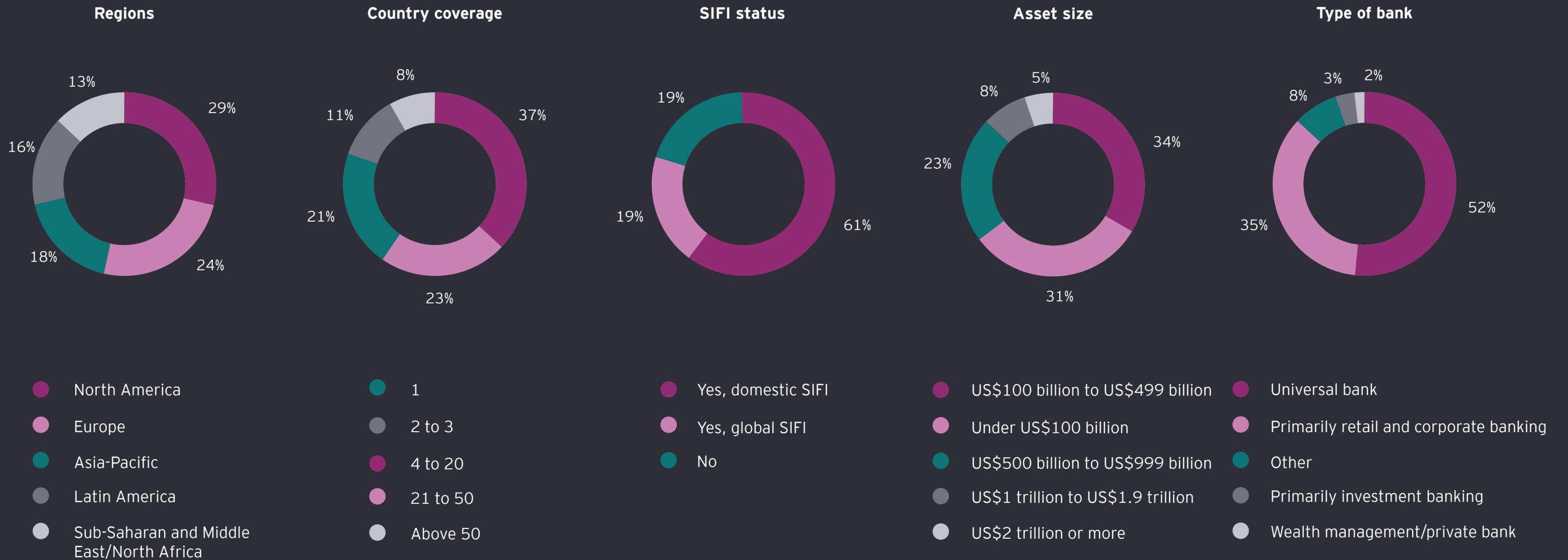
Research methodology and participant demographics

The global EY organization, in conjunction with the IIF, surveyed IIF member firms and other banks in each region globally (including a small number of material subsidiaries that are top-five banks in their home countries) from November 2020 through January 2021. Participating banks' CROs or other senior risk executives were interviewed, completed a survey, or both.

In total, 88 financial institutions across 33 countries participated. Survey data in this report relates to 62 of these institutions (generally larger banks). As shown in Figure 31, participating banks were fairly diverse in terms of asset size, geographic reach and type of bank. Regionally, those banks were

headquartered in Asia-Pacific (18%), Europe (24%), Middle East and Africa (13%), Latin America (16%) and North America (29%). Of those, 19% are globally systemically important banks (SIFIs) and 61% have been designated as systemically important domestically.

Figure 31: Participant demographics



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